

The background of the entire page 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 medallions, some of which are illuminated. A large, multi-tiered chandelier hangs from the ceiling on the left side. On the right side, a statue of a woman in classical attire is visible, standing on a pedestal. The overall color palette is warm, with gold, brown, and cream tones.

SEC Financial Reporting Series

2023 SEC quarterly reports – Form 10-Q



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Overview

We are pleased to present our *2023 SEC quarterly reports*, a reference guide to help you prepare your financial and related information for Form 10-Q.

The Securities Exchange Act of 1934 (Exchange Act or 1934 Act) requires most domestic SEC registrants to file a quarterly report with the Securities and Exchange Commission (SEC) on Form 10-Q. The Form 10-Q includes condensed financial information and other data prepared by a company's accounting personnel and reviewed by its independent auditors.

The SEC's integrated disclosure system enables companies to incorporate information included in one document into other documents. For example, the Form 10-Q 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. Additionally, for continuous or delayed security offerings, documents filed after the initial effective date of a Form S-3 or S-8 are automatically incorporated by reference into these registration statements until the security offering is terminated.

This publication describes the SEC's requirements for the content of Form 10-Q as of 30 November 2022. When preparing reports on Form 10-Q, 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 how information is organized by Section throughout this publication:

- ▶ Section 2 explains the general rules and requirements for preparing and filing Form 10-Q.
- ▶ Section 3 discusses the requirements for financial information in Part I of Form 10-Q.
- ▶ Section 4 discusses the principles of interim accounting and financial reporting.
- ▶ Section 5 covers quarterly financial information in an earnings release or quarterly report to shareholders.
- ▶ Section 6 explains the involvement of independent auditors.
- ▶ Section 7 discusses the requirements for "smaller reporting companies".

1.2

EY publications and checklists

The EY US firm publications provide interpretive guidance for preparing various SEC forms and schedules. These publications are available from any EY representative, and many are available free of charge on the EY AccountingLink website.¹

- ▶ *SEC annual reports – Form 10-K* summarizes the SEC requirements for annual reports on Form 10-K, as well as annual reports to shareholders that must be furnished under the proxy rules. It provides guidance for preparing annual reports to shareholders and Form 10-K.
- ▶ *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.

¹ The EY AccountingLink website can be found at <http://www.ey.com/US/Accountinglink>.

- ▶ *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 the disclosure requirements regarding executive compensation, auditor fees and the compensation, audit and nominating committees.
- ▶ *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 initiatives.

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

- ▶ *Disclosure checklist for interim financial reporting* – This checklist assists in determining that the financial statement disclosure requirements for condensed interim financial statements of US GAAP and Regulation S-X have been satisfied. It also outlines the line item caption aggregation requirements for interim financial statements in Article 10 and Rule 8-03 of Regulation S-X. Part II addresses certain financial and nonfinancial statement disclosures required for interim reporting under Regulations S-X and S-K (EY Form A78).
- ▶ *GAAP disclosure checklist* – This checklist should be completed if a full (rather than condensed) set of interim-period financial statements is presented. It assists in determining that the financial statement disclosure requirements of generally accepted accounting principles (GAAP) and Regulation S-X have been satisfied (EY Form A13).
- ▶ *SEC annual shareholders’ report checklist* – Parts II and III assist in addressing the SEC’s requirements for Management’s Discussion and Analysis (MD&A) and Part IV assists in the preparation of non-GAAP measures (EY Form A150).

1.3

Other considerations in preparing Form 10-Q

This publication is not a substitute for reading the Form 10-Q instructions and the disclosure instructions 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 nonbinding and, unlike SEC rules and regulations,² they do not have the force of law. However, registrants are generally expected to comply with the SEC staff views.

Registrants should consider the following Commission rules and interpretative guidance and the following staff guidance:

- ▶ Regulation S-K contains the requirements for nonfinancial statement disclosures for quarterly reports on Form 10-Q.
- ▶ Regulation S-X (Article 10 and Rule 8-03) provides the requirements for interim financial statements.
- ▶ Rules 13-01 and 13-02 of Regulation S-X provide the requirements for selected financial information and other qualitative disclosures for guarantors, co-issuers and entities whose securities function as collateral for registered debt, if the registrant qualifies to provide such alternative disclosure in lieu of separate financial statements for such entities. The disclosures may be located outside the interim financial statements in the interim report on Form 10-Q.

² “Statement Regarding SEC Staff Views,” 13 September 2018, SEC website, <http://www.sec.gov/news/public-statement/statement-clayton-091318>.

- ▶ Financial Reporting Releases (FRRs) address interpretative guidance and certain revisions to Regulations S-K and S-X. The Codification of Financial Reporting Policies (FRC) contains certain SEC releases (e.g., final rules and interpretive guidance) relating to financial reporting as published in the Accounting Series Releases (ASRs), and more recently, in FRRs.
- ▶ 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. They are codified in the Codification of Staff Accounting Bulletins.
- ▶ 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.
- ▶ Compliance and Disclosure Interpretations (C&DIs) and CF Disclosure Guidance Topics are views expressed by the SEC's Division of Corporation Finance.
- ▶ The Financial Reporting Manual (FRM) provides views on financial reporting matters from the Division of Corporation Finance's Office of Chief Accountant.³
- ▶ 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.⁴

The rules and regulations for financial reporting are complex. Any materially inaccurate or incomplete information in Form 10-Q can expose a company, and its directors and officers, 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 CEO and 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 Exchange Act. 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 might be appropriate to meet with the SEC staff to discuss a complex accounting or reporting issue. 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 the Office of the Chief Accountant, entitled "Guidance for Consulting with the Office of the Chief Accountant."⁵ Separately, registrants can discuss financial reporting and legal matters with the staff in the Division of Corporation Finance and can seek relief from financial reporting requirements under Rule 3-13 of Regulation S-X.⁶

³ The FRM can be found at the following link: <http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml>.

⁴ 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/>.

⁵ This guidance can be found at the following link: <http://www.sec.gov/info/accountants/ocasubguidance.htm>.

⁶ 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 either through email at DCAOLetters@sec.gov or through completing the online form *Request for Interpretive Advice* at https://www.sec.gov/forms/corp_fin_interpretive.

2

General rules

Form 10-Q is used for quarterly reports under Section 13(a) or 15(d) of the Exchange Act. Under Exchange Act Rules 13(a)-13 and 15(d)-13 a Form 10-Q should be filed for each of the first three quarters of each fiscal year by every issuer that:

- ▶ Has securities registered pursuant to Section 12⁷ of the Exchange Act and must file annual reports (generally Form 10-K) pursuant to Section 13(a) of the Exchange Act
- ▶ Has securities registered pursuant to the Securities Act and must file annual reports (generally Form 10-K) pursuant to Section 15(d) of the Exchange Act

Sections 13(a) and 15(d) of the Exchange Act exempt the following issuers from the quarterly reporting requirements:

- ▶ Investment companies required to file annual reports on Form N-CEN under Rule 30a-1 of the Investment Company Act of 1940
- ▶ Foreign private issuers required to file reports under Rule 13(a)-16 or 15(d)-16 on Form 6-K⁸
- ▶ Asset-backed security issuers required to file reports under Rule 13(a)-17 on Form 10-D

In addition, the following issuers are exempt from filing Part I – Financial Information of Form 10-Q (see section 3 of this publication):

- ▶ Mutual life insurance companies
- ▶ Mining companies that are not in the production stage but are exploring for or developing mineral deposits other than oil, gas or coal and that meet certain other conditions

2.1

When the report is due

Form 10-Q must be filed electronically after the end of each of the first three fiscal quarters (a fourth quarter report is not required). The SEC does not consider the Form 10-Q filed until it receives the document. 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-Q within the prescribed time period (see section 2.1.2). The deadlines for filing the Form 10-Q are determined by a company's filing status.

A registrant's filing status is determined at the end of each fiscal year for that year end's Form 10-K and subsequent Forms 10-Q. The determination is primarily based on its public float,⁹ calculated on the last business day of the most recent second fiscal quarter. This is intended to allow the registrant to determine

⁷ Section 12(b) of the Exchange Act requires issuers to register securities that are traded on a national exchange. Section 12(g) requires registration by unlisted companies that have more than \$10 million of assets and 2,000 or more record holders (or 500 record holders who are not accredited investors) except for bank or bank holding companies. For bank or bank holding companies, the trigger is 2,000 record holders, even if none are accredited investors. See Section 12(g) of the Exchange Act and Exchange Act Rule 12g5-1 for the definition of "held of record."

⁸ Foreign private issuers that are required by their home country to furnish quarterly financial information must use Form 6-K to furnish the same information with the SEC.

⁹ 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. 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 are recommended to consult with their legal counsel.

well in advance when it must file its next Form 10-K and subsequent Forms 10-Q. The cover page of Form 10-K requires disclosure of a registrant's public float as of the end of its most recent second fiscal quarter. In addition, both the cover pages of Form 10-K and Form 10-Q are required to indicate the registrant's filer status (i.e., large accelerated filer, accelerated filer and non-accelerated filer) and separately whether it qualifies as a smaller reporting company and/or emerging growth company. See section 2 of our publication, *SEC annual reports – Form 10-K*, for a discussion of certain circumstances affecting a company's filing status (i.e., a subsidiary of an accelerated filer, a change in fiscal year end and going private transactions).

Large accelerated and accelerated filers must file their quarterly reports on Form 10-Q within 40 days of each quarter end. If a registrant is not subject to the accelerated filing requirements, Form 10-Q is due 45 days after the fiscal quarter end.

2.1.1 Filer status determination

Entry thresholds for accelerated filer status

The table below summarizes the current entry thresholds for the various filer status categories that registrants have to monitor at their annual filer status re-determination date and the due dates for filing a Form 10-Q:

Status	Public float	Annual revenues	Form 10-Q due dates (days from quarter end)
Smaller reporting company and non-accelerated filer	Less than \$75 million	No limit	45 days
	\$75 million to less than \$700 million	Less than \$100 million	45 days
Smaller reporting company and accelerated filer	\$75 million to less than \$250 million	\$100 million or more	40 days
Accelerated filer (not a smaller reporting company)	\$250 million to less than \$700 million	\$100 million or more	40 days
Large accelerated filer	\$700 million and greater	Not applicable	40 days

A registrant with a public float of less than \$75 million qualifies for non-accelerated status, regardless of its revenue for the most recently completed fiscal year. A company that qualifies as a smaller reporting company based on its public float and has revenue of less than \$100 million in its most recently completed year also qualifies for non-accelerated filer status.

Certain smaller reporting companies may also be accelerated filers, which means that these companies must file on a more accelerated basis and need to obtain auditor attestation on internal control over financial reporting (ICFR).

Considerations for periodic filings after first registration statement

After a registrant's first registration statement is declared effective, a Form 10-Q for the quarter following the latest period for which financial statements were included in the registration statement is due the later of 45 days after the effective date of the registration statement or the date the Form 10-Q would otherwise be due. In addition, as discussed below, a new registrant would not meet the criteria to file on an accelerated basis (regardless of its public float) and its quarterly reports would be due 45 days after the fiscal quarter end until it has been a public company for at least a complete fiscal year.

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. The SEC staff clarified¹⁰ that Regulation A issuers that register on Form 8-A can file their first Form 10-Q (or Forms 10-Q covering two quarters) up to 45 days after the effective date of their Form 8-A or by the required due date of the Form 10-Q (as if the issuer had been required to file Form 10-Q), whichever is later.

Illustration 2-1: When the report is due

If an initial public offering (IPO) registration statement of a calendar-year company was effective on 14 July, the Form 10-Q for the fiscal quarter ended 30 June would be due 45 days from 14 July, which is 28 August. However, if the registration statement was effective on 24 June, the Form 10-Q would be due 45 days from the end of the quarter, which is 14 August.

Exit provisions based on public float only

The exit thresholds based solely on public float for large accelerated filer status and accelerated filer status (i.e., regardless of revenue) are set at 80% of the respective entry thresholds (detailed above) and have to be applied at every annual status re-determination date.

For example, a large accelerated filer whose public float, as of the last business day of its most recently completed second fiscal quarter (the re-determination date), is less than \$560 million (but more than \$60 million) would no longer be considered a large accelerated filer as of the end of that fiscal year. Such an issuer would become an accelerated filer for that fiscal year.

Similarly, a large accelerated filer or an accelerated filer would exit that status and become a non-accelerated filer as of the end of its fiscal year if its public float drops below \$60 million (regardless of revenue for its most recently completed fiscal year) at its annual re-determination date.

Exit provisions 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 smaller reporting company because its revenue was more than \$100 million and its public float was less than \$250 million on its prior annual re-determination date reports revenue below \$100 million and estimates that its public float is still less than \$250 million for purposes of the current year re-determination test.
- ▶ An issuer that was an accelerated filer (but not a smaller reporting company) 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 re-determination test.

For example, if a calendar-year issuer has a public float of \$230 million at 30 June 2022 and had revenue of \$101 million in 2021, it would be a smaller reporting company and an accelerated filer for purposes of its 2022 annual report based on its public float because it exceeded the revenue threshold. If its public float remains the same at 30 June 2023, and its annual revenue in 2022 falls to less than \$100 million, it would be a smaller reporting company and a non-accelerated filer for purposes of its 2023 annual report.

¹⁰ Refer to C&DI about Securities Act rules, Question 182.23 at: <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>

In contrast, if a calendar-year registrant has a public float of \$400 million at 30 June 2022 and had annual revenue of \$101 million in 2021, it also would not be eligible to be a smaller reporting company because it exceeds the revenue threshold, and it would be an accelerated filer for purposes of its 2022 annual report based on its public float. If its public float remains the same at 30 June 2023, its annual revenue in 2022 would need to fall below \$80 million for it to be a smaller reporting company and a non-accelerated filer for purposes of its 2023 annual report.

In each of these examples, the registrant's next Form 10-K for the calendar year ended 2023 would be the first periodic report affected by the longer due dates associated with its new non-accelerated filing status. The due dates of the quarterly reports on Form 10-Q for the remainder of the current fiscal year (i.e., the quarters ended 30 June and 30 September 2023 in the example above) would continue to be determined by the registrant's filing status as of the beginning of that fiscal year.

That is, even if the public float of a large accelerated filer or an accelerated filer falls below \$60 million as of the last business day of its second fiscal quarter, its Form 10-Q for both its second and third quarter of that fiscal year would continue to be due 40 days after each quarter end.¹¹ If a registrant becomes a non-accelerated filer, the Form 10-Q for its first interim quarter of the subsequent year would be the first Form 10-Q due 45 days after quarter end.

2.1.2

Late filing

Exchange Act Rule 12b-25 requires a registrant to promptly notify (within one business day of the 10-Q due date) the SEC on Form 12b-25 if it cannot file all or any required portion of Form 10-Q within the prescribed time period. Form 12b-25 is intended to serve as a disclosure mechanism and is broadly available via the SEC's EDGAR system. Thus, disclosure is available to the public regarding the reasons that a periodic report or portion thereof has not been filed on time.

The SEC will not grant extensions beyond the prescribed due date. However, the SEC will deem a registrant's Form 10-Q to have been filed timely, even if it actually was filed up to five business days late, provided it has complied with all the requirements and conditions of Rule 12b-25. The five-day relief period is available to all companies, regardless of their filing status. A specific relief provision of Rule 12b-25 provides that the SEC will deem a late Form 10-Q 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 undertakes that the Form 10-Q, or the delinquent portion thereof, will be filed no later than the fifth calendar day following the original due date.
- ▶ The registrant attaches, when 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-Q could not be filed on time.
- ▶ The Form 10-Q, or the delinquent portion thereof, is filed within the five-day extension period from the original due date.

A company would not be eligible to file a new registration statement on Form S-3 until the report is filed within the extension period. However, the company can continue to use an already effective Form S-3 to make offers and sales during the extension period if certain conditions are met.

¹¹ As discussed in section 7, in this circumstance, the issuer may be able to use the scaled disclosure provisions applicable to a smaller reporting company in these quarterly reports.

In addition to the requirements for the relief provision described above, the instructions for Form 12b-25 are summarized as follows:

- ▶ The form must be filed no later than one business day after the due date of the periodic report in question. The form is deemed to be filed on the date it is received by the SEC.
- ▶ The registrant must explain why it cannot file the report within the time required.
- ▶ If the form is being filed for a portion of a report and the balance of the report was filed by the original due date, the registrant must disclose the portion(s) omitted. When the registrant amends the report to include the information previously omitted, 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.

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 material information necessary under the circumstances to make the required information not misleading (e.g., disclosure of any internal control issues that led to the inability to file on time).

See section 8 of our publication, *SEC annual reports – Form 10-K*, for additional discussion of the SEC rules for late filing, Form 12b-25 and the involvement of independent auditors in the notification process.

2.1.3 Required review by independent auditors

Rules 8-03 and 10-01(d) of Regulation S-X require that a company's interim financial statements be reviewed by its independent auditors in accordance with PCAOB Auditing Standard (AS) 4105, *Reviews of Interim Financial Information* (PCAOB AS 4105), before it files its Form 10-Q with the SEC (see section 6 of this publication for further information on interim reviews by independent auditors). A Form 10-Q filed with the SEC prior to completion of a PCAOB AS 4105 review is considered to be substantially deficient and not timely filed. Even though a registrant is not required to state in its filing that the timely interim review was performed, there is an implicit assertion by filing the Form 10-Q that the registrant has met the filing requirements, including those for a timely review. See section 6 of this publication for additional discussion of interim review requirements.

2.2 Electronic filing using EDGAR

The entire Form 10-Q, including any financial statements, exhibits or other documents required as a part of the Form, must be either filed or furnished 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. (See section 2 of our publication, *SEC annual reports – Form 10-K*, for additional information about EDGAR filings.) There is no filing fee for Form 10-Q.

Under General Instruction G to Form 10-Q, at least one complete copy of Form 10-Q must be filed with each exchange on which the issuer has registered any class of securities.

2.2.1 XBRL

The SEC requires filers to use extensible Business Reporting Language (XBRL) tags for all primary financial statements, notes and financial statement schedules filed with the SEC.

Registrants are also required to tag in Inline XBRL a specific group of data points that appears on the cover page of the filing. Cover pages are to be tagged in Inline XBRL in accordance with the EDGAR Filer Manual.

The tagged Inline XBRL financial statements are due at the same time as the related EDGAR filing. A registrant cannot rely on Exchange Act Rule 12b-25 solely for the purpose of extending the due date of its tagged XBRL financial statements. If a company experiences unanticipated technical difficulties that prevent it from preparing and submitting its XBRL-tagged financial statements in a timely manner, an extension for up to six business days is available under the temporary hardship exemption provided by Rule 201(c) of Regulation S-T.

The Inline XBRL tags expose companies to the same liability for inaccuracies as the traditionally formatted financial statements. See section 2.3 of our publication, *SEC annual reports – Form 10-K*, for additional discussion of the SEC rules and transitional provisions for Inline XBRL reporting.

2.3

Signatures

Form 10-Q must be signed on the registrant's behalf by a duly authorized officer of the registrant (e.g., the principal executive officer) and by either the principal financial officer or the chief accounting officer of the registrant. However, if the principal financial officer or chief accounting officer is the officer duly authorized to sign on behalf of the registrant, one signature is acceptable provided that the registrant clearly indicates the dual responsibilities.

Although the principal executive officer is not required to sign Form 10-Q, the principal executive officer must sign the Section 906 and Section 302 management certifications that are included as exhibits to Form 10-Q. Of course, the principal executive officer may sign the Form 10-Q in that capacity or as the duly authorized officer if that responsibility is clearly indicated. Unlike Form 10-K, Form 10-Q does not require the signatures of any members of the board of directors or persons performing similar functions.

Rule 302 of Regulation S-T requires the signature in an EDGAR filing to be in typed form rather than manual. However, Rule 302 mandates the retention of a manually or electronically (as discussed below) signed signature page for a period of five years. In addition, signature authorization must be executed before or at the time of the electronic filing and such documentation must be made available to the SEC staff on request.

Rule 302(b) of Regulation S-T¹² 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-Q or in other filings.

¹² See SEC release [33-10889](#) *Electronic Signatures in Regulation S-T Rule 302*

2.4 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 certification by the chief executive officer (CEO) and the chief financial officer (CFO), or their equivalent,¹³ 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. Section 906 specifies that the certification must state that the periodic report “fully complies” with the requirements of Exchange Act Sections 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 Section 906 certification can be 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, of up to a \$1 million fine and imprisonment of 10 years (with harsher penalties for “willful” violations). The Section 906 certification requirement applies to all registrants, except for asset-backed security issuers and foreign private issuers that furnish interim financial information on Form 6-K.

The Section 906 certification is required to be “furnished” (versus filed) as Exhibit 32 to annual reports on Form 10-K and quarterly reports on Form 10-Q. 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 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.”

2.5 Content of the report

Instructions to Form 10-Q, Regulations 12B, 13A and 15D under the Exchange Act, and Regulations S-K and S-X provide the Form 10-Q requirements. The form itself, which is divided into two parts, is merely a guide and, except for the cover page, should not be used as a blank form to be filled in. Part I of the report should include all required item numbers and captions (e.g., Item 1 – Financial Statements). For any Part II item that is not applicable, the report should either (1) include the item with a response of “no,” “none” or “not applicable” or (2) omit the item. Information required by any item that previously has been reported by the registrant need not be reported again. In addition, a separate response to an item in Part II need not be presented when the information already is disclosed in Part I and the applicable item(s) in Part II incorporate by reference the information.

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-X and Regulation S-K) for the various items of Form 10-Q.

Form 10-Q

Item No.	Disclosure required
<i>Part I — Financial Information</i>	
Item 1.	Financial Statements (Rules 8-03 and 10-01 of Regulation S-X)
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations (Item 303 of Regulation S-K)
Item 3.	Quantitative and Qualitative Disclosures About Market Risk (Item 305 of Regulation S-K)
Item 4.	Controls and Procedures (Items 307 and 308(c) of Regulation S-K)

¹³ 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.

Part II — Other Information

- Item 1. Legal Proceedings (Item 103 of Regulation S-K)
- Item 1A. Risk Factors (Form 10-Q Instructions)
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (Items 701 and 703 of Regulation S-K)
- Item 3. Defaults Upon Senior Securities (Form 10-Q Instructions)
- Item 4. Mine Safety Disclosures (Form 10-Q Instructions)
- Item 5. Other Information (Item 407(c)(3) of Regulation S-K, Form 10-Q Instructions)
- Item 6. Exhibits (Item 601 of Regulation S-K)

The general instructions stipulate that Items 1, 2 and 3 of Part I of Form 10-Q are not considered to be “filed” for civil liability purposes under Section 18 of the Exchange Act, but other rules (notably the antifraud rules)¹⁴ of the Exchange Act do apply. However, all other Items in Form 10-Q are considered to be “filed” for purposes of liability under Section 18 of the Exchange Act. In addition, if information in Item 1 or 2 of Part I is used to satisfy the requirements in Part II, only the portion of Part I consisting of the information required by Part II will be considered “filed.”

Rule 12b-20 of the Exchange Act requires the registrant to disclose any material information, even if not specifically required, that is 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. If 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.

2.6

Wholly owned subsidiaries

If on the filing date a wholly owned subsidiary that also is a registrant meets the three tests described below, it may limit MD&A in its Form 10-Q to (1) the material changes in the results of operations between the current year-to-date period and the corresponding period of the previous year (e.g., changes in unit sales volume, prices charged and paid, production levels, production cost variances, labor costs and discretionary spending programs), and (2) the material effects on net income of any changes in accounting principles and practices or method of application. The wholly owned subsidiary also may omit the disclosures required by Item 3 of Part I and Items 2 and 3 of Part II. The three tests are:

- ▶ All of the wholly owned registrant’s equity securities are owned, either directly or indirectly, by a single parent that is a reporting company that is current in its reporting obligations under the applicable section of the Exchange Act (i.e., Section 13, 14 or 15(d)).

¹⁴ Exchange Act Rule 10b-5 states that it is unlawful for any person to make an untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they are made, not misleading.

- ▶ During the preceding 36 months and any subsequent period, there has been no 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 wholly owned registrant or its subsidiaries, and there has not been any material default in the payment of rentals under material long-term leases.
- ▶ The cover page of Form 10-Q prominently states that the wholly owned registrant meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing the Form 10-Q with the reduced disclosure format.

2.7 Incorporation by reference

Some companies prepare and publish quarterly reports to shareholders. The SEC does not require these reports and there are no instructions about the report's form or content. However, in accordance with Accounting Standards Codification (ASC) 270, the report must include summarized financial information and certain minimum disclosures (see section 5 of this publication). General Instruction D to Form 10-Q provides that the quarterly report to shareholders, or portions of it, may be incorporated by reference in response to all or part of the requirements of Part I of Form 10-Q if the report is made available to shareholders within the period prescribed for filing Form 10-Q, and if a copy of the report is filed as an exhibit to Part I.

General Instruction D also provides that other information may be incorporated by reference in full or in partial response to any item in Part II of Form 10-Q. In addition to the instructions to Form 10-Q, several rules under Regulation 12B contain instructions for incorporation by reference that are applicable to all Exchange Act filings, including Form 10-Q. (See section 2 of our publication, *SEC annual reports – Form 10-K*, for additional information about the requirements of Regulation 12B.)

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

2.8 Integrated reports

General Instruction E of Form 10-Q permits the quarterly report to shareholders and Form 10-Q to be integrated. However, under the SEC's EDGAR system, only those portions of an integrated report that satisfy the Form 10-Q requirements should be filed electronically. Instead of preparing an integrated report, companies that want to provide the Form 10-Q in the quarterly shareholders' report may do so by presenting the Form 10-Q in a separate section of the report.

2.9 Amendments

Occasionally, the SEC will consider a Form 10-Q deficient because a registrant has omitted material information or because it has not prepared the financial statements in accordance with generally accepted accounting principles or Regulation S-X. In such cases, an amendment should be filed with the SEC using the designation Form 10-Q/A. The amendment must include the complete text of the particular item being amended as required by Exchange Act Rule 12b-15.

A registrant that misses filing one or more interim period reports with the SEC or has to restate multiple historical periods may decide to file a comprehensive annual report on Form 10-K that includes the material information that would have otherwise been required in each delinquent filing (annual and quarterly reports). However, such an approach would not preclude an enforcement action by the SEC. And the registrant would not be eligible to use Form S-3 until it makes timely filings for the requisite period. (See section 2 of our publication, *SEC annual reports – Form 10-K*, for additional guidance on filing amendments to Exchange Act reports.) Amendments should be filed only after review by legal counsel and the independent auditors.

Amendments must be signed on behalf of the registrant by a duly authorized representative of the registrant (see Signatures above for further discussion). In addition, each CEO and CFO of the registrant must provide a new management certification. The CEO and CFO must furnish, as Exhibit 32, the complete Section 906 certification. However, the CEO and CFO may instead 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 Compliance and Disclosure Interpretations of Section 13(a) and 15(d) of the Exchange Act provide guidance on 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(c) 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 3 of this publication for further information about the Section 302 certification.)

Illustration 2-2: Modified Section 302 certification in amendment

Exhibit 31.1

Certification

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

1. I have reviewed this quarterly report on Form 10-Q/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(c) of Regulation S-K and such disclosures are required given the nature of the amendment.

2.10

Forward-looking information

As more fully discussed in section 2 of our publication, *SEC annual reports – Form 10-K*, the Private Securities Litigation Reform Act of 1995 (Litigation Reform Act) amended the federal securities laws to add a “safe harbor” provision that 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 abusive litigation when those predictions fail to materialize. 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."

2.11 Non-GAAP financial measures

Under Regulation G and Item 10 of Regulation S-K, when a company presents a non-GAAP financial measure in an SEC filing, such as a Form 10-Q or 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. FRR-65, *Conditions for Use of Non-GAAP Financial Measures*, and the SEC staff's Compliance & Disclosure Interpretations regarding non-GAAP financial measures provide guidance regarding the use of a non-GAAP financial measure.

The SEC staff has continued to focus on monitoring the disclosure of non-GAAP measures in registrants' periodic filings and earning releases. Our publications, *To the Point*, **[SEC staff updates guidance on non-GAAP financial measures](#)**; Technical Line, **[Spotlight on non-GAAP financial measures](#)**; SEC Reporting Update, **[Highlights of trends in 2022 SEC comment letters](#)**; 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 the challenges companies are encountering with their non-GAAP disclosures.

For additional considerations on non-GAAP financial measures, see our Technical Lines, **[How to appropriately use non-GAAP measures to discuss the effects of COVID-19](#)**, published 14 April 2020 and **[Accounting and reporting considerations for the war in Ukraine](#)**, published 6 April 2022.

For additional information regarding the definition of a non-GAAP financial measure, conditions for presentation and interpretive guidance, see section 2 of our publication, *SEC annual reports – Form 10-K*.

2.12 Key performance indicators and other metrics

Companies should identify key performance indicators (KPIs), whether financial or nonfinancial, that management uses to manage the business and that would be material to investors. Examples of such metrics include total customers, average revenue per user, active customers, number of memberships, same-store sales and number of data breaches. Metrics also can relate to external or macroeconomic matters (e.g., interest rates, economic growth rates, their anticipated trends), involve a combination of internal and external information or address environmental matters.

Item 303(a) of Regulation S-K requires disclosure of information not specifically referenced in the item that the registrant believes is necessary to understand its financial condition, changes in financial condition and results of operations. The item also requires discussion and analysis of other statistical data that in the registrant's judgment enhances a reader's understanding of MD&A.

The Commission has issued guidance¹⁵ advising registrants to provide additional disclosures about KPIs and other metrics in MD&A. KPIs and certain other metrics that companies commonly disclose are not subject to guidance for non-GAAP financial measures. However, as discussed below, the disclosures required for KPIs are broadly similar to certain disclosures required for non-GAAP measures.

¹⁵ 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 or (2) they are non-GAAP measures and Regulation G or Item 10(e) of Regulation S-K applies. If the metrics are not subject to either framework, the registrant should 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 every key performance indicator:

- ▶ 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 to achieve comparability and avoid misunderstandings. For more information, refer to our To the Point publication, **SEC issues guidance on disclosures about key performance indicators and other metrics in MD&A**.

2.13

Transition report – change in fiscal year

Form 10-Q also may be used for transition reports when a registrant changes its fiscal year end or a successor issuer has a different fiscal year end than its predecessor. Rules 13a-10 and 15d-10 of the Exchange Act provide the SEC's reporting and filing requirements in these circumstances. Section 2 of our publication, *SEC annual reports – Form 10-K*, addresses the periodic reporting requirements for a change in fiscal year.

3

Part I — Financial information

3.1 Item 1. Financial statements

The financial statements presented in Form 10-Q must be prepared in accordance with Article 10 of Regulation S-X (Rule 8-03 for smaller reporting companies, as discussed in section 7 of this publication) and the principles of accounting measurement in ASC 270 (see section 4 of this publication). Article 10 of Regulation S-X requires the interim financial statements to comply with Regulation S-X except as follows:

- ▶ The registrant may provide condensed financial information (see Basis of preparation below).
- ▶ The interim financial statements may be unaudited and may omit separate financial statements, which might otherwise be required by Regulation S-X (see Summarized income statement information, Guarantors and issuers of guaranteed securities, and Affiliates whose securities collateralize the registrant's securities below).
- ▶ In preparing the footnotes to the interim financial statements, registrants may presume that users of the condensed interim financial information either have read or have access to the most recent annual report (see Additional disclosure requirements below).
- ▶ Registrants may omit schedules otherwise required by Regulation S-X.

The Form 10-Q must include the following unaudited interim financial statements, which may be condensed:

- ▶ **Balance sheets:** Registrants must provide a balance sheet as of the end of the most recent fiscal quarter and as of the end of the preceding fiscal year. The balance sheet as of the end of the preceding fiscal year may be condensed to the same extent as the interim balance sheet. A balance sheet as of the end of the corresponding quarter of the preceding year also should be presented if it is necessary for an understanding of the effect of seasonal fluctuations on the registrant's financial condition.
- ▶ **Statements of comprehensive income:** Registrants must provide statements of comprehensive income for the most recent fiscal quarter, the fiscal year-to-date period and the corresponding periods of the preceding fiscal year. The SEC also permits the presentation of statements of comprehensive income for the cumulative 12-month period ended as of the most recent interim period balance sheet date and for the corresponding period of the preceding year. ASC 220 requires companies to present totals for net income and comprehensive income in either a single continuous statement¹⁶ or two consecutive statements.
- ▶ **Statements of cash flows:** Registrants must provide statements of cash flows for the fiscal year-to-date period and for the corresponding period of the preceding fiscal year. The SEC also permits the presentation of statements of cash flows for the cumulative 12-month period ended as of the most recent interim period balance sheet date and for the corresponding preceding period.

¹⁶ The single continuous presentation of comprehensive income is illustrated in the example provided in section 3.2.3 of this publication.

Reconciliation of changes in stockholders' equity: Registrants are required to include in their interim financial statements a reconciliation of changes in all components of stockholders' equity, either as a separate statement or in the notes to the financial statements, that satisfies the requirements of Rule 3-04 of Regulation S-X for the current and comparative year-to-date periods, with subtotals for each interim period.

Registrants engaged in the seasonal production and sale of a single-crop agricultural commodity may present statements of income and cash flows for the 12-month period ended as of the most recent interim period balance sheet date and for the corresponding preceding period in lieu of the year-to-date statements of income and cash flows described above.

3.2 Basis of preparation

The registrant may provide condensed interim financial information in Form 10-Q (i.e., under Article 10 of Regulation S-X). That is, major captions may be combined with others if certain criteria are met. These criteria, which are applied to the most recent interim financial statements, are summarized below. In addition, these criteria are explained in the decision diagram below and illustrated in the example worksheets that follow. Pursuant to SAB Topic 6.G, *Accounting Series Releases 177 and 286 – Relating to Amendments to Form 10-Q Regulation S-K, and Regulation S-X Regarding Interim Financial Reporting*, if a registrant previously combined captions, but now must present such captions separately in the current quarter's Form 10-Q, the registrant must retroactively reclassify the amounts in the prior-period financial statements to conform to the current-period presentation.

At most, account descriptions in the balance sheets and income statements must include the major, numbered captions in Regulation S-X (i.e., Rule 5-02 and 5-03). The only exception to this provision is inventories, for which registrants must separately disclose raw materials, work in process and finished goods, either on the face of the balance sheet or in a note to the interim financial statements. In accordance with SAB Topic 6.G, if a registrant uses the gross profit method or some other method to determine cost of goods sold during the interim period, the separate disclosure of raw materials, work in process and finished goods must be estimated based on management's knowledge of the registrant's production cycle and the costs (labor and overhead) associated with this cycle, as well as the relative sales and purchasing volume of the registrant. The SEC staff will not allow registrants to state that it is not practicable to determine the inventory components at an interim period.

Although combining major captions is permitted in interim information filed on Form 10-Q, most registrants use the same captions as in their annual report (plus any new significant captions that have arisen since that time). This avoids the confusion that might result from presenting different captions in Form 10-Q for quarters within the same year and also promotes comparability. Even if registrants elect to use the same captions as in their annual report, registrants still may provide the reduced interim financial statement disclosures.

3.2.1 Balance sheet

If material,¹⁷ registrants must show separately each balance sheet caption prescribed by Regulation S-X (i.e., numbered captions in Rule 5-02 of Regulation S-X) that is 10% or more of total assets, or that has increased or decreased by more than 25% since the preceding fiscal year-end. Otherwise, the caption amount may be combined with other captions in Form 10-Q. However, when applying these rules, the general format of the balance sheet should be retained (e.g., a current asset should not be combined with a noncurrent asset).

¹⁷ Notwithstanding the combination criteria, Rule 4-02 of Regulation S-X allows registrants to combine captions that are not material to the interim financial statements.

Illustration 3-1: Balance sheet

Under Rule 5-02(19) of Regulation S-X, the balance sheet must separately state, under the major caption of “Accounts and Notes Payable,” amounts payable to (1) banks for borrowings, (2) factors or other financial institutions for borrowings, (3) holders of commercial paper, (4) trade creditors, (5) related parties, (6) underwriters, promoters and employees (other than related parties) and (7) others. However, in balance sheets presented in Form 10-Q, an issuer could combine these sub-captions and show only the major caption, “Accounts and Notes Payable.” In addition, if “Accounts and Notes Payable” satisfied the combination criteria described above, it could be combined with other major captions.

3.2.2 Income statement

If it is material,¹⁸ registrants must show separately each income statement caption prescribed by Regulation S-X (i.e., numbered captions in Rule 5-03 of Regulation S-X) that is 15% or more of average net income for the most recent three fiscal years, or that has increased or decreased by more than 20% compared with the corresponding interim period of the preceding fiscal year.¹⁹ Otherwise, the caption amount may be combined with other captions in Form 10-Q. To calculate average net income, net losses are excluded unless all three years were losses, in which case, the average net loss should be used for the test. Although the registrant’s net loss years are excluded, the SEC staff expects the calculation of average net income to total the net income from those years with positive net income and divide by three (not the number of years in which net income was positive).

3.2.3 Statement of comprehensive income

ASC 220 requires companies to present totals for net income and comprehensive income in either a single continuous statement or two consecutive statements. To avoid a statement with only one line item, companies may want to consider the single continuous statement approach for interim periods. We understand that the SEC staff would not object to companies presenting a single continuous statement in interim periods and two consecutive statements in annual periods.

The following illustrations provide examples of the approaches when there are no noncontrolling interests.

Illustration 3-2: Single continuous statement interim presentation

ABC Company		
Condensed Consolidated Statement of Comprehensive Income		
Quarters Ended 31 March		
	20X3	20X2
Revenues	\$ 1,037,500	\$ 998,750
Expenses	(626,250)	(587,500)
Gain on sale of securities	<u>68,750</u>	<u>146,250</u>
Income from operations, before tax	480,000	557,500
Income tax expense ²⁰	(120,000)	(139,375)
Net income	<u>\$ 360,000</u>	<u>\$ 418,125</u>
Earnings per share basic and diluted	\$0.16	\$0.16
Comprehensive income	<u>\$ 323,700</u>	<u>\$ 379,438</u>

¹⁸ Notwithstanding the combination criteria, Rule 4-02 of Regulation S-X allows registrants to combine captions that are not material to the interim financial statements.

¹⁹ Banks and bank holding companies must show separately investment gains and losses, regardless of materiality.

²⁰ Income tax expense is calculated using a 25% total tax rate in all examples in this publication.

Illustration 3-3: Two consecutive statements interim presentation

ABC Company		
Condensed Consolidated Statement of Income		
Quarters Ended 31 March		
	20X3	20X2
Revenues	\$ 1,037,500	\$ 998,750
Expenses	(626,250)	(587,500)
Gain on sale of securities	68,750	146,250
Income from operations, before tax	480,000	557,500
Income tax expense ²¹	(120,000)	(139,375)
Net income	360,000	418,125
Earnings per share basic and diluted	\$0.16	\$0.16

ABC Company		
Condensed Consolidated Statement of Comprehensive Income		
Quarters Ended 31 March		
	20X3	20X2
Comprehensive income	\$ 323,700	\$ 379,438

See our *Disclosure checklist for interim financial reporting* (EY Form A78) and our *GAAP disclosure checklist* (EY Form A13) for disclosure requirements.

3.2.4

Statement of cash flows

The statements of cash flows may be abbreviated starting with a single figure of net cash flows from operating activities. Registrants must show separately each investing and financing cash flow caption that exceeds 10% of the average of net cash flows from operating activities for the most recent three fiscal years. Otherwise, the caption amount may be combined with other captions in Form 10-Q. To calculate the average net cash flows from operating activities, negative net operating cash flows are excluded unless all three years were negative, in which case, the average negative operating cash flows should be used for the test. Although the registrant's negative net operating cash flow years are excluded, the SEC staff expects the calculation of average net cash flows from operating activities to total those years with positive cash flows from operating activities and divide by three (not the number of years in which cash flows from operating activities were positive).

The disclosure of the amount of interest and income taxes paid is not required in interim financial statements. Further, SEC rules and GAAP do not require companies to provide supplemental disclosures of noncash investing and financing activities. However, companies may elect to provide this information on an interim basis. For example, companies often provide interim disclosures when a noncash investing or financing activity exceeds 10% of the three-year average of net cash flows from operating activities.

²¹ Income tax expense is calculated using a 25% total tax rate in all examples in this publication.

3.2.5 Reconciliation of changes in stockholders' equity

The reconciliation of changes in stockholders' equity should reconcile the beginning balance to the ending balance of each caption in stockholders' equity for each period for which a statement of comprehensive income is required to be filed. It should also comply with the content requirements of Rule 3-04 of Regulation S-X. As a result, registrants have to provide the reconciliation for both the year-to-date and quarterly periods as well as comparable periods in Form 10-Q but only for the year-to-date periods in registration statements.

The rule does not prescribe the format of the presentation as long as the appropriate periods are provided. Examples of presentations that would be acceptable include:

- ▶ A single statement that reconciles the components and total of shareholders' equity from the prior year end to the balances at the end of the first quarter and continues the reconciliation to the balances at the end of each succeeding quarter with comparative reconciliations for the prior-year periods
- ▶ One statement that reconciles those components and the total for both the year-to-date period and comparable prior-year period and a second statement that reconciles the beginning and ending balances for both the latest quarterly period and the comparable prior-year quarterly period

Illustration 3-4: Single continuous statement interim presentation						
ABC Company						
Reconciliation of Stockholders' Equity						
	Common stock				Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital	Retained earnings		
Balances, 1 January 20X3	115	\$ 10	\$ 515	\$ 1,070	\$ 26	\$ 1,621
Net income				40		40
Foreign currency translation adjustment					2	2
Stock-based compensation	5		5			5
Balances, 31 March 20X3	120	10	520	1,110	28	1,668
Net income				70		70
Foreign currency translation adjustment					(7)	(7)
Stock-based compensation	5		5			5
Balances, 30 June 20X3	125	10	525	1,180	21	1,736
Net loss				(10)		(10)
Foreign currency translation adjustment					3	3
Stock-based compensation	5		5			5
Balances, 30 September 20X3	<u>130</u>	<u>\$ 10</u>	<u>\$ 530</u>	<u>\$ 1,170</u>	<u>\$ 24</u>	<u>\$ 1,734</u>

	Common stock			Retained earnings	Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital			
Balances, 1 January 20X2	100	\$ 10	\$ 500	\$ 1,000	\$ 20	\$ 1,530
Net income				25		25
Foreign currency translation adjustment					2	2
Stock-based compensation	<u>5</u>	<u>—</u>	<u>5</u>	<u>—</u>	<u>—</u>	<u>5</u>
Balances, 31 March 20X2	105	10	505	1,025	22	1,562
Net loss				(5)		(5)
Foreign currency translation adjustment					2	2
Stock-based compensation	<u>5</u>	<u>—</u>	<u>5</u>	<u>—</u>	<u>—</u>	<u>5</u>
Balances, 30 June 20X2	110	10	510	1,020	24	1,564
Net income				30		30
Foreign currency translation adjustment					(5)	(5)
Stock-based compensation	<u>5</u>	<u>—</u>	<u>5</u>	<u>—</u>	<u>—</u>	<u>5</u>
Balances, 30 September 20X2	<u>115</u>	<u>\$ 10</u>	<u>\$ 515</u>	<u>\$ 1,050</u>	<u>\$ 19</u>	<u>\$ 1,594</u>

Illustration 3-5: Two-statement interim presentation

ABC Company Reconciliation of Stockholders' Equity						
	Common stock			Retained earnings	Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital			
Balances, 1 January 20X3	115	\$ 10	\$ 515	\$ 1,070	\$ 26	\$ 1,621
Net income				100		100
Foreign currency translation adjustment					(2)	(2)
Stock-based compensation	<u>15</u>	<u>—</u>	<u>15</u>	<u>—</u>	<u>—</u>	<u>15</u>
Balances, 30 September 20X3	<u>130</u>	<u>\$ 10</u>	<u>\$ 530</u>	<u>\$ 1,170</u>	<u>\$ 24</u>	<u>\$ 1,734</u>

	Common stock			Retained earnings	Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital			
Balances, 1 July 20X3	125	\$ 10	\$ 525	\$ 1,180	\$ 21	\$ 1,736
Net income				(10)		(10)
Foreign currency translation adjustment					3	3
Stock-based compensation	5		5			5
Balances, 30 September 20X3	<u>130</u>	<u>\$ 10</u>	<u>\$ 530</u>	<u>\$ 1,170</u>	<u>\$ 24</u>	<u>\$ 1,734</u>

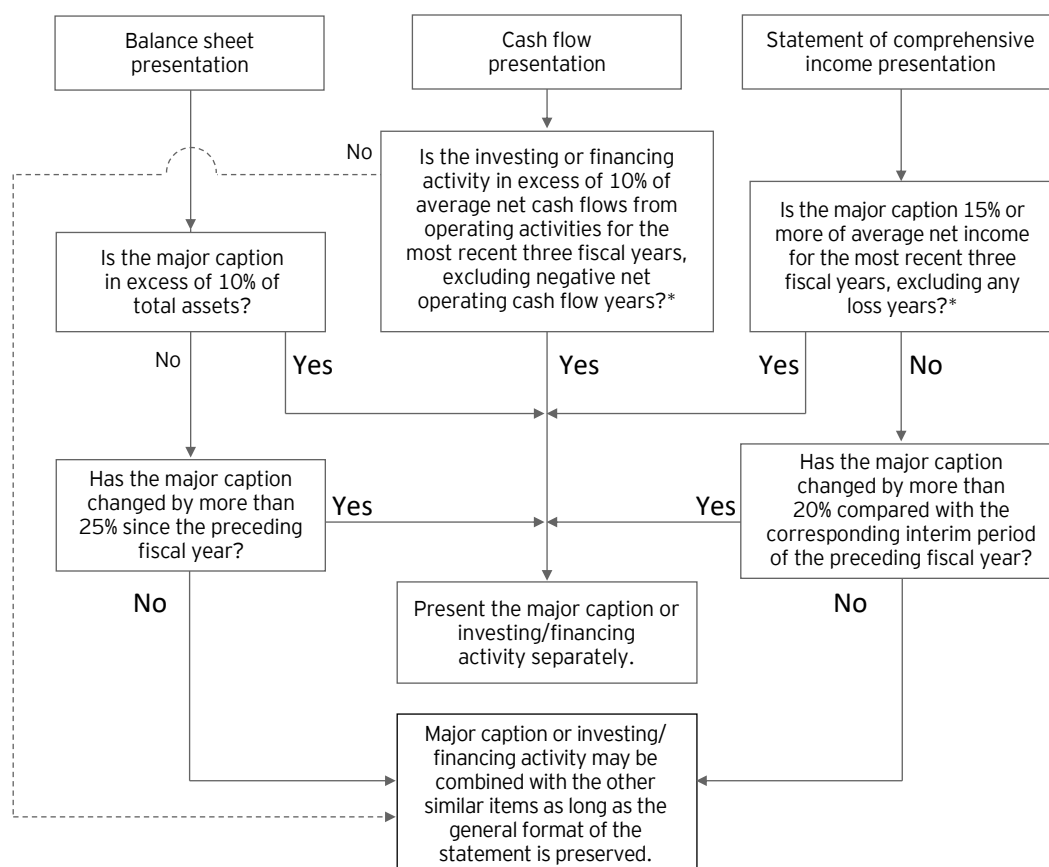
	Common stock			Retained earnings	Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital			
Balances, 1 January 20X2	100	\$ 10	\$ 500	\$ 1,000	\$ 20	\$ 1,530
Net income				50		50
Foreign currency translation adjustment					(1)	(1)
Stock-based compensation	15		15			15
Balances, 30 September 20X2	<u>115</u>	<u>\$ 10</u>	<u>\$ 515</u>	<u>\$ 1,050</u>	<u>\$ 19</u>	<u>\$ 1,594</u>

	Common stock			Retained earnings	Accumulated other comprehensive income	Total
	Shares outstanding	Common stock	Additional paid-in capital			
Balances, 1 July 20X2	110	\$ 10	\$ 510	\$ 1,020	\$ 24	\$ 1,564
Net income				30		30
Foreign currency translation adjustment					(5)	(5)
Stock-based compensation	5		5			5
Balances, 30 September 20X2	<u>115</u>	<u>\$ 10</u>	<u>\$ 515</u>	<u>\$ 1,050</u>	<u>\$ 19</u>	<u>\$ 1,594</u>

3.2.6

Decision diagram for condensing interim financial statements

The following is a decision diagram of the process to be followed for presentation of condensed balance sheets, statements of comprehensive income and statements of cash flows in Form 10-Q:



* If a company had negative operating cash flows or losses in all three fiscal years, the average negative operating cash flows or average loss should be used.

3.2.7

Worksheets for condensing financial statements

The following worksheets (i.e., balance sheet, statement of comprehensive income and statement of cash flows) provide an illustration of the criteria for preparing condensed interim financial information for the Form 10-Q in accordance with Article 10 of Regulation S-X. However, the worksheets are not meant to form a comprehensive example. Rather, the worksheets individually illustrate application of the criteria for preparing condensed interim financial information. In addition, the worksheets illustrate the major balance sheet and statement of comprehensive income captions as prescribed in Rules 5-02 and 5-03 of Regulation S-X, respectively. While we have not provided all of the disclosures on the face of the balance sheet or statement of comprehensive income below as prescribed by Rules 5-02 and 5-03, we have provided a footnote to the respective caption highlighting the additional disclosure that should be made in the financial statements when applicable.

The following assumptions were made:

- Net income (loss) for the years ended 31 December 20X0, 20X1 and 20X2, was \$27,000, (\$1,000) and \$12,000, respectively. Therefore, average net income for the three years ended 31 December 20X2 is \$13,000 $(\$27,000 + \$12,000)/3$ and 15% of average net income is \$1,950 $(\$13,000 \times 15\%)$.

For purposes of this example, income statements for the six months ended 30 June 20X3 and 20X2 have not been presented. However, the same amounts would be used to determine the condensed income statements for these periods.

- Net cash outflows from operating activities for the years ended 31 December 20X0, 20X1 and 20X2, were (\$20,000), (\$7,000) and (\$12,000), respectively. Therefore, average net cash outflows for the three years ended 31 December 20X2 are \$13,000 $[(\$20,000) + (\$7,000) + (\$12,000)]/3$ and 10% of average net cash outflows is \$1,300 $(\$13,000 \times 10\%)$.

Worksheets identifying caption combinations for condensed financial statements

ABC, Inc.

Balance sheets

	In accordance with Regulation S-X		In accordance with Form 10-Q condensing instructions	
	30 June 20X3	31 December 20X2	30 June 20X3	31 December 20X2
	<i>(In thousands)</i>			
Assets				
1. Cash and cash items	\$ 7,500	\$ 5,000	\$ 7,500	\$ 5,000 (D) (5)
2. Marketable securities	24,000	18,500	24,000	18,500 (A) (1)
3. Accounts and notes receivable			30,000	32,000 (A) (2)
3.1 Trade accounts receivable	20,000	22,000		
3.2 Receivable from related party	5,000	4,000		
3.3 Receivable from underwriters	3,000	3,500		
3.4 Other receivables	<u>2,000</u>	<u>2,500</u>		
	30,000	32,000		
4. Allowances for doubtful accounts and notes receivable	<u>(1,000)</u>	<u>(1,000)</u>	<u>(1,000)</u>	<u>(1,000)</u> (E)
	29,000	31,000	29,000	31,000
5. Unearned income	4,000	6,000	4,000	6,000 (D)
6. Inventories				(3)
6.1 Finished products	17,000	14,000	17,000	14,000 (B)
6.2 Work in process	35,000	28,500	35,000	28,500 (B)
6.3 Raw materials	<u>7,000</u>	<u>6,500</u>	<u>7,000</u>	<u>6,500</u> (B)
	59,000	49,000	59,000	49,000 (A)
7. Prepaid expenses	500	500		
8. Other current assets	1,000	1,000		(4)
Other			<u>1,500</u>	<u>1,500</u> (C)
9. Total current assets	125,000	111,000	125,000	111,000 (A)
10. Securities of related parties	4,000	7,000	4,000	7,000 (D)
11. Indebtedness of related parties- not current	6,000	5,500		
12. Other investments	8,000	7,500		
13. Property, plant, and equipment	86,500	70,000	86,500	70,000 (A)
14. Accumulated depreciation	<u>(30,500)</u>	<u>(27,500)</u>	<u>(30,500)</u>	<u>(27,500)</u> (A)
	56,000	42,500	56,000	42,500
15. Intangible assets	15,000	15,000	15,000	15,000 (E) (6)
16. Accumulated amortization	<u>(10,000)</u>	<u>(5,000)</u>	<u>(10,000)</u>	<u>(5,000)</u> (D)
	5,000	10,000	5,000	10,000
17. Other assets	2,000	1,500		(6)
Other			<u>16,000</u>	<u>14,500</u> (C)
18. Total assets	<u>\$206,000</u>	<u>\$185,000</u>	<u>\$206,000</u>	<u>\$185,000</u> (A)

	In accordance with Regulation S-X		In accordance with Form 10-Q condensing instructions	
	30 June 20X3	31 December 20X2	30 June 20X3	31 December 20X2
	(In thousands)			
Liabilities and shareholders' equity				
19. Accounts and notes payable			\$ 33,000	\$ 34,500 (A)
19.1 Notes payable to bank	\$ 3,000	\$ 4,000		
19.2 Factors or other financial institutions for borrowings	2,000	1,500		
19.3 Commercial paper	3,000	3,000		
19.4 Trade accounts payable	15,000	16,000		
19.5 Payable to related party	6,000	5,000		
19.6 Payable to underwriters	3,000	2,000		
19.7 Other payables	1,000	3,000		
20. Other current liabilities	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>	<u>15,000</u> (E) (4)
21. Total current liabilities	48,000	49,500	48,000	49,500 (A)
22. Bonds, mortgages and other long-term debt	22,000	7,000	22,000	7,000 (A) (7)
23. Indebtedness to related parties- noncurrent	10,000	14,000	10,000	14,000 (D)
24. Other liabilities	5,000	5,500	5,000	5,500 (E) (6)
25. Commitments and contingent liabilities				
26. Deferred credits			23,000	22,000 (A)
26.1 Deferred income taxes	13,000	12,000		
26.2 Deferred tax credits	2,000	1,500		
26.3 Material items of deferred income	<u>8,000</u>	<u>8,500</u>		
	<u>23,000</u>	<u>22,000</u>		
Total liabilities	<u>108,000</u>	<u>98,000</u>	<u>108,000</u>	<u>98,000</u>
27. Redeemable preferred stocks*	25,000	24,000	25,000	24,000 (A) (8)
ABC Inc.'s shareholders' equity				(9)
28. Nonredeemable preferred stocks	1,000	1,000	1,000	1,000 (E)
29. Common stock	3,000	2,900	3,000	2,900 (E)
30. Other shareholders' equity			52,000	43,000 (A)
30.1 Additional paid-in capital	15,000	14,000		
30.2 Other additional capital				
30.3 Retained earnings	<u>37,000</u>	<u>29,000</u>		
	56,000	46,900		
Accumulated other comprehensive loss	<u>(4,000)</u>	<u>(3,900)</u>	<u>(4,000)</u>	<u>(3,900)</u> (E) (10)
Total ABC Inc.'s shareholders' equity	52,000	43,000	52,000	43,000
31. Noncontrolling interest	<u>21,000</u>	<u>20,000</u>	<u>21,000</u>	<u>20,000</u> (A)
Total equity	<u>98,000</u>	<u>87,000</u>	<u>98,000</u>	<u>87,000</u>
32. Total liabilities and equity	<u>\$206,000</u>	<u>\$185,000</u>	<u>\$206,000</u>	<u>\$185,000</u> (A)

* Shares are conditionally redeemable and are not subject to the liability classification requirements of ASC 480

Worksheets identifying caption combinations for condensed financial statements — continued

ABC, Inc.

Statements of comprehensive income²²

	In accordance with Regulation S-X		In accordance with Form 10-Q condensing instructions	
	Three months ended 30 June		Three months ended 30 June	
	20X3	20X2	20X3	20X2
	(In thousands, except per share amounts)			
1. Net sales and gross revenues			\$ 79,940	\$ 70,850 (A)
1.1 Net sales of tangible products	\$ 78,000	\$ 70,850		
1.2 Operating revenue of public utilities or others				
1.3 Income from rentals				
1.4 Revenues from services				
1.5 Other revenues	<u>1,940</u>	<u>-</u>		
	79,940	70,850		
2. Costs and expenses applicable to sales and revenue			61,800	53,200 (A)
2.1 Cost of tangible goods sold	60,800	53,200		
2.2 Operating expenses of public utilities or others				
2.3 Expenses applicable to rental income				
2.4 Cost of services				
2.5 Expenses applicable to other revenues	<u>1,000</u>	<u>-</u>		
	61,800	53,200		
3. Other operating costs and expenses	1,000	1,200	1,000	1,200 (H)(11)
4. Selling, general, and administrative expenses	9,940	11,000	9,940	11,000 (A)
5. Provision for doubtful accounts and notes	1,500	1,450		
6. Other general expenses	500	475		
Other			2,000	1,925 (F)
7. Nonoperating income				
7.1 Dividends	300	450		
7.2 Interest on securities	650	700		
7.3 Profits on securities (net of losses)	-	-		
7.4 Miscellaneous other income	<u>50</u>	<u>50</u>		(12)
	1,000	1,200		
8. Interest and amortization of debt discount	1,200	800	1,200	800 (G)
9. Nonoperating expenses				
9.1 Losses on securities (net of profits)	525	450		
9.2 Miscellaneous income deductions	<u>75</u>	<u>50</u>		(12)
	600	500		
Nonoperating income, net			<u>400</u>	<u>700</u> (F)
10. Income before income tax expense, and Captions 12 and 14 (as applicable)	4,400	3,425	4,400	3,425 (A)
11. Income tax expense	(1,100)	(900)	(1,100)	(900) (H)
12. Equity in earnings of investees	<u>600</u>	<u>650</u>	<u>600</u>	<u>650</u> (H)(13)
13. Income from continuing operations	3,900	3,175	3,900	3,175 (A)
14. Discontinued operations	<u>800</u>	<u>775</u>	<u>800</u>	<u>775</u> (H)
15. Consolidated net income	4,700	3,950	4,700	3,950 (A)

²² For purposes of this example, the statements of comprehensive income for the six months ended 30 June 20X3 and 20X2 have not been presented.

16. Net income attributable to noncontrolling interest	<u>(200)</u>	<u>(100)</u>	<u>(200)</u>	<u>(100)(G)</u>
17. Net income attributable to ABC Inc. common shareholders	<u>\$ 4,500</u>	<u>\$ 3,850</u>	<u>\$ 4,500</u>	<u>\$ 3,850</u>
18. Earnings per share				
Basic earnings (loss) per share:				
Income from continuing operations attributable to ABC Inc. common shareholders	\$ 3.70	\$ 3.07	\$ 3.70	\$ 3.07
Discontinued operations attributable to ABC Inc. common shareholders	<u>0.80</u>	<u>0.78</u>	<u>0.80</u>	<u>0.78</u>
Net income attributable to ABC, Inc. common shareholders	\$ 4.50	\$ 3.85	\$ 4.50	\$ 3.85
Diluted earnings (loss) per share:				
Income from continuing operations attributable to ABC Inc. common shareholders	\$ 1.90	\$ 1.54	\$ 1.90	\$ 1.54
Discontinued operations attributable to ABC Inc. common shareholders	<u>0.40</u>	<u>0.39</u>	<u>0.40</u>	<u>0.39</u>
Net income attributable to ABC, Inc. common shareholders	\$ 2.20	\$ 1.93	\$ 2.20	\$ 1.93
Weighted average shares used to compute earnings per share:				
Basic	1,000	1,000	1,000	1,000
Diluted	2,000	2,000	2,000	2,000
Other comprehensive income, net of tax ²³				(L)
Foreign currency translation adjustments	50	40		
Unrealized gains on available-for-sale securities				
Unrealized gains arising during the period	40	50		
Less: Reclassification adjustments for gains included in net income	(20)	(20)		
Unrealized gains on available-for-sale securities, net	20	30		
Other comprehensive loss, net of tax	70	70		
Comprehensive income	4,570	3,920	4,570	3,920
Less: Comprehensive income attributable to noncontrolling interest	(195)	(99)	(195)	(99)
Comprehensive income attributable to ABC Inc. common shareholders	4,375	3,821	4,375	3,821

²³ This illustrates the net of tax presentation option. A company also may elect to present amounts before related tax effects. Under either alternative for annual periods, the amount of income tax expense or benefit allocated to each component of other comprehensive income must be either displayed on the face of the financial statements or disclosed in the notes.

Worksheets identifying caption combinations for condensed financial statements — continued

ABC, Inc.

Statements of cash flows

	In accordance with Regulation S-X		In accordance with Form 10-Q condensing instructions	
	Six months ended 30 June		Six months ended 30 June	
	20X3	20X2	20X3	20X2
	(In thousands)			
Cash flows from operating activities				
Net income	\$ 8,000	\$ 5,000		
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	3,740	3,200		
Deferred income taxes	500	400		
Loss on write-off of property, plant and equipment	500	—		
Changes in assets and liabilities, net of effects from purchase of Future Corp.	(7,240)	(3,850)		
Cash provided by operating activities	5,500	4,750	\$ 5,500	\$ 4,750 (I)
Cash flows from Investing Activities				
Purchases of property, plant, and equipment	(2,500)	(2,500)	(2,500)	(2,500) (J)
Proceeds from sale of property, plant, and equipment	—	250		
Acquisition of Future Corp. net of cash acquired	(15,000)	—	(15,000)	— (J)
Payment received on non- current note receivable	500	250		
Other			500	500 (K)
Cash used in investing activities	(17,000)	(2,000)	(17,000)	(2,000)
Cash flows from financing activities				
Decrease in short-term borrowings	(1,000)	(850)		
Proceeds from issuance of common stock	1,000	—		
Proceeds from issuance of 10% debentures	15,000	—	15,000	— (J)
Cash dividends paid	(118)	(116)		
Other	(882)	(884)	(1,000)	(1,850) (K)
Cash provided by (used in) financing activities	14,000	(1,850)	14,000	(1,850)
Increase in cash and cash equivalents	2,500	900	2,500	900
Cash and cash equivalents at beginning of period	5,000	2,000	5,000	2,000
Cash and cash equivalents at end of period	\$ 7,500	\$ 2,900	\$ 7,500	\$ 2,900

The following worksheet legend should be used when reviewing the criteria for preparing condensed interim financial information:

- A. Major caption of Regulation S-X that is more than 10% of total assets at 30 June 20X3 or more than 15% of average net income for the recent three fiscal years and cannot be combined.
- B. Inventory is the only major caption of Regulation S-X for which further detail is required in the interim financial statements in Form 10-Q. Registrants must state, either on the face of the interim balance sheet or in a note to the interim financial statements, raw materials, work in process and finished goods.

- C. Combination of major captions of Regulation S-X that have been combined because each caption is less than 10% of total assets at 30 June 20X3 and has not increased or decreased by more than 25% since 31 December 20X2.
- D. Major caption of Regulation S-X that is less than 10% of total assets at 30 June 20X3, but cannot be combined because it has increased or decreased more than 25% since 31 December 20X2.
- E. Major caption of Regulation S-X that is less than 10% of total assets at 30 June 20X3, and has not increased or decreased by 25% since 31 December 20X2, but is presented separately to maintain the general format of the balance sheet.
- F. Combination of major captions of Regulation S-X that have been combined because each caption is less than 15% of average net income for the three years ended 31 December 20X2 and has not increased or decreased by more than 20% as compared with the three months ended 30 June 20X2.
- G. Major caption of Regulation S-X that is less than 15% of average net income for the three years ended 31 December 20X2, but cannot be combined because it has increased or decreased by more than 20% as compared with the three months ended 30 June 20X2.
- H. Major caption of Regulation S-X that is less than 15% of average net income for the three years ended 31 December 20X2, and has not increased or decreased by more than 20% compared with the three months ended 30 June 20X2, but is presented separately to maintain the general format of the income statement.
- I. In accordance with Article 10 of Regulation S-X, the statement of cash flows may start with a single figure of net cash flows from operating activities.
- J. Investing or financing activity that cannot be combined because it exceeds 10% of the average net cash outflows from operating activities for the three years ended 31 December 20X2.
- K. Combination of investing or financing activities that have been combined because each investing or financing activity is less than 10% of the average of net cash outflows from operating activities for the three years ended 31 December 20X2.
- L. Although not prescribed by Regulation S-X, ASC 220 requires companies to present totals for net income and comprehensive income in a single continuous statement or two consecutive statements for interim periods. The worksheet provides an illustration of the condensed single statement approach for interim periods.

The following worksheet legend should be used when reviewing the captions as prescribed in Rules 5-02 and 5-03 of Regulation S-X:

1. For marketable securities other than equity securities, registrants must state, either parenthetically or in a note to the annual financial statements, the basis for determining the aggregate amount shown in the balance sheet along with the alternatives of the aggregate cost or the aggregate market value at the balance sheet date.
2. If the registrant's notes receivable balance exceeds 10% of the total receivables balance, Captions 3.1 to 3.4 must be provided separately for both accounts receivable and notes receivable, either on the face of the annual balance sheet or in a note to the annual financial statements. In addition, if a registrant has receivables from long-term contracts, Rule 5-02 requires registrants to provide additional disclosures, either on the face of the annual balance sheet or in a note to the annual financial statements (e.g., billed or unbilled amounts representing claims subject to uncertainty concerning their ultimate realization).

3. If the last-in, first-out (LIFO) inventory method is used, registrants must state, either parenthetically or in a note to the annual financial statements, the excess of replacement cost or current cost over the stated LIFO value.
4. Registrants must state, either on the face of the annual balance sheet or in a note to the annual financial statements, any other current asset in excess of 5% of total current assets or any other current liability in excess of 5% of total current liabilities. Other current liability items might include, but are not limited to, accrued payrolls, accrued interest, taxes (as well as the current portion of deferred income taxes) and the current portion of long-term debt.
5. Registrants must separately disclose the cash and cash items that are restricted as to withdrawal or usage (e.g., legally restricted deposits held as compensating balances against short-term borrowing arrangements). The provisions of any restrictions must be described in a note to the financial statements.
6. Registrants must state, either on the face of the annual balance sheet or in a note to the annual financial statements, any other asset in excess of 5% of total assets or any other liability in excess of 5% of total liabilities.
7. Registrants must state separately, either on the face of the annual balance sheet or in a note to the annual financial statements, the important features and provisions of long-term debt by issue, including (1) the general character of each issue including interest rate, (2) a brief indication of priority, (3) the basis of convertibility, if any, (4) the date of maturity or, if maturing serially, a brief indication of serial maturities and (5) contingencies affecting payment of principal or interest.
8. Registrants must state on the face of the annual balance sheet the title of each issue, the carrying amount, redemption amount and the number of shares authorized, issued and outstanding. If there is more than one issue, these amounts may be aggregated on the face of the balance sheet and detail provided in a note thereto. The registrant also must state the dollar amount of any shares subscribed but unissued, net of subscriptions receivable.
9. For each class of nonredeemable preferred shares and for each class of common shares, registrants must disclose on the face of the annual balance sheet the title, aggregate dollar amount and number of shares authorized, issued, outstanding, or in the treasury, as appropriate. In addition, if common stock is convertible, that fact should be disclosed on the face of the annual balance sheet. Further, registrants must show separately appropriated retained earnings and unappropriated retained earnings.
10. Although accumulated other comprehensive income (loss) is not a balance sheet caption prescribed by Rule 5-02, ASC 220 requires the disclosure of this amount on the face of the balance sheet.
11. Registrants must disclose any material amounts not included in major Income Statement Caption 2.
12. Registrants must state, either on the face of the annual income statement or in a note to the annual financial statements, material amounts included in miscellaneous other income or miscellaneous income deductions, with clear indication of the nature of the transactions from which the amount(s) arose.
13. Registrants must state, either parenthetically or in a note to the annual financial statements, the amount of dividends received from unconsolidated subsidiaries or equity investees. In addition, in accordance with Rule 4-01 of Regulation S-X,²⁴ registrants may present this item in a different position and in a different manner on the income statement.

²⁴ Rule 4-01 of Regulation S-X states that financial statements should be filed in such form and order, and should use generally accepted terminology, as will best indicate their significance and character in light of the provisions applicable thereto.

3.3 Summarized income statement information

Rule 4-08(g) of Regulation S-X requires consolidated financial statements in annual reports on Form 10-K to include in the notes to the financial statements summarized financial information (balance sheet and income statement information) about equity-method investees if, individually or in the aggregate, they exceed 10% significance under any one of the three significant subsidiary tests in Rule 1-02(w) of Regulation S-X. However, Article 10 of Regulation S-X requires only summarized income statement information in Form 10-Q for equity-method investees for which separate or combined audited financial statements would otherwise be required for annual periods under Rule 3-09 of Regulation S-X. That is, in the notes to the interim financial statements in a Form 10-Q, summarized income statement information would be required for those equity-method investees that meet either the investment test or the income test at the 20% level.²⁵

In the income test, significance is calculated as the lower of (1) the absolute value of the registrant's proportionate share of the pretax income or loss from continuing operations (after intercompany eliminations) attributable to the controlling interest of the equity method investee compared with the absolute value of the registrant's own pretax income or loss from continuing operations (after intercompany eliminations) attributable to the controlling interest or (2) the registrant's proportionate share of revenue from continuing operations of the equity method investee (after intercompany eliminations) compared with the registrant's own revenue from continuing operations for the most recently completed fiscal year.

If the revenue component of the test does not apply (because either the registrant or the investee does not have material revenue in each of the last two fiscal years), a registrant would use its average income for the last five fiscal years if the absolute value of its pretax income or loss from continuing operations (after intercompany eliminations) attributable to the controlling interest for the most recent fiscal year is at least 10% lower than the average of the absolute values of such income or loss for each of its last five fiscal years. A registrant that cannot average its income must calculate significance based on pretax income from continuing operations (after intercompany eliminations) attributable to the controlling interest for the last completed annual period.

The SEC staff believes that for purposes of such interim disclosures, the calculations of significance should be made for the year-to-date interim period (rather than any annual period) for the income test without applying any averaging. The investment test should be based on the most recent balance sheet date and year-end balance sheet included in the Form 10-Q. In certain situations, the interim financial statements could be required to include summarized year-to-date income statement information for an equity-method investee for which the Form 10-K did not include audited financial statements under Rule 3-09. However, the summarized income statement information need not be provided for any equity-method investee that would not be required to file quarterly financial information if it were a registrant (e.g., investment company, foreign private issuer, asset-backed security issuer, mutual life insurance company and certain nonproducing mining companies). See section 2 of this publication for additional information about registrants that are not required to file quarterly financial information.

Rule 1-02(bb)(ii) of Regulation S-X requires at least the following detail in the summarized income statement information (which can be presented in the aggregate for all significant investees):

- ▶ Net sales or gross revenue
- ▶ Gross profit (or costs and expenses applicable to net sales or gross revenue)
- ▶ Income or loss from continuing operations

²⁵ **Release 33-10786**, *Amendments to Financial Disclosures about Acquired and Disposed Businesses*. This release has more of an effect on annual reports on Form 10-K and is addressed in more detail in section 6.4.4.1 of our publication, *SEC Annual Reports – Form 10-K*.

- ▶ Net income or loss
- ▶ Net income or loss attributable to the entity

Insofar as is practicable, Rule 4-08(g) of Regulation S-X requires that this financial information should be presented as of the same dates and for the same periods as the interim financial statements, except that for interim periods, the SEC staff requires only the summarized income statement information to be presented for the year-to-date interim periods. If the equity method of accounting is applied on a lag basis (e.g., equity-method earnings may be recorded on a three-month lag because of the timing of the receipt of data from the equity-method investee), the summarized financial information of the equity-method investee would correspond to the lag period on which the registrant recognizes its equity-method earnings. Explanatory notes need not accompany the summarized financial information.

Rule 3-09 of Regulation S-X, which requires separate financial statements of an equity investee that meets certain significance thresholds, does not apply to interim financial statements filed on Form 10-Q. See section 6 of our publication, *SEC annual reports – Form 10-K*, for a further discussion of Rule 3-09 and summarized financial information.

Below is an example footnote disclosure of summarized income statement information in Form 10-Q. The example assumes that none of the investees has any noncontrolling interests.

Illustration 3-6: Note X — Summarized income statement information of affiliates

The Company has investments in three companies, each of which is significant and is accounted for under the equity method. Summarized income statement information of these investees is as follows:

	Six months ended June 30	
	20X3	20X2
Net sales	\$ 8,200,000	\$ 7,600,000
Costs and expenses:		
Cost of sales	5,500,000	5,100,000
General and administrative	<u>1,750,000</u>	<u>1,700,000</u>
	7,250,000	6,800,000
Income before income taxes	950,000	800,000
Income taxes	<u>237,500</u>	<u>200,000</u>
Net income	<u>\$ 712,500</u>	<u>\$ 600,000</u>

Note: Rule 1-02(bb) of Regulation S-X does not require the footnote to disclose the amount of equity in earnings (losses) recognized from equity-method investees. However, companies should consider separately disclosing in the footnote the aggregate amount of equity in earnings (losses) recognized from significant equity-method investees.

3.4

Guarantors and issuers of guaranteed securities

Financial statements of issuers and guarantors²⁶ of securities registered under the Securities Act must be included in a separate Form 10-Q for each issuer or guarantor unless specifically exempted under Rule 3-10 of Regulation S-X. If separate financial statements are required, such financial statements should be as of the same dates, for the same periods and on the same basis (e.g., GAAP, Article 10 of Regulation S-X) as the registrant's financial statements.

²⁶ Guarantees of securities are securities themselves for purposes of the Securities Act. As a result, offers and sales of both the guaranteed security and the guarantee must be registered under the Securities Act unless otherwise exempt from registration.

Rule 3-10 of Regulation S-X provides relief from the general requirement for full separate reporting by subsidiary issuers if the parent guarantees the subsidiary's debt and for subsidiary-guarantors of public debt issued by the parent. The general rule is that separate financial statements of the subsidiary issuer or guarantor would be required in the parent's Form 10-Q, but if certain conditions are met, no separate financial statements are required and a registrant could present summarized financial information (SFI) coupled with qualitative disclosures consistent with the requirements in Rule 13-01 of Regulation S-X (also referred to as alternative disclosure).

The rules allow companies to provide abbreviated disclosures in lieu of separate financial statements of subsidiary issuers and guarantors if the parent company²⁷ registrant is an issuer or co-issuer (jointly and severally) or the full and unconditional guarantor of the registered securities of a consolidated subsidiary issuer. In addition, 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.

See sections 2 and 6 of our publication, *SEC Annual Reports – Form 10-K*, and our *Disclosure checklist for interim financial reporting* (EY Form A78) for more detailed requirements for the abbreviated disclosures under Rule 13-01 of Regulation S-X.

Narrative disclosures

Once the registrant determines it has met the eligibility criteria in Rule 3-10 to omit the separate annual audited and unaudited interim financial statements of its subsidiary issuers and guarantors, it must comply with the disclosure requirements in Rule 13-01 and Exhibit 22 of Item 601 of Regulation S-K. These include requirements to make certain narrative disclosures about the issuers and guarantors, the terms and conditions of the guarantees, and how the rights and obligations of the issuers and guarantors, as well as other factors, may affect payments to holders of the debt securities.

Safe harbor fact patterns

In limited circumstances, narrative disclosure about the guarantees is permitted in lieu of summarized financial information as specified in Rule 13-01 of Regulation S-X. The disclosures required by Rule 13-01 only need to be provided if they are material. To help a registrant evaluate whether it can omit financial disclosure, the rule includes four fact patterns in which the financial information may always be omitted. Before preparing the financial disclosures specified by Rule 13-01, a registrant should first determine whether its facts match one of the following safe harbors:

- ▶ The assets, liabilities and results of operations of the obligor group are not materially different from those reported in the registrant's consolidated financial statements.
- ▶ The obligor group has no material assets, liabilities or results of operations.
- ▶ The issuer is a finance subsidiary, the parent company has provided a full and unconditional guarantee, and none of the parent company's other subsidiaries provides a guarantee.

²⁷ Rule 3-10 of Regulation S-X defines "parent company" as the entity that (1) is an issuer or full and unconditional guarantor of the guaranteed security (2) is (or will be following registration) an Exchange Act reporting company; and (3) consolidates each subsidiary issuer and guarantor of the guaranteed security

- ▶ A finance subsidiary and the parent company are joint and several co-issuers, and none of the parent company's other subsidiaries provides a guarantee.

Summarized financial information

Registrants that do not meet the safe harbors to provide only narrative disclosure, are required to disclose SFI for the balance sheet and statement of comprehensive income (loss) captions specified under Rule 1-02(bb) of Regulation S-X for the obligor group if the information is material. The alternative financial information does not have to include cash flow information for the obligor or non-obligor group.

The presentation and disaggregation of the obligor's group SFI in interim reports on Form 10-Q should be consistent with the disclosures in annual reports on Form 10-K, which is discussed in section 6 of our publication, *SEC annual reports – Form 10-K*. The disclosure should be separate for each guaranteed registered security and should focus on the entities that are co-issuers or guarantors of the registered debt or debt-like security and the parent (that is, the obligor group). In most cases, the registrant could provide combined SFI for the obligor group (to the extent the subsidiary co-issuers or guarantors are consolidated) but separate SFI may be warranted for some of the guarantor or co-issuer entities within the obligor group in some circumstances.

The rules require a registrant to provide the balance sheet SFI only as of the end of its most recent fiscal year and interim period. In quarterly reports, income statement SFI is only required for the most recent year-to-date period, but registrants may voluntarily provide comparative disclosure for the prior year-to-date period if they believe such presentation is material and beneficial to their investors.

Illustration 3-7: Example disclosure

Parent Company Inc., a multinational consumer goods registrant, is a calendar-year registrant with consolidated subsidiaries A, B and C. In 2020, Parent Company issued \$100 million of registered debt securities that are fully and unconditionally guaranteed by Subsidiaries A and B on a joint and several basis. Subsidiary C is not obligated under the indenture. Parent Company will provide the disclosures in its MD&A in the Liquidity section of its 31 March 2021 Form 10-Q.

Parent Company and Subsidiaries A and B constitute the Obligor Group, and Parent Company considered the following additional facts when preparing its disclosures:

- ▶ Investor X has a 25% noncontrolling interest in Subsidiary B.
- ▶ Approximately 75% of the Obligor Group's noncurrent assets consist of goodwill.
- ▶ The Obligor Group has material intercompany sales and related accounts receivable with Subsidiary C and a related-party loan receivable from unconsolidated Sister Company Y. Interest income from the loan receivable is immaterial.

The example disclosures provided below are summarized. We expect that registrants may include more detail regarding the legal provisions of the indenture and guarantees.

Financial and nonfinancial disclosure about issuers and guarantors of our Senior Notes

As discussed in Note X to the consolidated financial statements, "Debt," in 2020, we, as the parent company, issued \$100 million of Senior Notes that remain outstanding at 31 March 2021. The Senior Notes are guaranteed by Subsidiary A, our cleaning products operation, and Subsidiary B, our household appliances operation. There are no significant restrictions on the ability of the guarantors to make distributions to us. Our remaining consolidated subsidiary, Subsidiary C, is not obligated under the Senior Notes indenture.

The following is a description of the terms and conditions of the guarantees:

- ▶ The guarantors fully and unconditionally and jointly and severally guarantee the payment of the principal and premium (if any) and interest on the Senior Notes. If we fail to make a scheduled payment, Subsidiaries A and B are obligated to make it immediately and, if they do not, any holder of the Senior Notes may immediately bring suit directly against them for payment of all amounts due and payable.
- ▶ The guarantees are senior unsecured obligations of the guarantors that rank equal with all existing and future senior debt of the guarantors and are senior to all subordinated debt. However, the guarantees are effectively subordinated to any secured debt of the guarantors.
- ▶ The guarantees are subject to release in the following circumstances: (i) the sale, disposition, exchange or other transfer (including through merger, consolidation or otherwise) of the capital stock of a guarantor made in a manner not in violation of the indenture; or (ii) the designation of a guarantor as an “Unrestricted Subsidiary” under the indenture.

In addition, each guarantee is limited to an amount that will not render the guarantee, as it relates to each guarantor, voidable under applicable law relating to fraudulent conveyances or fraudulent transfers. If a guarantor were to become a debtor in a case under the US Bankruptcy Code, a court may decline to enforce its guarantee of the Senior Notes. This may occur when, among other factors, it is found that the guarantor originally received less than fair consideration for the guarantee and the guarantor would be rendered insolvent by enforcement of the guarantee.

On the basis of historical financial information, operating history and other factors, we believe that each of the guarantors, after giving effect to the issuance of its guarantee of the Senior Notes when the guarantee was issued, was not insolvent and did not and has not incurred debts beyond its ability to pay such debts as they mature. The Company cannot predict, however, what standard a court would apply in making these determinations or that a court would agree with our conclusions in this regard.

Basis of preparation explanatory note

Basis of preparation of the Summarized Financial Information

The following tables include summarized financial information of Parent Co. (issuer), Subsidiary A (guarantor) and Subsidiary B (guarantor) (together, the obligor group). Investments in and equity in the earnings of Subsidiary C, which is not a member of the obligor group, have been excluded.

The summarized financial information of the obligor group is presented on a combined basis with intercompany balances and transactions between entities in the obligor group eliminated. The obligor group's amounts due from, amounts due to and transactions with Subsidiary C have been presented in separate line items, if they are material. In addition, a loan receivable from Sister Company Y (an unconsolidated related party) is presented separately.

Investor X holds a 25% noncontrolling interest in Subsidiary B and has a representative on its Board of Directors. Also, Investor X could file suit to prevent Subsidiary B from performing under its guarantee, which could potentially delay or prevent payments to holders of the Senior Notes in the event of default. Therefore, summarized financial information for Subsidiary B is presented separately.

For the three months ended 31 March 2021, Subsidiary B's net income attributable to Investor X is \$2.5 million. At 31 March 2021 and 31 December 2020, Investor X's non-controlling interest in Subsidiary B's equity is \$13.75 million and \$16.25 million, respectively

SFI of the obligor group

Summarized Statements of Income (mil \$)	3 months ended 31 March 2021			
	Parent Co. Inc. and Subsidiary A		Subsidiary B	
Net sales to unrelated parties	175		58	
Net sales to non-obligor subsidiaries	20		-	
Gross profit	90		30	
Income from continuing operations	45		10	
Net income	45		10	
Summarized Balance Sheets (mil \$)	Parent Co. Inc. and Subsidiary A		Subsidiary B	
	31-Mar-21	31-Dec-20	31-Mar-21	31-Dec-20
ASSETS				
Receivables due from non-obligor subsidiaries	14	25	-	-
Other current assets	<u>100</u>	<u>200</u>	<u>100</u>	<u>125</u>
Total current assets	<u>114</u>	<u>225</u>	<u>100</u>	<u>125</u>
Goodwill	345	345	-	-
Loan receivable from Sister Company Y	34	25	-	-
Other noncurrent assets	<u>25</u>	<u>30</u>	<u>55</u>	<u>60</u>
Total noncurrent assets	<u>404</u>	<u>400</u>	<u>55</u>	<u>60</u>
LIABILITIES				
Current liabilities	80	150	50	70
Noncurrent liabilities	400	400	50	50

Exhibit 22. Subsidiary guarantors and issuers of guaranteed securities

\$100 million of Senior Notes	Issuer	Guarantor
Parent Company Inc.	X	
Subsidiary A		X
Subsidiary B		X

Location of disclosures in Form 10-Q

Registrants have the flexibility to elect to provide disclosures under Rule 13-01 of Regulation S-X in the notes to the interim financial statements or outside the interim financial statements in management's discussion and analysis (MD&A). Disclosures in the notes to the financial statements are subject to interim reviews by the external auditor while those in MD&A are not.

A detailed discussion of the 2020 amendments to Rule 3-10 of Regulation S-X and the disclosure requirements in Rule 13-01 can be found in our Technical Line, *How to apply the SEC's new requirements for registered debt issued or guaranteed by subsidiaries*, dated 30 April 2020.

3.5 Affiliates whose securities collateralize the registrant's securities

Rule 13-02 of Regulation S-X requires disclosures in interim reports on Form 10-Q about affiliates whose securities collateralize registered debt that are similar to those required by Rule 13-01 of Regulation S-X about subsidiary issuers and guarantors, if material. However, we expect the disclosure requirements in Rule 13-02 to apply infrequently because today it is rare for a registrant to pledge the securities of an affiliate as collateral for its registered debt obligation.

Materiality

A registrant must disclose any financial and narrative information about each affiliate if the information would be material for investors to evaluate the pledge of the affiliate's securities as collateral.

Narrative disclosures

Rule 13-02 requires 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.

Summarized financial information

Unlike the SFI for the obligor group for guaranteed securities, the financial information of all subsidiaries consolidated by an affiliate whose securities are pledged as collateral 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 of the registrant, 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 require separate financial statements of the unconsolidated affiliate.

3.6 Additional disclosure requirements

3.6.1 General

Article 10 of Regulation S-X provides that the condensed interim financial information should include sufficient disclosures (either on the face of the financial statements or in the accompanying footnotes) to avoid the presentation of misleading information. Registrants also may presume that users of the condensed interim financial information either have read or have access to the most recent annual report.

We recommend that a footnote in Form 10-Q refer to the most recently filed annual financial statements (e.g., financial statements in the annual report on Form 10-K), because many disclosures are excluded from the quarterly statements. This reference should be worded carefully to avoid implying that Form 10-Q is deficient unless the Form 10-K accompanies it.

Footnote disclosures that would substantially duplicate the disclosures in the most recent annual report (e.g., summary of significant accounting policies, account balances that have not changed significantly in amount or composition since the most recently completed fiscal year or other disclosures required by Rule 4-08 of Regulation S-X) generally may be omitted from the condensed interim financial statements. However, registrants must disclose events after the most recent fiscal year that have had a material effect on the registrant including:

- ▶ Material retroactive prior period adjustments (e.g., correction of an error, adoption of a Codification update)
- ▶ Significant business combinations or dispositions

Additionally, certain disclosures required by the Codification may be specifically required in interim financial statements (e.g., segment reporting in ASC 280 and certain disclosures required by ASC 820).

Our *Disclosure checklist for interim financial reporting* (EY Form A78) provides a comprehensive list of the interim disclosure requirements as well as the source of the disclosure (e.g., Regulation S-X or GAAP). In some cases, it refers registrants to the relevant disclosure requirements in our *GAAP disclosure checklist* (EY Form A13). A registrant that elects to present a complete set of interim financial statements (rather than condensed) should use EY Form A13.

3.6.2 Per-share information

Article 10 of Regulation S-X requires registrants to disclose earnings per share, as well as the basis of the earnings per share computation and the number of shares used. ASC 260 also requires additional disclosures about earnings per share (basic and diluted) in interim financial statements. See our *Disclosure checklist for interim financial reporting* (EY Form A78) for a summary of these disclosure requirements.

3.6.3 Retroactive adjustments

Article 10 of Regulation S-X requires the disclosure of any material retroactive adjustment made during any period included in Form 10-Q, together with its effect on net income (total and per share) of any prior period included in Form 10-Q and its effect on the balance of retained earnings. For example, if a calendar-year registrant files a Form 10-K/A to correct an error in its 20X1 financial statements, the 20X2 interim financial statements must disclose the effect of the error on net income (total and per share) for each prior period included in the registrant's Form 10-Q and the effect of the error on the balance of retained earnings as of 1 January 20X1.

Similar disclosures also must be made if the registrant's results of operations for any period presented have been adjusted after the initial reporting of such period for a retrospective adoption of a new accounting standard or a voluntary change in accounting principle. For example, if an issuer makes a voluntary change in accounting principle (e.g., change in inventory valuation method) in the second quarter, the registrant must disclose, in the second quarter interim financial statements, the effect of the adjustment on net income (total and per share) for the first quarter. The disclosure requirements in Article 10 relate to all retroactive adjustments and are in addition to those an accounting standard update may require in the interim financial statements.

3.6.4 Basis of presentation

Article 10 of Regulation S-X requires the unaudited interim financial statements to reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the interim results and to include a statement to that effect. In addition, registrants must state whether such adjustments are of a normal recurring nature; otherwise, the registrant must describe in appropriate detail the nature and amount of any nonrecurring adjustment. Below is an example basis-of-presentation footnote.

Illustration 3-8: Note A — Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and six-month periods ended June 30, 20X3 are not necessarily indicative of the results that may be expected for the year ended December 31, 20X3.

The condensed consolidated balance sheet at December 31, 20X2, has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in ABC, Inc.'s annual report on Form 10-K for the year ended December 31, 20X2.

3.7 Item 2. Management's discussion and analysis of financial condition and results of operations (Item 303 of Regulation S-K)

Item 303(c) of Regulation S-K provides the requirements of MD&A for interim financial statements. If the registrant includes MD&A in a quarterly shareholders' report, the MD&A in this report should be consistent with that in Form 10-Q, even if the registrant elects not to incorporate the Form 10-Q discussion by reference. Management should use its discretion as to the form and location of the discussion in the quarterly report to shareholders.

Because of the potential volatility in the business and economic environment, financial statement users and regulators have sought more transparency in companies' disclosures regarding risks, material trends and uncertainties, liquidity, capital resources, critical accounting estimates, fair value accounting and off-balance sheet arrangements – all required components of MD&A.²⁸ In each reporting period, companies should take a fresh look at their MD&A in light of current conditions because the SEC staff expects such disclosures to evolve over time.

Item 303 of Regulation S-K includes the objectives of MD&A, which focus the disclosure on material information relevant to assessing a registrant's financial condition, results of operations and cash flows. The objectives address both historical and forward-looking information and refer to material financial and other statistical data that will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations. The objectives also say that disclosures that meet the requirements are expected to better allow an investor to view the registrant from "management's perspective."

²⁸ The SEC staff frequently issues comments on MD&A during its review of registrant filings. See the latest edition of our SEC Reporting Update - Highlights of trends in SEC comment letters for common areas of focus by the SEC staff.

3.7.1 Overview

Management must discuss the registrant's financial condition, changes in financial condition, results of operations and cash flows in MD&A.

MD&A in interim financial statements should enable the reader to assess material changes in the registrant's financial condition and results of operations. Specifically, MD&A should satisfy the following overarching principles to 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. This includes material changes in the registrant's liquidity, capital resources, off-balance sheet arrangements, aggregate contractual obligations and results of operations.
- ▶ 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. This includes 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. This includes the reasons underlying material changes in financial statement line items of the interim financial statements from prior-period amounts.²⁹

3.7.2 Interim materiality considerations

Companies must assess materiality when preparing MD&A in their interim financial statements. FRR-501, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, states, "There may be different quantitative and qualitative factors to consider when deciding whether to include certain information in a specific quarterly or annual report." The SEC adds that material changes requiring disclosure in MD&A in annual reports should be discussed in the quarter in which they occur, but "there also may be circumstances where an item may not be material in the context of a discussion of annual results of operations, but is material in the context of interim results."

The interim MD&A rules allow registrants to presume that users of the interim financial statements have read or have access to MD&A in the registrant's prior annual report. Because MD&A in quarterly reports is complementary to MD&A in the most recent annual report and intervening quarterly reports, if adequate MD&A disclosure was provided previously, the SEC indicates that further disclosure in the subsequent quarterly report generally is not required. However, the SEC cautions that MD&A for the current quarterly report might need to provide an update if the earlier reports did not "adequately foreshadow subsequent events," or if new information becomes apparent in the current period that affects known trends and uncertainties.

²⁹ In addition to information required by the MD&A rules and interpretive SEC guidance, 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 (Exchange Act Rules 10b-5 and 12b-20).

3.7.3 Material changes

The underlying reasons for material changes in interim financial statement items must be described, to the extent necessary, for users to understand the business as a whole.

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 underlying reasons for material changes and their implications. The SEC intends the discussion to provide meaningful information about the underlying reasons for the change and to avoid simply reciting amounts that changed in the financial statements. If a material change is a result of multiple factors, each factor should be described and quantified to the extent practicable. This includes a quantitative and qualitative discussion where material changes in a line item offset one another, consistent with prior SEC interpretive guidance. However, if the reasons underlying a change in one item also relate to other items, repeating the discussion is not required.

The requirement to disclose material changes applies to all financial statements – not just the income statement. Determining which changes are material is the responsibility of the registrant. The interim MD&A rules do not require a discussion of every line item and its changes without regard to materiality, and “registrants need not recite the amounts of changes from period to period which are readily computable from the financial statements.” In addition, MD&A need not include information that would result in undue effort or expense to assemble the information.

SEC staff comment letters often ask registrants to provide more meaningful and detailed explanation of material period-to-period changes. The SEC staff typically requests that registrants provide more granular quantification and discussion about the specific factors, and the underlying reasons, that contributed to material period-to-period changes. For example, when MD&A cites two or more qualitative reasons that contributed to a material period-to-period change in a financial statement line item, the SEC staff requests that each reason be quantified and analyzed to provide more meaningful disclosure. The SEC staff also asks that registrants disclose in MD&A whether the reasons contributing to material changes represent trends that are expected to have a material effect on future periods.

In addition, Item 303(b) includes “product lines” as an example of a subdivision of the registrant’s business that should be discussed, if, in the registrant’s judgment, the information is necessary to an understanding of the registrant’s business. Disclosing information about product lines may be appropriate if a registrant does not provide an analysis of its results of operations by reportable segment, geographic area or other meaningful disaggregation below the consolidated level.

3.7.4 Changes in financial condition

Item 303(c) of Regulation S-K requires a discussion of material changes in financial condition, particularly addressing material changes in liquidity and capital resources. This is done by comparing the financial condition at the end of the most recent interim period with that at the end of the most recent fiscal year. If registrants present a balance sheet as of the end of the corresponding prior-year interim period (which is necessary only if users need it to understand the effect of seasonal fluctuations on the company’s financial condition), the registrant also should compare the financial condition at the end of the most recent interim period to that at the end of the corresponding prior-year interim period. When both comparisons are required, the discussion and analysis may be combined.

Registrants are required to satisfy the following liquidity and capital resources requirements in Item 303(b)(1) in Form 10-Q:

- ▶ Analyze their ability to generate and obtain adequate amounts of cash to meet their requirements and plans for cash separately for at least the following two relevant time horizons:
 - ▶ The short term (i.e., the next 12 months from the most recent fiscal period end required to be presented in the Form 10-Q)
 - ▶ The long term (i.e., beyond the next 12 months)
- ▶ Include a discussion of material cash requirements to cover both known contractual obligations and “other obligations,” including those that are not recorded on the balance sheet under US GAAP, and address the anticipated source of funds needed to satisfy the cash requirements and the general purposes of the requirements
- ▶ Include a discussion of material cash requirements for capital expenditures and other reasonably likely material cash requirements for items like human capital and intellectual property, including cash expenditures that would be classified as operating cash outflows and considered related to normal business operations

The *Tabular disclosure of contractual obligations* and a separately captioned discussion of “Off-Balance Sheet Arrangements” are no longer required in Item 303 based on 2020 amendments. As such, registrants may omit the *Tabular disclosure of contractual obligations* and any discussion of material changes during the interim period compared with the last annual table. Registrants may also exclude the separate caption “Off-Balance Sheet Arrangements” and integrate any of those disclosures in their liquidity and capital resources discussion.

3.7.5 Changes in results of operations

Item 303(c) requires a discussion of material changes in the results of operations of (1) the current fiscal year-to-date period compared with the corresponding period in the preceding fiscal year and (2) the most recently completed quarter compared with either the corresponding quarter in the preceding year or the immediately preceding quarter. If the immediately preceding quarter is discussed, the registrant needs to provide, in summary form, the financial information for that immediately preceding quarter that is the subject of the discussion or identify its prior filings on EDGAR that present such information.

A registrant that changes the comparative period in a Form 10-Q is required to explain the reasons for the change and present both comparisons in the quarterly filing where the change is made. If financial statements for the 12-month period ended as of the most recent interim period balance sheet are presented, the discussion also should cover material changes in that 12-month period compared with the corresponding 12-month period for the prior fiscal year. If MD&A in the registrant’s annual report includes a discussion of each relevant reportable segment, MD&A in the interim financial statements should address any material changes in revenues and expenses by reportable segment that is necessary to obtain an understanding of the business as a whole. See section 5 of our publication, *SEC annual reports – Form 10-K*, for further information on presenting segment information in MD&A.

A registrant should identify any significant elements of its income or loss from continuing operations that did not arise from, or are not necessarily representative of, its ongoing business. Examples of these items include:

- ▶ Unusual promotion or research and development expenses
- ▶ Unusually high or low export activities

- ▶ Identifiable costs of a business interruption caused by labor disruptions and other events
- ▶ Significant gains or losses from the disposition of assets

Management also should discuss any seasonal aspects of its business that had a material effect on its financial condition or results of operations.

3.7.6 Other considerations

Many of the disclosures applicable to MD&A for annual periods should be considered for material events or transactions that occur in interim periods, particularly if no similar events or transactions have occurred in preceding annual periods and no similar disclosures previously have been provided in MD&A. Our *SEC annual reports – Form 10-K*, Parts II and III of our *SEC annual shareholders' report checklist* (EY Form A150) and our *Disclosure checklist for interim financial reporting* (EY Form A78) include matters to consider.

In addition, a registrant that elects to disclose non-GAAP financial measures in MD&A must comply with Item 10(e) of Regulation S-K, which imposes conditions and restrictions on the use of non-GAAP financial measures in SEC filings and requires reconciliation to the most comparable GAAP measure. For additional information regarding the definition of a non-GAAP financial measure, conditions for presentation and interpretive guidance, see section 2 of our publication, *SEC annual reports – Form 10-K*.

3.8 Item 3. Quantitative and qualitative disclosures about market risk

Item 305 of Regulation S-K, which does not apply to smaller reporting companies,³⁰ requires quantitative and qualitative market risk disclosures to be presented outside the financial statements in both annual reports on Form 10-K and, if there have been material changes since the date of the most recent annual report, in Form 10-Q. 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 registrants have financial instruments that expose them to market risk.

The interim disclosures required under Item 305 of Regulation S-K must enable the reader to assess the sources and effects of material changes in market risk exposures that affect the quantitative and qualitative disclosures presented as of the end of the preceding fiscal year. For example, if a company enters into a significant amount of interest rate swaps in the first quarter, the company should disclose the change in risk management strategy.

The SEC staff expects companies to have reasonable procedures in place to monitor whether material changes in market risk are likely to have occurred since year end without necessarily having to recalculate or reassemble the quantitative information during the interim period.

While the quantitative and qualitative disclosures about market risk are required in response to Item 3 of Part I of Form 10-Q, registrants may elect to incorporate the disclosures by reference from a quarterly shareholders' report or integrate the disclosures within MD&A. In either case, the response to Item 3 of Part I of Form 10-Q should indicate any such incorporation by reference or provide a cross-reference to the responsive disclosures in MD&A.

When there have been no material changes in market risk since the most recent fiscal year end, registrants may refer to their market risk disclosures in their previous annual report on Form 10-K and indicate that their exposure to market risk has not changed materially since the prior fiscal year.

³⁰ Smaller reporting companies are not required to provide the disclosures specified in Item 305 of Regulation S-K. However, if a smaller reporting company chooses to voluntarily provide this information, it must comply with all of the disclosure requirements of Item 305.

For additional information about the SEC’s market risk disclosure rules, including additional illustrative examples of the disclosure requirements, see section 4 of our *SEC annual reports – Form 10-K*, our **SEC market risk disclosures** publication, and our *SEC annual shareholders’ report checklist* (EY Form A150).

3.9 Item 4. Controls and procedures

3.9.1 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:

“[C]ontrols 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 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 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. By contrast, Exchange Act Rules 13a-15(c) and 15d-15(c) require that the effectiveness of an issuer’s internal control over financial reporting be evaluated only as of the end of each fiscal year.

In providing the disclosures under Item 307, 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 as to whether the company’s disclosure controls and procedures are effective at the “reasonable assurance” level. In providing the disclosures under Item 307, 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 as to 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.”

In February 2018, the SEC issued an interpretive release³¹ on cybersecurity highlighting that disclosure controls and procedures should enable registrants to identify cybersecurity risks and incidents, assess and analyze their implications, and make timely disclosures.

Relationship between “disclosure controls and procedures” and “internal control over financial reporting”:

As discussed above, the effectiveness of disclosure controls and procedures must be assessed on a quarterly basis while the effectiveness of internal control over financial reporting must be assessed on an annual basis. In its commentary,³² 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. However, there are elements of disclosure controls and procedures that are beyond the scope of internal control over financial reporting, yet there are very few elements of internal control over financial reporting that could 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 assurance 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 regarding the processes and controls on which management relies to meet applicable Exchange Act disclosure requirements. See section 4 of our publication, SEC annual reports – Form 10-K, for additional information on management and auditor reporting on internal control over financial reporting (Section 404).

The SEC staff has indicated³³ 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 (as discussed in section 4 of this publication) should assess whether and how the error affects its conclusions about the effectiveness of the related internal controls, and hence the effectiveness of disclosure controls and procedures. When amending a filing, registrants should consider whether the disclosures they provided in the original filing to comply with Item 307 of Regulation S-K need to be modified, supplemented or corrected to explain whether management’s previous conclusions on the effectiveness of disclosure and control procedures continue to be appropriate in light of the assessment to restate financial statements or the non-reliance on a previously issued audit report or interim review.

3.9.2

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

Item 4 of Form 10-Q requires the issuer to disclose any change in internal control over financial reporting (ICFR) that occurred during the quarter 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 ICFR that was not necessarily in response to an identified significant deficiency or material weakness (e.g., the implementation of a new information system) if it materially affected the registrant’s ICFR.³⁴ Registrants should consider the effect material events, such as business combinations and restructurings, have on changes in ICFR.

³¹ SEC Releases 33-10459 and 34-82746, *Commission Statement and Guidance on Public Company Cybersecurity Disclosures* (Interpretation), issued 26 February 2018.

³² SEC Release 33-8238, *Management’s Reports on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports* (ICFR Final Rule), issued 5 June 2003.

³³ 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 <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.

³⁴ Question 7 of the SEC staff’s Section 404 FAQ available at: <http://www.sec.gov/info/accountants/controlfaq.htm>.

Read literally, Item 308(c) of Regulation S-K and the form of management's Section 302 of the Sarbanes-Oxley Act certification only require 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." For further information regarding the definition of internal control over financial reporting see section 4 of our publication, *SEC annual reports – Form 10-K*.

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). Similarly, a company can wait to disclose changes in internal control for an acquired business until the first annual report in which it includes the acquired business in its assessment of internal control over financial reporting. However, if the registrant were to identify a material weakness in advance of its Section 404 assessment, 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."³⁵

A registrant needs to also consider whether its implementation of a new accounting standard leads to a change in internal control that materially affected, or is reasonably likely to materially affect, the registrant's ICFR. The implementation of a new accounting standard may warrant revisions to information gathering and communication protocols in the organization or the design of business processes and internal control activities within them. We believe that registrants need to report any material change in internal control related to the adoption of a new accounting standard no later than the periodic filing for the period that first reflects the adoption of the new accounting standard.

3.9.3

Exhibit 31 Management's Section 302 certification

Registrants that file periodic reports under Section 13(a) or 15(d) of the Exchange Act, including banks and savings associations and smaller reporting companies,³⁶ must file management certifications called for by Section 302 of the Sarbanes-Oxley Act as Exhibit 31 to Form 10-Q. 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, *Civil Liabilities on Account of False Registration Statement*, 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.³⁷ Separate certifications are required to be filed by the CEO and CFO.

³⁵ Question 7 of the SEC staff's Section 404 FAQ available at: <http://www.sec.gov/info/accountants/controlfaq.htm>.

³⁶ Section 302 also applies to registered investment companies and issuers of asset-backed securities. However, those issuers should refer to supplemental guidance applicable to their particular circumstances, which are beyond the scope of this publication.

³⁷ 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).

4 Principles of interim accounting and financial reporting

4.1 General

ASC 270 is the primary authoritative source of principles of accounting measurement and financial reporting for interim periods. ASC 270 establishes an overall presumption that each interim period should be viewed primarily as an integral part of an annual period. Therefore, the accounting principles and practices used to prepare the quarterly report on Form 10-Q generally should be based on the principles and practices used to prepare the latest annual report on Form 10-K, unless a change in an accounting practice or policy has been adopted in the current year. However, companies may modify certain accounting principles and practices used to prepare the annual information (e.g., costs associated with revenue or income taxes) so that the interim results better relate to the results of operations for the annual period. The purpose of this section is to summarize and illustrate, where appropriate, the principles of accounting in ASC 270.

4.2 Revenue

The accounting principles of ASC 606, *Revenue from Contracts with Customers*, apply to both interim periods and the annual period. For example, in a construction contract in which an entity is building a facility on the customer's land, the entity would generally conclude that the customer controls any work in process arising from the entity's performance and, therefore, the entity would recognize revenue for the contract over time. The entity would select a single revenue recognition method (i.e., measure of progress) that depicts its performance in transferring control of the goods or services over time. At the end of each annual and interim reporting period, the entity would measure its progress toward complete satisfaction of the performance obligation and recognize the corresponding amount of revenue. As circumstances change over time, an entity would update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress would be accounted for as a change in accounting estimate in accordance with ASC 250.

Losses projected on contracts with customers are generally not recognized before they are incurred, unless there is specific US GAAP guidance that requires the accrual of expected losses (e.g., ASC 605-35, *Revenue Recognition – Construction-Type and Production-Type Contracts*).

An entity should apply the same procedures (e.g., sales "cut-off") for recognizing revenue at the end of each quarter that it applies at year end.

ASC 606 requires entities to estimate variable consideration and include amounts that are not constrained in the transaction price. Variable consideration includes, but is not limited to, discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses and penalties. When a contract includes variable consideration, an entity needs to update its estimates of the transaction price throughout the contract term to depict conditions that exist at each reporting period. This involves updating the estimate of variable consideration (including any amounts that are constrained) to reflect an entity's revised expectations about the amount of consideration to which it expects to be entitled considering uncertainties that are resolved or new information about the remaining uncertainties. This is required at each reporting period, irrespective of whether it is an interim or annual period.

Entities should look to ASC 270 for required revenue disclosures in interim financial statements. ASC 270 requires the same quantitative disclosure about revenue in interim financial statements as in the annual financial statements. See our *Disclosure checklist for interim financial reporting* (EY Form A78) for a summary of the interim disclosure requirements.

4.3 Costs associated with revenue

Costs associated with revenue should be treated similarly for both interim and annual reporting purposes. This includes costs associated directly with or allocated to products sold or services rendered, such as materials, wages, salaries and fringe benefits, manufacturing overhead and warranties.

4.3.1 Inventories and cost of sales

4.3.1.1 General practices

Current practice varies in determining inventory costs. For example, costs of goods sold may be based on standard or actual costs, while costs of inventory may be based on an average, FIFO or LIFO cost basis. While companies generally should apply the same principles and practices (e.g., inventory pricing methods and process for recording inventory write-downs) used at year end, the following exceptions exist for interim reporting:

- ▶ *Method for determining costs of goods sold:* Because many companies do not take physical inventories each quarter, ASC 270 recognizes that they may use a different method to determine the costs of goods sold for interim periods than they use for annual periods. For example, inventory and cost of goods sold in interim financial statements may be calculated based on an estimated gross profit percentage applied to interim sales, while inventory in annual financial statements may be based on a physical inventory near the end of the year and differences between estimated and actual inventory are adjusted through cost of goods sold at year end. If a company uses a different method to determine the costs of goods sold in interim and annual periods, the company should disclose the method used in the interim financial statements.
- ▶ *Process for recording inventory write-downs:* Inventory losses due to the application of the subsequent measurement guidance in ASC 330-10 should not be deferred beyond the interim period in which the decline occurs, unless the decline can reasonably be expected to be restored within the same fiscal year. If inventory is written down as of an interim date, the recovery of these losses in later interim periods of the same fiscal year should be reflected as a gain in the later interim period. However, gains recorded by an entity should not exceed the previously recognized losses. The gain should be recorded in the same line item in the income statement as the inventory write-down. Temporary declines in the market value of inventory measured using the LIFO or retail inventory methods, or the net realizable value of all other inventory that can reasonably be expected to be restored by the end of the fiscal year, need not be recognized at the interim date since no loss is expected to be incurred in the fiscal year.
- ▶ *Standard cost systems:* Generally, companies that use standard cost systems should adjust the carrying amount of inventory at standard cost at each interim balance sheet date to reflect actual costs in the same manner as at year end. That is, variances between standard cost and actual costs, such as purchase price, labor rate, usage, efficiency or other variances, are recognized in interim period earnings through an adjustment to the carrying amount of inventories at standard cost. However, if a company expects to absorb a portion, or all, of the purchase price variances or volume or capacity cost variances by year end, that portion of the variance should be deferred at the interim balance sheet date (i.e., continue to be reflected in the carrying amount of inventories). That is, if the interim period purchase price variance or volume or capacity cost variance is planned and expected to reverse before the end of the fiscal year, that variance is not recognized in interim period earnings because doing so would require the recognition

of an offsetting variance in the earnings of a later interim period. The effect of unplanned or unanticipated purchase price or volume variances, however, is reported at the end of an interim period following the same procedures used at the end of a fiscal year.

- ▶ *LIFO liquidation:* If the prior year's LIFO inventories have been liquidated at an interim date but are expected to be restored by the end of the fiscal year, (1) the inventory at the interim reporting date should not give effect to the LIFO liquidation, and (2) the cost of goods sold for the interim period should include the estimated cost of replacing the liquidated LIFO layer (i.e., cost of sales is adjusted to the amount it would have been if there had not been any LIFO liquidation). See further discussion below.

4.3.1.2

Interim LIFO calculations

The use of the LIFO inventory method in interim periods presents several special accounting considerations. LIFO calculations usually are made only at year end because of the possibly burdensome calculations and because changes in LIFO layers are determined on an annual basis. Thus, for financial reporting purposes, LIFO inventories generally are estimated at interim reporting dates. As a result, companies should consider including the following disclosure in their interim financial statements:

Illustration 4-1: Inventory

The Company uses the last-in, first-out (LIFO) method of valuing inventory. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs and are subject to the final year-end LIFO inventory valuation.

Because the techniques for applying LIFO and the types of interim records maintained vary from company to company, the methods used must be tailored to each particular case. Companies may use either of two approaches to estimate interim LIFO adjustments.

Under the first approach, a company estimates the annual adjustment for LIFO and allocates it to each quarter on a systematic and rational basis. Some companies use an allocation method based on actual inflation in the quarter because it relates to anticipated inflation for the year.³⁸ Generally, this method most closely reflects the nature of LIFO by charging each quarter's cost of sales with the most recent inventory cost. If this approach is used, the effect of a LIFO liquidation that is expected to occur by the end of the year is included as part of the projected annual LIFO adjustment and is, therefore, spread to the interim periods.

Under the second approach, a company makes a separate LIFO calculation each quarter by adjusting for (1) price changes during each quarter and (2) quantity changes that have occurred since the beginning of the year and that are not expected to reverse in a later period. In some cases, applying a separate calculation to interim periods might produce illogical interim results, particularly if inventory levels vary significantly during the year. In addition, a separate calculation might not be possible if the required information is not readily available (e.g., the actual price and quantity change since the beginning of the year).

If an interim liquidation is not expected to be replaced by year end, the effect would be recognized in the period that the liquidation occurs when a company determines its inventory by a separate quarterly LIFO calculation. However, as previously indicated, if the prior year's LIFO inventories have been liquidated at an interim date but are expected to be restored by the end of the fiscal year, the inventory at the interim reporting date should not give effect to the LIFO liquidation, and cost of goods sold for the interim period should include the estimated cost of replacing the liquidated LIFO layer. That is, any gain associated with

³⁸ However, a business that depends on a highly seasonal commodity should prorate its estimated annual LIFO adjustment over the fiscal year because, in such cases, price adjustments for the commodity relate to an annual period rather than to changes in general price level indices.

such a LIFO liquidation (i.e., the difference between the current year replacement cost and liquidated LIFO unit cost) should not be recognized in earnings in the interim period unless the company does not expect to replenish the prior years' LIFO layers before year-end.

The 1984 AICPA LIFO issues paper, *Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories* (LIFO Issues Paper), which was addressed by the SEC staff in SAB Topic 5.L, *LIFO Inventory Practices*, recommends that entities show the deferral of a temporary LIFO liquidation in the interim balance sheet as a deferred credit in the current liabilities section at an amount equal to the pretax income effect of the LIFO inventory liquidation. For practical purposes, the LIFO Issues Paper also endorses recording the amount as a credit to inventory, the effect of which is to do nothing if cost of sales has been recognized using a FIFO or average cost that approximates the expected cost of replacing the inventory.

For example, if a liquidated LIFO layer had a LIFO unit cost of \$12.50 per unit and the current cost was \$14.00 per unit, the gain on the LIFO layer liquidation would be \$1.50 per unit (\$14.00 – \$12.50). However, if the company expected to replenish the LIFO layer before year end, cost of goods sold would be recognized at the current cost of \$14.00 per unit.³⁹ In this case, if the company determines its inventory by a separate quarterly LIFO calculation, the company would need to record an increase in cost of goods sold of \$1.50 per unit to reverse the gain of the LIFO layer liquidation. Under the LIFO Issues Paper, the corresponding credit would be recorded either as a deferred credit (the preferred approach) or as a credit balance in the inventory account.

When a registrant liquidates a LIFO layer during an interim period and management does not intend to replace it before year end, SAB Topic 11.F, *LIFO Liquidations*, requires the registrant to disclose, either in a footnote or parenthetically on the face of the interim income statement, the incremental amount of income recognized as a result of a LIFO inventory liquidation (e.g., \$1.50 per unit in the above example).

4.4 Other costs and expenses

Other costs and expenses are costs unrelated to revenue, which are either (1) recognized as an expense in the interim period incurred or (2) allocated among interim periods based on an estimate of time expired, benefit received or activity associated with the periods. ASC 270 provides the following guidance for the accounting for other costs and expenses in interim periods:

- ▶ Registrants should apply the same procedures for assigning costs and expenses to an interim period as those followed at year end. When a specific cost or expense benefits more than one interim period, the cost or expense may be allocated to the respective interim periods.
- ▶ Costs and expenses that cannot be readily identified with the benefits or activities of other interim periods should be expensed in the interim period as incurred. Registrants should disclose the nature and amount of such costs unless items of a comparable nature are included in both the current interim period and in the corresponding interim period of the preceding year. For example, a recurring charge to bad debt expense based on a percentage of sales volume, which increases the allowance for doubtful accounts, usually would not be disclosed. On the other hand, significant plant relocation costs incurred in the current quarter should be disclosed if there was no item of a comparable nature in the corresponding quarter of the preceding year.
- ▶ The registrant should not arbitrarily assign costs or expenses to an interim period.
- ▶ If a gain or loss that arises during an interim period would not be deferred at year end, the gain or loss should be recognized in the current interim period.

³⁹ Under the LIFO Issues Paper, it would be appropriate to estimate the expected costs to replace the temporary quarterly liquidation.

ASC 270 provides the following examples to illustrate the aforementioned concepts:

- ▶ When a cost that is expensed for annual reporting purposes clearly benefits two or more interim periods, each interim period should be charged for an appropriate portion of the annual cost by the use of accruals or deferrals.
- ▶ Property taxes (and similar costs such as interest and rent) may be accrued or deferred at the annual reporting date, to achieve a full year's charge of taxes to costs and expenses. Similar procedures should be adopted at each interim reporting date to provide an appropriate cost in each period.
- ▶ Advertising costs may be deferred within a fiscal year if the benefits of an expenditure clearly extend beyond the interim period in which the expenditure is made. Advertising costs may be accrued and assigned to interim periods in relation to sales prior to the time the service is received if the advertising program is clearly implicit in the sales arrangement.

If common year-end adjustments can be projected, a pro rata portion of the estimated amounts should be assigned to each interim period. Examples given in ASC 270 are inventory shrinkage, allowance for uncollectible accounts, allowance for quantity discounts and discretionary year-end bonuses.

Below is an example comparing the effects of expensing advertising costs as incurred versus deferring advertising costs and allocating them throughout the fiscal year.

Illustration 4-2: Other costs and expenses					
Facts					
A company budgets \$200,000 in advertising costs for 20X3; 2% of projected sales of \$10 million. Many advertising costs are incurred for trade association shows and other projects early in the year, but they are expected to generate sales throughout the year. The company may defer the advertising costs when incurred and allocate the expense over the year on the basis of 2% of sales.					
	Quarter				
	1st	2nd	3rd	4th	Total
	<i>(In thousands)</i>				
Advertising deferred and allocated					
Sales	\$ 1,000	\$ 1,500	\$ 3,500	\$ 4,000	\$ 10,000
Costs and expenses, other than advertising	800	1,200	2,800	3,200	8,000
Advertising	<u>20</u>	<u>30</u>	<u>70</u>	<u>80</u>	<u>200</u>
	<u>820</u>	<u>1,230</u>	<u>2,870</u>	<u>3,280</u>	<u>8,200</u>
Pretax income	<u>\$ 180</u>	<u>\$ 270</u>	<u>\$ 630</u>	<u>\$ 720</u>	<u>\$ 1,800</u>
Advertising expensed as incurred					
Sales	\$ 1,000	\$ 1,500	\$ 3,500	\$ 4,000	\$ 10,000
Costs and expenses, other than advertising	800	1,200	2,800	3,200	8,000
Advertising	<u>150</u>	<u>30</u>	<u>10</u>	<u>10</u>	<u>200</u>
	<u>950</u>	<u>1,230</u>	<u>2,810</u>	<u>3,210</u>	<u>8,200</u>
Pretax income	<u>\$ 50</u>	<u>\$ 270</u>	<u>\$ 690</u>	<u>\$ 790</u>	<u>\$ 1,800</u>
Difference in pretax income	<u>\$ 130</u>	<u>\$ —</u>	<u>\$ (60)</u>	<u>\$ (70)</u>	<u>\$ —</u>

4.5

Seasonal revenue, costs or expenses

If interim results (i.e., revenues, costs or expenses) are subject to material seasonal variations, registrants must disclose the seasonal nature of the activities to avoid the inference that interim results are fairly indicative of the estimated results for a full fiscal year. In these circumstances, registrants should consider providing supplemental information for 12-month periods ended at the interim date for the current and preceding years.

4.6 Postretirement benefit costs

In accordance with ASC 715, the measurements of plan assets and the benefit obligation used to determine the current year net periodic benefit cost in the interim period must be based on the assumptions used for the previous year-end measurements unless either:

- ▶ More recent measurements of both plan assets and the benefit obligation are available
- ▶ A “significant event” occurs, such as a plan amendment, settlement or curtailment, which would ordinarily call for such measurements

Unless an employer remeasures both its plan assets and the benefit obligation during the fiscal year, the amount it reports in interim period financial statements should be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (1) subsequent accruals of net periodic benefit cost that exclude the amortization of amounts previously recognized in other comprehensive income (those amounts are reclassified from accumulated other comprehensive income as components of net periodic benefit cost and do not affect the asset or liability recognized in the statement of financial position), (2) contributions to a funded postretirement benefit plan and (3) benefit payments.

However, sometimes an employer remeasures both the plan assets and the benefit obligation during the fiscal year. That is the case, for example, when a significant event, such as a plan amendment, settlement or curtailment occurs that calls for a more recent measurement of plan assets and benefit obligations. On remeasurement, the employer should adjust its interim statement of financial position to reflect the overfunded or underfunded status of the postretirement benefit plan as of that remeasurement date. The employer uses the amounts from the more recent measurement to determine the net periodic benefit cost for the remainder of the fiscal period.

ASC 715 requires certain disclosures in interim financial statements. See our *Disclosure checklist for interim financial reporting* (EY Form A78) for a summary of the interim disclosure requirements. In addition, an employer applying an accounting method to immediately recognize actuarial gains and losses in net periodic benefit cost (i.e., upon remeasurement, typically during the fourth quarter of the fiscal year for a calendar-year company) should include in MD&A a discussion foreshadowing potential actuarial gains and losses that may arise on remeasurement. Similarly, if the employer applies this accounting method and remeasures the plan assets and benefit obligation during the fiscal year, it should disclose the amount of any actuarial gains and losses recognized in net periodic benefit cost on the measurement date as part of the notes to the interim financial statements.

If significant assumptions (e.g., mortality, expected returns on plan assets, assumed discount rates) have changed or are expected to change and the effect of the change will be material in future periods, companies should discuss the reasons for the change and its effects in MD&A.

Significant income statement effects related to benefit plan contributions should be disclosed and discussed in MD&A. For example, a company's expected contribution to plan assets that is larger in the current period than in the prior period would increase the expected return for the current period due to the expected return on the larger amount of contributed assets. As a reminder, the expected return component reduces the net periodic benefit cost. Noncash contributions (e.g., contributions of assets or company stock) to a defined benefit plan should be classified as noncash financing or investing activities, as appropriate, in the statement of cash flows. A registrant should disclose its funding approach in MD&A so that investors can understand its effect on liquidity.

4.7 Segments

ASC 280 requires registrants to disclose certain information about reportable segments in condensed financial statements of interim periods. In general, the results for each interim period should be based on the registrant's accounting principles used in the preparation of its latest annual financial statements unless a change in an accounting principle has been adopted in the current year.

In general, a registrant doesn't need to apply the quantitative tests to its operating segments when determining reportable segments for the interim period. However, if facts and circumstances change in an interim period, for example, if there is a change in the structure of an entity's internal organization, a new operating segment may be identified. In this case, application of the quantitative tests in an interim period could indicate that this operating segment is a reportable segment. If management expects that this segment will continue to be of significance, the segment should be disclosed as a new, separately reportable segment in interim reports.

Consistent with annual reporting, segment information for earlier interim periods is restated when a registrant changes its organization in a manner that causes the composition of its reportable segments to change, unless restatement is impracticable (in which case the registrant should disclose that fact). For example, if a change in the structure of a registrant's internal organization results in an additional reportable segment in the third quarter of 20X3, the new segmentation would need to be reflected in the segment disclosures for the third quarter and year-to-date periods ended 30 September 20X3 and 20X2. However, if it is impracticable to restate segment information for prior periods, including interim periods, to reflect the change, the registrant must disclose the current period segment information under both the old basis and the new basis of segmentation in the year in which the change occurs, unless it is also impracticable to do so (in which case the registrant should disclose that fact). The SEC staff views impracticable as a very high standard to meet. Following a change in the composition of its reportable segments, an enterprise must disclose whether it has restated the corresponding items of segment information for earlier periods.

A change in reportable segments during an interim period also will require retrospective revision of the prior-year annual financial statements if they are reissued after the financial statements covering the interim period of the segment change have been filed. Reissuance is required if those annual financial statements are required to be included or incorporated by reference into a registration or proxy statement (with the exception of a Form S-8). If the prior year financial statements are not reissued for a filing, the annual information does not need to be retrospectively revised until that information is included in the next Annual Report on Form 10-K.

See EY Form A78, *Disclosure checklist for interim financial reporting*, and our Financial reporting developments (FRD) publication, **Segment reporting**, for a summary of the interim disclosure requirements for segment reporting.

4.8 Guidance related to interim accounting and disclosure in other Codification Topics

Various Codification Topics include specific interim accounting and disclosure requirements, including:

- ▶ ASC 740 (see our FRD, **Income taxes**)
- ▶ ASC 820 (see our FRD, **Fair value measurement**)
- ▶ In addition to the Codification Topics and our FRD publications, see our *Disclosure checklist for interim financial reporting* (EY Form A78) for further information on interim disclosure requirements.

4.9 Unusual items, contingencies and uncertainties

Unusual or infrequently occurring items

The effects of unusual or infrequently occurring items that are material in relation to the operating results of the interim period should be reported separately in the period in which they occur. These transactions and events should not be prorated over the remaining interim periods in the fiscal year.

Contingencies

ASC 270 also requires registrants to disclose contingencies and other uncertainties that might affect the fairness of the presentation of the interim financial information. Such disclosures should be repeated and updated in the interim financial statements until the contingency has been removed, resolved or has become immaterial. The significance of a contingency or uncertainty should be judged in relation to the annual financial statements.

Going concern uncertainty

Management is required to evaluate for both annual and interim reporting periods whether there is substantial doubt about the entity's ability to continue as a going concern. If management concludes that substantial doubt exists and is not alleviated by its plans, management is required to include in the notes to the financial statements a statement that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued when applicable).

Additional disclosures are required to enable financial statement users to understand all of the following:

- ▶ Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans)
- ▶ Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
- ▶ Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern

These additional disclosures are required even if management concludes that substantial doubt about an entity's ability to continue as a going concern is alleviated as a result of its plans. The disclosures related to uncertainty about an entity's ability to continue as a going concern must be included in the notes to the financial statements until the conditions or events giving rise to the uncertainty are resolved. The disclosures are intended to include more information about the uncertainty and management's plans to alleviate it as that information becomes available. As the conditions or events giving rise to the uncertainty and management's plans to alleviate them change over time, the disclosures should change to provide users with the most current information, including information about how the uncertainty is resolved.

PCAOB AS 2415, *Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, requires the independent accountant to consider the adequacy of the disclosures in the registrant's annual financial statements if (1) the independent accountant concluded during the previous audit that there was substantial doubt about the registrant's ability to continue as a going concern or (2) the accountant became aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern in the course of performing review procedures on interim financial information.

Such disclosures might include: (1) the conditions, events and other salient facts that gave rise to the going concern uncertainty; (2) the possible effects of these conditions and events, including the discontinuance of operations; (3) management's evaluation of the significance of those conditions or

events and any mitigating factors; (5) management's plans (including relevant prospective financial information); and (6) information about the recoverability and classification of amounts recorded for assets or the amounts and classification of liabilities (e.g., long-term debt now classified as current). If there have been any material changes since the most recent annual or interim financial statements (e.g., changes in the conditions, events, and other salient facts that gave rise to the going concern uncertainty or in management's plans), management should update its previous disclosure in a note to the interim financial statements.

4.10 Accounting changes and adjustments to prior interim periods

4.10.1 General

ASC 250 provides guidance on the accounting for and reporting of accounting changes, including a change in accounting principle, a change in accounting estimate and a change in reporting entity. ASC 250 also applies to changes required by an ASU in the unusual instance that the ASU does not include specific transition provisions. When an ASU includes specific transition provisions, registrants must follow those provisions.

ASC 250 also addresses the correction of an error in previously issued financial statements. Such a correction is not an accounting change. See our FRD, [Accounting changes and error corrections](#), for further information on accounting changes, including changes in reporting entity and the correction of an error in previously issued financial statements.

4.10.2 Change in accounting principle

Under ASC 270, the interim financial statements should indicate any changes in accounting principles or practices from those applied in (1) the corresponding interim period of the prior fiscal year, (2) the preceding interim periods in the current fiscal year and (3) the prior annual report. The registrant should report changes in accounting practice or policy in the period in which the change is made, in accordance with the provisions of ASC 250.

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*, the SEC staff stated that disclosure of impending accounting changes due to recently issued US GAAP Codification updates is necessary to inform the reader about the expected effects of the changes on financial information to be reported in the future and, therefore, should be disclosed in accordance with existing MD&A requirements. See section 5 of our publication, *SEC annual reports – Form 10-K*, for further discussion on SAB Topic 11.M.

The SEC staff also believes that when a registrant adopts a new accounting standard in an interim period, the registrant should provide both the annual and interim period disclosures prescribed by the new accounting standard in that interim period, as well as in each subsequent interim period until the accounting change is reflected in audited annual financial statements.⁴⁰ The SEC staff presumes that users of the interim financial statements have not read the prior interim financial statements.

Changes in the method of applying an accounting principle (e.g., changing the method of applying a significant estimation process such as changing the number of LIFO pools used in a LIFO calculation) are subject to the guidance on accounting for a change in accounting principle under ASC 250, including the preferability requirements which may require a registrant to include a preferability letter from its independent accountant as Exhibit 18 to its quarterly report on Form 10-Q. See our FRD, [Accounting changes and error corrections](#), for further discussion on voluntary changes in accounting principle, including preferability considerations.

⁴⁰ https://www.sec.gov/corpfin/cf-manual/topic-1#Topic1_1500.

ASC 250 requires that registrants report a voluntary change in accounting principle made in an interim period by retrospective application both to the prior years as well as to the interim periods within the fiscal year that the accounting change was adopted. This is consistent with changes made in annual periods; however, the impracticability exception provided in ASC 250 cannot be applied to interim periods of the fiscal year in which the change is made. When an entity determines that retrospective application to pre-change interim periods of the fiscal year of the change is impracticable, the desired change may only be made as of the beginning of the subsequent fiscal year. The following example illustrates the reporting for a change in accounting principle in an interim period when the registrant concludes that it is impracticable to determine the period-specific effects of that change.

Illustration 4-3: Change in accounting principle in an interim period

In 20X6 a calendar year-end company makes a voluntary change in accounting principle in its third quarter. The effect of the change must be applied retrospectively to the first and second quarters of 20X6 and to the prior fiscal year presented for comparative purposes in its third quarter interim report. If the company determines that it is impracticable to apply the new principle to its 20X5 and prior financial statements, the cumulative effect of the change would be recognized as a component of opening retained earnings in 20X6 and the disclosure of the adoption would be included in its financial statements reported in 20X6. Alternatively, if the company determined that it was impracticable to apply the new accounting principle retrospectively to the first and second quarters of 20X6, it would be precluded from making the accounting change in the third quarter. If the company still elected to pursue the change in accounting principle, it could only make it (at the earliest) as of 1 January 20X7 (the beginning of the subsequent fiscal year) by recognizing the cumulative effect of the change in opening retained earnings as of 1 January 20X7.

4.10.2.1

Materiality of a change in accounting principle in an interim period

ASC 270 provides guidance on assessing materiality for accounting changes or error corrections made in an interim period and states that materiality should be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings. Changes that are material with respect to an interim period but not material with respect to the estimated income for the full fiscal year or the trend of earnings should be separately disclosed in the interim period of the change.

SAB Topic 5.F, *Accounting Changes Not Retroactively Applied Due To Immateriality*, provides guidance on accounting for changes that are deemed immaterial. If a registrant determines that the accounting change does not have a material effect on prior periods' financial statements and elects not to apply the change on a retrospective basis, the registrant may not adjust retained earnings at the beginning of the current fiscal year for the cumulative effect of prior periods. The registrant must report the cumulative effect of the change within operations in the interim period that the change is made, with separate disclosure if material to that interim period. However, consistent with ASC 270, if the cumulative effect of the change is material to the registrant's estimated income for the full fiscal year or to the trend of earnings, SAB Topic 5.F indicates that the registrant should apply the accounting change on a retrospective basis to the income statements for all periods presented (current year and prior year).

If a change in accounting principle does not have a material effect in the period of the change but is reasonably certain to have a material effect in later periods, certain disclosures required in ASC 250 (i.e., nature of and reason why the change is preferable) are provided whenever the financial statements of the period of change are presented. However, the accounting and disclosures otherwise required under ASC 250 are not included in the period of the change because the effects were immaterial in those prior periods. While a voluntary change in accounting principle may be immaterial to prior periods, it may have a profound effect on future periods, and its disclosure provides the financial statement user with the information necessary to assess that impact.

4.10.2.2 Disclosures for a change in accounting principle

When a registrant makes a voluntary change in accounting principle, it must disclose the following:

- ▶ The nature of and reason for the change, including an explanation of why the newly adopted accounting principle is preferable
- ▶ The method of applying the change, including all of the following:
 - ▶ A description of any prior-period information that has been retrospectively adjusted
 - ▶ The effect of the change on income from continuing operations, net income, any other affected financial statement line item and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. (Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income is not required.)
 - ▶ The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
 - ▶ If retrospective application to all prior annual periods is impracticable, disclosure of the reasons and a description of the alternative method used to report the change

If indirect effects of a change in accounting principle are recognized, the registrant must disclose (1) a description of the indirect effects of the change, including the amounts that have been recognized in the current period and the related per-share amounts, if applicable, and (2) unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are attributable to each prior period presented. (See *Disclosure checklist for interim financial reporting* (EY Form A78) for further information on the interim disclosure requirements.)

Financial statements of subsequent periods do not need to repeat the required disclosures initially made in the period of an accounting change (except in the circumstance discussed in section 4.10.2.1). However, registrants that issue interim financial statements must provide the required disclosures in the financial statements of both the interim and annual periods that include the direct or indirect effects of the change in accounting principle. For example, a registrant that makes a voluntary change in an accounting principle in the second quarter of 20X6 must include the required disclosures in its second and third quarter interim financial statements. The registrant must also include the required disclosures for the annual period in its annual financial statements for 20X6. That is, the third-quarter, year-to-date interim financial statements, as well as the 20X6 annual financial statements, include the initial period of the change, and therefore the disclosures must be provided. These disclosures are not required in the financial statements for any interim or annual periods after 20X6.

ASC 250 requires that in the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption should disclose the effect of the change on income from continuing operations, net income and related per-share amounts, if applicable, for the post-change interim periods. That is, for subsequent interim periods in the fiscal year of an accounting change, the registrant must determine and disclose the amounts that would have been reported under the “old” accounting principle had it not made the accounting change.

See our FRD, ***Accounting changes and error corrections***, section 3.8, *Disclosures for a change in accounting principle*, for further discussion.

4.10.3 Fourth-quarter accounting changes

ASC 250 requires that if a public company that regularly reports interim information makes an accounting change during the fourth quarter of its fiscal year and does not report the data required by ASC 270 (the minimum requirements for summarized interim financial data) in a separate fourth-quarter report or quarterly reporting in its annual report, that entity is required to disclose the effects of the accounting change on prior interim-period results in a note to the annual financial statements for the fiscal year in which the change is made.

This information may be disclosed in a separate footnote or, if the registrant elects to include the selected quarterly financial data in an unaudited note to the financial statements, the registrant may combine the disclosure required by ASC 250 and Item 302(a) of Regulation S-K in a single footnote. Item 302(a) requires material retrospective changes to the statements of comprehensive income, including accounting changes, for any of the quarters within the two most recent fiscal years (or any subsequent interim period for which financial statements are required) to be reflected and disclosed, including an explanation of the reason for the material change.

A registrant that adopts a change in accounting principle in the fourth quarter is not required to amend its previous filings on Form 10-Q to reflect the retrospectively adjusted interim financial statements.

4.10.4 Change in accounting estimate

ASC 250 requires that companies account for a change in accounting estimate either (1) in the period of the change if the change affects only that period or (2) in the period of change and in future periods if the change affects both. As a result, a change in an accounting estimate may not be accounted for by restating or retrospectively applying the change to prior periods or by reporting pro forma amounts for prior periods.

See our FRD, ***Accounting changes and error corrections***, Chapter 4, *Change in accounting estimate*, for further discussion. (See *Disclosure checklist for interim financial reporting* (EY Form A78) for further information on the interim disclosure requirements.)

4.10.5 Correction of an error

Once an error is identified, a company must assess the appropriate means to account for the correction of that error. A decision of whether a correction should be reflected in a restatement of prior financial statements and how to reflect that restatement, or if the error correction can be recognized in the current-period financial statements, is based on the materiality of the error to the current period and prior period(s) financial statements.

Examples of corrections of errors in previously issued financial statements include the following:

- ▶ A change from an accounting principle that is not generally accepted to one that is generally accepted
- ▶ Corrections of mistakes in the application of US GAAP
- ▶ Corrections of mathematical mistakes
- ▶ Oversight or misuse of facts that existed at the time the financial statements were prepared

Interim period materiality analysis

ASC 250 provides limited guidance on assessing materiality to interim reporting. While SAB Topic 1.N, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, and SAB Topic 1.M, *Assessing Materiality*, do not specifically address applicability to interim periods, the SEC staff expects the guidance to be applied to interim financial reporting as well.

ASC 250-10-45-27 addresses materiality in the context of interim financial reporting and states that the materiality assessment should include an assessment of the error in relation to both the trends of earnings and estimated income for the full fiscal year. Registrants should correct any known misstatements that arise or originate in the current interim period.

Entities should consider both quantitative and qualitative trends as subjective judgments are necessary when evaluating the quarterly materiality trends. Examples of trend of earnings considerations include quarterly earnings trends (i.e., consecutive quarter and year-to-date trends, as well as trends comparing quarterly information year to year), changing from net income to a loss or vice versa as well as comparing to analysts' expectations (e.g., meeting or exceeding analysts' expectations before an error is corrected and not meeting those expectations after the error is corrected).

Whether an entity should use interim or expected annual results when making materiality judgments depends on the circumstances. For example, an entity may encounter situations where an uncorrected error identified in the interim period is material to interim results but is not material to expected annual results. In those situations, management should consider the nature of the error and whether the interim period is representative of historical and expected financial trends of the entity. If the interim reporting period historically is a loss period due to seasonality or other factors (for what is otherwise a highly profitable business), we generally believe management would look to expected annual results when making quantitative judgments about materiality. Depending on the circumstances, we believe management also may choose to evaluate errors based on expected annual results when a significant portion of the errors are due to the effects of prior interim or annual period errors that are reversed in the current period (i.e., out of period amounts). If subsequent analysis shows that annual results were lower than expected, a previously immaterial error may now be considered material, resulting in a restatement at that time.

If the correction of an error is material to the current interim period's income, but not material to the estimated income of the current full fiscal year or to the trend of earnings, the correction of the error should be disclosed separately in the interim period.

Form 8-K filing and other filing requirements

When a registrant identifies a misstatement that materially affected a prior interim period, it should consider whether it must file an Item 4.02 Form 8-K, which applies to both annual and interim period financial statements that should no longer be relied on because of a misstatement. Typically, the correction of a material error in prior interim filings is made by filing a Form 10-Q/A.

See our FRD, ***Accounting changes and error corrections***, Chapter 6, *Correction of an error in previously issued financial statements*, for further discussion of correcting an error in previously issued financial statements.

4.10.6

Adjustments to prior interim periods of the current year

ASC 250 states an adjustment related to prior interim periods of the current fiscal year is an adjustment or settlement of (1) litigation or similar claims, (2) income taxes (except for the effects of retroactive tax legislation), (3) renegotiation proceedings or (4) utility revenue under rate-making processes, provided that the respective adjustment meets all of the following criteria:

- ▶ The effect of the adjustment or settlement is material in relation to income from continuing operations of the current fiscal year or in relation to the trend of income from continuing operations or is material by other appropriate criteria

- ▶ All or part of the adjustment or settlement can be specifically identified with and is directly related to business activities of specific prior interim periods of the current fiscal year⁴¹
- ▶ The amount of the adjustment or settlement could not be reasonably estimated prior to the current interim period but becomes reasonably estimable in the current interim period (e.g., in the third quarter, the registrant receives a final decision on a rate order)

When an event that qualifies for prior-period treatment occurs in the second, third or fourth quarter and relates to prior interim periods of the current fiscal year, the company should report the item as follows:

- ▶ Net income of the current fiscal quarter should reflect the portion of the adjustment that relates to that quarter
- ▶ Net income of each prior quarter of the current fiscal year should be retroactively adjusted for the portion of the adjustment for that respective quarter
- ▶ Any portion of the adjustment that relates to the prior fiscal year should be included in the determination of net income for the first quarter of the current fiscal year

Events that do not qualify for prior-period treatment (e.g., the event does not relate to prior interim periods of the current fiscal year) are recognized in the period of the event.

Prior-period treatment should not be applied to normal recurring adjustments resulting from changes in accounting estimates. For example, changes in provisions for doubtful accounts resulting from litigation or similar claims should not be treated as a prior-period adjustment. See *Disclosure checklist for interim financial reporting* (EY Form A78) for further information on the interim disclosure requirements.

⁴¹ This criterion would not be met solely because of incidental effects such as interest on a settlement.

5 Reporting quarterly information

5.1 Quarterly shareholders' reports and earnings releases

Registrants may provide earnings announcements either in a quarterly report to shareholders or in an earnings release. Currently, the SEC does not require registrants to issue a quarterly report to shareholders, an earnings release or similar announcement. However, the issuance of such a report might be required by the listing standards of a national securities exchange or association. In addition, communications about quarterly results are subject to Regulation FD, *Fair Disclosure*, as well as Form 8-K disclosure requirements.

5.1.1 Regulation FD

Communications about financial performance are subject to Regulation FD, which prohibits the selective disclosure of material nonpublic information. Regulation FD requires issuers that disclose material, nonpublic information to make public disclosure of that same information (1) simultaneously for intentional disclosures, or (2) "promptly" (within 24 hours or the start of the next trading day) for non-intentional disclosures. Regulation FD does not require that Form 8-K be used to provide public disclosure of material nonpublic information, but Item 7.01 of Form 8-K allows registrants to furnish information to the SEC as one alternative to satisfy the requirements of Regulation FD.

As a result of the increase in cybersecurity incidents in recent years, the SEC staff has reminded companies of the importance of maintaining Regulation FD policies that effectively address the fact that cybersecurity risks and incidents can constitute material, nonpublic information.

5.1.2 National securities exchange or association requirements

Neither the New York Stock Exchange (NYSE) nor the NYSE MKT (formerly NYSE Amex and the American Stock Exchange) requires listed companies to provide quarterly reports to shareholders. However, both exchanges require listed companies to publish quarterly information for each of the first three fiscal quarters in an earnings release as soon as the information is available. The earnings release must be distributed through a widely circulated news or wire service (e.g., NYSE requires distribution to Dow Jones & Company, Inc., Reuters Economic Services and Bloomberg Business News and encourages distribution to the Associated Press and United Press International; NYSE MKT requires distribution to one or more newspapers of general circulation in New York that regularly publish financial news and to one or more of the national newswire services).

For NYSE-listed companies, there is no longer a requirement to send copies of the earnings release and quarterly report to shareholders (if provided) to the NYSE. For NYSE MKT-listed companies, three copies of the earnings release and quarterly report to shareholders (if provided) should be sent to the NYSE MKT.

NASDAQ-listed companies must make available to their shareholders copies of quarterly reports, which may be Form 10-Q, either before or as soon as practicable following the filing of their Form 10-Q with the SEC. If the form of the quarterly report differs from Form 10-Q, the issuer must file one copy of the quarterly report with NASDAQ.

There are no specific rules about the content of earnings releases for NYSE and NYSE MKT-listed companies. Quarterly shareholders' reports for NASDAQ-listed companies should include disclosures of any substantial items that are unusual or nonrecurring, as well as income before and after income taxes.

However, if a registrant elects to distribute a quarterly shareholders' report containing summarized financial information (including fourth-quarter reports), ASC 270 requires certain minimum disclosures (see Information required in quarterly shareholders' reports below).

The only restrictions on the information included in the earnings release or the quarterly shareholders' 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 necessary to make the statements not misleading (i.e., Rule 10b-5 of the Exchange Act),⁴² and (2) the provisions of Regulation G for any non-GAAP financial measures presented. Regulation G applies whenever a company presents a non-GAAP financial measure and requires the registrant to (1) present 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. For additional information regarding the definition of a non-GAAP financial measure, conditions for presentation and interpretive guidance, see section 2 of our publication, *SEC annual reports – Form 10-K*.

5.1.3 Form 8-K reporting of earnings releases

Item 2.02 of Form 8-K requires registrants to furnish to the SEC, within four business days, any public announcement or release disclosing material nonpublic information about the registrant's results of operations or financial condition for a completed annual or quarterly fiscal period. Companies that make their earnings announcements in a quarterly shareholders' report before they file their periodic report with the SEC may provide the complete report as an exhibit to Form 8-K and specify in Item 2.02 the date and a brief description of the announcement or release and which portion of the report contains the information required to be furnished. Companies that do not publicly disclose their results until they file their periodic report with the SEC are not required to provide disclosure under Item 2.02 of Form 8-K.

Item 2.02 reporting is not triggered by the release of information that already has been disclosed publicly, such as the release of the same information in a different form. Similarly, Item 2.02 reporting would not be triggered if a subsequent disclosure were accompanied by additional information that was not material, regardless of whether or not it is already public. However, an Item 2.02 Form 8-K report would be required if the subsequent disclosure about a completed fiscal period were accompanied by additional or updated material nonpublic information.

Because the quarterly earnings release exhibit to the Item 2.02 of Form 8-K is considered "furnished" versus "filed" with the SEC, it is (1) not automatically incorporated by reference into registration statements, proxy statements or other reports and (2) not subject to liability under Section 18 of the Exchange Act.⁴³ However, quarterly earnings releases remain subject to Exchange Act Rule 10b-5, and thus could subject the registrant, corporate management, directors or possibly others⁴⁴ to civil liabilities, as well as criminal and SEC sanctions, and could expose the company to private liability. Safe harbors might be available under the Exchange Act if a company provides forward-looking statements in its announcement.⁴⁵

⁴² Exchange Act Rule 10b-5 states that it is unlawful for any person to make an untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they are made, not misleading.

⁴³ Section 18 of the Exchange Act provides for civil liability for false or misleading statements about material facts included in filed documents.

⁴⁴ Attorneys, accountants or others could "aid and abet" a violation and therefore be subject to an SEC enforcement action or criminal sanction.

⁴⁵ Section 21E of the Exchange Act provides a safe harbor for forward-looking statements, which protects public companies from liability in private litigation, when the statements are accompanied by "meaningful cautionary statements" or where the statement was made without knowledge of its falsity. See section 2 of our publication, *SEC annual reports – Form 10-K*, for further information on forward-looking statements.

Quarterly earnings press releases are subject to the provisions of Regulation G, as well as the disclosure requirements (but not the restrictions) of Item 10(e)(1) of Regulation S-K for any non-GAAP financial measures presented. For additional information regarding the definition of a non-GAAP financial measure, conditions for presentation and interpretive guidance, see section 2 of our publication, *SEC annual reports – Form 10-K*.

An issuer may satisfy the Item 10(e)(1) disclosure requirements by (1) providing the disclosures within Item 2.02 of Form 8-K, (2) providing the disclosures within the earnings release itself or (3) including the narrative disclosure in the most recent annual report and updating those statements, as necessary, no later than the time the Form 8-K is furnished to the SEC.

A company that wants to furnish an earnings release pursuant to Item 7.01 of Form 8-K to satisfy Regulation FD, could include its earnings release as an exhibit to a Form 8-K indicating that it is being furnished under both Items 7.01 and 2.02, provided the disclosure is furnished within the time frame required by Regulation FD and the requirements of both Items 7.01 and 2.02 are otherwise satisfied.

5.1.4

Quarterly conference calls

The disclosure of material nonpublic information about a completed fiscal period, whether orally, telephonically, via webcast, in a broadcast or by similar means need not be reported separately in Item 2.02 of Form 8-K, if all of the following conditions are met:

- ▶ The communication complements and occurs within 48 hours after a written release that, prior to the presentation, is furnished to the SEC on Form 8-K pursuant to Item 2.02.
- ▶ The presentation is broadly accessible to the public by dial-in conference call, webcast, broadcast or similar means.
- ▶ Financial and statistical information presented is available on the registrant's website, together with any information that is required under Regulation G.^{46,47}
- ▶ The presentation was announced by a widely disseminated press release that included instructions on when and how to access the presentation and the location on the registrant's website where the information is available.

In SEC Release 33-8176, *Conditions for Use of Non-GAAP Financial Measures*, the SEC stated that it intended this exception to accommodate existing practices (e.g., an analyst/investor conference call following a written earnings press release), but it did not intend the accommodation to shift the disclosure of material nonpublic information from written earnings press releases to subsequent conference calls and webcasts.

⁴⁶ The required information must appear on the company's website at the time the presentation is made. Information that is not provided in a presentation itself but is disclosed unexpectedly in the question and answer session that was part of that presentation must be posted on the company's web site promptly after it is disclosed.

⁴⁷ The SEC suggests, but does not require, that a registrant maintain the information in the investor relations section of its website for at least one year following the disclosure.

5.1.5 Information required in quarterly shareholders' reports

If a company whose securities are publicly traded⁴⁸ elects to distribute a quarterly shareholders' report containing summarized financial information (including fourth quarter reports), ASC 270 requires the following minimum disclosures:

- ▶ Sales or gross revenues, provision for income taxes, net income and comprehensive income
- ▶ Basic and diluted earnings per share, for each period presented, determined in accordance with ASC 260
- ▶ Seasonal revenue, costs or expenses
- ▶ Significant changes in estimates or provisions for income taxes
- ▶ Disposal of a component of an entity and unusual or infrequently occurring items
- ▶ Contingent items
- ▶ Changes in accounting principles or changes in accounting estimates
- ▶ Significant changes in financial position
- ▶ Reportable operating segment information (including provisions related to restatement of segment information in previously issued financial statements)⁴⁹
- ▶ Information about defined benefit pension plan(s) and other defined benefit postretirement plan(s) for each period presented, pursuant to ASC 715
- ▶ Information about the use of fair value to measure assets and liabilities recognized in the statement of financial position pursuant to ASC 820
- ▶ Information about derivative instruments as required by ASC 815
- ▶ Information about fair value of financial instruments as required by ASC 825
- ▶ Information about certain investments in debt and equity securities as required by ASC 320, ASC 321 and ASC 942
- ▶ Information about credit losses and impairments as required by ASC 326 and impairments as required by ASC 321
- ▶ Information about the credit quality of financial assets and the allowance for credit losses determined in accordance with the provisions of ASC 326
- ▶ Gross information and net information required by ASC 210-20
- ▶ Information about changes in accumulated other comprehensive income required by ASC 220
- ▶ Carrying amount of foreclosed residential real estate property and the amount of loans in the process of foreclosure required by ASC 310

⁴⁸ ASC 270 defines a publicly traded entity as "any company whose securities trade in a public market on either (1) a stock exchange (domestic or foreign) or (2) in the over-the-counter market (including securities quoted only locally or regionally), or any company that is a conduit debt obligor for conduit debt securities [as defined] that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets). Additionally, when a company is required to file or furnish financial statements with the SEC or makes a filing with a regulatory agency in preparation for sale of its securities in a public market, it is considered a publicly traded company for this purpose."

⁴⁹ See EY Form A78, *Disclosure checklist for interim financial reporting*, for specific disclosure requirements.

ASC 270 reminds registrants that the summarized financial data does not represent a fair presentation of financial position and results of operations in conformity with GAAP. However, if a registrant regularly provides a quarterly report to shareholders, the registrant should provide the above information for the current quarter, the current year-to-date period (or the last 12 months to date) and the corresponding periods of the prior fiscal year.

ASC 270 also encourages registrants to publish condensed interim balance sheet information and cash flow data. If condensed interim balance sheet or cash flow data are not presented, registrants should disclose significant changes in liquid assets, net working capital, long-term liabilities or shareholders' equity since the last reporting period. For the latter disclosure, a company might include a comment such as the following:

Illustration 5-1: Information required in quarterly shareholders' reports

"Effective May 1, 20X3, the Company acquired the assets and assumed the related liabilities of DEF Company for \$12.5 million and accounted for such acquisition as a purchase. The transaction was financed by the issuance of \$15 million of 9% notes due \$1 million annually beginning in 20X5. ..."

5.1.6

Fourth-quarter information in annual reports

When a company provides summarized financial data for earlier quarters in an annual report to shareholders but does not include summarized financial data for the fourth quarter in a separate fourth-quarter report or in the annual report, ASC 270 requires the registrant to disclose the following information in an unaudited note to the annual financial statements (collectively Fourth Quarter Disclosures):

- ▶ Accounting changes, including restatement, if appropriate, of financial information for the pre-change interim periods of the fiscal year in which the change is made (see discussion in section 4 of this publication)
- ▶ Disposals of components of an entity
- ▶ Unusual or infrequently occurring items recognized in the fourth quarter
- ▶ Aggregate effect of year-end adjustments material to the results of the fourth quarter⁵⁰

As discussed in the following section of this publication, when there has been a material retrospective change affecting comprehensive income, Item 302(a) of Regulation S-K requires the disclosure of quarterly financial data for the most recent two fiscal years, which includes some, but not all, of the Fourth Quarter Disclosures required by ASC 270. Selected quarterly financial data may be included outside the financial statements as supplementary information in annual shareholders' reports and in SEC filings, or in an unaudited note to the annual financial statements. If a registrant elects to include the selected quarterly financial data in an unaudited note to the financial statements, the registrant may combine the disclosure requirements of ASC 270 and Item 302(a) in a single footnote.

Below is an example disclosure within an unaudited note to the annual financial statements of a year-end adjustment that is material to the operating results of the fourth quarter. This example assumes that there were no accounting changes, disposals of components of an entity, unusual or infrequently occurring items recognized in the fourth quarter. In addition, this example assumes that the selected quarterly financial data was included outside the financial statements.

⁵⁰ SAB Topic 6.G indicates that the disclosures provided for a year-end adjustment that is material to the fourth quarter would be similar to the disclosures provided for a change in accounting estimate.

Illustration 5-2: Note N — Year-end adjustment (Unaudited)

The Company recorded an adjustment in the fourth quarter of 20X3 to increase the environmental reserve by \$300,000. The after-tax effect of this charge was to decrease basic earnings per share from income before discontinued operations by \$0.30.

5.2

Selected quarterly financial data in annual reports

Registrants that are not smaller reporting companies or foreign private issuers may omit the table of selected quarterly financial data for each quarter of the two most recent fiscal years from their annual report on Form 10-K, unless there has been a material retrospective change (or changes that are material in the aggregate) affecting comprehensive income within the most recent two fiscal years. That is, registrants reporting interim results on Form 10-Q need to consider the effects on Form 10-K reporting of any changes they make in the interim financial statements. Material retrospective changes may include, for example, a change in accounting principle or a disposition of a business that is accounted for as a discontinued operation. See the separate discussion of smaller reporting company filing requirements in section 7 of this publication.

If there has been a material retrospective change, a registrant is required to provide an explanation of the reasons for the material change and disclose, for each affected quarter 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 such changes. Rule 1-02(bb) provides flexibility for registrants to use the same line items that appear in their financial statements. The disclosure of quarterly financial data pursuant to Item 302 of Regulation S-K must be reviewed by the independent auditor.

If required, selected quarterly financial data is to be disclosed outside the financial statements as supplementary information in annual shareholders' reports and in SEC filings (or in an unaudited note to the financial statements).

Data to be Disclosed – Quarterly financial data may be designated “unaudited” and must include the following:

- ▶ Net sales or gross revenue
- ▶ Gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenue)
- ▶ 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.

See section 4.4.1 of our publication, *SEC annual reports – Form 10-K*, for a further discussion on interim financial information.

6 Interim reviews by independent auditors

6.1 General

Articles 8 and 10 of Regulation S-X require a registrant (other than a foreign private issuer) to engage an independent accountant to perform a review of the registrant's interim financial information in accordance with PCAOB AS 4105, before the registrant files its quarterly report on Form 10-Q. Although Articles 8 and 10 do not require the independent accountant to issue a separate review report, if the registrant states in Form 10-Q that an independent accountant has reviewed the interim financial information, the interim review report must be filed with the Form 10-Q.

A Form 10-Q filed with the SEC prior to completion of a PCAOB AS 4105 review is considered to be substantially deficient and therefore deemed to be not timely filed. Even though a registrant does not normally explicitly state in its filing that the timely interim review was performed, there is an implicit assertion by filing Form 10-Q that the registrant has met the filing requirements, including those for a timely review. If, in conjunction with legal counsel's advice, the registrant decides to submit the filing prior to the completion of the review, explicit disclosure should be made that the filing is deficient because the required PCAOB AS 4105 review has not been completed. The registrant also must label the columns of the financial statements as "not reviewed" and describe how the deficient filing will be remediated. On completion of the review, an amended Form 10-Q should be filed, removing both the label "not reviewed" and the disclosure that the PCAOB AS 4105 review had not been completed. If the registrant removes the disclosure, it would not be required to file the independent accountant's PCAOB AS 4105 review report with the amendment. However, if the registrant states when filing such an amendment that the PCAOB AS 4105 review has been performed, the SEC staff expects the PCAOB AS 4105 review report to be included in the amendment.

Item 302(a) of Regulation S-K requires registrants (other than foreign private issuers and smaller reporting companies) to include selected quarterly financial data when there has been a material retrospective change (or changes that are material in the aggregate) affecting comprehensive income in their annual reports and in certain other SEC filings (see section 5 of this publication). Consequently, when such disclosures are required, the independent accountant must perform a PCAOB AS 4105 review of the registrant's fourth-quarter interim financial information even though a separate fourth-quarter report on Form 10-Q is not required to be filed with the SEC. A review in accordance with PCAOB AS 4105 is not required if selected quarterly financial data is voluntarily provided. However, in such instances, that information would be subject to the requirements of PCAOB AS 2710, *Other information in documents containing audited financial statements*, for auditors to read and consider such information for material inconsistencies with the audited financial statements.

Auditors of voluntary filers⁵¹ must review their interim financial information in compliance with the PCAOB standards. In addition, the AICPA's "Compliance With Standards Rule" and AICPA AU-C Section 700, *Forming an Opinion and Reporting on Financial Statements*, requires independent auditors of voluntary filers of Form 10-Q to perform interim review procedures to comply with the interim review standards of both the PCAOB and the AICPA. When an interim review is performed under AICPA standards, they require issuance of a review report to management or the board of the audit client, but this report is not required to be included in the SEC filing unless the company includes a reference in the filing to the review.

⁵¹ A voluntary filer includes a company that does not have an obligation to file the Exchange Act reports (e.g., Forms 10-K, 10-Q, 8-K) but voluntarily files such reports with the SEC.

When an auditor issues a review report for a non-issuer⁵² that will be included in an SEC filing, the auditor follows the form of the report required by the PCAOB standards, and expands it to state that the review was also conducted in accordance with Generally Accepted Auditing Standards (GAAS).

6.2 Nature of PCAOB AS 4105 reviews

The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with PCAOB audit standards. A review of interim financial information provides the independent accountant with a basis for communicating whether they are aware of any material modifications that should be made to the interim financial information to conform with GAAP. A review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with GAAP.

A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters. However, a review does not contemplate: (1) tests of accounting records through inspection, observation or confirmation; (2) tests of controls to evaluate their effectiveness; (3) obtaining corroborating evidence in response to inquiries; or (4) performing certain other procedures ordinarily performed in an audit. A review might bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit.

In addition, the independent accountant should perform limited procedures quarterly to provide a basis for determining whether they have become aware of any material modifications that, in the independent accountant's judgment, should be made to the disclosures about changes in internal control over financial reporting in order for management's certifications to be accurate and to comply with the requirements of Section 302 of the Sarbanes-Oxley Act.

PCAOB AS 4105 provides guidance on determining the nature, timing and extent of procedures to be applied in conducting a review of interim financial information. Those procedures apply to interim financial information that is presented alone (e.g., quarterly report on Form 10-Q or quarterly report to shareholders) or that accompanies the audited financial statements of a public entity (e.g., selected quarterly financial data pursuant to Item 302 of Regulation S-K).

6.2.1 The accountant's knowledge of the entity's business and internal control

In accordance with PCAOB AS 4105, the independent accountant should have sufficient knowledge of the registrant's business and internal control as they relate to the preparation of both annual and interim financial information to (1) identify the types of potential material misstatements in the interim financial information and the likelihood of their occurrence and (2) select the inquiries and analytical procedures that will provide a basis for communicating whether any material modifications should be made to the interim financial information to conform with GAAP. See PCAOB AS 4105 for a list of procedures that the independent accountant should perform to update his or her knowledge of the registrant's business and internal control.

Knowledge of a registrant's internal control, as it relates to the preparation of both annual and interim financial information, includes knowledge of the relevant aspects of the registrant's control environment, risk assessment process, control activities, information and communication and monitoring. An independent accountant who has audited the registrant's financial statements or has performed an integrated audit of the financial statements and internal control over financial reporting for one or more annual periods should have acquired such knowledge during the course of the audit. However, independent accountants

⁵² For this purpose, a non-issuer is an entity whose financial statement audits are not subject to the oversight authority of the PCAOB.

that have not previously audited the registrant's annual financial statements (including an integrated audit of the financial statements and internal control over financial reporting) should perform procedures to obtain such knowledge, including inquiries of the predecessor accountant and review of the predecessor accountant's documentation for the preceding annual audit.

6.2.2 Interim review procedures

The procedures for conducting a PCAOB AS 4105 review principally consist of analytical procedures, inquiries and other procedures that address significant accounting and disclosure matters relating to the interim financial information to be reported. These procedures will allow the independent accountant to obtain a basis for communicating whether they are aware of any material modifications that should be made to the interim financial information for it to conform to GAAP. The inquiries made, and analytical and other procedures performed, should be specific to the issuer based on the independent accountant's knowledge of the registrant's business and internal control.

6.2.2.1 Analytical procedures

The objective of analytical procedures is to enable the independent accountant to identify and provide a basis for inquiring about relationships and unusual items that might indicate a material misstatement. A PCAOB AS 4105 review should include, at a minimum, the following analytical procedures (see PCAOB AS 4105 for additional analytical procedures):

- ▶ Compare the latest quarterly and year-to-date interim financial information to that of the immediately preceding quarter and that of the corresponding quarter and year-to-date periods of the previous fiscal year
- ▶ Compare recorded amounts or ratios developed from recorded amounts to expectations developed through an understanding of the registrant's business and industry
- ▶ Compare disaggregated revenue data (e.g., by month, product line or segment) from the latest quarter to the corresponding quarter of the previous fiscal year
- ▶ Consider interrelationships of financial and nonfinancial information that are reasonably expected to exist, including information used by the registrant (e.g., information in a board of directors' package or senior management committee's briefing materials)

6.2.2.2 Inquiries and other procedures

PCAOB AS 4105 requires the independent accountant to inquire of members of management who have responsibility for financial and accounting matters about matters concerning:

- ▶ Whether the interim financial information has been prepared in conformity with GAAP applied on the same basis as in the financial statements or information for the latest audited period and prior quarters
- ▶ Unusual or complex situations that might have an effect on the interim financial information⁵³

⁵³ Examples of unusual or complex situations include business combinations; new or complex revenue recognition methods; impairment of assets; disposal of a segment of a business; use of derivative instruments and hedging activities; sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity; computation of earnings per share in a complex capital structure; adoption of new stock compensation plans or changes to existing plans; restructuring charges taken in the current and prior quarters; the occurrence of infrequent transactions; the occurrence of significant unusual transactions; changes in litigation or contingencies; changes in major contracts with customers or suppliers; application of new accounting principles; changes in accounting principles or the methods of applying them; trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges; compliance with debt covenants; changes in related parties or significant new related-party transactions; material off-balance-sheet transactions, special-purpose entities and other equity investments; and unique terms for debt or capital stock that could affect classification.

- ▶ Significant transactions occurring or recognized in the last several days of the interim period
- ▶ The status of any uncorrected misstatements that were identified during the previous audit and interim review (i.e., whether adjustments have been made after the prior audit or interim period and, if so, the amounts recorded and period in which such adjustments were recorded)
- ▶ Matters about which questions have arisen in the course of applying the review procedures
- ▶ Events after the date of the interim financial information that could have a material effect on the presentation of the interim financial information
- ▶ Their knowledge of any fraud or suspected fraud affecting the entity involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements
- ▶ Whether they are aware of allegations of fraud or suspected fraud affecting the entity (e.g., received in communications from employees, former employees, analysts, regulators, short sellers or others)
- ▶ Significant journal entries and other adjustments
- ▶ Communications from regulatory agencies
- ▶ Significant deficiencies or material weaknesses in the design or operation of internal control over financial reporting, which could adversely affect the registrant's ability to initiate, authorize, record, process and report financial data
- ▶ In addition, PCAOB AS 4105 requires the independent accountant to perform other procedures including:
 - ▶ Read the minutes of meetings of the board of directors, shareholders and important committees of the entity (and its subsidiaries to the extent such exist). If minutes are not available, inquire of management about the matters dealt with at the meeting(s).
 - ▶ Review the work papers or obtain the report(s) of other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity, its subsidiaries or its other investees. In these circumstances, the independent accountant ordinarily is in a position similar to that of a principal auditor⁵⁴ who makes use of the work or reports of other auditors during the course of an audit of the financial statements.
 - ▶ Obtain evidence that the interim financial information agrees or reconciles with the accounting records (e.g., trace and agree financial statement amounts to the company's general ledger or other appropriate records).
 - ▶ Read the interim financial information to consider whether, based on the results of the review procedures performed and other information that has come to the accountant's attention, the interim information to be reported conforms with US GAAP and SEC rules and regulations.
 - ▶ Read the entire document that accompanies the interim financial information (e.g., quarterly report to shareholders and Form 10-Q) to see whether the other information included in the document, or the manner of its presentation, is not materially inconsistent with the quarterly financial information.
 - ▶ Evaluate management's quarterly certifications about internal control over financial reporting (see section 6.2.3 of this publication).

⁵⁴ See AS 1205, Part of the Audit Performed by Other Independent Auditors.

A PCAOB AS 4105 review does not contemplate obtaining corroborating evidence for responses to inquiries concerning litigation, claims and assessments. Consequently, independent accountants are not required to send a legal letter to a registrant's attorney concerning these matters. However, if information comes to the independent accountant's attention that causes them to question whether the interim financial information departs from GAAP (including disclosures) with respect to litigation, claims or assessments, and the independent accountant believes that the registrant's attorney might have specific information concerning this matter, an inquiry of the lawyer concerning this matter is appropriate.

A PCAOB AS 4105 review is not designed to identify conditions or events that might indicate substantial doubt about an entity's ability to continue as a going concern. However, such conditions or events might have existed at the date of the prior-period financial statements (annual or interim). In addition, during the course of the current-period PCAOB AS 4105 review, the independent accountant might become aware of conditions or events that might affect the entity's ability to continue as a going concern. In either case, the independent accountant should (1) inquire of management as to its plans for dealing with the adverse effects of the conditions and events and (2) consider the adequacy of the disclosure about such matters in the interim financial information. Ordinarily, it is not necessary for the independent accountant to obtain evidence in support of the information that mitigates the effects of the conditions and events.

If the independent accountant becomes aware of information that might cause the interim financial information not to be in conformity with GAAP in all material respects, the independent accountant should make additional inquiries or perform other procedures that the independent accountant considers appropriate to provide a basis for communicating whether they are aware of any material modifications that should be made to the interim financial information. For example, if during the course of a PCAOB AS 4105 review the independent accountant becomes concerned about whether a sales transaction is recorded in conformity with GAAP, the independent accountant should perform additional procedures, such as discussing the terms of the transaction with senior marketing and accounting personnel, reading the sales contract, or both, to resolve those concerns.

Because the independent accountant performing the interim review ordinarily will be engaged to audit the annual financial statements, the independent accountant should consider coordinating the interim review with the audit. That is, certain auditing procedures could be performed concurrently with the PCAOB AS 4105 review. For example, information gained from reading the minutes of meetings of the board of directors for the review also may be used for the annual audit. Also, there might be significant or unusual transactions occurring during the interim period under review for which the auditing procedures that would need to be performed for purposes of the audit of the annual financial statements could be performed, to the extent practicable, at the time of the interim review (e.g., business combinations, restructurings or significant revenue transactions).

6.2.3 Management's Section 302 certification

Item 308(c) of Regulation S-K requires each issuer to disclose any change in internal control over financial reporting that occurred during the last fiscal quarter that has "materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting." PCAOB AS 4105 indicates that the independent accountant should perform limited procedures each quarter to provide a basis for determining whether they have become aware of any material modifications that, based on their judgment, should be made to the disclosures in Item 4 of Part I of Form 10-Q about changes in internal control over financial reporting in order for management's Section 302 certification to be accurate and to comply with the requirements of the Sarbanes-Oxley Act.

When the independent accountant becomes aware of matters that lead them to believe that modification to the disclosures in Item 4 of Part I of Form 10-Q about changes in internal control over financial reporting is necessary for management's Section 302 certification to be accurate and to comply with the requirements of the Sarbanes-Oxley Act, the independent accountant should communicate the matter to the appropriate level of management as soon as practicable. If, in the independent accountant's judgment, management does not respond appropriately to the independent accountant's communication within a reasonable period of time, the independent accountant should inform the audit committee. If, in the auditor's judgment, the audit committee does not respond to the independent accountant's communication within a reasonable period of time, the independent accountant should evaluate whether to resign from the engagement.

If management has remediated one or more material weaknesses during the quarter, the independent accountant should inquire of management (and others, as appropriate) to determine that the control has, in fact, been placed in operation prior to the end of the quarter. However, the independent accountant has no responsibility under PCAOB AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements* (AS 2201), to test the design or operating effectiveness of the new or modified control in conjunction with the independent accountant's PCAOB AS 4105 review procedures.

6.2.4 Written representations from management

Written representations from management are obtained for all interim financial information presented and for all periods covered by the review. PCAOB AS 4105 requires certain minimum representations. However, each management representation letter should be tailored to include additional representations about matters specific to the registrant's business or industry.

6.2.5 Communications to management, audit committee and others

Generally, audit committees have established practices to review and discuss the quarterly financial information and MD&A with management and the independent accountants prior to the filing of the registrant's quarterly report on Form 10-Q. In addition, the audit committee typically reviews and discusses earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies. Not only are these procedures best practices, but they also satisfy the requirements of the NYSE listing standards. As a result, audit committees and independent accountants generally engage in an active dialogue each quarter.

PCAOB AS 4105 requires the independent accountant to determine whether any of the matters described in PCAOB AS 1301, *Communications with Audit Committees*, as they relate to interim financial information, have been identified. These matters might include (1) the process used by management to develop critical accounting estimates, (2) significant new accounting policies or a change in a significant accounting policy affecting the interim financial information, (3) misstatements that, either individually or in the aggregate, could have a material effect on the entity's financial reporting process, and (4) disagreements with management. If any such matters have been identified, the independent accountant should communicate such matters to the audit committee or be satisfied through discussions with the audit committee that such matters have been communicated to the audit committee by management.

Because the objective of a review of interim financial information differs significantly from that of an audit, any communication the independent accountant may make about the quality, not just the acceptability, of the registrant's accounting principles as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. In addition, the independent accountant also should inform the audit committee about any uncorrected misstatements pertaining to the current period whose effects management believes are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole.

In addition, PCAOB AS 4105 requires the independent accountant to communicate with management, and in certain circumstances the audit committee, about certain other matters involving interim financial information to be filed with the SEC. Matters discussed with management include (1) material departures from GAAP, (2) filing of the Form 10-Q before completion of the independent accountant's review and (3) fraud and illegal acts. Matters communicated directly to the audit committee include (1) material departures from GAAP about which management does not respond to the independent accountant's communication in a reasonable time, (2) fraud involving senior management and fraud that results in a material misstatement of the financial statements and (3) illegal acts involving senior management.

AS 2201 requires the independent accountant to communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit. (See section 4 of our publication, *SEC annual reports – Form 10-K*, for a discussion of the definitions in AS 2201 of "significant deficiency" and "material weaknesses.") When timely communication is important, the independent accountant should communicate these matters, as well as matters relating to fraud or possible illegal acts, during the course of the audit rather than at the conclusion of the audit. The decision about whether to issue an interim communication should be determined based on the relative significance of the matters noted and the urgency of corrective follow-up action required. The independent accountant communicates to management and the audit committee at an interim date those internal control deficiencies that, in their view, are clearly indicative of significant deficiencies or material weaknesses that management has not also identified or has not yet begun corrective action as of that date. This facilitates management's ability to take timely corrective action and perhaps correct a significant deficiency or material weakness identified by the independent accountant in advance of the year-end assessment date.

Rule 2-07 of Regulation S-X, *Communication with Audit Committees*, also requires the auditor to communicate the following matters to the audit committee prior to the filing of an audit report: (1) all critical accounting policies and practices used; (2) material alternative treatments within GAAP that have been discussed with management including the ramification of the alternative treatment as well as the auditor's preference and (3) other material written communications between the auditor and management (e.g., letter of representations). While these communications are required prior to the filing of an audit report, the SEC staff indicated that it would expect these communications could occur as frequently as quarterly, or more often on a real-time basis.

6.3 Reporting on interim reviews

If a PCAOB AS 4105 review has been performed, the independent accountant may issue a review report. Unless the registrant specifically states in its Form 10-Q that an independent accountant has reviewed the interim financial information, the review report need not be filed with the interim financial information. PCAOB AS 4105 prescribes the form and content of the review report.

Below is an example of a report on a review of condensed consolidated interim financial information in accordance with PCAOB AS 4105.

Illustration 6-1: Interim review report
<p>Report of Independent Registered Public Accounting Firm</p> <p>To the Shareholders and the Board of Directors of ABC Company.</p> <p>Results of Review of Interim Financial Statements</p> <p>We have reviewed the accompanying condensed consolidated balance sheet of ABC Company and subsidiaries (the Company) as of March 31, 20X3, the related condensed consolidated statements of comprehensive income, shareholders' equity and cash flows for the three-month periods ended March 31, 20X3 and 20X2, and the related notes (collectively referred to as the "condensed consolidated interim financial statements"). Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated interim financial statements for them to be in conformity with U.S. generally accepted accounting principles.</p> <p>We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of ABC Company as of December 31, 20X2, the related consolidated statements of comprehensive income, shareholders' equity and cash flows for the year then ended, and the related notes (not presented herein); and in our report dated February 15, 20X3, we expressed an unqualified audit opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 20X2, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.</p> <p>Basis for Review Results</p> <p>These financial statements are the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial statements consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.</p> <p>Signature</p> <p>City and State or Country</p> <p>Date</p>

When the auditor performs a review of a non-issuer's interim financial information under PCAOB standards, the auditor must do so under AICPA standards as well and issue a review report. If the auditor intends to refer to both the PCAOB and AICPA standards in the review report (which would be required if the review report is included in an SEC filing), the format of the report follows the requirements of the PCAOB and includes a reference to state that the review was also conducted in accordance with Generally Accepted Auditing Standards (GAAS).

While interim review reports are useful to management and directors, there is a concern that the limitations of such reports are not understood by the general investing public. As a result, pursuant to Rule 436(c) of the Securities Act, review reports on unaudited interim financial information are not part of the registration statement prepared or certified by accountants within the meaning of Section 7 or Section 11 of the Securities Act. Therefore, independent accountants do not *consent* to the use of an interim review report. However, issuers are required by Item 601 of Regulation S-K to file as Exhibit 15 to the registration statement (or to any Form 10-Q which is incorporated by reference into the registration statement) a letter from the independent accountants, which acknowledges their awareness of the use in a registration statement of their report on unaudited interim financial information, which is not subject to the consent requirement of Section 7 of the Securities Act.

Under FRC Section 605.04b, when a review report is included or incorporated by reference into a registration statement, the issuer should disclose in the registration statement that the review report included in such registration statement is not a “report” or “part” of the registration statement within the meaning of Sections 7 and 11 of the Securities Act. The issuer must specifically state that the independent accountant’s Section 11 liability does not extend to such review reports. Below is an example of such a disclosure.

Illustration 6-2: Incorporation by reference

Independent Accountants

With respect to the unaudited condensed consolidated interim financial information of ABC Company for the three-month periods ended 31 March 20X3 and 20X2, incorporated by reference in this Prospectus, Ernst & Young LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated 26 April 20X3, included in ABC Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 20X3, and incorporated by reference herein, states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their reports on such information should be restricted in light of the limited nature of the review procedures applied. Ernst & Young LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the “Act”) for their report on the unaudited interim financial information because that report is not a “report” or a “part” of the Registration Statement prepared or certified by Ernst & Young LLP within the meaning of Sections 7 and 11 of the Act.

6.4

Letters for underwriters and certain other requesting parties

Under Section 11 of the Securities Act, the registrant’s underwriters could be liable if any part of a registration statement contains material omissions or misstatements. Therefore, as part of the underwriter’s due diligence, the underwriter typically asks the registrant to engage the independent accountant to issue a comfort letter. When interim financial statements are included in the registration statement, the underwriter generally requests that the independent accountant provide negative assurance about whether (1) any material modification should be made to the unaudited condensed interim financial information for it to be in conformity with GAAP and (2) the unaudited condensed interim financial information complies as to form in all material respects with the requirements of the Securities Act and the related rules and regulations adopted by the SEC.

PCAOB AS 6101, *Letters for Underwriters and Certain Other Requesting Parties*, requires that the independent accountant perform a PCAOB AS 4105 review of unaudited interim information to provide negative assurance in a comfort letter. When the independent accountant has not performed a PCAOB AS 4105 review, the comfort letter can report only procedures performed and findings obtained.

7

Smaller reporting companies

7.1 Definition of a smaller reporting company

The SEC amended the definition of a smaller reporting company (SRC) in 2018 to allow more companies to provide scaled disclosures in SEC filings.⁵⁵ However, investment companies, asset-backed issuers and majority-owned subsidiaries of a parent that is not an SRC aren't eligible for SRC status.

7.1.1 Entry provisions

An issuer filing an initial registration statement for common equity (Securities Act or Exchange Act) qualifies as an SRC if either of the following conditions is met:

- ▶ Its estimated public float is below \$250 million at completion of the IPO
- ▶ It has less than \$100 million in annual revenue for the fiscal year completed before the IPO and its estimated public float is less than \$700 million at completion of the IPO

The IPO candidate 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 common share price at IPO is known.

A domestic SEC reporting company would qualify for SRC status if it meets either of the following thresholds at its annual re-determination date (last business day of its second fiscal quarter) even if it previously did not qualify as an SRC:

- ▶ Public float is below \$200 million at the re-determination date
- ▶ Annual revenue for the year completed before the re-determination date is less than \$80 million and public float at the re-determination date is less than \$560 million (including no public float).

An issuer that newly qualifies as an SRC at its annual re-determination date may choose to reflect its change to SRC status in its quarterly report for that second fiscal quarter or in a quarterly or annual report filed thereafter.⁵⁶ However, the registrant must reflect its SRC status by checking the box on the cover page of its SEC filings no later than in its first Form 10-Q for the next fiscal year regardless of whether it chooses to apply the scaled (i.e., reduced) disclosure standards permitted for such issuers.

Any foreign private issuer (FPI) is eligible to qualify as an SRC in accordance with the threshold requirements above. However, to take advantage of the disclosure relief as a smaller reporting company, an FPI must use domestic forms (i.e., Form 10-K and Form 10-Q, not Form 20-F and Form 6-K) and it must file financial statements prepared using US GAAP.

An issuer that previously qualified for SRC status continues to qualify for SRC status unless at its next re-determination date (last business day of its second fiscal quarter) it meets one of the three exit criteria described below.

⁵⁵ SEC Releases 33-10513 and 34-83550, *Smaller Reporting Company Definition* (Final Rules), issued 10 September 2018.

⁵⁶ As discussed in Section 2 of this publication, the due dates of the quarterly reports on Form 10-Q for the remainder of the current fiscal year would continue to be determined by reference to the registrant's filing status determined as of the beginning of that fiscal year (i.e., large accelerated or accelerated filer).

7.1.2 Exit provisions

A registrant that qualifies as an SRC must re-determine annually whether it continues to qualify as an SRC on its re-determination 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 the re-determination date:

- ▶ Public float exceeds \$250 million and annual revenue exceeds \$100 million.
- ▶ Annual revenue exceeds \$100 million and it has no public float.
- ▶ 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.

Once a reporting issuer fails to qualify for SRC status at its annual re-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 or defer adoption of a new or amended accounting standards) during this same period.

7.2 Form 10-Q filing by a smaller reporting company

The Form 10-Q of a smaller reporting company is due 45 or 40 days after the end of its first three fiscal quarters depending on whether it is a non-accelerated or accelerated filer. See section 2 of our publication, *SEC annual reports – Form 10-K*, for a discussion of the circumstances affecting a company's filing status.

7.2.1 Content

A smaller reporting company 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 otherwise applicable to larger public companies. Nevertheless, the SEC stressed in the adopting release the importance of consistent disclosures that allow investors to make period-to-period comparisons, whether quarterly or annually.

The following table shows the item number, caption and disclosure requirement (which refers to the items and rules in Regulations S-K and S-X) of the disclosure instructions for the various items of a Form 10-Q that apply to companies that are not smaller reporting companies and the related scaling offered to smaller reporting companies.

Form item	Form 10-Q instructions	Disclosure requirement	Scaling for smaller reporting companies
Part I			
Item 1	Financial statements	S-X Rule 10-01	Scaled in Article 8-03 of Regulation S-X
Item 2	Management's discussion and analysis	S-K Item 303(b)	Same as non-smaller reporting company
Item 3	Quantitative and qualitative disclosures about market risk	S-K Item 305	Not required
Item 4	Controls and procedures	S-K Item 307 S-K Item 308(c)	Same as non-smaller reporting company
Part II			
Item 1	Legal proceedings	S-K Item 103	Same as non-smaller reporting company
Item 1A	Risk factors	Material changes in risk factors since those disclosed in last 10-K	Not required
Item 2	Unrestricted sales of equity securities and use of proceeds	S-K Item 701 if not previously included in a Form 8-K S-K Item 703	Same as non-smaller reporting company Same as non-smaller reporting company
Item 3	Defaults upon senior securities	Disclose if not previously included in a Form 8-K	Same as non-smaller reporting company
Item 4	Mine safety disclosures	S-K Item 104	Same as non-smaller reporting company
Item 5	Other information	Any information required to be disclosed on Form 8-K during the quarter but not reported S-K Item 407(c)(3) changes to procedures to nominate members of the board of directors	Same as non-smaller reporting company Same as non-smaller reporting company
Item 6	Exhibits	S-K Item 601	Same as non-smaller reporting company

7.2.2

Rule 8-03 of Regulation S-X — Interim financial statements of smaller reporting companies

Rule 8-03 of Regulation S-X describes the interim financial statement requirements for smaller reporting companies. The primary financial statements required of a smaller reporting company in Form 10-Q are identical to those of a larger issuer (i.e., a balance sheet as of the end of the most recent fiscal quarter and as of the end of the preceding fiscal year; income statements for the most recent fiscal quarter, the year-to-date period and for the corresponding periods of the preceding fiscal year; and statements of cash flows for the year-to-date period and the comparable prior-year period). SRCs are also required to include a reconciliation of changes in all components of stockholders' equity (as a separate statement or in the notes to the financial statements) for the current and comparative year-to-date period, with subtotals for each interim period. Rule 8-03 also requires that footnote disclosures be provided as needed for fair presentation and to ensure that the financial statements are not misleading. The interim financial statements of a smaller reporting company must include a statement that, in the opinion of management, the financial statements include all adjustments necessary to make the financial statements not misleading.

Like a larger issuer, a smaller reporting company must have the interim financial statements it includes in Form 10-Q reviewed by an independent public accountant (see section 6 of this publication). The financial statements of a smaller reporting company, including an FPI filing on Form 10-Q, must be prepared in accordance with US generally accepted accounting principles.

Other Articles within Regulation S-X do not apply to the interim financial statements of smaller reporting companies, except that a smaller reporting company must comply with:

- ▶ Article 2 regarding the qualifications of the independent auditor and its report, if any
- ▶ Rule 4-10 regarding the accounting and reporting for oil and gas producing activities

Although the content required in the interim financial statements of a smaller reporting company is largely similar to that required of a larger issuer under Article 10 of Regulation S-X, there are several notable differences as discussed below.

Presentation

Article 10 permits the presentation of certain financial statements that Rule 8-03 does not otherwise address.⁵⁷ For example, Article 10 allows the presentation of a balance sheet as of the end of the corresponding fiscal quarter of the preceding fiscal year if such information is necessary to understand the effects of seasonal fluctuations on a registrant's financial condition. Article 10 also permits the presentation of income statements and cash flows statements for the cumulative 12-month period ended during the most recent fiscal quarter and for the corresponding preceding period. Further, unlike Rule 8-03, Article 10 permits registrants engaged in the seasonal production and sale of a single-crop agricultural commodity to provide interim statements of income and cash flows for the 12-month period ended during the most recent fiscal quarter and for the corresponding preceding period, in lieu of the year-to-date statements otherwise required.

Condensed statements

The condensing rules under Rule 8-03 are different from those under Article 10. As discussed in section 3 of this publication, a larger issuer (i.e., non-SRC) must show separately each balance sheet caption prescribed by Regulation S-X that is 10% or more of total assets, or that has increased or decreased by more than 25% since the preceding fiscal year, as well as each income statement caption that is 15% or more of average net income for the most recent three fiscal years, or that has increased or decreased by more than 20% compared with the corresponding interim period of the preceding fiscal year. However, Rule 8-03 requires that a smaller reporting company show separately only balance sheet captions that are 10% or more of total assets, regardless of the percentage change since the preceding fiscal year. Similarly, a smaller reporting company is required to present in its condensed income statement each cost and expense category presented in the annual financial statements that exceeds 20% of sales or gross revenue without regard to the percentage change from the corresponding interim period of the preceding fiscal year.

A larger issuer may abbreviate its statement of cash flows starting with a single figure of net cash flows from operating activities. To the extent material, a larger issuer also must show separately each investing and financing cash flow caption that exceeds 10% of the average of net cash flows from operating activities for the most recent three fiscal years. However, Rule 8-03 requires that the interim cash flows statement of a smaller reporting company include only net cash flows from operating, investing and financing activities, as well as cash at the beginning and end of each period and the increase or decrease

⁵⁷ If a smaller reporting company wishes to present any of the financial statements otherwise permitted by Article 10, it is recommended that the company pre-clear its request with the SEC staff.

in such balance. That is, Rule 8-03 does not require a smaller reporting company to show any captions within investing and financing activities. Nevertheless, a smaller reporting company should consider identifying and quantifying material investing and financing activities.

Equity-method investees

As discussed in section 3 of this publication, Article 10 of Regulation S-X requires summarized income statement information in Form 10-Q for equity-method investees for which separate or combined audited financial statements would otherwise be required for annual periods under Rule 3-09 of Regulation S-X. That is, year-to-date summarized income statement information would be required for equity-method investees that are 20% significant under either the investment test or the income test.

Rule 8-03(b)(3) of Regulation S-X requires the interim financial statements of a smaller reporting company to disclose summarized income statement information for equity-method investees that constitute 20% or more of the smaller reporting company's consolidated assets, equity⁵⁸ or income from continuing operations attributable to the registrant. These tests differ from Article 10 and could require the disclosure of summarized income statement information by SRCs in more circumstances than Article 10. For example, Rule 8-03 applies an asset test for purposes of disclosing summarized income statement information of equity-method investees, which Article 10 does not.

The SEC staff does not believe the SEC intended for the disclosure requirements for a smaller reporting company to be more onerous than those for a registrant that is not a smaller reporting company. Therefore, smaller reporting companies may determine significance for purposes of reporting summarized financial information in a manner consistent with Article 10.

Subsidiary issuers and guarantors

Effective for quarterly reports on Form 10-Q for periods ending after 4 January 2021, the requirements for separate financial statements and abbreviated disclosures in lieu of separate financial statements for smaller reporting companies are aligned with those for non-smaller reporting companies discussed section 3.4 of this publication. Smaller reporting companies will no longer be permitted to omit disclosures about subsidiary guarantors or co-issuers of their registered debt from their interim reports on Form 10-Q, as allowed under the legacy instruction 3 to Rule 8-01 of Regulation S-X.

7.2.3 Item 303 MD&A

The MD&A requirements discussed further in section 3 of this publication also apply to a smaller reporting company and must cover the two-year period required in Article 8 of Regulation S-X.

⁵⁸ While Rule 8-03 specifies a significance test based on "equity," we understand that this reference was intended to be the same as the investment test of significance.

A

Abbreviations

Abbreviation	FASB Accounting Standards Codification
ASC 205-20	FASB ASC 205-20, <i>Presentation of Financial Statements – Discontinued Operations</i>
ASC 210-20	FASB ASC 210-20, <i>Balance Sheet – Offsetting</i>
ASC 220	FASB ASC 220, <i>Comprehensive Income</i>
ASC 250	FASB ASC 250, <i>Accounting Changes and Error Corrections</i>
ASC 260	FASB ASC 260, <i>Earnings Per Share</i>
ASC 270	FASB ASC 270, <i>Interim Reporting</i>
ASC 280	FASB ASC 280, <i>Segment Reporting</i>
ASC 310	FASB ASC 310, <i>Receivables</i>
ASC 320	FASB ASC 320, <i>Investments – Debt Securities</i>
ASC 321	FASB ASC 321, <i>Investments – Equity Securities</i>
ASC 325	FASB ASC 325, <i>Investments – Other</i>
ASC 330	FASB ASC 330, <i>Inventory</i>
ASC 480	FASB ASC 480, <i>Distinguishing Liabilities from Equity</i>
ASC 715	FASB ASC 715, <i>Compensation – Retirement Benefits</i>
ASC 740	FASB ASC 740, <i>Income Taxes</i>
ASC 805	FASB ASC 805, <i>Business Combinations</i>
ASC 815	FASB ASC 815, <i>Derivatives and Hedging</i>
ASC 820	FASB ASC 820, <i>Fair Value Measurement</i>
ASC 825	FASB ASC 825, <i>Financial Instruments</i>
ASC 942	FASB ASC 942, <i>Financial Services – Depository and Lending</i>
ASC 958	FASB ASC 958, <i>Not-for-Profit Entities</i>

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SCORE no. 17961-221US

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