# FREQUENTLY ASKED QUESTIONS ABOUT RETROSPECTIVELY REVISED FINANCIAL STATEMENTS

## Retrospectively Revised Financial Statements

***When must an issuer retrospectively revise financial statements?***

The staff (the "Staff") of the U.S. Securities and Exchange Commission (the "SEC") has indicated that an issuer may need to retrospectively revise its audited financial statements due to, for example, a subsequent change in accounting principle under Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections* ("ASC 250"), or upon the occurrence of discontinued operations after year-end, or as a result of a change in segment reporting after year-end.[1] The Staff indicates that revised financial statements, as well as affected disclosures, must be on file for incorporation by reference into a Form S-3 prior to filing of the registration statement (or a proxy statement which requires financial statements, as discussed in response to the question "*Does the Staff's position with regard to retrospectively revised financial statements apply when the company is filing a proxy statement?*").

[1] *See* Section 13100 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual.*

***When is retrospective application of an accounting principle required under ASC 250?***

In May 2005, the Financial Accounting Standards Board ("FASB") issued ASC 250. This standard changed the default method for reflecting the adoption of new accounting standards from prospective, *i.e.*, reflecting the cumulative effect of a change in accounting principle on net income only in the year of the change (along with supplemental pro forma disclosures demonstrating the change), to retrospective, whereby the prior period comparative financial statements (*e.g.*, the prior period balance sheet and the prior two years for annual statements) are revised to reflect the new accounting method as if it had applied throughout the reporting period. Under ASC 250, any new FASB accounting standard requires the retrospective method, unless otherwise specified in the new standard.

ASC 250 applies both to a mandatory change in accounting principle occurring as a result of FASB's adoption of a new standard and to a voluntary change, such as a change from one GAAP principle to another GAAP principle upon a determination of "preferability" by the issuer.

***How does retrospective application of financial statements differ from restatement of previously issued financial statements?***

ASC 250 draws a distinction between "retrospective application" for changes in an accounting principle, and the "restatement" of previously issued financial statements as a result of an error. Restating for a material error is what is commonly referred to as a "restatement," where prior periodic reports are amended to include revised financial statements and notes to the financial statements reflecting the changes necessary to correct the error. Under the retrospective application method, revision of the financial statements would be made only to the comparative financial statements, without any requirement to amend prior reports.

***How are retrospectively revised financial statements reflected in a periodic report?***

If a retrospective revision of the financial statements is required, a Form 10-K filed after a change in accounting principle would include retrospectively revised annual financial statements for the prior comparative periods. For example, if an issuer has a change in accounting principle in 2012, then the issuer's Form 10-K would include the 2011 audited annual financials reflecting the new accounting principle, as well as revised 2010 and 2009 audited annual financial statements, reflecting the information as if the new accounting principle had been in place since the beginning of the period covered by the financial statements.

***Are there exceptions to the requirement to present retrospectively revised financial statements?***

ASC 250 mandates retrospective application "when practicable," noting that impracticability occurs whenever any of the following conditions apply:

- after making every reasonable effort, the issuer is unable to do so;
- retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated; or
- retrospective application requires significant estimates, and it is impossible to distinguish objectively information about those estimates that:
  - provide evidence of circumstances that existed on the date(s) at which the estimated amounts would be recognized, measured or disclosed, and
  - would have been available when the financial statements for that prior period were issued.

ASC 250 also limits the retrospective application requirement to direct effects of the change in accounting principle (along with any related income tax effects), so it does not require revision of the prior period financials for certain indirect effects, such as changes in management compensation based on earnings per share. Instead, indirect effects are recognized in the period of the accounting change.

***Are some accounting changes still reflected prospectively in the financial statements?***

ASC 250 provides that, in certain circumstances, accounting changes are reflected prospectively and do not require retrospective revision of prior period financial statements. These include changes in methods used for accounting for depreciation, amortization or depletion, changes in accounting estimates (*e.g.*, the bad debt allowance or service life of an asset) or changes from FIFO to LIFO (which had special treatment as a change in estimate rather than a change in accounting method under the pre-ASC 250 standard of Accounting Principles Bulletin No. 20).

***Must an issuer revise related disclosures such as Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")?***

The Staff generally expects issuers to include revised MD&A disclosure with the retrospectively revised financial statements, but only if the changes are material to previously reported results of operations. Other related disclosures may also be affected by the retrospective revision of the financial statements (and thus may require revision as well), such as, for example, the Selected Financial Data required by Item 301 of Regulation S-K and the Ratio of Earnings to Fixed Charges.

***What other changes may require retrospectively revised financial statements?***

If management changes the structure of its internal organization so that the composition of the issuer's reportable segments changes, then the information for the prior comparative periods must be retrospectively revised, if practicable, in accordance with Accounting Standards Codification Topic 280, *Segment Reporting* ("ASC 280").[2] A revised segment footnote must be provided in the required annual financial statements reflecting the new reportable segments, along with revisions to the Business description and the MD&A, all to be included in the registration statement or in a Form 8-K that is incorporated by reference into the registration statement. In addition to the retrospectively revised financial statements, the Staff expects that the MD&A will specifically describe the change in segment reporting and include an explanation of why the chief operating decision maker (defined in ASC 280 as the function which allocates resources to and assesses the performance of the segments of an issuer) has changed how decisions are made about the allocation of resources or the assessment of performance. In addition, the MD&A disclosure is expected to include discussion of the results of operations for the current and prior periods on a segment basis, including any related trends based on the revised segment disclosures.

Financial statements after the date a component of an issuer is disposed of, or classified as held for sale in accordance with Accounting Standards Codification Topic 205-20, *Discontinued Operations* ("ASC 205-20"), must include retrospective reclassification of relevant prior periods to report the results of the component in "discontinued operations."[3] In addition to retrospective application in the financials, the Staff expects to see discussion in the MD&A of:

- the events that led to the discontinued operations and the material terms of termination related to the discontinued operations;
- the impact on the issuer's operating results;

[2] *See* Section 13300 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual.*

[3] *See* Section 13200 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual.*

- a description of any contingent obligations, financial commitments or continuing relationships with the discontinued operations; and
- any impact of the discontinued operations on liquidity and capital resources.

Sections 13400-13600 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual* note other areas where retrospective application is called for, including a change in the reporting entity or the consummation of a transaction accounted for similar to a pooling of interests (*i.e.*, the reorganization of entities under common control), stock splits, and material retrospective adjustments to provision amounts in business combinations under Accounting Standards Codification Topic 805-10-25. Other recent accounting standards that have required retrospective application include Accounting Standards Codification Topic 810, *Noncontrolling Interests in Consolidated Financial Statements,* and Accounting Standards Codification Topic 470-20, *Accounting for Convertible Debt Instrument That May Be Settled in Cash upon Conversion*.

## Form S-3 Requirements for Retrospectively Revised Financial Statements

***What does Form S-3 require with respect to retrospectively revised financial statements?***

The requirement to file the retrospectively revised prior annual financial statements with respect to a newly filed registration statement arises under Item 11(b)(ii) of Form S-3, which requires that the registration statement either include or incorporate by reference financial statements compliant with Regulation S-X if there has been a change in an accounting principle, or a restatement due to correction of a material error. Under the guidance provided by the Staff in the Division of Corporation Finance *Financial Reporting Manual*, this would also encompass discontinued operations or changes in segment presentation.

The requirement under Item 11(b)(ii) of Form S-3 to include or incorporate by reference retrospectively revised audited financials is only triggered when the Form S-3 incorporates by reference retrospectively revised, unaudited interim financials for a period ended after the date of the relevant event, *e.g.*, the change in accounting principle, or the identification of discontinued operations or a change in segment reporting. If the Form S-3 is filed before the event has occurred, or after the event has occurred but before a periodic report is filed reflecting the event, then the Form S-3 would incorporate by reference the subsequent periodic reports reflecting the change, and no earlier filing of audited, retrospectively revised financial statements would generally be required. The Staff does note in the Division of Corporation Finance *Financial Reporting Manual* that, in certain circumstances, pro forma financial statements prepared in accordance with Article 11 of Regulation S-X may be necessary.[4]

When the updating requirement is triggered, the Staff expects issuers to incorporate by reference, or include in the Form S-3, retrospectively revised, audited financial statements during any period between when the change in accounting principle or other triggering event occurs, and when the issuer is obligated to present the retrospectively revised financials for the comparative periods in the Form 10-K filed after the change.

[4] *See* Section 13110 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual*.

***How does an issuer file retrospectively revised annual audited financial statements in anticipation of a Form S-3 filing?***

An issuer may include the retrospectively revised financials and related disclosure directly in the registration statement as contemplated by Item 11(b)(ii) of Form S-3; however most issuers elect to provide the retrospectively revised financials as an exhibit to an Item 8.01 Form 8-K, which would also include all of the affected disclosures, such as MD&A.

***Does the requirement to file retrospectively revised financial statements apply in the context of a takedown off of an effective registration statement?***

The requirement to file the retrospectively revised annual financial statements might also be, but is not necessarily triggered by, a takedown off of an already effective shelf registration statement. The updating requirement of Item 11(b)(ii) of Form S-3 is read by the Staff as applying at the time of filing the registration statement; however, the Staff indicates that the issuer should evaluate if the information in the retrospectively revised financial statements would constitute a "fundamental change" in the information that is provided in the prospectus such that it would need to be updated in accordance with the undertaking specified in Item 512(a) of Regulation S-K.

***Does the Staff provide any relief from the requirement to file retrospectively revised financial statements in advance of filing a registration statement on Form S-3?***

The Staff indicates that it would not require that retrospectively revised financial statements be incorporated by reference into a newly filed registration statement solely because of a stock split, as long as the issuer includes in the filing Selected Financial Data which includes revised relevant per-share information for all required periods, along with prominent disclosure of the stock split.[5]

In a dialogue with the SEC Regulations Committee of the AICPA's Center for Audit Quality, the Staff indicated that, for issuers complying with FASB's June 2008 guidance added to ASC 260, *Determining Whether Instruments Granted in Share-Based Payment Transaction are Participating Securities*, retrospectively revised financials would not be required if the issuer and the issuer's auditors were comfortable with only including disclosure focused on earnings per share revised to reflect the effect of the new accounting pronouncement in the Selected Financial Data portion of the filing (or incorporated by reference from a Form 10-Q or Form 8-K), along with "full and robust" disclosure about the implications.

## Applicability of the Staff's Position to Other Filings

***Does the Staff's position with regard to retrospectively revised financial statements apply when the company is filing a Form S-8?***

The Staff takes the position in Securities Act Forms Compliance and Disclosure Interpretations Question 126.40 (August 14, 2009) that the filing of a Form S-8 would not necessarily trigger the need to file or incorporate by reference retrospectively revised annual financial statements, because Form S-8 does not include the same updating requirement that is specified in Item 11(b)(ii) of Form S-3. In particular, General Instruction G.2 to Form S-8 requires that "material

[5] *See* Section 13500 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual*.

changes in the registrant's affairs" be disclosed in the registration statement, which in the Staff's view does not necessarily rise to the same level as contemplated by Item 11(b)(ii)'s express call for the retrospectively revised or restated financials. The Staff thus leaves it open to the judgment of issuers and auditors to determine whether, based on materiality, the retrospectively revised information should be included or incorporated by reference into the Form S-8.

***Does the Staff's position with regard to retrospectively revised financial statements apply when the company is filing a proxy statement?***

As noted throughout Topic 13 in the Division of Corporation Finance *Financial Reporting Manual*, the Staff takes a similar approach on retrospectively revised financials with respect to any proxy statements which require that financial statements be included or incorporated by reference, even though Item 13 of Schedule 14A does not include the same language as set forth in Item 11(b)(ii) of Form S-3.

***Is an interim filing of retrospectively revised financial statements permissible even when no Form S-3 or proxy statement will be filed?***

The Staff acknowledges in Section 13100 in Topic 13 of the Division of Corporation Finance *Financial Reporting Manual* that issuers may elect to file an Item 8.01 Form 8-K to provide the retrospectively revised annual financial statements when the post-event quarterly financial statements are filed.

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