SEC "Hot Button"
Accounting Issues

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Under Sarbanes-Oxley, the SEC is required to review disclosures and financial statements for every registrant at least once every three years. Understanding the common concerns of the SEC can be a valuable tool when preparing year-end financial statements. RotenbergMeril has summarized key SEC comments below. These comments are also available publicly through the SEC's Edgar database.

1. Revenue recognition

In the past, the SEC staff focused on multiple element arrangements and software revenue recognition. The SEC often asked companies whether they disclosed accounting policies for each material revenue stream and whether they have addressed uncertainties that would affect revenue recognition.

2. Consolidations

Variable interest entities—new accounting rules require companies to consider who has effective control over an entity when deciding who should consolidate it to their financial statement.

3. Loss contingencies

The SEC often inquires whether companies are providing adequate disclosure about potential exposures that might lead to losses.

4. Business combinations

The SEC is interested in accounting for intangible assets, including goodwill, in order to assure they are appropriately identified and valued. Comments often focus on valuation techniques that are used in the performance of goodwill impairment test. Frequent comments on the completeness of disclosures around fair value measurements have also been documented.

SEC staff may request more information in situations where a disproportionate amount of the purchase price is allocated to goodwill.

5. Fair value measurements

SEC comments have focused on the completeness of GAAP-required disclosures and on providing sufficient detail for market participant assumptions used in the determination of fair value.

6. Financial instruments

SEC comments have centered on the complexities of accounting for financial instruments and the disclosures related to other than temporary impairments or investments in debt and equity securities.

7. Impairments

Staff may comment when a registrant's revenues decline or when its market capitalization declines below book value. The comments are aimed at determining whether or not there are impairments in goodwill. The staff may also ask questions about valuations, both those prepared by third parties and those prepared by management.

8. Income taxes

In comments about income taxes, SEC staff members have asked registrants to support recoverability of their net deferred tax asset and to enhance the company's discussion of the components of the income tax rate reconciliation.

9. Materiality

If SEC staff become aware that a registrant has concluded that a misstatement is immaterial, typically noted when the registrant has corrected an error without amending previously filed reports, details of the materiality assessment are often requested.

10. Management Discussion & Analysis (MD&A)

SEC staff often requests an expansion of this annual report section to include a discussion of recent economic events and their current and/or expected future impact on operations, the company's financial position, and its liquidity. Particular, detailed information on customers, recent order activity, trends, and credit shortage is frequently needed.

"Boilerplate" risk factors, versus those tailored to the registrant's own facts and circumstances, or risk factors that are inconsistent with the discussion in MD&A often result in comments from the SEC.

The SEC comments how registrants do not adequately discuss factors contributing to fluctuations in operating results beyond what is readily apparent from the face of the financials. Often addition explanations are required and requested.

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