

The background of the image is a photograph of a grand, ornate interior space, likely a government building or a large hall. The ceiling is a dome with a complex pattern of square and circular recessed panels, each containing a decorative medallion. The walls are also highly detailed with classical architectural elements, including a large statue of a woman in a niche. A large, multi-tiered chandelier hangs from the ceiling, casting a warm glow. The overall atmosphere is one of historical grandeur and institutional authority.

SEC Financial Reporting Series

2022 SEC
annual reports –
Form 10-K

EY

Building a better
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1 Overview

We are pleased to present our *SEC Annual Reports – Form 10-K* reference guide to help you prepare your financial and related information for annual reports on Form 10-K and annual shareholders' reports.

The Securities Exchange Act of 1934 (Exchange Act or 1934 Act) requires most publicly held companies to file an annual report with the Securities and Exchange Commission (SEC) on Form 10-K and to distribute an annual shareholders' report under the SEC's proxy rules. Both Form 10-K and the annual shareholders' report include financial statements and other data that involve a company's accounting personnel and its independent auditors.

The SEC's integrated disclosure system is designed so the instructions in the forms under the 1933 and 1934 Acts refer to Regulation S-X for financial statement disclosures and Regulation S-K for the required nonfinancial statement disclosures. By standardizing disclosure items in SEC filings, companies can incorporate information from one document into subsequently filed documents.

For example, disclosures in the Annual Report to Shareholders (ARS) or definitive proxy statement can be incorporated into a Form 10-K, and the Form 10-K can be incorporated into 1933 Act filings such as Forms S-1, S-3, S-4 or S-8, subject to the eligibility requirements of these forms. Also, for continuous or delayed securities offerings, reporting documents filed under the 1934 Act after the initial effective date of a Form S-3 or S-8 are automatically incorporated by reference into these registration statements until the securities offering is terminated.

This publication describes the SEC's requirements for the content of Form 10-K and annual shareholders' reports as of 30 November 2022 and reflects the following SEC releases that became effective in 2022:

- ▶ **Release 33-11070**, *Updating EDGAR Filing Requirements and Form 144 Filing*
- ▶ **Release 33-11098**, *Inflation Adjustments under Titles I and III of the JOBS Act*

On 26 October 2022, the SEC issued **Release 33-11126**, *Listing Standards for Recovery of Erroneously Awarded Compensation*, describing final rules that direct national securities exchanges to establish listing standards requiring listed companies to claw back incentive-based compensation received by current and former executive officers during the three years preceding an accounting restatement. The rules require companies to disclose their clawback policies and any compensation subject to clawback in annual reports and in proxy and information statements. For additional information on these rules, which are expected to affect companies in 2024, refer to our To the Point, **[SEC adopts rules to require 'clawback' policies and disclosures](#)**.

In addition, the SEC proposed the following rules that are not yet finalized:

- ▶ **Release 33-11042**, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*: The proposed rules would require registrants to provide robust disclosures about climate-related risks, their climate-related targets and goals, their greenhouse gas (GHG) emissions and how the board of directors and management oversee climate-related risks. The proposal would also require registrants to quantify the effects of certain climate-related events and transition activities in their audited financial statements. Refer to our To the Point publication, **[SEC proposes enhancing and standardizing climate-related disclosures](#)**, for additional information.

- ▶ **Release 33-11038, *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*:** The proposed rules would require registrants to disclose information about a material cybersecurity incident on Form 8-K within four business days of determining that the incident is material. Registrants would have to provide updated disclosures in periodic reports, including Form 10-K, about previously reported incidents, describe their policies and procedures, if any, for the identification and management of risks from cybersecurity threats and provide disclosures about the board's oversight of cybersecurity risks and management's role in assessing and managing these risks and in implementing cybersecurity policies. Refer to our To the Point publication, [***SEC proposes requiring more cybersecurity disclosures***](#), for additional information.
- ▶ **Release 34-93783, *Share Repurchase Disclosure Modernization*:** The proposed rules would require registrants to provide disclosures about repurchases of their equity securities before the end of the first business day following the execution of a share repurchase. Issuers would be required to disclose on proposed Form SR the total number and class of securities purchased, the average price paid per share and the total number of shares purchased pursuant to a plan intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).

When preparing reports on Form 10-K and annual shareholders' reports, readers of this publication should consider applicable changes to SEC reporting requirements in final rules issued after 30 November 2022.

1.1 Section highlights

The following is an overview of the sections in this publication:

- ▶ Section 2 explains the general rules and requirements for preparing and filing Form 10-K.
- ▶ Sections 3, 4 and 5 discuss the requirements for Part I and Part II of Form 10-K, other than financial statements and schedules.
- ▶ Sections 6 and 7 discuss the requirements for financial statements and schedules.
- ▶ Section 8 covers late filings.
- ▶ Section 9 discusses the requirements for "smaller reporting companies."
- ▶ Section 10 discusses the annual shareholders' report, the proxy statement and Part III and Part IV of Form 10-K.

1.2 EY publications and checklists

EY publications provide interpretive guidance for preparing various SEC forms and schedules. These publications are available free of charge from any EY representative or on the EY [**AccountingLink website**](#).

- ▶ *SEC Reporting Update – Highlights of trends in SEC comment letters* discusses the SEC staff's comments on public company filings to provide insights on the SEC staff's concerns and areas of focus.
- ▶ *Proxy statements – An overview of the requirements and observations about current practice* summarizes the requirements of Regulation 14A and Schedule 14A under the Exchange Act for soliciting annual meeting and other proxies. This publication includes an overview of the disclosure requirements regarding executive compensation, auditor fees and the audit, and compensation and nominating committees.
- ▶ *SEC quarterly reports – Form 10-Q* summarizes the rules and practices that apply to quarterly financial accounting and reporting on Form 10-Q. It provides guidance for preparing quarterly reports to shareholders and Form 10-Q.

- ▶ *Pro forma financial information – A guide for applying Article 11 of Regulation S-X* summarizes the requirements for pro forma financial information and illustrates how registrants may apply the guidance to different transactions and pro forma adjustments.
- ▶ *SEC in Focus* is a quarterly newsletter summarizing current activities and regulatory developments at the SEC. The newsletter provides an update on activities and events relating to SEC matters, including Commission open meetings, final rules and rule proposals, SEC staff “hot buttons,” SEC personnel changes and significant SEC enforcement actions.
- ▶ *Financial reporting briefs* provides a snapshot of the major accounting and regulatory developments during the quarter. It includes a reference library that lists the EY publications issued during the quarter, along with the links to them on our EY [AccountingLink website](#).

The following is a list of EY checklists intended to assist registrants in preparing Form 10-K and annual shareholders' reports:

- ▶ *GAAP disclosure checklist* – assists in determining that the financial statement disclosure requirements of generally accepted accounting principles and Regulation S-X have been satisfied (EY Form A13)
- ▶ *GAAP disclosure checklist supplement for health care entities* – contains the disclosures required by Accounting Standards Codification (ASC) 954 (EY Form A68)
- ▶ *Form 10-K and registration statement checklist supplement to GAAP disclosure checklist* – Parts I and II of the checklist assist in determining that the Form 10-K requirements relating to financial statements and financial schedules have been satisfied (EY Form A69)
- ▶ *GAAP and Regulation S-X checklist supplement for insurance companies* – includes the disclosures required by ASC 944 and Article 7 of Regulation S-X (EY Form A69B)
- ▶ *GAAP and Regulation S-X checklist supplement for banks, bank holding companies and savings institutions* – includes disclosures required by ASC 942, ASC 948 and Article 9 of Regulation S-X and summarizes disclosures required by Regulation S-K Subpart 1400 (EY Form A69C)
- ▶ *GAAP, Regulation S-X and Regulation S-K checklist supplement for oil and gas producing companies* – includes the disclosures required by ASC 932 and Regulation S-X and Regulation S-K Subpart 1200, Disclosure by Registrants Engaged in Oil and Gas Producing Activities (EY Form A69E)
- ▶ *SEC annual shareholders' report checklist* – assists in determining whether certain nonfinancial statement disclosures required for the annual shareholders' report, many of which are identical to those of Form 10-K, have been satisfied. Parts II and III of the checklist address the SEC's requirements for management's disclosure and analysis (MD&A) (EY Form A150). Part IV of the checklist assists in the preparation of non-GAAP disclosures.

1.3 Other considerations in preparing Form 10-K

This publication is not a substitute for reading the Form 10-K instructions and the referenced disclosure requirements in Regulations S-K and S-X. In addition, the views of the SEC and its staff should be considered. We note that SEC staff views are non-binding and, unlike SEC rules and regulations, do not have the force and effect of law. However, registrants are generally expected to comply with the SEC staff's views.

Registrants should consider the following Commission rules, interpretive guidance and SEC staff interpretive guidance:

- ▶ Regulation S-K contains the requirements for nonfinancial statement disclosures.
- ▶ Regulation S-X provides the requirements for financial statements and schedules.

- ▶ Staff Accounting Bulletins (SABs) are written accounting interpretations and practices followed by the SEC's Division of Corporation Finance and the Office of the Chief Accountant (OCA).
- ▶ Staff Legal Bulletins (SLBs) are written interpretations of the requirements of the federal securities laws or related rules and regulations published by the SEC's legal staff.
- ▶ The Division of Corporation Finance Financial Reporting Manual (FRM)¹ provides views on financial reporting matters from the staff at the Division of Corporation Finance's Office of the Chief Accountant.
- ▶ The Division of Corporation Finance Compliance and Disclosure Interpretations (C&DIs) are staff interpretations and positions on various rules and regulations including certain content required in the Form 10-K. They are published primarily by the Division's Office of Chief Counsel.
- ▶ CF Disclosure Guidance Topics and sample comment letters provide observations and views expressed by the staff of the Division of Corporation Finance about disclosures required by existing SEC rules and regulations.
- ▶ The highlights of meetings the Center for Audit Quality (CAQ) SEC Regulations Committee holds periodically with the SEC staff describe the staff's views on emerging financial reporting issues relating to SEC rules and regulations and can be found on the CAQ website.²
- ▶ Financial Reporting Releases (FRRs) sometimes address revisions to Regulations S-K and S-X. The Codification of Financial Reporting Policies (FRC) contains the current interpretive guidance provided by the SEC relating to financial reporting as published in the Accounting Series Releases (ASRs), and more recently, in FRRs.

The rules and regulations for financial reporting are complex. Any materially inaccurate or incomplete information in Form 10-K can expose a company and its directors, officers and independent auditors to liability under the federal securities laws. Additionally, as discussed in section 2 of this publication, Section 906 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) requires the chief executive officer (CEO) and chief financial officer (CFO) to provide a certification accompanying each periodic report, stating, among other things, that the report "fully complies" with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934. Section 906 provides for criminal penalties for an officer who provides the certification "knowing" it to be untrue, of up to a \$1 million fine and imprisonment of 10 years (with harsher penalties for "willful" violations).

In certain situations, it may be appropriate to consult on complex accounting issues with the SEC staff. The SEC staff has expressed its willingness to discuss proposed accounting treatments with registrants and their auditors for unusual, complex or innovative transactions for which no clear authoritative guidance exists. The SEC website provides guidelines for consultations with the SEC staff of OCA, titled "Guidance for Consulting with the Office of the Chief Accountant."³ Separately, registrants can discuss financial reporting and legal matters with the staff in the Division of Corporation Finance and can seek relief from SEC financial reporting requirements under Rule 3-13 of Regulation S-X.⁴

¹ The FRM can be found at the following link: <http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml>.

² The CAQ SEC Regulations Committee highlights can be found on the CAQ website at <https://www.thecaq.org/about-us/our-committees/sec-regulations-committee/>.

³ This guidance can be found at the following link: <http://www.sec.gov/info/accountants/ocasubguidance.htm>.

⁴ Requests for interpretation or pre-clearance of complex or unusual financial reporting positions can be submitted to the staff of the Office of the Chief Accountant at the Division of Corporation Finance by completing the online form *Requests for No-Action, Interpretive, Exemptive, and Waiver Letters* at https://www.sec.gov/forms/corp_fin_noaction?#no-back.

2

General rules

Three types of companies are required to file annual reports with the SEC pursuant to Sections 13(a) or 15(d) of the Exchange Act:

- ▶ A company having any class of securities listed on a national securities exchange must register these securities on Form 8A or Form 10 pursuant to Section 12(b) of the Exchange Act and must file annual reports on Form 10-K as long as such registration continues in effect.
- ▶ An unlisted company with more than \$10 million of assets and 2,000⁵ or more holders (or 500 holders who are not accredited investors) of any class of equity securities⁶ must register these securities on Form 10 according to Section 12(g) of the Exchange Act and must file annual reports on Form 10-K. For banks, bank holding companies and savings and loan holding companies, the 2,000 holder threshold is without regard to whether the investors are accredited. These annual reporting requirements continue until the SEC receives notification on Form 15 that (1) the number of holders of such registered securities has been reduced to fewer than 300 (1,200 for banks, bank holding companies and savings and loan holding companies) or (2) the number of security holders has been reduced to fewer than 500 and the company had less than \$10 million in assets on the last day of each of the three most recent years.
- ▶ A company registering either equity or debt securities under the Securities Act is required by Section 15(d)⁷ of the Exchange Act to file at least one annual report on Form 10-K.⁸ Section 15(d) provides an automatic suspension of the periodic reporting obligation if the issuer has fewer than 300 security holders of record at the beginning of the fiscal year. A Form 15 should be filed to notify the SEC of such suspension, but the suspension is granted by statute and is not contingent on filing the Form 15. However, Rule 12h-3 of the Exchange Act permits a company to suspend its reporting obligations under Section 15(d) at any time during the year if the issuer has (1) fewer than 300 (1,200 for banks, bank holding companies and savings and loan holding companies) security holders or (2) fewer than 500 security holders and less than \$10 million in assets on the last day of each of the three most recent fiscal years. Rule 12h-3 requires the filing of Form 15 as a condition of the suspension.

Form 10-K is the primary form for these annual reports and is designed to update much of the information contained in the registrant's original registration statement. Therefore, Form 10-K provides continuing disclosure of material facts about the registrant. Because the securities regulations are complex, preparing

⁵ The Jumpstart Our Business Startups Act (JOBS Act), enacted 5 April 2012, amended the record holder definition in Section 12(g)(5) of the Exchange Act to exclude (1) current or former employees who received securities through an employee stock compensation plan that is exempt from registration and (2) holders of securities issued through permitted crowdfunding. The Fixing America's Surface Transportation Act (FAST Act), enacted 4 December 2015, amended the JOBS Act to apply the new record holder thresholds for banks and bank holding companies to savings and loan holding companies.

⁶ A December 2007 SEC final rule, *Exemption of Compensatory Employee Stock Options From Registration Under Section 12(g) of the Securities Exchange Act of 1934* (SEC Release No. 34-56887), exempted non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under written stock option plans if certain conditions regarding permitted option holders, transferability restrictions and information requirements are met. The exemption does not cover the common stock or other securities underlying the options; companies must continue to apply the Exchange Act Section 12 registration requirements separately to the underlying class to determine if registration is required. As a result, a private company does not have to register using Form 10 just because it has more than 500 option holders, provided it meets certain conditions.

⁷ Section 15(d) of the Exchange Act also requires the filing of an annual report by registrants that are asset-backed security issuers. General Instruction J to Form 10-K specifies the information asset-backed issuers must include in Form 10-K.

⁸ However, despite the automatic exemption based on a lower security holder count described later in this section, many indenture agreements require that companies with public debt outstanding continue to file Exchange Act reports with the SEC regardless of the number of debt holders.

Form 10-K requires cooperation among corporate officers, independent auditors, attorneys and the audit committee of the board of directors. Generally, the rules discussed in this section apply to a smaller reporting company (SRC) and an emerging growth company (EGC). The rules and requirements that are unique or inapplicable to SRCs are discussed in section 9 of this publication. Requirements that have been modified for EGCs are discussed in the relevant sections of this publication.

2.1 When the report is due

The SEC does not consider the Form 10-K filed until it receives the document or it is “accepted” per EDGAR. If the due date falls on a holiday or weekend, registrants have until the next business day to file. The rules require registrants to promptly notify the SEC if they cannot file all or any required portion of Form 10-K within the prescribed time period (see section 8, Notification of late filing). The deadlines for filing the Form 10-K are determined by a company’s filing status (i.e., non-accelerated, accelerated or large accelerated filer).

For purposes of determining filing status, a registrant must determine its public float, which is the aggregate worldwide market value of its voting and non-voting common equity held by non-affiliates. For this purpose, public float is calculated on the last business day of a company’s most recent second fiscal quarter, which is intended to allow the company to determine well in advance when it must file its next Form 10-K. A registrant must disclose on the cover page of Form 10-K the company’s public float as of the end of its most recent second fiscal quarter. A registrant (including a foreign private issuer (FPI) that elects to file its annual report on Form 10-K) also must indicate its filing status on the cover page of Form 10-K by selecting from the following options: (1) large accelerated filer, (2) accelerated filer or (3) non-accelerated filer. In addition, a registrant that is not a large accelerated filer may also be identified as an emerging growth company, an SRC or both.

2.1.1 Large accelerated filer determination

Rule 12b-2 of the Exchange Act defines a “large accelerated filer” as an issuer that meets all of the following conditions as of the end of its fiscal year:

- ▶ Has a public float of \$700 million or more (measured as of the last business day of its most recent second fiscal quarter)
- ▶ Has been a public company for at least 12 months⁹ subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act
- ▶ Has previously filed at least one annual report

When a company meets the definition of a large accelerated filer as of the end of its fiscal year, it must file its Form 10-K for that fiscal year within 60 days after its fiscal year end. In the subsequent fiscal year, the company must file its quarterly reports on Form 10-Q within 40 days of each quarter end. Once a company is a large accelerated filer, it remains so unless it satisfies the exit provisions discussed separately below.

2.1.2 Accelerated filer determination

Rule 12b-2 of the Exchange Act defines an “accelerated filer” as an issuer that meets all of the following conditions as of the end of its fiscal year:

- ▶ Has a public float of \$75 million or more but less than \$700 million (measured as of the last business day of its most recent second fiscal quarter)

⁹ A calendar month for purposes of applying this requirement comprises an entire month. For example, if a registrant became subject to the requirements of Section 13(a) of the Exchange Act on 15 January and remained subject to it through the end of the year, it would have been subject to Section 13(a) for 11 months as of 31 December.

- ▶ Has been a public company for at least 12 months subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act
- ▶ Has previously filed at least one annual report
- ▶ Is unable to qualify as an SRC because of its revenues (as discussed below)

The SEC amended its rules, effective 27 April 2020, to allow issuers with less than \$100 million in annual revenues¹⁰ and less than \$700 million in public float to qualify as non-accelerated filers and not be subject to any accelerated filing requirements. Consequently, these issuers are not subject to the requirements for auditor attestation for internal control over financial reporting (ICFR) in Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX).

The following table summarizes the entry thresholds for the various acceleration status categories that registrants have to monitor at their annual filer status redetermination date, along with the auditor attestation requirements for ICFR:

Status	Public float	Annual revenues	Required to obtain auditor attestation on ICFR
SRC and non-accelerated filer	Less than \$75 million	No limit	No
	\$75 million to less than \$700 million	Less than \$100 million	No
SRC and accelerated filer	\$75 million to less than \$250 million	\$100 million or more	Yes
Accelerated filer (not SRC)	\$250 million to less than \$700 million	\$100 million or more	Yes
Large accelerated filer	\$700 million and greater	Not applicable	Yes

Companies that qualify as EGCs continue to be exempt from the requirements of Section 404(b) even if they are accelerated filers.

When a company meets the definition of an accelerated filer as of the end of its fiscal year, it must file its Form 10-K for that fiscal year within 75 days after its fiscal year end. In the subsequent fiscal year, the company must file its quarterly reports on Form 10-Q within 40 days of each quarter end. Once a company is an accelerated filer, it remains so unless it satisfies the exit provisions discussed separately below.

Subsidiaries of accelerated filers or large accelerated filers: When a company that is or was a subsidiary of a company required to file on an accelerated basis (i.e., a large accelerated filer or an accelerated filer) must file separate periodic reports with the SEC (e.g., because it issues publicly traded equity or debt securities, or it is spun off), it does not automatically succeed to the filing status of its parent or former parent. Instead, the subsidiary or former subsidiary must make its own determination as to its filing status under Rule 12b-2 based on its specific facts and circumstances.

There are situations, however, in which a newly formed public company may elect to adopt the filing status of another company for purposes of filing a registration statement on Form S-3. For example, a spun-off entity may attempt to use its parent's reporting history or a newly formed holding company may

¹⁰ The amended rules also allow business development companies to qualify as non-accelerated filers if they have investment income of less than \$100 million and a public float of \$75 million to less than \$700 million.

seek to use its predecessor's reporting history.¹¹ The SEC staff has indicated that because of the interrelationship between Form S-3 eligibility and accelerated filer status, if a newly formed public company seeks to use and is deemed eligible to use Form S-3 on the basis of another entity's reporting history, that company also would be an accelerated filer.¹²

Change in year-end: When a company changes its year-end, the end of the transition period (regardless of whether the transition report is filed on Form 10-K or Form 10-Q – see *Transition report – Change in fiscal year* later in this section for more discussion of transition reports) is the company's new fiscal year-end. A company would determine its filing status as of its new fiscal year-end, including a lookback from its new fiscal year-end to determine whether it met the public float test of Rule 12b-2 as of the end of its second fiscal quarter of its new fiscal year.

Subsequent to filing Form 15: If a company goes private and files a Form 15 with the SEC suspending its reporting obligations under the Exchange Act, it does not automatically retain its prior status requiring accelerated filing if it re-enters the Exchange Act reporting system. Such a company would evaluate its status under Rule 12b-2 based on its specific facts and circumstances as of the end of its first fiscal year on re-entering the Exchange Act reporting system.

2.1.3 Non-accelerated filer determination

The term “non-accelerated filer” is not defined in Rule 12b-2, or elsewhere in the SEC's rules. However, the SEC said in SEC Release No. 34-88365 that “if an issuer does not meet the definition of accelerated filer or large accelerated filer, it is considered a non-accelerated filer.”¹³ The cover page of Form 10-K is required to indicate whether the registrant is a non-accelerated filer, accelerated or large accelerated (i.e., its acceleration status). An issuer must separately indicate on its Form 10-K cover page whether it qualifies as an SRC. (The requirements for SRC status are discussed in section 9 of this publication.) An issuer may be either (1) an accelerated filer and an SRC or (2) a non-accelerated filer and an SRC.

When a company is a non-accelerated filer as of the end of its fiscal year, it must file its Form 10-K for that fiscal year within 90 days after its fiscal year end. A non-accelerated filer must file its quarterly reports on Form 10-Q within 45 days of each quarter end. A non-accelerated filer must reassess its status each fiscal year.

It is important to note that the requirement to obtain an auditor's attestation on the effectiveness of ICFR under Section 404(b) applies to a filer that is required to transition to accelerated or large accelerated filer status in its Form 10-K for the current fiscal year and an SRC that qualifies for accelerated filer status (i.e., it has annual revenue of more than \$100 million and a public float of \$75 million to less than \$250 million), unless they are EGCs.

2.1.4 Exit provisions

Exit threshold based only on public float (regardless of revenue)

The exit thresholds based solely on public float for large accelerated and accelerated filer status are set at 80% of the respective entry thresholds and have to be applied at every annual status redetermination date. A domestic registrant has to measure its public float on the last business day of its second fiscal quarter for purposes of its year-end filer status determination. Any change in acceleration status must first be reflected in the annual report for the year for which the accelerated status assessment is made.

¹¹ SEC Staff Legal Bulletin No. 4, Question 9 dated 16 September 1997.

¹² Footnote 76 to SEC Release No. 33-8760 dated 15 December 2006.

¹³ Footnote 5 to SEC Release No. 34-88365 dated 12 March 2020.

For example, a large accelerated filer whose public float, as of the last business day of its most recently completed second fiscal quarter, is less than \$560 million but more than \$60 million would no longer be considered a large accelerated filer for that fiscal year. Such an issuer would become an accelerated filer¹⁴ with its Form 10-K for that year that would be due 75 days after year end. A large accelerated filer whose public float drops below \$60 million would become a non-accelerated filer with its Form 10-K due 90 days after year end.

Similarly, an accelerated filer whose public float falls below \$60 million as of the last business day of its second fiscal quarter would no longer be considered an accelerated filer for that fiscal year and would become a non-accelerated filer for its annual report that would be due 90 days after that year end.

Exit thresholds based on public float in combination with revenue

An accelerated filer would also become a non-accelerated filer as of the end of its fiscal year, considering both its revenue and public float, in each of the following situations:

- ▶ An issuer that qualified as an accelerated filer and SRC because its revenue was more than \$100 million and its public float was less than \$250 million on its prior annual redetermination date reports revenue below \$100 million and estimates that its public float is still less than \$250 million for purposes of the current-year redetermination test.
- ▶ An issuer that was an accelerated filer (but not an SRC) in the prior year because its revenue was more than \$100 million and its public float was greater than \$250 million reports revenue below \$80 million and estimates public float below \$560 million for purposes of its current annual redetermination test.

For example, if a calendar year-end issuer has public float of \$230 million at 30 June 20Y2 and had annual revenue of \$101 million in 20Y1, it would be an SRC and an accelerated filer for the purposes of its 20Y2 annual report based on its public float because it exceeded the revenue threshold. If its public float remains the same at 30 June 20Y3 and its annual revenue in 20Y2 falls to less than \$100 million, it would be an SRC and a non-accelerated filer for the purposes of its 20Y3 annual report.

In contrast, if a calendar year-end issuer has public float of \$400 million at 30 June 20Y2 and had an annual revenue of \$101 million in 20Y1, it also would not be eligible to be an SRC because it exceeds the revenue threshold, and it would be an accelerated filer for the purposes of its 20Y2 annual report based on its public float. If its public float remains the same at 30 June 20Y3, its annual revenue in 20Y2 would need to fall below \$80 million for it to be eligible to be an SRC and a non-accelerated filer for the purposes of its 20Y3 annual report.

Registrants that have seen changes in their public float due to fluctuations in stock price as of their accelerated filer redetermination date (i.e., 30 June 20Y2 for calendar-year companies) should consider whether they entered accelerated or large accelerated filer status for year-end filings. Registrants that determine that for the first time they have to follow the accelerated filing dates for their 20Y2 Form 10-K filings should begin planning to comply with Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires them to obtain independent auditor attestation on the effectiveness of their ICFR.¹⁵

All issuers must include a checkbox on the cover page of Form 10-K to indicate whether an ICFR auditor attestation is included in their annual report, regardless of their acceleration status and whether such auditor attestation is required.

¹⁴ This excludes certain SRCs with annual revenue of less than \$100 million, which would qualify as non-accelerated filers (see section 9 for further discussion on exit provisions for SRCs).

¹⁵ However, EGCs continue to be exempt from Section 404(b) even if they are accelerated filers.

2.1.5 Transition between accelerated and SRC status and requirement for auditor attestation of ICFR

The chart below provides guidance for companies transitioning between the ICFR auditor attestation requirements based on a change in their filer status.

Prior status	Initial public float	Initial annual revenue	Required to obtain auditor attestation on ICFR?	Enter/exit ICFR attestation requirement if:
SRC and non-accelerated filer	Less than \$75 million	Less than \$100 million	No	The issuer's (1) public float increases to \$700 million or more (making it a large accelerated filer) or (2) public float increases to \$75 million but less than \$700 million and revenue increases to \$100 million or more (making it an accelerated filer)
SRC and non-accelerated filer	Less than \$75 million	\$100 million or more	No	The issuer's (1) public float increases to \$700 million or more (making it a large accelerated filer) or (2) public float increases to \$75 million but less than \$700 million (making it an accelerated filer), unless revenue decreases to less than \$100 million (in which case it remains an SRC and non-accelerated filer)
SRC and non-accelerated filer	\$75 million or more, but less than \$700 million	Less than \$100 million	No	The issuer's (1) public float increases to \$700 million or more (making it a large accelerated filer) or (2) revenue increases to \$100 million or more (making it an accelerated filer), unless public float also decreases to less than \$75 million (in which case it remains an SRC and non-accelerated filer)
SRC and accelerated filer	\$75 million to less than \$250 million	\$100 million or more	Yes	The issuer's (1) public float decreases to less than \$60 million (making it a non-accelerated filer and an SRC) or (2) revenue decreases to less than \$100 million (making it a non-accelerated filer and an SRC), unless public float also increases to \$700 million or more (in which case it becomes a large accelerated filer)
Accelerated filer	\$250 million to less than \$700 million	\$100 million or more	Yes	The issuer's (1) public float decreases to less than \$60 million (making it an SRC and non-accelerated filer) or (2) revenue decreases to less than \$80 million (making it an SRC and non-accelerated filer), unless public float also increases to \$700 million or more (in which case it becomes a large accelerated filer)
Large accelerated filer	\$700 million and greater	Less than \$100 million	Yes	The issuer's (1) public float decreases to less than \$60 million (making it an SRC and non-accelerated filer) or (2) public float decreases to between \$60 million and less than \$560 million and revenue remains below \$100 million (making it an SRC and non-accelerated filer)
Large accelerated filer	\$700 million and greater	\$100 million or more	Yes	The issuer's (1) public float decreases to less than \$60 million (making it an SRC and non-accelerated filer) or (2) public float decreases to between \$60 million and less than \$560 million and revenue decreases to less than \$80 million (making it an SRC and non-accelerated filer)

2.1.6 Acceleration status after IPO

At the end of the fiscal year in which a company conducts its initial public offering (IPO), it could not qualify to be an accelerated or large accelerated filer, because it would not have had periodic reporting obligations for at least 12 months. It would be considered a non-accelerated filer for purposes of its first annual report on Form 10-K following its IPO.

For example, a company with an IPO registration statement on Form S-1 that became effective on 3 December 20Y2 closed on its IPO offering on 4 December 20Y2 and raised approximately \$800 million in public float. It files its annual report for its fiscal year ended 31 December 20Y2 as a non-accelerated filer within 90 days of its fiscal year end. It remeasures its public float on the last business day of its second fiscal quarter for 20Y3 at \$900 million. At 31 December 20Y3, this new registrant would become a large accelerated filer since its public float exceeded \$700 million, it has previously filed at least one annual report on Form 10-K and it has had Exchange Act periodic reporting obligations for at least 12 months.

2.1.7 Financial schedules

Financial schedules (see section 7, *Financial schedules*) may be filed by amendment up to 30 days following the due date of Form 10-K. Thus, the financial schedules for a non-accelerated filer must be filed within 120 days of its fiscal year end. For an accelerated filer, financial schedules must be filed within 105 days of its fiscal year end. For a large accelerated filer, financial schedules must be filed within 90 days of its fiscal year end.

2.1.8 Part III information

The information required in Part III of Form 10-K (e.g., information regarding directors and executive officers, executive compensation, security ownership) may be incorporated by reference from a proxy statement, or provided in an amended Form 10-K, within 120 days of the issuer's fiscal year end. The 120-day period applies to all companies, despite their filer status.

2.1.9 Financial statements of significant equity investees

Financial statements of significant equity investees (see section 6, *Financial statements and parent company information*) may be filed in an amendment to the Form 10-K in certain circumstances. When the investee is a non-accelerated filer or is not a registrant, issuers can file a US investee's financial statements within 90 days of the investee's fiscal year end in an amended Form 10-K or on the due date of the registrant's Form 10-K, whichever is later. Otherwise, when the investee is a large accelerated filer or an accelerated filer, and its reporting deadline falls after the date the issuer files its Form 10-K, the issuer must file the investee's financial statements in an amended Form 10-K by the due date of the investee's Form 10-K.

If the investee is a foreign business, issuers can file the investee's financial statements within six months after the investee's fiscal year end in an amended Form 10-K or on the due date of the registrant's Form 10-K, whichever is later.¹⁶

¹⁶ The SEC's *Foreign Issuer Reporting Enhancements* (FIRE) rule (SEC Release Nos. 33-8959 and 34-58620 dated 23 September 2008) accelerated the reporting deadline for annual reports filed on Form 20-F by foreign private issuers from six months to four months after their fiscal year end, regardless of the size of issuer. However, the text of Rule 3-09 of Regulation S-X was not amended by the FIRE rule. Rule 3-09 continues to allow the financial statements of foreign business investees to be filed up to six months after the investee's fiscal year end or the due date of the registrant's Form 10-K, whichever is later.

2.1.10 Initial Form 10-K filing due date for registrants

When the effective date of a registrant's initial registration statement is within 45 days (90 days for an SRC) of its fiscal year end, but the registration statement does not include audited financial statements of the recently completed fiscal year, the due date of the new registrant's first Form 10-K depends on whether its securities are registered under the Exchange Act or the Securities Act, as follows:

- ▶ If securities are registered under Section 12(b) or 12(g) of the Exchange Act, the new registrant is required to file its first Form 10-K within 90 days of its fiscal year end. See additional guidance in section 2.1.11 for the initial Form 10-K filing due date for Regulation A issuers.
- ▶ If the securities are registered only under the Securities Act, the registrant is required to file a Special Report¹⁷ on Form 10-K within 90 days of the effective date of the initial registration statement. A complete annual report on Form 10-K is not required until the following fiscal year.

2.1.11 Initial Form 10-K filing due date for Regulation A issuers

Regulation A issuers are subject to periodic reporting obligations (e.g., Forms 10-K, 10-Q) under the Exchange Act when they register their securities on Form 8-A under Section 12(b) of the Exchange Act to be able to list their securities on a national securities exchange. In Question 182.22 of the C&DIs about Securities Act rules, the SEC staff clarified that Regulation A issuers that register on Form 8-A can file their first annual report on Form 10-K for the preceding year within 90 days of the effective date of their Form 8-A.

2.2 Electronic filing using EDGAR

Virtually all submissions to the SEC, including Form 10-K, must be made electronically using the SEC's EDGAR system. The rules for electronic filings on the EDGAR system are included in Regulation S-T and the EDGAR Filer Manual. The EDGAR Filer Manual is an essential "how to" manual prepared by the SEC that describes the technical format and other requirements for an electronic submission. The EDGAR Filer Manual, which is updated periodically, can be downloaded from the SEC website (www.sec.gov). While electronic filing has become routine, the SEC has established a "Filer Support" line that registrants may call for assistance with unusual situations (+1 202 551 8900).

Regulation S-T requires that, with a few exceptions, all filings and related correspondence with the SEC be submitted electronically. However, registrants may request a hardship exemption from electronic filing because of technical difficulties or undue burdens and expenses. The temporary hardship exemption is available automatically for unanticipated technical difficulties by filing Form TH, "Notification of Reliance on Temporary Hardship Exemption," within one business day of the required filing date. After filing on Form TH, registrants have six days to submit the filing on EDGAR without losing their timely-filer status. A continuing hardship exemption also may be granted by the SEC staff for a specific or indefinite period.

Exhibits filed before the registrant's transition to EDGAR reporting are not required to be refiled in electronic format. However, new exhibits must be filed electronically and amendments to previously filed paper exhibits require the amended exhibit to be electronically refiled in its entirety.

While Regulation S-T specifies that information included in filings must be searchable, the staff will not object to the use of images or graphics that are not text-searchable. Filers that use items that are not text searchable must also present the information as searchable elsewhere in the filing. The EDGAR system provides the ability to include graphic and image files in documents, the ability to use hyperlinks, including links to previously filed documents on the SEC public website EDGAR database, and the ability

¹⁷ Special Report on Form 10-K is only required to include audited financial statements that comply with Regulation S-X. A Special Report on Form 10-K does not require, but permits, the inclusion of management's discussion and analysis and other narrative disclosures otherwise required in a Form 10-K.

to use the Internet to transmit filings to the EDGAR system. The SEC does not accept magnetic media (e.g., diskettes, tapes, cartridges). Filings should be submitted to EDGAR via the Internet or direct transmission. Filers may submit their filings in ASCII, HTML or iXBRL format.

Manual signatures are no longer required. Instead, signatures in the electronic filing document should be typed. However, the registrant must maintain evidence of appropriate authorization (see Signatures and director involvement later in this section for further discussion).

2.3 XBRL

2.3.1 Background

The SEC continues to work on an interactive data initiative to significantly increase the speed and accuracy of data retrieval and analysis. Extensible Business Reporting Language (XBRL), the financial and operational business reporting offshoot of Extensible Markup Language (XML), is a freely licensable, open technology standard. Instead of treating financial information as a block of text – as in a standard internet page or a printed document – XBRL provides a computer readable identifying “tag” for each individual item of data. For example, “net profit” has its own unique tag. As a result of attaching identifying XBRL tags to individual pieces of data, a business-reporting document becomes “smart” (i.e., a computer can read the data in context, search for information or perform calculations).

2.3.2 SEC’s requirement for interactive data (XBRL)

The SEC’s rule on XBRL, *Interactive Data to Improve Financial Reporting*, issued in 2009,¹⁸ requires the use of XBRL for SEC financial reporting. Interactive data is required for the entirety of the financial statements, including the footnotes and all required registrant schedules. Currently, the SEC is not requiring tagging of MD&A and executive compensation. However, the SEC has been adding tagging requirements to the majority of its recent final rules.

2.3.2.1 Inline XBRL filing of tagged data

The SEC requires operating companies to use Inline XBRL and embed tags in their financial statements, rather than provide this data in separate XBRL exhibits. The SEC does not view XBRL exhibits or Inline XBRL data to be part of the financial statements and in scope for the financial statement audit. Controls over XBRL are within the scope of the registrant’s disclosure controls and procedures (DCP) but not its ICFR.

The Inline XBRL requirements apply to all filers,¹⁹ regardless of whether they are EGCs, SRCs or FPIs that prepare financial statements in accordance with IFRS as issued by the International Accounting Standards Board (IASB).

2.3.2.2 SEC observations

The SEC staff addresses XBRL filing issues by publishing *Staff Observations from Review of Interactive Data Financial Statements* on the SEC’s website at <http://www.sec.gov/spotlight/xbrl/staff-review-observations.shtml>. The SEC staff monitors trends in custom tagging in XBRL exhibits and the use of unnecessary customized tags that could potentially reduce comparability across companies. SEC rules permit custom tags to be used only when a standard tag from the XBRL taxonomy doesn’t exist for a financial element. The SEC staff plans to continue monitoring trends in custom tagging and may consider further guidance or other actions.

¹⁸ Release Nos. [33-9002](#) and [34-59324](#).

¹⁹ Investment companies registered with the SEC under the 1940 Act and business development companies (BDCs) are not included in the definition of operating companies, and accordingly are currently not in the scope of XBRL rules or Inline XBRL tagging requirements.

The staff of the SEC Office of Interactive Disclosure periodically updates its interpretative responses to frequently asked questions about XBRL: Staff Interpretations and FAQs Related to Interactive Data Disclosure, which is available at <http://www.sec.gov/spotlight/xbrl/staff-interps.shtml>.

The SEC staff's C&DIs about interactive data are also available at <https://www.sec.gov/corpfin/interactive-data-cdi>. In August 2019, the SEC staff issued several C&DIs that address matters related to the adoption of Inline XBRL.

2.3.2.3 Disclosure controls and procedures considerations

The SEC's adopting release on XBRL from December 2008 makes clear that an issuer's disclosure controls and procedures must address the interactive data reporting requirements. Further, under Exchange Act Rules 13a-15 and 15d-15 and Item 307 of Regulation S-K management of the issuer must consider its controls over interactive data in disclosing the conclusions of its principal executive and principal financial officer regarding the effectiveness of its DCP.

Therefore, an issuer should document the processes it follows and identify the DCP that it relies on in tagging its financial statements. An issuer also should consider establishing processes and documentation to provide evidence that those controls and procedures are performed and reviewed. To evaluate the effectiveness of DCP under Exchange Act Rules 13a-15 and 15d-15 and Item 307 of Regulation S-K, companies should:

- ▶ Identify the controls and procedures they rely on to comply with the SEC reporting requirements for XBRL tagging
- ▶ Assess whether the disclosure controls and procedures result in timely, accurate and complete XBRL tagging
- ▶ Assess whether the XBRL tagging presents the financial information accurately in all material respects

However, the XBRL final rule from December 2008 amended Exchange Act Rules 13a-14 and 15d-14 to exclude interactive data from the scope of the officer certification requirements.

2.3.2.4 Internal control over financial reporting

Although most issuers will not have XBRL controls that fall within the scope of ICFR, the SEC observes that as technology associated with interactive data improves, the integration of such technology into the overall financial reporting process could cause the related controls and procedures to fall within the scope of internal control over financial reporting.

2.3.2.5 Consequences of noncompliance

If a company is delinquent in providing its XBRL data to the SEC, the company will be deemed not to be current in its Exchange Act reporting obligations. Consequently, the company could not use short-form registration statements on Forms S-3, F-3 or S-8, and it would not be considered to have adequate current public information for purposes of the resale exemption safe harbor under Rule 144 of the Securities Act. However, such a company will be considered to be current in its reporting obligations when it provides the XBRL data to the SEC.

2.3.2.6 Liability considerations

Registrants are liable for inaccuracies in XBRL data under the Securities Act and the Exchange Act.

2.3.2.7 **SEC form cover page requirements**

The cover page of Form 10-K requires a company to indicate, by a Yes or No check mark, whether it has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). All the information presented on the cover page of Form 10-K must be tagged.

2.3.2.8 **AICPA attestation guidance**

Management is responsible for the completeness, accuracy and consistency of its XBRL data. The standards of the PCAOB and the rules and regulations of the SEC do not require that an independent auditor perform procedures related to the XBRL data, as part of its audit services. In addition, unlike other information in documents containing the audited financial statements (e.g., MD&A), the independent auditor is not required to read the XBRL submission for material inconsistencies with the information or manner of its presentation appearing in the financial statements as part of its audit procedures.

In 2013, the AICPA issued Statement of Position 13-02, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information (SOP 13-02)*. SOP 13-02 describes the components of an XBRL agreed-upon procedures engagement and the principles a practitioner should follow in completing such an engagement.

2.3.3 **Taxonomies**

All XBRL tagging must apply the appropriate taxonomy (i.e., set of defined tags and definitions). The approved taxonomies are available on the [FASB website](#) and the [SEC website](#). The SEC staff encourages companies to adopt the latest version of the US GAAP taxonomy the SEC has approved.

2.4 **Signatures and director involvement**

The following persons, or persons performing similar functions, must sign the Form 10-K: the principal executive officer or officers, the principal financial officer, the controller or principal accounting officer and at least a majority of the board of directors or persons performing similar functions.²⁰ When an officer also signs as a director, the Form 10-K must indicate both capacities below the signature.

When adopting the requirement for directors' signatures, the SEC stated that its intention was to encourage directors to devote attention to reviewing the Form 10-K and "to seek the involvement of other professionals to the degree necessary to give themselves sufficient comfort."

Documents filed electronically necessarily include typed, rather than manual, signatures. Registrants must maintain a manually or electronically (as discussed below) signed signature page or other document authenticating and acknowledging the signatures included in all electronic filings. This document must be executed before or at the same time the filing is made and must be retained for five years. Accordingly, the filing of typed signatures does not relieve the registrant of its obligation to obtain signatures from the officers, directors and others (e.g., auditors) before the filing is submitted. On request, registrants must provide the SEC with documentation supporting typed signatures.

²⁰ For asset-backed security issuers, the Form 10-K must be signed either (1) on behalf of the depositor by the senior officer in charge of securitization of the depositor or (2) on behalf of the issuing entity by the senior officer in charge of the servicing function of the servicer.

Electronic Signatures Rule 302 of Regulation S-T

Rule 302(b) of Regulation S-T²¹ permits a signatory to an electronic filing on EDGAR who follows certain procedures to sign an authentication document through an electronic signature that meets certain requirements specified in the EDGAR Filer Manual. Signatories have the option of signing an authentication document either manually or electronically; however, the signing process for an electronic signature is required to meet certain conditions that are consistent with the evidentiary purposes of the authentication document.

When a signatory signs an authentication document using an electronic signature, the signing process for the electronic signature must, at a minimum:

- ▶ Require the signatory to present a physical, logical (e.g., use of password), or digital credential that authenticates the signatory's identity
- ▶ Reasonably provide for non-repudiation of the signature
- ▶ Provide that the signature be attached, affixed, or otherwise logically associated with the signature page or document being signed
- ▶ Include a time stamp to record the date and time of the signature

Companies should consult with their securities counsel about when and whether it is appropriate to avail themselves of the electronic signature authentication in their SEC filings on Form 10-K or in other filings.

Other considerations for officer and director signatures in SEC filings

The requirement for directors to sign the Form 10-K may affect the timing of the preparation of Form 10-K. Management should develop procedures to obtain their signatures. This might be done by scheduling a meeting of the board of directors or its audit committee shortly before the Form 10-K is due so that directors may review the form, possibly with counsel and the independent auditors. Alternatively, the directors may sign a signature page in advance, or execute a power of attorney, and approve the use of their signatures after receiving a draft of the Form 10-K.

Regarding the signing of a report or other documentation through power of attorney, Item 601(b)(24) of Regulation S-K requires the following:

- ▶ If the name of any officer or director is signed pursuant to a power of attorney, signed copies of such power of attorney must be filed with the SEC.
- ▶ If the power of attorney is included elsewhere in the filing, a reference must be made in the index to the part of the filing containing the power of attorney.
- ▶ If the name of any officer signing on behalf of the registrant is signed by a power of attorney, certified copies of the board of directors' resolution authorizing such signature must be filed with the SEC.
- ▶ A power of attorney should relate only to a specific SEC filing or amendment. A power of attorney that confers general authority is not acceptable.

²¹ See SEC Release [33-10889](#), *Electronic Signatures in Regulation S-T Rule 302*.

2.5 Section 906 management certifications

Section 906 of the Sarbanes-Oxley Act (Section 1350 of Chapter 63 of Title 18 of the United States Code) requires a separate certification by the CEO and CFO (or their equivalent)²² to “accompany” each periodic report that includes financial statements. The contents of this certification are specified in Section 906(a) of the Sarbanes-Oxley Act, *Certifications of Periodic Financial Reports*, not in an SEC rule. The certification must state that the periodic report “fully complies” with the requirements of Exchange Act Section 13(a) and 15(d) and that “information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.” The certification can take the form of a single certification signed by both the company’s CEO and CFO. Section 906 provides for criminal penalties for an officer who provides the certification “knowing” it to be untrue. They can be fined up to \$1 million and imprisoned for up to 10 years (with harsher penalties for “willful” violations). The Section 906 certification requirement applies to all registrants, except asset-backed security issuers.

The Section 906 certification is required to be “furnished” (versus filed) as Exhibit 32 to annual and quarterly SEC reports. As “furnished” information, the Section 906 certification is not subject to the civil liability provisions of Section 18 of the Exchange Act and would not be incorporated by reference into Securities Act registration statements unless the issuer expressly specifies otherwise.

For signed documents filed electronically, SEC rules require issuers to retain the manually or electronically signed original of each Section 906 management certification for five years. In addition, the SEC has stated that an individual required to sign the Section 906 certification “may not have the certification signed on his or her behalf pursuant to a power of attorney or other form of confirming authority.” Refer to the recent amendments to Rule 302(b) of Regulation S-T described in section 2.4 above permitting the option to authenticate signatures in SEC filings electronically.

2.6 Transmittal letter

General instruction D(3) to Form 10-K requires registrants to discuss in a transmittal letter to the Form 10-K any changes in accounting principles or practices, or in the method of applying those principles or practices, from its last Form 10-K. This requirement is separate from the requirement to include, as an exhibit, a “preferability letter” from the independent auditors regarding a change in accounting principle.

2.7 Content of the report

Instructions to Form 10-K, Regulations 12B, 13A, 15D and AB under the Exchange Act, and Regulations S-K and S-X include Form 10-K requirements. The form itself, which is divided into four parts, is merely a guide and, except for the cover page, should not be used as a blank form to be filled in. The report should include all required item numbers and captions (e.g., Item 1, *Business*). When required information is presented elsewhere, generally it is not necessary to repeat the information, provided that it is adequately cross-referenced. All information should be given as of the latest practicable date, except where it must be given for the fiscal year end or as of a specified date.

Regulation S-K includes the nonfinancial statement disclosure requirements for Exchange Act periodic reports and Securities Act registration statements. With the notable exception of financial statements and schedules, which are governed by Regulation S-X, the instructions to Form 10-K generally refer to the disclosure requirements of Regulation S-K.

²² The SEC certification rules refer to “each principal executive officer” and “each principal financial officer,” which will be referred to as CEO and CFO for purposes of the discussion of certifications in this publication.

The following table shows the item number, caption and location of the disclosure instructions, which is noted parenthetically and refers to the items in Regulation S-K for the various items of Form 10-K.

Form 10-K

Item No.	Disclosure Required
Part I	
Item 1	Business (Item 101)
Item 1A	Risk Factors (Item 105)
Item 1B	Unresolved Staff Comments (The disclosure requirements are included in the Instructions to Form 10-K.)
Item 2	Properties (Item 102)
Item 3	Legal Proceedings (Item 103)
Item 4	Mine Safety Disclosures (Item 104)
Part II	
Item 5	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities (Items 201, 701 and 703)
Item 6	[Reserved] (Item 6 "Selected Financial Data" was removed and reserved by SEC Release No. 33-10890 dated 19 November 2020.)
Item 7	Management's Discussion and Analysis of Financial Condition and Results of Operations (Item 303)
Item 7A	Quantitative and Qualitative Disclosures About Market Risk (Item 305)
Item 8	Financial Statements and Supplementary Data (Item 302 – The financial statements are subject to the disclosure requirements of Regulation S-X.)
Item 9	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure (Item 304(b))
Item 9A	Controls and Procedures (Items 307 and 308)
Item 9B	Other Information (The disclosure requirements refer to Form 8-K.)
Item 9C	Disclosure Regarding Foreign Jurisdictions that Prevent Inspections (The disclosure requirements are included in the Instructions to Form 10-K.)
Part III	
Item 10	Directors, Executive Officers and Corporate Governance (Items 401, 405, 406 and 407(c)(3), (d)(4) and (d)(5))
Item 11	Executive Compensation (Items 402 and 407(e)(4) and (e)(5))
Item 12	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters (Items 201(d) and 403)
Item 13	Certain Relationships and Related Transactions, and Director Independence (Items 404 and 407(a))
Item 14	Principal Accountant Fees and Services (Item 9(e) of Schedule 14A)
Part IV	
Item 15	Exhibits and Financial Statement Schedules (Item 601 – The financial statements and financial schedules are subject to the provisions of Regulation S-X.)
Item 16	Form 10-K Summary (optional)

Rule 12b-20 of the Exchange Act requires the registrant to disclose any material information, even if not specifically required, that may be necessary to keep the required information from being misleading.

Rule 12b-21 of the Exchange Act states that information required by any of the parts "need be given only insofar as it is known or reasonably available to the registrant." Therefore, if obtaining the information involves unreasonable effort or expense, or it rests peculiarly within the knowledge of another person not affiliated with the registrant, the information may be omitted. When information is omitted, the registrant must:

- ▶ Give the information on the subject that it does possess or can acquire without unreasonable effort or expense, together with the sources thereof
- ▶ Include a statement either that an unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information

The application of Rule 12b-21 depends on the registrant's facts and circumstances, and we have observed that use of this accommodation has been rare.

2.8

Wholly owned subsidiaries²³

Wholly owned subsidiaries that are required to file an annual report on Form 10-K because they have issued registered securities may avail themselves of the significant disclosure accommodations listed in General Instruction I.(2) in their annual report on Form 10-K, if they meet *all* of the following conditions²⁴ as of the filing date:

- ▶ All of the registrant's equity securities must be owned, directly or indirectly, by a single parent that is subject to the Exchange Act reporting requirements and has filed all applicable material pursuant to Sections 13, 14 or 15(d) of the Exchange Act.
- ▶ The registrant must name its parent in the description of its business.
- ▶ During the preceding 36 months and any subsequent period, there must not have been a material default in the payment of principal, interest, a sinking or purchase fund installment or any other material default not cured within 30 days, for any indebtedness of the registrant or its subsidiaries or a material default in the payments of rentals under a long-term lease.
- ▶ The cover page of the Form 10-K must contain a statement that the registrant meets the conditions for filing the reduced disclosures in General Instruction I.(1) of Form 10-K.

Wholly owned subsidiaries that meet the conditions described above are not required to include any of the proxy disclosures otherwise required in Part III of Form 10-K. Further, only the following other items of Form 10-K are required:

Item 1	Business
Item 1A	Risk Factors
Item 1B	Unresolved Staff Comments
Item 2	Properties
Item 3	Legal Proceedings
Item 4	Mine Safety Disclosures
Item 5	Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities (This item is required although it generally is not applicable to wholly owned subsidiaries.)
Item 7	Management's narrative analysis of the results of operations over the last two years (in lieu of full MD&A)
Item 7A	Quantitative and Qualitative Disclosures About Market Risk
Item 8	Financial Statements and Supplementary Data
Item 9	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A	Controls and Procedures
Item 9B	Other Information
Item 9C	Disclosure Regarding Foreign Jurisdictions that Prevent Inspections
Item 14	Principal Accountant Fees and Services
Item 15	Exhibits and Financial Statement Schedules (except the exhibit of subsidiaries required by Item 601 of Regulation S-K)

²³ The terms "wholly owned subsidiary" and "totally owned subsidiaries" are defined in Exchange Act Rule 12b-2 and applied in various other SEC rules.

²⁴ The conditions are specified in General Instruction I.(1) of Form 10-K, and one of them is that the issuer is not an asset-backed securities issuer.

In lieu of Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, the Form 10-K may include management's narrative analysis of the results of operations that explains the reasons for material changes in the amount of revenue and expense items between the most recent fiscal year presented and the immediately preceding fiscal year.

The responses to Item 1, *Business*, and Item 2, *Properties*, may be limited to a brief description of business done during the year and a brief description of material properties. The description of business should indicate the general nature and scope of the registrant's business, and material properties need to be described only to the extent necessary to provide an understanding of the business. Exhibit 21 listing subsidiaries, otherwise called for by Item 15(c), also may be omitted.

Wholly owned subsidiaries are *not* exempt from the SEC requirements for the Section 302 and Section 906 management certifications, Item 307 disclosures about disclosure controls and procedures, and Item 308 reporting on internal control over financial reporting.

Debt or preferred stock registered under the Securities Act may be guaranteed by one or more affiliates of the issuer. It's common for a parent company to raise capital by offering its own securities that are guaranteed by one or more subsidiaries or through one of its subsidiaries with guarantees from the parent and/or one or more other subsidiaries. If certain conditions are met, Rule 3-10 of Regulation S-X allows for alternative financial disclosure or, in certain instances, narrative disclosure in the parent company's annual report on Form 10-K and other filings in lieu of separate financial statements for each subsidiary issuer and guarantor of registered debt. See the discussion about subsidiary guarantors or subsidiary issuers of guaranteed securities in section 6, *Financial statements and parent company information*.

2.9 Combined periodic reporting

The SEC staff has indicated that it would not object to the filing of a combined periodic report (i.e., Form 10-K or Form 10-Q) for parent and subsidiary registrants and multiple series registrants in certain situations.

2.9.1 Parent and subsidiary

Parent and subsidiary registrants may file a combined periodic report if all of the following conditions are met:

- ▶ The parent company owns substantially all of the subsidiary²⁵
- ▶ There are no more than nominal differences between the financial statements of the parent and the subsidiary and the nonfinancial disclosures of the parent and subsidiary are substantially similar
- ▶ All of the following items are included in the combined periodic report:
 - ▶ Separate audit reports for each entity
 - ▶ Separately reviewed interim financial statements for each entity
 - ▶ Separate reports on disclosure controls and procedures and internal control over financial reporting for each entity
 - ▶ Separate complete sets of annual and interim financial statements (e.g., balance sheet, statement of operations, statement of comprehensive income, statement of cash flows and statement of changes in stockholders equity, as applicable)
 - ▶ Separate footnotes for areas that differ between the parent and the subsidiary
 - ▶ Separate CEO/CFO Certifications for each entity

²⁵ "Substantially all" is not defined in terms of a minimum percentage ownership. Recently, based on the facts and circumstances, the SEC Staff has shown flexibility in interpreting this criterion to provide combined periodic reports.

2.9.2 Multiple series registrants

A multiple series registrant is a trust or partnership that offers the sale of its investments in multiple series, on a single registration statement. Because multiple series registrants are formed as trusts or partnerships under state law, each series is established as both a legal entity and as an SEC issuer; however, the trust or partnership is considered the only entity with SEC reporting requirements (i.e., the legal registrant). Because an investor invests in an individual series of the trust or partnership, financial statements of each individual series of the trust or partnership still must be provided. The SEC staff will not object to the filing of a combined periodic report for the trust or partnership and each individual series as long as certain separate reporting continues to be applied at both the legal registrant and the series level. Specifically, to qualify to file a combined periodic report, there must be separate assessments of materiality for purposes of Regulations S-K and S-X for the legal registrant and for each series and all of the following items must be separately provided for the legal registrant and for each series in the combined periodic report:

- ▶ Separate annual financial statements and audit reports or separately reviewed interim financial statements
- ▶ Separate reports on disclosure controls and procedures and internal control over financial reporting

Multiple series registrants also should include in the “controls and procedures” disclosure of their periodic reports a statement that the CEO/CFO certifications are applicable to each of the series as well as to the trust (partnership).

2.10 Incorporation by reference

Most of the information required in Form 10-K is required in other SEC filings or in the annual shareholders’ report prescribed by the SEC’s proxy requirements. Instead of reproducing information in the Form 10-K that has already been included in a previous SEC filing or an annual shareholders’ report, a registrant may incorporate by reference that information into the Form 10-K. For example, in lieu of reproducing the same financial statements in response to Item 8 of Form 10-K, a registrant may incorporate by reference into the Form 10-K the sections of the annual shareholders’ report containing the audited financial statements. Rule 303 of Regulation S-T stipulates that registrants that incorporate by reference all or portions of their annual reports to shareholders must file the incorporated portions in electronic form as an exhibit (Exhibit 13) to the Form 10-K filing.

General Instruction G to Form 10-K provides that information called for by Parts I and II (Items 1 through 9A or any portion thereof) *may* be incorporated by reference from the registrant’s annual shareholders’ report. As a condition to the incorporation of any information from the annual shareholders’ report, the entire report must comply with the requirements of Rule 14a-3(b) or 14c-3(a) – the SEC requirements for annual shareholders’ reports in conjunction with proxy statements or information statements. Thus, a registrant filing Form 10-K pursuant to Section 15(d)²⁶ must conform its annual shareholders’ report to the SEC’s proxy requirements, even though it is not otherwise required to do so, to incorporate any portion of the report into Form 10-K.

General Instruction G also provides that information called for by Part III of Form 10-K (Items 10, 11, 12, 13 and 14) may be incorporated by reference from the registrant’s definitive proxy or information statement *if* the proxy or information statement is filed with the SEC not later than 120 days after the fiscal year end. However, if the information called for by these items cannot be incorporated by reference, it must either be included within Form 10-K when filed, or included by amendment on Form 10-K/A no later than 120 days after the fiscal year end. In addition, as discussed in section 10 of this publication, the following four disclosures required by Part III of Form 10-K are not required to be included in the annual proxy statement, and may be included in the Form 10-K as filed, or by amendment: (1) executive officers, (2) audit committee financial experts, (3) code of ethics and (4) changes in shareholder nominating procedures.

²⁶ Unlike Sections 12(b) and 12(g) registrants, Section 15(d) reporting companies are not subject to the SEC’s proxy rules.

In addition to the instructions to Form 10-K, several rules under Regulation 12B contain instructions for incorporation by reference that are applicable to all Exchange Act filings, including Form 10-K.

Financial statements may be incorporated by reference when they meet the requirements of Form 10-K (subject to General Instruction G of Form 10-K discussed above regarding incorporation by reference from annual shareholders' reports). Financial statements and data must be presented in comparative format. Rule 12b-23 provides that a registrant cannot incorporate this material by reference unless it includes the entire period for which the comparative data is required. Thus, it is not permissible to separately incorporate by reference a previous year's financial statements or data.

A Form 10-K may incorporate by reference financial statements filed under the Securities Act, such as from a registration statement. When this is done, Rule 12b-36 requires that an auditor's consent be filed with the Form 10-K.

Rule 12b-23(d) also requires that when information on EDGAR is incorporated by reference, registrants are required to include an active hyperlink.

Rule 12b-23 also requires that:

- ▶ The matter incorporated by reference must be clearly identified in the reference by page, paragraph, caption or otherwise.
- ▶ If only certain portions of a document are incorporated by reference and filed with the report, the document from which the material is taken must be clearly identified in the reference.
- ▶ An express statement that the specified matter is incorporated by reference must be made at the particular place in the report where the information is required.
- ▶ Material must not be incorporated by reference in any case where such incorporation would render the report incomplete, unclear or confusing.
- ▶ If any modification has occurred in the text of any document incorporated by reference since its filing, a registrant must file with the reference a statement containing the text of the modification and the date it was made.

When financial statements or other information included in the published annual shareholders' report are incorporated by reference, registrants should specifically identify the information so incorporated. Failure to do so could imply that the entire annual report (including the "president's letter" and other subjective information) is incorporated by reference; the entire annual report then could be deemed a "filed document" under the Exchange Act. This could unnecessarily expose the registrant to additional liability.

2.10.1 Cross-referencing and location of financial statement disclosures

To address concerns about financial statement users' understanding of auditors' responsibilities, registrants are prohibited from having financial statements cross-reference disclosures in other parts of a filing or incorporate information by reference from other filings, unless cross-referencing or incorporating information by reference is specifically permitted by the Commission rules, US GAAP or IFRS as issued by the IASB.

2.11 Integrated reports

The SEC permits the annual shareholders' report and Form 10-K to be filed as a combined report. A registrant must satisfy the following conditions when integrating the annual shareholders' report with Form 10-K:

- ▶ The report must contain all the information required by Form 10-K, including the cover page and required signatures. A cross-reference sheet should indicate the location of information required by the items of the form. When responses to certain items of the form are separated within the report, an appropriate cross-reference should be made.

- ▶ If the information required by Part III of Form 10-K (see General Instruction G) is omitted, a definitive proxy or information statement must be filed not later than 120 days after the end of the fiscal year covered by the Form 10-K.

Information contained in integrated annual reports, other than that required by the Form 10-K instructions, is not deemed “filed” for purposes of liability under Section 18 of the Exchange Act. Before electing to prepare an integrated report, certain factors should be considered. Cost may not be a significant factor because the savings of preparing only one document may be offset by its larger size and by additional printing and mailing costs.²⁷ Another consideration is the additional disclosures required by the SEC rules. All information required by the Form 10-K instructions must be included. Some commercial companies will have to include audited financial statements of unconsolidated subsidiaries, investees and affiliates, as well as financial schedules.

Some registrants have followed a practice similar to integration – including the Form 10-K as a separate section in the annual shareholders’ report. If the registrant wants to include the Form 10-K information in the annual shareholders’ report, this approach may be more desirable and/or cost-efficient than fully integrating the two reports. Registrants could continue to eliminate duplication through incorporation by reference.

2.12 Summary annual reports

Some registrants have prepared “summary annual reports” in lieu of the traditional annual report most public companies provide to their shareholders. The summary annual report does not include all of the financial disclosures required by the SEC’s proxy rules, which require that audited consolidated financial statements, MD&A and certain other information be included in an annual report to all shareholders when soliciting proxies for the annual meeting. Because the summary annual report is not used for compliance purposes, there are no specific rules about its content. The only restrictions on the information in the summary annual report are (1) the general requirement that corporate communications by public companies must not include false or misleading information or fail to disclose material information that would make the communications not misleading (i.e., Rule 10b-5 of the Exchange Act) and (2) the provisions of Regulation G for any non-GAAP financial measures presented. Registrants that use a summary annual report must continue to provide shareholders with the complete information required under the proxy rules, which may be included in an addendum to the annual meeting proxy statement. Because the use of a summary annual report does not reduce the amount of information that must be provided to shareholders, its use has been limited.

2.13 Amendments and comprehensive annual reports

Occasionally, a registrant may need to amend a filing or management may believe it is more efficient to include multiple delinquent or corrected filings in one document. The SEC has rules for filing amended or delinquent filings.

2.13.1 Amendments

A Form 10-K may be deficient because a registrant has omitted material information, or because the registrant has not prepared the financial statements in accordance with generally accepted accounting principles or Regulation S-X. In other cases, the registrant may choose to file the financial schedules (see section 7, *Financial schedules*) as an amendment to the Form 10-K no later than 30 days after the applicable due date of the Form 10-K. Alternatively, under particular circumstances, the registrant may have to file Part III information (regarding directors and executive officers and executive compensation

²⁷ Section 2 of our publication, *Proxy statements – An overview of the requirements and observations about current practice*, discusses proxy delivery requirements, including the internet availability of proxy materials that also may reduce printing and mailing costs.

and transactions) after the initial filing of Form 10-K but within 120 days of the fiscal year end. Under these circumstances, an amendment to Form 10-K is required. Amendments should be filed only after review by legal counsel and the independent auditors.

All amendments to Exchange Act reports should be filed under cover of the form amended, marked with the letter “A” to designate the document as an amendment (e.g., Form 10-K/A). The amended report should indicate the reasons for the revisions included therein in an explanatory note. The amendment must include the entire item as amended, rather than just the amended or additional text (e.g., if the liquidity discussion within MD&A is amended, the entire Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operations*, should be refiled). However, based on informal discussions with the SEC staff, a registrant is not required to refile the entire Item 8, *Financial Statements and Supplementary Data*, when filing the financial schedules as an amendment to a previously filed Form 10-K.

Amendments must be signed on behalf of the registrant by a duly authorized representative of the registrant (see Signatures and director involvement above for further discussion). In addition, each CEO and CFO must provide a new management certification. The CEO and CFO must furnish, as Exhibit 32, the complete Section 906 certification. However, in lieu of the complete Section 302 certification, the CEO and CFO may file, as Exhibit 31, a modified Section 302 certification to comply with Section 13(a) or 15(d) of the Exchange Act. The SEC staff’s C&DI of Section 13(a) and 15(d) of the Exchange Act provides guidance on the modifications to Section 302 certifications when a periodic report is amended. Paragraph 3 of the certification may be omitted if there are no financial statements or other financial information in the amendment. If the amendment does not contain or amend disclosures required by Item 307 or 308 of Regulation S-K and such disclosures are not required given the nature of the amendment, the registrant may omit paragraphs 4 and 5. See section 4, *Part II*, for further information about the Section 302 certification.

Illustration 2-1: Modified Section 302 certification in amendment

Exhibit 31.1

CERTIFICATION

I, [identify the certifying individual], certify that:

1. I have reviewed this annual report on Form 10-K/A of [identify registrant]; and
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

Date:

[Signature]

[Title]

Note: Paragraphs 1 and 2 may not be omitted under any circumstances. Paragraph 3 of the certification should be added if there are financial statements or other financial information in the amendment. Paragraphs 4 and 5 should be added if the amendment contains or amends disclosures required by Item 307 or 308 of Regulation S-K and such disclosures are required given the nature of the amendment.

2.13.2

Comprehensive annual reports

A registrant that has missed filing one or more required reports with the SEC may decide to file the delinquent financial information in one comprehensive annual report sometimes referred to as a “Super 10-K.”

The comprehensive annual report would need to include all material information that would otherwise have been available had the registrant filed individual reports. It must also include the necessary unaudited quarterly financial statements along with a sufficiently detailed discussion of operating results, trends and liquidity for each interim and annual period presented.

Filing a comprehensive annual report does not absolve a registrant from any liability under the Exchange Act for failing to file all required reports and would not remove the possibility of enforcement action for the registrant's filing delinquencies. In addition, filing a comprehensive annual report does not result in the registrant being considered "current" for purposes of Regulation S, Rule 144 or Form S-8 registration statements. Finally, the registrant would not be eligible to use Form S-3 until it establishes a sufficient history of making timely filings.

2.14 Forward-looking information

The Private Securities Litigation Reform Act of 1995 (Litigation Reform Act) amended federal securities laws to add a "safe harbor" provision, which protects public companies from liability in private litigation for forward-looking statements (e.g., estimates, projections) made by them and by others on their behalf. This protection is provided when a company includes appropriate cautionary language when making a forward-looking statement. The Litigation Reform Act's safe harbor (Section 27A of the Securities Act and Section 21E of the Exchange Act) is intended to promote disclosures about a company's future prospects by reducing the threat of litigation when those predictions fail to materialize.

Rule 175 of the Securities Act and Rule 3b-6 of the Exchange Act (collectively, the SEC safe harbor) provide protection from liability under the federal securities laws for forward-looking statements made in filings with the SEC. To qualify for protection under the SEC safe harbor, a forward-looking statement has to be made in "good faith" and with a "reasonable basis." Critics believed the SEC safe harbor had been ineffective because its protection depends on the defendant's state of mind. As a result, courts had been reluctant to dismiss private lawsuits before allowing plaintiffs to complete discovery, which can be protracted and costly to the defendant. The risk of costly litigation led many registrants to avoid disclosing forward-looking information to the extent possible.²⁸

The statutory safe harbor provided by the Litigation Reform Act provides protection only in private litigation. In cases brought by the SEC, the defendant only can rely on the SEC safe harbor, and the SEC can obtain injunctive or other relief, including a civil penalty, if it proves that the defendant deliberately or recklessly made a false or misleading forward-looking statement.

The purpose of the statutory safe harbor is to provide an objective legal standard, which does not involve the defendant's state of mind, against which courts can evaluate allegedly fraudulent forward-looking statements and dismiss cases where those statements were immaterial because they were made in a sufficiently cautionary manner. To qualify for protection under the statutory safe harbor, forward-looking statements must be (1) identified as forward-looking statements and (2) "accompanied by meaningful cautionary language identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." The Litigation Reform Act still allows courts to decide that allegedly fraudulent forward-looking statements were immaterial, and thus not actionable, even though those statements were not made in this manner. However, when forward-looking statements are made in a manner that qualifies for safe harbor protection, the Litigation Reform Act protects against any liability in private litigation for those statements.

The Litigation Reform Act also raised the standard of liability for forward-looking statements by requiring "actual knowledge" that the statement was false or misleading. If a private lawsuit (i.e., one not brought by the SEC) involving an allegedly fraudulent forward-looking statement comes to trial, the plaintiff must

²⁸ In certain circumstances, forward-looking information is required to be disclosed, particularly in MD&A, which must include a discussion of certain "known trends and uncertainties." In addition, certain predictions must be disclosed in going-private transactions.

prove that the person who made the statement knew (or, for a statement made by a business, the executive officer who approved the statement knew) that the statement was false or misleading. However, if the statement in question was identified as a forward-looking statement and was accompanied by meaningful cautionary language, the courts can dismiss private lawsuits without allowing discovery and a trial to examine the defendant's state of mind.

Registrants should consult their legal counsel regarding protection of their forward-looking disclosures under the safe harbor. In evaluating whether to seek safe harbor protection, a company may wish to consider the degree of risk that actual results could differ materially from the forward-looking disclosure and the exposure that might result from any such material difference. When a company makes several forward-looking statements with common risk factors, it may wish to provide a cross-reference to a single presentation of cautionary language about those risk factors.

Meaningful cautionary language: The statutory safe harbor's requirement for meaningful cautionary language essentially adopted the judicial doctrine (known as "bespeaks caution") that had developed under case law. Under this doctrine, a number of federal courts determined that sufficient cautionary language renders an allegedly misleading forward-looking statement immaterial as a matter of law. To qualify as "meaningful," the cautionary language accompanying forward-looking statements must provide substantive information about risk factors that realistically could cause actual results to differ materially from those in the forward-looking statement. In addition, such cautionary language must be relevant to the particular projection and thus must be tailored to the circumstances. "Boilerplate" cautionary language is insufficient. Cautionary language should be prominently disclosed and communicate the degree of risk that results could differ from the forward-looking statement.

Whether the cautionary language that accompanies a forward-looking statement is "meaningful" ultimately will be determined in a court of law. However, companies seeking safe harbor protection for their forward-looking statements should disclose significant known risk factors that are most likely to affect results. As a basic premise, the cautionary language should set out all significant and relevant assumptions underlying the forward-looking statement. The cautionary language should then specifically identify factors that could cause those assumptions to be wrong. To the extent possible, the cautionary language should identify the relative effect those factors could have on whether the projection turns out to be wrong. Safe harbor protection does not depend on identifying the particular factor that causes the forward-looking statement not to come true. However, there may be situations where a company has a strong justification (e.g., the risk of significant competitive harm) for omitting an important known risk factor from its cautionary language.

Forward-looking statements: The Litigation Reform Act's definition of "forward-looking statement" is generally consistent with the definition under the SEC safe harbor. Forward-looking statements include: (1) a statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items; (2) a statement of the plans and objectives of management for future operations; (3) a statement of future economic performance, including such statements in MD&A; and (4) any statement of the assumptions underlying or relating to any forward-looking statement.

Eligibility: Under the Litigation Reform Act, only certain forward-looking statements are eligible for safe harbor protection. The safe harbor applies to forward-looking statements made by, among others, (1) an issuer subject to the reporting requirements of the Exchange Act and (2) persons acting on behalf of such an issuer (e.g., officer, director, employee).

The Litigation Reform Act excludes statements made by or on behalf of certain issuers from safe harbor protection. Specifically, the safe harbor is not available for companies making their initial public offering, investment companies, partnerships, limited liability companies, direct participation investment programs, blank check companies or penny stock issuers. The safe harbor also is not available for an issuer that during the three years preceding such statement was found to have violated specified laws. Safe harbor protection

is not available to any person convicted of any felony or misdemeanor described in clauses (i) through (iv) of Section 15(b)(4)(B) of the Exchange Act, or who, because of a governmental action, received a judicial or administrative decree or order that addresses violations of the antifraud provisions of the securities laws.

The Litigation Reform Act also excludes statements made about certain types of transactions or in certain documents from safe harbor protection. The safe harbor is not available for financial statements prepared in accordance with generally accepted accounting principles. Even though the safe harbor excludes certain issuers, transactions and documents, in those circumstances an issuer still may decide that it is appropriate and prudent to include cautionary language in forward-looking statements.

Duty to update: The Litigation Reform Act provides that there is no duty to update a forward-looking statement (i.e., a duty to update a statement that was true when made, but which became untrue through later events). However, the Litigation Reform Act is silent as to whether there is a duty to correct a forward-looking statement (i.e., a duty to correct a statement that was false when made). Registrants should consult with legal counsel about whether they have an obligation to correct such statements.

Oral statements: The Litigation Reform Act extended safe harbor protection to oral forward-looking statements, such as those made in conference calls to discuss quarterly and annual results. The safe harbor is available for oral statements made by officers, directors, employees and issuers that are otherwise eligible for the safe harbor (as long as those statements are not made about transactions excluded from safe harbor protection). To qualify under the safe harbor, an oral statement must be identified as a forward-looking statement and must state that results could materially differ from the projection or estimate. However, the Litigation Reform Act does not require the speaker to identify the important factors that could cause results to differ materially from the projection. That is, the speaker is not required to state the meaningful cautionary language that would be necessary if the communication were in writing. Instead, the speaker may refer to “readily available” written documents (e.g., SEC filings) containing meaningful cautionary language that is appropriate to the circumstances.

Many companies provide cautionary language in Forms 10-K and 10-Q, or in a Form 8-K report, which they can refer to when they make oral presentations that include forward-looking statements. In these circumstances, it is important that companies update the cautionary language periodically, as dictated by economic, industry and business developments, so that the statements remain meaningful and provide the desired safe harbor protection.

2.15 Non-GAAP financial measures

2.15.1 Definition

Item 10(e)(2) of Regulation S-K defines a “non-GAAP financial measure” as a numerical measure of a company’s historical or future financial performance, financial position or cash flows that excludes (includes) amounts, or is subject to adjustments that have the effect of excluding (including) amounts, that are included (excluded) in the most directly comparable measure calculated in accordance with GAAP. Thus, non-GAAP financial measures may be forward-looking.

Non-GAAP financial measures provide an alternative source of information, and management may disclose them to help investors understand a company’s operating performance, cash flows or financial position. Common non-GAAP measures include earnings before interest, taxes, depreciation and amortization (EBITDA) and, for real estate investment trusts, funds from operations (FFO).

The definition of non-GAAP financial measures specifically excludes measures that are required to be disclosed by GAAP, SEC rules or an applicable system of regulation imposed by a government, governmental authority or self-regulatory organization (e.g., capital or reserves calculated for regulatory purposes). In addition, non-GAAP financial measures do not include certain statistical and operating measures. For example, non-GAAP financial measures do not include unit sales, number of website visitors, gross billings/bookings, number of employees, number of subscribers, number of advertisers or any ratios or measures that are calculated using financial amounts calculated in accordance with GAAP.

A ratio that includes a non-GAAP financial measure also is considered a non-GAAP financial measure. For example, if operating margin is calculated using a non-GAAP measure of operating income (e.g., operating income, adding back stock compensation expense) and sales revenue determined under GAAP, the statistic would be considered a non-GAAP financial measure. Moreover, forward-looking information is not considered a non-GAAP financial measure as long as the information is determined using GAAP-based measurement principles. In addition, the definition of non-GAAP financial measures excludes the measure of segment profit or loss used by the chief operating decision maker to allocate resources and assess performance because ASC 280²⁹ requires companies to disclose it in the notes to the financial statements. However, including in the segment note one or more additional measures that meet the definition of a non-GAAP measure is prohibited.

2.15.2 Conditions for presentation

Under Item 10(e) of Regulation S-K, when a company presents a non-GAAP financial measure in an SEC filing, including an earnings release furnished in Form 8-K, it must (1) present, with equal or greater prominence, the most directly comparable financial measure calculated and presented in accordance with GAAP and (2) numerically reconcile the non-GAAP financial measure, by schedule or other clearly understandable format, to the most directly comparable GAAP measure. If a company presents a forward-looking non-GAAP measure, similar disclosures are required. However, a reconciliation of the forward-looking non-GAAP financial measure to the corresponding forward-looking GAAP measure is not required if it would involve an “unreasonable effort.” In that case, FRR-65, *Conditions for use of Non-GAAP Financial Measures*, indicates that a company should provide any reconciling information that is available without an unreasonable effort and disclose the nature and significance of any reconciling information that is unavailable.

Item 100(b) of Regulation G also states that a non-GAAP financial measure, taken together with accompanying information, may not misstate a material fact or omit a material fact necessary to make the presentation not misleading, in light of the circumstances in which the presentation is made.

The SEC staff’s C&DIs provide guidance on non-GAAP measures that may be misleading. Items may be misleading if they apply “individually tailored” accounting principles, adjust performance measures to remove normal cash operating expenses or exclude nonrecurring charges but not nonrecurring gains. The C&DIs also warn that the presentation of a non-GAAP financial measure might not satisfy the SEC rules if the measure is not presented consistently with prior presentations. Accordingly, issuers should include appropriate disclosures that describe changes in the methodology used to calculate a non-GAAP financial measure and should consider recasting prior-period measures using the new calculation methodology.

In addition, in order to present the corresponding GAAP measure with equal or greater prominence, the SEC staff believes that it must be presented first. This includes in the required reconciliation (i.e., reconciling from the GAAP measure to the non-GAAP measure).

The C&DIs also note that disclosures of non-GAAP financial measures also should be balanced with disclosures regarding the corresponding GAAP measure. For instance, the SEC staff expects non-GAAP cash flow and liquidity measures to be balanced with a discussion of cash flows from operating, investing and financing activities reported in the statement of cash flows. Similarly, the SEC staff expects non-GAAP performance measures to be balanced with a discussion of net income or income from continuing operations reported in the statement of operations.

²⁹ ASC 280 requires that companies report certain measures for each reportable segment on a basis consistent with that used for internal management reporting purposes. ASC 280 requires segment revenues, assets, a measure of operating profit or loss, and any other significant segment measures to be reconciled to the corresponding GAAP measures, with significant reconciling items separately identified and described.

The following additional disclosure requirements apply to any disclosure of a non-GAAP financial measure in material provided to the SEC, such as a Form 10-K filing or an earnings release furnished in Form 8-K:

- ▶ The issuer must disclose the reasons why management believes the non-GAAP financial measure provides useful information to investors about the company's financial condition and results of operations.³⁰
- ▶ The issuer must disclose, to the extent material, any additional purposes for which management uses the non-GAAP financial measure.

The following restrictions apply to any disclosure of a non-GAAP financial measure in any SEC filing, such as Form 10-K:

- ▶ A non-GAAP liquidity measure other than EBIT (earnings before interest and taxes) or EBITDA (earnings before interest, taxes, depreciation and amortization) may not exclude charges or liabilities that required cash settlement, will require cash settlement or would have required cash settlement absent an ability to settle in another manner.
- ▶ A non-GAAP performance measure may not be adjusted to eliminate or smooth items identified as "nonrecurring, infrequent or unusual," when (1) the nature of the charge or gain is such that it is reasonably likely³¹ to recur within two years or (2) there was a similar charge or gain within the prior two years.
- ▶ Non-GAAP financial measures may not be presented on the face of the company's GAAP financial statements or in the accompanying notes (unless the measure is required or permitted to be presented in the financial statements by the standard setter responsible for establishing the accounting principles used in preparing that issuer's financial statements).
- ▶ Non-GAAP financial measures may not be presented on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X.
- ▶ An issuer may not use titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

The non-GAAP rules and regulations are described in detail in our Technical Line, [***Spotlight on non-GAAP financial measures***](#). Our To the Point, [***SEC staff updates guidance on non-GAAP financial measures***](#), and Technical Line, [***A closer look at the SEC staff's scrutiny of non-GAAP financial measures***](#), discuss the SEC staff's main areas of focus and challenges companies encounter with their non-GAAP disclosures. For additional considerations on non-GAAP financial measures during the COVID-19 pandemic, see our Technical Line, [***How to appropriately use non-GAAP measures to discuss the effects of COVID-19***](#), dated 14 April 2020. Also, see our [***SEC Reporting Update: Highlights of trends in 2022 SEC comment letters***](#) and [***Accounting and reporting considerations for the war in Ukraine***](#) publications for recent developments.

³⁰ FRR-65, *Conditions for Use of Non-GAAP Financial Measures*, states that the required disclosures should not be boilerplate. The disclosures should be specific to the non-GAAP financial measure, the manner in which management uses the measure given the registrant's business and industry, and the manner in which investors might use the measure.

³¹ As the SEC stated in FRR-61, "reasonably likely" is a lower disclosure threshold than "more likely than not."

2.16 Transition report – change in fiscal year

Rules 13a-10 and 15d-10 of the Exchange Act provide the SEC's reporting and filing requirements when a registrant changes its fiscal year end or a successor issuer has a different fiscal year end than its predecessor. These rules designate as the "transition period" the short period between the end of the registrant's most recent fiscal year and the opening date of its newly selected fiscal year (e.g., a change in fiscal year from 31 December to 30 September would result in a nine-month transition period). Similarly, the reports required by Rules 13a-10 and 15d-10 are designated "transition reports." Under the accelerated reporting rules, the deadline for a transition report filed by a large accelerated filer or an accelerated filer mirrors the deadline for the respective Exchange Act form. Other rules, which are not addressed in this publication, provide the reporting and filing requirements for a change in fiscal year end by foreign private issuers (Rules 13a-10(g) and 15d-10(g) of the Exchange Act) and registered investment companies (Rule 30b1-3 of the Investment Company Act of 1940).

2.16.1 Transition reporting on Forms 10-K and 10-Q

Transition reports are required for all transition periods in excess of one month. A transition report on Form 10-K, including audited financial statements, is required for transition periods of six or more months. For transition periods less than six months, a registrant has the option of filing its transition report on either Form 10-Q, including unaudited financial statements, or Form 10-K, including audited financial statements.

Transition periods of one month or less may be reported in conjunction with the first report on Form 10-Q or Form 10-K of the fiscal year following transition. A change from a fiscal year ending as of the last day of the month to a 52 to 53-week fiscal year end of the same month, or vice versa, does not create a transition period.

2.16.2 Transition period of six months or more

The due date for a transition report on Form 10-K is computed based on the close of the transition period or the date of the determination to change the fiscal year, whichever is later. A transition report on Form 10-K must include audited financial statements for the transition period and specified financial information for the prior-year period comparable to the transition period. The comparable information may be unaudited and can be presented within the financial statements or in the notes thereto.

The comparable information must include revenue, gross profits, income taxes, income or loss from continuing operations, net income or loss and related per share amounts. In addition, the effects of discontinued operations, if applicable, should be included. If it is not practicable or cannot be cost-justified to develop the information for comparable periods, the SEC staff might accept financial information for the prior-year period most nearly comparable to the transition period. In that case, the SEC staff would expect disclosures similar to those required in a Form 10-Q where comparable periods are not presented (see discussion below).

In addition to the transition period, a transition report on Form 10-K must include audited financial statements for fiscal years preceding transition as otherwise required by Form 10-K (i.e., three years). The SEC will accept, but does not require, restatement of prior-period financial statements on the basis of the newly adopted fiscal year. Pursuant to Rule 3-06 of Regulation S-X, a transition period of nine or more months will be considered a full year.

For example, if there is a nine-month transition period, the requirements of Form 10-K would be satisfied by providing audited balance sheets as of the close of the transition period and the preceding fiscal year end, and audited statements of income and cash flows for the nine-month transition period and two preceding fiscal years. Conversely, if there is a six-month transition period, the transition report on Form 10-K would include audited balance sheets as of the close of the transition period and the two preceding fiscal years, and audited statements of income and cash flows for the six-month transition period and the three preceding fiscal years.

When the transition period is required to be included in subsequent reports, it is shown on the face of the statements. Financial information for the comparable period would be included either within comparative financial statements or in the notes thereto. The Form 10-K for the fiscal year following transition would include audited balance sheets as of the close of that fiscal year and the transition period. The periods for which audited statements of income and cash flows are required would be determined considering Rule 3-06 of Regulation S-X (i.e., at least 33 consecutive months of audited statements of income and cash flows must be presented).

2.16.3 Transition period less than six months

The due date for a transition report on Form 10-Q is computed based on the close of the transition period or the date of the determination to change the fiscal year, whichever is later. A transition report on Form 10-Q must include condensed unaudited financial statements for the transition period and financial information about the comparable period of the prior year. When a registrant files a transition report on Form 10-Q, separate audited statements of income and cash flows are required to be filed for the transition period in the Form 10-K for the full year following transition. Therefore, a registrant with a transition period of less than six months may elect to file a transition report on Form 10-K and include audited financial statements for the transition period. Registrants might want to choose this option to allow more time to prepare financial statements covering the transition period and to avoid the possibility of later having to revise previously published unaudited financial statements for the transition period.

When a registrant files a transition report on Form 10-Q, the Form 10-K for the full year following transition may include the audited balance sheet as of the end of the fiscal year preceding transition in lieu of an audited balance sheet as of the close of the transition period. This option is in consideration of the fact that the transition period balance sheet filed on Form 10-Q was not required to be audited. Further, notes to the financial statements for the transition period included in the annual report may be integrated with the notes for the full fiscal year. While financial schedules are not required in a transition report on Form 10-Q, audited financial schedules (see section 7, *Financial schedules*) including the transition period are required to be filed in subsequent annual reports on Form 10-K.

For a transition period of one month or less, in lieu of a transition report on Form 10-K or Form 10-Q, a registrant may separately include the unaudited financial statements for the transition period in the Form 10-Q for the first quarter of the newly adopted fiscal year that ends after the determination date for the change in fiscal year. However, separate audited statements of income and cash flows still are required to be filed for the transition period in the Form 10-K of the full year following transition. If the registrant's first report is the Form 10-K for the full year following transition, the transition period of one month or less would be separately covered in that Form 10-K.

Where comparative information is required in a transition report on Form 10-Q or in a quarterly report based on the quarters of the newly adopted fiscal year, a registrant is not required to recast data for the comparable period, where recasting either is not practicable or cannot be cost-justified, if the registrant provides all of the following:

- ▶ Financial statements for the quarters reported on the old fiscal year basis most nearly comparable to the transition period or the interim period reported on the new fiscal year basis
- ▶ An adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected
- ▶ An assessment of the comparability of the data
- ▶ An explanation of why the statements have not been recast

2.16.4 Reporting prior to the determination date

An issuer is required to file an annual report on Form 10-K for any fiscal year that ended before the date on which the determination was made to change its fiscal year. Similarly, an issuer is required to file a quarterly report for any quarter of the old fiscal year that ended before the date of the issuer's determination to change its year end.

2.16.5 Quarterly reporting during transition

During the transition period, registrants have the option of filing quarterly reports based on the quarters of either the old or newly adopted fiscal year, provided that once the quarterly reporting basis is changed to the new fiscal year, that basis must be followed consistently.

For example, an issuer with a 31 December year end that decides on 15 April 20Y2 to change its year end to 30 November 20Y2 would have an option to file its next Form 10-Q based on the quarter ended 30 June 20Y2 (old fiscal year basis) or 31 August 20Y2 (new fiscal year basis).

If the length of the transition period is other than three, six or nine months, the quarter ends of the new fiscal year will not correspond to those of the old fiscal year. Accordingly, the change in quarterly reporting from the old to the new fiscal year might result in a period that would not be covered in a separate report on Form 10-Q. Such a period would be covered by the next report on either Form 10-Q or Form 10-K, or in the transition report, depending on when the change occurred. Such a period would be reported separately in a quarterly report on Form 10-Q, or on a cumulative basis in the transition report or the Form 10-K for the fiscal year following the transition.

In the above example, if the issuer filed its Form 10-Q for the quarter ended 31 August 20Y2, separate financial statements for the two-month period ended 31 May 20Y2 would be included in that Form 10-Q. On the other hand, if the issuer continued to file Forms 10-Q on the old fiscal-year basis, the two-month period ended 30 November 20Y2 would be included in the 11-month period ended 30 November 20Y2 in the transition report on Form 10-K.

Although the financial statements of the period created by the change in the basis of quarterly reporting (as well as a one-month transition period) must be provided separately from those of the current quarter when included in a quarterly Form 10-Q, the transition rules provide that other information required by Form 10-Q, such as MD&A, may be combined for those periods and the current quarter.

2.16.6 Quarterly reporting after transition

The requirement to file quarterly reports on the new basis begins with the first quarter in the fiscal year following transition. However, the rules do not require an issuer to file new Forms 10-Q for any quarters of the fiscal year following transition that have already been reported on the old fiscal-year basis. For example, an issuer with a 31 December year end might decide on 15 December 20Y2 to change its year end to 30 April 20Y2. This registrant would have filed Forms 10-Q for the three quarters of its old fiscal year and would not be required to file Forms 10-Q for the quarters of its 20Y3 fiscal year that ended before its determination to change (i.e., the quarters ending 31 July 20Y2 and 31 October 20Y2). Such an issuer would file its next quarterly report for the quarter ending 31 January 20Y3, which would include separate financial statements for the one-month period ended 31 October 20Y2.

2.16.7 Reporting fiscal year changes on Form 8-K

A registrant is required to report, on Form 8-K, its decision to adopt a new fiscal year. This filing is due four business days after the date on which the registrant determines to change its fiscal year end. Item 5.03 of Form 8-K requires a registrant to report both the date on which it decides to change its fiscal year and the date of its new fiscal year. In addition, the Form 8-K must state whether a Form 10-K or Form 10-Q will be filed to report financial information for the transition period.

2.16.8 Transition reporting for successor issuers

In the situation where a successor issuer has a different fiscal year than its predecessor, the periods to be covered are different from those described above. The period to be included in the transition report by the successor issuer ends on the date of the succession, rather than on the day before the beginning of the newly adopted year. This ensures a transition period that reflects the predecessor's operations separately from those of the successor. In addition, the due date for the transition report always is measured from the date of succession (i.e., the end of the transition period). Examples of succession include the leveraged buy-out of a public company and the reverse acquisition of a public company by a nonpublic company (a backdoor registration).³²

2.16.9 MD&A for transition periods

The length of the transition period will determine the extent of disclosures required under Item 303 of Regulation S-K, *Management's Discussion and Analysis of Financial Condition and Results of Operations*. For transition periods of nine or more months, information is required under Item 303(b) as if the transition period were a full fiscal year. For shorter transition periods, the information for interim periods under Item 303(c) is required.

2.16.10 Examples of reporting requirements for changes in year end

Although not intended to cover all circumstances, the examples on the following pages illustrate reporting requirements and alternatives, following a change in fiscal year end. The actual reporting requirements and options will vary based on the length of the transition period and the date on which the determination was made to change the fiscal year end. A registrant considering a change in fiscal year end should consult with its independent auditors and legal counsel regarding its reporting obligations. Because the financial statements in annual shareholders' reports and Form 10-K should be identical under the uniform financial statement instructions, these illustrations apply to both unless otherwise discussed with the SEC staff.

³² If a backdoor registration is accomplished by taking a private company public by merger with a "shell company," as defined by Regulation C, additional reporting considerations might be applicable. For further information, see the July 2005 SEC Final Rule, *Use of Form S-8, Form 8-K, and Form 20-F by Shell Companies* (Release Nos. 33-8587 and 34-52038).

**Examples of reporting requirements for changes in year end
(Transition periods less than six months)**

Reports filed prior to transition report (1)	Transition report	Reports filed for periods subsequent to transition report (4) (6)
Example 1: Change from 31 Dec 20Y1 to 28 Feb 20Y2 (Decision made 1 Mar 20Y2)		
Form 8-K filed within 4 business days after 1 Mar 20Y2	Form 10-Q filed 45 days after 1 Mar 20Y2:	Form 10-K: Audited statements of income and cash flows
Form 10-K filed 90 days after 31 Dec 20Y1: Audited financial statements for the three years ended 31 Dec 20Y1	Unaudited financial statements from 1 Jan 20Y2 to 28 Feb 20Y2 (2) from 1 Jan 20Y1 to 28 Feb 20Y1 (5)	from 1 Mar 20Y2 to 28 Feb 20Y3 from 1 Jan 20Y2 to 28 Feb 20Y2 from 1 Jan 20Y1 to 31 Dec 20Y1 from 1 Jan 20Y0 to 31 Dec 20Y0
	or	Unaudited statements of income and cash flows
	Form 10-K filed 90 days after 1 Mar 20Y2: Audited statements of income and cash flows from 1 Jan 20Y2 to 28 Feb 20Y2 and three years ended 31 Dec 20Y1 (6)	from 1 Jan 20Y1 to 28 Feb 20Y1(3) Audited balance sheets as of 28 Feb 20Y3 and either 28 Feb 20Y2 or 31 Dec 20Y1
	Unaudited statements of income and cash flows from 1 Jan 20Y1 to 28 Feb 20Y1 (3)	Form 10-Q: Unaudited financial statements (5) from 1 Mar 20Y2 to 31 May 20Y2 from 1 Jun 20Y2 to 31 Aug 20Y2 and six months ended 31 Aug 20Y2
	Audited balance sheets as of 28 Feb 20Y2; 31 Dec 20Y1 and 20Y0	from 1 Sep 20Y2 to 30 Nov 20Y2 and nine months ended 30 Nov 20Y2

Note: The above tables reflect reporting deadlines for issuers that are “non-accelerated filers.” For large accelerated filers and accelerated filers, the reporting deadline would correspond to the deadline applicable to the respective Form.

See subsequent pages for footnote references.

**Examples of reporting requirements for changes in year end
(Transition periods less than six months)**

Reports filed prior to transition report (1)	Transition report	Reports filed for periods subsequent to transition report (4) (6)
Example 2: Change from 31 Dec 20Y1 to 28 Feb 20Y2 (Decision made 1 Nov 20Y2)		
Form 8-K filed within 4 days business after 1 Nov 20Y2	Form 10-Q filed 45 days after 1 Nov 20Y2:	Form 10-Q: Unaudited financial statements (5)
Form 10-K filed 90 days after 31 Dec 20Y1: Audited financial statements for the three years ended 31 Dec 20Y1	Unaudited financial statements from 1 Jan 20Y2 to 28 Feb 20Y2 (2) from 1 Jan 20Y1 to 28 Feb 20Y1 (5)	from 1 Sep 20Y2 to 30 Nov 20Y2 (9) Form 10-K: Audited statements of income and cash flows from 1 Mar 20Y2 to 28 Feb 20Y3
Form 10-Q filed 45 days after 31 Mar 20Y2, 30 Jun 20Y2 and 30 Sep 20Y2: Unaudited financial statements from 1 Jan 20Y2 to 31 Mar 20Y2, with comparable prior-year period from 1 Apr 20Y2 to 30 Jun 20Y2 and six months ended 30 Jun 20Y2, with comparable prior-year periods from 1 Jul 20Y2 to 30 Sep 20Y2 and nine months ended 30 Sep 20Y2, with comparable prior-year periods	or Form 10-K filed 90 days after 1 Nov 20Y2: Audited statements of income and cash flows from 1 Jan 20Y2 to 28 Feb 20Y2, and three years ended 31 Dec 20Y1 (6) Unaudited statements of income and cash flows from 1 Jan 20Y1 to 28 Feb 20Y1 (3) Audited balance sheets as of 28 Feb 20Y2; 31 Dec 20Y1 and 20Y0	from 1 Jan 20Y2 to 28 Feb 20Y2 from 1 Jan 20Y1 to 31 Dec 20Y1 from 1 Jan 20Y0 to 31 Dec 20Y0 Unaudited statements of income and cash flows from 1 Jan 20Y1 to 28 Feb 20Y1 (3) Audited balance sheets as of 28 Feb 20Y3 and either 28 Feb 20Y2 or 31 Dec 20Y1

Note: The above tables reflect reporting deadlines for issuers that are “non-accelerated filers.” For large accelerated filers and accelerated filers, the reporting deadline would correspond to the deadline applicable to the respective Form.

See subsequent pages for footnote references.

**Examples of reporting requirements for changes in year end
(Transition periods more than six months)**

Reports filed prior to transition report (1)	Transition report	Reports filed for periods subsequent to transition report (4) (6)
Example 3: Change from 31 Dec 20Y1 to 31 Oct 20Y2 (Decision made 1 Feb 20Y2)		
Form 8-K filed within 4 business days after 1 Feb 20Y2	Form 10-K filed 90 days after 31 Oct 20Y2:	Form 10-Q: Unaudited financial statements (5)
Form 10-K filed 90 days after 31 Dec 20Y1: Audited financial statements for the three years ended 31 Dec 20Y1	Audited statements of income and cash flows from 1 Jan 20Y2 to 31 Oct 20Y2 (7) and two years ended 31 Dec 20Y1 (6)	from 1 Nov 20Y2 to 31 Jan 20Y3 from 1 Feb 20Y3 to 30 Apr 20Y3 and six months ended 30 Apr 20Y3 from 1 May 20Y3 to 31 Jul 20Y3 and nine months ended 31 Jul 20Y3
Form 10-Q filed 45 days after 31 Mar 20Y2 and 30 Jun 20Y2 (8): Unaudited financial statements from 1 Jan 20Y2 to 31 Mar 20Y2 and comparable prior-year period from 1 Apr 20Y2 to 30 Jun 20Y2 and six months ended 30 June 20Y2, with comparable prior-year periods	Unaudited statements of income and cash flows from 1 Jan 20Y1 to 31 Oct 20Y1 (3) Audited balance sheets as of 31 Oct 20Y2 and 31 Dec 20Y1	Form 10-K: Audited financial statements from 1 Nov 20Y2 to 31 Oct 20Y3 from 1 Jan 20Y2 to 31 Oct 20Y2 (7) from 1 Jan 20Y1 to 31 Dec 20Y1
or		Unaudited statements of income and cash flows from 1 Jan 20Y1 to 31 Oct 20Y1 (3)
Form 10-Q filed 45 days after 30 Apr 20Y2 and 31 Jul 20Y2 (8): Unaudited financial statements from 1 Jan 20Y2 to 31 Jan 20Y2 and from 1 Feb 20Y2 to 30 Apr 20Y2, with comparable prior-year periods (5) from 1 May 20Y2 to 31 Jul 20Y2 and six months ended 31 Jul 20Y2, with comparable prior-year periods (5)		

Note: The above tables reflect reporting deadlines for issuers that are “non-accelerated filers.” For large accelerated filers and accelerated filers, the reporting deadline would correspond to the deadline applicable to the respective Form.

See subsequent pages for footnote references.

**Examples of reporting requirements for changes in year end
(Transition periods more than six months)**

Reports filed prior to transition report (1)	Transition report	Reports filed for periods subsequent to transition report (4) (6) (10)
Example 4: Change from 31 Dec 20Y1 to 31 Oct 20Y2 (Decision made 15 Nov 20Y2)		
Form 8-K filed within 4 business days after 15 Nov 20Y2	Form 10-K filed 90 days after 15 Nov 20Y2:	Form 10-Q: Unaudited financial statements (5)
Form 10-K filed 90 days after 31 Dec 20Y1: Audited financial statements for the three years ended 31 Dec 20Y1	Audited statements of income and cash flows from 1 Jan 20Y2 to 31 Oct 20Y2 (7) and two years ended 31 Dec 20Y1 (6)	from 1 Nov 20Y2 to 31 Jan 20Y3 from 1 Feb 20Y3 to 30 Apr 20Y3 and six months ended 30 Apr 20Y3 from 1 May 20Y3 to 31 Jul 20Y3 and nine months ended 31 Jul 20Y3
Form 10-Q filed 45 days after 31 Mar 20Y2, 30 Jun 20Y2 and 30 Sep 20Y2: Unaudited financial statements from 1 Jan 20Y2 to 31 Mar 20Y2, with comparable prior-year period from 1 Apr 20Y2 to 30 Jun 20Y2 and six months ended 30 Jun 20Y2, with comparable prior-year periods from 1 Jul 20Y2 to 30 Sep 20Y2 and nine months ended 30 Sep 20Y2, with comparable prior-year periods	Unaudited statements of income and cash flows from 1 Jan 20Y1 to 31 Oct 20Y1 (3) Audited Balance Sheets as of 31 Oct 20Y2 and 31 Dec 20Y1	Form 10-K: Audited financial statements from 1 Nov 20Y2 to 31 Oct 20Y3 from 1 Jan 20Y2 to 31 Oct 20Y2 (7) from 1 Jan 20Y1 to 31 Dec 20Y1 Unaudited statements of income and cash flows from 1 Jan 20Y1 to 31 Oct 20Y1 (3)

Note: The above tables reflect reporting deadlines for issuers that are “non-accelerated filers.” For large accelerated filers and accelerated filers, the reporting deadline would correspond to the deadline applicable to the respective Form.

See subsequent pages for footnote references.

The following note references correspond to the examples presented on the previous pages:

- (1) This column lists reporting requirements subsequent to the latest fiscal year end to the date of the transition report.
- (2) Form 10-K covering the full year from 1 March 20Y2 to 28 February 20Y3 must include separate audited statements of income, comprehensive income and cash flows covering the transition period from 1 January 20Y2 to 28 February 20Y2.
- (3) This information may be in a note to the financial statements and must include revenue, gross profits, income taxes, income or loss from continuing operations, net income or loss, and related per share amounts, as well as the effects of discontinued operations, if applicable.
- (4) These reports would be based on the new fiscal year and filed subsequent to the transition period within the prescribed time period for the appropriate form.
- (5) Although the rules encourage registrants to recast prior-year financial information on a comparable basis with the transition period and new fiscal-year quarters, this is not required if it is not practicable or cannot be cost-justified, provided certain disclosures are made.
- (6) The rules also allow registrants to recast all prior years to correspond to the newly adopted fiscal year.
- (7) The 10-month period from 1 January 20Y2 to 31 October 20Y2 would be considered equivalent to a year for purposes of meeting the requirement to provide financial statements for three fiscal years. However, unaudited financial information for the comparable period of the preceding year must be provided.
- (8) As an alternative to transition period quarterly reporting consistent with the basis of either the old or the new fiscal year, a registrant may switch the basis of quarterly reporting during the transition period. In this example, the registrant may file the first Form 10-Q on the old fiscal-year basis (for the old quarter ended 31 March 20Y2 with unaudited financial statements from 1 January 20Y2 to 31 March 20Y2 and comparable prior-year period) and the second Form 10-Q on the new fiscal-year basis (for the new quarter ended 31 July 20Y2 with unaudited financial statements from 1 April 20Y2 to 30 April 20Y2 and from 1 May 20Y2 to 31 July 20Y2 and comparable prior-year periods).
- (9) A Form 10-Q must be filed for any quarter of the fiscal year following transition that ends after the issuer determined to change its year end. When the determination to change the year end is made after the close of the transition period, compliance with this requirement may result in an overlap in quarterly reporting. In this example, the month of September 20Y2 is reported in both the 30 September 20Y2 Form 10-Q (old fiscal-year basis) and the 30 November 20Y2 Form 10-Q (new fiscal-year basis).
- (10) The audited financial statements filed on Form 10-K must include at least 33 months of audited financial information, including the transition period. In this example, a total of 34 months are provided (two 12-month fiscal years plus the 10-month transition period). Had the transition period in this example been at least six months but less than nine months, an additional year of audited financial statements would have been required to present the minimum of 33 months of audited financial information.

3 Part I of Form 10-K

Regulation S-K contains most of the rules for disclosure of information required in Part I of Form 10-K, including:

Item 101	Description of Business
Item 102	Description of Property
Item 103	Legal Proceedings
Item 104	Mine Safety Disclosure
Item 105	Risk Factors

This section is designed to assist management in preparing information required by the above items in Items 1 through 4 of Form 10-K.

3.1 Item 1. Business

Item 1 of Form 10-K, *Business*, calls for information specified in Item 101 of Regulation S-K, *Description of Business*, about: (1) the development of the registrant's business (which may provide only material updates along with a hyperlink to the most recently filed full discussion of developments that, together with the update, would present a complete discussion) and (2) a description of the business done and intended to be done by the registrant and its subsidiaries, focusing on each reportable segment about which financial information is presented in the financial statements.

Item 101(c), *Description of business*, of Regulation S-K allows the registrant to focus its business discussion on its dominant segment or each reportable segment about which financial information is presented the registrant's financial statements. It contains a non-exclusive list of topics that ordinarily require disclosures only if they are material to an understanding of the registrant's business taken as a whole:

- ▶ Revenue-generating activities, products and/or services, and any dependence on revenue-generating activities, key products, services, product families or customers, including governmental customers
- ▶ Status of development efforts for new or enhanced products, trends in market demand and competitive conditions
- ▶ Sources and availability of raw materials
- ▶ The duration and effect of all patents, trademarks, licenses, franchises and concessions held
- ▶ Description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts by the government
- ▶ Extent to which the business is or may be seasonal
- ▶ Effects of compliance with government regulations
- ▶ Description of human capital resources, including number of employees, and any human capital measures or objectives on which management focuses

The list is nonexclusive, which the SEC said is intended to make the requirements more clearly principles-based and less likely to elicit disclosure that is not material.

There may be situations where information should be disclosed about a particular segment even though the information is not material in quantitative terms and may not otherwise appear significant to the registrant's business taken as a whole. Furthermore, copies of contracts or other agreements are required to be filed as exhibits to Form 10-K if they are specifically referred to in the registrant's discussion of segments.

These SEC guidelines are subjective and require careful consideration by management.

Certain information about the nature of organization required by ASC 275, should be included in the notes to the financial statements of domestic registrants preparing annual reports on Form 10-K. Among other things, ASC 275 requires disclosures about the risks and uncertainties existing as of the balance sheet date in the following areas: (1) nature of operations, (2) use of estimates in the preparation of the financial statements, (3) certain significant estimates and (4) current vulnerability because of certain concentrations.³³

The disclosure requirements of ASC 280, *Segments*, are described in detail in our GAAP disclosure checklist (EY Form A13) and in our Financial reporting developments publication, *Segment reporting – Accounting Standards Codification 280*.³⁴

3.2 Other business-related disclosures

3.2.1 Effect of compliance with government regulations

Item 101(c)(2)(i) requires registrants to disclose the material effects that compliance with government regulations, including environmental regulations, may have on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. Registrants must disclose any material estimated capital expenditures for environmental control facilities for the rest of its fiscal year and any succeeding periods. The information specified in Item 101(c)(2)(i) should be discussed with respect to, and to the extent material to an understanding of, the business taken as a whole, except that if the information is material to a particular segment, the registrant should identify that segment.

These disclosures should be coordinated with related environmental disclosures under Item 103 of Regulation S-K, *Legal Proceedings* (see below), and Item 303 of Regulation S-K, *Management's Discussion and Analysis of Financial Condition and Results of Operations* (see section 5, *Item 7. MD&A*).

3.2.2 Human capital resources

Human capital resources disclosures required by Item 101(c)(2)(ii) of Regulation S-K include a description of human capital resources and any measures or objectives on which management focuses, if they are material to an understanding of the business. Examples of human capital measures and objectives that may be material are measures on personnel attraction, development and/or retention. In its 2020 adopting release, [33-10825, Modernization of Regulation S-K Items 101, 103, and 105](#), the SEC emphasized that these measures are examples of potentially relevant subjects, not mandates, and provided registrants with significant disclosure flexibility related to human capital disclosures.

³³ See section 5 of this publication with respect to the ASC 275 financial statement requirements about significant estimates and vulnerabilities from concentrations, which also meet the MD&A disclosure requirements.

³⁴ The SEC staff continues to emphasize segment disclosures and the application of ASC 280 in its comment letters. The SEC staff comments generally focus on (1) the identification of operating segments, (2) the aggregation of operating segments, and (3) the disclosure of the measure of profit or loss for reportable segments, the appropriate entity-wide disclosures for products and services, revenues attributable to individual foreign countries and revenues from major customers, and reconciliations required by ASC 280. See our [SEC Reporting Update: Highlights of trends in 2022 SEC comment letters](#) publication for additional details.

The SEC also said in its 2020 adopting release that its principles-based requirement will allow the human capital disclosures to evolve over time in response to factors such as the industry, the various regions or jurisdictions in which the registrant operates, strategy (e.g., vertically integrated), and macroeconomic and other conditions that affect human capital resources, such as national or global health matters.

There is only one human capital metric for which quantitative disclosure is required: the number of persons employed by the registrant. Registrants can determine whether to quantify their other human capital disclosures based on the focus of the registrant's management. The SEC is expected to propose requiring more human capital disclosures in 2023 based on its annual regulatory agenda.

Our September 2020 publication, *[How to approach the SEC's new human capital disclosures](#)*, provides guidance for registrants to consider as they begin preparing their disclosures.

3.2.3 Website access disclosure

Item 101(e)(3) of Regulation S-K requires a company to disclose in its Form 10-K its company website address, if it has one. Item 101(e) also requires accelerated and large accelerated filers to disclose the following additional information:

- ▶ Whether the issuer provides access to its SEC reports (i.e., Form 10-K, Form 10-Q and Form 8-K) and related amendments free of charge on or through the company's website as soon as reasonably practicable after the report is electronically filed with, or furnished to, the SEC (i.e., typically the same day)
- ▶ If the issuer does not provide such website access, why it does not and whether the issuer will voluntarily provide electronic or paper copies of its SEC filings free of charge on request

Disclosure of a company's website address in its Form 10-K will not, by itself, cause information on the website to be included or incorporated by reference into the SEC report, unless the company explicitly incorporates any such information by reference.³⁵

Illustration 3-2: Website access disclosure

Website access to company reports

The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge on the Company's website at www.XX.com as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission.

³⁵ On 1 August 2008, the SEC issued an interpretive release, *Commission Guidance on the Use of Company Websites* (SEC Release No. 34-58288), that provides guidance regarding the use of company websites under the Exchange Act and the antifraud provisions of the federal securities laws. The guidance focuses on: (1) when information posted on a company website is "public" for purposes of the applicability of Regulation FD; (2) company liability for information on company websites – including previously posted information, hyperlinks to third-party information, summary information and the content of interactive websites; (3) the types of controls and procedures advisable with respect to such information; and (4) the format of information presented on a company website, with the focus on readability, not printability.

3.3 Item 1A. Risk factors

In their annual reports, issuers³⁶ must disclose risk factors, as specified in Item 105 of Regulation S-K, that apply to an investment in the issuer rather than participation in a particular securities offering. The Form 10-K instructions require registrants to discuss risk factors concisely and in “plain English.” Item 105 requires the discussion of material risk factors to be organized under relevant subheadings in addition to each risk factor appearing in a separate subcaption that adequately describes the risk. Risks that could apply generically to any registrant are discouraged, and if provided, they have to be placed at the end of the risk factors disclosure in a subheading titled “General risk factors.” If a filing’s risk factors section exceeds 15 pages, the registrant must include a summary of the principal risk factors that is no more than two pages in the forepart of the annual report where risk factors are discussed.

In February 2018, the SEC issued an interpretive release to help companies prepare disclosures about cybersecurity risks and incidents. The release includes a framework for registrants to consider when evaluating whether to disclose information about risks and incidents involving cybersecurity. The release also reminds registrants to consider cyber matters in the context of various policies such as those for insider trading and selective disclosure (Regulation FD).

Until the proposed cybersecurity risk rules noted in section 1 are finalized, companies should consider the February 2018 SEC interpretative guidance when preparing their cybersecurity disclosures. Our **SEC Reporting Update: SEC issues guidance on cybersecurity**, summarizes that guidance.

While the SEC is considering new climate-related disclosure rules as noted in section 1, companies should make sure they comply with the SEC’s 2010 interpretive guidance³⁷ on climate-related disclosures, which addresses several potential risks that a registrant may have to consider for risk factor disclosure. For example, power companies and car makers may consider disclosures related to President Biden’s plan to use the government’s buying power to make the nation’s electricity sector carbon pollution-free by 2035 and achieve net zero emissions throughout the economy by 2050, but they would need to tailor any disclosures to the specific risks they face. See our Technical Line, **Revisiting the SEC’s guidance on climate change disclosures in today’s environment**.

The **sample comment letter** the SEC staff posted on the SEC website in May 2022 highlights some potential risks that registrants may consider disclosing in relation to the direct or indirect impacts of the war in Ukraine and the related international response, including cybersecurity and supply chain risks. In the past year, the SEC staff has asked some registrants to provide more information about specific risk factors when the disclosures have been limited to general statements about uncertainties created by the war in Ukraine and related sanctions (e.g., risk related to the registrant’s reputation in connection with operations or halted operations in affected regions).

The SEC staff has also highlighted the need for risk factor disclosures about the anticipated phase-out of the London Interbank Offered Rate (LIBOR).³⁸

³⁶ Issuers of asset-backed securities and SRCs are not required to disclose risk factors in their annual reports.

³⁷ FRR-82 (SEC Release No. 33-9106), *Commission Guidance Regarding Disclosure Related to Climate Change*.

³⁸ See **SEC Staff Statement on LIBOR Transition** (12 July 2019) and **SEC Staff Statement on LIBOR Transition—Key Considerations for Market Participants** (7 December 2021)

3.4 Item 1B. Unresolved staff comments

Issuers that meet the definition of a large accelerated filer or an accelerated filer (see discussion on when the report is due in section 2), as well as that of a “well-known seasoned issuer,”³⁹ must disclose in their Form 10-K the substance of any unresolved written comments received from the SEC staff. Disclosure is required only if the comments were received from the SEC staff more than 180 days before the issuer’s fiscal year end covered by the annual report, the issuer believes the comments are material and the comments remain unresolved at the time of the Form 10-K filing. SEC staff comments that have been resolved, including those the issuer and the SEC staff have agreed will be addressed in future Exchange Act reports, are not required to be disclosed. In disclosing unresolved SEC staff comments, the issuer is allowed to provide other information, including its position, for any such comment.

Illustration 3-3: Unresolved staff comments

We are engaged in ongoing discussions with the SEC staff concerning the presentation of our reportable segments in the footnotes to our audited financial statements included in our annual reports on Form 10-K. We presently disclose three reportable segments, the ABC reportable segment, the DEF reportable segment and the GHI reportable segment. The SEC staff has questioned how we meet all of the aggregation criteria specified in the applicable accounting standard to aggregate our separate X and Y businesses within our ABC reportable segment, rather than reporting each individually. We continue to believe that our X and Y businesses have similar economic characteristics and meet each of the applicable aggregation criteria, and that aggregation is consistent with the objectives and basic principles of the accounting standard for segment reporting.

3.5 Item 2. Properties

Item 102 of Regulation S-K requires registrants to describe the location and general character of their “principal physical properties” that are material and identify the business segment(s) that use these properties. Item 102 also requires disclosure of how the property is held (if not in fee) and of any material encumbrance.

The disclosure under Item 2 of Form 10-K should be sufficient to reasonably inform investors as to the “suitability, adequacy, productive capacity and extent of utilization of the facilities by the registrant.” If appropriate, the disclosure about properties may be provided on a collective basis.

3.6 Item 3. Legal proceedings

Item 103 of Regulation S-K requires a brief description of:

- ▶ Any material pending legal proceedings involving the registrant or its subsidiaries, or of which any of their property is the subject, other than “ordinary routine litigation incidental to the business” (e.g., actions for negligence or other claims of a kind normal to the issuer’s business)
- ▶ Any similar proceedings known to be contemplated by governmental authorities

³⁹ Securities Act Rule 405 defines a “well-known seasoned issuer” (or WKSI) as an issuer, that as of the most recent determination date, was eligible to use Form S-3 or Form F-3, with either of the following attributes:

- ▶ Worldwide market value of \$700 million or more of outstanding voting and non-voting common equity held by non-affiliates of the registrant (i.e., “public float”)
- ▶ Issued at least \$1 billion aggregate principal amount of non-convertible securities, other than common equity, in registered primary offerings for cash, not exchange, in the last three years

The WKSI definition specifically excludes asset-backed issuers, registered investment companies, business development companies and ineligible issuers.

- ▶ Any proceedings in which the adversary is any director, officer or affiliate of the registrant, any beneficial owner of more than 5% of any class of voting securities of the registrant or any associate of any of the foregoing persons, or in which any such persons have a material interest adverse to the registrant or any of its subsidiaries

However, no disclosure is required for any of these types of proceedings (or group of similar proceedings) involving primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10% of consolidated current assets.

Item 103 of Regulation S-K also requires a brief description of any material bankruptcy, receivership or similar proceeding involving the registrant or any of its significant subsidiaries.

Separately, Item 103 of Regulation S-K requires a brief description of any administrative or judicial proceeding (or group of similar proceedings) under any Federal, State or local environmental protection provisions that: (1) is material to the business or financial condition of the registrant; (2) involves claims for damages (or potential monetary sanctions, capital expenditures, current or deferred charges to income) greater than 10% of consolidated current assets, exclusive of interest and costs; or (3) involves a governmental authority as a party and potential monetary sanctions (unless the registrant reasonably believes that aggregate monetary sanctions, exclusive of interest and costs, will not exceed \$300,000). A registrant may choose a higher threshold than \$300,000 under the third criterion above, if the threshold is reasonably designed to result in disclosure of any material federal, state or local environmental protection proceeding and does not exceed the lesser of \$1 million or 1% of the registrant's current assets.

For any of the proceedings subject to disclosure under Item 103 of Regulation S-K, the description should include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties involved, the allegations and the relief sought. The information required in Item 103 may be provided by hyperlink or cross-reference to legal proceedings disclosure elsewhere in the same filing (e.g., financial statement footnotes).

Although this is not specifically required to be included in Item 3 of Form 10-K, the Iran Threat Reduction and Syria Human Rights Act of 2012, amended Section 13 of the Exchange Act to require public companies to disclose in their annual reports on Form 10-K whether they or their affiliates knowingly engaged in specified activities involving Iran. The required disclosures include:

- ▶ The nature and extent of the activity
- ▶ Gross revenues and net profits attributable to the activity
- ▶ Whether the registrant or any of its affiliates intend to continue engaging in such activities⁴⁰

In addition, if these disclosures are required, companies must separately file a notice with the SEC stating that such disclosures are included in the Form 10-K.

3.6.1 Disclosure of certain tax penalties

The American Jobs Creation Act of 2004 (AJCA) requires SEC registrants to disclose in their SEC reports whether they have been required to pay certain penalties for failing to disclose to the Internal Revenue Service (IRS) their participation in listed transactions. For tax understatements or valuation misstatements attributable to reportable avoidance transactions, the AJCA also requires that SEC registrants disclose certain associated penalties. The disclosure requirement is one of several provisions in the AJCA designed to crack down on tax avoidance transactions.

⁴⁰ The SEC staff issued guidance on complying with the Iran Threat Reduction and Syria Human Rights Act of 2012. The staff clarified that the term "affiliate" refers to any person who directly or indirectly controls, is controlled by or is under common control with the issuer. If neither the issuer nor its affiliates have engaged in any of the specified activities, no disclosure is required. The SEC staff C&DIs can be found at <http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm#147.01>.

The AJCA added Section 6707A, *Penalty for Failure to Include Reportable Transaction Information with Return*, to the Internal Revenue Code (the Code). Section 6707A(e) of the Code requires a person that files periodic reports with the SEC, or is consolidated with another person for purposes of those reports, to disclose in those reports the requirement to pay the penalties set forth in Section 6707A(e)(2). The IRS, but not the SEC, issued guidance on the disclosure requirement through the publication of Revenue Procedure 2005-51 (the Revenue Procedure) in August 2005.

Required Form 10-K disclosure: The Revenue Procedure provides that any person or company that files a Form 10-K with the SEC, either separately or consolidated with another company, must disclose in Item 3 of Form 10-K, *Legal Proceedings*, the requirement to pay any of the penalties set forth in Section 6707A(e)(2) of the Code (see listing below).

The Revenue Procedure requires the following disclosures in Item 3 of Form 10-K:

- ▶ The amount of the penalty
- ▶ Whether the penalty has been paid in full
- ▶ The Code section and subparagraph under which the penalty was determined
- ▶ A description of the penalty, using language prescribed by the Revenue Procedure

Disclosure of the requirement to pay a specified tax penalty is required in the Form 10-K that relates to the fiscal year in which the IRS sends the company notice and demand for payment of the penalty. If the penalty is paid in full prior to the IRS sending notice and demand for payment, disclosure of the requirement to pay such penalty is required in the Form 10-K that relates to the fiscal year in which the penalty is paid.

If a company fails to make the required disclosures in Form 10-K, the disclosures must be made in the next Form 10-K filed with the SEC. The Form 10-K disclosure obligation continues in each successive Form 10-K filing until the company discloses its requirement to pay any of the specified penalties. Each failure to disclose the requirement to pay the specified penalties in Form 10-K will be treated as a “failure to disclose a listed transaction,” subject to an additional \$200,000 penalty. The Revenue Procedure does not indicate that filing an amendment to a Form 10-K would relieve the registrant of the requirement to make the disclosures in its next Form 10-K.

Tax penalties subject to Form 10-K disclosures: Section 6707A(e)(2) of the Code requires an SEC registrant to disclose the requirement to pay any of the following types of penalties:

- ▶ The penalty imposed by Section 6707A(a) of the Code in the amount determined under Section 6707A(b)(2) of the Code for failure to disclose a listed transaction
- ▶ The accuracy-related penalty imposed by Section 6662A(a) of the Code at the 30% rate determined under Section 6662A(c) of the Code for a reportable transaction understatement for which the relevant facts affecting the tax treatment of the item were not adequately disclosed in accordance with the Section 6011 regulations
- ▶ The 40% accuracy-related penalty imposed by Section 6662(h) for a gross valuation misstatement, if the company would (but for the exclusionary rule of Section 6662A(e)(2)(C)(ii)) have been subject to the accuracy-related penalty under Section 6662A(a) at the 30% rate determined under Section 6662A(c)
- ▶ The penalty imposed by Section 6707A(e) for failure to disclose any of the penalties described above in periodic reports required under Section 13 or 15(d) of the Exchange Act

An SEC registrant must disclose the requirement to pay the 40% accuracy-related penalty under Section 6662(h) if any of the following are true:

- ▶ It consented to the assessment of the 40% penalty without the issuance of a statutory notice of deficiency if the IRS proposed the 30% penalty determined under Section 6662A(c) in the alternative in a notice of proposed deficiency (30-day letter).
- ▶ It consented to the assessment of the 40% penalty or did not timely petition the Tax Court if the IRS included the 30% penalty determined under Section 6662A(c) in the alternative in a statutory notice of deficiency.
- ▶ The government raised the 30% accuracy-related penalty under Section 6662A(c) in the alternative in any pleading in a judicial proceeding challenging the applicability of the 40% penalty and the court expressly determined that the 30% penalty applied in the alternative to the 40% penalty.
- ▶ It expressly acknowledged the applicability of the 30% accuracy-related penalty under Section 6662A(c) in the alternative to the 40% accuracy-related penalty under Section 6662(h) in a written settlement agreement with the government.

3.7

Item 4. Mine safety disclosures

Item 4 of Form 10-K requires registrants to include a brief statement that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act is included in Exhibit 95, *Mine Safety Disclosure Exhibit*, to the Form 10-K. Exhibit 95 must be filed to provide the information required by Item 104 of Regulation S-K.

Item 104 of Regulation S-K requires a registrant that is the operator, or that has a subsidiary that is an operator, of a coal or other mine in the US to provide the information specified below for the time period covered by the report (i.e., for the fiscal year):

- ▶ For each coal or other mine of which the registrant or a subsidiary of the registrant is an operator, identify the mine and disclose:
 - ▶ The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under Section 104 of the Federal Mine Safety and Health Act of 1977 (Act) for which the operator received a citation from the Mine Safety and Health Administration (MSHA).
 - ▶ The total number of orders issued under Section 104(b) of such Act.
 - ▶ The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under Section 104(d) of such Act.
 - ▶ The total number of “flagrant” violations under Section 110(b)(2) of such Act.
 - ▶ The total number of imminent danger orders issued under Section 107(a) of such Act.
 - ▶ The total dollar value of proposed assessments from MSHA under such Act. Registrants must provide the total dollar value of assessments proposed by MSHA relating to any type of violation during the period covered by the report, regardless of whether the registrant has challenged or appealed the assessment.
 - ▶ The total number of mining-related fatalities at mines subject to such Act. Registrants must report all fatalities occurring at a coal or other mine during the period covered by the report unless the fatality has been determined by MSHA to be unrelated to mining activity.

- ▶ A list of coal or other mines, of which the registrant or a subsidiary of the registrant is an operator, that receive written notice from MSHA of:
 - ▶ A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under Section 104(e) of such Act; or
 - ▶ The potential to have such a pattern.
- ▶ Any pending legal action before the Federal Mine Safety and Health Review Commission (FMSHRC) involving such coal or other mine. In doing so, the registrant must report the total number of legal actions that were pending before FMSHRC by mine as of the last day of the time period covered by the report categorized according to the type of proceeding, as well as the aggregate number of legal actions instituted and the aggregate number of legal actions resolved during the reporting period.

4 Part II of Form 10-K

Regulation S-K contains the rules for disclosure of information required in Part II of Form 10-K, including:

Item 201	Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters
Item 302	Supplementary Financial Information
Item 303	Management's Discussion and Analysis of Financial Condition and Results of Operations
Item 304	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 305	Quantitative and Qualitative Disclosures About Market Risk
Item 307	Disclosure Controls and Procedures
Item 308	Internal Control Over Financial Reporting
Item 701	Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities
Item 703	Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Regulation S-X provides the financial statement requirements of the registrant and its subsidiaries for Item 8 of Part II of Form 10-K. Section 6, *Financial statements and parent company information*, discusses the Form 10-K financial statement requirements of Regulation S-X in detail. This section is designed to help management prepare information required by the above Regulation S-K items, except for Regulation S-K Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, which is discussed in section 5 of this publication.

4.1 Item 5. Market for registrant's common equity, related stockholder matters and issuer purchases of equity securities

Items 201(a) and (b) of Regulation S-K require disclosure of certain information about each class of the registrant's common stock. Briefly, a registrant is required to disclose the following information:

- ▶ Principal US markets on which the registrant's common stock is traded and all US securities exchanges on which the common stock is listed (when there is no established trading market, a statement to that effect should be made)⁴¹
- ▶ If the principal market is an exchange, the trading symbol(s) for each class of the registrant's common equity
- ▶ If there is no established public trading market for a class of common equity, a statement to that effect and, if applicable, the range of high and low bid information for each full quarterly period within the two most recent fiscal years, indicating the source of such quotations. Also, the disclosure should indicate, if applicable, that any over-the-counter market quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.
- ▶ Approximate number of shareholders as of the latest practicable date (identifying the method of computation – e.g., number of record holders)

⁴¹ Likewise, a foreign registrant should identify the principal foreign trading market(s) and the corresponding trading symbol(s) for each class of its common equity.

Registrants must adjust the market price data to give retroactive effect to material changes resulting from stock dividends, stock splits and reverse stock splits.

Illustration 4-1: Common stock market prices

The Company's common stock trades at low volumes on the OTC Markets - pink sheets. The approximate number of record holders of the Company's common stock at February 15, 20Y3 was 1100.

High and low stock quotations on the pink sheets for the last two fiscal years were:

Quarter Ended	20Y2		20Y1	
	Sales Quotation		Sales Quotation	
	High	Low	High	Low
March 31	\$ 21-1/4	\$ 17-1/2	\$ 20-1/4	\$ 16-3/4
June 30	22-1/2	18-3/4	21-1/2	16-1/2
September 30	23	19-1/4	21-3/4	17
December 31	24-3/4	18-1/4	22-1/2	17-1/4

These quotations do not reflect retail markup, markdown or commission and may not necessarily represent the prices of actual transactions during these quarterly periods.

4.2 Securities authorized for issuance under equity compensation plans

Item 201(d) of Regulation S-K requires registrants to provide in their Form 10-K, tabular information for all equity compensation plans and individual compensation arrangements in effect as of the end of the latest fiscal year. The disclosures summarize the potential dilution that could occur from past and future equity grants for all plans and arrangements, whether or not approved by security holders.

Even though the Form 10-K instructions indicate that the disclosures required under Item 201(d) of Regulation S-K must be provided in response to both Item 5 and Item 12 of Form 10-K, the SEC staff has indicated that those disclosures should be included only in response to Item 12 of Part III of Form 10-K. That is, Item 5 of Part II of Form 10-K should include the disclosures required under Items 201(a) and (b) of Regulation S-K, which are discussed above.

If the registrant is submitting a compensation plan for shareholder action, the registrant must provide the information required under Item 201(d) in response to Item 10 of Schedule 14A (the proxy statement). Even if the registrant does not submit a compensation plan for shareholder action, the registrant may provide the information required under Item 201(d) in its proxy statement. In either case, the registrant may incorporate the proxy statement disclosure by reference into Item 12 of Form 10-K if the proxy statement is filed no later than 120 days after the company's fiscal year end. See *2023 Proxy statements – An overview of the requirements and observations about current practice*, for a further discussion of the requirements of Item 201(d) of Regulation S-K.

4.2.1 Stock performance graph

Item 201(e) of Regulation S-K requires registrants to provide a performance graph that compares the registrant's cumulative total shareholder return during the previous five years with a performance indicator of the overall stock market (i.e., a broad-based index), and the registrant's peer group. Instruction 7 to Item 201(e) states the disclosure is required only in a registrant's annual shareholders' report that precedes or accompanies a proxy or information statement relating to an annual meeting of security holders for the election of directors. Accordingly, the performance graph is not required in Item 5 of Part II of Form 10-K and is discussed further in section 10 of this publication.

4.2.2 Recent sales of unregistered securities; use of proceeds from registered securities

Item 701 of Regulation S-K requires disclosure of information about all securities of the registrant sold by the registrant within the past three years that were not registered under the Securities Act (including sales of reacquired securities, new issues, securities issued in exchange for property, services or other securities and new securities resulting from the modification of outstanding securities). Item 5(a) of Part II of Form 10-K indicates that Item 701 of Regulation S-K information need not be disclosed in the Form 10-K if such information previously has been included in a Quarterly Report on Form 10-Q, or in a Current Report on Form 8-K.⁴² Therefore, Form 10-K disclosure would be limited to any sales of unregistered securities during the fourth fiscal quarter that were not previously reported in an Item 3.02 Form 8-K.

Item 701 requires disclosure of the following information:

- ▶ Date of sale, the amount and the title of securities sold
- ▶ Names of the principal underwriters, if any, and for any securities not publicly offered, the name of the person or class of persons to whom the securities were sold
- ▶ For securities sold for cash, the aggregate offering price and aggregate underwriting discounts or commissions
- ▶ For any securities sold other than for cash, the nature of the transaction and the nature and aggregate amount of consideration received by the registrant
- ▶ The section of the Securities Act or SEC rule under which exemption from registration was claimed and a brief description of the facts relied on to claim such exemption
- ▶ If the securities sold by the registrant are convertible or exchangeable into equity securities, or are warrants or options representing equity securities, the terms of conversion or exercise for the securities

Following the effective date of the registrant's first registration statement filed under the Securities Act, Item 701(f) of Regulation S-K requires disclosure in periodic reports (Form 10-K or Form 10-Q) of certain information about the use of proceeds. Such disclosures are required until the later of disclosure of the application of all of the offering proceeds or disclosure of the termination of the offering.

Illustration 4-2: Use of proceeds

On November XX, 20Y2, the Company sold 7,475,000 shares of common stock in an initial public offering at a price of \$17.00 per share pursuant to a Registration Statement on Form S-1 (Registration No. 333-XXXXX), which was declared effective by the Securities and Exchange Commission on October XX, 20Y2. The aggregate proceeds to the Company from the offering were approximately \$116.8 million reflecting gross proceeds of \$127.0 million, net of underwriting fees of approximately \$8.9 million and other offering costs of approximately \$1.3 million. During the period from the offering through December 31, 20Y2, the Company used the proceeds from the initial public offering as follows: approximately \$59.3 million to fund operations, approximately \$13.3 million for the purchase of property and equipment and approximately \$13.2 million for the acquisition of ABC, Inc.

⁴² Item 3.02 of Form 8-K requires reporting when the aggregate amount of previously undisclosed unregistered sales of equity securities exceeds 1% of the number of shares outstanding of the respective class. Form 10-Q and Form 10-K continue to require the registrant to report unregistered sales of equity securities during the most recent fiscal quarter that did not meet the disclosure threshold and were not reported in any Item 3.02 Form 8-K.

4.2.3 Purchases of equity securities by the issuer and affiliated purchasers

Item 703 of Regulation S-K requires disclosure of all repurchases (i.e., both open market and private transactions) of any of the issuer's "equity securities" registered under Section 12 of the Exchange Act, by or on behalf of the issuer or any "affiliated purchaser" (as defined in Exchange Act Rule 10b-18).

Disclosure of the following information must be provided, aggregated on a monthly basis and in a tabular format, about all issuer repurchases for its last fiscal quarter (i.e., the fourth quarter for purposes of disclosure in Form 10-K):

- ▶ The total number of shares (or units) purchased (with disclosure, in a brief footnote to the table, of the nature of transactions other than through a publicly announced repurchase plan or program)
- ▶ The average price paid per share (or unit)
- ▶ The total number of shares (or units) purchased as part of publicly announced repurchase plans or programs (with disclosure in a footnote to the table of the principal terms of each such plan or program)
- ▶ The maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs

Illustration 4-3: Disclosure of repurchases

The following information describes the Company's stock repurchases during the fourth quarter of the fiscal year ended December 31, 20Y2.

Period	Total number of shares (or units) purchased	Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
October 1 – October 31, 20Y2	3,000	38.75	3,000	60,000
November 1 – November 30, 20Y2	–	–	–	60,000
December 1 – December 31, 20Y2	<u>10,000</u>	38.85	<u>10,000</u>	<u>50,000</u>
Total	<u>13,000</u>		<u>13,000</u>	<u>50,000</u>

4.3 Item 7A. Quantitative and qualitative disclosures about market risk

Item 305 of Regulation S-K, which does not apply to SRCs,⁴³ requires quantitative and qualitative market risk disclosures about all financial instruments to be presented outside the financial statements in both annual reports on Form 10-K and in registration statements. Market risk is a broad term referring to economic losses because of adverse changes in the fair value of a financial instrument. Item 305 affects most registrants as nearly all have financial instruments that expose them to market risk.

⁴³ SRCs are not required to provide the disclosures specified in Item 305 of Regulation S-K. However, if an SRC chooses to voluntarily provide this information, it must comply with all of the disclosure requirements of Item 305.

The quantitative disclosures are intended to provide an investor with a greater ability to assess the registrant's exposure to market risk (e.g., interest rate risk, foreign currency exchange rate risk, commodity price risk, equity price risk) and must be disclosed in one of three ways: (1) a comprehensive table (i.e., tabular presentation) that schedules cash flow amounts by maturity dates for all instruments that are sensitive to future changes in interest rates, currency exchange rates, commodity prices, or other market factors, (2) a sensitivity or "shock" analysis that quantifies the effect of at least one hypothetical move in market conditions relating to each market risk factor or (3) specified "value at risk" disclosures (the most complex of the three options) that measure the potential exposure to adverse market movements over a specified time period with a selected likelihood of occurrence.

Registrants are required to disclose various elements of the modeling techniques used to derive the quantitative disclosures as well as relevant assumptions or limitations of the amounts. In addition, Item 305 requires disclosure of the reasons for material changes in the amount of reported market risk compared with the information reported in the prior year.

The qualitative disclosures include discussion of a company's primary risk exposures, its objectives for managing those exposures and actual or expected material changes in the primary market risk exposures. The qualitative disclosures should provide a context for the required quantitative disclosures.

The disclosures are required only when the exposure to market risk is material. Under the SEC's rules, a materiality assessment must be made for each market risk exposure category (e.g., interest rate risk, foreign currency exchange rate risk) in the trading and other-than-trading portfolios. Materiality assessments are based on the fair value of market risk sensitive instruments as of the end of the reporting period, as well as the materiality of the potential loss in future earnings, fair values or cash flows from reasonably possible near-term market movements. The SEC's rules provide the following guidelines for evaluating whether a potential loss is material: the magnitude of past market movements, expectations about the magnitude of reasonably possible future market movements and potential losses that could arise from leverage, option or multiplier features.

The SEC staff has stated that it usually is most appropriate to present the market risk information in a single location outside the financial statements. A separate section in Form 10-K for the market risk disclosures is common, but not necessary. The SEC staff has indicated that management instead may elect to integrate the market risk disclosures with MD&A and the description of business sections.

Item 303 of Regulation S-K requires discussion in MD&A of known events, trends or uncertainties that are reasonably likely to materially affect the registrant. If a known market risk materially affected reported trends or financial condition in the period presented, or is reasonably likely to materially affect future reported results or liquidity, discussion of the market risk and its effects is necessary in MD&A. The quantitative and qualitative market risk disclosure rules require more information than Item 303 because Item 305 requires specific descriptive and quantitative disclosures about losses from market risk sensitive instruments that could result from reasonably possible market changes. For example, a sensitivity analysis responsive to Item 305 presents quantitative information about possible future losses from reasonably possible near-term changes in market rates and prices. This information need not be repeated in MD&A, but cross-references may be necessary to make a particular disclosure complete.

For additional information about the SEC's market risk disclosure rules, including additional examples of the disclosure requirements, see our publication, [***SEC market risk disclosures***](#). See also our *SEC annual shareholders' report checklist* (EY Form A150).

4.4 Item 8. Financial statements and supplementary data

See section 6, *Financial statements and parent company information*, for financial statement requirements.

Item 302 of Regulation S-K requires disclosure of certain interim financial information and additional disclosures about oil and gas producing activities. The required information may be disclosed outside the financial statements as supplementary financial information.

4.4.1 Interim financial information

When there are one or more retrospective changes to the statements of comprehensive income for any of the quarters within the most recent two fiscal years that individually or in the aggregate are material, Item 302(a) of Regulation S-K requires registrants to provide an explanation of the reasons for the changes and disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to the statements of comprehensive income (as specified in Rule 1-02(bb)(ii) of Regulation S-X) and earnings per share reflecting the changes. Rule 1-02(bb) provides flexibility for registrants to use the same line-item captions that appear in their financial statements, if necessary, in lieu of the line-item captions prescribed in Rule 1-02(bb). If required, the disclosure of quarterly financial data must be reviewed by the independent auditor.

Item 302(a) of Regulation S-K applies to all companies that have securities registered under Sections 12(b) (except mutual life insurance companies) or 12(g) of the Exchange Act, except SRCs and foreign private issuers. If required, selected quarterly financial data must be disclosed outside the financial statements as supplementary information (or in an unaudited note to the financial statements, if so desired) in annual shareholders' reports and in SEC filings, such as Form 10-K.

The SEC does not require selected quarterly financial data in an IPO registration statement or Exchange Act registration statement (i.e., Form 10). Item 302(a) applies beginning with the first filing on Form 10-K after the registrant's initial registration of securities under sections 12(b) or 12(g) of the Exchange Act.

Some examples of a retrospective change that may trigger Item 302(a) disclosure include:

- ▶ A correction of an error
- ▶ A disposition of a business that is accounted for as discontinued operations
- ▶ A reorganization of entities under common control
- ▶ A change in an accounting principle

These examples are not intended to be an exhaustive list, and the amounts may not always be material such that disclosure would be required under Item 302(a). Further, not all changes in accounting principles would result in a retrospective change.

Data to be disclosed: Summarized financial information should generally include the following disclosures:

- ▶ Net sales or gross revenue
- ▶ Gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenues)
- ▶ Income (loss) from continuing operations
- ▶ Net income (loss)
- ▶ Net income (loss) attributable to the registrant
- ▶ Earnings per share data (basic and, when applicable, diluted)

Registrants in specialized industries (e.g., banks, insurance companies) may substitute other information for sales and related costs and expenses if doing so is necessary for a more meaningful presentation.

Quarterly data of subsidiaries and investees: Quarterly financial data are not required to be included in supplemental financial statements for unconsolidated subsidiaries and equity investees unless the financial statements are for a company that is itself a registrant required to provide disclosures under Item 302 of Regulation S-K.

4.4.2 Information about oil and gas producing activities

Item 302(b)⁴⁴ of Regulation S-K requires registrants engaged in “significant” oil and gas producing activities to present, as supplementary information, disclosures pursuant to ASC 932 (specifically ASC 932-235-50).⁴⁵ The oil and gas activities are significant if one or more of the tests in the definition of significant oil and gas activities in ASC 932-235-20 are met. Disclosures that relate to annual periods and disclosures required as of the beginning of an annual period are presented for each year for which an income statement is required. Disclosures as of the end of an annual period are presented as of the date of each required audited balance sheet. These disclosures are summarized in our *GAAP, Regulation S-X and Regulation S-K checklist supplement for oil and gas producing companies* (EY Form A69E).

Securities Act Rule 175 and Exchange Act Rule 3b-6 provide a safe harbor from the liability provisions of the securities laws for disclosures about the value of proved oil and gas reserves (such as a standardized measure of discounted future net cash flows relating to proved oil and gas reserves, as set forth in ASC 932-235-50-29 through 50-33).

4.5 Item 9. Changes in and disagreements with accountants on accounting and financial disclosure

If during the registrant’s two most recent fiscal years, or any subsequent interim period, the registrant’s principal auditor, or an independent auditor on whom the principal auditor expressed reliance in its report, resigned, declined to stand for re-election or was dismissed, the registrant is subject to additional disclosure requirements pursuant to Item 304 of Regulation S-K.

When a change in auditors occurs, the registrant is required to report the event within four business days in a Form 8-K under Item 4.01, and provide the disclosures required by Item 304(a) of Regulation S-K.⁴⁶ These disclosures include:

- ▶ Whether the auditor resigned, declined to stand for re-election or was dismissed and the date the change occurred.
- ▶ Whether the principal auditor’s report on the financial statements for either of the past two years contained an adverse opinion or disclaimer of opinion, or was qualified as to uncertainty (e.g., a going concern uncertainty), audit scope or accounting principles and the nature of any opinion modification or qualification.

⁴⁴ The SEC had proposed eliminating Item 302(b), disclosure of oil and gas producing activities, on the condition that the FASB finalize amendments to US GAAP that would require disclosures now required by Item 302(b). The FASB had not (as of the adopting release date of the 19 November 2020 amendments to Regulation S-K) finalized the amendments, so the Commission retained Item 302(b) and may reconsider the proposal in the future.

⁴⁵ A registrant engaged in oil and gas producing activities also is subject to the financial reporting and disclosure requirements included in Item 102 of Regulation S-K and Rule 4-10 of Regulation S-X.

⁴⁶ A merger of accounting firms always results in a change in accountants if there is a change in legal entity of the firm that performs the audit. An Item 4.01 Form 8-K must be filed no later than four business days after the merger. In addition, a change to an accountant that is related in some manner to the former accountant (e.g., the firms are affiliates or are members of the same network) would require an Item 4.01 Form 8-K to be filed no later than four business days after the change in accountant if the new and former accountants are separate legal entities and are separately registered with the PCAOB.

- ▶ Whether the decision to change auditors was recommended or approved by the audit or similar committee of the board of directors.
- ▶ Whether there were any disagreements with the auditor during the two most recent fiscal years and any interim period preceding a resignation, declination or dismissal. If this is the case, certain additional disclosures are required.
- ▶ Whether during the two most recent fiscal years and any subsequent interim period⁴⁷ before such resignation, declination or dismissal there were any reportable events (e.g., auditor communication about a lack of sufficient internal controls, including an adverse opinion on the effectiveness of ICFR, inability of the auditor to rely on management's representations, need for the auditor to expand significantly the scope of the audit), in which case, certain additional disclosures are required.

Once these disclosures have been filed in a Form 8-K, a later Form 10-K is not required to repeat them. However, proxy statements relating to the annual election of directors or the election, approval or ratification of the principal auditor are required to contain all disclosures required by Item 304(a) of Regulation S-K, despite any previous disclosure. These disclosures may be made in the annual shareholders' report or in the proxy statement itself.

Following a change in auditors, Form 10-K and the annual report to shareholders are required to include the disclosures specified in Item 304(b) of Regulation S-K if they apply. Disclosure is required if there were disagreements (or reportable events) involving the former auditor *and* the financial statements include transactions or events that are accounted for, or disclosed, in a manner with which the former auditor would have taken exception. The required disclosures include the existence and nature of the disagreement or reportable event, and the effect on the financial statements of applying the accounting method that would have been required by the former auditors. These disclosures are not required if the method asserted by the former auditors has been superseded by subsequently issued accounting standards updates and is no longer generally accepted.

4.6 Item 9A. Controls and procedures

4.6.1 Item 307 Disclosure controls and procedures

Definition: Exchange Act Rules 13a-15(a) and 15d-15(a) require registrants to maintain "disclosure controls and procedures." Exchange Act Rules 13a-15(e) and 15d-15(e) define the term "disclosure controls and procedures" as:

"Controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the [Exchange] Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the [Exchange] Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure."

Evaluation and disclosure: Exchange Act Rules 13a-15(b) and 15d-15(b) require each issuer's management to evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness of the issuer's disclosure controls and procedures as of the end of each fiscal quarter. Based on that evaluation, Item 307 of Regulation S-K

⁴⁷ This SEC staff interprets this to mean through the dismissal or termination date.

requires each Form 10-Q and, for the fourth quarter, the Form 10-K, to disclose the conclusions of the registrant's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the registrant's disclosure controls and procedures as of the end of the period covered by the report.

In providing the disclosures under Item 307 of Regulation S-K, some companies have indicated that disclosure controls and procedures are designed only to provide "reasonable assurance" that they will meet their objectives. While not objecting to such language, the SEC staff has required these companies to disclose management's conclusion about whether the company's disclosure controls and procedures are effective at the "reasonable assurance" level. In providing the disclosures under Item 307 of Regulation S-K, other companies have disclosed that there is "no assurance" that disclosure controls and procedures will operate effectively under all circumstances. In these cases, the SEC staff has requested that the companies clarify that their disclosure controls and procedures are designed to provide "reasonable assurance," subject to the conditions discussed above.

The SEC staff reminds registrants that management's conclusions about the effectiveness of the registrant's disclosure controls and procedures in interim and annual reports under Item 307 of Regulation S-K must include an explicit statement about whether disclosure controls and procedures are either "effective" or "ineffective." In addition, management's conclusion must consider disclosure controls and procedures "in their totality." The SEC staff will require a registrant to amend its filing if it discloses inappropriate expressions of management's conclusions, such as conclusions that disclosure controls and procedures are "adequate," "effective, except for," or "effective except as disclosed below."

Relationship between "disclosure controls and procedures" and "internal control over financial reporting": In its commentary,⁴⁸ the SEC expresses its view that there is "substantial overlap" between a company's disclosure controls and procedures and its internal control over financial reporting (discussed below). However, there are some elements of disclosure controls and procedures that are beyond the scope of internal control over financial reporting, and there are some (albeit very few) elements of internal control over financial reporting that may fall outside the scope of a registrant's disclosure controls and procedures. In the SEC's view, the elements of internal control over financial reporting that provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles would always be included in a company's disclosure controls and procedures. Aside from those elements, the SEC indicated that companies can be expected to make judgments about the processes and controls on which management relies to meet applicable Exchange Act disclosure requirements.

The SEC staff has indicated⁴⁹ that a registrant may exclude a business it acquired during the year from its assessment of internal control over financial reporting. In light of the overlap between a company's disclosure controls and procedures and its internal control over financial reporting, the registrant also may exclude these controls from its evaluation of disclosure controls and procedures. In these situations, the registrant should indicate the significance of the acquired business to the registrant's consolidated financial statements.

An entity that identifies a material error should assess whether and how it affects the entity's conclusions about the effectiveness of the related internal controls, and hence the effectiveness of disclosure controls and procedures. When amending a prior filing to correct a material error, registrants should consider whether the disclosures previously provided to comply with Item 307 of Regulation S-K need to be modified,

⁴⁸ SEC Release No. 33-8238, *Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, issued 5 June 2003.

⁴⁹ Regulation S-K C&DI 214.01, *Item 307 – Disclosure Controls and Procedures*. The SEC staff Regulation S-K C&DIs can be found at <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.

supplemented or corrected in order to explain whether management's previous conclusions regarding the effectiveness of disclosure and control procedures continue to be appropriate in light of the assessment to restate financial statements or non-reliance on a previously issued audit report or interim review.

4.6.2 Item 308 (a) & (b) Internal control over financial reporting

With the exception of newly public companies, all issuers are required to provide a report by management assessing the effectiveness of the company's internal control over financial reporting, as required by Section 404(a).⁵⁰

However, non-accelerated filers and EGCs are exempted from the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act. Refer to sections 2.1.1, 2.1.2 and 2.1.3 in this publication for further information on the determination of filer status.

Transition from non-accelerated to accelerated or large accelerated filer: When a non-accelerated filer meets all of the criteria in Rule 12b-2 of the Exchange Act to be an accelerated filer or a large accelerated filer as of the end of its fiscal year, its Form 10-K for that fiscal year will be due on an accelerated basis and it must comply with Section 404(b).

Assume, for example, that a calendar-year registrant filed its 20Y2 Form 10-K as a non-accelerated filer and reported revenues higher than \$100 million for 20Y2 and did not have its auditor attest to the effectiveness of ICFR. Also assume that on 30 June 20Y3, the registrant's public float had increased to \$80 million, and as of 31 December 20Y3, it met the criteria of an accelerated filer.⁵¹ The registrant's 20Y3 Form 10-K will be due 16 March 20Y4 (75 days after year end) and must include its auditor's report on the effectiveness of ICFR as of 31 December 20Y3.

Refer to section 2.1.5 above for further information regarding transition between acceleration status categories and requirement for auditor attestation of ICFR.

Transition when exiting EGC status: When an issuer loses its EGC status, it must comply with the requirements of Section 404(b), unless it is a non-accelerated filer (as described above). A registrant with EGC status loses its eligibility as an EGC five years after its common equity IPO. An issuer also loses its EGC status if it meets any of the following criteria:

- ▶ Has annual revenues exceeding \$1.235 billion⁵²
- ▶ Issues more than \$1 billion in nonconvertible debt securities over a rolling 36-month period, including securities issued in registered or unregistered offerings
- ▶ Becomes a large accelerated filer (i.e., a seasoned issuer with public float of \$700 million or more)

A registrant that loses EGC status would be required to file its annual report for that year as a non-EGC. For example, if a calendar-year EGC exceeds \$1.235 billion in annual revenue in 20Y3, the EGC relief provisions would not apply to its 20Y3 Form 10-K. This means the registrant would have to comply with Section 404(b) in its 20Y3 Form 10-K, unless it is a non-accelerated filer.

⁵⁰ Section 404 reporting commences with the second annual report of any newly public company. The surviving issuer in a reverse acquisition is not considered a newly public company. The SEC staff has published Regulation S-K C&DI 215.02 for companies to consider in such reverse acquisition situations (<http://www.sec.gov/divisions/corpfin/guidance/reqs-kinterp.htm>).

⁵¹ This example assumes the issuer is not an SRC with annual revenue of less than \$100 million, which would qualify the issuer as a non-accelerated filer when applying the revenue and public float thresholds discussed in Section 2.1.1.

⁵² The cap on annual gross revenues reflects inflation adjustments required by the JOBS Act. The final rules the SEC adopted to implement the latest adjustment were effective 20 September 2022.

The FAST Act amended the JOBS Act to provide relief to companies that begin the IPO process as an EGC but lose that status before they complete the IPO process. Once a company files or submits its IPO registration statement on a confidential basis and qualifies as an EGC, if a disqualifying event occurs, the issuer would continue to qualify as an EGC until the earlier of the date on which the issuer consummates its IPO, or the end of the one-year period beginning on the date the company ceases to be an EGC.

Transition when there is a change in fiscal year end: A registrant that changes its fiscal year is required to provide a management report on internal control over financial reporting, and the related auditor attestation report, when filing a transition report on Form 10-K.⁵³ This is because transition reports filed on Form 10-K must contain audited financial statements and, accordingly, also must include management's report on internal control, subject to the transition provisions described above.

If the transition report is filed on Form 10-Q, a registrant would be required to provide only a management assessment as of its new fiscal year end in connection with the registrant's first Form 10-K filed following a change in fiscal year.

For example, assume on 1 April 20Y2 an accelerated filer changes its fiscal year from 31 December to 31 March and elects to file its transition report on Form 10-Q for the transition period 1 January 20Y2 to 31 March 20Y2. Such accelerated filer's transition report on Form 10-Q for the period ended 31 March 20Y2 is not required to include internal control reports. The registrant would include only a management report on internal control over financial reporting, and related auditor attestation report, in the registrant's next annual report on Form 10-K for the fiscal year ending 31 March 20Y3. Therefore, the registrant would not be required to perform an assessment of, and file a report on, its internal control over financial reporting as of the end of the 31 March 20Y2 transition period, unless it elected to file its transition report on Form 10-K rather than Form 10-Q.

Definition: Exchange Act Rules 13a-15(a) and 15d-15(a) require registrants to maintain "internal control over financial reporting." Exchange Act Rules 13a-15(f) and 15d-15(f) define the term "internal control over financial reporting" as:

"A process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles,⁵⁴ and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements."

⁵³ Question 6 of the SEC staff's document, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports: Frequently Asked Questions (revised 24 September 2007)* (Section 404 FAQ).

⁵⁴ As discussed in the section Relationship between "disclosure controls and procedures" and "internal control over financial reporting" above, the elements of internal control over financial reporting that address this objective also would represent an element of the company's disclosure controls and procedures.

This definition is consistent with the definition of internal accounting controls in Section 13 of the Exchange Act, which was added by the Foreign Corrupt Practices Act of 1977. This definition also encompasses the subset of internal controls addressed in the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control – Integrated Framework* (COSO Report) pertaining to financial reporting objectives. Thus, "internal control over financial reporting" does not extend to the other elements of internal control identified in the COSO Report relating to the effectiveness and efficiency of a company's operations and a company's compliance with applicable laws and regulations (with the exception of compliance with the applicable laws and regulations directly related to the preparation of financial statements, such as compliance with SEC regulations).

Management report: Exchange Act Rules 13a-15(c) and 15d-15(c) require each issuer's management to evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness, as of the end of each fiscal year, of the issuer's internal control over financial reporting.⁵⁵ Item 308(a) of Regulation S-K requires each Form 10-K to include a report of management on the company's internal control over financial reporting,⁵⁶ which must, at a minimum, include the following:

- ▶ A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the registrant
- ▶ A statement identifying the framework used by management to evaluate the effectiveness of the registrant's internal control over financial reporting
- ▶ Management's assessment of the effectiveness of the registrant's internal control over financial reporting as of the end of the registrant's most recent fiscal year, including a statement about whether internal control over financial reporting is effective⁵⁷
- ▶ A statement that the registered public accounting firm that audited the financial statements included in the annual report has issued an attestation report on the registrant's internal control over financial reporting (accelerated filers and large accelerated filers only)

While Item 308(a) of Regulation S-K clarifies the information required in management's report on internal control over financial reporting, it does not specify the exact format or content of the management report. If management's report indicates that internal control over financial reporting is designed to provide only "reasonable assurance" that it will meet its objectives, the SEC has stated that "the discussion must be presented in a manner that neither makes the disclosure in the report confusing nor renders management's assessment concerning the effectiveness of the company's internal control over financial reporting unclear."

⁵⁵ If a subsidiary issuer or subsidiary guarantor is exempt from Exchange Act reporting under Rule 12h-5, the SEC staff has indicated that Form 10-K is required to include only a Section 404 report for the consolidated parent company. Also, in this situation, the information required to be furnished by Item 9A of Form 10-K applies only to the consolidated parent company and, accordingly, a separate Section 404 report is not required for such subsidiary issuer or subsidiary guarantor.

⁵⁶ While the SEC's final Section 404 rule does not mandate the location of management's annual report on internal control over financial reporting, the Commission has indicated that it is important for the report to be in close proximity to the corresponding audit report on internal control over financial reporting issued by the company's independent registered public accounting firm. Further, the SEC staff stated its expectation that companies will choose to place the internal control reports together near their MD&A disclosure or in a portion of the document immediately preceding the financial statements. We believe that including both management's Section 404(a) report and the auditor's Section 404(b) report in Item 9A on Form 10-K satisfies those expectations. Because Exchange Act Rule 14a-3 was not amended to require the information specified in Items 307 and 308 of Regulation S-K, internal control reports are not required in "glossy" annual reports.

⁵⁷ Negative assurance (i.e., a statement that nothing has come to management's attention to suggest that the company's internal control over financial reporting is not effective) will not satisfy this requirement.

Exchange Act Rules 13a-15(c) and 15d-15(c) provide that management must base its evaluation of the effectiveness of its internal control over financial reporting on a “suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.” The SEC further indicated that, in its view, a suitable framework must be free from bias; permit reasonably consistent qualitative and quantitative measurements of a company’s internal control; be sufficiently complete so that relevant factors that would alter a conclusion about the effectiveness of a company’s internal control are not omitted; and be relevant to an evaluation of internal control over financial reporting. The SEC cited the COSO Report as a suitable, recognized internal control framework meeting the requirements of Exchange Act Rules 13a-15(c) and 15d-15(c).⁵⁸

COSO updated its internal control framework in 2013 to address changes in the business, operating and regulatory environment since it issued its original framework in 1992.

Scope of management’s assessment: Because the process of evaluating internal control over financial reporting will vary from company to company, SEC rules do not specify the methods or procedures to be performed in an evaluation.⁵⁹ The SEC’s interpretive guidance, *Commission Guidance Regarding Management’s Report on Internal Control over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, states that the methods and procedures for identifying financial reporting risks will vary based on characteristics of the company such as its size, complexity, organizational structure and its processes and financial reporting environment, as well as the control framework used by management. However, an instruction to Item 308 of Regulation S-K states, “the registrant must maintain evidential matter, including documentation, to provide reasonable support for management’s assessment of the effectiveness of the registrant’s internal control over financial reporting.”

In adopting its Section 404 reporting rules in 2003, the SEC stated:

“The assessment of a company’s internal control over financial reporting must be based on procedures sufficient both to evaluate its design and to test its operating effectiveness. Controls subject to such assessment include, but are not limited to: controls over initiating, recording, processing and reconciling account balances, classes of transactions and disclosure and related assertions included in the financial statements; controls related to the initiation and processing of non-routine and non-systematic transactions; controls related to the selection and application of appropriate accounting policies; and controls related to the prevention, identification, and detection of fraud. The nature of a company’s testing activities will largely depend on the circumstances of the company and the significance of the control. However, inquiry alone generally will not provide an adequate basis for management’s assessment.

An assessment of the effectiveness of internal control over financial reporting must be supported by evidential matter, including documentation, regarding both the design of internal controls and the testing processes. This evidential matter should provide reasonable support: for the evaluation of whether the control is designed to prevent or detect material misstatements or omissions; for the conclusion that the tests were appropriately planned and performed; and that the results of the tests were appropriately considered.”

⁵⁸ The *Guidance on Assessing Control*, published by the Canadian Institute of Chartered Accountants, and the *Turnbull Report*, published by the Institute of Chartered Accountants in England & Wales, also are identified by the SEC as suitable frameworks.

⁵⁹ In June 2007, the SEC published interpretive guidance, *Commission Guidance Regarding Management’s Report on Internal Control over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934* (SEC Release Nos. 33-8810 and 34-55929, FRR-77), for management of all public companies subject to Section 404 regarding their evaluations of internal control over financial reporting. The SEC also amended Exchange Act Rules 13a-15(c) and 15d-15(c) to provide for a non-exclusive safe-harbor such that a company that performs an evaluation of internal control in accordance with the interpretive guidance satisfies the annual evaluation required by those Exchange Act Rules.

The SEC staff also stated in the Section 404 FAQs its views on the scope of management's assessment as it relates to a consolidated entity (i.e., variable interest entity (VIE) or an acquired business). The SEC staff indicated that management's report on internal control over financial reporting typically should include controls at all consolidated entities, regardless of the basis for consolidation. For instance, the SEC staff indicated that the internal controls of an entity consolidated by virtue of variable interest entity accounting should be covered in management's report on internal control over financial reporting if the registrant's initial involvement with the VIE occurred after 15 December 2003.

The SEC staff acknowledged that it might not always be possible to assess an acquired business's internal control over financial reporting in the period between the consummation date and the date of management's assessment.⁶⁰ In such instances, the SEC staff would not object to management referring in its internal control report to a discussion in the registrant's Form 10-K regarding the scope of management's assessment and to such disclosure noting that management excluded the acquired business⁶¹ from management's report on internal control over financial reporting. If such a reference is made, however, management must identify the excluded acquired business and indicate the significance of the business to the registrant's consolidated financial statements.

Despite management's exclusion of an acquired business's internal controls from its annual assessment, a registrant must disclose any material change to its internal control over financial reporting because of the acquisition pursuant to Exchange Act Rule 13a-15(d) or 15d-15(d). However, if the registrant excludes a recently acquired business 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 its ICFR assessment. In addition, the period during which management may omit an assessment of an acquired business's internal control over financial reporting from its assessment of the registrant's internal control may not extend beyond one year from the date of acquisition, nor may this assessment be omitted from more than one annual management report on internal control over financial reporting.

As for the timing of the evaluation and testing, the SEC's adopting release states: "management of each company should perform evaluations of the design and operation of the company's entire system of internal control over financial reporting over a period of time that is adequate for it to determine whether, as of the end of the company's fiscal year, the design and operation of the company's internal control over financial reporting are effective."

This approach makes practical sense recognizing that some controls operate continuously while others operate only at certain times, such as the end of the fiscal year. The SEC recognizes that, while the evaluation date is as of the end of the fiscal year, for practical purposes, the testing of many internal controls must be performed at interim dates with appropriate roll-forward procedures.

The adopting release also acknowledges that, while "management" is ultimately responsible for the assessment of internal control over financial reporting, the necessary activities to evaluate the design and operating effectiveness of the company's internal control over financial reporting may be conducted by non-management personnel acting under the supervision of management.

⁶⁰ The term "business" includes those acquisitions that would constitute a business based on the facts and circumstances as outlined in Article 11-01(d) of Regulation S-X. While in some instances an acquisition may not meet the definition of a business in ASC 805 and would not be accounted for as a business combination, it nevertheless may be a business under the definition in Article 11 used for SEC reporting purposes. This guidance applies irrespective of whether the acquisition is significant under Rule 1-02(w) of Regulation S-X.

⁶¹ Question 3 of the SEC staff's Section 404 FAQs addresses whether management may exclude a business acquired through a "material purchase business combination" from management's report on ICFR. However, at the 25 September 2013 CAQ SEC Regulations Committee meeting, the SEC staff said that a business acquired through a merger of entities under common control also would be eligible for the temporary ICFR scope exemption.

Effects of material weaknesses and significant deficiencies: If a “material weakness” exists at the end of the fiscal year, it must be disclosed in management’s internal control report, and the presence of a material weakness would preclude management from concluding that internal control over financial reporting is effective.⁶²

Management’s certification called for by Section 302 of the Sarbanes-Oxley Act requires the certifying officers to disclose to the registrant’s auditors and the audit committee all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting.⁶³ In PCAOB Auditing Standard (AS) 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements*, a “significant deficiency” is defined as “a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company’s financial reporting.” AS 2201 and the SEC define the term “material weakness” as “a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis.” AS 2201 indicates that the “reasonable possibility” of an event, included in the definition of a material weakness, has the same meaning as the terms “reasonably possible” or “probable” as defined in the FASB’s Codification. An aggregation of significant deficiencies in internal control over financial reporting could constitute a material weakness and also preclude management from determining that a company’s internal control over financial reporting is effective.

While this is not addressed in the SEC rules, we believe that a material weakness in internal control that was identified and corrected during the fiscal year would not preclude management from concluding that internal control over financial reporting was effective as of the end of the fiscal year. In those circumstances, management’s internal control report would not be required to disclose the existence and correction of a material weakness earlier in the company’s fiscal year. However, under Item 308(c) of Regulation S-K (discussed below), a change during a fiscal year necessary to correct a material weakness in internal control would need to be disclosed in the periodic SEC report covering the respective fiscal quarter.

Auditor attestation: Rules 1-02 and 2-02 of Regulation S-X require the issuer’s registered public accounting firm to attest to, and report on whether the registrant maintained, in all material respects, effective internal control over financial reporting as of the assessment date. Item 308(b) of Regulation S-K requires each Form 10-K of an accelerated or a large accelerated filer (other than EGCs) to include the attestation report from the issuer’s registered public accounting firm on the registrant’s internal control over financial reporting, issued pursuant to auditing standards adopted by the PCAOB.

4.6.3 Item 308(c) Changes in internal control over financial reporting

The SEC staff clarified that it would not object if a registrant does not disclose changes or improvements to controls made in preparation of the registrant’s first Section 404 report (e.g., between its IPO and second Form 10-K report date). However, if the registrant were to identify a material weakness in advance of its Section 404 compliance date, the SEC staff stated that the registrant “should carefully consider whether that fact should be disclosed, as well as changes made in response to the material weakness.”⁶⁴

⁶² When management concludes that the company’s internal control over financial reporting is ineffective, the SEC staff indicated that the company should consider including in their disclosures: (1) the nature of any material weakness; (2) its effect on financial reporting and the control environment and (3) management’s current plans, if any, for remediating the weakness.

⁶³ The SEC expects that the certifying officers also would make the auditors and audit committee aware of any significant deficiencies, material weaknesses or fraud requiring disclosure of which they become aware outside, or subsequent to, the formal evaluation process.

⁶⁴ Question 7 of the SEC staff’s Section 404 FAQ.

After the registrant's first Section 404 report, Item 9A of Form 10-K requires the issuer to disclose any change in internal control over financial reporting that occurred during the fourth quarter of the fiscal year that has "materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting." The SEC staff clarified that this would encompass disclosing a change (including an improvement) to internal control over financial reporting that was not necessarily in response to an identified significant deficiency or material weakness (i.e., the implementation of a new information system) if it materially affected the registrant's internal control over financial reporting.

Read literally, Item 308(c) of Regulation S-K and the form of management's Section 302 (of the Sarbanes-Oxley Act) certification require only disclosure of material changes in internal control over financial reporting that occurred during a fiscal quarter, not the underlying reasons for such changes (e.g., significant deficiency, material weakness, business acquisition, change in the design of internal controls to increase their effectiveness and efficiency). However, the SEC has stated, "a company will have to determine, on a facts and circumstances basis, whether the reasons for the change, or other information about the circumstances surrounding the change, constitute material information necessary to make the disclosure about the change not misleading."

The SEC staff has discussed the importance of considering whether changes to internal controls in conjunction with the adoption of a new accounting standard require disclosure as a material change in ICFR in the relevant quarter under Item 308(c) of Regulation S-K. When these disclosures are required, registrants should include these disclosures no later than the period of the change, which would be the first quarter the new standard is adopted in most cases.

4.6.3.1 **Exhibit 31 Management's Section 302 certification**

The management certification called for by Section 302 of the Sarbanes-Oxley Act must be filed as Exhibit 31 to the Form 10-K. As "filed" information, Section 302 certifications remain subject to the civil liability provisions of Section 18 of the Exchange Act, and may be incorporated by reference into registration statements filed under the Securities Act where they would become subject to the liability provisions of Section 11 of the Securities Act.

The specified form of the Section 302 certification is included in Item 601, *Exhibits*, of Regulation S-K. The certifications must be filed in the exact form specified by the SEC rules.⁶⁵ Separate certifications are required to be filed by the CEO and CFO.⁶⁶

4.7 **Item 9B. Other information**

Item 9B of Form 10-K requires disclosure of any reportable events not reported on Form 8-K as required during the fourth quarter of the year covered by the Form 10-K, whether or not otherwise required to be disclosed in the Form 10-K. If disclosure of the required delinquent information is made in Item 9B, such disclosure is not required to be repeated in a report on Form 8-K.

⁶⁵ In SEC Release No. 33-8238, *Asset-Backed Securities*, the Commission amended Item 601 of Regulation S-K to add the specific form and content of the required Section 302 certification to the exhibit filing requirements for asset-backed securities issuers. The requirements relating to the asset-backed issuer Section 302 certification are specified in paragraph (d) of Exchange Act Rules 13a-14 and 15d-14.

⁶⁶ The introductory language in paragraph 4 and the language in paragraph 4(b) of the certification contain references to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting. The CEO and the CFO of a registrant may omit the language making such references until the registrant becomes subject to the internal control over financial reporting requirements (e.g., between its IPO and second Form 10-K report date).

Certain Form 8-K items qualify for a limited safe harbor from public and private claims under Exchange Act Section 10(b) and Rule 10b-5 for failure to file a timely Form 8-K regarding certain items. Under the limited safe harbor, a failure to file a report on Form 8-K for the specified events will not be deemed to be a violation of Section 10(b) and Rule 10b-5 under the Exchange Act. This safe harbor applies only to a failure to file; material misstatements or omissions in a Form 8-K continue to be subject to Section 10(b) and Rule 10b-5 liability. In addition, the safe harbor does not provide protection from Section 10(b) or Rule 10b-5 liability that might arise from the registrant's failure to satisfy any other separate duties to disclose the information (e.g., in a registration statement under the Securities Act). The limited safe harbor extends only until the due date of the registrant's next periodic report for the period during which the Form 8-K was not timely filed.

4.8 Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections

The SEC amended its interim final rules to implement submission and disclosure requirements for companies that the SEC identifies as having filed annual reports whose financial statements are audited by registered public accounting firms in foreign jurisdictions that don't allow inspections by the PCAOB (i.e., Commission-Identified Issuers), as mandated by the Holding Foreign Companies Accountable Act (the HFCA Act). The Commission amended Form 10-K to add Part II, Item 9C entitled "Disclosure Regarding Foreign Jurisdictions that Prevent Inspections." For most registrants (other than those whose audit report is issued by a firm that is unable to be inspected by the PCAOB (i.e., in China or Hong Kong)), the response to this new item will likely be "Not applicable." All registrants must present the PCAOB ID number of the audit firm(s) providing the opinion(s) related to the financial statements in their annual reports. The SEC did not provide guidance on the location of the PCAOB ID number. While it's ultimately the registrants' decision where the PCAOB ID is presented, they may consider including it in the index to Item 8 of the Form 10-K (covered in section 6 of this publication), following the reference to the financial statement opinion (e.g., Report of Independent Registered Public Accounting Firm (PCAOB ID: XXXX)). If the registrant's financial statements are audited by predecessor and successor auditors, the registrant must present PCAOB ID numbers for both audit firms.

5 Item 7. Management's discussion and analysis (MD&A)

Financial statement users and regulators continue to seek more transparency in companies' disclosures about results of operations, liquidity and capital resources, critical accounting estimates, fair value accounting, and off-balance sheet arrangements – all components of MD&A that are discussed in this section.⁶⁷

This section is designed to help management prepare the information required by Item 303 of Regulation S-K, Management's Discussion and Analysis of Financial Condition and Results of Operations. Our *SEC annual shareholders' report checklist* (EY Form A150) provides a helpful reference for preparing MD&A.

MD&A is required in annual shareholders' reports, as well as in Form 10-K. Because the requirements are the same for both documents, the text of MD&A in the annual shareholders' report should be consistent with that in Form 10-K if the registrant elects not to incorporate it by reference. Management may use its discretion on the form and location of the discussion in the annual shareholders' report.

5.1 Overview

Management must discuss the registrant's financial condition, changes in financial condition, results of operations and cash flows in MD&A. Registrants should satisfy the following overarching principles to provide an effective MD&A discussion and allow investors to view the registrant from management's perspective:

- ▶ Provide material information relevant to an assessment of the financial condition and results of operations of the registrant, including an evaluation of the amount and certainty of cash flows from operations and from outside sources
- ▶ Focus the discussion on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or of the registrant's future financial condition, including descriptions and amounts of matters that are reasonably likely, based on management's assessment, to have a material impact on future operations
- ▶ Discuss the financial statements and other statistical data the registrant believes will enhance the reader's understanding of the registrant's financial condition, changes in financial condition, cash flows and results of operations

The discussion generally should cover the most recent three fiscal years (i.e., the same period covered by the financial statements). However, registrants that provide three years of financial statements in a filing can omit a discussion of the earliest year from MD&A if a discussion of that year was included in any previous filing, does not warrant material retrospective revision and the registrant does not believe repeating such information is necessary to an understanding of its financial condition, changes in financial condition and results of operations.⁶⁸ Registrants that elect to omit this discussion must disclose where the omitted information can be found in the prior filing.⁶⁹ Registrants may use any presentation that enhances a reader's understanding of their financial condition, changes in their financial condition and results of their operations.

⁶⁷ The SEC staff frequently comments about MD&A. See our [SEC Reporting Update: Highlights of trends in 2022 SEC comment letters](#), for common areas of focus by the SEC staff.

⁶⁸ The SEC staff addressed this matter in [CD&I Regulation S-K, Question 110.03](#). A registrant must assess its information about the earliest of three years and, if it believes it to be necessary to an understanding of its financial condition, changes in financial condition and results of operations, include it in the current disclosure or expressly incorporate by reference its discussion from a previous filing.

⁶⁹ The SEC staff issued [CD&I Regulation S-K, Question 110.02](#), which indicates that a statement merely identifying the location in a prior filing where the omitted discussion can be found does not incorporate such disclosure into the filing unless the registrant expressly states that the information is incorporated by reference.

5.2 Overall presentation of MD&A

The SEC encourages each company and its management to take a fresh look at MD&A each period (even when there are no new requirements), with a view to enhancing its quality.

As to the overall presentation of MD&A, companies should:

- ▶ Focus on material information, eliminate immaterial information and avoid unnecessary duplicative disclosure
- ▶ Present their disclosure so that the most important material information is most prominent (e.g., using a “layered” approach)
- ▶ Consider starting MD&A with an executive-level overview that provides context for the remainder of the discussion
- ▶ Provide not only disclosure of MD&A requirements, but also an analysis that explains management's view of the implications and significance of that information
- ▶ Provide a balanced view of the underlying dynamics of the business, including not only a description of a company's successes but also of instances when it failed to realize goals, if material

5.2.1 Executive-level overview

Under the MD&A rules, a company has the flexibility to present MD&A in a manner that it believes is most meaningful for investors. An executive-level overview can provide helpful context for the MD&A presentation. It should include the most important matters on which the company's executives focus in evaluating its financial condition and operating performance. However, the SEC believes that an executive-level overview should not merely repeat the more detailed discussion and analysis that follows.

The SEC expects a good executive-level overview to:

- ▶ Include economic or industry-wide factors relevant to the company
- ▶ Inform the reader about how the company earns revenue and generates cash
- ▶ If necessary or useful, discuss the company's lines of business, location(s) of operations and principal products and services (but not merely duplicate the disclosure in the Description of Business section of the filing)
- ▶ Provide insight into material opportunities, challenges and risks (e.g., those presented by known material trends and uncertainties), on which the company's executives are most focused for both the short- and long-term, as well as the actions they are taking to address these opportunities, challenges and risks

As with the balance of MD&A, the SEC expects the executive-level overview to be dynamic and evolve over time. In addition, the SEC recommends that companies avoid including boilerplate disclaimers or other generic language that would detract from the executive-level overview.

Recognizing that some contend an executive-level overview might create additional legal exposure, the SEC has emphasized that the failure to disclose all material information in an executive-level overview should not create any liability under the “buried facts” doctrine, under which a court could consider disclosure to be false and misleading if its overall significance is obscured because material information is “buried,” such as in a footnote or appendix. Because an executive-level overview is only an introduction, it would not be expected to include disclosure of all material matters required by the SEC's MD&A rules.

5.2.2 Clarity, understandability and organization

The SEC recommends that companies present MD&A in clear and understandable language. In addition, companies should structure their MD&A to prominently present the most relevant information.

Accordingly, the SEC encourages companies to consider the following when preparing MD&A:

- ▶ Using tabular presentations of relevant financial or other information (e.g., a tabular comparison of dollar changes, percentage changes or other pertinent information followed by a discussion and analysis of the more significant relevant changes)
- ▶ Using headings to help readers follow the flow of MD&A and to promote a better understanding of MD&A
- ▶ Using a “layered” approach to emphasize the most important information and analysis (e.g., beginning a section with a statement of the principal factors, trends or other matters that are the main subjects of the section, before providing more detailed analysis of period-to-period information)

5.2.3 Emphasis on material information

Companies should focus on and emphasize the most important information in MD&A. In addition to providing material information in response to specific MD&A rules, companies must provide other material information that is necessary to make the required statements, in light of the circumstances in which they are made, not misleading. For example, the SEC cautions companies that, if material information (historical or forward-looking) is disclosed publicly other than in an SEC filing (e.g., earnings release, conference call with analysts, website posting), the company should evaluate the information to determine whether it is required to be included in MD&A. The SEC stated, “We are not seeking to sweep into MD&A all the information that a company communicates.” Instead, the SEC expects each company to consider whether elements of such communications are required to be included in MD&A, or consider whether their inclusion would enhance the presentation of MD&A.

5.2.4 Key performance indicators

Companies should identify key performance indicators, whether financial or nonfinancial, that management uses to manage the business and that would be material to investors. Such key indicators could relate to external or macroeconomic matters (e.g., interest rates, economic growth rates, their anticipated trends). Other key indicators might be specific to a company. Examples include: manufacturing plant capacity and utilization, backlog, trends in bookings, website visitors, employee turnover rates, information based on units or volume, customer satisfaction, time-to-market, interest rates, product development, service offerings, throughput capacity, affiliations/joint undertakings, market demand, customer/vendor relations, employee retention, business strategy, changes in managerial approach or structure and regulatory actions or regulatory environment. Since these measures are nonfinancial, the SEC believes that the disclosure of such information would fall outside the scope of the requirements of Item 10 of Regulation S-K regarding non-GAAP financial measures.

The Commission has issued guidance,⁷⁰ advising registrants to provide additional disclosures about key performance indicators (KPIs) and other metrics included in MD&A. The SEC noted that registrants often disclose financial and nonfinancial metrics in MD&A that can vary significantly among companies and industries based on the facts and circumstances.

⁷⁰ Refer to Release 33-10751, *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*, for further information.

When disclosing metrics in MD&A, a registrant should consider whether (1) they are US GAAP measures and whether the US GAAP disclosure framework applies to them, or (2) they are non-GAAP measures and Item 10(e) of Regulation S-K applies to them. If the metrics are not subject to either of those existing disclosure frameworks, the registrant should then consider what additional information is needed to provide adequate context to help an investor understand them. The SEC generally expects, based on the facts and circumstances, the following disclosures about each KPI:

- ▶ A clear definition of the metric and a description of how it is calculated
- ▶ A statement indicating the reasons why the metric provides useful information to investors
- ▶ A statement indicating how management uses the metric in managing or monitoring the performance of the business

If there are estimates or assumptions underlying the metric or its calculation, a company should evaluate whether disclosure of such items is necessary for the disclosure of the metric not to be misleading.

If a company changes the method it uses to calculate or present the metric from one period to another, it should consider the need to disclose, if material:

- ▶ The differences in how the metric is calculated or presented
- ▶ The reasons for such changes
- ▶ The effects of any such changes on the amounts or other information being disclosed and on amounts or other information previously reported
- ▶ Other differences in methodology and results that would reasonably be expected to be relevant to understanding the company's performance or prospects

Depending on the significance of the changes in the methodology and results, a company should consider whether it is necessary to recast previously reported metrics to conform to the current presentation and place the current disclosure in an appropriate context. Also refer to our To the Point publication, [**SEC issues guidance on disclosures about key performance indicators and other metrics in MD&A**](#), for additional information.

5.2.5 Segment analysis

Requirements: The SEC's requirements for management's discussion of business segments are designed to be flexible so that registrants may discuss their business in the manner most appropriate to individual circumstances. The MD&A rules require registrants to discuss each relevant reportable segment and/or other subdivision of the business (e.g., geographic area, product line) to provide an understanding of the business. The discussion must focus on each relevant reportable segment and/or other subdivision of the business and the business as a whole.

There may be other situations where information should be disclosed about a particular segment, even though the information is not material in quantitative terms and may not otherwise appear significant to the registrant's business taken as a whole. These SEC guidelines are subjective and require careful consideration by management.

ASC 280 measures: If a registrant determines segment profitability on a basis that differs from GAAP on a consolidated basis (as allowed by ASC 280), and discloses any such ASC 280 measure of a segment's operating performance in MD&A, MD&A should include a discussion of the reconciling items (as disclosed in the aggregate under ASC 280, between GAAP income and the sum of all reportable segments' operating profit or loss) that are applicable to that segment. However, in these circumstances, the SEC

does not expect a numerical reconciliation of the ASC 280 segment measure to the corresponding GAAP measure. Instead, the disclosure may be limited to a narrative discussion in MD&A of items that affect the GAAP operating results of a segment, but that are not included in segment operating profit defined by management. Nevertheless, companies may want to consider providing a numerical reconciliation, which might be useful in facilitating the discussion of the reconciling items.

For example, the SEC would expect discussion in MD&A if a registrant's measure of segment operating profit or loss excludes the effects of revenues or expenses attributable to a segment. If a reconciling item (e.g., a material restructuring or impairment charge) relates to a specific segment, but is not included in the ASC 280 measure of the segment's operating profit or loss disclosed in MD&A, the registrant is expected to disclose the nature of the excluded item, the "applicable portion" of the charge attributable to the reportable segment, and the circumstances that lead to incurring the charge.

In all cases, disclosures about segment profitability determined under ASC 280 should be explained in a balanced and informative manner to include how the segment's performance affects the GAAP consolidated financial statements.

Non-GAAP financial measures: The SEC's definition of non-GAAP financial measures specifically excludes measures of profit or loss and total assets for each segment that are required to be disclosed under ASC 280. The SEC staff's Non-GAAP C&DIs state, "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."

The SEC staff's non-GAAP C&DIs provide the following SEC staff views (among others) on the applicability of Item 10(e) of Regulation S-K to the disclosure of other information on a business segment basis:

- ▶ Segment measures that are adjusted to include amounts excluded from, or to exclude amounts included in, the measure reported to the CODM for purposes of making decisions about allocating resources to the segment and assessing its performance do not comply with ASC 280. Such measures are, therefore, non-GAAP financial measures.
- ▶ The ASC 280 financial statement note reconciling the segment measures to the consolidated financial statements may total the profit or loss for the individual segments; however, the presentation of such a "consolidated" segment profit or loss measure in any context other than in the ASC 280-required reconciliation in the financial statement note would be the presentation of a non-GAAP financial measure and therefore would be required to be presented in conformity with all the non-GAAP rules and regulations.

5.2.6

Material changes

The reasons underlying material changes in financial statement items must be described to the extent necessary for users to understand the business as a whole, including when a material change is a result of multiple factors. In that case, each factor necessary to an understanding of a material change must be described and quantified. This applies to all financial statements – not just the income statement – and material changes in a line item must be described even when the changes offset each other.⁷¹ In recent comment letters, the SEC staff has asked registrants to provide more details about the specific factors and underlying reasons that contributed to material period-to-period changes. Refer to our **SEC Reporting Update: Highlights of trends in 2022 SEC comment letters** publication. Determining which changes are material is left to the registrant.

⁷¹ The 1989 MD&A Interpretive Release provided the following effective disclosure example: "Revenue from sales of single-family homes for 1987 increased 6 percent from 1986. The increase resulted from a 14 percent increase in average sales price per home, partially offset by a 6 percent decrease in the number of homes delivered."

If the reasons underlying a material change in one line item in the financial statements also relate to other line items, a registrant is not required to repeat the reasons in the discussion. In addition, a line-by-line analysis of the financial statements as a whole is neither required nor generally appropriate, and a registrant need not recite the amounts of changes from period to period if they are readily computable from the financial statements or presented in accompanying tables.

As noted above, the SEC encourages companies to present a tabular comparison of the results in different periods, with percentage changes, followed by a narrative discussion and analysis of the reasons for material changes and their implications. The SEC intends the discussion to provide meaningful discussion of the underlying reasons for the change and to avoid simply reciting amounts that changed in the financial statements.

5.3 Results of operations

In discussing the results of operations, management should:

- ▶ Describe any unusual or infrequent events or transactions or any significant economic changes that materially affect income from continuing operations and the extent to which income was affected
- ▶ Describe any other significant components of revenue or expense necessary to understand the results of operations
- ▶ Describe any known trends, events or uncertainties that have had, or are reasonably likely to have, a material effect on sales, revenue or income from continuing operations
- ▶ Disclose any future changes in the relationship between costs and revenue if events are known that are reasonably likely to cause a material change, such as known future increases in labor or materials costs or prices
- ▶ Discuss the extent to which material changes in net sales or revenue are the result of changes in sales volume, introduction of new products or services or sales prices
- ▶ Discuss current-year changes in idle facilities when such changes materially affect the results of operations

Discussion of commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have or are reasonably likely to have a material current or future effect on a registrant's revenues or expenses or results of operations must be provided even when the arrangement results in no obligations being reported in the registrant's consolidated balance sheets. See section 5.5 for further discussion of these commitments and obligations. The SEC has stated that "appropriate disclosure in MD&A should be considered and may be required" in the following circumstances:

- ▶ When material unusual or nonrecurring items, aberrations or other significant fluctuations are reflected in a company's financial statements, disclosure may be needed to ascertain the likelihood that past performance will be indicative of future performance, after considering the extent of variability in earnings and cash flows.
- ▶ If the economic characteristics of any business arrangements, or the methods used to account for them, materially affect results of operations or liquidity "in a structured or unusual fashion," disclosure may be needed to understand those effects.

5.3.1 Effect of inflation and changing prices

If a macroeconomic factor, such as a change in prices, has a material impact on a registrant's business, the registrant should discuss it as part of its explanation of results of operations by factor in qualitative and quantitative terms, as required by Item 303(b). In recent comment letters, the SEC staff has requested that registrants disclose the material impacts of inflationary pressures and what they are doing to mitigate those effects. See our *SEC Reporting Update: Highlights of trends in 2022 SEC comment letters* publication for additional details.

5.3.2 Climate change

While the SEC hasn't yet finalized new climate-related disclosure requirements as noted in section 1, the SEC staff has issued comment letters to registrants about their compliance with the SEC's 2010 guidance on this topic. The staff's comments align with the **sample comment letter** that the staff posted on the SEC website in September 2021 to illustrate the types of comments it had begun issuing to companies about their compliance with the 2010 guidance and whether information they included voluntarily in separate corporate social responsibility reports should be included in annual reports filed with the SEC.⁷² See our Technical Line, *Revisiting the SEC's guidance on climate change disclosures in today's environment* and our *SEC Reporting Update: Highlights of trends in 2022 SEC comment letters*.

The 2010 guidance identifies factors companies should consider when assessing whether to include climate-related disclosures in MD&A, including:

- ▶ Legislation and regulation
- ▶ International accords
- ▶ Indirect consequences of regulation or business trends
- ▶ Physical effects of climate change

Legislation and regulation: Significant developments in federal and state legislation and regulation regarding climate change could trigger disclosure obligations under Item 303 of Regulation S-K. Item 303 requires a company to assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on its financial condition or results of operations. In the case of a known uncertainty, such as proposed legislation or regulation, the guidance indicates that assessing potential MD&A disclosure requirements consists of two steps. First, management must evaluate whether the proposed legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, management must proceed on the assumption that the legislation or regulation will be enacted. Second, management must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the company's business. Unless management determines that a material effect is not reasonably likely, disclosure is required in MD&A regarding the legislation.

In addition to disclosing the potential effect of proposed legislation or regulation, the company also would have to consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the proposed legislation or regulation.

The guidance states that a company should not limit its disclosure of the reasonably likely effects of a proposed law to potential negative consequences. The guidance observes that changes in laws or in business practices of some companies in response to those changes may provide new opportunities.

⁷² FRR-82 (SEC Release No. 33-9106), *Commission Guidance Regarding Disclosure Related to Climate Change*.

The guidance identifies several examples of possible consequences of proposed legislation and regulation related to climate change, including:

- ▶ Costs to purchase, or profits from sales of, allowances or credits under a “cap and trade” system
- ▶ Costs required to improve facilities and equipment to reduce emissions to comply with regulatory limits or to mitigate the financial consequences of a “cap and trade” regime
- ▶ Changes to operating profitability arising from increased or decreased demand for goods and services produced by the company arising directly from legislation or regulation, and indirectly from changes in costs of goods sold

International accords: The guidance indicates that, if material, companies should disclose the effect on their business of treaties or international accords relating to climate change. Companies operating in countries that signed the Paris Agreement, which set a long-term temperature goal, may consider disclosing the effects of any national policies, laws or regulations aimed at reducing emissions to meet that commitment.⁷³ The guidance suggests that companies reasonably likely to be affected by such agreements should monitor the progress of any potential agreements and consider the potential effects.

Indirect consequences: Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. The guidance identifies the following potential indirect consequences or opportunities:

- ▶ Decreased demand for goods that produce significant greenhouse gas emissions
- ▶ Increased demand for goods with lower emissions than competing products
- ▶ Increased competition to develop innovative products
- ▶ Increased demand for generation and transmission of energy from alternative sources
- ▶ Decreased demand for services related to carbon-based energy sources, such as drilling services or equipment maintenance services

These business trends or risks may require disclosure in MD&A.

Physical effects: The guidance indicates that significant physical effects of climate change, such as the severity of weather (e.g., floods, hurricanes), sea levels, the arability of farmland and water availability and quality have the potential to affect a company's operations and results. For example, severe weather can cause damage to physical plants and facilities and can disrupt manufacturing and distribution processes.

5.3.3

Cybersecurity

Until the SEC finalizes the proposed cybersecurity disclosure requirements noted in section 1, registrants should consider the February 2018 interpretive release the SEC issued to help companies prepare disclosures about cybersecurity risks and incidents. The release includes a framework for registrants to consider when evaluating whether to disclose information about risks and incidents involving cybersecurity. The framework is similar to the one previously established by the SEC staff in CF Disclosure Guidance: Topic No. 2 *Cybersecurity*.

⁷³ The Paris Agreement, United Nations Climate Change: <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>.

The Commission interpretive guidance instructs registrants to consider the risks associated with cyber attacks and breaches when making disclosure. Cyber attacks include gaining unauthorized access, corrupting data, disrupting the operations of the registrant or its business partners and denial-of-service attacks on websites.

While there are currently no specific SEC disclosure rules that refer to cybersecurity risks or cyber incidents, the Commission's interpretive release summarized the applicability of existing Regulation S-K requirements to cybersecurity risks and incidents that could have a material effect on a registrant's financial statements. The guidance also notes that material cybersecurity risks or cyber incidents must be disclosed when necessary to make other required disclosures, in light of the circumstances, not misleading.

The release also reminds registrants to consider cyber matters in the context of various policies such as those for insider trading and selective disclosure (Regulation FD). Where a company has become aware of a cybersecurity incident or risk that would be material to its investors, the SEC would expect it to make appropriate disclosure timely and sufficiently prior to the offer and sale of securities and to take steps to prevent directors and officers (and other corporate insiders who were aware of these matters) from trading its securities until investors have been appropriately informed about the incident or risk.

The SEC expects registrants to consider the direct and indirect effects of cyber incidents such as costs for remediation, protection and litigation, as well as implications of possible theft of intellectual property, customer information or other sensitive data, and the related reputational damage with customers and investors. Registrants also should consider the potential for lost revenues.

Registrants should address cybersecurity risks and cyber incidents in their MD&A if the costs or other consequences associated with one or more known incidents or the risks of potential incidents represent a material event, trend or uncertainty that is reasonably likely to have a material effect on the registrant's results of operations, liquidity or financial condition or would cause reported financial information not to necessarily be indicative of future operating results or financial condition as described in Item 303 of Regulation S-K.

For example, if material intellectual property is stolen in a cyber attack, and the effects of the theft are reasonably likely to be material, the registrant should describe the property that was stolen and the effect of the attack on its results of operations, liquidity and financial condition and whether the attack would cause reported financial information not to be indicative of future operating results or financial condition. If it is reasonably likely that the attack will lead to reduced revenues, an increase in cybersecurity protection costs, including litigation, the registrant should discuss these possible outcomes, including the amount and duration of the expected costs, if material. Alternatively, if the attack did not result in the loss of intellectual property, but it prompted the registrant to materially increase its cybersecurity protection expenditures, the registrant should note those increased expenditures.

In addition to MD&A, registrants should also consider the need to address cybersecurity risks and cyber incidents in their risk factor disclosures (Item 105 of Regulation S-K as discussed in section 3 of this publication), description of a business (Item 101 of Regulation S-K as discussed in section 3 of this publication), legal proceedings disclosures (Item 103 of Regulation S-K as discussed in section 3 of this publication), financial statement disclosures and management's assessment of the effectiveness of disclosure controls and procedures (Item 307 of Regulation S-K as discussed in section 4 of this publication).

Given the increasing frequency and severity of cyber attacks and the release of the interpretive guidance, we believe the SEC staff is likely to focus on cybersecurity disclosure matters in its filing reviews.

For additional information on cybersecurity disclosures, see our publications, **[SEC Reporting Update: Highlights of trends in 2022 SEC comment letters](#)** and **[SEC Reporting Update: SEC issues guidance on cybersecurity](#)**.

5.3.4 Pro forma MD&A

When a registrant has a material acquisition or applies pushdown accounting (as discussed further in section 6 of this publication), it should consider whether to include a supplemental discussion in MD&A based on pro forma financial information. When determining whether a supplemental discussion based on pro forma information is necessary, the registrant should consider all the facts and circumstances surrounding the transaction, the nature of the pro forma adjustments to be made and the overall meaningfulness of the supplemental discussion.

For example, if the application of pushdown accounting in historical financial statements results in separate predecessor and successor periods, the historical financial statements may not be comparable. As a result, the registrant may determine that a discussion based on pro forma financial information would be meaningful to investors.

If a pro forma MD&A discussion is deemed appropriate, the registrant should clearly disclose why management believes the presentation is meaningful, how the presentation was derived and whether there are any risks or limitations associated with the presentation (e.g., the results might not necessarily be indicative of future results). In addition, the registrant should not present the pro forma results more prominently than the discussion about the historical results required by Item 303 of Regulation S-K.

The SEC staff believes that the pro forma presentation should be presented in a format consistent with Article 11 of Regulation S-X.⁷⁴ The SEC staff said that it would not be appropriate to merely combine the pre- and post-transaction results without reflecting all relevant pro forma adjustments required by Article 11. Refer to *Pro forma financial information: A guide for applying Article 11 of Regulation S-X* for additional information.

When a registrant concludes that its adoption of a new accounting standard using a retrospective approach has significantly affected the comparability of financial statements for the periods presented, it may present supplemental pro forma MD&A to help explain changes in its financial statement line items. These disclosures, if presented, should focus on (1) the effect on each financial statement line item affected by such retrospective treatment (i.e., revenue and expense line items) and (2) the assumptions that the registrant used in estimating the effect on the prior-year information presented (e.g., any practical expedients applied, date of adoption).

5.4 Liquidity and capital resources

Registrants must analyze their ability to generate and obtain cash and to meet their requirements and plans for cash in the short term (i.e., 12 months from the most recent fiscal period end presented) and separately in the long term. The discussion should analyze material cash requirements from known contractual obligations (e.g., lease obligations, purchase obligations, other liabilities reflected on the registrant's balance sheet) and other obligations and specify the type of obligation and the relevant time period for the related cash requirements. Cash requirements include capital expenditures and other material items, such as research and development, human capital, and intellectual property.

Some companies may choose to present a contractual obligations table. The table was previously required by Regulation S-K, but that requirement was rescinded by **Release 33-10890, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information** dated 19 November 2020.

⁷⁴ The SEC staff said that other formats (e.g., pro forma information specified by ASC 805) also may be appropriate depending on the specific facts and circumstances.

A discussion of commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have or are reasonably likely to have a material current or future effect on a registrant's liquidity, cash requirements or capital resources must be provided, even when the arrangement results in no obligations being reported in the registrant's consolidated balance sheet. See section 5.5 for further discussion of these commitments and obligations.

Based on these objectives, registrants must provide the following disclosures:

- ▶ Liquidity - A registrant must identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way. If a material deficiency is identified, indicate the course of action that the registrant has taken or proposes to take to remedy the deficiency. A registrant must also identify and separately describe internal and external sources of liquidity and briefly discuss any material unused sources of liquid assets. Except where it is otherwise clear from the discussion, the registrant must discuss balance sheet conditions or income or cash flow items that the registrant believes may be indicators of its liquidity condition.

Where financial statements presented are required by Rule 4-08(e)(3) of Regulation S-X to include disclosure of restrictions on the ability of both consolidated and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances, the discussion of liquidity must include a discussion of the nature and extent of such restrictions and the impact such restrictions have had or are reasonably likely to have on the ability of the parent company to meet its cash obligations.

- ▶ Capital resources - A registrant must describe its material cash requirements, including commitments for capital expenditures, as of the end of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements and the general purpose of such requirements.

A registrant must also describe any known material trends, favorable or unfavorable, in the registrant's capital resources and indicate any reasonably likely material changes in the mix and relative cost of such resources. The discussion must consider changes among equity, debt and any off-balance sheet financing arrangements.

Although this is not required by the SEC's rules or interpretive releases, registrants should consider available internal cash flow projections in analyzing liquidity and capital resources. Such projections likely would be helpful in identifying any expected material changes in liquidity. Further, as discussed in a 1994 enforcement release, identification of a future material liquidity deficiency based on internal cash flow projections likely would be considered by the SEC to be a "known trend" that would require discussion in MD&A.

Registrants commonly organize their discussion of liquidity and capital resources around the categories presented in their statements of cash flows (i.e., operating, investing and financing). That's because the SEC expects a company's discussion and analysis of liquidity to focus, in part, on material changes in the operating, investing and financing cash flows depicted in its statements of cash flows and to present a balanced discussion dealing with cash flows from investing and financing activities, as well as from operations. However, that discussion should not be merely a recitation of the items in the statements of cash flows. It should focus on the underlying drivers of change.

The following bullets include additional guidance on liquidity and capital resources disclosure:⁷⁵

- ▶ Discuss material changes in the underlying drivers when discussing changes in operating, investing and financing activity cash flows – The SEC warns that a registrant's MD&A discussion of cash flows from operating activities should not be limited to discussing changes in the line items that reconcile net income to operating cash flows. Instead, the SEC expects all companies to address material changes in the underlying drivers of operating cash flows (e.g., cash receipts from the sale of goods and services and cash payments to acquire materials for manufacture or goods for resale).⁷⁶
- ▶ Discuss changes in cash received from customers and other sources and cash paid to suppliers, employees and others – The operating activities discussion should provide information on changes in cash received from customers and other sources and cash paid to suppliers, employees and others. Instead of providing a summary of the statement of cash flows prepared using the indirect method, a company might consider discussing increases in supplier costs and the extent to which it passed those costs along to customers.
- ▶ Discuss any known trends and uncertainties that are reasonably expected to have material effects on the separate sources and uses of cash – The operating activities discussion also should discuss any known trends and uncertainties that are reasonably expected to have material effects on the separate sources and uses of cash. Examples mentioned by the SEC staff included new product releases, pricing changes, maturing product lines, rising costs and changes in credit terms.
- ▶ Evaluate capital expenditures on a discretionary and non-discretionary basis (e.g., new capacity expansion versus maintenance of existing capacity) and discuss anticipated funding sources (e.g., the extent that cash received from customers will be available) – The SEC staff observed that companies typically disclose the quantity of historical and anticipated capital expenditures in the investing activities discussion. Companies should consider separately disclosing capital expenditures that are discretionary and those that are nondiscretionary and discuss any anticipated funding sources. In addition, if a company believes it is reasonably likely that it will be required to reduce or delay capital expenditures, it could describe the effect of these reductions and delays to cash flows from customers.
- ▶ Discuss the availability of funds from investments – For example, companies may need to disclose in the investing activities discussion that material funds invested in investments designated as held to maturity are not available for immediate use.
- ▶ Discuss the availability of credit – The financing activities discussion should include the potential effect on liquidity of (1) financing arrangements that are reasonably likely to be available to the company, (2) financing arrangements that the company would like to use but are no longer available or are reasonably likely to become unavailable, (3) difficulties accessing the debt markets, (4) reliance on commercial paper or other short-term financing arrangements, (5) maturity mismatches between borrowing sources and the assets funded by those sources and (6) changes in borrowing terms requested by counterparties and changes in the valuation of collateral and counterparty risk.

⁷⁵ This guidance was developed under the legacy rules prior to their amendment on 19 November 2020 (**Release 33-10890, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information***) and is based on interpretations provided by the SEC or its staff that we believe remain relevant under the amended rules.

⁷⁶ For example, if a decrease in operating cash flows was caused by a revised credit policy resulting in extended payment terms, the SEC would expect the company to disclose this in MD&A, to the extent material, as well as the amount of the associated decrease in operating cash flow if not otherwise apparent. In addition, the SEC would expect the company to disclose the expected future implications of a new credit policy to liquidity.

Narrative disclosure should be considered, and may be required, if the company's financial statements do not adequately convey the registrant's financing arrangements during the period, or the effect of those arrangements on liquidity. For example, if borrowings during the period are materially different from the period-end amounts recorded in the financial statements, FRR-83, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*, states that MD&A must disclose the intra-period variations to facilitate investors' understanding of the company's liquidity position.

For companies with repurchase agreements, the MD&A discussion of liquidity should consider whether obligations to repurchase assets are reasonably likely to result in the use of a material amount of cash or other liquid assets. Even if the repurchase obligation involves a transaction accounted for as a sale under applicable accounting standards, FRR-83 states that disclosures about the repurchase obligation may be required in the MD&A discussion of liquidity.

- ▶ Discuss the factors that might materially influence credit ratings, the potential implications of known or reasonably likely changes in credit ratings or credit rating outlook and management's expectations about credit rating prospects – The simple disclosure of a company's credit ratings from each of the major credit rating agencies provides limited value to investors. If a company does not expect a ratings downgrade, a company could disclose its basis for that conclusion. If a company anticipates that a ratings downgrade might occur in the foreseeable future, the company could consider disclosing in the financing activities discussion the reasonably likely expected changes in borrowing costs, costs of capital and the future operating prospects of the company.⁷⁷
- ▶ Discuss any uncertainty or trends surrounding future compliance with financial covenants and the material implications of a breach. When the filing provides actual ratios or amounts under the agreement, also consider providing the company-specific calculations⁷⁸ – The SEC staff recommended that a company explain the basis for conclusions about compliance with debt covenants, including those affecting debt obligations the company guarantees. For example, the financing activities discussion also might include disclosures about a company's expectation of meeting debt covenant requirements in the short-term and long-term. In addition, a company should consider disclosing any reasonably likely ratings downgrades and the effect on financial covenants. If a breach of financial covenants is reasonably likely, FRR-72, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, suggests that the company disclose that fact and analyze the effect, including the following, if material⁷⁹:
 - ▶ The steps that the company is taking to avoid the breach
 - ▶ The steps that the company intends to take to cure, obtain a waiver of or otherwise address the breach
 - ▶ The effect or reasonably likely effect of the breach (including the effects of any cross-default or cross-acceleration or similar provisions) on financial condition or operating performance
 - ▶ Alternate sources of funding to pay off resulting obligations or replace funding

⁷⁷ In its 7 October 2009 proposal, *Credit Ratings Disclosure*, the SEC reiterated the need for MD&A disclosure of the material effects of any change in a credit rating.

⁷⁸ In these circumstances, registrants should disclose the required ratios or amounts, as well as the actual ratios or amounts as of each reporting date, in order to allow investors to understand the amount of "cushion" available. The SEC staff also has asked registrants to consider showing the specific computations used to arrive at the actual ratios or amounts (with corresponding reconciliations to US GAAP amounts, if necessary).

⁷⁹ FRR-72 indicates that similar disclosure expectations would apply to mandatory prepayment provisions, "put" rights and other similar provisions.

- ▶ Discuss whether covenants affect the company's ability to incur additional debt or equity financing to a material extent⁸⁰ – If there are limitations to incur additional debt or equity financing, FRR-72 suggests that the company disclose that fact as well as:
 - ▶ The consequences of those limitations on the company's financial condition and operating performance
 - ▶ Alternate sources of funding and, to the extent material, the consequences (e.g., costs) of accessing those alternatives
- ▶ Discuss any uncertainties and reasonably likely implications related to loan facilities from banks and other lending institutions, the commercial paper market, cash and securities held at banks and other financial institutions, illiquid investments, future pension funding, share repurchase programs and dividend payments – Current market conditions call for complete disclosures about a company's liquidity and capital resources. Companies could provide insight into the possible material implications of any inability to access sources of funding that have been available in the past. The SEC staff believes that a company should discuss uncertainties about the future amounts of pension funding, as well as its ability to pay those amounts. Similarly, a company should discuss any uncertainties regarding its intentions to continue share repurchase and dividend payment programs.
- ▶ Discuss any material amount of debt incurred – Companies should explain the reason for incurring the debt, the use of the proceeds and how incurring the debt achieves the company's business objectives.⁸¹ On the other hand, if debt was incurred for general working capital purposes, companies should disclose the anticipated amount and timing of material working capital needs.⁸² These disclosures can be provided in the financing activities discussion.
- ▶ Discuss any other relevant relationships with counterparties or guarantors – For example, companies should discuss receivable positions with derivative counterparties and any financial guarantors (e.g., monoline insurers), if material, in the financing activities discussion.
- ▶ Provide the additional disclosures required when an opinion on a company's financial statements contains an explanatory paragraph about a going concern uncertainty – FRR Section 607.02 requires companies not only to provide disclosure in the notes to the financial statements of their financial difficulties and plans to overcome them, but also to present a detailed management discussion of material cash flows covering the 12-month period following the date of the financial statements. Such a discussion would be updated quarterly, as appropriate.

⁸⁰ FRR-72 indicates that examples of these covenants include, but are not limited to, debt incurrence restrictions, limitations on interest payments, restrictions on dividend payments and various debt-ratio limits.

⁸¹ For example, if debt were issued to fund the construction of a new plant that will allow the company to expand its operations into a new geographic area, the SEC would expect the company to disclose the reason for incurring the debt, as well as the expected commencement date of the plant operations.

⁸² FRR-72 also reminds companies of the requirement in Item 5 of Form 10-K and Item 701(f) of Regulation S-K to disclose the use of proceeds from offerings of registered securities.

5.5 Off-balance sheet arrangements

Instruction 8 to Item 303(b) states that a discussion of commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have or are reasonably likely to have a material current or future effect on a registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources must be provided in MD&A even when the arrangement results in no obligations being reported in the registrant's consolidated balance sheets. These arrangements may include⁸³:

- ▶ Guarantees
- ▶ Retained or contingent interests in assets transferred
- ▶ Contractual arrangements that support the credit, liquidity or market risk for transferred assets
- ▶ Obligations that arise or could arise from variable interests held in an unconsolidated entity
- ▶ Obligations related to derivative instruments that are both indexed to and classified in a registrant's own equity under US GAAP

To avoid repetition, a company's MD&A discussion of off-balance sheet arrangements is allowed to cross-reference information disclosed in the notes to its financial statements if specific, relevant information in those notes is clearly identified. If a company chooses to cross-reference its financial statement disclosures, its MD&A discussion still must integrate the substance of those disclosures and inform investors of the significant information included in the notes to the financial statements.

The specific types of off-balance sheet arrangements that should be considered for disclosure under the new instruction are discussed further below.

Guarantee contracts: Guarantee contracts to which the initial recognition and measurement provisions of ASC 460 apply:

- ▶ **Financial guarantees:** ASC 460 defines financial guarantees as contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in an "underlying" (e.g., specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable) that is related to an asset, liability or an equity security of the guaranteed party. Financial guarantees would include: (1) a financial standby letter of credit, which is an irrevocable guarantee of the payment of a specified financial obligation, (2) a market value or market price guarantee of either a financial asset (e.g., a debt or equity security) or a nonfinancial asset (e.g., real estate) owned by the guaranteed party, (3) a guarantee of the market price of the common stock of the guaranteed party, (4) a guarantee of the collection of the scheduled contractual cash flows from a loan and (5) a guarantee granted to a business or its owner(s) that the revenue of the business (or a specific portion of the business) will be at least a specified amount for a specified period of time.
- ▶ **Performance guarantees:** ASC 460 defines performance guarantees as contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement. Performance guarantees would include: (1) a performance standby letter of credit, which is an irrevocable undertaking by a guarantor to make payment in the event a specified third party fails to perform under a nonfinancial contractual obligation, and (2) a construction completion guarantee.

⁸³ Registrants should note that the categories of off-balance sheet arrangements contained in the disclosure requirements in Form 8-K, which are triggered when a registrant becomes subject to the obligation or commitment arising from an off-balance sheet arrangement, differ from the categories contained in the MD&A disclosure requirements.

- ▶ **Indemnifications:** ASC 460 defines indemnifications as agreements that contingently require the guarantor to make payments to an indemnified party based on changes in an underlying that is related to an asset, liability or an equity security of the indemnified party. Indemnifications would include agreements that require payments in the event of (1) an adverse judgment in a lawsuit, or (2) the imposition of additional taxes because of either a change in the tax law or an adverse interpretation of the tax law.
- ▶ **Indirect guarantees of the indebtedness of others:** ASC 460 defines indirect debt guarantees as agreements between the debtor and the guarantor requiring the guarantor to transfer funds to the debtor when (1) funds become available to creditors of the guaranteed party and (2) those creditors may enforce the debtor's claim against the guarantor. Indirect debt guarantees would include a keepwell agreement, which is an agreement or undertaking to provide funds or property, or arrange the provision of funds or property, to an affiliate or third-party in the event of deterioration in its net income or fixed charge coverage.

ASC 460 also includes two groups of specific exceptions to its scope. The first group is exempt from ASC 460 in its entirety, while the second group is subject to only the disclosure requirements of ASC 460. Registrants should consider whether disclosure of both groups of exceptions, all of which are listed below, is necessary.⁸⁴

- ▶ Employment-related costs, including deferred compensation contracts
- ▶ Stock issued to employees
- ▶ Uncertainty in income taxes
- ▶ A lessee's residual value guarantee in leases
- ▶ Guarantees accounted for as variable lease payments under ASC 842
- ▶ Guarantees or indemnifications issued by insurance and reinsurance companies and accounted for under ASC 944
- ▶ Measurement of credit losses for instruments in the scope of ASC 326
- ▶ Guarantees that constitute vendor rebates and profit margin guarantees
- ▶ Guarantees that obligate an entity to reacquire equipment at a guaranteed price at a specified time (i.e., a forward) or to accept a customer's request to reacquire the equipment (i.e., a put option), accounted for under the repurchase agreement guidance in ASC 606
- ▶ Guarantees whose existence prevents the guarantor from recognizing a sale or earnings from a sale (e.g., a transaction that involves the sale of a marketable security to a third-party buyer with the buyer having an option to put the security back to the seller at a specified future date or dates for a fixed price, if the existence of the put option prevents the transferor from accounting for the transaction as a sale, as described in ASC 860-20-55-20 through 55-23).
- ▶ A registration payment arrangement within the scope of ASC 825-20
- ▶ Guarantees of an entity's own performance (e.g., guarantee that an entity will complete a contract by a specified deadline)

⁸⁴ Prior to Release 33-10890, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, dated 19 November 2020, both groups of exceptions were excluded from the definition of off-balance sheet arrangements.

- ▶ Guarantees that are accounted for as derivative instruments at fair value under ASC 815
- ▶ Guarantees for which the underlying is related to the functional performance (not changes in price or value) of nonfinancial assets that are owned by the guaranteed party (e.g., product warranties)
- ▶ Contingent consideration in a business combination in the scope of ASC 805
- ▶ Guarantees for which the guarantor's obligation would be reported as an equity item, rather than a liability, under US GAAP (e.g., certain guarantees that can be settled in the guarantor's own equity shares)
- ▶ A guarantee by an original lessee that is relieved of its primary obligation under the original lease and has become secondarily liable under a new lease as discussed in ASC 842
- ▶ Intercompany guarantees: (1) a guarantee issued either between parents and their subsidiaries or between entities under common control, (2) a parent's guarantee of its subsidiary's debt to a third-party and (3) a subsidiary's guarantee of the debt owed to a third-party by either its parent or another subsidiary of that parent

Retained or contingent interests in assets transferred: Off-balance sheet arrangements include (1) any retained or contingent interest in assets transferred to an unconsolidated entity or (2) contractual arrangements that support the credit, liquidity or market risk for transferred assets.

Derivative instruments that are both indexed to and classified in a registrant's own equity under US GAAP: The only derivatives that are subject to the separate MD&A disclosure requirements involve obligations, including contingent obligations, under derivative instruments that are indexed to the company's own stock and classified as equity. Such derivatives are not reported as assets or liabilities, nor do changes in their value affect net income. The derivatives within the scope of the separate MD&A disclosure requirements are excluded from the scope of ASC 815.

For many of these types of contracts (e.g., forward sale contracts, written call options or warrants, purchased put options), following the initial recognition and measurement of the contract at fair value, there often is no subsequent accounting, or subsequent accounting only when the contract is settled. In other cases, the contract might be classified as temporary equity based on the amount of the potential cash redemption obligation. MD&A disclosure of the "risk of loss" from these types of contracts is required in all cases, regardless of whether the contract is classified as temporary or permanent equity, or whether the expected form of settlement is physical, net share or net cash. MD&A should address the implications to liquidity, capital resources and equity dilution of the reasonably likely settlement alternatives for equity derivatives.

Variable interests⁸⁵: Off-balance sheet arrangements subject to the separate MD&A disclosure requirements also include obligations arising out of a material variable interest in an unconsolidated entity. Under ASC 810, "variable interests" are contractual, ownership or other pecuniary interests in an entity that change with changes in the fair value of the entity's net asset value exclusive of variable interests.⁸⁶

⁸⁵ See our Financial reporting developments publication, *Consolidation: Determination of a controlling financial interest and accounting for changes in ownership interests*, for additional information.

⁸⁶ The determination of whether an enterprise holds a variable interest in an entity requires an economic analysis of the rights and obligations of the instrument or contract held by the enterprise. Variable interests are generally interests in the entity that are designed to absorb or receive the variability created by the entity's assets, liabilities or other contracts. That is, interests in a VIE that introduce risk into the entity are generally not variable interests in the entity, while interests in a VIE that absorb risk generally are variable interests in the entity.

The scope of the instruction is not limited to variable interests in an unconsolidated "variable interest entity," as defined in ASC 810. Rather, the scope of the instruction includes obligations arising out of variable interests held in any entity, even an entity that is not subject to the consolidation guidance provided by ASC 810. That is, the scope can include obligations arising out of variable interests in an entity in which the equity investors exercise control through voting rights and have a sufficient equity investment at risk such that the entity does not require subordinated financial support (i.e., a voting interest entity).

With respect to unconsolidated entities, MD&A disclosure is required of any obligation, including a contingent obligation, that is held by, and material to, the registrant and arises from a variable interest, as defined in the Accounting Standards Codification. ASC 810-10-55-16 through 55-41 provide examples of such variable interests, which include, but are not limited to:

- ▶ Equity investments
- ▶ Investments in subordinated beneficial interests⁸⁷ or subordinated debt instruments
- ▶ Written put options on the assets of the entity, or similar obligations that protect holders of senior interests from suffering losses
- ▶ Total return swaps and similar arrangements used to transfer substantially all of the risk related to certain assets without actually transferring the assets
- ▶ Contracts for services (e.g., management contracts) if the contracted compensation (whether fixed or variable) is designed to be different from the market value of the services provided

Disclosure threshold: MD&A disclosure is required for off-balance sheet arrangements (as defined) that have or are reasonably likely to have a material current or future effect on a registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources.

To determine whether MD&A disclosure is required for a particular off-balance sheet arrangement within the definition discussed above, management should assess the likelihood of the occurrence of any known trend, demand, commitment, event or uncertainty that could either require performance of a guarantee or other obligation, or require the company to recognize an impairment or other loss. If management objectively and reasonably concludes that the likelihood of occurrence is not reasonably likely, then no disclosure is required, even if the consequences of an occurrence could be material. If management cannot objectively and reasonably determine that such an occurrence is not reasonably likely, management then must evaluate the consequences assuming occurrence. Disclosure is required unless management determines that it is not reasonably likely that the effects would be material.

Disclosure of an off-balance sheet arrangement is not required until an unconditionally binding definitive agreement exists or such an agreement is subject to only customary closing conditions. In the absence of such agreement, disclosure is not required until settlement of the transaction occurs. Thus, companies are not required to disclose off-balance sheet arrangements that are still being negotiated. However, if settlement of an arrangement occurs after the balance sheet date but before the date of the SEC filing, the company would have to consider whether disclosures are required in MD&A, in addition to any separate Form 8-K report related to the contract or transaction.

⁸⁷ The Accounting Standards Codification defines beneficial interests as "rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to all of the following: (a) senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through, (b) premiums due to guarantors, (c) commercial paper obligations and (d) residual interests, whether in the form of debt or equity."

Disclosures: The instruction does not include itemized disclosure requirements for off-balance sheet arrangements within its scope. However, the legacy rules (prior to **Release 33-10890, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information** dated 19 November 2020) did include such requirements that we believe can be helpful. A registrant should consider these legacy requirements when preparing its current disclosure and include it within the MD&A section or sections that correspond to its impact. The requirements in the legacy instruction included the following and generally covered material changes from the previous fiscal year:

- ▶ **Nature and business purpose.** A company must disclose the nature and business purpose of the arrangement.
- ▶ **Financial importance.** A company must disclose the importance of the arrangement to liquidity, capital resources, market risk support, credit risk support or other benefits.
- ▶ **Financial effect and exposure to risk.** A company must disclose:
 - ▶ Amounts of revenues, expenses and cash flows arising from the arrangement
 - ▶ The nature and amount of any interests retained, securities issued and other indebtedness incurred by the company in connection with the arrangement
 - ▶ The nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the company arising from the arrangement that are, or are reasonably likely to become, material and the triggering events or circumstances that could cause them to arise
- ▶ **Contingencies involving continued availability.** A company must disclose:
 - ▶ Any known event, demand, commitment, trend or uncertainty that will, or is reasonably likely to, result in the termination or material reduction in availability of an arrangement that provides material benefits
 - ▶ The course of action that the company has taken, or proposes to take, in response to any such circumstances

Contingencies could also result in the termination or limitation of an off-balance sheet arrangement, such as adverse changes in the company's credit rating, financial performance or ratios, stock price and the value of underlying or indexed assets.

5.6 Known trends, events, demands, commitments and uncertainties

One of the most difficult judgments management makes in MD&A relates to known "trends, events and uncertainties" that might affect future earnings or other measures of performance.

Item 303 of Regulation S-K indicates that registrants should describe any known trends or uncertainties that have had, or that are reasonably likely to have, a material favorable or unfavorable effect on financial results.

The discussion should highlight known material trends, events and uncertainties that are reasonably likely to cause the reported financial information not to be necessarily indicative of future operating results or financial condition. This includes discussion of both (1) matters that would have an effect in the future and have not had an effect in the past and (2) matters that have had an effect in the past and are not expected to have an effect in the future.

A discussion of known trends, events and uncertainties is required unless management determines that (1) the known trend, event or uncertainty "is not reasonably likely to occur" or (2) assuming that the known trend, event or uncertainty comes to fruition, that its consequences would not be reasonably likely to have a material effect on financial condition or results of operations. The SEC believes that "reasonably likely" is a lower disclosure threshold than "more likely than not."

Adding to the difficulty of judging the potential effect of known events is the SEC's acknowledgment that it has, and will continue to use, the benefit of hindsight in evaluating filings. However, any forward-looking information supplied in MD&A might be covered by either (1) the SEC's safe harbor rules (Securities Act Rule 175 and Exchange Act Rule 3b-6), as long as the necessary conditions are met (i.e., the forward-looking information was prepared on a reasonable basis and disclosed in good faith) or (2) the statutory safe harbor for forward-looking information (see Forward-looking information in section 2 of this publication). The SEC also provides its views on important factors to be considered in formulating and disclosing projections in Item 10(b) of Regulation S-K, such as the appropriate basis and format for projections, and how to facilitate investor understanding of projections, and in particular, their limitations. As part of their disclosure controls and procedures (Exchange Act Rules 13a-15 and 15d-15), registrants should consider all known trends, events and uncertainties as part of the MD&A preparation process and consider documenting the reasons for disclosure or nondisclosure.

To identify known trends and uncertainties, the SEC suggests that a company consider financial, operational and other information (including nonfinancial information) known to the company. The SEC also suggests that companies consider whether or not the available information itself is material and should be disclosed. FRR-72 states, "This information, over time, may reveal a trend or general pattern in activity, a departure or isolated variance from an established trend, an uncertainty, or a reasonable likelihood of the occurrence of such an event that should be disclosed." FRR-72 adds that quantification of the material effects of known material trends and uncertainties "should be considered and may be required to the extent material if quantitative information is reasonably available."

In addition, ASC 275-10-50-16 requires disclosures in the notes to the financial statements about vulnerability from concentrations when all three of the following conditions are met:

- ▶ The concentration of risk exists at the date of the financial statements
- ▶ The concentration makes the enterprise vulnerable to the risk of a near-term "severe impact"⁸⁸
- ▶ It is at least reasonably possible that the events that could cause the severe impact will occur in the near-term

Companies should consider whether they have concentrations in volume of business transacted with a particular customer, supplier or lender; revenue from particular products or services; available sources of supply materials, labor or services; or market or geographical area in which they operate that might meet the three criteria above.

5.6.1 Sovereign debt exposures

In January 2012, the SEC staff issued CF Disclosure Guidance: Topic No. 4, *European Sovereign Debt Exposures*, to help registrants determine what they should disclose in MD&A about their exposures to countries experiencing significant economic, fiscal or political challenges, when default is more likely to occur than if such factors did not exist.

⁸⁸ The Accounting Standards Codification defines "severe impact" as "a significant financially disruptive effect on the normal functioning of the entity. Severe impact is a higher threshold than material. Matters that are important enough to influence a user's decisions are deemed to be material, yet they may not be so significant as to disrupt the normal functioning of the entity. Some events are material to an investor because they might affect the price of an entity's capital stock or its debt securities, but they would not necessarily have a severe impact on (disrupt) the enterprise itself. The concept of severe impact, however, includes matters that are less than catastrophic."

The SEC staff's guidance does not list the specific countries subject to enhanced disclosure. Instead, the SEC staff expects registrants to use their own judgment in determining for which countries to provide disclosures. The SEC staff noted that the countries for which these disclosures are made will change as risks change over time. Registrants should disclose in MD&A their basis for identifying countries included in their enhanced disclosure.

This interpretive guidance indicates that the following should be included in MD&A on a country-by-country and financial statement category basis for those countries identified as representing heightened exposure of the registrant:

- ▶ Gross funded exposures
- ▶ Gross unfunded commitments
- ▶ Net funded exposures

5.7

Critical accounting policies and estimates

Item 303(b)(3) defines critical accounting estimates as estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had, or are reasonably likely to have, a material impact on the registrant's financial condition or results of operations. For each critical accounting estimate, registrants are required to disclose:

- ▶ Why the estimate is subject to uncertainty
- ▶ How much the estimate and/or assumption has changed over a relevant period⁸⁹
- ▶ The sensitivity of the reported amounts to the methods, assumptions and estimates underlying the estimate's calculation

In addition, the discussion should provide quantitative as well as qualitative information when this information is material and reasonably available. That is, for both qualitative and quantitative information, the disclosure requirement is triggered if the information is necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had, or is reasonably likely to have, on the registrant's financial condition or results of operations. Furthermore, the critical accounting estimates disclosure must supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements.

Because critical accounting estimates and assumptions are based on matters that are highly uncertain, the SEC believes that companies should analyze their specific sensitivity to change based on other outcomes that are reasonably likely to occur and would have a material effect. The SEC believes that companies should provide a quantitative, as well as qualitative disclosure, when quantitative information is reasonably available and would provide material information.⁹⁰

In particular, the SEC staff has noted that registrants' disclosures about critical accounting policies and estimates often are too general and should be expanded to include a description of the significant estimates and assumptions made by management. Some of the areas that the SEC staff has commented

⁸⁹ Item 303(b)(3) does not specify the period over which a registrant should discuss the changes in the estimate or assumption. However, pursuant to SEC Release No. 33-10890 dated 19 November 2020, this approach is intended to give registrants the flexibility to determine the relevant period necessary to describe material changes in estimates or assumptions that would facilitate an understanding of estimation uncertainty, consistent with the principles-based nature of MD&A.

⁹⁰ For example, if reasonably likely changes in the long-term rate of return used in accounting for a company's pension plan would have a material effect on the company's financial condition or results of operations, the SEC believes that the company should disclose and quantify the effect that could result given the range of reasonably likely outcomes.

on include allowance for loan losses, contingencies, derivatives, goodwill and other asset impairments, inventory, pensions and other postretirement benefit costs and obligations, recognition of intangible assets as part of a business combination, revenue recognition and share-based payments.

Illustration 5-2: MD&A: Critical accounting policies & estimates

The Company's accounting policies are more fully described in Note 1 of the Consolidated Financial Statements. As disclosed in Note 1, the preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ significantly from those estimates. The Company believes that the following discussion addresses the Company's most critical accounting policies, which are those that are most important to the portrayal of the Company's financial condition and results of operations and require management's most difficult, subjective and complex judgments.

Pension benefits

The Company sponsors multiple defined benefit pension plans that cover certain US employees. For a description of our related accounting policies, refer to Note 2 in the consolidated financial statements. Changes in significant assumptions could materially affect the amounts, particularly the long-term rate of return on plan assets and the rate used to discount the projected benefit obligation:

- ▶ Return on plan assets – The Company determines the expected long-term rate of return on plan assets based on the building block method, which consists of aggregating the expected rates of return for each component of the plan's asset mix. The Company's assumed expected rate of return considers past returns on plan assets as well as various other factors, such as the plans' investment guidelines, the expected mix of asset classes and current market conditions. The expected long-term rate of return on plan assets was 7.25% and 7.50% as of December 31, 20Y3 and 20Y2, respectively. The decline in the expected long-term rate of return is primarily attributed to a shift in the plan asset mix to fixed-income securities from equities, which comprised 42% and 37% of plan assets as of December 31, 20Y3 and 20Y2, respectively.
- ▶ Discount rate – When estimating this rate, the Company analyzes the rates of return on high-quality, fixed-income investments that receive one of the two highest ratings from a recognized rating agency and the schedule of expected cash needs of the plans. The Company estimated discount rates of 4.50% and 3.75% at December 31, 20Y3 and 20Y2, respectively.

The following illustrates the effects of a 1% change in the discount rate or return on plan assets (in millions) on the net periodic benefit cost and projected benefit obligation:

Assumption	Change	20Y4 net periodic benefit cost	20Y3 projected benefit obligation
Discount rate	1% increase	\$ (8)	\$ (85)
	1% decrease	9	90
Return on plan assets	1% increase	(15)	N/A
	1% decrease	15	N/A

For 20Y4, we expect net periodic pension cost to decline by approximately \$2 million due to the 75-basis point increase in the discount rate partially offset by the 25-basis point decline in the expected long-term rate of return due to the shift in plan asset mix.

In addition, ASC 275-10-50-8 requires disclosures in the notes to the financial statements about certain significant estimates when information that is known to management prior to the issuance of financial statements meets both of the following criteria: (1) it is at least reasonably possible (as defined in the

Accounting Standards Codification) that management's estimate of the effect on the financial statements of a condition, situation or set of circumstances existing at the date of the financial statements will change in the near-term as a result of one or more future confirming events and (2) the effect of the change would be material to the financial statements. The disclosure should indicate the nature of the uncertainty and an indication that it is at least reasonably possible that a change in the estimate will occur in the near-term. Disclosure of the factors that cause the estimate to be sensitive to change also is encouraged but not required.

5.7.1 Impairment of goodwill

The SEC staff may ask registrants to provide more robust disclosures about their critical accounting estimates related to goodwill impairment testing and the details of any recognized goodwill impairments. The SEC staff has asked in its comments for more discussion in MD&A of the following:

- ▶ 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, how goodwill is assigned to reporting units, and how the implied fair value of goodwill is derived in the second step
- ▶ The facts and circumstances leading to an impairment
- ▶ How the fair value of each reporting unit was estimated, including the significant assumptions and estimates used
- ▶ Any reporting unit with a material amount of goodwill whose estimated fair value does not substantially exceed its carrying amount (i.e., the reporting unit is "at risk" of failing a future Step 1 impairment test)

When the SEC staff believes that the factors resulting in a goodwill impairment have not been satisfactorily disclosed, the SEC staff frequently requests additional information as to the factors and circumstances leading to the impairment.

Even if no impairment is identified in a particular reporting period, the SEC staff expects registrants to provide comprehensive disclosures of their critical accounting estimates in MD&A related to goodwill impairment testing. The SEC staff frequently issues comments when these disclosure requirements are not met or the disclosures are not clear and meaningful. At a minimum, the disclosures should include:

- ▶ The annual assessment date and a description of when an interim test is required (e.g., whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of the reporting unit).
- ▶ A description of how the estimated fair value of a reporting unit is determined and the significant assumptions used in that analysis

Although detailed information such as the fair value or the carrying amount of reporting units is not required by GAAP, the SEC believes that meaningful information about the potential for a future goodwill impairment should be included in MD&A. The SEC staff frequently asks that registrants discuss in MD&A the possibility of future impairment of goodwill for any reporting unit that may have a material amount of goodwill "at risk." Specifically, the SEC staff expects a registrant's MD&A to disclose the following for reporting units that are "at risk" of impairment:⁹¹

- ▶ The percentage by which the fair value exceeds the carrying value as of the most recent impairment test

⁹¹ If a registrant does not have any reporting units that are at risk of failing Step 1 of the goodwill impairment test, that fact should be disclosed in MD&A.

- ▶ The amount of goodwill assigned to the reporting unit
- ▶ A qualitative discussion of key assumptions that drive the fair value of the reporting unit (i.e., the SEC staff encourages, but does not require, disclosure of the key numerical assumptions or a quantitative sensitivity analysis) and how the assumptions were determined
- ▶ A discussion of the degree of uncertainty associated with the key assumptions, including specifics to the extent possible (e.g., the valuation model assumes recovery from a business downturn within a defined period of time)
- ▶ A discussion of any potential events and/or circumstances that could reasonably be expected to negatively affect the key assumptions

While no bright lines exist to determine whether a reporting unit's goodwill is "at risk," the SEC staff has stated that it expects a registrant to apply judgment when making those disclosures.

The SEC staff also may question whether adequate disclosure was made in previous filings when a goodwill impairment charge is recorded for a reporting unit that was not previously disclosed as being at risk. Further, the SEC staff may challenge the timing of a goodwill impairment charge, particularly when the reasons for the charge existed in prior periods.

5.7.2 Income taxes

The SEC expects registrants to provide in MD&A certain disclosures relating to income taxes. These disclosures are discussed in greater detail in our *SEC annual shareholders' report checklist* (EY Form A150).

The SEC staff has expressed concerns that registrants' income tax disclosures in MD&A often don't tell a complete story about the company's tax positions and related trends and uncertainties. Discussed below are some types of disclosures registrants should consider:

Realizability of deferred tax assets – The SEC staff routinely requests disclosures to be included in MD&A regarding uncertainties that might exist about the realization of deferred tax assets that are not offset by deferred tax liabilities. The SEC staff has requested that registrants include the following in their MD&A:

- ▶ Disclosure of the basis for management's determination that it is more likely than not that the net deferred tax asset will be realized.
- ▶ Disclosure of the types of uncertainties that may affect the ultimate realization of deferred tax assets (e.g., those related to estimates of future taxable income)
- ▶ Disclosure of the registrant's intention to evaluate the realizability of the deferred tax asset quarterly by assessing the need for a valuation allowance

Examples of uncertainties related to future taxable income may include:

- ▶ Possible declines in sales, margins and revenues stemming from a variety of sources, such as loss of market share, technological obsolescence or increased competition
- ▶ The amount of expected future taxable income that would have to be generated to realize the deferred tax assets, and whether the existing levels of pretax earnings for financial reporting purposes are sufficient to generate that minimum amount of future taxable income
- ▶ The period that future taxable income would have to be earned to realize the deferred tax asset
- ▶ Whether the source of the expected future taxable income will stem from ordinary and recurring operations or whether sales of operating assets will be necessary to achieve the required levels of income

- ▶ If the source of the expected future taxable income is from other than ordinary and recurring operations, the amount of taxable income that could be generated from those transactions should be disclosed along with a discussion of how management plans to consummate those transactions and any material uncertainties that could affect those transactions.

See our FRD, *Income taxes*, for further discussion about the disclosure of the realizability of deferred tax assets in MD&A.

Income tax rate reconciliations – The income tax rate reconciliation in the notes to the financial statements identifies and quantifies differences between the amount of reported total income tax expense or benefit from continuing operations and the amount computed by multiplying the pretax income or loss from continuing operations by the domestic federal statutory income tax rate, showing the nature and amount (using percentages or dollar amounts) of each significant reconciling item. The SEC staff believes this tabular disclosure provides a great source of information for MD&A. In addition, the staff believes that registrants would benefit from using the income tax rate reconciliation as a starting point for the narrative income tax disclosures in MD&A and tying MD&A disclosures directly to the rate reconciliation to reduce confusion about where the items discussed flow through the reconciliation. Narrative disclosures should include a detailed discussion of what drove the change in the effective tax rate and the overall susceptibility of the rate to changes, which should help users determine whether the past rate is indicative of the future rate.

The SEC staff may question 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 may question registrants when information in the income tax rate reconciliation is inconsistent with disclosures elsewhere in the filing.

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 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, reconciling items affected by multiple factors should be clarified and disaggregated so that users can understand factors driving the reconciling item. For example, reconciling items labeled “foreign rate differential” should be limited to statutory tax rate differences. The SEC staff has suggested that registrants present a multi-column reconciliation that separately presents the reconciling items and taxable income by material foreign jurisdictions⁹² in addition to the domestic jurisdiction and on a consolidated basis.

5.7.3

Investments (including high-yield, highly leveraged transactions)

FRR Section 501.06.b provides disclosure considerations for registrants that participate in high-yield or highly leveraged transactions⁹³ or make non-investment grade loans or investments. Discussion of the potentially greater returns, and potentially greater risks, because of the registrant's involvement in these transactions may be included in the business discussion, or other appropriate location of the Form 10-K, but the effects resulting from participation should be analyzed in MD&A.

⁹² 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 disclosure of such amounts (e.g., \$1 billion of our foreign profits were earned in Ireland, which has an effective tax rate of 10%).

⁹³ FRC Section 501.06b does not define those types of transactions. However, the SEC referred to criteria set forth in a 1989 Federal Reserve Board release that issued bank examination guidelines regarding highly leveraged transactions. In those guidelines, the criteria for a highly leveraged financing include a debt to total assets ratio exceeding 75%. In any event, registrants should indicate how highly leveraged transactions are defined for MD&A purposes.

The SEC indicated that registrants should consider disclosing:

- ▶ Relevant lending and investing policies
- ▶ The amount of holdings and potential risks inherent in such holdings
- ▶ Information regarding the level of activity
- ▶ Amounts of holdings, if any, giving rise to significantly greater risks
- ▶ An analysis of the actual and reasonably likely material effects of the above matters on income and operations

These disclosures are discussed in greater detail in our *SEC annual shareholders' report checklist* (EY Form A150).

5.7.4 Emerging growth company disclosures

Section 7(a) of the Securities Act, as amended by Section 102(b) of the JOBS Act, exempts an EGC from adopting new or revised accounting standards following public company effective dates if private companies have a delayed effective date. Instead, the effective date for private companies will apply to EGCs that don't elect to follow public company effective dates.

Generally, if an EGC follows the extended transition provisions for private companies and it loses its EGC status after it would have had to adopt a standard absent the extended transition, the issuer should adopt the standard in its next filing after losing status. However, depending on the facts and circumstances, the SEC staff in the Division of Corporation Finance said that it may not object to other alternatives.⁹⁴

For example, if a calendar-year EGC completed its IPO in January 2020 and used the relief to defer adopting the new leases standard (ASC 842) until the effective date for private companies (i.e., annual period beginning on 1 January 2022 and interim periods within the annual period beginning on 1 January 2023 for calendar-year entities)⁹⁵ but lost its EGC status on 31 December 2021, either because it exceeded the annual revenues threshold (\$1.07 billion in 2021)⁹⁶ or because its public float as of 30 June 2021 (the last business day of its second quarter) exceeded \$700 million, it would have been required to adopt the new leases standard in its 2021 Form 10-K.⁹⁷

5.8 Other disclosures

5.8.1 Accounting estimate and policy changes (including pending adoption of new accounting standards)

FRR-72 states that "appropriate disclosure in MD&A should be considered and may be required" if a change in an accounting estimate causes a material improvement in earnings. FRR-72 adds that "the change and the underlying reasons for the change should be disclosed so that readers do not incorrectly attribute the effect to operational improvements." MD&A also should discuss the expected effect on financial information to be reported in the future of changes in accounting estimates that have not been fully recognized in the statement of operations, if material (e.g., a change in the amortization period for intangibles, a change in the pension or OPEB discount rate or expected return on plan assets).

⁹⁴ SEC staff Financial Reporting Manual, Section 10230.1.f, updated on 1 December 2017.

⁹⁵ The FASB has deferred the effective date of the new leases standard for private companies to fiscal years beginning after 15 December 2021 and interim periods in the following fiscal year.

⁹⁶ As noted in section 4, the cap on annual gross revenues is now \$1.235 million.

⁹⁷ For ASC 842, an entity can choose to apply the modified retrospective transition provisions at the beginning of the earliest comparative period presented in the financial statements or at the beginning of the period of adoption. Full retrospective application is prohibited. See our Financial reporting developments publication, *Lease Accounting (ASC 842)*, for additional information.

The SEC staff indicated in SAB Topic 11.M, *Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period*, that registrants should discuss the effect of yet-to-be-adopted accounting standards that, when adopted, are expected to materially affect financial condition or results of operations. SAB Topic 11.M requirements include:

- ▶ A brief description of the new standard, the date by which adoption is required, and the date on which the registrant plans to adopt, if earlier
- ▶ A discussion of the methods of adoption allowed by the standard and the method expected to be used by the registrant, if determined
- ▶ Disclosure of the potential effect of other significant matters that the registrant believes might result from the adoption of the standard (e.g., technical violations of debt covenant agreements, planned or intended changes in business practices)
- ▶ A discussion of the effect that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable

If a pending accounting standard update will affect the preparation of the financial statements, but not have a material effect, SAB Topic 11.M encourages companies to disclose that a standard has been issued and that its adoption will not have a material effect on its financial position or results of operations.

The objectives of the disclosure should be to (1) provide notification that a standard has been issued that the registrant will be required to adopt in the future and (2) assist investors in assessing the significance of the effect that the standard will have on the financial statements of the registrant when adopted. The requirements of SAB Topic 11.M do not extend to Exposure Drafts of proposed accounting standards updates.

The SEC staff has reminded registrants that the objectives of SAB Topic 11.M and the purpose of financial statement disclosures are not necessarily consistent. MD&A should discuss known information about the expected effect of a new accounting standard on *future* periods, while the financial statement notes should disclose the anticipated effect of a new standard on *historical* financial statements. By distinguishing these objectives, a preparer can avoid redundancy in its disclosures.

SAB Topic 11.M does not require a company to quantify the effects of a new accounting standard. However, the SEC staff does expect companies to disclose the expected effects on the financial statements of adopting a pending standard to the extent those effects are known. If the effects of adopting a new accounting standard are not known, companies should disclose that fact. It might be appropriate to disclose a range of possible effects if an approximate amount is not known. The SEC staff has indicated that qualitative disclosures should be included if quantitative information is not available.

The SEC staff has said that if a registrant does not know or cannot reasonably estimate the effect on the financial statements of adopting a new standard, 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.

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 describe the process they use 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 major 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 and to be reviewed and discussed with the audit committee.

5.8.2 Discontinued operations

SAB Topic 5.Z, *Accounting and Disclosures Relating to Discontinued Operations*, provides interpretive guidance on disclosures about discontinued operations required in MD&A. Registrants should discuss known trends, events and uncertainties involving discontinued operations that might materially affect the registrant's liquidity, financial condition and results of operations (including net income) in MD&A for periods "between the date when a component of an entity is classified as discontinued and the date when the risks of those operations will be transferred or otherwise terminated." This discussion should include changes in the plan of disposal or changes in circumstances related to the plan.

The potential effect on the registrant's reported results or liquidity of any material contingent liability, such as product or environmental liabilities or litigation that might remain with the registrant despite disposal of the underlying business also should be discussed.

If a registrant had decided to discontinue a component of the business and subsequently decides to retain it, the SEC staff expects MD&A to discuss any material effect on results of operations, liquidity and capital resources, and the reasonably likely effects of known trends, commitments or contingencies.

5.8.3 Foreign operations

Although FRR Section 501.09 discusses disclosures about foreign operations, it does not mandate any specific disclosures. The section uses such terms as "encourages" and "should consider" in discussing information that registrants might disclose to enhance readers' understanding of the financial statements. These supplemental disclosures generally would be included in MD&A.

The discussion of disclosures in FRR Section 501.09 is general and, except for the considerations noted below, contains no guidelines or indication of the SEC's expectations. Thus, registrants have considerable latitude in deciding what, if any, supplemental disclosures would help users better understand the effect of foreign operations and translation on the financial statements. Each registrant should evaluate its own situation and make disclosures that it considers meaningful.

Discussed below are several types of disclosures registrants should consider:

Effect of rate changes: Registrants are encouraged to present an analysis and discussion of the effects of exchange rate changes on the reported results of operations and the nature and extent of currency risks to which the registrant is exposed, including the reasonably likely future effects of changes in exchange rates on operations. The purpose of these disclosures is to assist financial statement users in understanding the implications of rate changes, comparing recent results with those of prior periods and anticipating future effects of rate changes. Examples include: quantification of the effect on sales and operating results of a weakening (strengthening) foreign currency; discussion of foreign operating results as reflected in the local currency, with the effects of translation noted; and the effects of exchange rate changes on backlog, interest expense, wages, cost of raw material purchased from the parent, transactions between subsidiaries, inventory levels, debt-to-equity ratio, working capital, effective tax rate and cost of sales.

Registrants that make such disclosures should take care that they are not misleading. For example, reported dollar sales of foreign operations might decline because of a change in exchange rates, but that change also might affect selling prices, sales volume and cost structures. In that situation, it might not be sufficient to discuss only the effects of translation on reported sales. Registrants that quantify the effects of translation at different exchange rates should evaluate the need to clearly explain that disclosure. In addition, when preparing these disclosures, registrants should consider the SEC rules on presenting

non-GAAP financial measures. The SEC staff's non-GAAP C&DIs note that MD&A can explain how changes in exchange rates between periods affect the changes in various financial statement line items by presenting the historical amounts and the current amounts in constant currency. Additionally, a description of the process of calculating the constant currency amounts and the basis of presentation is required.

Registrants also are encouraged to identify material unhedged monetary assets, liabilities or commitments denominated in currencies other than the operation's functional currency, as well as management's strategies to manage the currency risks associated with such exposures.

Cash flow implications of functional currencies: Under ASC 830, one of the functional currency indicators is cash flow (ASC 830-10-55-5). That indicator points to a foreign functional currency when cash flows related to the foreign operation's individual assets and liabilities are primarily in the foreign currency and do not directly affect the parent's cash flows. Conversely, that indicator points to the parent's currency (e.g., the US dollar) when cash flows related to the foreign operation's individual assets and liabilities directly affect the parent's cash flows on a current basis and are generally available for remittance to the parent. The SEC believes that financial statement users might presume cash is available from foreign operations with a US dollar functional currency, but not from those with a foreign functional currency. Thus, Section 501.09 suggests that a discussion of the availability of cash flows from foreign operations may be appropriate in certain circumstances such as:

- ▶ **Foreign functional currency:** If the foreign operations' cash flows are not available to meet the needs of other operations, registrants should consider discussing those operations in a disaggregated manner, because it may be more meaningful than a discussion of liquidity and capital resources for the registrant as a whole. On the other hand, if cash flows of foreign operations are generally available to meet the parent's cash needs, registrants should consider discussing the basis for using the foreign functional currency (i.e., that the choice was made because of the significance of functional currency indicators other than the direct effect of the foreign operation's cash flows on the parent's cash flows). The SEC believes that such discussion would facilitate an understanding of the registrant's operations.
- ▶ **US dollar functional currency:** There may be foreign operations where the US dollar is the functional currency (e.g., significant foreign operations in highly inflationary economies) even though cash remittances to the parent are not likely. In such situations, the SEC believes that discussion of only consolidated liquidity and capital resources might not be sufficient. Discussing those operations in a disaggregated manner might be more meaningful.

The SEC has suggested it would like to see registrants display net investments by major functional currency and present an analysis of the translation component of equity either by significant functional currency or by geographical areas used for segment disclosure purposes.

5.8.4 Loss contingencies (including environmental and product liabilities)

The discussion requirements for environmental and other loss contingencies address (1) the effects of compliance with environmental laws on the registrant's business, (2) pending legal proceedings and (3) environmental risks and contingencies.

Registrants are required to discuss the following items in disclosures about environmental contingencies:

- ▶ The effect of potential environmental liabilities, quantified to the extent reasonably practicable
- ▶ The aggregate potential cleanup costs in light of joint and several liability, including a discussion of whether insurance coverage may be contested, and whether and to what extent potential sources of contribution or indemnification constitute reliable sources of recovery that may be factored into the determination of whether a material future effect is not reasonably likely to occur

- ▶ Historical and anticipated environmental expenditures, and, if material, recurring costs associated with managing hazardous substances and pollution in ongoing operations, capital expenditures to limit or monitor hazardous substances or pollutants, mandated remediation expenditures and other cleanup expenditures that can be anticipated but that are not currently required

The disclosure requirements for product liability contingencies provided in SAB Topic 5.Y include a discussion of the following: (1) the nature of personal injury or property damages alleged by claimants, (2) the aggregate settlement costs by type of claim and (3) the related costs of administering and litigating claims.

The SEC staff expects environmental and product liability disclosures to be disaggregated to provide investors with a full understanding of the contingencies. The SEC staff's positions regarding disaggregation of these contingencies are discussed in our *SEC annual shareholders' report checklist* (EY Form A150).

5.8.5 Restructuring charges

ASC 420 addresses financial accounting and disclosure related to exit or disposal activities. The SEC staff expects MD&A to supplement the financial statement disclosures required by ASC 420 for material restructuring activities by, for example, including the following:

- ▶ A discussion of the events and decisions that gave rise to the restructuring costs and restructuring plan, and the likely effects of management's plans on financial position, future operating results and liquidity, to the extent material (e.g., an inability to realize previously projected economies of scale, a failure to renew or secure key customer contracts or a failure to keep downtime at acceptable levels because of aging equipment)
- ▶ Anticipated effects of the restructuring plan on future operating results, and the periods in which those effects are expected to be realized including whether cost savings from the plan are expected to be offset by anticipated increases in other expenses or reduced revenues
- ▶ The periods in which material cash outlays are anticipated and the expected source of funding
- ▶ To the extent necessary for the readers' understanding, separate disclosure and explanation of discretionary or decision-dependent costs such as exit costs

For restructuring charges recognized in prior periods, the SEC staff believes the following items should be discussed in MD&A:

- ▶ Material changes in the accrued balances of each significant component of the charge, either as a result of cash expenditures associated with the plan's implementation or from revisions to the plan or changes in estimates, with particular emphasis on the amounts and reasons for reversals of reserves established in prior periods and their effect on current-period income
- ▶ The progress achieved during the year in implementing the restructuring plan, including qualitative and quantitative discussion of the extent to which the objectives of the major components of the restructuring plan have been accomplished
- ▶ If savings anticipated by the restructuring plan are not achieved as expected (either as to amount or timing), the related reasons for this circumstance and the likely effects on future operating results and liquidity

In the event a company recognizes liabilities for exit costs and involuntary employee termination benefits relating to multiple exit plans, it should present separate information for each individual exit plan that has a material effect on the balance sheet, results of operations or cash flows.

If management anticipates that future restructuring actions are likely to occur in a subsequent period and such actions are likely to result in charges that could have a material effect on the results of operations or financial position of the company, the SEC staff expects such actions to be discussed in MD&A.

The SEC staff has noted that economic or other events that cause a registrant to consider or adopt an exit plan, or that impair the carrying amount of assets, generally occur over time. Accordingly, the SEC staff believes that as those events and the resulting trends and uncertainties evolve, they often will meet the requirement for disclosure in MD&A prior to the period in which the exit costs and liabilities are recognized under GAAP.

Our *SEC annual shareholders' report checklist* (EY Form A150) provides additional information about the SEC staff's expectations concerning the discussion of restructuring charges.

5.8.6 Transactions with related and certain other parties

FRR-61 observes that both US GAAP and the SEC's rules require disclosure about transactions with related parties, but certain other parties are not within the definition of "related parties," such as parties that are able to negotiate transactions on terms that would not be available from more clearly independent third parties on an arm's-length basis. For example, former senior management would not meet the definition of a related party under US GAAP, but they might be able to negotiate terms that are more favorable than those available to clearly independent third parties. FRR-61 suggests that further MD&A discussion might be needed to explain the importance of relationships and transactions with related and certain other parties, where material. Disclosures suggested by FRR-61 include:

- ▶ A description of the elements of the transactions necessary to understand their business purpose and economic substance, their effects on the financial statements and any related special risks or contingencies
- ▶ Identification of the related and certain other parties transacting business with the registrant
- ▶ How the parties determined prices
- ▶ Terms or other aspects of transactions and arrangements that differ from those that would likely be negotiated with clearly independent parties
- ▶ A description of the evaluation made to support any assertion of fairness of the transactions
- ▶ Any ongoing contractual or other commitments

5.8.7 Miscellaneous

Federal financial assistance: For financial institutions that receive material federal financial assistance, the SEC expects registrants to discuss the nature, amount and effect of the assistance on financial condition or results of operations.

Treasury stock transactions: MD&A should contain an explanation of material changes in earnings per share resulting from a change in the number of shares outstanding, such as that resulting from a large purchase of treasury stock. The SEC staff has indicated that MD&A should address the effect of such transactions as they affect balance sheet and income statement captions, including earnings per share. Although some repurchases of outstanding stock might not have a material effect on other financial statement captions, discussion might be required to explain the effect on the trend of earnings per share.

Government inquiries: The SEC issued FRR-32, *Disclosure Obligations of Companies Affected by the Government; Defense Contract Procurement Inquiry and Related Issues*, to remind defense contractors, as well as other registrants, of their obligation to disclose any reasonably likely material effects on the financial statements associated with the government's investigation into illegal or unethical activity in the procurement of defense contracts.

Based on the nature of the government's inquiry, disclosure also might be required in Form 10-K under "Description of Business" and "Legal Proceedings," as well as financial statement disclosure of loss contingencies.

Statistical disclosures for banking registrants (Subpart 1400 of Regulation S-K): In September 2020, the SEC adopted rules to update and clarify the requirements for statistical disclosures that bank and savings and loan registrants include in their SEC filings. The amendments eliminate certain disclosure requirements that overlap with US GAAP, IFRS and other SEC rules and replace Industry Guide 3, *Statistical Disclosure by Bank Holding Companies*, with a new Subpart 1400 of Regulation S-K.

Subpart 1400 of Regulation S-K requires bank holding companies and other lending institutions to disclose the following items, which are in addition to any relevant US GAAP disclosures:

- ▶ Distributions of assets, liabilities and stockholders' equity, the related interest income and expense, and interest rates and interest differential (e.g., providing disclosures that help users understand components of net interest earnings and evaluate the impact of potential changes in interest rates on future income)
- ▶ Weighted average yield of investments in debt securities by maturity
- ▶ Maturity analysis of the loan portfolio, including amounts that have predetermined interest rates and floating or adjustable interest rates
- ▶ Certain credit ratios and the factors that explain material changes in the ratios or their components during the periods presented
- ▶ The allowance for credit losses by loan category
- ▶ Information about bank deposits, including average amounts and rate paid, and uninsured amounts

The rules became effective 16 November 2020 (except for the rescission of Industry Guide 3, which will be effective 1 January 2023) and apply to fiscal years ending on or after 15 December 2021. Early compliance with the disclosures in Subpart 1400 of Regulation S-K is permitted.

See our *GAAP and Regulation S-X checklist supplement for banks, bank holding companies and savings institutions* (EY Form A69C) for additional disclosures that might be applicable.

6 Financial statements and parent company information

6.1 General

Item 8 of Form 10-K, *Financial Statements and Supplementary Data*, requires financial statements meeting the requirements of Regulation S-X, except that Form 10-K is not required to include audited financial statements of significant acquired businesses or real estate operations (Rules 3-05 and 3-14 of Regulation S-X) or pro forma financial information (Article 11 of Regulation S-X) or the corresponding financial statements and pro forma financial information under Article 8 of Regulation S-X for SRCs.

Form 10-K might be required to include audited financial statements beyond those of the registrant. This section provides guidance for determining whether the following additional financial information and separate financial statements are required:

- ▶ Disclosure of the restricted net assets of subsidiaries in the notes to the consolidated financial statements
- ▶ A schedule of condensed parent company financial statement information (Schedule I, Rule 5-04(c) of Regulation S-X)
- ▶ Financial statements of unconsolidated subsidiaries and investees accounted for by the equity method (Rule 3-09 of Regulation S-X)⁹⁸
- ▶ Disclosures of summarized financial information of unconsolidated subsidiaries and investees in the notes to the consolidated financial statements (Rule 4-08(g) of Regulation S-X)
- ▶ Financial statements of subsidiaries that guarantee securities of the registrant (Rule 3-10 of Regulation S-X)

Consolidated financial statements must be included in Item 8 of Form 10-K, or incorporated by reference therein. Other financial statements required by Regulation S-X may be included in Item 8 or Item 15, *Exhibits, Financial Statement Schedules*, of Form 10-K.

The SEC also may require, by informal written notice, financial statements in addition to, or in substitution for, those listed above (Rule 3-13 of Regulation S-X). Alternatively, when requested by the registrant, the SEC may permit the omission of one or more of the required financial statements. Omission, addition or substitution of financial statements may occur if the SEC believes it is consistent with the protection of investors. Regulation S-X governs the form and content of and the requirements for financial statements, including the notes to financial statements and financial schedules. The proxy rules also require that the consolidated financial statements comply with Regulation S-X.

⁹⁸ The terms “investees” and “equity investees” in this section mean investments accounted for by the equity method. Also, the SEC staff has expressed that if an investee is required to be accounted for using the equity method under ASC 323, separate financial statements of the investee are required if the investee is significant under either the investment or income test in Rule 1-02(w) of Regulation S-X at a level of 20% or greater. ASC 323-10 requires an investor that has the ability to exercise significant influence over the operating and financial policies of the investee to apply the equity method of accounting only when it has an investment(s) in common stock or an investment that is in-substance common stock. In-substance common stock is an investment in an entity that has risk and reward characteristics substantially similar to that entity’s common stock. In other words, the requirements for financial statements of equity-method investments apply regardless of whether the investment is in the form of common stock.

6.2 Consolidated financial statements

Form 10-K must include audited balance sheets for two years (Rule 3-01 of Regulation S-X) and statements of comprehensive income and cash flows for three years (Rule 3-02 of Regulation S-X) of the registrant and its predecessors. Form 10-K also must include disclosure of changes in shareholders' equity and noncontrolling interests for each period a statement of comprehensive income is required (Rule 3-04 of Regulation S-X), which may be included as a financial statement or in the notes.

In addition, ASC 220 requires disclosures about comprehensive income and its components. The guidance also requires registrants to present items of net income, items of other comprehensive income and total comprehensive income in one continuous statement or two separate but consecutive statements for each reporting period.⁹⁹

As noted earlier, a registrant subject to the SEC's proxy rules must present consolidated financial statements in accordance with Regulation S-X. The SEC staff expects the registrant's consolidated financial statements presented in its annual shareholders' report and Form 10-K to be identical. Generally, the registrant's financial statements will be incorporated by reference from the ARS.

Financial schedules are required in Form 10-K (but not annual shareholders' reports) to provide detailed information in support of certain financial statement captions. See section 7 of this publication for a discussion and illustrative examples of these schedules.

Article 3A of Regulation S-X (as supplemented by the definitions of "control" and "subsidiary" in Article 1 of Regulation S-X and "controlling financial interest" in ASC 810) governs the presentation of consolidated financial statements. It states that when consolidating subsidiaries, a registrant should follow principles of inclusion or exclusion that clearly exhibit the financial position and results of operations of the registrant.

There is a presumption that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for a fair presentation when the reporting entity directly or indirectly has a controlling financial interest in another entity. The determination of the entities to be included in the consolidated financial statements generally will be made by reference to generally accepted accounting principles. If an entity is included or excluded from the consolidated financial statements for the current year compared with the prior year and such inclusion or exclusion has a material effect on the consolidated financial statements, the entity's inclusion or exclusion should be disclosed to enable investors to assess the comparability of the consolidated financial statements.

6.3 Restrictions on net assets

The SEC requires that the notes to consolidated financial statements disclose restrictions on the transfer of assets from subsidiaries to the parent. In addition, Schedule I in Form 10-K, if required, calls for condensed financial statements of the parent company.

6.3.1 Disclosure in the notes to the consolidated financial statements

Rules 4-08(e)(1) and (2) of Regulation S-X require a registrant to disclose the following information about any restrictions that limit the payment of dividends by the registrant:

- ▶ Restrictions on dividend payments by the parent
- ▶ The amount of consolidated retained earnings or net income restricted, or free of restrictions, related to dividend payments

⁹⁹ See our *GAAP disclosure checklist* (EY Form A13) for a summary of these disclosures.

- ▶ The amount of consolidated retained earnings that represents the undistributed earnings of equity-method investees

Rule 4-08(e)(3) of Regulation S-X requires registrants to disclose, if material, the following information in the notes to their audited annual financial statements¹⁰⁰ about any restrictions that limit the payment of dividends by the registrant:

- ▶ The nature of any restrictions on the ability of consolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances (i.e., borrowing arrangements, regulatory restraints, foreign government restraints)
- ▶ The amount of such restricted net assets as of the end of the most recently completed fiscal year for consolidated subsidiaries¹⁰¹

We present the full definition of “restricted net assets” in section 6.3.3 below. It resides in Rule 1-02(dd) of Regulation S-X and should be applied in all rules in Regulation S-X that use the term.

6.3.2 Condensed parent company financial statements

The condensed parent company financial statements in Schedule I, if required, must be for the same periods as the consolidated financial statements – generally balance sheets for two years and other statements for three years. Registrants may condense the parent company financial statements using the same rules for combining financial statement captions used for preparing condensed interim financial statements in Article 10 of Regulation S-X.¹⁰² The notes to the condensed financial statements must disclose material contingencies, guarantees, long-term obligations (including maturities for the next five years), and mandatory dividend and redemption requirements of redeemable stock. Other notes to the financial statements may be omitted. Schedule I also must disclose cash dividends paid to the parent by consolidated subsidiaries, unconsolidated subsidiaries and investees for each of the last three years. An example of Schedule I is included in section 7 of this publication.

Registrants must include the schedule when the parent’s share of the “restricted” net assets of consolidated subsidiaries exceeds 25% of consolidated net assets.

6.3.3 Definition of restricted net assets

The SEC defines restricted net assets in Rule 1-02(dd) as follows:

“The term restricted net assets shall mean that amount of the registrant’s proportionate share of net assets of consolidated subsidiaries (after intercompany eliminations) which as of the end of the most recent fiscal year may not be transferred to the parent company by subsidiaries in the form of loans, advances or cash dividends without the consent of a third party (i.e., lender, regulatory agency, foreign government). Not all limitations on transferability of assets are considered to be restrictions

¹⁰⁰ When these restrictions are disclosed in the notes to the financial statements, the MD&A discussion of liquidity must describe the nature of the restrictions and the extent of their effect on the parent’s ability to meet its cash obligations (see section 5 of this publication).

¹⁰¹ The text of Rule 4-08(e) also requires disclosure of the amount of restricted net assets as of the end of the most recently completed fiscal year for unconsolidated subsidiaries separate from the amount for consolidated subsidiaries. However, most registrants do not have “unconsolidated subsidiaries” and we have excluded a separate discussion of unconsolidated subsidiaries from this section to focus on the guidance that is more commonly applicable. Commission staff has observed that investment companies, particularly BDCs, may have unconsolidated subsidiaries that are not accounted for using the equity method of accounting. All other registrants typically do not. Accordingly, BDCs with unconsolidated subsidiaries that are not accounted under the equity method of accounting should keep in mind that Rule 4-08(e) requires them to disclose the restrictions and amount of restricted net assets of such subsidiaries separately from the same information for consolidated subsidiaries.

¹⁰² Our publication, *SEC quarterly reports – Form 10-Q*, illustrates the preparation of condensed financial statements in Form 10-Q.

for purposes of this rule, which considers only specific third party restrictions on the ability of subsidiaries to transfer funds outside of the entity. For example, the presence of subsidiary debt which is secured by certain of the subsidiary's assets does not constitute a restriction under this rule. However, if there are any loan provisions prohibiting dividend payments, loans or advances to the parent by a subsidiary, these are considered restrictions for purposes of computing restricted net assets. When a loan agreement requires that a subsidiary maintain certain working capital, net tangible asset, or net asset levels, or where formal compensating arrangements exist, there is considered to be a restriction under the rule because the lender's intent is normally to preclude the transfer by dividend or otherwise of funds to the parent company. Similarly, a provision which requires that a subsidiary reinvest all of its earnings is a restriction, since this precludes loans, advances or dividends in the amount of such undistributed earnings by the entity. Where restrictions on the amount of funds which may be loaned or advanced differ from the amount restricted as to transfer in the form of cash dividends, the amount least restrictive to the subsidiary shall be used. Redeemable preferred stocks and noncontrolling interests shall be deducted in computing net assets for purposes of this test."

The tests should consider only third-party restrictions on the subsidiary's ability to transfer net assets through loans, advances or payment of cash dividends. Limitations on the transfer of specific assets or practical limitations, such as a subsidiary's illiquidity, are not considered in the test for restricted net assets. For example, assets pledged as collateral under a subsidiary's debt agreement should not be included in the computation. In addition, the illiquid nature of a subsidiary's noncurrent assets is not relevant to the tests; thus, it should be assumed that all assets of the subsidiary are available for loan, advance or dividend to the parent unless third-party agreements would restrict the payment of such dividends, advances or loans to the parent. However, loan provisions requiring a minimum level of working capital, net tangible assets or net assets also need to be considered. A loan agreement that requires the subsidiary to reinvest all earnings also should be considered.

A registrant's disclosure that it intends to permanently reinvest the undistributed earnings of a subsidiary (and as a result of meeting the criteria of ASC 740, does not provide income taxes on those earnings) generally would not indicate restricted net assets because no third-party restriction is involved.

Many loan agreements contain restrictions limiting cash dividends, loans and advances. If only one provision exists, the restricted amount may be easy to compute. However, some agreements may contain several provisions that restrict the flow of funds to the parent. In these circumstances, it is necessary to consider each provision in computing the maximum amount the subsidiary can transfer to the parent and still comply with all the provisions. Examples are provided later in this section.

Restrictions on foreign subsidiaries' net assets might exist in several ways. Currency exchange controls might restrict loans and dividends to the parent. Foreign government incentives, such as "tax holidays" or grants, might require registrants to reinvest earnings or otherwise limit dividends. However, foreign withholding taxes on dividend payments generally would not be restrictions on net assets because the withheld amounts reduce a tax liability. Additionally, the existence of a limited market for foreign currency, thereby making it not economically feasible to transfer funds, would not be considered a restriction of net assets.

Bank subsidiaries have restricted net assets because of restrictions of the Federal Reserve Act (Section 23A) on loans to affiliates. Further, the Office of the Comptroller of the Currency (a bureau of the US Department of Treasury) restricts dividends of national banks. Some state regulatory agencies also restrict state banks from paying dividends or making loans and advances to their parent. Such restrictions should be considered in determining the extent of restricted net assets of subsidiaries.

Insurance company subsidiaries have restricted net assets primarily because statutory regulations might prohibit or restrict the amount of loans or dividends to the parent company. As a result, for most insurance registrants, restricted net assets will include their insurance subsidiaries' statutory surplus requirements, such as the minimum legal capital requirements of the states in which insurance subsidiaries operate. Other considerations in determining the amount of restricted net assets might include statutory operating ratios or administrative guidelines or rules that result in statutory capital requirements that exceed minimum legal requirements or that otherwise limit the amount of loans or dividends to the parent company.

The computation of restricted net assets should be based on the subsidiary's actual year-end balance sheet as determined in accordance with generally accepted accounting principles, including "pushdown" accounting if applied. Management may not include in the calculation of restricted net assets the effects of transactions or events that have not occurred, even if the transactions could be easily accomplished.

A registrant with a consolidated shareholders' deficit is considered to have a net asset base of zero for the purpose of computing its proportionate share of the restricted net assets of consolidated subsidiaries. As a result, any restrictions placed on the net assets of consolidated subsidiaries with positive equity would be deemed to exceed the 25% threshold in Rule 5-04(c) resulting in a requirement to provide parent company financial information. This is viewed by the SEC staff as consistent with the guidance in SAB Topic 6K2.b (Question 3), which states that a subsidiary with an excess of liabilities over assets has no restricted assets. Anomalous results can be discussed with the SEC staff.

For purposes of computing restricted net assets of foreign subsidiaries, the SEC staff expects registrants to use US GAAP and the currency measurement and translation principles of ASC 830.

6.3.4

Computing the restricted net assets of subsidiaries

The following steps summarize how to determine the restricted net assets of a subsidiary:

- Step 1: Determine net assets of the subsidiary – The subsidiary's shareholders' equity, excluding its redeemable stock and noncontrolling interest reflected in its balance sheet.¹⁰³
- Step 2: Adjust subsidiaries for intercompany eliminations – Add amounts due to (or subtract amounts due from) the parent and other consolidated subsidiaries. Intercompany profits that are eliminated in consolidation also are adjustments. (This step identifies the subsidiary's net assets reflected in the consolidated financial statements).
- Step 3: Determine the parent's proportionate share of the subsidiary's net assets – Multiply the results in 2 above by the parent's proportionate share (generally its ownership percentage).
- Step 4: Determine the amount of restricted net assets – Note that (1) there are no restricted net assets for a subsidiary if its net assets after intercompany eliminations are negative; (2) a subsidiary has no restricted net assets if it can transfer by loan, advance or dividend, or any combination thereof, without the consent of a third-party, an amount equal to or greater than the parent's proportionate share of net assets and (3) computed restricted net assets for a subsidiary cannot be greater than the parent's proportionate share of the subsidiary's net assets.

Where restrictions on the amount of funds which may be loaned or advanced differ from the amount restricted as to transfer in the form of cash dividends, the amount least restrictive to the subsidiary can be used.

¹⁰³ While noncontrolling interests that are not redeemable are classified as equity, amounts attributable to noncontrolling interests are not available to the consolidated parent's shareholders and therefore are excluded from the calculation of net assets.

6.3.5 Examples of computing restricted net assets

Example 1 – Restrictive covenants of a 100%-owned subsidiary's debt agreement are as follows:

- ▶ Net tangible assets, excluding intercompany accounts, cannot be less than \$10
- ▶ Eighty percent of accumulated earnings must be maintained and cannot be paid out as dividends
- ▶ Current ratio of 2:1 is required

The balance sheet of the subsidiary at 31 December 20Y2 is:

Current assets	\$ 25	Current liabilities	\$ 11
Noncurrent tangible assets	30	Long-term debt	<u>19</u>
		Total liabilities	30
		Common stock	10
		Retained earnings	<u>15</u>
		Total shareholders' equity	<u>25</u>
	<u>\$ 55</u>		<u>\$ 55</u>

There are no intercompany balances. Net assets are \$25. The loan covenants restrict net assets as follows:

	<u>Computed restrictions</u>
<i>Net tangible assets</i>	
Currently \$25, cannot be less than \$10; therefore	\$10
<i>Dividends</i>	
80% of retained earnings cannot be paid out; therefore	\$12 (80% of \$15)
<i>Current ratio</i>	
Current ratio must be at least 2:1. Therefore \$22 of current assets is restricted (current assets required of \$22 given current liabilities of \$11).	\$22

Conclusion – Restricted net assets for purposes of the test are \$10. The amount computed from the dividend restriction (\$12) is not used because transfer to the parent could be accomplished by loan or advance. The amount computed from the current ratio requirement (\$22) is not used because noncurrent assets could be transferred to the parent. In this example, the subsidiary could transfer \$15 (\$25 minus \$10) to the parent without violating any of the covenants by (1) a dividend or loan of current assets of \$3 and (2) a loan of noncurrent assets¹⁰⁴ of \$12.

Example 2 – Restrictive covenants of a 100%-owned subsidiary's debt agreement are as follows:

- ▶ Net tangible assets, excluding intercompany accounts, cannot be less than \$10
- ▶ Sixty percent of accumulated earnings must be maintained and cannot be paid out as dividends

¹⁰⁴ Although the subsidiary's noncurrent assets are not in a form that is readily transferable to the parent company, the nonmonetary or illiquid nature of the assets is not relevant for purposes of the parent company tests. The objective of the tests is to require parent company disclosures when the parent company does not have control of its subsidiaries' funds because it does not have unrestricted access to their net assets.

At 31 December 20Y2, the balance sheet of the subsidiary is:

Current assets	\$ 40	Current liabilities	\$ 10
Noncurrent tangible assets	15	Long-term debt	<u>20</u>
		Total liabilities	30
		Common stock	10
		Retained earnings	<u>15</u>
		Total shareholders' equity	<u>25</u>
	<u>\$ 55</u>		<u>\$ 55</u>

There are no intercompany balances. Net assets are \$25. The computation of restricted net assets is as follows:

	<u>Computed restrictions</u>
<i>Net tangible assets</i>	
Currently \$25, cannot be less than \$10; therefore	\$10
<i>Dividends</i>	
60% of retained earnings cannot be paid out; therefore	\$ 9 (60% of \$15)

Conclusion – Restricted net assets for purposes of the test are \$10. The maximum amount that can be loaned or advanced to the parent without being in violation of the net tangible asset covenant is \$15 (\$25-\$10). If the registrant were to pay a dividend of \$6 (\$15-\$9), the maximum amount of a dividend that could be paid without violating the dividend covenant, it also could loan or advance \$9 without violating the net tangible asset covenant. In either situation, the amount unrestricted from transfer to the parent is \$15; therefore, restricted net assets are \$10 (\$25-\$15).

Example 3 – Assume the same balance sheet and covenants as Example 2, except that the debt agreement also requires the subsidiary to maintain a current ratio (after intercompany accounts) of not less than 3:1.

Conclusion – Restricted net assets for purposes of the test are \$10. Restricted current assets resulting from the current ratio covenant are \$30. This is the amount that must be maintained in current assets to meet the required 3-to-1 ratio requirement given current liabilities of \$10. However, \$15 can be paid in dividends, loaned or advanced (in combination) to the parent, without violating any covenant if no more than \$6 represented a dividend and at least \$5 of the transferred amount consisted of noncurrent assets. (A transfer of current assets greater than \$10 would reduce current assets and result in a violation of the 3:1 minimum current ratio.) Thus \$10 is restricted. Restricted net assets for use in the test are the amount least restrictive to the subsidiary, which in this case is \$10.

Example 4 – The rules require that the parent's proportionate share of net assets of subsidiary companies be computed after intercompany eliminations. To illustrate, assume the same facts as Example 2, except that \$10 of the \$40 of current assets represents an intercompany receivable.

Net assets	\$ 25
Intercompany receivable	<u>(10)</u>
Adjusted net assets	<u>\$ 15</u>

Conclusion – Restricted net assets for purposes of the test are \$10. Because \$5 still could be loaned or advanced or paid in dividends to the parent without violating a covenant, restricted net assets are \$10 in these circumstances, as they were in Example 2.

Example 5 – Assume the same facts as Example 2, except that the subsidiary is 80%-owned.

Net assets	\$ 25
Ownership percent	<u>80%</u>
Parent's share of net assets	<u>\$ 20</u>

Conclusion – Restricted net assets for purposes of the test are \$5. Since \$15 could be loaned or advanced to the parent without violating any of the covenants in Example 2, restricted net assets for purposes of the test would be \$5 (\$20-\$15).

Example 6 – Company A owns 70% of Subsidiary B, which owns 90% of Subsidiary C. Subsidiary B may not pay any dividends or make any affiliate loans or advances. Therefore, all of B's net assets are restricted. C has net assets of \$100 and unrestricted net assets of \$45. How should Company A compute its share of restricted net assets of Subsidiary C for purposes of the test?

Conclusion – Restricted net assets for purposes of the test are \$18. Since all of B's net assets are restricted, any dividend, loan or advance from C to B would cause those assets also to be restricted. However, C can make loans directly to A of up to \$45, even though it is a subsidiary of B. Therefore, A's share of C's net assets for purposes of the test would be computed as follows:

C's net assets	\$ 100
A's ownership percent (70% x 90%)	<u>63%</u>
A's share of net assets	<u>\$ 63</u>

Because C's unrestricted net assets of \$45 could be loaned to A, restricted net assets for purposes of the test would be \$18 (\$63-\$45).

6.3.6

Disclosure in the notes to the financial statements

Restricted net assets of subsidiaries computed under these SEC rules do not necessarily result in dividend restrictions on the consolidated entity. In some instances, the limitation that results in subsidiaries' restricted net assets is a dividend restriction (e.g., restrictions by regulators on banks and insurance subsidiaries), and in others (e.g., some subsidiary debt covenants), it does not restrict the ability of the parent to pay dividends. In many cases, the point will be moot because the subsidiary's restricted net assets will be less than other restrictions on the parent paying dividends.

Depending on the nature and possible interrelationship of restrictions on the transfer of funds to the parent and restrictions on payment of dividends by the parent, the disclosures relating to these matters might be included in the following notes to the financial statements:

- ▶ Long-term debt (e.g., when the more important information relates to restrictions arising from debt covenants)
- ▶ Shareholders' equity (e.g., when dividends are significantly restricted)
- ▶ Investment in affiliates (e.g., when the disclosure of restrictions on the transfer of funds to the parent arises primarily because of restrictions existing at affiliated companies, such as investees)

The following is an example of the disclosures in the notes to the financial statements required by these rules (Regulation S-X Rule 4-08(e)(3)):

Illustration 6-1: Disclosure of long-term debt and dividend restrictions

The Company's long-term debt agreement requires minimum current ratio and net tangible asset levels and otherwise restricts the payment of cash dividends. Certain of its consolidated subsidiaries are subject to debt agreements that limit cash dividends and loans to the Company. At December 31, 20Y2, restricted net assets of the consolidated subsidiaries were \$12,000. Under the most restrictive covenants, consolidated retained earnings in the amount of \$40,000 were free of limitations on the payment of dividends at December 31, 20Y2.

6.4 Equity method investees

Separate financial statements are required in Form 10-K, but not the annual shareholders' report, for equity method investees that individually exceed 20% significance for any of the three years presented (significance is based on the investment or income tests as described later in this section). The significance of any lower-tier equity investees and unconsolidated subsidiaries should be measured against their contribution to the consolidated financial statements. For example, separate financial statements of an equity method investee of a consolidated subsidiary or unconsolidated investment would be required if it met the significant subsidiary test at the 20% threshold compared with the consolidated financial statements.

In addition, US GAAP requires summarized financial information, or separate financial statements, for material unconsolidated subsidiaries and investees. The SEC requires this information when equity method investees exceed 10% significance individually or in the aggregate (Rule 4-08(g) of Regulation S-X). In addition, ASC 323-10-50 requires certain other disclosures for material investments, including the percentage of the investee owned, the accounting method for the investment, any difference between the carrying amount and the underlying equity in net assets and the market value, if available.

Entities whose financial statements or summarized information are included in a registrant's SEC filing because they are significant equity method investees under Rule 3-09 or 4-08(g) of Regulation S-X are considered public business entities under the FASB's definition in ASU 2013-12. Therefore, such financial statements or information, in general, would need to be prepared following the accounting and disclosure requirements applicable to public business entities for standards issued by the FASB that use the public business entity (PBE) definition. However, the SEC staff observer at the July 2017 EITF meeting announced a limited exception to this requirement for entities that would not meet the definition of a PBE if their financial statements were not included in an SEC filing of another entity. The SEC staff observer said that the financial statements of such other entities would not have to comply with the accounting and disclosure requirements for PBEs under ASC 842, *Leases*.

6.4.1 Separate financial statements

Rule 3-09 of Regulation S-X requires that Form 10-K, but not the annual shareholders' report, contain separate financial statements, prepared in accordance with Regulation S-X (including financial schedules), for equity method investees accounted for by the equity method when such entities are individually significant.¹⁰⁵ The Regulation S-X significant subsidiary tests are described later in this section under the

¹⁰⁵ Rule 3-09 of Regulation S-X also applies to significant unconsolidated subsidiaries. ASC 810 requires consolidation of all majority-owned subsidiaries except if control does not rest with the majority owner. Consequently, unconsolidated majority-owned subsidiaries will exist in limited circumstances (e.g., when a subsidiary is in legal reorganization, bankruptcy, under severe restrictions imposed by a foreign government, when minority owners have substantive participating rights (see ASC 810-10-25-2 through 25-14), or when a subsidiary is a VIE and the majority owner is not the primary beneficiary).

heading Significant subsidiary definition. The separate financial statements are only required to be audited¹⁰⁶ for those fiscal years in which the entity is individually significant at the 20% level applying the income test and investment test. However, if the prior year(s) are audited, for audits conducted in accordance with either AICPA or PCAOB standards, **AICPA AU-C 700.48**, Comparative Financial Statements and Comparative Information, and PCAOB AS 3105, Reports on Comparative Financial Statements, require that the auditors also report on the prior year(s), respectively. Rule 3-09 applies to all equity method investees, regardless of whether the investment is held by the registrant, a subsidiary or another investee. Accordingly, separate financial statements are required for any lower-tier investee in which the registrant's proportionate share of such investee meets the 20% test relative to consolidated financial statements of the registrant.

Financial statements of two or more equity method investees may be combined if they are under common management or common control as permitted by ASC 810-10-55-1B.

Insofar as practicable, these separate financial statements should be as of the same dates, and for the same periods, as the audited consolidated financial statements. If it is not practicable to provide separate financial statements at the same dates and for the same periods as the audited consolidated financial statements, the financial statements required by Rule 3-09 of Regulation S-X can be presented at a different date (e.g., the investee's fiscal year end). The filing in Form 10-K of the financial statements required by Rule 3-09 of Regulation S-X can become complicated if the fiscal years of the registrant and the investee differ, or if either the registrant or the investee is a large accelerated filer or an accelerated filer (see the When the report is due discussion in section 2).

6.4.2 Summarized financial information

Rule 4-08(g) of Regulation S-X requires consolidated financial statements in annual shareholders' reports and Form 10-K to include disclosure in the notes to the financial statements of summarized financial information about equity method investees if, individually or in the aggregate, they exceed 10% significance under any one of the three significant subsidiary tests. Registrants must present summarized financial information for the same periods as consolidated financial statements. Thus, registrants must present the summarized balance sheet information for the most recent two fiscal years and the summarized income statement information for the most recent three years.

In addition, the SEC staff generally believes that Rule 4-08(g) permits the aggregation of all equity investees, whether individually significant (i.e., greater than 10%) or not. However, in situations in which aggregation can be misleading or suppress important information, the SEC staff may request separate information. For example, the SEC staff might request that investees in different businesses be aggregated separately. The SEC staff also might request separate information for individual investees that are very significant quantitatively or qualitatively.

The SEC requires at least the following detail in the summarized financial information:

- ▶ Current assets
- ▶ Noncurrent assets
- ▶ Current liabilities

¹⁰⁶ The SEC staff has indicated that the audit of a non-issuer's financial statements that are filed with the SEC in order to comply with Rule 3-09 of Regulation S-X and are not referred to in the auditors' report need not be performed by an auditor registered with the PCAOB, and the auditor's report need not indicate the audit was performed in accordance with PCAOB standards (in which case the audit may be performed in accordance with, and refer to, the auditing standards of the AICPA).

- ▶ Noncurrent liabilities
- ▶ Redeemable preferred stock
- ▶ Noncontrolling interests
- ▶ Net sales or gross revenue
- ▶ Gross profit (or costs and expenses applicable to net sales or gross revenue)
- ▶ Income or loss from continuing operations
- ▶ Net income or loss
- ▶ Net income or loss attributable to the entity

No explanatory notes need accompany the summarized information.

In industries that usually do not present classified balance sheets, Rule 1-02(bb) of Regulation S-X states that “information shall be provided as to the nature and amount of the major components of assets and liabilities.” However, long-term liabilities and redeemable stock must be disclosed whether or not a classified balance sheet is presented.

Registrants in specialized industries may substitute other information if that will make their presentation more meaningful. For example, a finance company would disclose net loans receivable when that item is one of its largest assets. A bank could present total interest income, total interest expense, provision for loan losses, and security gains or losses. An insurance company could present net premiums earned, net investment income, underwriting costs and expenses and realized gains or losses on investments.

Separate audited financial statements for equity method investees may be included in the annual shareholders’ report and SEC filings in lieu of the summarized financial information required in the notes to the financial statements by Rule 4-08(g) of Regulation S-X, if the financial statements are prepared in accordance with US GAAP, IFRS as issued by the IASB, or are reconciled to US GAAP. This is consistent with ASC 323-10-50-3, which allows either the presentation of separate financial statements or summarized information in the reporting entity’s notes to the financial statements. When separate financial statements are presented for the most significant equity method investee, summarized information for the remaining entities is still required.¹⁰⁷

For example, if the annual shareholders’ report includes the separate audited financial statements of an equity investee otherwise required in Form 10-K by Rule 3-09 of Regulation S-X, the registrant’s financial statement notes need not include summarized financial information for the investee. However, if the investee is a foreign business, and its financial statements are presented on the basis of a GAAP other than US GAAP or IFRS as issued by the IASB and are not reconciled to US GAAP [because the investee is less than 30% significant (Item 17(c)(2)(vi)) of Form 20-F], the disclosures required by Rule 4-08(g) still must be provided and presented in accordance with US GAAP.

The SEC has emphasized that the information should be complete and that “requests for permission to omit some entities from the summarized financial information will not be granted in a routine manner” (FRR 213.03.b). However, it is not necessary to include information that is not practicable to furnish for entities that, individually and in the aggregate, are immaterial.

¹⁰⁷ However, if the aggregate significance of all remaining equity method investees does not exceed 10% (e.g., remaining significance is 6%) and the registrant considers summarized financial information for remaining investees to be immaterial, the SEC staff said it would not object to the omission of the Rule 4-08(g) disclosure in its entirety.

6.4.3 Example of the summarized financial information

The following example is an excerpt from a note to the consolidated financial statements in an annual shareholders' report. It illustrates the presentation of summarized financial information and assumes there are no noncontrolling interests in consolidated subsidiaries of any of the affiliates.

Illustration 6-2: Summarized financial information			
Summary financial information for affiliated companies (20% to 50%-owned) accounted for by the equity method is as follows:			
	20Y2	Affiliated companies 20Y1 (in thousands)	20Y0
Current assets	\$ 1,700	\$ 1,900	
Property, plant, equipment and other assets	1,330	1,100	
Current liabilities	700	900	
Long-term debt	1,130	1,200	
Net sales	11,000	9,000	\$ 7,500
Gross profit	3,000	2,800	2,200
Net income and net income attributable to the entity	1,500	1,000	800

When there are several affiliated companies, it is often helpful to readers to disclose the registrant's share of the net assets and net income of each entity.

6.4.4 Significant subsidiary definition

The significance of a subsidiary or investee is based on the "significant subsidiary" tests specified in Rule 1-02(w) of Regulation S-X. If any of the three significance tests are met at the 10% level for equity method investees, individually or in the aggregate, summarized financial information is required in a note to the consolidated financial statements in annual shareholders' reports and Form 10-K.¹⁰⁸ If either the investment test or the income test is individually met by an equity method investee at the 20% level, separate financial statements of the investee are required in Form 10-K. The term significant subsidiary means a subsidiary that meets any of the conditions above based on the following tests:

- ▶ **Asset test:** The registrant's and its other subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the subsidiary or investee compared to consolidated total assets as of the end of the most recently completed fiscal year
- ▶ **Investment test:** The registrant's and its other subsidiaries' investments in and advances to the subsidiary or investee as of the end of the most recently completed fiscal year compared to consolidated total assets
- ▶ **Income test:** The lower of the following two components:
 - ▶ The absolute value of the registrant's and its other subsidiaries' equity in the tested investee's income (loss) from continuing operations before income taxes (after intercompany eliminations) attributable to the controlling interest compared with such income on a consolidated basis

¹⁰⁸ These tests are based on the financial statements that the subsidiary or investee would file if it were a registrant (i.e., consolidated financial statements prepared in conformity with GAAP, including "pushdown" accounting, if appropriate).

- ▶ The registrant's proportionate share of the investee's revenue from continuing operations (after intercompany eliminations) compared with revenue from continuing operations of the registrant,¹⁰⁹ provided both the subsidiary and the registrant had material revenue in each of the last two years

If the revenue component of the income test does not apply (e.g., because the tested investee or the registrant does not have material revenue for each of the last two years) and the absolute value of the registrant's consolidated income (loss) from continuing operations before income taxes attributable to the controlling interest for the most recent fiscal year is at least 10% lower than the average of the absolute value of such amounts for each of its last five fiscal years, the registrant should apply the income test using its five-year average pretax income from continuing operations in the denominator. Amended Rule 1-02(w)(1)(iii) calls for using the absolute value of a registrant's consolidated income (loss) for each of the five years for purposes of the five-year average. Income averaging over any period for the investee is not permitted.

For purposes of the significance of foreign companies (either as the investor, unconsolidated subsidiary or investee), the significance tests must be computed using the investor's basis of accounting in both the numerator and denominator (e.g., US GAAP).

Rule 1-02(w) of Regulation S-X further provides that when a loss has been incurred in the current-year on a consolidated basis, or by the subsidiary or investee being tested (but not both), the equity in the income or loss of the tested subsidiary or investee should be excluded from consolidated income or loss in the test. For example:

	Situation 1	Situation 2
Income (loss) of tested subsidiary	\$ (1,000)	\$ 1,000
Income (loss) of parent and its subsidiaries	\$ 10,000	\$ (10,000)

Computation (for Situation 1): Income of parent and its subsidiaries excluding loss of tested subsidiary: $(\$10,000 - (\$1,000) = \$11,000)$; $1,000^{110}/11,000 = 9\%$ (subsidiary would not be significant)

Computation (for Situation 2): Loss of parent and its subsidiaries excluding income of tested subsidiary: $(\$10,000) - \$1,000 = (\$11,000)$; $1,000/11,000^{111} = 9\%$ (subsidiary would not be significant)

In addition, Rule 1-02(w) of Regulation S-X provides that when evaluating the aggregate significance of individually insignificant entities, the income test should be performed separately for profitable and loss entities (i.e., losses should not be offset against earnings). Aggregate losses of entities with losses and aggregate earnings of entities with earnings should be separately compared to the registrant's consolidated earnings or loss subject to the adjustment illustrated above.

As a general policy, the SEC staff does not allow alternative measures to determine significance; however, strict application of the above guidance could produce anomalous results in some circumstances. For example, if a registrant that has historically incurred significant losses reports a marginal profit for the most recent year, the rules would require that the marginal profit be used in applying the significant subsidiary income test. The SEC staff has said it will consider waiver requests when the application of the required tests provides anomalous results.

¹⁰⁹ For an investment accounted for under the fair value option, the SEC staff has expressed a view that the numerator for the revenue component should be calculated using the registrant's proportionate share of the investee's revenues as if the equity method of accounting had been applied.

¹¹⁰ Use the absolute value of the (\$1,000) loss for the subsidiary tested.

¹¹¹ Use the absolute value of the (\$11,000) loss of parent and subsidiaries, excluding the income of subsidiary tested.

Illustration 6-3: Calculating 20Y2 significance for income test, including five-year averaging calculation, under Rule 1-02(w)

- ▶ Investee income (loss) below represents the Registrant's proportionate share of Investee earnings
- ▶ Assume investment test under Rule 1-02(w) does not exceed 20% in any year presented
- ▶ The tested investee did not have material revenue during fiscal year 20Y1
- ▶ Income (loss) from continuing operations before income taxes, exclusive of amounts attributable to any noncontrolling interests:

	Registrant	Investee
20Y2	\$ 300	\$ 130
20Y1	\$ (300)	\$ 200
20Y0	\$ (400)	\$ (20)
20Y9	\$ 1,850	n/a
20Y8	\$ 1,350	n/a
20Y7	\$ 1,000	n/a

Computation: Registrant five-year average income (loss) from continuing operations before income taxes, exclusive of amounts attributable to noncontrolling interests: $\$300 + \$300^* + \$400^* + \$1,850 + \$1,350 = \$4,200/5 = \$840$

* Use absolute value in this calculation as required under Rule 1-02(w)
Conclusion: Registrant should use the five-year average of \$840 as the denominator in computing significance of Investee for the income test because 20Y2 income is at least 10% less than the average (in this case, 20Y2 income of \$300 is 64% less than the average of \$840). For 20Y2, separate audited financial statements of Investee are not required because Investee income of \$130 is only 15.5% of the five-year average income of Registrant of \$840. However, summarized financial information would be required.

Illustration 6-4: Calculating 20Y1 significance for income test under Rule 1-02(w)

Computation: Registrant five-year average income (loss) from continuing operations before income taxes, exclusive of amounts attributable to noncontrolling interests: $\$300^* + \$400^* + \$1,850 + \$1,350 + \$1,000 = \$4,900/5 = \$980$

* Use absolute value in this calculation as required under Rule 1-02(w)

Conclusion: Registrant should use the five-year average of \$980 for 20Y1 as the denominator in computing significance of Investee for the income test because 20Y1 income is at least 10% less than the average (in this case, \$300 (absolute value of 20Y1 loss of \$(300)) is 69% less than the average of \$980). For 20Y1, separate audited financial statements of Investee are required because Investee income of \$200 is 20.4% of the five-year average income of Registrant of \$980.

Because the Investee was significant in any one of the three years, the Investee's financial statements must be presented for all three years. However, separate audited financial statements of Investee only are required for 20Y1 because 20Y1 is the only year for which the income test is met at the 20% or greater level. The Investee's financial statements for 20Y2 and 20Y0 may be unaudited. However, if the 20Y0 financial statements had been audited in accordance with either AICPA or PCAOB standards, AICPA AU-C 700 and PCAOB AS 3105 require that the auditor also report on the 20Y0 financial statements, respectively.

6.4.4.1

Rule 3-09 considerations

Applying the income test to Rule 3-09: The numerator of the income component is calculated based on the registrant's proportionate share of the pretax income from continuing operations reflected in the separate financial statements of the investee for the period in which the registrant recognizes income or loss from the investee under the equity method, adjusted for any basis differences. In determining the basis differences, the registrant should consider ASC 323-10-35-34 and 35-32A. While not an exclusive list, items affecting net income of the registrant that should be excluded from the test are impairment charges at the investor level, gains/losses from stock sales by the registrant; dilution gains/losses from stock sales by the investee and preferred dividends. The financial information used in the significance tests must be based on GAAP for public business entities.

Furthermore, the SEC staff expressed its view that the denominator of the income test should reflect the amounts included in the registrant's income statement as income from continuing operations, after adjustment to place the denominator on a basis that is consistent with the numerator. Accordingly, adjustments should be made as necessary to reported pretax income to (1) adjust for noncontrolling interests in income of consolidated subsidiaries and (2) adjust equity in earnings of all equity method investees to exclude the effects of income tax accounting by those investees and the investor, as well as any discontinued operations reported by those investees. That is, adjustments should be made to the denominator for all items similar to those in the numerator to achieve an "apples to apples" calculation.

Rule 3-09 financial statements in the year in which an investee is acquired, disposed of, or changes status: In the year a registrant acquires a significant investee, the Form 10-K should include separate financial statements of the investee for the period of ownership. If the registrant determines that audited investee financial statements from the date of acquisition (or application of the equity method) cannot be obtained without undue difficulty or cost, the SEC staff indicated that it may favorably consider pre-filing requests to include investee financial statements for the entire year in lieu of financial statements from the date of acquisition (or application of the equity method). In addition, Rule 3-05 of Regulation S-X may require audited financial statements in registration statements or proxy statements for additional periods.

When a company disposes of an equity-method investment during the year (i.e., the registrant sells its entire interest or the interest is now eligible for cost-method accounting), the SEC staff expects the Form 10-K to include an income statement of the investee through the date of disposal if the investee otherwise met the income test at the 20% significance level, not including any gain or loss on disposal. However, if the registrant determines that audited investee financial statements through the date of disposal cannot be obtained without undue difficulty or cost, the SEC staff indicated that it may favorably consider a pre-filing request for (1) the presentation of summarized financial information pursuant to Rule 4-08(g) of Regulation S-X in lieu of full audited financial statements of the investee in the year of disposition or (2) the inclusion of investee financial statements for the entire year in lieu of financial statements through the date of disposition.

However, if the investee is sold near the end of the most recent fiscal year, the SEC staff may be more reluctant to waive the requirement if the investee is very significant, quantitatively or qualitatively, during that year. In this circumstance, the SEC staff will consider, among other things, the significance of the registrant's participation in the investee's business, whether similar investments comprise a significant part of the registrant's business, and whether significant intercompany transactions have occurred. However, the SEC staff also has indicated that it will not grant relief from Rule 3-09 of Regulation S-X if the investment is disposed after year end and is otherwise significant to the most recent fiscal year.

When a formerly consolidated wholly owned or majority-owned subsidiary becomes an equity-method investee, the SEC staff has expressed its view that the income test under Rule 1-02(w) of Regulation S-X in the year of change should include the registrant's equity in the investee's pretax earnings for the period of the fiscal year for which the equity method of accounting was applied to such investee.

Calculating significance of equity investees following a retrospective accounting change or the registrant's discontinued operation: The SEC staff believes that, following a change in accounting principle that requires retrospective application or a discontinued operation in the current fiscal year, the registrant need not remeasure significance using the restated financial statements in any registration statement or proxy statement filed during the current fiscal year (even if the restated financial statements of prior fiscal periods are required to be included in such filings). Registrants also do not need to recompute significance to determine whether the Rule 3-09 financial statements should be included in the Form 10-K for a fiscal year to which an accounting change was applied retrospectively.

However, for purposes of determining whether the Rule 3-09 financial statements should be included in the current fiscal year Form 10-K, the registrant should use the restated financial statements (for all periods presented), which reflect a discontinued operation, to determine whether the equity investee was significant for any period presented. Registrants should make the calculation at the end of each fiscal year based on the primary financial statements of the registrant presented in the annual report. As a result, previously insignificant equity-method investees (i.e., below 20% significance level) might now become significant and the current fiscal year Form 10-K might require separate financial statements of such equity-method investees for all periods presented, audited in the periods in which significant. Registrants are encouraged to contact the SEC staff if this application results in an impracticable answer based on the registrant's particular facts and circumstances.

In addition, the SEC staff indicated that in a scenario in which an equity investee was disposed of before the event that required retrospective presentation for an accounting change or discontinued operation, and the equity investee was not previously significant under Rule 3-09 of Regulation S-X, but became significant in the current period solely as a result of restatement because of the retrospective presentation, financial statements of that equity investee would not be required.

Similarly, if a registrant's financial statements are retroactively restated in accordance with ASC 323 to reflect equity-method accounting for an investment previously accounted for under the cost method, Rule 3-09 financial statements and summarized financial information may be required for periods in which the cost method was previously used if the significance tests are met.

Applying Rule 3-09 when a registrant and its equity investee have different year ends: When a registrant and its equity investee have different year ends, the registrant may or may not record its equity in earnings on a lag basis. Therefore, depending on the registrant's particular accounting treatment, questions arise as to how and when the significance tests should be performed. Generally, significance tests should be determined using the investee's financial results used by the registrant to calculate the registrant's equity in the income or loss of the investee presented in the registrant's financial statements, not amounts derived from the investee's financial statements required to be filed under S-X Rule 3-09. Illustration 6-5 illustrates the application of Rule 3-09 of Regulation S-X when the registrant records equity in earnings on a lag basis, and Illustration 6-6 illustrates the application of Rule 3-09 of Regulation S-X when the registrant does not record equity in earnings on a lag basis.

Illustration 6-5: Equity in earnings is recorded on a lag basis

- ▶ Registrant has a 31 December year end
- ▶ Equity investee has a 30 September year end and is not a foreign business
- ▶ Registrant records equity income on a three-month lag basis (i.e., the registrant records its equity in the investee's income for the fiscal year ended 30 September 20Y2 in its 31 December 20Y2 financial statements)

The SEC staff believes that the significance tests should be performed using the 30 September 20Y2 financial statements of the equity investee and the 31 December 20Y2 financial statements of the registrant.

Illustration 6-6: Equity in earnings is not recorded on a lag basis

- ▶ Registrant has a 31 December year end
- ▶ Equity investee has a 30 June year end and is not a foreign business
- ▶ The registrant's 31 December 20Y2 financial statements include its equity in the investee's income for the 12 months ended 31 December 20Y2 (i.e., there is no lag in reporting)

The SEC staff believes that the significance tests should be based on a period consistent with the amounts recognized in the registrant's financial statements. That is, the significance calculations should be based on the equity investee's adjusted 31 December 20Y2 results compared with the registrant's 31 December 20Y2 results.

In addition, registrants should file financial statements for the investee's fiscal year end that is closest to the registrant's fiscal year end to meet the requirements of Rule 3-09 of Regulation S-X. However, if the equity investee's fiscal year end differs from the registrant's fiscal year end by six months, the SEC staff said that the registrant should consider its specific facts and circumstances and follow a consistent approach on an investee by investee basis. For example, if the registrant's year end is 31 December 20Y2 and the equity investee has a 30 June year end, the registrant can determine whether to file the investee's financial statements for the fiscal year prior to the registrant's year end (e.g., 30 June 20Y2) or after the registrant's year end (e.g., 30 June 20Y3).

6.4.5

Example

The following example illustrates how to apply these tests to establish whether a registrant must file separate financial statements or summarized financial information of equity method investees.

Example 1 – Illustrates some of the disclosure combinations that can result under the rules. To limit the length of the example, only the income component of the test is illustrated (for illustration purposes, assume the revenue component is not applicable).

Company	Registrant's and its consolidated subsidiaries' share of pretax income (After intercompany eliminations)		
	Situation 1	Situation 2	Situation 3
<i>Investees</i>			
Company A	\$ 41,000	\$ 4,000	\$ 102,000
Company B	18,000	3,000	1,000
Company C	11,000	2,000	1,000
	<u>\$ 70,000</u>	<u>\$ 9,000</u>	<u>\$ 104,000</u>

Assume: Consolidated pretax income of \$500,000. Therefore, 10% equals \$50,000 and 20% equals \$100,000.

The minimum requirements for financial data are:

	Form 10-K Complete financial statements	Annual Shareholders' Reports and Form 10-K Summarized financial information in notes to consolidated financial statements
Situation 1	None	Presented for Companies A, B and C in the aggregate
Situation 2	None	None
Situation 3	Company A	None

The rule requires summarized financial information “for all such subsidiaries and persons.” FRR Section 213.03b (ASR No. 302, *Separate Financial Statements Required By Regulation S-X*) emphasizes that the information should be complete and that “requests for permission to omit some entities from the summarized financial information will not be granted in a routine manner.” However, summarized financial information for entities that are clearly immaterial may be omitted.

For example, in Situation 2 above, the investees represent less than 2% of consolidated income. If the investment test and other measures of materiality also resulted in immaterial amounts, the summarized information for the investees could be omitted.

Similarly, in Situation 3 above, investees B and C are clearly immaterial individually and in the aggregate. If other tests also resulted in immaterial amounts, summarized information for only Company A need be presented.

6.5 Preparing separate financial information of subsidiaries

The SEC staff views on the allocation of expenses in the financial statements of a registrant’s subsidiaries in SAB Topic 1.B and the FASB’s guidance about the application of “pushdown” accounting primarily apply to the subsidiaries’ financial statements that a registrant includes in its filings with the SEC. However, the provisions also pertain to subsidiary financial information included in the parent’s Form 10-K.

6.5.1 Pushdown accounting

When the FASB issued ASU 2014-17, which gives all acquired entities that are businesses or nonprofit activities the option to apply pushdown accounting in their separate financial statements when an acquirer obtains control of them, the SEC staff rescinded the guidance in SAB Topic 5.J, *New Basis of Accounting Required in Certain Circumstances*, that required registrants to apply pushdown accounting in certain circumstances.

Pushdown accounting reflects the new basis of accounting recorded by the parent at acquisition. In other words, the parent’s basis is reflected as the historical cost basis of assets and liabilities reflected in the subsidiary’s financial statements and summarized financial information.

6.5.2 Allocation of expenses

SAB Topic 1.B discusses the SEC staff’s approach to the allocation of expenses and related disclosure in the separate financial statements of subsidiaries, divisions or other components of a business when these financial statements are included in filings with the SEC. Because many of the costs of operating the components of a business are incurred by the parent company (e.g., income taxes, interest, advertising, accounting, legal), the SEC staff believes it is essential that the separate entity’s financial statements include its allocable share of these costs. SAB Topic 1.B provides specific guidance on allocating expenses, as well as the related disclosure requirements, and should be referred to when these separate financial statements are being prepared.

For annual reporting purposes, the primary thrust of SAB Topic 1.B is directed at the financial statements included in the Form 10-K of a registrant that has public securities and that also is a subsidiary of another entity (which incurs common costs on behalf of the subsidiary registrant).

The provisions of SAB Topic 1.B also are applicable to the separate financial statements (pursuant to S-X Rule 3-09) or summarized financial information (pursuant to S-X Rule 4-08(g)) included in the parent’s Form 10-K for unconsolidated subsidiaries. Generally, the financial statements of a significant unconsolidated subsidiary that is itself a registrant would be incorporated by reference from the unconsolidated subsidiaries’ Form 10-K, and therefore, already would reflect the provisions of SAB Topic 1.B.

6.6 Subsidiary guarantors or subsidiary issuers of guaranteed securities

Rule 3-10 allows companies to provide alternative disclosures in lieu of separate audited financial statements of subsidiary issuers and guarantors in certain cases.

The rules allow companies to provide alternative disclosures in lieu of separate audited financial statements of subsidiary issuers and guarantors if the parent company is (1) an issuer or co-issuer (jointly and severally) or (2) the full and unconditional guarantor of the registered debt securities of a consolidated subsidiary issuer.

To be a “full and unconditional” guarantor, the parent company must be obligated by the guarantee to make a scheduled payment immediately upon the subsidiary issuer’s failure to do so. Further, the holders of the guaranteed debt securities must have immediate legal recourse against the parent guarantor for its failure to pay.

In addition to the above criteria, the following conditions must be met to omit the separate subsidiary issuer and guarantor audited financial statements:

- ▶ The consolidated audited financial statements of the parent company have been filed.
- ▶ The subsidiary issuer/guarantor is consolidated in the parent company’s financial statements. (The subsidiary is no longer required to be 100% owned by the parent.)
- ▶ The guaranteed security is debt or debt-like.

Summarized financial information: Registrants are allowed to disclose summarized financial information (SFI), as defined under Rule 1-02(bb) of Regulation S-X, of the issuers and guarantors combined as a group (the obligor group). The disclosure of additional line items is required if it is material for investors to evaluate the sufficiency of the guarantee. At a minimum, SFI must include the following balance sheet and income statement line items, if applicable:

- ▶ Current assets, noncurrent assets, current liabilities, noncurrent liabilities and, when applicable, redeemable preferred stock and noncontrolling interests
- ▶ Net sales or gross revenues, gross profit, income/loss from continuing operations, net income/loss and net income/loss attributable to the group

Defining the obligor group and combined presentation: All eligible subsidiary issuers and guarantors may be combined with the parent company into a single column of SFI titled “Obligor Group,” unless further disaggregation is required. The SFI must be presented on a combined basis with intercompany transactions and resulting balances among the entities included in the obligor group eliminated.

Intercompany amounts between the obligor group and non-obligors must remain (that is, not eliminated for purposes of the disclosure) and be separately identified in the SFI in addition to other related-party transactions and balances. However, the SFI of the obligor group, including any SFI of disaggregated issuers and guarantors, must exclude non-obligor subsidiaries even if those entities are consolidated by entities in the obligor group. That is, an issuer’s or guarantor’s investment in a subsidiary that is not an obligor must be excluded from the SFI of the issuer or guarantor.

Periods presented: SFI must be presented for the most recent fiscal year presented in the parent company’s financial statements in the annual report on Form 10-K.

Materiality: Disclosure of additional SFI line items is required if it is material for investors to evaluate the sufficiency of the guarantee.

Disclosure required by the rules can be omitted using a different standard of materiality that is consistent with the US Supreme Court's definition. That is, disclosure otherwise required by the rules can be omitted if there is not a substantial likelihood that it would have been viewed by a reasonable investor as having significantly altered the total mix of information made available.

To help registrants evaluate whether they can omit disclosure on the basis it is not material, the SEC identified four examples of situations in which the SFI may be omitted. One of the four situations is where the assets, liabilities and the results of operations of the obligor group (on a combined but not consolidated basis) are not materially different from the corresponding amounts in the consolidated financial statements of the parent company.

Disclosure location: Rule 13-01 permits the disclosure of alternative guarantor information to be provided outside of the parent's financial statements in management's discussion and analysis. If the registrant elects to present the alternative disclosures information in the annual financial statements, it must be audited.

Duration of disclosure: The rules permit parent companies to cease reporting the alternative disclosures when the SEC reporting obligations of its subsidiary issuers and guarantors have been suspended or terminated.

Additional information on how to apply Rule 3-10 can be found in our Technical Line, [How to apply the SEC's new requirements for registered debt issued or guaranteed by subsidiaries.](#)

6.7 Affiliates whose securities collateralize the registrant's securities

Rule 13-02 requires disclosures about affiliates whose securities are pledged as collateral that are similar to those required about subsidiary issuers and guarantors. The disclosures in Rule 13-02 are not required for any secured debt offering registered before 4 January 2021 for which the registrant was not required to file separate S-X Rule 3-16 financial statements. Key considerations are discussed below.

Materiality: The disclosures are required if they are material.

Narrative disclosures: Rule 13-02 requires certain narrative disclosures, including descriptions of the securities pledged as collateral, each affiliate whose securities are pledged, the terms and conditions of the collateral arrangement, the events or circumstances that would require delivery of the collateral, and whether a trading market exists for the pledged securities.

Financial disclosures: SFI of the affiliates is also required under Rule 13-02, if material. Unlike the SFI for the obligor group for guaranteed securities, the financial information of all subsidiaries consolidated by an affiliate would be included in the SFI even if those subsidiaries' securities are not pledged as collateral. When there are multiple affiliates whose securities have been pledged as collateral, disaggregation of the SFI may be required, if disclosures about the items addressed in the narrative disclosures apply to one or more, but not all, of the affiliates.

Non-consolidated affiliates: In the rare cases when an affiliate whose securities have been pledged as collateral is not a consolidated subsidiary, the registrant must provide any additional financial and narrative information material for investors to evaluate the pledge; the information must be sufficient so that it is not misleading and might include separate financial statements of the unconsolidated affiliate.

See our *Form 10-K and registration statement checklist – supplement to GAAP disclosure checklist* (EY Form A69) for additional disclosures that might be applicable.

Unless the requirements of Rule 13-02 apply, each registered security issued and outstanding before 4 January 2021 is subject to the requirements of S-X Rule 3-16. While S-X Rule 3-16 requires registrants that pledge the securities of an affiliate as collateral to provide the separate audited financial statements of that affiliate, registrants have rarely been required to do so in practice. That's because the securities typically include a provision that removes the collateral when the SEC requirement to provide separate financial statements is triggered.

A summary of the final amended changes to Rule 3-10 of Regulation S-X and how to apply the new requirements can be found in our Technical Line, ***How to apply the SEC's new requirements for registered debt issued or guaranteed by subsidiaries.***

6.8 Regulation S-X waiver requests

Companies may request waivers or modifications to their financial reporting requirements under Rule 3-13 of Regulation S-X. Under certain circumstances, SEC rules may require companies to provide financial statements that are burdensome to generate but not material to the total mix of information available to investors. These companies may request permission from the SEC staff under Rule 3-13 to omit those statements or provide alternative information that may be of comparable benefit to investors.

We have observed indications that the SEC staff is receptive to working with companies making waiver requests under Rule 3-13 such as those required by Rule 3-09 of Regulation S-X.

The staff's authority to provide relief under Rule 3-13 is limited to financial statements only. Companies cannot use Rule 3-13 to request waivers from the SEC staff for US GAAP requirements or information other than financial statements (e.g., Regulation S-K disclosures).

As a reminder, a company's failure to obtain a waiver or comply with the reporting rules could prevent a registration statement from being declared effective or result in the filer being non-timely.

7 Financial schedules

This section includes the Regulation S-X rules for financial schedules, along with an example of each schedule. While the financial schedules will be required only in certain limited circumstances, it is important to recognize when each schedule is required and how to prepare it properly. For commercial and industrial companies, Rule 5-04 of Regulation S-X specifies which schedules are to be filed. The form and content of schedules is specified by Article 12 of Regulation S-X.

Schedules should be filed in support of each set of financial statements required by Article 3 of Regulation S-X. For example, if financial statements are filed for equity method investees under Rule 3-09 of Regulation S-X, schedules supporting those financial statements are required. However, the required schedule information may be presented in a single schedule with the information shown separately for each set of financial statements filed.

Schedules may be omitted when they are not applicable or the amounts are immaterial (as defined by specific materiality standards for each schedule and the general materiality standard of Rule 4-02 of Regulation S-X). Further, if the information required by any schedule is shown in the related financial statements or the notes thereto, the schedule may be omitted. When a schedule has been omitted, the reason for omission should be stated in Form 10-K. Usually this is set forth under Exhibits and Financial Statement Schedules required by Item 15(a) and (c) of Form 10-K.

Schedules are required to be audited if the related financial statements are required to be audited.

Some schedules are filed for the most recent balance sheet (e.g., 31 December 20Y2); whereas, other schedules are filed for each period for which an income statement is required (e.g., for each of the three years in the period ended 31 December 20Y2). The following table indicates the requirements for each schedule.

7.1 Filing requirements

Title	Filed for last balance sheet	Filed for each income statement
I Condensed financial information of registrant	*	*
II Valuation and qualifying accounts		X
III Real estate and accumulated depreciation	X	
IV Mortgage loans on real estate	X	
V Supplemental information concerning property-casualty insurance operations	*	*

* The information required by this schedule must be provided as of the same dates and for the same periods as the audited consolidated financial statements.

Note: The schedules on the following pages represent different situations and are not interrelated.

7.2 Schedule I – Condensed financial information of registrant

The schedule prescribed by Rule 12-04 of Regulation S-X should be filed when the restricted net assets (as defined in Rule 1-02(dd) of Regulation S-X) of consolidated subsidiaries exceed 25% of consolidated net assets as of the end of the most recently completed fiscal year.¹¹² The schedule prescribed by Rule 12-04 is titled “Condensed financial information of registrant” but it also is commonly and informally referred to as “parent-company-only condensed financial information” because it reflects the standalone financial statements of the parent/registrant legal entity excluding consolidated subsidiaries, and hence, shows the full amount of related intercompany receivables, payables and investments to such subsidiaries.

Rule 12-04. Condensed financial information of registrant

- (a) Provide condensed financial information about financial position, cash flows and results of operations of the registrant as of the same dates and for the same periods for which audited consolidated financial statements are required. The financial information required need not be presented in greater detail than is required for condensed statements by Rule 10-01(a)(2), (3) and (4) of Regulation S-X. Detailed footnote disclosure which would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations and guarantees. Descriptions of significant provisions of the registrant’s long-term obligations, mandatory dividend or redemption requirements of redeemable stocks and guarantees of the registrant shall be provided along with a five-year schedule of maturities of debt. If the material contingencies, long-term obligations, redeemable stock requirements and guarantees of the registrant have been separately disclosed in the consolidated statements, they need not be repeated in this schedule.
- (b) Disclose separately the amounts of cash dividends paid to the registrant for each of the last three fiscal years by consolidated subsidiaries, unconsolidated subsidiaries and 50%-or-less owned persons accounted for by the equity method, respectively.

The following example shows how condensed financial statements might be presented. This example is not intended to illustrate rigid presentation guidelines. Rule 10-01 of Regulation S-X allows flexibility in the level of detail presented in condensed financial statements.

¹¹² Section 6 of this publication provides guidance for determining restricted net assets.

Illustration 7-1: Schedule I

Assume that restricted net assets of consolidated subsidiaries exceed 25% of consolidated net assets at 31 December 20Y2.

Schedule I – Condensed financial information of registrant – ABC, Inc.*Condensed balance sheets*

	December 31	
	20Y2	20Y1
	(In thousands)	
Assets		
Current assets		
Cash	\$ 5,000	\$ 2,500
Accounts receivable (including \$125,000 and \$167,000 due from subsidiaries in 20Y2 and 20Y1, respectively), less allowances – \$150,000 in 20Y2 and 20Y1	7,500	8,000
Inventories	3,500	2,500
Prepaid expenses	<u>250</u>	<u>300</u>
Total current assets	16,250	13,300
Property, plant and equipment	25,000	17,500
Less accumulated depreciation	<u>(10,000)</u>	<u>(8,500)</u>
	15,000	9,000
Other assets (principally investment in and amounts due from wholly owned subsidiaries)	<u>95,250</u>	<u>79,700</u>
	<u>\$126,500</u>	<u>\$102,000</u>
Liabilities and shareholders' equity		
Current liabilities	\$ 11,500	\$ 10,050
Long-term debt	28,000	14,000
Other noncurrent liabilities	7,300	7,000
Shareholders' equity		
Common stock	3,000	2,900
Other shareholders' equity	75,000	69,050
Accumulated other comprehensive income (loss), net of tax	<u>1,700</u>	<u>(1,000)</u>
	<u>79,700</u>	<u>70,950</u>
	<u>\$126,500</u>	<u>\$102,000</u>

See accompanying notes to condensed financial statements.

Schedule I – Condensed financial information of registrant – ABC, Inc. – Continued**Condensed statements of income**

	Year ended December 31		
	20Y2	20Y1	20Y0
	(In thousands)		
Net sales and gross revenue	\$ 17,500	\$ 15,000	\$ 16,000
Management fees from wholly owned subsidiaries	<u>1,500</u>	<u>2,000</u>	<u>2,500</u>
	19,000	17,000	18,500
Costs and expenses:			
Cost of products sold	7,490	6,060	6,450
Selling and administrative expenses	3,400	4,400	2,100
Interest expense	<u>3,610</u>	<u>2,040</u>	<u>2,550</u>
	<u>14,500</u>	<u>12,500</u>	<u>11,100</u>
Income before income taxes and equity in net income of subsidiaries	4,500	4,500	7,400
Federal and state income tax	<u>(2,250)</u>	<u>(2,250)</u>	<u>(3,200)</u>
Income before equity in net income of subsidiaries	2,250	2,250	4,200
Equity in net income of subsidiaries	<u>5,990</u>	<u>2,750</u>	<u>2,300</u>
Net income	<u>8,240</u>	<u>5,000</u>	<u>6,500</u>
Other comprehensive income (loss), before tax	5,400	(2,500)	5,100
Income tax expense (benefit) related to items of other comprehensive income	<u>(2,700)</u>	<u>1,250</u>	<u>(2,100)</u>
Other comprehensive income (loss)	2,700	(1,250)	3,000
Comprehensive income	<u>\$ 10,940</u>	<u>\$ 3,750</u>	<u>\$ 9,500</u>

See accompanying notes to condensed financial statements.

Condensed statements of cash flows

	Year ended December 31		
	20Y2	20Y1	20Y0
	(In thousands)		
Net cash from operating activities	\$ 11,200	\$ 7,500	\$ 8,350
Investing activities:			
Acquisition of Future Corp.	(10,000)	-	-
Purchases of property, plant and equipment	(7,900)	(1,950)	(1,550)
Other	<u>500</u>	<u>-</u>	<u>200</u>
	(17,400)	(1,950)	(1,350)
Financing activities:			
Proceeds from issuing debentures	15,000	-	-
Proceeds from sale of common stock	1,000	-	-
Dividends paid	(2,950)	(2,900)	(2,320)
Payments on long-term obligations	(1,350)	(1,160)	(1,240)
Net decrease in short-term borrowings	<u>(3,000)</u>	<u>(1,000)</u>	<u>(2,500)</u>
	<u>8,700</u>	<u>(5,060)</u>	<u>(6,060)</u>
Increase in cash	<u>\$ 2,500</u>	<u>\$ 490</u>	<u>\$ 940</u>

See accompanying notes to condensed financial statements.

Schedule I – Condensed financial information of registrant – ABC, Inc. – Continued**Notes to Condensed Financial Statements**
(In Thousands)**Note A – Basis of presentation**

In the parent-company-only financial statements, the Company's investment in subsidiaries is stated at cost plus equity in undistributed earnings of subsidiaries since the date of acquisition. The Company's share of net income of its unconsolidated subsidiaries is included in consolidated income using the equity method. The parent-company-only financial statements should be read in conjunction with the Company's consolidated financial statements.

Note B – Long-term debt¹¹³

Long-term debt consisted of the following at December 31:

	<u>20Y2</u>	<u>20Y1</u>
	<i>(In thousands)</i>	
7% convertible sinking fund debentures due through 20Y5	\$ 14,000	\$ 15,000
10% debentures due through 20Z3	<u>15,000</u>	<u>–</u>
	29,000	15,000
Less current portion	<u>1,000</u>	<u>1,000</u>
	<u>\$ 28,000</u>	<u>\$ 14,000</u>

Maturities of long-term debt for the five years succeeding December 31, 20Y2 are \$1,000 in 20Y3, \$2,500 in 20Y4, \$13,500 in 20Y5, \$1,500 in 20Y6, \$1,500 in 20Y7, and \$9,000 thereafter.

Through June 30, 20Y5, the 7% debentures are convertible into shares of common stock at the rate of one share for each \$40 face amount. The 7% convertible sinking fund debentures are secured by accounts receivable, inventory and other general current assets of the Company.

In 20Y2, the Company sold \$15,000 in 10% debentures to finance the purchase of Future Corp. and partially finance the construction of the Company's new plant. The debt is collateralized by the new plant with a carrying amount at December 31, 20Y2 of \$11,200. The debenture matures in annual principal installments of \$1,500 beginning in 20Y4. The indentures for both issues of debentures include, among other things, provisions relative to additional borrowings, maintenance of working capital and restrictions on the amount of retained earnings available for the payment of dividends. Under the most restrictive of these covenants, retained earnings in the amount of \$32,000 were free of such limitations at December 31, 20Y2.

Note C – Guarantee¹²⁰

UVW Corp., a subsidiary of the Company, has \$7,000 of long-term debt outstanding. Under the terms of the debt agreement, the Company has guaranteed the payment of all principal and interest. In the event of a default under the debt agreement, the Company will be directly liable to the debt holders. The debt matures at various times between 20Y4 and 20Y6. The maximum potential amount that the Company could be liable for under the guarantee is approximately \$10,200.

¹¹³ If in the consolidated financial statements these items were identified as relating to the parent, Notes B and C could be omitted from the schedule.

Schedule I – Condensed financial information of registrant – ABC, Inc. – Continued**Note D – Dividends from subsidiaries and investees**

Cash dividends paid to ABC, Inc. from the Company's consolidated subsidiaries and investees accounted for by the equity method are summarized as follows:

	Year ended December 31		
	20Y2	20Y1	20Y0
	<i>(In thousands)</i>		
Consolidated subsidiaries	\$ 750	\$ 800	\$ 700
Investees	50	50	40
	<u>\$ 800</u>	<u>\$ 850</u>	<u>\$ 740</u>

7.3

Schedule II – Valuation and qualifying accounts

The schedule prescribed by Rule 12-09 of Regulation S-X is required to be filed in support of valuation and qualifying accounts included in each balance sheet. Many registrants comply with this requirement by including the required information in the notes to the financial statements. (Also see Rule 4-02 of Regulation S-X regarding omission of immaterial items and combination of insignificant amounts).

Rule 12-09 Valuation and qualifying accounts

COL. A	COL. B	COL. C		COL. D	COL. E
		Additions			
		(1)	(2)		
Description ¹	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts – describe	Deductions – describe	Balance at end of period

¹ List, by major classes, all valuation and qualifying accounts and reserves not included in specific schedules. Identify each class of valuation and qualifying accounts and reserves by descriptive title. Group (a) those valuation and qualifying accounts which are deducted in the balance sheet from the assets to which they apply and (b) those reserves which support the balance sheet caption, Reserves. Valuation and qualifying accounts and reserves as to which the additions, deductions and balances were not individually significant may be grouped in one total and in such case the information called for under columns C & D need not be given.

Commentary

This schedule is required for each period for which an income statement is required and the valuation or qualifying account was material. Note that the instructions to the schedule require disclosures to be grouped in (a) those valuation and qualifying accounts which are deducted in the balance sheet from the assets to which they apply and (b) those reserves which support the balance sheet caption, "Reserves."

Illustration 7-2: Schedule II

Assume:	Year ended December 31		
	20Y2	20Y1	20Y0
	<i>(In thousands)</i>		
Allowance for doubtful accounts	\$ 850	\$ 775	\$ 600
Reserve for cash discounts	600	525	500
Investments, advances and other assets (reserve for uncollectible advances)	400	–	–
Totals	<u>\$ 1,850</u>	<u>\$ 1,300</u>	<u>\$ 1,100</u>

Schedule II – Valuation and qualifying accounts

ABC, Inc. and subsidiaries

31 December 20Y2

(In Thousands)

COL. A Description	COL. B Balance at beginning of period	COL. C Additions		COL. D. Deductions – describe	COL. E Balance at end of period
		Charged to costs and expenses	Charged to other accounts – describe		
Year Ended 31 December 20Y2:					
Deducted from assets accounts:					
Allowance for doubtful accounts	\$ 775	\$ 675		\$ 600 ⁽¹⁾	\$ 850
Reserve for cash discounts	525	2,075		2,000 ⁽²⁾	600
Investments, advances, and other assets	–	400		–	400
Total	<u>\$ 1,300</u>	<u>\$ 3,150</u>		<u>\$ 2,600</u>	<u>\$ 1,850</u>
Year Ended 31 December 20Y1:					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 600	\$ 675		\$ 500 ⁽¹⁾	\$ 775
Reserve for cash discounts	500	2,000		1,975 ⁽²⁾	525
Total	<u>\$ 1,100</u>	<u>\$ 2,675</u>		<u>\$ 2,475</u>	<u>\$ 1,300</u>
Year Ended 31 December 20Y0:					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 550	\$ 350		\$ 300 ⁽¹⁾	\$ 600
Reserve for cash discounts	650	1,450		1,600 ⁽²⁾	500
Total	<u>\$ 1,200</u>	<u>\$ 1,800</u>		<u>\$ 1,900</u>	<u>\$ 1,100</u>

⁽¹⁾ Uncollectible accounts written off, net of recoveries.⁽²⁾ Discounts taken by customers during year.

Note: The instructions require that those accounts that are deducted from asset accounts be stated separately from those which support the balance sheet caption, "Reserves."

7.4

Schedule III – Real estate and accumulated depreciation

The schedule prescribed by Rule 12-28 of Regulation S-X should be filed for real estate (and the related accumulated depreciation) held by persons a substantial portion of whose business is that of acquiring and holding for investment real estate or interests in real estate, or interests in other persons a substantial portion of whose business is that of acquiring and holding real estate or interests in real estate for investment. Real estate used in the business should be excluded from the schedule.

Rule 12-28. Real estate and accumulated depreciation¹

(For certain real estate companies)

COL. A	COL. B	COL. C		COL. D		COL. E			COL. F	COL. G	COL. H	COL. I
Description ²	Encumbrances	Initial Cost to Company		Cost Capitalized Subsequent to Acquisition		Gross Amount at Which Carried at Close of Period ^{3, 4, 5, 6, 7}			Accumulated Depreciation	Date of Construction	Date Acquired	Life on Which Depreciation in Latest Income Statements is Computed
		Land	Buildings and Improvements	Improvements	Carrying Costs	Land	Buildings and Improvements	Total				

¹ All money columns shall be totaled.

² The description for each property should include type of property (e.g., unimproved land, shopping center, garden apartments, etc.) and the geographical location.

³ The required information is to be given as to each individual investment included in column E except that an amount not exceeding five percent of the total of column E may be listed in one amount as "miscellaneous investments."

⁴ In a note to this schedule, furnish a reconciliation in the following form, of the total amount at which real estate was carried at the beginning of each period for which income statements are required, with the total amount shown in column E.

Balance at beginning of period.....	\$.....
Additions during period:	
Acquisitions through foreclosure	\$.....
Other acquisitions .....	.....
Improvements, etc. ....	.....
Other (describe) .....	.....
.....
Deductions during period:	
Cost of real estate sold	\$.....
Other (describe) .....	.....
Balance at close of period	\$.....

If additions, except acquisitions through foreclosure, represent other than cash expenditures, explain. If any of the changes during the period result from transactions, directly or indirectly with affiliates, explain the bases of such transactions and state the amounts involved. A similar reconciliation shall be furnished for the accumulated depreciation.

⁵ If any item of real estate in investments has been written down or reserved against, describe the item and explain the basis for the write-down or reserve.

⁶ State in a note to column E the aggregate cost for Federal income tax purposes.

⁷ The amount of all intercompany profits included in the total of column E shall be stated, if material.

Commentary

Schedule III is required only for certain real estate companies as described by Rule 5-04 of Regulation S-X. Real estate used in the business should be excluded from the schedule.

This schedule is required only to support the most recent balance sheet required. However, reconciliations of the changes in real estate and accumulated depreciation (Note 4 of Rule 12-28 of Regulation S-X) are required in support of each income statement required, as shown in the example. As with the other schedules, this schedule is not required to be separately presented if all of the required information is included in the financial statements or notes thereto. The staff has also accepted summarized presentation by type (e.g., self-storage, single family homes, geography) for entities with a significant number of real estate investments.

Illustration 7-3: Schedule III

The illustrative Schedule III presented below assumes that ABC Real Estate Corp. and subsidiaries is required to file this schedule.

Schedule III – Real estate and accumulated depreciation
ABC Real Estate Corp. and subsidiaries
31 December 20Y2
(In Thousands)

COL. A Description	COL. B Encumbrances	COL. C Initial Cost to Company		COL. D Cost Capitalized Subsequent to Acquisition		COL. E Gross Amount at Which Carried at Close of Period			COL. F Accumulated Depreciation	COL. G Date of Construction	COL. H Date Acquired	COL. I Life on Which Depreciation In Latest Income Statements is Computed
		Land	Buildings and Improvements	Improvements	Carrying Costs	Land	Buildings and Improvements	Total				
Office Buildings:												
ABC Bldg. (Ashtabula, Ohio)		\$ 200	\$3,000	\$ 250	\$ 62	\$ 200	\$3,250	\$3,450	\$ 275	1-X0	3-X0	40 Yrs. ⁽¹⁾ 10 Yrs. ⁽²⁾
XYZ Bldg. (San Leandro, California)	\$1,000	100	2,000	100		100	2,100	2,200	30	5-X3	8-X3	40 Yrs. ⁽¹⁾ 10 Yrs. ⁽²⁾
Motels:												
ABC Inn (Springfield, Missouri)		50	1,200	80	\$ 62	50	1,342	1,392	50	2-X0	2-X0	20 Yrs. ⁽¹⁾ 10 Yrs. ⁽²⁾
XYZ Motel (Johnstown, Pennsylvania)	500	18	1,000	40		18	1,040	1,058	148	9-X3	9-X3	20 Yrs. ⁽¹⁾ 10 Yrs. ⁽²⁾
Miscellaneous Investments	100	10	400			10	400	410	140	Various	Various	Various
Totals	\$1,600	\$ 378	\$7,600	\$ 470	\$ 62	\$ 378	\$8,132	\$8,510^(3,4)	\$ 643⁽⁴⁾			

	Year Ended December 31 (In Thousands)	
	20Y2	20Y1
Investment in real estate:		
Balance at beginning of year	\$ 4,918	\$ 4,918
Additions through cash expenditures	3,412	-
Improvements	180	-
Balance at end of year	<u>\$ 8,510</u>	<u>\$ 4,918</u>
Accumulated Depreciation:		
Balance at beginning of year	\$ 376	\$ 197
Additions charged to costs and expenses	267	179
Balance at end of year	<u>\$ 643</u>	<u>\$ 376</u>

(1) Estimated useful life for buildings
(2) Estimated useful life for furniture and fixtures
(3) Represents aggregate cost for federal income tax purposes.
(4) Reconciliation of "Real Estate and Accumulated Depreciation"

7.5

Schedule IV – Mortgage loans on real estate

The schedule prescribed by Rule 12-29 of Regulation S-X should be filed by persons specified under Schedule III for investments in mortgage loans on real estate.

Rule 12-29. Mortgage loans on real estate¹**(For certain real estate companies)**

COL. A	COL. B	COL. C	COL. D	COL. E	COL. F	COL. G	COL. H
Description <small>2, 3, 4</small>	Interest Rate	Final Maturity Date	Periodic Payment Terms ⁵	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages <small>3, 6, 7, 8, 9</small>	Principal Amount of Loans Subject to Delinquent Principal or Interest ¹⁰

¹ All money columns shall be totaled.

² The required information is to be given for each individual mortgage loan which exceeds three percent of the total of column G.

³ If the portfolio includes large numbers of mortgages most of which are less than three percent of column G, the mortgages not required to be reported separately should be grouped by classifications that will indicate the dispersion of the portfolio, i.e., for a portfolio of mortgages on single family residential housing. The description should also include number of loans by original loan amounts (e.g., over \$100,000, \$50,000-\$99,999, \$20,000-\$49,999, under \$20,000) and type loan (e.g., VA, FHA, Conventional). Interest rates and maturity dates may be stated in terms of ranges. Data required by columns D, E and F may be omitted for mortgages not required to be reported individually.

⁴ Loans should be grouped by categories, e.g., first mortgage, second mortgage, construction loans, etc., and for each loan the type of property, e.g., shopping center, high-rise apartments, etc., and its geographic location should be stated.

⁵ State whether principal and interest is payable at level amount over life to maturity or at varying amounts over life to maturity. State amount of balloon payment at maturity, if any. Also state prepayment penalty terms, if any.

⁶ In a note to this schedule, furnish a reconciliation in the following form, of the carrying amount of mortgage loans at the beginning of each period for which income statements are required, with the total amount shown in column G.

Balance at beginning of period		\$.....
Additions during period:		
New mortgage loans	\$.....	
Other (describe) .....	.....
.....	\$.....
Deductions during period:		
Collection of principal.....	\$.....	
Foreclosures .....	.....
Cost of mortgages sold.....	.....
Amortization of premium.....	.....
Other (describe) .....	.....	.....
Balance at close of period		\$.....

If additions represent other than cash expenditures, explain. If any of the changes during the period result from transactions, directly or indirectly, with affiliates, explain the bases of such transactions, and state the amounts involved. State the aggregate mortgages (a) renewed and (b) extended. If the carrying amount of new mortgages is in excess of the unpaid amount of the extended mortgages, explain.

⁷ If any item of mortgage loans on real estate investments has been written down or reserved against, describe the item and explain the basis for the write-down or reserve.

⁸ State in a note to column G the aggregate cost for Federal income tax purposes.

⁹ The amount of all intercompany profits included in the total of column G shall be stated, if material.

¹⁰ (a) Interest in arrears for less than three months may be disregarded in computing the total amount of principal subject to delinquent interest. (b) Of the total principal amount, state the amount acquired from controlled and other affiliates.

Commentary

Schedule IV is required only for certain real estate companies as described by Rule 5-04 of Regulation S-X. This schedule is required only in support of the most recent balance sheet required. However, reconciliations of the changes in mortgage loans (see Note 6 of Rule 12-29 of Regulation S-X) are required to support each income statement required, as shown in the example.

Illustration 7-4: Schedule IV

The illustrative Schedule IV presented below assumes that ABC Real Estate Corp. and subsidiaries is required to file this schedule.

Schedule IV – Mortgage loans on real estate ABC Real Estate and subsidiaries 31 December 20Y2 (In Thousands)							
COL. A	COL. B	COL. C	COL. D	COL. E	COL. F	COL. G	COL. H
Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
Short-term construction loan: Billings, Montana Garden Apartments	Prime + 3%	20YY	Principal payable in full at maturity		\$ 4,000	\$ 3,500	(3)
Long-term first mortgage loan: Springfield, Ohio Sports Coliseum	10 1/2%	20YY	Payable in semi-annual installments of \$175,000 plus interest		7,000	7,000	
Long-term junior mortgage loans: For loans, each having a carrying amount less than 3% of total carrying amount	10 1/2%	20YY-20YY	Various	\$ 1,000 ⁽²⁾	300	300	
		Totals		\$ 1,000	\$ 11,300	\$ 10,800 ⁽¹⁾	

See accompanying notes to this schedule on the following page.

- (1) For Federal income tax purposes, the aggregate cost of investments in mortgage loans on real estate is the carrying amount, as disclosed in the schedule.
- (2) The first mortgage loans on these properties are not held by the Company. Accordingly, the amounts of the prior liens at 31 December 20Y2 are estimated.
- (3) No mortgage loans are delinquent with respect to principal or interest.
- (4) Loans included in the schedule which were extended or renewed during the year aggregated approximately \$210,000.
- (5) Reconciliation of "Mortgage Loans on Real Estate:"

	Year ended December 31		
	20Y2	20Y1	20Y0
	<i>(In Thousands)</i>		
Balance at beginning of year	\$ 7,000	\$ 4,550	\$ 2,650
Additions during year:			
New mortgage loans and additional advances on existing loans	4,200	2,800	2,000
Interest income added to principal	300	300	300
Amortization of discount	200	-	-
	<u>11,700</u>	<u>7,650</u>	<u>4,950</u>
Deductions during year:			
Collection of principal	800	650	400
Foreclosure	100	-	-
	<u>900</u>	<u>650</u>	<u>400</u>
Balance at end of year	<u>\$ 10,800</u>	<u>\$ 7,000</u>	<u>\$ 4,550</u>

7.6

Schedule V – Supplemental information concerning property-casualty insurance operations

The schedule prescribed by Rule 12-18 of Regulation S-X should be filed when a registrant, its subsidiaries or 50%-or-less-owned equity basis investees have liabilities for property-casualty (P/C) insurance claims. The required information should be presented as of the same dates and for the same periods for which the information is reflected in the audited consolidated financial statements required by Rules 3-01 and 3-02 of Regulation S-X. The schedule may be omitted if reserves for unpaid P/C claims and claims adjustment expenses of the registrant and its consolidated subsidiaries, its unconsolidated subsidiaries and its 50%-or-less-owned equity basis investees did not, in the aggregate, exceed one half of common stockholders' equity of the registrant and its consolidated subsidiaries as of the beginning of the fiscal year. For purposes of this test, only the proportionate share of the registrant and its other subsidiaries in the reserves for unpaid claims and claim adjustment expenses of 50%-or-less-owned equity basis investees taken in the aggregate after intercompany eliminations should be taken into account.

Rule 12-18. Supplemental information (for property-casualty insurance underwriters)¹

COL. A	COL. B	COL. C	COL. D	COL. E	COL. F	COL. G	COL. H		COL. I	COL. J	COL. K
Affiliation with registrant	Deferred policy acquisition costs	Reserves for unpaid claims and claim adjustment expenses	Discount, if any, deducted in Column C ⁴	Unearned premiums	Earned premiums	Net investment income	Claims and claim adjustment expenses incurred related to		Amortization of deferred policy acquisition costs	Paid claims and claim adjustment expenses	Premiums written
							(1) Current year	(2) Prior year			

(a) Consolidated property-casualty entities²

(b) Unconsolidated property-casualty subsidiaries^{2,3}

(c) Proportionate share of registrant and its subsidiaries' 50%-or-less owned property casualty equity investees^{2,3}

¹ Information included in audited financial statements, including other schedules, need not be repeated in this schedule. Columns B, C, D and E are as of the balance sheet dates, columns F, G, H, I, J and K are for the same periods for which income statements are presented in the registrant's audited consolidated financial statements.

² Present combined or consolidated amounts, as appropriate for each category, after intercompany eliminations.

³ Information is not required here for 50%-or-less owned equity investees that file similar information with the Commission as registrants in their own right, if that fact and the name of the affiliated registrant are stated. If ending reserves in any category (a), (b) or (c) above is less than 5% of total reserves otherwise required to be reported in this schedule, that category may be omitted and that fact so noted. If the amount of the reserves attributable to 50%-or-less owned equity investees that file this information as registrants in their own right exceeds 95% of the total category (c) reserves, information for the other 50%-or-less owned equity investees need not be provided.

⁴ Disclose in a footnote to this schedule the rate, or range of rates, estimated if necessary, at which the discount was computed for each category.

Illustration 7-5: Schedule V

The illustrative Schedule V presented below assumes that ABC Holdings, Inc. and subsidiaries is required to file this schedule.

Schedule V – Supplemental information concerning property-casualty insurance operations											
ABC Holdings, Inc. and subsidiaries											
31 December 20Y2											
<i>(In Thousands)</i>											
COL. A	December 31					Year ended December 31					
	COL. B	COL. C	COL. D	COL. E	COL. F	COL. G	COL. H		COL. I	COL. J	COL. K
Affiliation with Registrant	Deferred Policy Acquisition Costs	Reserves for Unpaid Claims and Claim Adjustment Expenses	Discount, if any, Deducted in Column C ¹	Unearned Premiums	Earned Premiums	Net Investment Income	Claims and Claim Adjustment Expenses Incurred Related to	(2) Prior Year	Amortization of Deferred Policy Acquisition Costs	Paid Claims and Claim Adjustment Expenses	Premiums Written
Registrant and consolidated subsidiaries:							Current Year (1)				
20Y2	\$ 99,692	\$ 2,586,048	\$ 6,277	\$ 551,626	\$ 1,221,127	\$ 294,568	\$ 1,042,431	\$ 73,643	\$ 243,004	\$ 952,771	\$ 1,284,024
20Y1	96,380	2,378,310	8,249	485,419	1,095,504	235,100	902,811	40,194	224,578	901,384	1,097,148
20Y0	101,091	2,063,944	7,318	459,504	1,073,434	239,976	897,922	42,133	236,890	737,531	1,101,697

¹ Certain long-term disability payments for workers' compensation are discounted at rates ranging from 5% to 8%.

8 Notification of late filing

A registrant must notify the SEC when it is not able to file all or any portion of Form 10-K when due. The SEC will not grant extensions beyond the prescribed due date. However, if a registrant meets certain conditions under a specific relief provision, the SEC may deem its Form 10-K to have been filed timely even if it actually was filed up to 15 days late. All companies, including large accelerated filers and accelerated filers are eligible for this relief.

This section explains the requirements of Rule 12b-25 of Regulation 12B, *Registration and Reporting*, and related Form 12b-25, for notifying the SEC of late filings. The following discussion focuses on Form 10-K, but the requirements of Rule 12b-25 also apply to late filings on Forms 10-Q, 11-K, 20-F, 10-D, N-SAR, N-CSR and transition reports on Forms 10-K and 10-Q (see When the report is due discussion in section 2).

This section does not discuss the requirements of electronic filers unable to file a report solely due to electronic difficulties, including submission or posting of an Interactive Data File. Registrants should see Rule 201 or Rule 202 of Regulation S-T regarding late electronic postings.

8.1 Importance of timely filing

Late filing of Form 10-K is a serious matter. In announcing the current rules, a 1980 SEC Release (No. 33-6203) stated:

“It should be emphasized that the new notification and relief procedures should not be taken as an excuse for non-timely reporting. Failure by public companies to observe the periodic reporting requirements presents an obstacle to the maintenance of fair and informed trading markets in the securities of publicly-held companies. The pricing mechanism of the market is dependent on timely information and, thus, late reporting may adversely affect the quality of this process. In this regard, the Commission will, of course, continue to consider enforcement actions in connection with delinquent reporting.”

In subsequent releases, the SEC has commented on the need for greater diligence by registrants to achieve timely and complete filing of reports. If a registrant does not file Form 10-K by its due date, or does not comply with conditions for the 15-day relief period, the registrant has violated the applicable provisions of the Exchange Act. In such a case, the registrant would be subject to a potential enforcement proceeding by the SEC and a possible suspension in trading in addition to a number of other consequences discussed below.

8.2 Other possible consequences of late filing

There are a number of other possible consequences of late filing. For example, as long as a registrant fails to file any report required under the Exchange Act, the SEC will not permit any of its Securities Act registration statements to become effective.¹¹⁴ In addition, to use Form S-3, an issuer must have complied in all respects, including timeliness, with the reporting requirements of the Exchange Act for the last 12 months. Companies that otherwise meet the definition of a well-known seasoned issuer (see section 3 of this publication) would not be eligible to file an automatic shelf registration statement because timely filing for the last 12 months is a Form S-3 eligibility requirement.

¹¹⁴ SEC Release No. 33-5196 dated 27 September 1971.

For certain shareholders to sell restricted securities (and for affiliates to sell any securities) under Securities Act Rule 144, the registrant must have filed the reports required by the Exchange Act during the 12 months preceding the sale. Therefore, as long as a required report remains unfiled, the issuer's stock may not be sold by these individuals under Rule 144.

8.3 Rule 12b-25 and Form 12b-25

If it cannot file all or any required portion of Form 10-K within the prescribed time period, the registrant must notify the SEC on Form 12b-25.¹¹⁵ This form serves as a disclosure mechanism and is available via EDGAR. Thus, information is available to the public about a registrant's reasons for not filing a periodic report or a portion of a report on time.

In certain circumstances, a registrant may file Form 10-K up to 15 days late and still not suffer the consequences of a late filing. A specific relief provision of Rule 12b-25 provides that the SEC will deem a late Form 10-K to have been filed timely if *all* of the following conditions are met:

- ▶ A properly filed notification on Form 12b-25 discloses that filing timely would have caused unreasonable effort or expense, and the registrant agrees that the Form 10-K, or the delinquent portion thereof, will be filed no later than the fifteenth calendar day following the original due date (fifth calendar day for Form 10-Q).
- ▶ The registrant attaches, where applicable, a statement from any person other than the registrant (e.g., actuary, engineer, independent auditor) whose inability to furnish a required opinion, report or certification, was the reason that the Form 10-K could not be filed on time.
- ▶ The Form 10-K, or the delinquent portion thereof, is filed within the represented time period (see above).

The SEC staff has expressed concern that some companies may be using Form 12b-25 to delay disclosing financial difficulties. To deter such actions, the SEC staff examines Forms 12b-25 as they are filed and reviews the registrant's related reports. The staff expects transparent disclosure explaining the reasons for the delay.

In addition to the requirements for the relief provision described above, the instructions for the form are summarized as follows:

- ▶ The form must be filed by registrants who are unable to file in a timely fashion: (1) all or any portion of an annual report, a quarterly report, transition report or distribution report required by Sections 13 or 15(d) of the Exchange Act or (2) all or any portion of an annual report, semi-annual report or transition report on Form N-SAR or N-CSR required by Sections 13 or 15(d) of the Exchange Act or Section 30 of the Investment Company Act of 1940.
- ▶ The form must be filed no later than one business day after the due date of the periodic report in question.
- ▶ The registrant must explain why it cannot file the report within the time required.¹¹⁶
- ▶ If the form is being filed for a portion of a report and the balance of the report was filed by the due date, the registrant must disclose the portion(s) omitted. When the registrant amends the report to include the omitted information, the registrant must state in the upper right corner of the amendment: "The following items were the subject of a Form 12b-25 and are included herein." Then it must list the item numbers.

¹¹⁵ In EDGAR, Form 12b-25 related to a Form 10-K filing is designated as the form type "NT 10-K."

¹¹⁶ The SEC staff has expressed concerns with the quality of explanations provided. It often finds the explanations provided by registrants to be boilerplate.

Like other Exchange Act filings, Form 12b-25 is subject to Exchange Act Rule 12b-20. That is, in addition to the required information, the report must contain any additional information necessary to make the required information not misleading. For example, at the 3 April 2009 CAQ SEC Regulations Committee meeting, the SEC staff stated that Form 12b-25 also might need to disclose any internal control issues that led to the registrant's inability to file the Form 10-K on time.

8.4 Portions of Form 10-K due following the filing date

Rule 12b-25 specifically excludes: (1) schedules required by Article 12 of Regulation S-X that may be filed by amendment up to 30 days after the due date of the registrant's annual report on Form 10-K and (2) financial statements of significant unconsolidated subsidiaries and equity investees.¹¹⁷ In addition, information called for in Part III of Form 10-K (Item 10, *Directors, Executive Officers and Corporate Governance*; Item 11, *Executive Compensation*; Item 12, *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*; Item 13, *Certain Relationships and Related Transactions, and Director Independence*; and Item 14, *Principal Accountant Fees and Services*) may be incorporated by reference from the registrant's definitive proxy statement filed within 120 days after year end. If the proxy statement is not filed within the 120-day period, the information must be filed as part of Form 10-K, or as an amendment to Form 10-K not later than the end of the 120-day period.

The SEC staff expects registrants to comply with Rule 12b-25 when they are not able to file financial schedules, Part III information or financial statements of unconsolidated subsidiaries and equity investees within the applicable prescribed time period. In these cases, the 15-day relief provision of Rule 12b-25 is available when its conditions are met.

8.5 Involvement of independent auditors

Rule 12b-25(c) discusses the possible involvement of independent auditors with Form 12b-25:

"If paragraph (b) of this [rule] is applicable and the reason the subject report/portion thereof cannot be filed timely without unreasonable effort or expense relates to the inability of any person, other than the registrant, to furnish any required opinion, report or certification, the Form 12b-25 shall have attached as an exhibit a statement signed by such person stating the specific reasons why such person is unable to furnish the required opinion, report or certification on or before the date such report must be filed."

It is important to distinguish between the responsibilities of the registrant and its independent auditors. The registrant must explain why the report cannot be filed; the independent auditors must explain why the audit cannot be completed *only* if that is the reason for the registrant's inability to make a timely filing. The following are examples of situations that a registrant would be required to explain in Form 12b-25, but that should *not* require a letter from the registrant's independent auditors:

- ▶ The preliminary results of the year-end physical inventory indicate a substantial shortage that is under investigation by the registrant.
- ▶ Year-end financial information for material foreign subsidiaries or branches has not been received.
- ▶ Certain accounting records were accidentally destroyed and are in the process of being reconstructed.

¹¹⁷ See section 2 of this publication for a discussion of the filing deadlines for financial statements required under Rule 3-09 of Regulation S-X.

If a registrant is not able to complete its financial statements for any reason, the independent auditors obviously will not be able to complete their audit. In a Form 12b-25 filed under such circumstances, the registrant should explain the reasons for its inability to complete the financial statements. In most cases, it should not be necessary for the independent auditors to submit a statement because it is the registrant's inability to complete its financial statements, rather than the independent auditors' inability to complete the audit, that results in the late filing and requires Form 12b-25 to be filed. However, if the independent auditors' statement is given, it should explain that the audit could not be completed because of the registrant's inability to complete its financial statements including, if known, the registrant's reasons.

8.6 Complete and accurate statements

It is important that any notifications filed by the registrant and supporting statements by any other persons, including the registrant's independent auditors, be complete and accurate. Filing false or misleading information, including the reason(s) cited for the filing delay, would constitute a violation of Section 18 of the Exchange Act and could subject the registrant or such other person to civil liabilities, as well as criminal or administrative sanctions.

9 Smaller reporting companies (SRCs)

9.1 SRC rules

SEC rules allow an SRC to use the scaled (generally reduced) disclosure and reporting requirements.

An SRC may choose, on an item-by-item basis within any filing, whether to apply Regulation S-K's scaled disclosure requirements or its more rigorous disclosure requirements for larger public companies. Nevertheless, the SEC has stressed the importance of consistent disclosures that allow investors to make period-to-period comparisons, whether quarterly or annually.

9.2 Definition of a 'smaller reporting company'

Regulation S-K Item 10(f)(1) defines an SRC as an issuer that is not an investment company, an asset-backed issuer or a majority-owned subsidiary whose parent is not an SRC and meets either of the following conditions after performing its initial qualification test (e.g., upon filing an initial registration statement for common equity):¹¹⁸:

- ▶ Its public float¹¹⁹ is below \$250 million.
- ▶ Its annual revenue for the most recently completed fiscal year is less than \$100 million and public float is less than \$700 million (including no public float).

Once an issuer determines that it does not qualify for SRC status because it exceeded one or more of the conditions above at the initial qualification test, it will remain unqualified unless it meets certain thresholds when making its annual determination as discussed further below.

9.2.1 Annual redeterminations

The annual determination (or redetermination) for SRC status is performed as of the last business day of the company's second fiscal quarter. For a calendar-year company, the annual test for the year ending 31 December 20Y2 would be performed on 30 June 20Y2, the last business day of the second quarter.

The SEC set different entry and exit thresholds for SRC status to minimize moves from one category to the other due to relatively small changes in public float. The subsequent qualification thresholds are set at 80% of the initial qualification thresholds described above.

Entry thresholds

A registrant that did not initially qualify as an SRC may subsequently qualify only if it meets one of the following thresholds:

- ▶ Its public float is below \$200 million at the determination date.

¹¹⁸ A company filing an initial registration statement for shares of its common equity (Securities Act or Exchange Act) should determine its estimated public float as of a date within 30 days of the date the registration statement is filed and then finalize its public float calculation at the time the IPO is completed and the common share price at IPO is known.

¹¹⁹ Public float is determined by multiplying the aggregate number of voting and non-voting common shares held by non-affiliates by the price at which the common shares were last sold, or the average of the bid and asked prices, in the principal market for the registrant's common shares. Thus, the determination of public float is premised on the existence of a public trading market for the issuer's common equity securities. This is different than the definition of market capitalization, which is an amount equal to the total number of issued and outstanding shares of the issuer's common equity securities. Calculating a registrant's public float may involve judgment and legal interpretations and analysis, including determining affiliate status based on the facts and circumstances. Registrants should consult with their legal counsel.

- ▶ Its annual revenue for the fiscal year completed before the determination date is less than \$80 million, and its public float at the determination date is less than \$560 million (including no public float).

For purposes of performing the two-part revenue and public float qualification test, a registrant should ordinarily look to its audited financial statements for the most recent fiscal year required to be included in its initial registration statement or its last annual report on Form 10-K.

Additionally, application of the two-part revenue and public float test depends on the annual revenue and public float tests performed in the prior year. Generally, if a registrant loses its SRC status because it exceeds either the \$100 million annual revenue or \$700 million public float threshold, the registrant is only required to apply the 80% threshold to the criteria it previously exceeded when performing the current qualification test. Refer to FRM Section 5120.1b for further details.

Illustration 9-1: Requalification test for SRCs

ABC registrant is a calendar-year company that completed its IPO on 5 March 20Y0 and qualified as an SRC. On 30 June 20Y0, the registrant lost its SRC status because its public float was \$710 million as of 30 June 20Y0, and its annual revenues were \$90 million for the fiscal year ended 31 December 20Y9.

Scenario 1 – At the next determination date (30 June 20Y1), the registrant’s public float was \$600 million and its annual revenues were \$90 million for the fiscal year ended 31 December 20Y0.

Since its public float didn’t fall below \$560 million (i.e., 80% of the initial qualification thresholds) as of 30 June 20Y1, the registrant does not qualify as an SRC. At the next determination date (i.e., 30 June 20Y2), the registrant would also only be required to apply the 80% threshold to the criteria it previously exceeded (i.e., public float), assuming its annual revenue remains below \$100 million.

Scenario 2 – At the next determination date (30 June 20Y1), the registrant’s public float was \$500 million and its annual revenues were \$90 million for the fiscal year ended 31 December 20Y0.

Since its public float fell below \$560 million (i.e., 80% of the initial qualification thresholds) as of 30 June 20Y1, the registrant re-qualifies as an SRC.

An issuer must check a box on the cover page of its SEC filings indicating whether it meets the definition of an SRC.

Exit provisions

A registrant that qualifies as an SRC must redetermine annually whether it continues to qualify as such on its redetermination date (the last business day of its second fiscal quarter for which a public trading price of its common stock is available) by measuring its public float and revenue for the most recently completed year. A registrant that previously qualified as an SRC maintains that status until one of three exit criteria is met at its next redetermination date:

- ▶ Its public float exceeds \$250 million and its annual revenue exceeds \$100 million.
- ▶ Its annual revenue exceeds \$100 million and it has no public float.
- ▶ Its public float exceeds \$700 million, regardless of annual revenue.

If a registrant has no public float (e.g., it has only public debt or preferred stock), it would continue to qualify if its annual revenues are less than \$100 million during its most recently completed fiscal year for which audited financial statements are available.

Eligibility for FPIs

Any FPI is eligible to qualify as an SRC in accordance with the threshold requirements. However, to take advantage of the disclosure relief as an SRC, an FPI must use domestic forms (e.g., Form 10-K, not Form 20-F) and file financial statements prepared using US GAAP. Refer to the FPI section below for more information.

9.2.2 Implications of changes in SRC status

A reporting issuer newly qualifying as an SRC on its annual determination date (i.e., the last business day of its second fiscal quarter) may choose to reflect its change to SRC status in its quarterly report for that second fiscal quarter or defer to a quarterly or annual report filed thereafter. However, the registrant must reflect its SRC status no later than in its first Form 10-Q for the next fiscal year.

Once a reporting issuer fails to qualify for SRC status at its annual determination, it may choose to continue using the scaled disclosures permitted for SRCs in its annual report on Form 10-K for the current fiscal year but must begin providing non-scaled larger company disclosures in its first Form 10-Q for the next fiscal year.

In addition, the issuer can continue taking advantage of other SRC accommodations (e.g., provide financial statements of an acquired business in accordance with Article 8 of Regulation S-X if it made its initial filing on Form 8-K and its acquisition before the new fiscal year starts, defer adoption of a new or amended accounting standards) during this period.

9.2.3 Interaction between SRC status and accelerated filer status

The SEC's definitions of accelerated filers and large accelerated filers exclude SRCs that have not yet begun to generate significant revenues and allow issuers with less than \$100 million in annual revenues and less than \$700 million in public float to qualify as non-accelerated filers. Consequently, these issuers are not subject to the requirements for auditor attestation for ICFR.

The definitions provide relief to companies that no longer qualify as EGCs but do not provide relief for all SRCs that qualify as accelerated filers. That is, issuers that qualify for SRC status under the public float test only (i.e., they have a public float of less than \$250 million but more than \$75 million) will continue to be accelerated filers if their annual revenue is above \$100 million.

For considerations related to the redetermination of SRC, EGC and filer status for a company created by the merger of a special purpose acquisition company and an operating company, refer to our Technical Line, *[Navigating the requirements for merging with a special purpose acquisition company](#)*.

9.3 Form 10-K filing by an SRC

9.3.1 Content

The following table shows the item number, caption and location of the disclosure instructions for the various items of a Form 10-K filed by an SRC. Items that are not applicable in their entirety are noted parenthetically as "Not required."

Form Item	Form 10-K instructions	Disclosure requirement	Scaling for SRCs
Part I			
Item 1	Business	S-K Item 101	Scaled
Item 1A	Risk factors	S-K Item 105	Not required
Item 1B	Unresolved staff comments	Material unresolved SEC staff comment letters received more than 180 days before the fiscal year end	Required if SRC is accelerated filer
Item 2	Properties	S-K Item 102	Same as non-SRC
Item 3	Legal proceedings	S-K Item 103	Same as non-SRC
Item 4	Mine safety disclosures	S-K Item 104	Same as non-SRC

Form Item	Form 10-K instructions	Disclosure requirement	Scaling for SRCs
Part II			
Item 5	Market for registrant's common equity and related stockholder matters	S-K Item 201 S-K Item 701 S-K Item 703	Same as non-SRC except stock performance graph in Item 201(e) Same as non-SRC Same as non-SRC
Item 7	Management's discussion and analysis	S-K Item 303	Scaled
Item 7A	Quantitative and qualitative disclosures about market risk	S-K Item 305	Not required
Item 8	Financial statements Supplementary financial information	S-X Rules 3-01 through 3-04 S-X Articles 4 and 5 S-X Article 7 if the registrant is an insurance company or Article 9 if it's a bank holding company S-K Item 302	Scaled in Article 8 of Regulation S-X ¹²⁰ Not required
Item 9	Changes in and disagreements with accountants on accounting and financial disclosure	S-K Item 304(b)	Same as non-SRC
Item 9A	Controls and procedures	S-K Items 307 and 308	Same as non-SRC An SRC is required to include an audit report on its ICFR only if it is also an accelerated filer
Item 9B	Other information	Any information required to be disclosed on Form 8-K during the quarter but not reported	Same as non-SRC
Item 9C	Disclosure Regarding Foreign Jurisdictions that Prevent Inspections	HFCA Act disclosure	Same as non-SRC
Part III			
Item 10	Directors, executive officers and corporate governance	S-K Items 401, 405, 406 and 407(c)(3), (d)(4) and (d)(5)	Scaled corporate governance disclosures under Item 407
Item 11	Executive compensation	S-K Items 402 and 407(e)(4) and (e)(5)	Scaled executive compensation disclosures under Item 402
Item 12	Security ownership	S-K Items 201(d) and 403	Same as non-SRC
Item 13	Certain relationships and related transactions, and director independence	S-K Items 407(a) and 404(c) S-K Items 404(a) and (d) S-K Item 404(b)	Same as non-SRC Expanded for SRCs Not required
Item 14	Principal accountant fees and services	Item 9(e) of Schedule 14A	Same as non-SRC
Part IV			
Item 15	Exhibits Financial statement schedules	S-K Item 601 Exhibits S-X Article 12 Financial Statement Schedules	Same as non-SRCs Not required
Item 16	Form 10-K summary	Optional	Optional

¹²⁰ In November 2019, the FASB issued ASU 2019-10, which deferred effective dates for its standards on credit losses and long duration insurance contracts for SEC filers that are SRCs. For details, see our To the Point, [***FASB defers certain effective dates for major standards.***](#)

The following is a list of the item requirements in Regulation S-K and Regulation S-X for which there are different Form 10-K disclosure requirements for SRCs. For more details about the proxy statement disclosure requirements of SRCs, refer to our publication *Proxy statements – An overview of the requirements and observations about current practice*.

9.3.2 Item 101. Description of business

Item 101(h) of Regulation S-K describes the disclosure requirements for an SRC. In Form 10-K, an SRC is required to describe only business developments for the period of time that is material to an understanding of the general development of the business. An SRC is permitted to provide only material updates along with a hyperlink to the most recently filed full discussion of its business developments that, together with the update, would present a complete discussion.

This business development description must include a discussion of the following topics specified in Item 101(h):

- ▶ Form and year of organization
- ▶ Any bankruptcy, receivership or similar proceeding
- ▶ Any material reclassification, merger, consolidation or purchase or sale of a significant amount of assets not in the ordinary course of business

An SRC also must briefly describe its business, including the following if it is material to an understanding of its business:

- ▶ Principal products or services and their markets
- ▶ Distribution methods of the products or services
- ▶ Status of any publicly announced new product or service
- ▶ Competitive business conditions, its competitive position in the industry and methods of competition
- ▶ Sources and availability of raw materials, and the names of principal suppliers
- ▶ Dependence on one or a few major customers
- ▶ Patents, trademarks, licenses, franchises, concessions, royalty agreements or labor contracts (including their duration)
- ▶ Need for any government approval of principal products or services, and if pending, the status of the government approval process
- ▶ Effect of existing or probable governmental regulations
- ▶ Estimate of the amount spent during each of the last two fiscal years on research and development activities, and the extent to which those costs are borne directly by customers
- ▶ Costs and effects of compliance with environmental laws (federal, state and local)
- ▶ Number of total employees and number of full-time employees

SRCs are not required to disclose financial information about their geographic areas similar to what non-SRCs would do pursuant to the requirements in Item 101(d).

SRCs are not required to provide the disclosures in Item 101(c)(2)(ii) about their human capital resources, including the number of persons employed and any human capital measures or objectives that management focuses on when managing the business. Instead, SRCs are only required to disclose material information about their labor contracts, including duration. SRCs may voluntarily choose to apply any disclosure requirements for non-SRCs that are more extensive than those required for SRCs.

An FPI complying with the SRC disclosures must provide disclosure about enforceability of civil liability against foreign persons (as set forth in Item 101(g) of Regulation S-K).

9.3.3 **Item 201. Common equity and related stockholder matters**

An SRC is not required to furnish a stock performance graph (Item 201(e) of Regulation S-K, which is discussed further in section 4 of this publication).

9.3.4 **Item 303. MD&A**

The MD&A requirements discussed further in section 5 of this publication also apply to an SRC.

9.3.5 **Item 305. Market risk disclosures**

An SRC is not required to file the quantitative and qualitative disclosures about market risk (as discussed in section 4 of this publication).

9.3.6 **Financial information of SRCs**

9.3.6.1 **Financial Information of the SRC registrant**

Article 8 of Regulation S-X - Annual financial information

SRCs may choose to comply with either the requirements for SRC financial statements in Article 8 or those for non-SRCs elsewhere in Regulation S-X. Article 8 of Regulation S-X requires SRCs to file an audited balance sheet as of the end of the two most recent fiscal years and audited statements of comprehensive income, cash flows and changes in stockholders' equity and noncontrolling interests for the two most recent fiscal years. Larger registrants are required to file audited financial statements for three fiscal years.

SRCs always have to comply with the following:

- ▶ Article 2 of Regulation S-X, which outlines the requirements for the report and qualifications of the auditor
- ▶ Rule 4-10 regarding the accounting and reporting for oil- and gas-producing activities

SRCs should also provide all information required by any applicable SEC industry guide.

SRCs that choose to prepare their financial statements in accordance with Article 8 are not required to follow the presentation requirements of Rules 5-02 and 5-03 of Regulation S-X or provide the related note disclosures. SRCs can also omit the financial schedules required by Rule 5-04 and any note disclosures required by Rule 4-08 (with the exception of the derivative accounting policy disclosures in Rule 4-08(n)).

Although S-K Item 302 exempts an SRC from its requirements for additional disclosures about oil and gas producing activities, an SRC engaged in oil and gas producing activities still must provide the disclosures required by Regulation S-K Subpart 1200, *Disclosure by Registrants Engaged in Oil and Gas Producing Activities*, under instruction of S-K Item 102, and under S-X 8-01, it must follow the accounting and reporting standards specified in S-X 4-10. Thus, an SRC still must provide the disclosures otherwise required by ASC 932.

9.3.6.2 Financial statements of other entities

Financial information for equity method investees

SRCs are not required to provide separate financial statements of significant equity method investees. However, under Rule 8-03(b)(3), they are required to provide summarized financial data, including sales, gross profit, net income from continuing operations and net income for significant equity investees that individually or in the aggregate represent 20% or more of their consolidated assets, equity or income from continuing operations attributable to the registrant in both annual and interim financial statements. While this requirement is similar to the interim reporting requirement for larger companies, the threshold for SRCs is higher (20%) than the threshold for summarized information in annual financial statements for larger companies (10%), and SRCs aren't required to provide any balance sheet data.

Other financial statement requirements

SRCs must comply with the requirements of the following rules:

- ▶ Rule 3-10 for separate financial statements of subsidiary issuers and guarantors
- ▶ Rule 13-01 for summarized financial information of subsidiary issuers and guarantors
- ▶ Rule 3-16 for separate financial statements of affiliates whose securities collateralize the registrant's securities¹²¹
- ▶ Rule 13-02 for summarized financial information of affiliates whose securities collateralize the registrant's securities

If omission of separate financial statements required by Rule 13-01 and Rule 13-02 is permitted, SRCs must present summarized financial information for the most recent fiscal year in the registrant's financial statements in the annual report on Form 10-K (i.e., the same period required for non-SRCs, discussed in section 6 of this publication). Otherwise, separate financial statements required by Rule 3-10 and Rule 3-16 may be presented for two years rather than three years (i.e., the periods required for Article 8 of Regulation S-X). Like other registrants, SRCs can also avail themselves of the provisions of Rule 3-13 of Regulation S-X to request relief from providing required financial statements when the relief is consistent with the protection of investors.

In addition, SRCs are not required to provide financial statement schedules. As outlined above, SRCs are not subject to the reporting requirements of Rule 5-04 of Regulation S-X (regarding the requirement to provide Schedule I) or the related disclosure requirements in Rule 4-08(e) of Regulation S-X. However, when the restricted net assets of an SRC's consolidated subsidiaries represent a significant portion of consolidated net assets as of its year end the SRC should consider including disclosures within the liquidity section of its MD&A of the amount and a description of the nature of the restrictions on the net assets of the consolidated subsidiaries.

¹²¹ For securities issued and outstanding before 4 January 2021, unless the requirements of Rule 13-02 apply.

10 Annual shareholders' report, Part III of Form 10-K and proxy statement

10.1 Annual shareholders' report

The SEC encourages, but does not require, the incorporation by reference of portions of the annual shareholders' report into Form 10-K. Regulation S-K contains the uniform requirements for most of the information other than financial statements required in various SEC forms and annual shareholders' reports. Some Regulation S-K items, or portions of them, are required in both the annual shareholders' report and Form 10-K. In addition, financial statements for both documents must comply with Regulation S-X.

Annual shareholders' reports of companies registered under Sections 12(b) or 12(g) of the Exchange Act are required to comply with the SEC proxy rules (Rule 14a-3 of the Exchange Act) and must include the following:¹²²

- ▶ Consolidated financial statements – Audited balance sheets for each of the two most recent fiscal years and statements of income, comprehensive income and cash flows for each of the three most recent fiscal years prepared in accordance with Regulation S-X, but financial schedules, exhibits and separate financial statements (e.g., significant investees) may be omitted
- ▶ Supplementary financial information – Item 302 of Regulation S-K – Disclosure of material quarterly changes¹²³ and information about oil and gas producing activities
- ▶ Changes in and disagreements with accountants on accounting and financial disclosure – Item 304(b) of Regulation S-K (if applicable, the required disclosures are the same as for Form 10-K – see section 4 of this publication)
- ▶ MD&A of financial condition and results of operations – Item 303 of Regulation S-K
- ▶ Quantitative and qualitative disclosures about market risk – Item 305 of Regulation S-K
- ▶ A brief description of the general nature and scope of the business done by the registrant and its subsidiaries for the latest fiscal year
- ▶ Segment information – Item 101 of Regulation S-K, paragraph (c)(1) and instructions 1 and 2
- ▶ Director and executive officer information – Name, principal occupation or employment and name of employer and its principal business
- ▶ Market disclosures for the issuer's common equity and related stockholder matters – Item 201(a) and (b) of Regulation S-K (Note: The annual shareholders' report is not required to include the disclosures under Item 201(d) of securities authorized for issuance under equity compensation plans, which is required in Form 10-K.)
- ▶ Stock performance graph – Item 201(e) of Regulation S-K

The requirements in annual shareholders' reports for financial statements (except financial schedules, exhibits and separate financial statements), supplementary information, MD&A, market risk, market disclosures for the issuer's common equity and related stockholder matters, and disagreements with prior independent auditors are identical to the related Form 10-K requirements. In addition, Form 10-K requirements for the description of business, including segment data, and the director and officer information include the related annual shareholders' report requirements.

¹²² Companies reporting under Section 15(d) of the 1934 Act are required to file on Form 10-K but are not required to file an annual shareholders' report that complies with the SEC's proxy rules. See section 2 of this publication for further discussion.

¹²³ Registrants may omit the summarized financial information from their annual report, unless there has been a material retrospective change (or changes that are material in the aggregate) affecting comprehensive income. See section 4.4.1 of this publication for further discussion.

A registrant is not required to incorporate portions of its annual shareholders' report into its Form 10-K. If the financial statements in the annual shareholders' report are not incorporated by reference into Form 10-K, the SEC expects the financial statements in Form 10-K and the annual shareholders' report to be *identical*. Further, if there is no incorporation by reference, the other disclosures provided in those documents (market disclosures on common equity and related stockholder matters, supplementary financial information, MD&A, market risk disclosures, and disagreements with prior independent auditors) must be similar.

Section 404 reports are not required in annual shareholders' reports. However, if internal control over financial reporting is ineffective or the auditor has issued an adverse opinion on internal control over financial reporting (i.e., there are material weaknesses in internal control), the SEC staff has strongly suggested that the issuer consider including the Section 404 reports in the annual shareholders' report to avoid a misleading presentation.

Effective January 2023, a registrant must submit annual reports to security holders in electronic format in accordance with the EDGAR Filer Manual. A company can no longer furnish its annual report to the Commission by posting an electronic version on its website or mailing paper copies to shareholders.

10.1.1 Stock performance graph

Item 201(e) of Regulation S-K requires registrants to provide a performance graph that compares the registrant's cumulative total shareholder return during the previous five years with a performance indicator of the overall stock market (i.e., a broad-based index), and the registrant's peer group. The disclosure is required only in a registrant's annual shareholders' report that precedes or accompanies a proxy or information statement relating to an annual meeting of security holders for the election of directors and will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except when the registrant decides to specifically incorporate it by reference. The performance graph has the same legal status as the annual report to shareholders and is not deemed to constitute soliciting material or a "filed" document. SRCs (see section 9, *Smaller reporting companies*) are not required to disclose a performance graph.

The peer group index should be either of the following:

- ▶ A published industry or line of business index
- ▶ Peer issuer(s) selected in good faith

If the registrant does not use a published industry or line of business index and does not believe that it can reasonably identify industry peer issuers, it may use issuer(s) with similar market capitalization(s). If a registrant elects to construct its own peer group, the identity of the issuer(s) and the basis for its (their) selection must be disclosed. In addition, the returns of the component issuers making up the index must be weighted according to their market capitalization. Cumulative total shareholder return is measured by dividing the change in the market value of the registrant's share price plus the cumulative amount of dividends, assuming dividend reinvestment, by the share price at the beginning of the measurement period. An index prepared by a trade group is considered an index prepared by an affiliate of the registrant. Under the rule, an index prepared by an affiliate of the registrant may be treated as a published index only if it is "widely recognized and used." Even if the index is made "accessible to the registrant's security holders," it may not meet this requirement. In most cases reviewed by the SEC staff, trade group indices did not satisfy this requirement, so constituent registrants had to be identified.

A registrant that is part of the Standard and Poor's 500 (S&P 500) must use that index as its broad-based equity market index. Registrants not part of the S&P 500 may use a different broad-based equity market index that includes companies that trade on the same stock exchanges or are of comparable market capitalization. Examples of other indices include the NYSE AMEX Composite, Russell 2000 and the Dow Jones Wilshire 5000 Total Stock Market Index. Certain published indices may be based solely on price, not total shareholder return (i.e., the index may not reflect the assumed reinvestment of dividends); therefore, such indices would require adjustments, which may be difficult, to comply with the SEC's requirement.

The total shareholder returns must be shown for a five-year period measured from a fixed point (measurement point) assuming a fixed investment. The measurement point is defined at the close of trading on the last trading date preceding the first day of the fifth preceding fiscal year. The registrant may present a graph that exceeds five years; however, the measurement point remains the same.

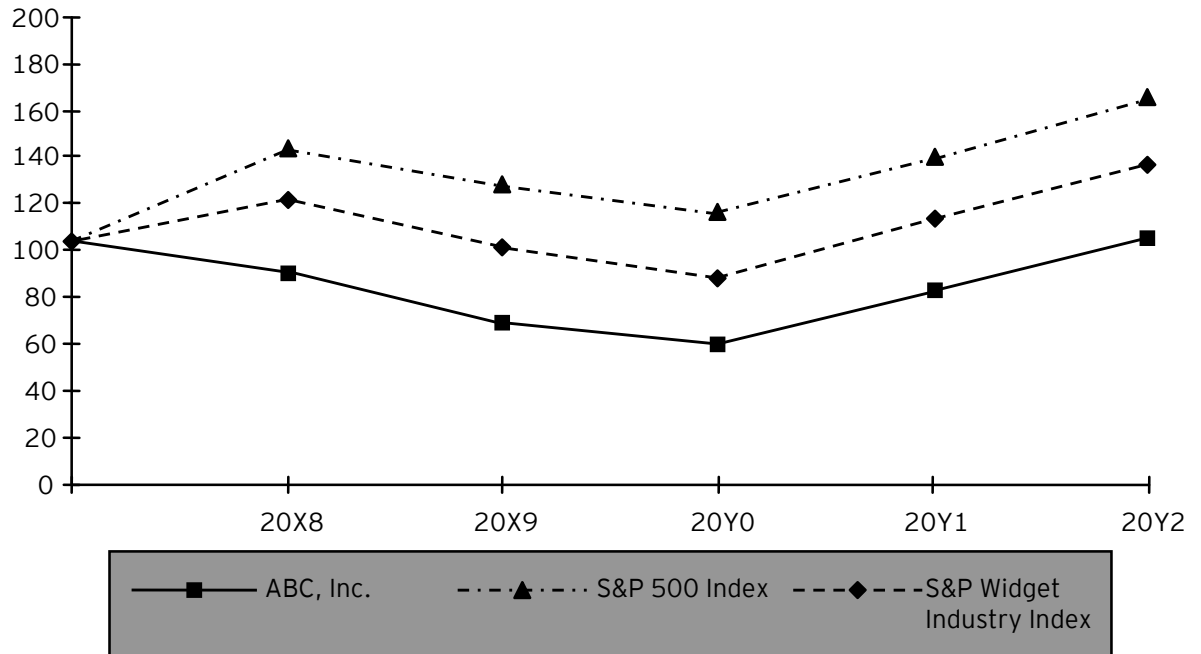
The SEC staff has responded to a number of implementation questions concerning the performance graph. The interpretive guidance follows:

- ▶ A registrant may plot monthly or quarterly returns provided that each return is plotted at the same interval, and the annual changes in cumulative total return must be reflected clearly.
- ▶ In calculating the measurement point, a registrant should weight the stock prices of the issuers in a self-constructed peer or market capitalization index in accordance with the market capitalization for such issuers as of that date. The returns of the component issuers should be weighted according to their market capitalization as of the beginning of each period for which a return is indicated.
- ▶ A change to a self-constructed peer or market capitalization index generally is equivalent to a change in the index used, which requires disclosure of the reason for the change along with presentation (in the year of the change) of both the old and new indices. Presentation on the old basis is not required if the information omitted is the result of application of pre-established objective criteria to the composition of the index or, in the case of a self-constructed peer index, the registrant is no longer in the same industry or line of business. In these cases, a specific description of, and the bases for, the change must be disclosed, including the name of the entity or entities removed from the index.
- ▶ A self-constructed peer or market capitalization index may, but is not required to, exclude the registrant.
- ▶ In place of data for the last trading day of a given fiscal year, a registrant may use data for the last day in that year made available by a third-party index provider.
- ▶ A registrant created by a spin off may begin its performance graph presentation on the effective date of the registration of its common stock under Section 12 of the Exchange Act. Similarly, following an initial public offering, a registrant may begin its performance graph as of that date.
- ▶ A registrant that spins off a portion of its business should treat that transaction as a special dividend, make the appropriate adjustments to its shareholder return data and disclose the occurrence of the transaction and resultant adjustments. However, the SEC staff has not provided any additional guidance regarding what would be considered "appropriate adjustments."
- ▶ The presentation of the registrant's performance graph does not change as a result of a merger or other acquisition involving the registrant, if the registrant remains in existence and its common stock remains outstanding.
- ▶ A registrant with several distinct lines of business may construct a composite peer group index composed of registrants from different industry groups, representing each of the registrant's lines of business (with the component registrants weighted by revenues or assets of the reporting company's lines of business). Alternatively, the registrant may plot a separate peer index line for each of its lines of business. In both instances, the basis and the relative importance given to each line of business should be disclosed.

Registrants that are considering constructing a peer group index should consider the complexities involved. In addition to the difficulties of selecting an appropriate group of peer issuers, registrants might be subject to greater SEC scrutiny than if a published industry index were used. Further, it might be difficult to evaluate whether the selected group of peer issuers will continue to provide an appropriate comparison in future years, which might result in the need to make adjustments to the issuers included in the peer group. Such adjustments would require disclosure in addition to presentation on the basis of both the old and new indices.

Illustration 10-1: Performance graph

The following graph sets forth the cumulative total shareholder return (assuming reinvestment of dividends) to ABC, Inc.'s shareholders during the five-year period ended 31 December 20Y2, as well as the corresponding returns on an overall stock market index (S&P 500 Index) and ABC Inc.'s peer group index (S&P Widget Industry Index):



The stock performance graph assumes \$100 was invested on 31 December 20Y7.

10.2

Part III of Form 10-K

Regulation S-K contains the rules for disclosure of information required in Part III of Form 10-K, including:

Item 201(d)	Securities Authorized for Issuance under Equity Compensation Plans
Item 401	Directors, Executive Officers, Promoters and Control Persons
Item 402	Executive Compensation
Item 403	Security Ownership of Certain Beneficial Owners and Management
Item 404	Transactions with Related Persons, Promoters and Certain Control Persons
Item 405	Compliance With Section 16(a) of the Exchange Act
Item 406	Code of Ethics
Item 407	Corporate Governance

In addition, Item 14, *Principal Accountant Fees and Services*, in Part III of Form 10-K requires disclosure identical to that required by Item 9(e) of Schedule 14A (the proxy statement).

10.3

Part IV of Form 10-K

Part IV of Form 10-K requires a registrant to provide a list of documents filed in the report and include any other required financial statements (e.g., subsidiaries not consolidated, 50% or less owned persons), exhibits required by Item 601 of Regulation S-K (e.g., articles of incorporation) and financial statement schedules (e.g., Schedule I, Condensed financial information of registrant).

Item 16 in Part IV of the Form 10-K allows, but does not require, registrants to include an optional summary of the Form 10-K. The summary should provide more information than a table of contents and allow users to easily locate where the disclosure is fully presented in the Form 10-K. The summary does not need to cover all areas of the Form 10-K but must be presented fairly and include a hyperlink to where the material discussed can be found in the 10-K (or exhibits).

The exhibit index of nearly all filings subject to Item 601 of Regulation S-K, including those on Forms 10-K and 20-F, must include a hyperlink to each exhibit listed therein. To enable the inclusion of such hyperlinks, registrants must submit such filings in HTML.

Registrants must provide a description of their securities, as described in Item 202 of Regulation S-K, as a filed exhibit.¹²⁴

10.3.1 Confidential information in exhibits

The SEC permits registrants to redact confidential information from material contracts filed as exhibits under Item 601(b)(1) of Regulation S-K without submitting a confidential treatment request if the redacted information (1) is not material and (2) would likely cause competitive harm if it were publicly disclosed. The SEC staff may request that the registrant provide its materiality and competitive harm analysis on a supplemental basis. The registrant may request confidentiality of such supplemental material submitted pursuant to Rule 83 while it is in the possession of the Commission or its staff.

Registrants are required to:

- ▶ Mark the filing's exhibit index to indicate that portions of an exhibit have been omitted
- ▶ Include a prominent statement on the first page of the exhibit saying that certain information has been excluded because it is not material and would likely cause competitive harm if it were publicly disclosed
- ▶ Indicate with brackets where information has been omitted from the exhibit

Also, under Item 601(a)(5) of Regulation S-K, registrants are not required to file schedules or similar attachments to a filed exhibit if they do not contain material information or were not otherwise disclosed in the exhibit or the filing. The filing must contain a list briefly identifying the contents of all omitted schedules.

10.4 Incorporation by reference of proxy material

General Instruction G provides that information called for by Part III of Form 10-K (Items 10, 11, 12, 13 and 14) may be incorporated by reference from the registrant's definitive proxy or information statement *if* the proxy or information statement is filed with the SEC no later than 120 days after the fiscal year end. However, if the information called for by these items cannot be incorporated by reference, it must be included within Form 10-K when filed or included by amendment on Form 10-K/A no later than 120 days after the fiscal year end.

Proxy statements – An overview of the requirements and observations about current practice summarizes the requirements of Regulation 14A and Schedule 14A under the Exchange Act for soliciting annual meeting proxies. This publication includes an overview of many of the disclosures required in Part III of Form 10-K.

There are four exceptions to the general rule that Part III Item 10 information will be identical to, and generally incorporated by reference from, the annual meeting proxy statement. These exceptions are discussed further below.

¹²⁴ Registrants can incorporate a previously filed exhibit by reference (via hyperlink) if the information previously filed remains unchanged.

10.4.1 Item 10. Executive officers

General Instruction G(3) provides that information required by Item 10 of Form 10-K (Item 401 of Regulation S-K) for executive officers may be included in Part I of Form 10-K under an appropriate caption. If this is done, this information need not be included in the proxy or information statement.

10.4.2 Item 10. Audit committee financial experts

The disclosures about audit committee financial experts (Item 407(d)(5) of Regulation S-K) must be provided in response to Item 10 of Form 10-K, but an instruction to Item 407(d)(5) specifically states that the disclosures may be omitted from the proxy or information statement. Nevertheless, if the company elects to provide the disclosures about audit committee financial experts in its proxy statement, it also may incorporate them by reference into the Form 10-K if the proxy statement is filed no later than 120 days after the company's fiscal year end. Otherwise, the disclosures about audit committee financial experts must be included in the Form 10-K.

Item 407(d)(5) requires a public company to disclose whether its board of directors has determined that the company has at least one financial expert (as defined) on its audit committee. If so, the company also must disclose the name of its audit committee financial expert and whether that person is independent. If the audit committee does not have such an expert, the company is required to explain why not. If the company has more than one audit committee financial expert, it may, but is not required to, disclose the names of any additional audit committee financial experts and whether the person(s) is (are) independent.

If the board of directors determines that a person qualifies as an audit committee expert because of "other relevant experience," the company must briefly describe that person's relevant experience. The SEC staff believes "other relevant experience" cannot be satisfied merely by education.

10.4.3 Item 10. Code of ethics

The disclosures about the issuer's code of ethics (Item 406 of Regulation S-K) must be provided in response to Item 10 of Form 10-K, but the proxy or information statement is not required to provide those disclosures. Nevertheless, if the company elects to provide the disclosures about its code of ethics in its proxy statement, it also may incorporate them by reference into the Form 10-K if the proxy statement is filed no later than 120 days after the company's fiscal year end. Otherwise, the disclosures about the code of ethics must be included in the Form 10-K.

Item 406 of Regulation S-K requires an issuer to disclose whether it has adopted a code of ethics (as defined) that covers its principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. If so, the issuer must make its code of ethics publicly available by one of the following means: filing the code of ethics as an exhibit to its Form 10-K, posting the code of ethics on its website, provided the Form 10-K disclosed that intention and the website address or by providing disclosure in its Form 10-K that a copy of the code is available without charge on written request. If the issuer has not adopted a code of ethics, it is required to disclose why it has not done so.

Once a company files its first annual report with the required disclosures, it is required to file Form 8-K to report significant amendments to its code of ethics, or any waivers, affecting the specified officers.

Illustration 10-2: Code of ethics (included under Item 10 of Form 10-K)

The Company has adopted a code of ethics that applies to all of its directors, officers (including its chief executive officer, chief financial officer, chief accounting officer, controller and any person performing similar functions) and employees. The Company has filed a copy of this Code of Ethics as Exhibit XX to this Form 10-K. The Company also has made the Code of Ethics available on its website at www.companyethicsexample.com.

10.4.4 **Item 10. Shareholder nominating procedures**

The disclosures about material changes, during the fourth fiscal quarter, to the procedures disclosed in the most recent proxy statement for security holders to recommend a director candidate (Item 407(c)(3) of Regulation S-K, as discussed below) must be provided in response to Item 10 of Form 10-K, but Item 407(c)(3) specifically states that the disclosures may be omitted from the proxy or information statement. Nevertheless, if the company elects to provide the disclosures about such changes in its proxy statement, it also may incorporate them by reference into the Form 10-K if the proxy statement is filed no later than 120 days after the company's fiscal year end. Otherwise, the disclosures about such changes must be included in the Form 10-K.

Item 407(c)(3) requires a public company to disclose any material changes to the procedures disclosed in the most recent proxy statement for security holders to recommend a director candidate. A company is required to report any material change in its periodic Exchange Act report for the period that the material change occurs (i.e., the company's quarterly report on Form 10-Q or, for changes that occur during the fourth fiscal quarter, the company's annual report on Form 10-K). A material change requiring disclosure would include the adoption of procedures by which security holders may recommend a nominee if the company disclosed in its last proxy statement that it did not have any such procedures.

10.4.5 **Item 12. Authorized equity compensation**

In addition to the four exceptions to Item 10 discussed above, the information required by Item 201(d) of Regulation S-K in response to Item 12 of Form 10-K is not required to be included in a proxy or information statement in all cases. The proxy or information statement is not required to provide this disclosure unless the registrant is submitting a compensation plan for shareholder action. Nevertheless, even if the registrant does not submit a compensation plan for shareholder action, a registrant that provides the information required under Item 201(d) in its proxy statement may incorporate the disclosure by reference into Item 12 of Form 10-K if the proxy statement is filed no later than 120 days after the company's fiscal year end. Otherwise, the Form 10-K must include the disclosure upon filing or by amendment within 120 days of the fiscal year end.

The Form 10-K instructions indicate that the disclosures required under Item 201(d) of Regulation S-K must be provided in response to both Item 5 and Item 12. However, the SEC staff has indicated that the disclosures required under Item 201(d) only should be included in response to Item 12 of Part III of Form 10-K. See our publication, *Proxy statements – An overview of the requirements and observations about current practice*, for a further discussion of the requirements of Item 201(d) of Regulation S-K.

A Common questions domestic 10-K filers ask

Question	Large accelerated	Accelerated	Non-accelerated	SRCs	EGCs	Voluntary filers
When is management required to report on internal controls under SOX 404(a)?	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing ¹²⁵
When is an independent auditor's report on internal controls (SOX 404(b)) needed?	Required beginning with the second 10-K filing	Required beginning with the second 10-K filing unless an EGC	Exempt	Required beginning with the second 10-K filing if the SRC is also an accelerated filer (unless an EGC)	Exempt	Exempt
Does Regulation S-X apply?	Yes	Yes	Yes	Yes, but may elect certain scaled disclosures (Article 8)	Yes, but could qualify as an SRC	Yes
Is the entity an issuer under the Sarbanes-Oxley Act? ¹²⁶	Yes	Yes	Yes	Yes	Yes	No
Which auditing standards apply (PCAOB or AICPA)?	PCAOB	PCAOB	PCAOB	PCAOB	PCAOB	PCAOB and AICPA ¹²⁷
When is the filing due?	60 days after the fiscal year end	75 days after the fiscal year end	90 days after the fiscal year end	75 days after the fiscal year end if the SRC is an accelerated filer or 90 days after the fiscal year end if the SRC is a non-accelerated filer	Accelerated filer EGC: Refer to the due dates for accelerated filer Non-accelerated filer EGC: Refer to the due dates for non-accelerated filer	90 days after the fiscal year end

¹²⁵ Assumes a company does not have prior history of filing a Form 10-K. Otherwise, the company, upon becoming a voluntary filer, must continue to provide management's assessment on internal controls under SOX 404(a) without any gap.

¹²⁶ The term "issuer" means any person (includes natural person and other entities) that issues or proposes to issue securities, subject to certain exceptions as defined in Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), the securities of which are registered under Section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under Section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

¹²⁷ Regulation S-X Rule 1-02(d) notes that, when used in regard to financial statements of entities that are not issuers, the term "audit" means an examination of the financial statements by an independent accountant in accordance with either PCAOB or AICPA standards (US GAAS). However, we understand that the SEC staff interprets that definition to apply to the financial statements of entities (other than the filer) whose financial statements are included in a filing (e.g., financial statements of significant acquired businesses under S-X Rule 3-05, financial statements of significant equity investees under S-X Rule 3-09, target financial statements in a Form S-4) and therefore voluntary filers must comply with the requirements for "issuers."

B Abbreviations

Abbreviation	FASB Accounting Standards Codification
ASC 220	FASB ASC Topic 220, <i>Comprehensive Income</i>
ASC 275	FASB ASC Topic 275, <i>Risks and Uncertainties</i>
ASC 280	FASB ASC Topic 280, <i>Segment Reporting</i>
ASC 323	FASB ASC Topic 323, <i>Investments – Equity Method and Joint Ventures</i>
ASC 360	FASB ASC Topic 360, <i>Property, Plant and Equipment</i>
ASC 420	FASB ASC Topic 420, <i>Exit or Disposal Cost Obligations</i>
ASC 460	FASB ASC Topic 460, <i>Guarantees</i>
ASC 606	FASB ASC Topic 606, <i>Revenue from Contracts with Customers</i>
ASC 740	FASB ASC Topic 740, <i>Income Taxes</i>
ASC 805	FASB ASC Topic 805, <i>Business Combinations</i>
ASC 810	FASB ASC Topic 810, <i>Consolidation</i>
ASC 815	FASB ASC Topic 815, <i>Derivatives and Hedging</i>
ASC 825	FASB ASC Topic 825, <i>Financial Instruments</i>
ASC 830	FASB ASC Topic 830, <i>Foreign Currency Matters</i>
ASC 842	FASB ASC Topic 842, <i>Leases</i>
ASC 932	FASB ASC Topic 932, <i>Extractive Activities – Oil and Gas</i>
ASC 942	FASB ASC Topic 942, <i>Financial Services – Depository and Lending</i>
ASC 944	FASB ASC Topic 944, <i>Financial Services – Insurance</i>
ASC 948	FASB ASC Topic 948, <i>Financial Services – Mortgage Banking</i>
Abbreviation	Other authoritative standards
ASU 2014-17	Accounting Standards Update No. 2014-17, <i>Business Combinations (Topic 805)</i>
ASU 2013-12	Accounting Standards Update No. 2013-12, <i>Definition of a Public Business Entity</i>
ASU 2019-10	Accounting Standards Update No. 2019-10, <i>Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates</i>

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