

# *Stay informed* 2014 SEC comment letter trends Retail & Consumer

*Current developments in  
SEC reporting*

*December 2014*





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To our Clients and Friends:



The developments of the past few years affecting the Retail & Consumer (R&C) industry—many driven by the evolving needs and behaviors of consumers—have set the stage for an era of disruption. Accelerating technological trends, innovation in all aspects of the supply chain, and the resulting need to develop adaptive business models to service customers continue to redefine the industry. In the near future, mobile technology will likely drive big changes in the ways consumers shop and how retail and consumer companies interact with them.

Business models and practices are being challenged in an ever-shrinking global economy where barriers to entry are being eliminated in every sector of the economy. The local consumer has access to global products, highlighting the need for companies to continuously evaluate their approach to product availability, convenience and assortment variation, merchandising and marketing techniques, and supply chain capabilities. Transparency into inventory and pricing become differentiators, causing continuing channel shifting; competition is no longer from traditional sources, it may be on-line and the right shopping experience is essential. As the cost to serve customers becomes critical, consolidation is accelerating as companies strive to build smarter organizations and invest in the right capabilities—in terms of human capital, innovation and brand management.

Advances in smartphones, sensor-based technologies, and data analytics are transforming the shopping experience. Many retail and consumer companies are grappling with how these developments will affect consumer expectations and interactions, as well as the supporting business model as they seize the opportunities that these developments present.

These business challenges, changes, and opportunities, together with ongoing regulatory developments in the financial reporting environment, underscore the need for continued focus on high quality and transparent financial reporting. Understanding where the SEC staff focuses their review is an important consideration in the year-end reporting process.

We hope you find this latest edition of our annual publication of SEC comment letter trends for registrants in the R&C industry to be a useful reference tool as you prepare your year-end reports. Please do not hesitate to reach out to your engagement team or PwC contact to discuss the information included in this publication or on any other financial reporting matters.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Jon', with a stylized flourish at the end.

Jon Sackstein  
US Retail and Consumer Assurance Leader

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## SEC developments

2014 was a busy year at the SEC. Although there were only a few changes in senior personnel (compared to 2013 when several high profile staff positions were filled and three Commissioners, including a new Chair, were appointed), one notable change was the appointment of Jim Schnurr as the SEC's Chief Accountant. Schnurr joined the SEC staff in October and will play a major role in shaping the SEC's agenda at a time when accounting, auditing, and financial reporting are key areas of focus. This focus reflects a common understanding that transparent, accurate, and reliable financial reporting forms the foundation of trust which allows our capital markets to function properly and provides the transparency and confidence investors need when making decisions.

Following through on initiatives started in 2013, 2014 has seen a high level of activity in the SEC's enforcement program, with renewed attention on financial fraud, issuer disclosure, and gatekeepers. The Enforcement Division's Financial Reporting and Audit Task Force—a small group of experienced attorneys and accountants charged with developing state-of-the-art tools to better identify financial fraud and incubating cases to be handled by other groups—is one example of how the SEC has increased its focus. The Task Force monitors high-risk areas, analyzes industry performance trends, reviews restatements, revisions, and class action filings as well as academic research. It is also working on the SEC's Accounting Quality Model—sometimes referred to as Robocop—which is being developed to use data analytics to assess the degree to which a company's financial reporting appears noticeably different from its peers. The Task Force was very busy during 2014 with even more activity expected in 2015.

The SEC staff has continued to focus on internal control over financial reporting, with more attention on how companies evaluate deficiencies relating to immaterial financial statement errors. The SEC staff signaled its intention to increase its focus in this area in late 2013, and this has led to more frequent comments and questions in 2014, with more likely to come in 2015.

Recognizing that full and fair disclosure is a central goal of the US securities laws and is critical to the

fulfillment of the SEC's core mission, during 2014 the SEC launched a "Disclosure Effectiveness" initiative. Through this initiative, the SEC is looking for ways to update and modernize its disclosure system and to eliminate duplicative or overlapping requirements, while continuing to provide material information. Trying "to put better disclosure into the hands of investors," the SEC staff is taking a fresh look at the question: what information do investors need to make informed decisions? In addition to looking at the specific disclosures companies provide, the SEC staff is also looking closely at how disclosures are provided, particularly in light of advances in technology and changes in how information is consumed. For instance, the SEC staff might explore a "company file" approach through which investors would access company-specific information on the SEC's website through tabs such as "Business information," "Financial information," "Governance information," and "Executive compensation," instead of searching for that same information by combing through a reverse chronological list of filings. The SEC staff has been clear that reducing disclosure is not the objective of this important project (indeed, they have said that updating the requirements may well result in additional disclosures), but they have indicated that they believe the initiative can reduce costs and burdens on companies.

Even before any rule changes are adopted (or proposed), companies already have the ability to improve the quality and relevance of their disclosures by reducing redundancy, removing out-of-date, unnecessary information, and refining disclosures to focus on those issues which are truly applicable and material. The SEC staff has been encouraging companies to experiment with the presentation of the information in their filings with the objective of improving the transparency, quality, and relevance of their disclosures.



John A. May  
SEC Services Leader



# The comment letter process

The SEC's Division of Corporate Finance (CorpFin) has a long history of reviewing selected filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934. The intent of these reviews is to monitor and enhance compliance with applicable disclosure and accounting requirements.

Until Sarbanes-Oxley, these reviews were periodic and not subject to specific intervals. Section 408 of the Sarbanes-Oxley Act requires the SEC to review registrants who issue Exchange Act reports no less frequently than once every three years. A significant number of companies are selected more frequently.

CorpFin does not publicly disclose the criteria it uses to select companies and filings for review, but Section 408 directs the SEC to consider the following selection criteria:

- Issuers with material restatements of financial results
- Issuers that experience significant volatility in their stock price as compared to other issuers
- Issuers with the largest market capitalization
- Emerging companies with disparities in price to earnings ratios
- Issuers whose operations significantly affect any material sector of the economy
- Any other factors that the SEC may consider relevant.

Once a company or filing is selected, the extent of the review may be (1) a full cover-to-cover review, (2) a review of the financial statements and related disclosures (e.g., MD&A), or (3) a targeted review of one or more specific items of disclosure. The identified reviewer concentrates on critical disclosures that appear to conflict with SEC rules or the applicable accounting standards and on disclosure that appears to be materially deficient in explanation or clarity. They evaluate the disclosure from a potential investor's perspective and ask questions that an investor might ask when reading the document.

CorpFin performs its reviews through 12 Assistant Director (AD) offices organized based on specialized industry, accounting, and disclosure expertise. An issuer's AD assignment is shown in EDGAR following the basic company information that precedes the company's filing history. This organizational structure

can sometimes explain why multiple companies in the same industry receive very similar comments around the same time.



## Responding to SEC Comment Letters

The SEC staff's comments are based primarily on a company's disclosure and other public information, such as information on the company's website, in press releases, discussed on analysts calls, etc. (nonpublic information, such as whistleblower tips and PCAOB inspection reports, can also be a source of comments). SEC staff comments reflect its understanding of the applicable facts and circumstances. In comments, the SEC staff may request that a company provide additional supplemental information so the staff can better understand the company's disclosure, or may ask that the company provide additional or different disclosure in a future filing or change the accounting and/or revise the disclosure by filing an amendment.

## *The comment letter process*

When responding to the SEC staff, keep these best practices in mind:

**Own the process**—Companies should leverage the knowledge and experience of their auditors and SEC counsel, but it's important to maintain ownership. As with any project, there should be a clear owner and project manager coordinating the input from various sources and developing a response.

**Don't rush**—Companies should evaluate how long they believe it will take to respond. Although the letter from the SEC staff will request a response in 10 business days, it is acceptable for management (usually through counsel's call to the SEC staff) to request more time if 10 days is not sufficient. A thoughtful and complete response is better than a quick reply.

**Think about future filings**—Companies should discuss letters received shortly before it is planning to file a registration statement with its auditors and counsel to determine if there are any implications on the content and timing of the registration statement. Questions about timing can also be discussed with the SEC staff as well as the possibility of an expedited review of the company's response.

**Ask the SEC staff**—Companies can call the SEC staff if they do not understand the comment. The objective should not be for the company to explain their position, but to gain clarification when a comment or aspects of the comment are unclear.

**Remember that comments become public**—Comments become part of the public domain once submitted and resolved. Comments and the related responses are posted to the SEC's website no earlier than 20 days after the review is completed or the registration statement is declared effective. Even those comment letters related to Emerging Growth Companies that have filed confidentially eventually are made public. CorpFin will redact any information subject to a Rule 83 confidential treatment request without evaluating the substance of that request.

**Don't rely solely on precedent**—The use of previous comments and responses of other companies may be helpful in responding but should not be the primary basis of the response. Each comment is based on specific facts and circumstances and may involve different levels of materiality. Accordingly, the reason the staff accepted a response for one company may not be applicable in another situation. Make sure the response is appropriate based on the company's specific facts and applicable accounting literature.

**Address the intent of the question**—Consider, if possible, the objective of the SEC staff comment. Sometimes providing a complete answer that addresses the intent of the question can stave off future comments.

**Provide planned disclosures**—Many comments will request additional disclosure in future filings. To ensure there is a meeting of the minds, provide the SEC staff with a draft of the applicable disclosure, even if the data used is from a prior period. This will allow the SEC staff to assess whether the narrative sufficiently addresses their comment and may prevent future comments on the same disclosure.

The company or its representatives should feel free to involve the SEC's Office of the Chief Accountant (OCA) (distinct from CorpFin's Office of Chief Accountant) at any stage in this process. Generally, OCA addresses questions concerning the application of GAAP while CorpFin resolves matters concerning the age, form, and content of financial statements required to be included in a filing.

## **Closing a Filing Review**

When a company has resolved all SEC staff comments on an Exchange Act registration statement, a periodic or current report, or a preliminary proxy statement, CorpFin provides the company with a letter to confirm that its review of the filing is complete.

When a company has resolved all SEC staff comments on a Securities Act registration statement, the company may request that the SEC declare the registration statement effective so that it can proceed with the transaction.

A more detailed discussion of the filing review process used by the Division of Corporate Finance can be found on the SEC's website at

<http://www.sec.gov/divisions/corpfin/cffilingreview.htm>.



# Overview

This publication includes an analysis of comments published by the SEC staff from October 1, 2013 to September 30, 2014, relating to Form 10-K and Form 10-Q filings of R&C registrants<sup>1</sup>. The comment letter themes provide insights into key areas of focus of the SEC staff for registrants to consider as they prepare for their year-end annual financial reporting. The comments are primarily in areas applicable to all industries and are not necessarily unique to this sector. That said, we have found that sometimes the details of the comments within the broad categories may include industry-specific considerations, which are highlighted where applicable.

The total number of first round comments received by R&C registrants during this period (nearly 1,343 total comments) increased 5% from the same period in the previous year. However, both accelerated and non-accelerated filers (representing 20% and 32% of the total comments, respectively) each experienced a decline in the number of comments by approximately 15%. This decline was more than offset by increases in comments issued to smaller reporting companies and non-accelerated filers. Smaller reporting companies represented 39% of the comments in 2014 and experienced an increase in comments of 31% over the comparative period. Comments issued to non-accelerated filers nearly doubled, representing 9% of the comments in 2014.

The 2014 comment letter “hot topics” are generally consistent with those noted in our 2013 publication. Consistent with the prior year, the top two areas of comment were related to MD&A and compliance. Segments and controls and procedures saw relative increases in the number of comments. Impairments, which was previously the fourth most frequent comment topic, fell out of the top ten. Comments on executive compensation increased during the 2014 comment letter cycle, re-emerging on the top 10 list.

<sup>1</sup> The population of comments was analyzed based on the following SIC codes indicated on the SEC EDGAR website:

Retail: 3942-3950, 5000, 5010, 5013, 5020, 5040-5047, 5063-5099, 5130-5150, 5190, 5311-5412, 5600-5661, 5700-5735, 5810, 5812, 5900-5990, 7600

Consumer Products: 100, 200, 700, 2000-2090, 2111, 2200-2273, 2300-2390, 2510-2531, 2590, 2670, 2840-2844, 3021, 3100-3140, 3420, 3630, 3634, 3651, 3652, 3873, 3910-3931

The following table summarizes the top ten “hot topics”.

2014 Rank	Nature of comment	2014 %	2013 Rank
1	Management's discussion and analysis (MD&A)	23%	1
2	Compliance	13%	2
3	Segments	7%	3
4	Controls and procedures	5%	9
5	Income taxes	4%	6
6	Business information and risk factors	4%	5
7	Acquisitions and divestitures	3%	7
8	Revenue recognition and related areas	3%	8
9	Loss contingencies	2%	10
10	Executive compensation	2%	n/a

Consumer Product companies received more comments than in the prior period, representing over 70% of the total comments issued compared to approximately 55% in the comparative period.

The top five list for Retail companies and Consumer Product companies was generally the same; however, Consumer Product companies received comments on internal control more frequently than Retail companies. Retail companies, in contrast, received comments on income taxes more frequently than Consumer Product companies.

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# Management's Discussion and Analysis

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is a critical component of registrants' communications with investors and continues to be the top area for comment by the SEC staff in 2014. The key objectives of MD&A are to provide a narrative explanation of the financial statements that enables investors to see the company through the eyes of management, to offer context to the financial statements, and to provide information that allows investors to assess the likelihood that past performance is indicative of future performance. We have found that the majority of SEC staff comments in this area are not aimed at meeting specific technical requirements, but rather at enhancing the quality of disclosures to meet these objectives.

The requirements themselves are set forth in Item 303 of Regulation S-K, which identifies five categories of disclosure in MD&A: liquidity, capital resources, results of operations, off-balance-sheet arrangements, and contractual obligations. Additional guidance is also contained in Financial Reporting Release (FRR) 36 and FRR 72.

More recently, following the release of its December 2013 Report on Review of Disclosure Requirements in Regulation S-K mandated by the JOBS Act, the SEC has indicated that the Division of Corporation Finance will pursue a project to develop recommendations focused on improving and streamlining disclosure requirements. This project may reduce the costs and burdens on companies and eliminate duplicative disclosures in MD&A, but may also identify opportunities to increase the transparency of information, which may lead to new requirements.

The comment letter process has reinforced the well-established MD&A objectives that disclosures should be: 1) transparent in providing relevant information, 2) tailored to the company's facts and circumstances, 3) consistent with the financial statements and other public communications, and 4) comprehensive in addressing the many business risks that exist in today's economic environment. Results of operations, liquidity, and capital resources are the three areas of MD&A that received the most attention in SEC comment letters relative to these objectives. We have provided relevant examples of comments issued in each of these areas.

## Results of operations

SEC staff comments have reminded registrants that the results of operations section should provide readers with a clear understanding of the significant components of revenues and expenses and events that have resulted in or are likely to cause a material change in the relationship between costs and revenues.

The SEC staff has frequently issued comments specifying that MD&A should not simply repeat information provided elsewhere in the filing; rather, it should explain the underlying drivers behind changes in the financial position, results of operations and cash flows of registrants. Registrants are asked to quantify the impacts that such factors have had, especially when the performance of an item has been impacted by multiple factors.

General observations on the population of SEC staff comments include the following:

**Drivers behind fluctuations:** Many comments relate to improving registrants' disclosures of significant fluctuations between periods, including pricing, volume, the impact of acquisitions, and currency movements. The SEC staff has asked for more detailed descriptions related to the specific factors driving such fluctuations and for registrants to quantify each factor separately, even when they net to an insignificant change overall.

**Segment discussion:** SEC staff comments have also encouraged the use of a segment analysis if such analysis would provide readers with a more in-depth understanding of the consolidated results. The segment analysis may be integrated with the discussion of the consolidated results to avoid unnecessary duplication.

**Disclosing known trends:** The SEC staff has asked registrants to disclose known trends affecting the business, in particular, disclosure of events that have occurred and how those events were a positive or negative indicator of future performance. Examples include loss of a significant customer, development of new products that might increase future revenues or reduce costs, entering a new market, or an acquisition that is expected to impact operating results.

**Consistency of information:** The SEC staff has been known to review public information for consistency with the information included in a registrant's periodic

## Management's discussion and analysis

filings. When management discusses events or trends on earnings calls, social media channels, or the company's website, the SEC staff may question why such events are not also addressed in MD&A.

When key performance indicators (KPIs) are reported, the SEC staff has issued comments asking registrants to disclose how such KPIs were determined. The number of SEC staff comments relating to how e-commerce results affect KPIs, such as comparable store sales (also referred to as "same-store sales") for retail companies, has increased. There is diversity in practice in how registrants present e-commerce results and KPIs. The presentation depends on each registrant's own specific facts and circumstances, including the significance of e-commerce sales, how that business is managed, and how e-commerce sales are fulfilled. In recent comment letters, the SEC staff frequently asked registrants to disclose whether e-commerce results were included in KPIs, such as comparable store sales, and at times requested that registrants disclose comparable sales data for e-commerce and other sales channels separately. Also, as shown in the sample comments below, comparable store sales is a key R&C measure for which SEC staff frequently asked for clarification.

*The SEC has frequently asked R&C registrants to disclose whether e-commerce results were included in key performance indicators.*

### Sample comments

- 1) We note that your MD&A section is overly brief and does not present all of the information required under Item 303 of Regulation S-K. In future filings, you should provide more analysis of the disclosure you are currently providing. For example, discuss the reasons for the increases or decreases in operating expenses and address the material changes in line items under the "Expenses" section, including general and administrative, professional fees and in-process research and development. Rather than simply repeat information that is contained in the financial statements, you should provide an analysis and narrative disclosure throughout your MD&A section so that investors understand the company's business model and future plans in the context of the financial information provided in this section.
- 2) Please provide a discussion of the extent to which changes in your revenues are attributable to changes in price and changes in volume. Although you disclose the percentage change in prices and volume sold, you do not quantify the dollar impact of those changes between periods. We also note that you disclose same store sales changes by major product category. To provide your investors with a better understanding of the underlying drivers of changes in your results, where same store sales for a particular product category changed significantly between periods, please disclose management's insight into the reasons for such a change.
- 3) Disclosure in various parts of your filing indicates that you have made material acquisitions during each of the periods reported in your 10-K. However, your MD&A does not appear to include clear, consistent discussion of the impact of these acquisitions on your reported results of operations. Revise the disclosure throughout your MD&A to provide this information. See Item 303(a)(3)(i) of Regulation S-K.
- 4) Please confirm that you will revise your disclosure in the future filings to disclose your definition of same store sales and comparable direct sales and how these metrics relate to comparable sales.
- 5) To the extent direct-to-consumer sales had a material effect on your comparable store sales or on any change in trends of this metric please confirm that you will present this key performance indicator in a manner that either separately quantifies the direct-to-consumer activity or provides transparent disclosure regarding the impact of direct-to-consumer sales on this metric.
- 6) Please tell us what considerations you have given to providing a breakout of your retail sales both with and without online sales. If online sales are included in comparable store sales and have a measurable effect on changes in your comparable store sales, please revise your Management's Discussion and Analysis of Financial Condition and Results of Operations to include a discussion excluding online sales for each of the periods presented, or alternatively, separately quantify the online activity included in comparable store sales for each period presented in future filings.

## Liquidity and Capital resources

A key objective of the liquidity and capital resources discussion is to provide a clear picture of the registrant's ability to generate cash and to meet existing known or reasonably likely future cash requirements. The SEC staff expects the liquidity and capital resources discussion to address material cash requirements, sources and uses of cash, and material trends and uncertainties related to a registrant's ability to use its capital resources to satisfy its obligations. General observations from our analysis of SEC staff comments include the following:

**Disclosure of events impacting liquidity:** The SEC staff has asked registrants to discuss known trends, events, or uncertainties that are reasonably likely to impact future liquidity. Such events could include entry into material commitments, loss of customers or contracts, treasury stock repurchase programs, or plans for significant capital expenditures.

**Cash flow analysis:** One of the common criticisms in the liquidity analysis is when registrants simply repeat information readily found on the face of the statement of cash flows. Instead, registrants are expected to disclose the underlying factors driving changes in operating assets and liabilities and the related cash flows.

**Debt agreements and related covenants:** Comments from the SEC staff have requested expanded disclosure of the material terms of debt agreements, including an indication of compliance with financial covenants. In situations where there has been or is projected to be a violation with regard to covenant compliance, registrants should provide a detailed description of the covenants, the target and actual covenant measures for the most recent reporting period, and an indication of the sensitivity of those measurements, if applicable.

**Stranded cash:** For companies with foreign operations, the SEC staff has focused on the registrant's ability to repatriate cash to the United States in order to meet significant upcoming obligations, such as debt repayments or mandatory pension contributions. Comments have focused on the relationship between liquidity needs and the income tax assertion about management's intent to permanently reinvest foreign earnings. The SEC staff has also asked companies to quantify the amount of cash held overseas and the amount of incremental deferred tax, if any, that would be recorded if cash were to be repatriated.

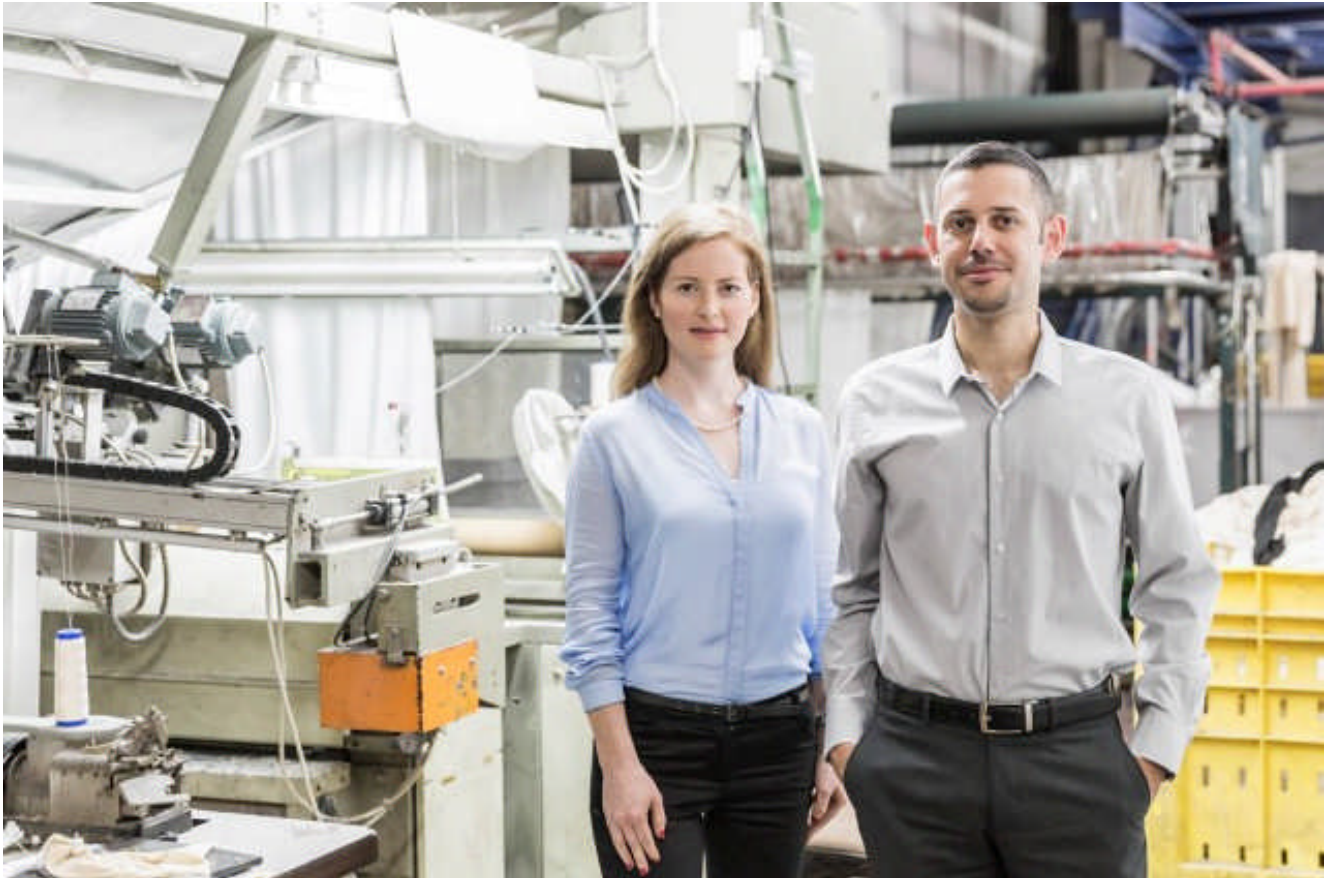
## Sample comments

- 1) Please identify and discuss any known trends, demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in your liquidity increasing or decreasing in any material way. In this regard, we note your disclosure that your long-term indebtedness has steadily increased and has more than doubled since 2009. Please refer to Item 303(a)(1) of Regulation S-K.
- 2) In future filings, please provide a more informative analysis and discussion of changes in operating cash flows, including changes in working capital components, for each period presented. In doing so, please explain the underlying reasons for and implications of material changes between periods to provide investors with an understanding of trends and variability in cash flows. Please ensure your discussion and analysis is not merely a recitation of changes evident from the financial statements. Refer to Item 303(a) of Regulation S-K.
- 3) Please revise your analysis of liquidity to discuss your coverage ratio. As part of your analysis, please provide your insights into the factors that caused this coverage ratio to vary giving due effect to the variability in cash flow of your assets across the three-year period presented. In your response, please show us what your revised disclosure will look like.
- 4) We note your disclosure that as of the end of the period you were in compliance with all financial covenants of the Senior Secured Notes. We also note that you exceeded the indebtedness ratio which restricted your ability to pay dividends. Please explain if the indebtedness ratio is an aspect of the financial covenants and if so how exceeding it did not result in non-compliance of the covenants.
- 5) Given your significant foreign operations, please enhance your liquidity disclosure to address the following:
  - Disclose the amount of cash and cash equivalents held by foreign subsidiaries as compared to your total amount of cash and cash equivalents as of December 31, 2012. To the extent that one jurisdiction holds a material portion of cash and cash equivalents, please disclose this fact along with the amount.



### *Management's discussion and analysis*

- Disclose the nature and extent of any legal or economic restrictions on the ability of your subsidiaries to transfer funds to you in the form of cash dividends, loans or advances and the impact such restrictions have had or are expected to have on your ability to meet cash obligations.



# Non-GAAP measures

Companies often supplement their GAAP financial information with non-GAAP information that is intended to provide additional insight into the financial performance of the business. A non-GAAP financial measure is a numerical measure that adjusts the most directly comparable measure determined in accordance with GAAP. Such measures provide supplemental information regarding a company's historical or future financial position, operating performance, cash flows, or liquidity. They generally convey changes to the business that are organic separate from those that may be considered unusual, infrequent, or not representative of underlying trends. Common non-GAAP financial measures in the R&C industry include earnings before interest, taxes, depreciation and amortization (EBITDA), adjusted EBITDA, funds from operations, adjusted earnings or adjusted earnings per share, and net debt.

A company has flexibility in which non-GAAP financial measures it chooses to report, if any, and how it calculates such metrics, subject to certain prohibitions. Therefore, a limitation inherent in non-GAAP financial measures is that they are subjective and may not be comparable to similarly titled non-GAAP financial measures used by other companies, including peers.

When non-GAAP financial information is presented in periodic reports filed with the SEC, registrants are required by Item 10(e) of Regulation S-K to include:

- The reasons why management believes that the non-GAAP measure is relevant to investors
- The additional purposes, if any, for which management uses the non-GAAP measure
- The most directly comparable GAAP financial measure with equal or greater prominence to facilitate comparability among other registrants
- A reconciliation to the comparable GAAP measure

Regulation G requires a similar reconciliation between the non-GAAP measure and the most comparable financial measure calculated in accordance with GAAP, and is applicable to all public disclosures of non-GAAP measures.

Below are some of the circumstances that generated comment letters reviewed in our analysis:

- Use of misleading terminology that implies a non-GAAP measure is a standard measure, e.g., a measure that includes adjustments to the standard definition of EBITDA should not be labeled "EBITDA"
- Inappropriate use of a non-GAAP measure that excludes normal cash expenses necessary to operate the business, e.g., advertising costs or salaries
- Presentation of a non-GAAP liquidity measures that omit items which are cash-settled
- Giving greater prominence to non-GAAP results over GAAP results
- Use of "infrequent," "unusual," or "non-recurring" adjustments to create non-GAAP measures when such adjustments have previously recurred or are reasonably likely to recur

*When evaluating whether and how to disclose non-GAAP measures, registrants should ensure that they understand and adhere to the applicable rules.*

## Sample comments

- 1) Within your reconciliation of net income to Adjusted EBITDA, you have included a line item referred to as "Non-recurring items. Item 10(e) of Regulation S-K prohibits adjusting a non-GAAP financial performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. Please revise or tell us why you believe referring to these items as "non-recurring items" is in accordance with Item 10(e) of Regulation S-K.

## *Non-GAAP measures*

- 2) We note your results of operations discussion discloses numerous non-GAAP measures such as underlying EBITDA, underlying net income attributable to the company from continuing operations, underlying pre-tax income/loss, underlying effective tax rate and underlying Free Cash Flow. Please tell us how you considered the following disclosure requirements of Item 10(e) of Regulation S-K for non-GAAP measures: A statement disclosing the reasons why management believes the presentation of these non-GAAP

measures provides useful information to investors regarding the registrant's financial condition and results of operations; A statement disclosing the additional purposes, if any, for which management uses these non-GAAP measures; and disclosure addressing whether the presentation of these non-GAAP measures is balanced and provides equal or greater prominence, of the most directly comparable GAAP measure. Please also provide us draft disclosures to be included in future filings.



# Compliance

When preparing financial statements, registrants must be diligent in ensuring transactions and disclosures are appropriately reflected in the financial statements. Another equally important item, that is sometimes overlooked, is compliance with the instructions for Form 10-K and Form 10-Q, particularly related to signatures, certifications, and exhibits, as well as the appropriate inclusion of any required consents (such as those from the independent registered public accounting firm and from other named third party experts). Regulation S-T outlines the general rules and regulations for electronic filings, while Regulation S-K (primarily Item 601) outlines requirements specific to filings under the Securities Act of 1933 (“Securities Act”) and Securities Exchange Act of 1934 (“Exchange Act”). In comment letters, the SEC staff often requested amendments to filings that did not include the required signatures (in typed form) or did not include all required exhibits, such as material contracts. In the 2014 comment letter cycle, slightly more than half of the comments in this area were received by smaller reporting companies, with approximately 25% received by large accelerated filers.

As registrants prepare their financial statements, management should revisit the guidance referred to above to ensure compliance with the relevant requirements. Comments received in this category primarily related to:

- Omission of signatures of officers
- Departures from language included in the certifications for the principal executive officer and principal financial officer as required by Sections 302 and 906 of the Sarbanes-Oxley Act and as outlined in Regulation S-K Item 601(b)(31)
- Omission of exhibits and appendices required to be included and referenced within the filing (primarily focused on exhibits for material contracts as required by Regulation S-K, Item 601(b)(10) and for consents of named third party experts as required by Regulation S-X Item 601(b)(23))

## Sample comments

- 1) We note that Form 10-K did not include the signatures of your principal executive officer, your principal financial officer and your controller or principal accounting officer on behalf of the registrant in the second signature block as required by General Instruction D(2)(a) and (b) of Form 10-K. In future filings, please revise to include the signatures of your principal executive officer, your principal financial officer and your controller or principal accounting in the second signature block. Please note that any person who occupies more than one of the specified positions shall indicate each capacity in which he or she signs the report on behalf of the registrant in the second signature block. Please refer to general instruction D.2. of Form 10-K.
- 2) We note that the certifications required by Exchange Act Rule 15d-14(a), filed as Exhibits 31.1 and 31.2, appear to have omitted required language in the introductory portion of paragraph 4 and the entirety of paragraph 4(b) concerning internal control over financial reporting pursuant to Item 601(b)(31)(i) of Regulation S-K. Please provide us with your basis for filing these modified certifications or file an amendment to your Form 10-K to include complete certifications. Please also amend the two subsequently filed quarterly reports on Form 10-Q accordingly.
- 3) Please note that Item 15 of Form 10-K requires you to file the exhibits required by Item 601 of Regulation S-K. With the exception of the certifications required by Item 601(b)(31) and (32), you have not filed any of the required exhibits, such as the following: Articles of incorporation; Bylaws; Subsidiaries of the registrant; and Material contracts. Please file all the required exhibits, or as applicable incorporate them by reference, and provide an exhibit index in an amendment to your Form 10-K.

*While compliance matters do not typically require significant effort to remediate, they may require an amended filing.*



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# Segment reporting

The purpose of segment disclosures is to provide investors with the ability to see the company through the eyes of management. In particular, it usually allows investors to obtain information about a company at a disaggregated level. Segment reporting continues to be a hot topic for comment letters across all industries, including the R&C industry. The most common comments issued by the SEC staff have been on the proper identification of operating segments and the aggregation of operating segments into reportable segments.

It is not unusual for the SEC staff to request documentation supporting the registrant's identification of operating segments. The SEC staff has often asked issuers to submit the information given to the chief operating decision maker (CODM) to allow the SEC staff to consider whether the information is consistent with the registrant's identification of its segments (particularly when a company reports only one segment). In addition, the SEC staff reviews publicly available information to identify inconsistencies in how the segment disclosure is presented. For example, the SEC staff may listen to a registrant's earnings calls, read press releases and investor presentations, and review information on a company's website to identify inconsistencies.

The SEC staff has also challenged registrants to explain how the operating segments meet the "economic similarities" criterion for purposes of aggregation. Comment letters may request information from registrants to demonstrate that the operating segments exhibit similar long-term financial performance, sometimes requesting an analysis of the historical gross margins for each operating segment.

The FASB and SEC have both suggested that segment reporting may warrant updating given changes in technology and how information can be accessed and used. Until and unless changes are made, registrants should assess their segments based on the existing standard, and continually reassess their segment conclusions, especially when there is a change in the registrant's business and management reporting structure.

Specific to the R&C sector, we have also noted an increase in SEC staff comments in 2014 related to the

entity-wide disclosure requirements specified by ASC 820, including revenues by product or service, net sales by geographic location, information about major customers, and material long-lived assets by geographic location. The SEC staff comments focused on omitted disclosures or inconsistencies between the financial statement footnote disclosure and information provided outside of the financial statements.

## Sample comments

- 1) Please identify your CODM and explain your rationale in identifying the CODM as an individual or group with details sufficient to understand how your approach is consistent with FASB ASC 280-10-50-5 through 280-10-50-9. Please also submit an organizational chart which shows the individuals responsible for making resource allocation decisions and assessing performance of your business units; and your internal reporting structure.
- 2) Please submit a copy of the reports, schedules and information packages provided to the CODM covering all business activities and operating results plus any additional reports, schedules or other information upon which the CODM may have relied in making resource allocation decisions and assessing performance. Please also submit a copy of all additional information provided to your board of directors covering business activities and operating results which was not also provided to your CODM, and explain how your identification of operating segments has properly considered this information in accordance with FASB ASC 280-10-50-6.
- 3) We note your disclosure that you have two operating segments, Indirect and Direct. It appears to us through your disclosures in this filing that you may analyze components of your Direct Segment at a disaggregated level (i.e., e-commerce, full-price stores, outlet stores). Please tell us how you considered the guidance in FASB ASC 280-10-50 in determining that all revenue-generating activities in the Direct segment represent one operating segment.

### *Segment reporting*

- 4) We note that your supplemental materials reveal differences in EBIT CAGR, EBIT margin percentages, and EBIT growth percentages, comparing your various operating segments on both a historical and forward looking basis. We would like to understand how you determined that the factors underlying these differences do not represent dissimilarities between the economic characteristics and attributes of your operating segments and would not therefore preclude aggregation, as discussed in FASB ASC 280-10-50-11. Accordingly, please tell us the specific reasons for the differences in these EBIT related metrics and explain how you considered these differences as part of your aggregation analysis.
- 5) You disclose your operations are largely concentrated in the United States and Canada. Foreign operations appear to comprise 28% of your pretax income from continuing operations. Please disclose in future filings the amounts of your revenues and long-lived assets that are domestic and foreign in the format required by ASC 280-10-50-41. Please provide us your proposed disclosures.



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## Controls and procedures

We have heard various members of the SEC staff signal that internal control over financial reporting (ICFR) is an area of increasing interest. At the 2013 AICPA National Conference on Current SEC and PCAOB Developments, several presenters noted that as part of the comment letter process, the SEC staff is looking for potential indicators of material weaknesses, such as corrections of an error or disclosures regarding material changes in internal controls. Presenters also commented that the SEC staff may be interested in a registrant's conclusions regarding ICFR in instances where they do not agree with a registrant's conclusion on an accounting matter. This focus on ICFR has continued to be mentioned in the months since the conference, and we expect it to be discussed again at the 2014 conference. We have begun to see an increasing volume of comments in this area. Registrants should continue to carefully evaluate the ICFR and disclosure controls and procedures (DC&P) implications in responses to the SEC staff and the sufficiency of their disclosures, assessments, and certifications. The SEC staff's comments have increasingly challenged registrants' conclusions regarding the existence or severity of internal control deficiencies.

While the SEC staff is likely to question why a restatement did not result in the reporting of a material weakness, we have also seen comments about the existence of material weaknesses when errors are corrected by means of revision of comparative financial statements.

Companies sometimes assess control deficiencies with a priority focus on the Control Activities component of COSO. It is important to evaluate the implications of control deficiencies on all COSO components. The SEC staff has asked for additional information about the company's consideration of specific components within the COSO framework.

The SEC staff has also questioned registrants when there is no explicit conclusion about the effectiveness of DC&P or when management has concluded that ICFR is ineffective but DC&P is effective. Under Rule 13a-15(b) of the Exchange Act, the registrant's management must evaluate the effectiveness of DC&P as of the end of each fiscal quarter. This evaluation includes assessing the controls and other procedures designed to ensure that information required to be disclosed by the registrant in its filings is recorded, processed, summarized, and reported, within the time

periods specified in the SEC's rules and forms. Although separately assessed, it is important to remember that there is substantial overlap between the processes considered part of DC&P and those considered part of ICFR. Nearly all of ICFR falls within the scope of DC&P, whereas there are aspects of DC&P that extend beyond what is considered part of ICFR. Because of this overlap in scope, it is rare that a material weakness in ICFR would not also result in DC&P being considered ineffective.

Item 308 of Regulation S-K requires registrants to disclose any change in the company's ICFR that has materially affected, or is reasonably likely to materially affect, the registrant's ICFR each quarter. Changes requiring disclosure include changes in internal control made in the process of remediating previously identified material weaknesses, as a result of the integration of significant acquisitions, or due to the implementation of new information technology systems. The SEC staff often looks to information contained in companies' current reports, on their websites, and in other sources to identify potential changes in ICFR. SEC staff comments in this area have focused on the timeliness and completeness of the disclosures in periodic filings.

If a registrant has identified one or more material weaknesses in its internal control over financial reporting, the SEC staff may ask that the registrant include a risk factor (in accordance with Item 503(c) of Regulation S-K) to explain the potential adverse effects resulting from these circumstances and how it could impact the company's financial reporting, results of operations and market value.

### *Sample comments*

- 1) It appears that your control structure failed, in either design or execution, to prevent an error from being detected before resulting in a material restatement. It remains unclear whether there were no controls in place that would have prevented such an error, or if the controls in place failed. Please clarify. Further, because the control failure resulted in a material restatement, it is unclear why you believe the related weakness is not material. Please explain.
- 2) We continue to question your evaluation of the deficiencies in ICFR and your determination that it was not reasonably possible that a material misstatement of your financial statements would

## ***Controls and procedures***

not be prevented or detected on a timely basis as a result of certain control deficiencies.

- 3) Tell us why the severity is limited to the specific, individual process-level errors you describe in your response and how you determined that the reasonably possible potential error for each is limited to the various errors identified. For example, how was it determined that the significant deficiency is limited to only being manifested through an immaterial error in a specific type of revenue transaction?
- 4) Please describe in greater detail how you considered the numerous deficiencies in evaluating the monitoring and risk assessment components of COSO. Specifically, we continue to question whether one or more deficiencies exist in the risk assessment or monitoring component and whether one or more such unidentified deficiencies represent a material weakness.
- 5) In light of the ineffectiveness of your internal controls over financial reporting at June 30, 2013, it is unclear to us how you determined that your disclosure controls and procedures were effective. Please explain.
- 6) Exchange Act Rule 13a-15(b) or 15d-15(b) requires that management evaluate, with the participation of the principal executive and principal financial officers, the effectiveness of disclosure controls and procedure as of the end of each fiscal quarter. Please revise to disclose that your principal executive and financial officer participated in the evaluation. Item 308(a) of Regulation S-K.
- 7) We see you assessed your disclosure controls and procedures as of December 31, 2012 as "not effective" due to the material weakness that resulted in the restatement of your financial statements. Subsequently, you conclude that as of March 31, 2013, disclosures controls and procedures are effective and state that there have been no changes in internal control over financial reporting in the fiscal quarter ended March 31, 2013. Please tell us how disclosure controls and procedures are now effective at March 31, 2013 without any changes in internal control over financial reporting. Please also reconcile the statement that there were no changes in internal control over financial reporting in the quarter ended March 31, 2013 with the disclosure of the remediation efforts to address the material weakness subsequent to year-end in your Form 10-K.
- 8) In light of the disclosure regarding disclosure controls and procedures in your quarterly reports, please revise this section to provide a risk factor to alert investors to your ineffective controls and procedures. The risk factor should disclose all material risks resulting from these circumstances. In this regard, consider addressing the risk to the Company if it is unable to adequately correct any material weaknesses in its internal controls and procedures. Alternatively, if you have determined that a risk factor is unnecessary, tell us the basis for your conclusion.



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# Income taxes

The accounting for income taxes, including related disclosure requirements, is often complex and involves significant judgment. SEC staff comments have focused on disaggregation in the income tax provision disclosures, additional detail related to the determination of the valuation allowance, including foreshadowing release of such allowances when necessary, as well as the sufficiency and consistency of indefinite reinvestment disclosures.

## Income tax provision disclosures

Comments frequently ask registrants to enhance their disclosure of how the results of operations are impacted by having proportionally higher or lower earnings in jurisdictions with different tax rates and the extent to which foreign effective tax rates differ from the domestic rate.

The SEC staff also issued comments when it was unclear whether the registrant's effective tax rate reconciliation included each item that exceeded five percent of income tax expense calculated using the applicable statutory tax rate (as required by ASC 740-10-50-12 and Rule 4-08(h) of Regulation S-X).

### Sample comments

- 1) Please revise to disclose the foreign and domestic components of your income before taxes for each period presented in your consolidated statements of operations. Refer to the guidance outlined in Rule 4-08(h) of Regulation S-X.
- 2) To the extent material pre-tax income is attributed to a country or countries with a significantly low tax rate, we believe that fact should be disclosed in accordance with Item 303(a)(3)(i) of Regulation S-K. You should also discuss the relationship between domestic and foreign effective tax rates in greater detail. It appears that separately discussing foreign effective income tax rates may be material to an understanding of your business. Please provide us with a draft of the disclosures you intend to provide in future filings.

## Valuation allowances

The SEC staff continued to scrutinize registrants' assessments of the realizability of deferred tax assets. These assessments involve significant judgment. In comment letters, the SEC staff has asked registrants to explain the nature and weight of the positive and negative evidence considered. When significant changes occurred in the realizability of deferred tax assets, comments often asked registrants to explain the circumstance that lead to the change in the valuation allowance and to justify the timing of when the change was recorded. When changes in circumstances impacting the realizability of net deferred tax assets can be foreseen, registrants should consider foreshadowing disclosures in periods preceding the change.

### Sample comments

- 1) Your disclosures indicate that you have recorded domestic cumulative losses for the last three years. You have not recorded a valuation allowance on your deferred tax assets recorded for domestic federal net operating losses as you believe that the forecasted future taxable income and certain tax planning opportunities eliminate the need for any valuation allowance. Please expand your disclosures to provide additional insight on how you determined it is more likely than not that you will realize these domestic deferred tax assets. Please address the following in your disclosures: Please discuss the nature of the positive and negative evidence that you considered, how that evidence was weighted, and how that evidence led you to determine it was not appropriate to record a valuation allowance on these deferred income tax assets. You should consider discussing the significant estimates and assumptions used in your analysis; Please disclose the amount of pre-tax income that you need to generate to realize the deferred tax assets; Please include an explanation of the anticipated future trends included in your projections of future taxable income; Please provide additional clarity regarding the nature of the tax planning opportunities you are relying upon; and Please disclose that the deferred tax liabilities you are relying on in your assessment of the realizability of your deferred tax assets will reverse in the same period and jurisdiction and are of the same character as the temporary differences giving rise to the deferred tax assets.

## Income taxes

- 2) Please expand your disclosures to provide additional insight into how you determined the amount of the valuation allowance to record. In this regard, please consider each of the following points in your disclosures: Please expand your discussion of the positive and negative evidence that you considered, how that evidence was weighted, and how that evidence led you to determine it was appropriate to record a partial valuation allowance on the deferred income tax assets. Please explain how you determined that no valuation allowance was required for the remaining deferred tax assets at March 31, 2013. Please include a discussion of the anticipated future trends included in your projections of future taxable income as of March 31, 2013.



## Indefinite reinvestment assertion and related liquidity disclosures

The SEC staff has frequently asked registrants to explain the factors supporting their indefinite reinvestment assertion, including a description of their plans for reinvestment in each foreign jurisdiction. In addition, the SEC staff reminded registrants that when an indefinite reinvestment assertion is made, ASC 740-30-50 requires disclosure of the amount of the unrecognized deferred tax liability on undistributed earnings of foreign subsidiaries, or a statement that such determination is not practicable.

The interplay between a registrant's indefinite reinvestment assertion and liquidity has continued to be an area of SEC staff comment. Registrants have been asked to disclose the amount of cash and cash equivalents in jurisdictions with an indefinite reinvestment assertion, the potential tax consequence of repatriation, and a description of events that may cause such foreign earnings to become taxable. The SEC staff has indicated that highlighting the amount of cash that may not be available to fund domestic operations or obligations without paying a significant amount of taxes upon repatriation is an important element of transparent liquidity disclosures.

### Sample comments

- 1) If material, please disclose the balance of cash and short-term investments held by foreign subsidiaries, state that you would need to accrue and pay taxes if the foreign balances were repatriated and state whether you intend to repatriate any portion of the cash held by foreign subsidiaries. Please provide us with a draft of the disclosures you intend to provide in future filings.
- 2) We note your disclosure that you generally intend to indefinitely reinvest your non-U.S. earnings in foreign subsidiaries. To assist investors in understanding the availability of funds in U.S. operations, please confirm that in future Exchange Act filings you will disclose the following: the amount of cash and cash equivalents that are currently held by your foreign subsidiaries; if foreign earnings are repatriated, disclose that these amounts would be subject to income tax liabilities both in the US and in the various foreign countries; and explain any other implications or restrictions upon your liquidity that is impacted by significant of your cash, cash equivalents and short term investments held by foreign subsidiaries.

# Business information and risk factors

The business environment has become increasingly complex and, as a result, the number of risks registrants have to manage has also increased. During the current year comment letter cycle, there was an increase in the number of SEC staff comments focused on the level of disclosure around registrants' business operations and the completeness of the associated risk factors. Registrants should carefully consider whether their business description and risk factors disclosures are complete and transparent.

## Business information

Registrants are required by Item 101 of Regulation S-K to provide information about their business, including products and product development, raw materials, supplier relationships, intellectual property, seasonality, concentration of customers, competition, and financial information about segments and geographic areas, among other items. SEC staff comments during the 2014 comment letter cycle were centered on incomplete and unclear disclosures. Registrants should review the requirements of S-K Item 101 to ensure they have addressed all of the required disclosures and ensure that the disclosures are sufficiently detailed and transparent.

### Sample comments

- 1) Please provide a description of industry conditions and your competitive position within the industry. Please see Item 101(h)(4)(iv) of Regulation S-K.
- 2) Please disclose the following information for each of your properties: The nature of your ownership or other interest in the property. A description of all interests in your properties, including the terms of all underlying agreements and royalties.

- 3) Please advise what current licenses you have obtained and how these licenses impact your operations.

## Risk factors

Registrants are required by Item 503(c) of Regulation S-K to provide a description of significant risk factors within Item 1A of the Form 10-K. SEC staff comments indicated that registrants should avoid overly broad and boilerplate disclosure and provide more specific information on the actual risks affecting the registrant. Registrants should also address market risks, including credit and interest risks, in Item 7A of the Form 10-K.

### Sample comments

- 1) Please add a risk factor to your disclosure discussing the risks you are exposed to from currency rate changes.
- 2) Please add a risk factor to your disclosure discussing the risks you are exposed to from competition.
- 3) Please add a risk discussing the current weakening of the European economy and its potential impact on your financial condition.
- 4) In future filings, please ensure that the caption of each risk factor adequately describes the risk, and that each risk factor presents a material risk currently impacting your business. In this regard, risks such as "Risks Related to the Economy;" "Risks Related to Technology;" and "Risks Related to Competition" appear to discuss risks that could apply to any company.

*Comments indicated that registrants should avoid overly broad and boilerplate disclosure and provide more specific information on the actual risks affecting the registrant.*

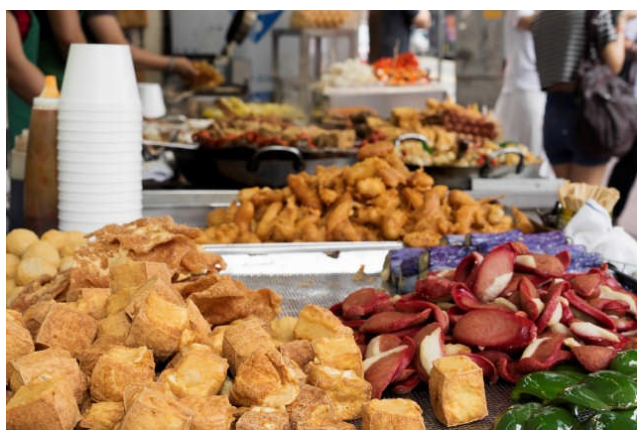
# Business combinations

Acquisition-related accounting and disclosure requirements can be complex, and can vary based on the nature of the transaction and the nature of the assets acquired and liabilities assumed. As companies continue to seek growth opportunities through acquisitions, the SEC staff continues to comment on various acquisition accounting and disclosure items.

ASC 805, *Business Combinations*, requires extensive disclosures to enable users to evaluate the nature and financial effects of a business combination. Companies should carefully consider all of the disclosure guidance in preparing financial statements, both in the period of the acquisition and in subsequent periods.

For companies in the R&C industry, the SEC staff comments have focused on both the accounting and disclosure requirements of ASC 805, including:

- Questions about how fair value was determined and the key assumptions used
- The reasons for significant adjustments to the initial fair values and the reasons why such information was not available at an earlier date
- How goodwill was allocated to reporting units and the interplay with the company's operating segments disclosures
- How the company evaluated whether the acquired set of assets and activities represented an asset or business



## Sample comments

- 1) We note that during the quarter, the Company recorded a measurement period adjustment, based on the receipt of new appraisals, to reflect a change in the estimate of the acquisition date fair value of the loans acquired in the first quarter acquisition. Please confirm, if true, that the new information obtained in the fourth quarter was directly related to facts and circumstances that existed as of the acquisition date. Further, provide us with additional information in regard to the nonperforming loans in question, which resulted in the adjustments, addressing whether these loans were nonperforming at the acquisition date or became nonperforming during the year. We reference ASC 805-10-25-13 to 19.
- 2) Please provide us proposed revised disclosure to be included in future periodic reports that indicates your accounting policy for business combinations. In your disclosure, please specifically indicate: that you apply the acquisition method; how you record assets acquired and liabilities assumed; how you record contingent consideration; how you determine the value of goodwill; and, how you treat acquisition costs.
- 3) Please tell us specifically how you considered and applied the guidance in ASC 805-30-25-4 and ASC 805-30-30-4 through 6 in reassessing whether you have correctly identified all of the assets acquired and all of the liabilities assumed prior to recognizing a gain on this bargain purchase. Tell us in detail the methodologies used in determining fair value of the assets and liabilities and whether you employed the services of an independent expert for this purpose.



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# Revenue recognition

Revenue recognition continued to be a focus area of SEC staff comment. In the prior year, we noted a number of example comments related to gross versus net revenue presentation. For 2014, however, the focus has been predominantly on the determination of recorded revenue. In our examination of current year comment letters, we found that the SEC staff frequently requested that registrant clarify their revenue recognition policy disclosures and sometimes requested further information to assess whether the policy is consistent with U.S. GAAP.

Common areas of focus related to revenue policies included clarifying when title transfers (including whether the four criteria outlined in SAB 104 have been met), the accounting for gift cards (including the related income statement classification of breakage and the methodology used for recognition), accounting for multiple element arrangements, accounting for product returns (including management's estimation process), and customer incentives.

The use of gift cards is quite common in the retail environment. Under current guidance, there are several acceptable methods for recognizing gift card breakage (proportional, liability, and remote methods) and each company has its own specific facts to consider when determining if and when to record breakage. Historically, the SEC staff has objected to recognizing estimated breakage immediately upon issuance of the right, as it is inconsistent with the principles in SAB Topic 13. Immediate recognition would result in the retailer recognizing income before the delivery or performance criterion has been met. Retailers, however, may be able to estimate expected breakage and recognize such amounts in proportion to the rights actually redeemed. Given the degree of estimation and accounting variation in this area, the SEC staff's comments have focused on the disclosure of the accounting policies related to gift cards to provide investors more insight into the estimation process.

R&C companies often offer a wide array of customer incentives to increase demand for their product. Retailers commonly offer coupons, rebates issued at point of sale, free products ("buy-one-get-one-free"), price protection, and price matching programs. Consumer product companies commonly provide vendor allowances, including volume rebates and cooperative advertising allowances, market development allowances, and mark-down allowances (compensation for poor sales levels of vendor merchandise). Consumer product companies also may

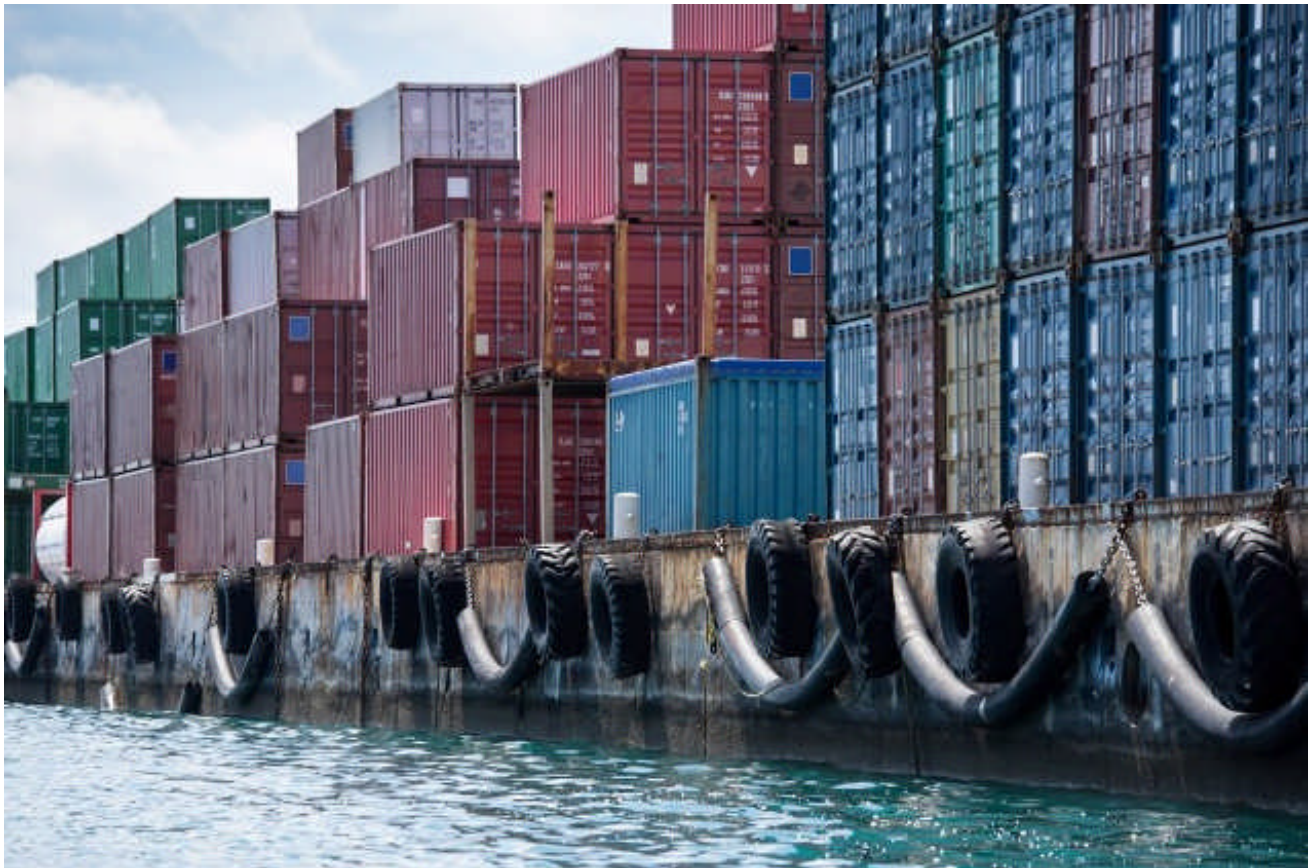
offer product placement or slotting fees to retailers. Issues related to recording sales incentives typically include the classification, timing, and measurement of the consideration provided. ASC 605-50, *Customer Payments and Incentives*, codifies the guidance relating to customer payments and incentives. Through comment letters, the SEC staff requested that companies provide information concerning the estimates used in these areas, as well as the related accounting policies, including where such amounts are recorded in the financial statements.

## Sample comments

- 1) Please tell us whether you recognize breakage for gift cards, gift certificates, and/or customer loyalty points and if so, the amounts recognized during each of the fiscal years presented. Please tell us your accounting policies for recognizing breakage and the historical data that supports your recognition policy, the amounts of breakage recognized and the line item in which breakage is recorded. In addition, to the extent material, please disclose your accounting policies for recognizing breakage in future filings.
- 2) Please tell us how you determined that it was appropriate to classify gift card breakage as a reduction of cost of goods sold. Please tell us and, if material, disclose the amount of breakage recognized during the periods presented.
- 3) In connection with the sales of products, you often provide certain supply chain management programs. These services are provided exclusively in connection with the sales of products, and as such, the price of such services is generally included in the price of the products delivered to the customer. You do not account for these services as a separate element, as the services do not have stand-alone value and cannot be separated from the product element of the arrangement. Please expand your disclosures to clarify the typical length of time over which these supply chain management services are provided and when you record revenues related to this combined unit in light of these services pursuant to ASC 605-25-25-6.

## Revenue recognition

- 4) We note your statement that the sales return reserve represents the gross profit effect of sales returns. Please explain to us in more detail how you determine and record your sales return reserve. It is unclear to us if you are reducing sales for the gross profit of expected returns or if you are reducing sales and cost of sales to reflect estimated returns. Please refer to ASC 605-15-45-1.
- 5) We note your disclosure of accrued rebate and incentive checks. Please tell us your consideration of disclosing: the nature of the rebate and incentive programs offered to customers; your accounting policy for each of these programs, including the Statements of Comprehensive Income line item in which the cost of these programs is included; and the timing of recognition of the rebates and incentives. If the rebates and incentives are treated as expenses rather than a reduction of revenues, please tell us the basis for such classification. Please refer to ASC 605-50-45.
- 6) You disclose that you record funds received from vendors for price protection, product rebates and marketing/promotion as revenue, cost of goods sold or selling, general and administrative expenses. Please explain to us the nature of the items that you classify as revenue, how you applied FASB ASC 605-50-45-12 through 45-15, and the amount of such revenue recognized in the periods presented.



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# Loss contingencies

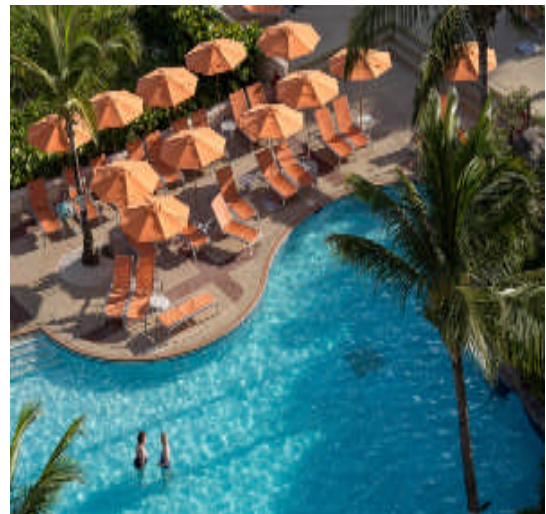
The SEC staff continues to focus on ensuring that registrants comply with the guidance of ASC 450, *Contingencies*. Some registrants are resistant to providing the required disclosures for fear that they may divulge information that could adversely affect the outcome of litigation. To that end, the SEC staff has indicated that they will accept disclosure of estimated exposure on an aggregated basis, rather than requiring separate disclosure for each individual matter.

GAAP requires companies to record an accrual for a loss contingency when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Even if the criteria for accrual have not been met, disclosure may still be required if the loss is reasonably possible and the possible loss or range of loss is material. For loss contingencies that meet the criteria for disclosure, registrants should disclose the nature of the contingency and an estimate of the possible loss or range of loss (or a statement that such estimate cannot be made).

To keep investors apprised of material developments associated with the nature, timing, and amount of a loss contingency, such details should generally not be disclosed for the first time in the period in which they are recorded. The SEC staff has frequently evaluated the disclosures in periods prior to the period in which a loss is recorded and commented on the lack of adequate early-warning or foreshadowing disclosures. Such comments often request additional information to understand the triggering event for recording the loss and whether such losses should have been recorded in an earlier period. The SEC staff expects that loss contingency disclosures will be updated regularly, both qualitatively and quantitatively, for developments in the related matters and as more information becomes available.

## Sample comments

- 1) In future filings, for any contingencies where there is at least a reasonable possibility that a loss or an additional loss may have been incurred, please provide an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.
- 2) Although you do not expect the outcome of outstanding legal proceedings to have a material adverse impact on your financial position, the outcome of any such matters could be material to your results of operations or cash flows in a given period. Despite your assertion that it is not presently possible to determine your ultimate exposure to these matters, please tell us if you are able to estimate a loss or a range of losses that are at least reasonably possible, and revise your future filings to provide this disclosure as required by ASC 450-20-50-3 and 50-4.





# Executive compensation

Item 402 of Regulation S-K contains extensive disclosure requirements related to executive compensation. The applicability of these disclosures varies based on each registrant's particular facts and circumstances. SEC staff comments in this area focused on enhancing the disclosures of specific aspects of an employee's performance and/or the criteria used to evaluate and determine compensation awards. This includes a narrative description of any material factors necessary to an understanding of the information disclosed in the summary compensation table, including the use of benchmark or market data. The SEC staff also issued comments when disclosures of a registrant's compensation policies and practices as they relate to risk management (required by Item 402(s) of Regulation S-K) were omitted.

Dodd-Frank rulemaking continues to draw attention to this area. Registrants should remain focused on executive compensation disclosures and ensure the Compensation, Disclosure and Analysis requirements set forth in Item 4-02 of Regulation S-K are met.



## Sample comments

- 1) We note that you have not provided a quantitative discussion of the actual pretax earnings targets to be achieved for your named executive officers to earn their cash bonuses. Please disclose your pretax targets. Also, please explain in greater detail how you calculated the annual bonus for each executive officer. Note that under Item 402(b)(1)(v) of Regulation S-K, a filer must disclose how it determined the amount and formula for each element of compensation. Please also discuss any discretion that may be exercised in granting such awards absent attainment of the stated performance goal. Please see Instruction 4 to Item 402(b) of Regulation S-K.
- 2) We note that you refer to a compensation liability due to your former officer. In future filings, please update to clarify the status of those payments and whether they are still due to be paid.
- 3) We note that the salaries of your named executive officers increased. Please provide a narrative description of any material factors necessary to an understanding of the information disclosed in your summary compensation table, such as the reasons for these increases and the material terms of the employment agreements of your named executive officers. In this regard, we note your disclosure that you have entered into written employment agreements with your executive officers. See Item 402(o) of Regulation S-K. Please also file your employment agreements as exhibits to your Form 10-K. See Item 601(b)(10) of Regulation S-K.

*Dodd-Frank rulemaking continues to draw attention to executive compensation disclosures.*



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## About the retail and consumer practice

Within PwC we have combined both retail and consumer-oriented companies into one practice group. Drawing on the talents of approximately 15,000 partners and professional staff worldwide dedicated to serving clients within the R&C industry, we help companies to solve complex business problems and measurably enhance their ability to build value, manage risk and improve performance in an internet-enabled world by providing industry-focused assurance, tax, and advisory services.

Our R&C practice is a leading financial accounting, tax and advisory consulting business. Our experience cuts across all geographies and all segments of the R&C sector, serving the food & beverage, health & beauty care, tobacco & confectionery and other consumer products manufacturers, as well as a broad spectrum of retailers to include food, drug, mass merchandisers and specialty retailers. Our combined R&C practice allows us to understand issues across the entire supply chain, from source to sale, and to easily transfer our knowledge to clients related to attesting to and ensuring the accuracy of financial statements and reporting systems, providing local, state and global tax and compliance advice, managing and mitigating enterprise risk, improving business processes and operations, implementing technologies, and helping clients with mergers and acquisitions to drive growth and improved profitability.

Our global practice is organized to serve clients with similar issues and problems in order to facilitate the sharing of knowledge and to deliver world-class client service. Our professionals are dedicated to providing insight into the industry and are aligned with many global organizations and trade associations that serve the interests of the industry and our clients. We are associate members of the Grocery Manufacturers Association (GMA) and exclusive sponsors of their CFO Council, a group of consumer goods financial executives who identify and explore financial issues of importance to the organization's members. Our professionals make presentations at several GMA events throughout the year and jointly develop an annual Financial Benchmarking Report for the GMA which has become an industry standard and recognized as the definitive report on financial metrics for the consumer packaged goods industry. For the National Retail Federation (NRF), we play a leading role as technical advisor to the NRF's Financial Executives Council, Internal Audit &

Compliance, and IT Councils, assisting them in understanding the implications of new accounting regulations and compliance issues, as well as security and privacy issues and related IT issues. We are also associate members of the Retail Industry Leaders Association (RILA) where we sponsor their Tax Leaders Committee and provide counsel on emerging tax and regulatory issues emanating from Washington, DC. Additionally, we are members of the American Apparel and Footwear Association (AAFA) where our professionals are active members of the Supply Chain, Information Systems and Sustainability committees and the In-Store Marketing Institute, which is involved in POS and in-store operating systems. We have a strategic partnership with Kantar Retail, recognized as the premier market intelligence group in the U.S. for the retail industry. Our acquisition of Strategy& (formerly Booz & Company) in this past year has presented another unique opportunity for our R&C sector as we are able to connect clients with resources for strategy advice and execution skills with unrivalled global scale and experience. Lastly, on a global basis, we are affiliated with the Consumer Goods Forum—the global food manufacturers association, and the World Economic Forum, where we help facilitate industry-related discussion groups.

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