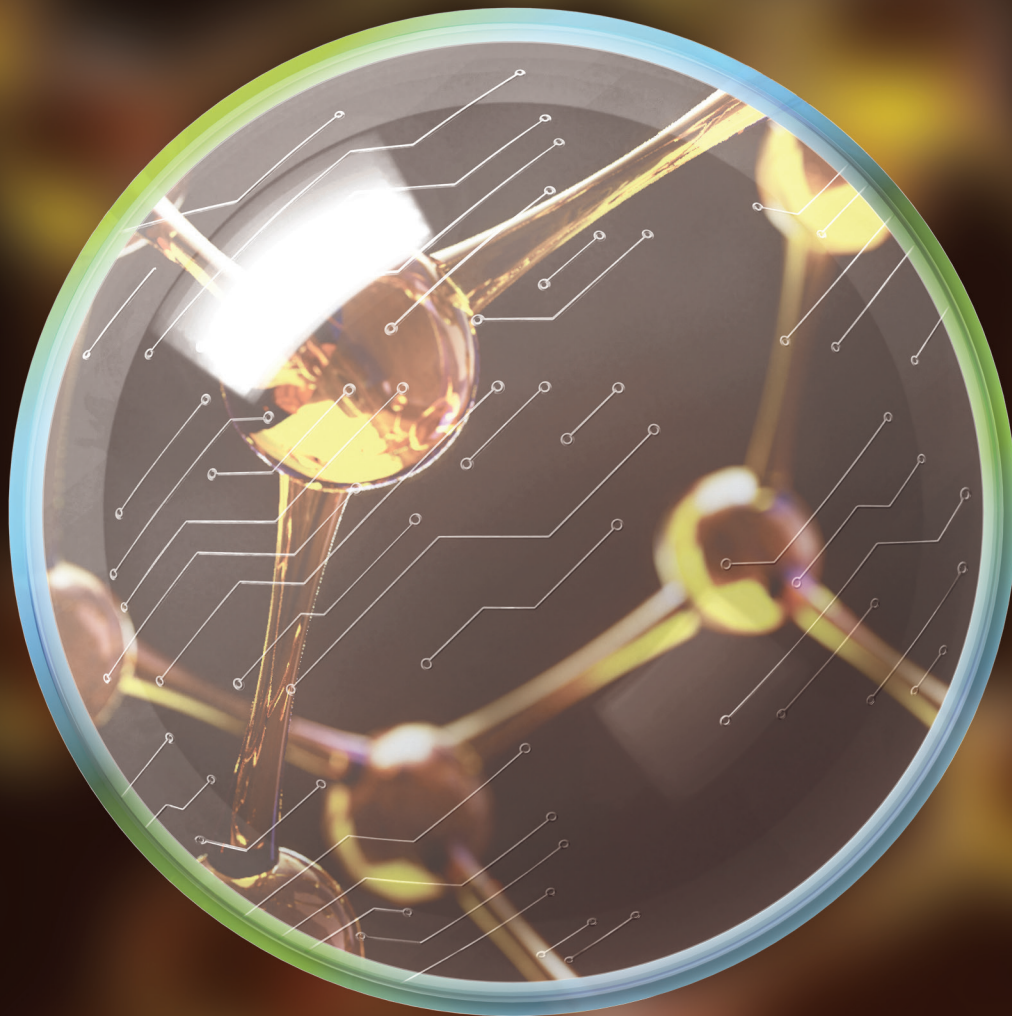


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## **Life Sciences Industry Accounting Guide**

Accounting and Financial Reporting in Uncertain Times:  
Considerations for Navigating Macroeconomic and Geopolitical  
Challenges

March 2024

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*Income Taxes*

*Initial Public Offerings*

*Leases*

*Noncontrolling Interests*

*Non-GAAP Financial Measures and Metrics*

*Revenue Recognition*

*SEC Comment Letter Considerations, Including Industry Insights*

*Segment Reporting*

*Share-Based Payment Awards*

*Statement of Cash Flows*

*Transfers and Servicing of Financial Assets*

# Contents

## Preface

## Contacts

### Chapter 1 — Accounting and Financial Reporting in Uncertain Times: Considerations for Navigating Macroeconomic and Geopolitical Challenges

Chapter 2 — Revenue Recognition

Chapter 3 — Research and Development

Chapter 4 — Acquisitions and Divestitures

Chapter 5 — Consolidation

Chapter 6 — Contingencies and Loss Recoveries

Chapter 7 — Statement of Cash Flows

Chapter 8 — Income Taxes

Chapter 9 — Compensation

Chapter 10 — Financial Instruments

Chapter 11 — Leases

Chapter 12 — Initial Public Offerings

Chapter 13 — Other Accounting and Financial Reporting Topics

Appendix A — Differences Between U.S. GAAP and IFRS Accounting Standards

### Appendix B — Titles of Standards and Other Literature

### Appendix C — Abbreviations

# Preface

The life sciences ecosystem encompasses a wide array of entities that discover, develop, and manufacture health care products. Such entities include pharmaceutical manufacturers; biotechnology companies; medical device, diagnostic, and equipment manufacturers; and service companies such as drug distributors, contract research organizations (CROs), contract manufacturing organizations (CMOs), and health technology companies.

Finance and accounting professionals in the life sciences industry face complex issues and must exercise significant judgment in applying existing rules to matters such as research and development (R&D) costs, acquisitions and divestitures, consolidation, contingencies, revenue recognition, income taxes, financial instruments, and financial statement presentation and disclosure. The 2024 edition of Deloitte's *Life Sciences Industry Accounting Guide* (the "Guide") addresses these and other relevant topics affecting the industry this year. It includes interpretive guidance, illustrative examples, recent standard-setting and rulemaking developments (through March 8, 2024), and key differences between U.S. GAAP and IFRS<sup>®</sup> Accounting Standards. In addition, this Guide discusses (1) accounting and financial reporting considerations associated with the macroeconomic and geopolitical environment that apply specifically to the life sciences industry, (2) environmental, social, and governance (ESG) matters that have become topics of increased focus, and (3) the impact of the Inflation Reduction Act of 2022 (IRA).

[Appendix B](#) lists the titles of standards and other literature we cited, and [Appendix C](#) defines the abbreviations we used. Key changes made to this Guide since publication of the 2023 edition are summarized in Appendix D.

We hope the Guide is helpful in navigating the various accounting and reporting challenges that life sciences entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

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# Chapter 1 — Accounting and Financial Reporting in Uncertain Times: Considerations for Navigating Macroeconomic and Geopolitical Challenges

## 1.1 Executive Summary

Today's consumers and companies face numerous challenges associated with the current macroeconomic and geopolitical environment (the "current environment"). Reports of continuing global supply-chain disruptions, labor shortages, inflation, and geopolitical events dominate the news and are top of mind for many financial executives.

On the basis of Deloitte's [Q3 2023 CFO Signals survey](#), some of the most common issues affecting CFOs include (1) internal matters such as employee retention, employee working arrangements and morale, generative artificial intelligence (GenAI), and cost management and (2) external concerns such as inflation, interest rates, policies and regulations, and geopolitical tensions.

Certain of these challenges started during the COVID-19 pandemic, which gave rise to new operational and financial difficulties, often with unique accounting and financial reporting implications (see Deloitte's March 25, 2020 [updated January 11, 2021], [Financial Reporting Alert](#)). For example, as a result of significant global supply-chain disruptions and labor shortages brought on by the pandemic, many product and employment costs increased. In addition, global central banks raised interest rates in an attempt to temper the impact of historically high inflation rates.

More recently, the convergence of various macroeconomic and geopolitical factors has created a volatile and uncertain environment in which a business's decision-making and accounting and financial reporting have become increasingly challenging. As business leaders struggle to deal with macroeconomic and geopolitical changes, both preparers and users of financial statements need to understand the impacts and potential impacts of those changes, which involve a myriad of factors. Some of the more prominent factors affecting life sciences companies include:

- Risk of recession.
- Interest rate increases.
- Tightening of credit and concerns about the banking sector.
- Concerns about the real estate sector, both residential and commercial.
- Continuing inflation, including geographic and sector-specific impacts.



- Tightened labor market.
- Changes in foreign currency exposures as a result of both the geopolitical environment and supply-chain challenges.
- Climate risk.

While each factor on its own poses challenges in the application of accounting standards, the convergence of these factors significantly increases the level of complexity involved and, therefore, the amount of effort needed to develop significant accounting estimates, such as the valuation of receivables, inventory, investments, property and equipment, leased assets, goodwill, and intangibles. In addition to the many potential impacts on accounting estimates, the factors can also have more direct accounting implications. For example, as interest rates rise, debt covenant violations may increase, which could call for an evaluation of debt classification and going-concern considerations, among others. Further, given the current environment, life sciences companies may also need to reevaluate their foreign currency exposures, the effectiveness of hedging relationships, and — while generally considered rare — the potential need to change a foreign entity's functional currency as a result of significant changes in economic facts and circumstances.

In light of the changing macroeconomic and geopolitical environments, life sciences companies should also be mindful of the considerations below related to risk assessment, internal controls, and SEC disclosures.

### 1.1.1 Risk Assessment

To address the complexity in the current environment, life sciences companies may need to revisit their historical risk assessments and revise their processes and controls to ensure that their accounting and reporting reflects the changing macroeconomic and geopolitical factors. In August 2023, SEC Chief Accountant Paul Munter released a [statement](#) reinforcing the importance of assessing risk comprehensively to ensure effective financial reporting and internal controls. He discussed risk assessment considerations for both management and auditors related to the changing economic conditions.

At the highest level, addressing this changing environment means revisiting risk assessments to ensure that management has identified new risks or changes in existing risks, including fraud risks, that are affecting the company. For example, management might consider the following:

- If management mitigated its exposure to foreign currency fluctuations by denominating more of its transactions in a particular currency, has it unwittingly changed the functional currency of the related business? Alternatively, if management mitigated its foreign currency exposure by expanding its hedging program, has it adequately considered counterparty risk, especially given the concerns about the banking sector?
- If management changed or diversified its suppliers in response to supply-chain constraints or geopolitical concerns, has this supplier change increased the company's exposure to foreign currency fluctuations and, if so, is that appropriately disclosed in the company's financial statements and SEC filings?
- Which of the current macroeconomic and geopolitical factors, or combination of factors, affect the overall risk of fraud either at an entity level or with respect to specific risks within the entity's existing accounting and reporting structure?



In addition, organizations that use or are considering using GenAI in accounting and financial reporting should carefully consider the potential risks associated with this technology. GenAI models can be biased and inaccurate, and they may not be able to capture all the nuances of the current business environment. Therefore, organizations may need to revise their processes and controls to mitigate these risks.

While many of the changes outlined above are one-off occurrences, others have a clear recurring impact. For instance, when the inflation rate was lower, life sciences companies may have been successful in passing on minor cost increases to their customers so that cost changes may not have had a substantial impact on margins. However, because customers may now be more resistant to price increases, companies may face difficulties in passing on significant cost increases to their customers. Pressure to increase margins may instead lead companies to explore cost-saving initiatives such as layoffs and restructuring activities, which can create new accounting, reporting, and fraud risks.

### 1.1.2 Design and Operation of Internal Controls

Each new material risk identified by management is typically accompanied by a corresponding change in the design or operation of a company's internal control over financial reporting. From a design point of view, management may consider the need to challenge (1) how well the control addresses the risk, (2) the frequency with which the control is performed, (3) the competency and authority of those performing the control, and (4) the level of aggregation or disaggregation, predictability, and the criteria for investigation in a management review control. For example, management may consider the following:

- In a highly inflationary environment, does the existing fluctuation analysis, in which management reviews changes over an amount or percentage, continue to be effective as an internal control or should the criteria for investigation be changed? For example, in an inflationary environment, a decrease in costs as a percentage of sales may warrant investigation even if the decrease did not exceed a defined threshold for investigation. Conversely, in situations in which every cost has increased above management's threshold for investigation, should management consider whether that investigation has been diligent or whether it reflects a confirmation bias since management expected costs to increase?
- Do personnel reviewing the fluctuation analysis understand the business well enough to tell the difference between an unusual fluctuation and an expected fluctuation?
- As a result of the tight labor market, has the company experienced turnover and had challenges hiring qualified personnel? Management should also consider whether, as a result of these challenges in hiring qualified personnel, it takes more time to fill vacancies, which possibly puts stress on existing controls and processes and thereby increases the opportunity for fraud.

A common example of changing the frequency of when a control is performed is an interim goodwill impairment analysis in response to a triggering event. However, there are other circumstances in which the frequency of a control may need to be changed, even if it is not called for by accounting standards. For example, if an entity is experiencing significant cost increases, management should consider whether to only update the standard cost of inventory annually or to do it on a more frequent basis. If management instead relies on its process for capitalizing variances, it should assess whether (1) that process adequately considers the fact that some costs are relatively stable while others continue to undergo significant change and (2) the analysis should be disaggregated by product line, cost type, or other unit to ensure a reasonable allocation.

Beyond the design of a control, it is also important to think about how controls operate in a changing environment. Processes such as developing a forecast for use in an impairment analysis and reviewing that forecast may need to be modified when many of the factors discussed above come together. For example, a global entity may encounter very different economic circumstances in different geographic locations, with some countries experiencing deflation and others experiencing significant inflation. The company's consideration of inflation will necessarily be affected by the degree of inflation in the geographic locations in which the company operates, and a one-size-fits-all approach will not fit every company. In addition, since interest rate changes will affect the weighted-average cost of capital used in a discounted cash flow analysis, management should consider whether tightening credit has had an impact on debt-to-equity ratios. Even if a company is projecting solid profitable growth, its ability to grow could be challenged by labor availability in a tight labor market.

Management should consider the above factors, among others, in the preparation and review of forecasts and should challenge whether historical results and relationships continue to be indicative of future projected results. It should also consider potential fraud risks and schemes related to pressures resulting from interest rate changes, since such pressures could affect the company's forecasts and ability to meet targets for key performance indicators.

### **1.1.3 Inflation**

Although the effects of inflation vary by company, there are some common topics that life sciences companies should evaluate when considering how recent inflationary trends may affect their accounting and financial reporting.

Because inflation is most likely driving up costs of acquiring goods/inventory and related packaging materials, as well as employee wages, life sciences companies should consider whether they can pass along those increased costs to their customers.

Life sciences companies may also have increased costs associated with long-term revenue contracts that they may or may not be able to pass along to their customers. If a company is unable to raise its prices under a revenue contract, the company's estimated profitability on the contract may decline or result in a loss on the contract. Companies should consider the potential accounting implications of reduced or negative profitability on a revenue contract, including the period in which to record a loss if applicable.

Inflation may result in renegotiating long-term contracts, such as leases or long-term supply agreements, which in turn may have potential accounting implications. For example, depending on the terms, a modification to a lease contract may require a company to reassess the classification and measurement of the lease.

In addition, global central banks have raised interest rates in an attempt to temper the impact of high inflation. Companies should consider whether the increase in interest rates has resulted in an impairment of financial assets. Companies should also consider potential impacts on estimated credit and loan loss reserves.

As life sciences companies review their investment strategies in light of recent inflation, they may consider making different types of investments or moving away from holding excess cash on hand. For example, a company may consider investing in digital assets (such as cryptocurrencies) or Treasury Inflation-Protected Securities as a hedge against inflation. Companies contemplating such investments should consider the complex accounting and financial reporting that may result from holding them. For example, inflation-indexed debt securities are subject to specific interest recognition guidance under U.S. GAAP and should be evaluated to determine whether they contain any derivative that is required to be accounted for separately for accounting purposes.

Further, life sciences companies should monitor the appropriateness of the discount rate used to measure any pension-related liabilities, particularly since even a seemingly small change in the discount rate can affect a company's pension liability significantly. For example, higher interest rates may lead to decreases in pension liabilities and required employer contributions. However, such decreases may be offset by higher employee wages, which are further discussed in [Section 1.1.4](#).

### **1.1.4 Labor Shortages**

Labor shortages may manifest themselves in the form of employee turnover, departures, and demands for higher wages at all levels of the organization. As costs of retaining labor increase in a production environment, companies should consider how these increased labor costs affect the cost of inventory and whether these higher costs can be offset by price increases as companies sell these goods to their customers. Companies should also consider the potential accounting implications of including increased costs in inventory.

To address employee demands for increased compensation, many companies are revisiting their compensation structures. Adjustments may take the form of increased hourly wages, retention bonuses, improved incentive compensation or stock compensation, or other benefits. Companies should consider the accounting implications of these changes in compensation structure. For example, if a company provides retention bonuses to employees, the company should consider the contractual terms of those arrangements and assess during what period those bonuses should be recognized. In addition, certain companies may need to consider changes in their workforce and the related compensation structure when evaluating assumptions used to measure their pension liability.

In response to a shortage in labor, some companies may be forced to operate at a reduced capacity. In such a case, companies should consider whether there are costs that have been capitalized into inventory historically but should be expensed currently because of abnormal production levels (e.g., indirect costs such as rent and depreciation).

Increased turnover and the shortage of employees may also put stress on a company's internal control environment. As employee responsibilities shift, companies should assess whether appropriately skilled and trained individuals are in place to effectively design, implement, operate, and monitor controls, including controls related to information technology (IT).

### **1.1.5 Communication With Stakeholders**

In addition to considering potential accounting-related impacts of inflation and labor shortages, life sciences companies will need to evaluate their communication strategies related to such risks and uncertainties. While private and public companies alike will need to comply with the disclosure requirements under U.S. GAAP, public companies will also need to consider the SEC's reporting requirements, including required disclosures about trends and uncertainties in the business, risk factors, and MD&A sections of filings. For many companies, these issues may require disclosure in MD&A of known trends or uncertainties that could affect sales, net income, or liquidity. Further, companies should tailor these disclosures to their specific circumstances and avoid generic boilerplate descriptions of inflation and labor shortages. When public companies identify new or emerging risks in the current environment, they should consider the impacts of those risks and corresponding disclosure in MD&A.

At the 2023 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff discussed the importance of disclosures about risks and uncertainties, specifically the need for registrants to provide high-quality and transparent disclosures, especially during times of economic uncertainty. The SEC staff noted that when registrants discuss information about estimates and uncertainties, they should clearly explain their significant management judgments, key assumptions, and known risks so that investors can better understand the significant risks of adjustments to the financial statements in future periods and make informed investment decisions.

For more information, see Deloitte's September 15, 2023, [Financial Reporting Alert](#) and December 10, 2023, [Heads Up](#).

### **1.1.6 Ongoing Accounting and Financial Reporting Considerations Stemming From the Current Environment**

We believe that in addition to the economic factors discussed above, the following accounting and reporting issues will continue to be the most pervasive and challenging for life sciences entities as a result of the current environment:

- *Preparation of forward-looking cash flow estimates and forecasts* — The use of forward-looking information is pervasive in an entity's assessment of, among other things, the impairment of nonfinancial assets (including goodwill), the realizability of deferred tax assets, and the entity's ability to continue as a going concern. Unique complexities associated with preparing forward-looking information in the current environment include the following:
  - There is a wide range of possible outcomes.
  - The associated economic impact of the current environment is highly dependent on variables that are difficult to predict and may not affect all subsectors the same.
  - Each entity must then translate the effect of those macro conditions into estimates of its own future cash flows.

Nevertheless, entities will need to make good-faith estimates, prepare comprehensive documentation supporting the basis for such estimates, and provide robust disclosure of the key assumptions used and, potentially, their sensitivity to change.

- *Recoverability and impairment of assets* — Perhaps the most acute examples of the increased challenge associated with forward-looking information are the impairment tests for long-lived assets, intangibles, and goodwill. These nonfinancial assets use recoverability and impairment models that rely on the development of cash flow projections that are subject to the significant uncertainties noted above. However, impairments establish a new cost basis for the assets and do not permit the subsequent reversal of the recorded impairment. Good-faith estimates in the current reporting period could result in material recorded impairments; if unforeseen favorable developments occur in subsequent quarters, the recognized impairment would no longer be indicated, but it cannot be reversed.
- *Accounting for financial assets* — At the onset of the pandemic, many entities experienced severe declines in the fair value of financial assets, particularly equity securities. Likewise, the ability of debtors to comply with the terms of loans and similar instruments was adversely affected. Entities should continue to carefully consider and apply the appropriate impairment and loss recognition guidance.

- *Contract modifications and penalties* — Changes in economic activity caused by the current environment may cause many entities to renegotiate the terms of existing contracts and arrangements. Examples include contracts with customers, compensation arrangements with employees, leases, and the terms of many financial assets and liabilities. As a result of these changes, entities will need to ensure that the appropriate guidance in U.S. GAAP is considered.
- *Subsequent events* — It may be challenging for an entity to separate recognized and unrecognized subsequent events in a global marketplace that is extremely volatile and in which major developments occur daily (e.g., the stock market's daily reaction to new information). Although entities may not have all facts “on hand” on the balance sheet date, once such facts are gathered, an assessment must be based on conditions as they existed on the balance sheet date. As the global landscape evolves, entities are encouraged to remain vigilant, document the nature and timing of events, and consult with their accounting advisers.
- *Going concern* — In the current environment, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern within one year after the date on which the interim or annual financial statements are issued (or available to be issued, when applicable). The initial assessment (before consideration of management's plans) will require an entity to consider, among other things, (1) the extent of operational disruption, (2) potential diminished demand for products or services, (3) contractual obligations due or anticipated within one year, (4) potential liquidity and working capital shortfalls, and (5) access to existing sources of capital (e.g., available line of credit). An entity can only base this initial assessment on information that is available (i.e., known and reasonably knowable) as of the issuance date of the financial statements. An entity may be able to alleviate substantial doubt, if such doubt exists, if it is probable that the entity's plans will be effectively implemented and, when implemented, will mitigate the conditions that are raising substantial doubt in the first instance and will do so within one year after the issuance date of the financial statements. Further, an entity must provide comprehensive disclosures in its annual and interim financial statements when events and conditions are identified that raise substantial doubt about the entity's ability to continue as a going concern even when management's plans alleviate such doubt.
- *Loss contingencies* — Many entities are facing disruption and delays or are incurring other contingencies in the current environment. Entities are required to disclose both recognized and unrecognized contingencies and the nature of the contingencies, particularly when loss is reasonably possible but not yet recorded in the financial statements.
- *Share-based compensation* — Many life sciences entities provide share-based compensation to incentivize employees and retain talent. Share-based compensation awards may be subject to various vesting conditions and requirements that have been affected in the current environment or, as a result of declines in financial performance of the underlying stock, may be considered deeply out-of-the-money. Entities should carefully evaluate changes in these awards to ensure that the appropriate accounting treatments are being applied.

Entities must carefully consider their unique circumstances and risk exposures when analyzing how recent events may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material current or potential effects of the current environment. It is also critical that management understand the risks entities face and how those risks affect them. Further, SEC registrants must consider whether (1) certain disclosures are required by Form 8-K (e.g., material impairment charges, liquidity events that result in a violation of debt covenants) and (2) to disclose information in areas such as MD&A or the risk factors section in addition to their disclosures in the footnotes to the financial statements.

Registrants must consider the impacts of the current environment on their required disclosures and public filings. Applicable SEC staff guidance includes [CF Disclosure Guidance Topics 9](#) and [9A](#) (which were issued in response to the pandemic) and a [sample letter](#) discussing disclosure considerations (which was issued in response to the Russia-Ukraine War). While the guidance in those documents was prompted by specific events, it continues to apply in the current environment.

The remainder of this chapter further discusses key accounting and financial reporting considerations for life sciences entities related to conditions that may result from the current environment. In addition, disclosure matters related to the current environment are discussed in [Section 1.13](#). For more information about the topics highlighted in the sections below, see the following Deloitte *Financial Reporting Alert* newsletters:

- [“Accounting and Financial Reporting in Uncertain Times: Considerations for Navigating Macroeconomic and Geopolitical Challenges.”](#)
- [“Accounting and Financial Reporting Considerations Related to the Current Macroeconomic and Geopolitical Environment.”](#)
- [“Financial Reporting Considerations Related to COVID-19 and an Economic Downturn.”](#)
- [“COVID-19 and Financial Reporting Trends — Accounting for the Pandemic in the Current Quarter.”](#)
- [“COVID-19 and Non-GAAP Measures.”](#)
- [“COVID-19 Financial Reporting Trends — Different News or More of the Same?”](#)

## 1.2 Potential Impact on Contract R&D Arrangements

Life sciences entities that have contractual arrangements to perform contract R&D for others (e.g., biotechs and CROs) may experience changes in the cost of performing contract R&D (e.g., as a result of a shift in the mix of in-person monitoring visits and remote monitoring, or because of changes in patterns of enrolling patients in clinical trials), which could have revenue recognition implications. For example, an entity that uses a cost-based input method to measure its progress toward complete satisfaction of a performance obligation would need to reevaluate whether its measure of progress is affected by changes in the overall cost of the R&D program or whether any increased costs should be excluded from the measure of progress because they do not depict the entity's performance in transferring control of the contract R&D (e.g., if the costs are due to unexpected amounts of wasted materials, labor, or other resources). Further, the potential disruption in an entity's performance of contract R&D could affect its estimate of variable consideration in circumstances in which the entity is entitled to receive R&D milestone payments if (1) clinical trial regulatory approvals are received by a certain date, (2) regulatory approval for commercialization is ultimately achieved, or (3) both. See Chapter 2 for more information about collaborative arrangements accounted for as revenue contracts.

### 1.3 Impairment of Nonfinancial Assets (Including Goodwill)

As a result of the changes in the current environment, life sciences entities should consider whether they are experiencing any conditions (e.g., decreased revenues, order cancellations, supply-chain disruptions, or declines in share price) that indicate that their assets should be tested for impairment (i.e., a “triggering event” has occurred). Even assets that have an annual impairment testing requirement, such as goodwill or indefinite-lived intangible assets, should be tested for impairment when a triggering event occurs. For example, the decline in global equity markets in the current environment may have led an entity to conclude that it was required to test goodwill for impairment (because a decline in market capitalization could signal a change in facts and circumstances “that would more likely than not reduce the fair value of a reporting unit below its carrying amount,” in accordance with ASC 350-20-35-30). The guidance on testing assets for impairment varies depending on the asset being tested. Some nonfinancial assets are tested for impairment individually, while others are tested as part of a larger unit of account. Further, some nonfinancial assets are tested by using a recoverability test, while others are tested by using a fair value or net realizable value test.

In addition, it is important to consider the order in which assets are tested so that the entity can ensure that any required adjustments are made before including those assets in the testing of larger units of account. Assets that are not held for sale should be tested for impairment in the following order: (1) assets outside the scope of ASC 360-10 (other than goodwill), such as inventory, capitalized costs of obtaining or fulfilling a revenue contract, and indefinite-lived intangible assets; (2) long-lived assets in accordance with ASC 360-10; and (3) goodwill in accordance with ASC 350-20.

#### 1.3.1 Indefinite-Lived Intangible Assets Other Than Goodwill

As stated in ASC 350-30-35-4, an indefinite-lived intangible asset is one for which “there is no foreseeable limit on the period of time over which it is expected to contribute to the cash flows of the reporting entity.” Certain brands, trademarks, or licenses are common examples.

Indefinite-lived intangible assets are tested annually for impairment and more frequently if events or changes in circumstances indicate that it is more likely than not that the intangible asset is impaired in accordance with ASC 350-30. ASC 350-30-35-18B provides examples of these events or changes in circumstances, which include, but are not limited to, financial performance, legal or political factors, entity-specific events, and industry or market considerations. On the basis of the impairment assessment, if an entity determines that it is more likely than not that the carrying value of the intangible asset exceeds its fair value, the entity performs a valuation to determine the fair value of the asset and recognizes an impairment loss equal to the excess of the carrying amount of the intangible asset over its fair value.

A valuation technique that is often applied to the measurement of a brand or trademark is the relief from royalty method. This method, which focuses primarily on expected revenues and royalty rates, requires the entity to make fewer assumptions than other income methods. Entities are expected to use their best estimate of all required business and valuation assumptions for this or other income methods used to measure the fair value of an indefinite-lived intangible asset.

In addition to evaluating the need for an interim impairment test, an entity should also consider whether there are any indicators that an intangible asset classified as indefinite-lived has become finite-lived, which might occur if an entity changes its expected use of the asset in response to the effects of the current environment.





### Disclosure Considerations

ASC 350-30-50-3 provides specific disclosure requirements for each recognized impairment loss related to an intangible asset.

## 1.3.2 Long-Lived Assets

A life sciences entity should consider whether it is experiencing (1) a decline in revenues, (2) an increase in costs (i.e., a decline in net cash flows), or (3) both as a result of the current environment. Such changes may indicate that the entity should test its long-lived assets for recoverability. Although we expect each entity to be affected differently in terms of both the effects of the current environment on its cash flows and the susceptibility of its long-lived assets to impairment, an entity should document its considerations regarding the recoverability of its long-lived assets.

Entities are required by ASC 360-10-35-21 to test a long-lived asset (asset group) that is classified as held and used for recoverability “whenever events or changes in circumstances indicate that its carrying amount may not be recoverable” (e.g., a significant adverse change in the business climate that could affect the value of a long-lived asset [asset group]). Events or changes in circumstances that prompt a recoverability test are commonly referred to as “triggering events.” In light of events such as the idling of manufacturing facilities, or trends related to decreases in consumer spending, many entities are likely to experience one or more of the triggering events listed in ASC 360-10-35-21. For example, triggering events that may be present as a result of the current environment include, but are not limited to, a “significant decrease in the market price of a long-lived asset (asset group),” a “significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition,” or a “current-period operating or cash flow loss combined with . . . a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group).”

ASC 360-10-35-23 states that “a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.” Such a combination is called an asset group.

An asset group may include not only long-lived assets that are within the scope of ASC 360-10 but also other assets such as receivables, inventory, indefinite-lived intangible assets, or goodwill. ASC 360-10-15-5 provides a list of assets that are not within the scope of ASC 360-10. Note that ASC 360-10 applies to long-lived assets that are not within the scope of other GAAP, such as property, plant, and equipment (PP&E); finite-lived intangible assets (customer relationships, technology, brands, and tradenames); and right-of-use assets.

To test a long-lived asset (asset group) for recoverability, an entity compares the carrying value of the asset (asset group) to the undiscounted net cash flows generated from the asset’s (asset group’s) use and eventual disposal. While the use of undiscounted cash flows generally indicates that a long-lived asset (asset group) is less prone to impairment, reductions in the estimates of undiscounted cash flows based on the expected duration and magnitude of conditions in the current environment may indicate that the carrying amount of the long-lived asset (asset group) is not recoverable.

If an entity estimates future cash flows to test the recoverability of a long-lived asset (asset group), such an estimate should include only the future cash flows (cash inflows minus associated cash outflows) that are (1) directly associated with the asset (asset group) and (2) expected to arise as a direct result of the use and eventual disposition of the asset (asset group). To estimate future cash flows, the entity must consider both cash inflows and cash outflows. ASC 360 indicates that it may be useful for the entity to apply a probability-weighted approach when it is considering alternative courses of action to recover the carrying amount of a long-lived asset (asset group). Such an approach may also be beneficial when the

entity is considering alternative courses of action to manage cash outflows in response to anticipated revenue declines as well as when evaluating the extent of government intervention and the potential effects of any such intervention on both cash inflows and cash outflows.

ASC 360-10-35-30 states, in part, that the “assumptions used in developing [cash flow estimates should] be reasonable in relation to the assumptions used in developing other information used by the entity for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others.”

If the entity determines that the carrying amount of the long-lived asset (asset group) is not recoverable, the entity then performs the next step in the impairment test by recognizing an impairment loss for the amount by which the carrying amount of the long-lived asset (asset group) exceeds its fair value. It then allocates that amount, in accordance with ASC 360-10-35-28, to the long-lived assets that are within the scope of ASC 360-10 “on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the group shall not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable without undue cost and effort.”

If an entity determines that a long-lived asset (asset group) is recoverable, it does not recognize an impairment loss, even if the carrying value of that asset (asset group) exceeds its fair value. Regardless of whether an entity recognizes an impairment loss, it should still consider whether the existence of a trigger indicates that there has been a change in the useful life or salvage value of its long-lived assets. If so, it should revise its depreciation or amortization estimates accordingly.

Sometimes, an entity may conclude that the affected long-lived assets will be sold, abandoned, or otherwise disposed of. Under ASC 360, if the held-for-sale criteria in ASC 360-10-45-9 are met, the entity is required to measure the asset (asset group) “at the lower of its carrying amount or [its] fair value less cost to sell” in accordance with ASC 360-10-35-43. A long-lived asset that will be abandoned will continue to be classified as held and used until it is disposed of. Such an asset is disposed of when it ceases to be used. However, a “long-lived asset that [is] temporarily idled shall not be accounted for as if abandoned,” in accordance with ASC 360-10-35-49. Further, in accordance with ASC 360-10-35-48, “[w]hen a long-lived asset ceases to be used, the carrying amount of the asset should equal its salvage value, if any.”



### Disclosure Considerations

ASC 360-10-50 provides disclosure requirements for impairments of long-lived assets classified as held and used and for long-lived assets classified as held for sale or disposed of.

## 1.4 Forecasting

Life sciences entities continue to face challenges related to forecasting as a result of the ongoing uncertainties associated with the current environment.

In thinking about both a new normal and future trends, some life sciences companies are evaluating whether customer preferences have shifted in such a way that they most likely will not reach the same performance levels they achieved before the pandemic. Other companies that may be benefiting currently are assessing whether they will continue to outperform in future periods or revert back to historical performance, or whether other trends or drivers (e.g., inflation, future regulations) are affecting results.

With all the unknowns and uncertainties, including the timing and pattern of economic recovery, we have noted that more companies are preparing multiple forecasts with different recovery scenarios and are probability-weighting the likelihood of each outcome. In addition, with the increase of liquidity challenges and shortfalls of capital resources, many companies have enhanced their focus on forecasting cash position and cash flows rather than allowing cash flow estimates to be simply derived on the basis of forecasted operations.

While the approach to forecasting operations that some companies have taken leverages historical data from the 2008 financial crisis (the “financial crisis”) as an appropriate benchmark, we believe that such companies should exercise caution in determining the extent to which the financial crisis is comparable to the current environment given the fundamental differences between the two economic periods. For example, the current environment may present a myriad of factors such as change in customer behavior, workforce adjustments, and industry-specific impacts, which were not necessarily present during the financial crisis and may not affect all entities in the same fashion.

While we do not believe that there is a one-size-fits-all approach to addressing the forecasting challenges that exist currently, we have seen the following strategies prove to be effective for a number of companies:

- Evaluating recovery and financial forecasts from an outside-in perspective first. Specifically, focusing on the factors, issues, and conditions outside of a company's control that are known and knowable.
- Automating components of forecasting to help remove bias and facilitate more real-time and frequent reforecasting as key drivers and trends change, while also analyzing data at a more detailed level.
- Considering facts that both support and contradict assumptions regarding the company's timing and pattern of recovery, sustainability, and growth.

## 1.5 Revenue Contracts

Some life sciences companies may seek to mitigate the effects of the current environment by offering features such as price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms, opportunities to terminate agreements without penalty, or revisions to purchase commitments.

If revisions are made to a revenue contract, significantly different reporting outcomes may result depending on the nature of the changes. Companies must consider the specific facts and circumstances of changes in contractual terms (including their business practices and communications with customers) to determine whether to account for the impact of such changes at a single point in time or over a longer period. See Chapter 2 for more considerations related to revenue recognition.

### 1.5.1 Failure-to-Supply Penalties

Some contracts with customers include a clause requiring the entity to pay a penalty to the customer if it is unable to fulfill an order on a timely basis or to meet certain performance conditions specified in the contract. As illustrated in Example 20 in ASC 606 (ASC 606-10-55-194 through 55-196), an entity should consider such a penalty to be variable consideration in estimating the transaction price with the customer. Further, the obligation to pay a penalty under such a scenario, once triggered, does not represent a contingent loss under ASC 450-20; rather, the obligation should be accounted for as a contractual liability. The probability of payment is irrelevant if settlement of the liability is required by law or by contract. That is, other than deferred revenues, liabilities established by law or contract should

be recorded at their stated amounts unless the guidance in U.S. GAAP requires otherwise. An entity's uncertainty about whether an obligee will require performance does not (1) allow the entity to choose to avoid the future sacrifice or (2) relieve the entity of the obligation. Once recognized, a contractual or legal liability that is not deferred revenue (i.e., a contract liability under ASC 606) should be derecognized only when the conditions for liability derecognition in ASC 405-20-40-1 have been met (i.e., relief through repayment, or through a legal release either judicially or by the creditor).

## 1.5.2 Retroactive Payback Provisions

In certain countries, companies are required to pay rebates to the country's government health care system if domestic industry sales exceed specified thresholds in a given year. In such a case, the portion of the payback allocated to an individual company is based on that company's current market share (or sales) in relation to the industry as a whole. For revenue recognition purposes, a retroactive payback provision represents variable consideration that would need to be estimated, subject to the variable consideration constraint. In light of the significant health care costs being incurred in many jurisdictions with such provisions, there may be an increased likelihood that domestic industry sales will exceed specified thresholds. Conversely, a life sciences entity's market share could be negatively affected by supply-chain disruption as a result of the current environment. Therefore, an entity may need to consider revising its estimates of such provisions.

## 1.6 Going-Concern Analysis and Disclosures

The current environment is significantly disrupting the operations of many businesses. Entities will need to consider whether such disruption will be prolonged and result in diminished demand for products or services or significant liquidity shortfalls (or both) that, among other things, raise substantial doubt about whether the entity may be able to continue as a going concern.

As part of performing this assessment, management may need to consider whether the entity's financial statements should continue to be prepared on a going-concern basis (i.e., whether ASC 205-30 is applicable). Even more importantly, management must consider whether (on the basis of ASC 205-40), (1) there are conditions and events that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the interim or annual financial statements are issued and (2) these conditions are able to be mitigated by management's plans.

ASC 205-40 requires an entity to provide disclosures in the **annual** and **interim** financial statements when events and conditions are identified that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued. Such disclosures are required even when management's plans alleviate such doubt about the entity's ability to continue as a going concern. If management's plans do not alleviate substantial doubt about the entity's ability to continue as a going concern, in addition to the required disclosures, management must state in the notes to the financial statements that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the annual or interim financial statements are issued.

As indicated in ASC 205-40-55-2, assessing whether there is substantial doubt about an entity's ability to continue as a going concern may involve the consideration of factors such as the following:

- a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios

- b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood.

Entities should consider the impacts to their forecasts described earlier in this chapter when updating their going-concern analysis. Management should be mindful of the timing of certain forecasted transactions and the entity's ability to accurately predict and consummate those transactions in the current environment. See Section 13.6 for more information about a going concern.

## 1.7 Subsequent Events

Given the current environment and the likelihood that events may occur rapidly or unexpectedly, entities should carefully evaluate information that becomes available after the balance sheet date but before the issuance of the financial statements. ASC 855-10-25-1 and ASC 855-10-25-3 provide the following guidance on evaluating subsequent events:

### ASC 855-10

**25-1** An entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. See paragraph 855-10-55-1 for examples of recognized subsequent events.

**25-3** An entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued. See paragraph 855-10-55-2 for examples of nonrecognized subsequent events.

Often the "events" are (1) company-specific and (2) associated with a specific account that permits a more precise analysis. However, sometimes the "events" are macroeconomic (such as those resulting from the current environment) and have a pervasive impact on many estimates in a set of financial statements, which may make it difficult to ascertain whether such conditions "existed" on the balance sheet date. The medium-term and long-term effects of the current environment on economic activity are still unknown. However, the current environment will be a factor in an entity's analysis of estimates residing in the financial statements, including, but not limited to, estimates related to receivable reserves, obsolescence reserves, impairment analyses, variable and contingent compensation, and current expected credit loss reserves. While the events stemming from the current environment are extremely volatile, entities will nevertheless be required to consider conditions as they existed on the balance sheet date when evaluating subsequent events. There are currently many approaches to the consideration of subsequent events in complex estimate analyses such as impairment models (e.g., whether changes in circumstances that alter projection models before the issuance date can be considered given the fluidity of the situation).

Given the current environment, significant judgment will most likely be required in assessments related to subsequent event matters. Entities are encouraged to consult with their advisers as needed.



### Disclosure Considerations

ASC 855-10-50-2 notes, in part, that “[s]ome nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading.” In such circumstances, the disclosures must include (1) the “nature of the event” and (2) an “estimate of its financial effect, or a statement that such an estimate cannot be made.”

## 1.8 Loss Contingencies

ASC 450 defines a loss contingency as an “existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.” Instability in the economy resulting from the current environment may cause entities to incur losses that should be recognized, disclosed, or both.

All loss contingencies (including incurred but not reported [IBNR] claims such as those related to medical care) should be evaluated under ASC 450-20 unless the contingency is within the scope of other authoritative literature that specifically prescribes an alternate accounting model. ASC 450-20 requires accrual of a loss contingency when (1) it is probable that a loss has been incurred and (2) the amount can be reasonably estimated. To accrue a loss contingency, an entity must determine the probability of the uncertain event and demonstrate its ability to reasonably estimate the loss associated with the uncertain event. Loss contingencies that do not meet both recognition criteria may need to be disclosed in the financial statements. Given the general uncertainty associated with the current environment, entities may find it challenging to develop estimates for loss contingencies. For example, an entity that is self-insured for medical claims may have difficulty estimating its IBNR liability if it concludes that historical claim patterns may not be representative of future expected claims because of the current environment.



### Disclosure Considerations

Under ASC 450-20-50, entities must disclose both recognized and unrecognized contingencies if certain criteria are met. In some situations, disclosure of the nature of the accrual and amount accrued may be necessary to prevent the financial statements from being misleading. For unrecognized contingencies, disclosure of the nature of the contingency and an estimate of the possible loss or range of loss (or a statement that an estimate cannot be made) is required in certain situations. Specifically, disclosure is called for if there is a reasonable possibility that a loss may be incurred but has not been accrued in the financial statements because the amount is not probable or reasonably estimable. Disclosure is also required if there is a reasonable possibility of unrecorded losses in excess of the amount accrued in the financial statements.

For more information about loss contingencies, see Deloitte’s Roadmap [Contingencies, Loss Recoveries, and Guarantees](#) and Chapter 6 of this Guide.

## 1.9 Recognition of Losses on Firmly Committed Executory Contracts

At the inception of a firmly committed executory contract, both parties to the contract expect to receive benefits that are equal to or greater than the costs to be incurred under the contract. Because of the impacts of the current environment, the fair value of the remaining contractual rights of a firmly committed executory contract may unexpectedly decline below the remaining costs, resulting in a firmly committed executory loss contract. For example, an entity engaged to provide services to its customer in accordance with a firmly committed executory contract may experience a significant increase in the cost of providing the services (e.g., lack of availability of personnel to provide services resulting in the use of higher outsourced labor cost), which could result in an overall loss on the contract. We generally believe

that in the absence of specific guidance to the contrary (e.g., a firm purchase commitment for goods or inventory under ASC 330 or certain executory contracts related to exit or disposal activities within the scope of ASC 420), it is inappropriate to accrue for a loss related to a firmly committed executory contract.

## 1.10 Future Operating Losses

An entity may forecast operating losses for a certain period as a result of the current environment. Such losses may result from declines in customer demand or disruptions in the supply chain. Future operating losses do not meet the definition of a liability, nor do they qualify for accrual under ASC 450-20. Instead, they should be reflected in the period in which the related costs are incurred.

## 1.11 Insurance Recoveries

Entities that incur losses stemming from the current environment may be entitled to insurance recoveries. For example, losses associated with increased medical claims, asset impairments, or shareholder litigation may be considered insured losses by many entities. Further, entities may have business interruption insurance that provides coverage for lost profits due to a suspension of the entities' operations.

### 1.11.1 Insured Losses

If an entity incurs a loss attributable to the impairment of an asset or to the incurrence of a liability and expects to recover all or a portion of that loss through an insurance claim, the entity should record an asset for the amount for which recovery from the insurance claim is considered probable (not to exceed the amount of the total losses recognized). The entity should subsequently recognize amounts greater than those for which recovery from an insurance claim was initially deemed probable only to the extent that those amounts do not exceed actual additional covered losses or direct, incremental costs incurred to obtain the insurance recovery. A conclusion that a potential insurance recovery is probable may involve significant judgment and should be based on all relevant facts and circumstances. In determining whether it is probable that an insurance recovery will be received, an entity will most likely need, among other factors, to understand the solvency of the insurance carrier and have had enough dialogue and historical experience with the insurer related to the type of claim in question to assess the likelihood of payment. Other potential challenges an entity may encounter when evaluating whether a loss is considered recoverable through insurance include, but are not limited to, (1) the need to consider whether losses stemming from a pandemic are specifically excluded as a covered event, (2) the extent of coverage and limits, including multiple layers of insurance from different carriers, and (3) the extent, if any, to which the insurance carrier disputes coverage. Consultation with legal counsel may also be necessary.



### Connecting the Dots

We believe that while applicable to SEC registrants, the following guidance from footnote 49 of [SAB Topic 5.Y](#) applies to all entities evaluating an insured loss that is contested by the insurance carrier:

The staff believes there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant. Registrants that overcome that presumption should disclose the amount of recorded recoveries that are being contested and discuss the reasons for concluding that the amounts are probable of recovery.



Any expected recovery that is greater than covered losses or direct, incremental costs incurred represents a gain contingency and therefore has a higher recognition threshold. An entity should generally recognize insurance proceeds that will result in a gain when the proceeds are realized or realizable, whichever is earlier. Such insurance proceeds are realized when the insurance carrier settles the claim and no longer contests payment. Payment alone does not mean that realization has occurred if such payment is made under protest or is subject to refund.

### **1.11.2 Business Interruption**

Events associated with the current environment have led many entities to temporarily suspend operations for reasons ranging from supply-chain disruption to, during the pandemic, state and local government orders requiring individuals to shelter in place and temporarily cease operations. Business interruption insurance differs from other types of insurance coverage in that it is designed to protect the prospective earnings or profits of the insured entity. That is, business interruption insurance provides coverage if business operations are suspended because of the loss of use of property and equipment resulting from a covered loss. Business interruption insurance also generally provides for reimbursement of certain costs and losses incurred during the interruption period. Such costs may be analogous to losses from property damage and, accordingly, it may be appropriate to record a receivable for amounts whose recovery is considered probable. We encourage entities to consult with their independent auditors in connection with their evaluation of whether a receivable may be recorded for expected insurance recoveries associated with fixed costs incurred during an interruption period.

The loss of profit margin is considered a gain contingency and should be recognized when the gain contingency is resolved (i.e., the proceeds are realized or realizable). Because of the complex and uncertain nature of the settlement negotiation process, such recognition generally occurs at the time of final settlement or when nonrefundable cash advances are made.

### **1.11.3 Classification of Insurance Recoveries**

ASC 220-30-45-1 addresses other income statement presentation matters related to business interruption insurance from the perspective of classification and allows an entity to “choose how to classify business interruption insurance recoveries in the statement of operations, as long as that classification is not contrary to existing [U.S. GAAP].”

For presentation within the statement of cash flows, ASC 230-10-45-21B indicates that “[c]ash receipts resulting from the settlement of insurance claims, excluding proceeds received from corporate-owned life insurance policies and bank-owned life insurance policies, shall be classified on the basis of the related insurance coverage (that is, the nature of the loss).” For example, insurance settlement proceeds received as a result of claims related to a business interruption should be classified as operating activities.

## **1.12 Share-Based Compensation Plans and Awards**

We have seen an increased level of activity related to share-based compensation plans and awards. The ongoing impact of the current environment has led to the obsolescence of many previously established company-specific performance targets and the possibility that employees' outstanding stock options could become “underwater” or out-of-the-money. While some companies have modified awards to revise performance targets, others have delayed the timing of granting awards, issued “off-cycle” grants, modified the strike price of existing underwater options, and extended the exercise period for awards, all presumably in an effort to ensure that share-based compensation arrangements continue to provide the intended motivation for company employees and executives to work toward accomplishing company goals and objectives.

Regardless of the specific action taken, modifications of stock awards can lead to a host of accounting challenges and consequences. For example, when revising performance targets, companies need to be mindful that the performance conditions are sufficiently objective and determinable; otherwise, an award may not be considered “granted,” leading to variable and potentially increased expense if compensation cost must be recorded before the grant date is established. In addition, when modifying stock awards, companies need to consider whether such awards were expected to vest before the modification and, if so, whether the modified awards provide incremental value to the recipients. Further, companies that grant stock options or similar awards will need to consider recent market volatility when valuing their stock awards and the related compensation expense to be reported. See Chapter 9 for additional considerations related to share-based compensation.

### 1.13 Considerations Related to Reflecting Impacts of the Current Environment in Non-GAAP Measures

While some of the key SEC requirements and interpretations related to non-GAAP measures address the prominence, reconciliation, usefulness, and purpose of such measures, an overarching theme of the guidance is that they should not be misleading, regardless of whether the measures are used in a filing (e.g., Form 10-K) or elsewhere (e.g., press release). As described in [Section 100](#) of the SEC Division of Corporation Finance (the “Division”) Compliance and Disclosure Interpretations (C&DIs) on non-GAAP financial measures, non-GAAP measures that could mislead investors may include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods (e.g., adjusting for an item in the current reporting period but not doing so for a similar item in the prior period without appropriately disclosing the change and explaining the reasons for it).
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains (e.g., “cherry picking” non-GAAP adjustments to achieve the most positive measure).
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.
- Are mislabeled or not clearly labeled as non-GAAP measures or otherwise include adjustments that are not clearly or accurately labeled or described.

In interactions with the SEC staff regarding non-GAAP measures viewed as misleading, some registrants have proposed supporting continued presentation of such measures by adding transparent disclosures related to the calculation of the measures or about the measures’ purpose and use. However, Question 100.06 of the C&DIs indicates that even detailed disclosures about a misleading measure would not prevent it from being misleading.

At the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff indicated that once a non-GAAP measure or adjustment is concluded to be misleading or otherwise inconsistent with non-GAAP rules, the staff expects the registrant to correct the presentation in the next filing or publicly available SEC document by removing the measure or adjustment. If comparable periods are presented, the non-GAAP measure or adjustment should be removed from all periods presented. At the 2023 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC further emphasized that non-GAAP measures continue to be one of the topics the SEC staff comments on most frequently.



## Changing Lanes

On December 13, 2022, the SEC staff released **new and updated C&DIs** on non-GAAP financial measures. The staff has observed that the volume of non-GAAP disclosure comments has remained high over the past several years and that it continues to receive questions on this topic. The new and updated C&DIs help increase the transparency of the SEC staff's process for evaluating certain non-GAAP measures as well as its criteria for considering such measures misleading.

At the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, Division Chief Accountant Lindsay McCord emphasized that the intent of the new and updated C&DIs is to communicate interpretive feedback that the SEC staff has provided to registrants in various speeches and the comment letter process. In addition, she noted that the updates to the C&DIs are not intended to change the SEC staff's position on non-GAAP adjustments that it has not objected to in the past (e.g., adjustments for restructuring costs and stock-based compensation). However, Ms. McCord further acknowledged that conclusions about the application of the C&DIs to non-GAAP measures and adjustments will depend on a registrant's individual facts and circumstances.

The following changes related to misleading non-GAAP measures were made to the C&DIs:

- C&DI Question 100.01 was updated to add interpretive guidance on what may be considered normal or recurring. The C&DI cautions issuers that a non-GAAP measure may be considered misleading if it excludes cash operating expenses that are normal and recurring in the operation of a registrant's business.

At the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, Ms. McCord explained that the SEC staff evaluates whether an expense is "normal" by considering the nature and effect of the non-GAAP adjustment and how the expense is related to the registrant's operations, revenue-generating activities, business strategy, industry, and regulatory environment. She also noted that the SEC staff evaluates whether an operating expense is considered "recurring" when it occurs repeatedly or occasionally, including at irregular intervals of reoccurrence.

- C&DI Question 100.04 was updated to clarify that adjustments that represent the application of individually tailored accounting principles extend beyond the original example of adjustments that accelerate revenue recognition. The C&DI specifies that non-GAAP adjustments that change the GAAP recognition and measurement principles would be considered individually tailored and may cause the non-GAAP measure presentation to be misleading. The C&DI includes new examples that illustrate the application of individually tailored accounting principles and thus may be misleading.
- C&DI Question 100.05 was added to highlight the SEC's guidance that non-GAAP measures should be labeled as such and that adjustments should be clearly labeled and described in the disclosures. The C&DI also gives examples of misleading labels and descriptions for non-GAAP measures.
- C&DI Question 100.06 was added to emphasize that no amount of disclosure can make a measure compliant with the non-GAAP rules if it has been determined to be misleading.

Further, when evaluating whether an adjustment stemming from the current environment is appropriate in a non-GAAP measure, a registrant should consider various factors, including, but not limited to, whether the adjustment is:

- Directly related to the current environment.
- Incremental to normal operations and nonrecurring (i.e., it is not expected to become the new normal).
- Objectively quantifiable, as opposed to an estimate or projection.

A registrant must use judgment when evaluating whether an adjustment is consistent with these factors. However, we believe that a non-GAAP measure of performance that eliminates normal recurring cash operating expenses would generally not be appropriate.

In addition, any new adjustments or changes to non-GAAP measures related to the current environment should be clearly labeled, and changes to such measures should be transparently disclosed. If new adjustments to non-GAAP measures are added because of the current environment, an entity should ensure that its disclosure controls and procedures address the assessment and approval of the revised non-GAAP measures, including the consistency of presentation between periods and transparent disclosures about any changes.

See Deloitte's Roadmap [Non-GAAP Financial Measures and Metrics](#) for more information about SEC requirements and interpretations related to such measures and metrics. In addition, see Deloitte's Roadmap [SEC Comment Letter Considerations, Including Industry Insights](#) for current trends in SEC comments.

### **1.13.1 Alternatives to Non-GAAP Measures**

Given the potential challenges associated with many of the adjustments discussed above, an SEC registrant may determine that transparent disclosure in MD&A may more effectively inform investors about certain impacts of the current environment than non-GAAP measures. For example, if a registrant elects to provide disclosures that simply quantify the estimated impact of the current environment on financial statement line items without adjusting the registrant's GAAP results (i.e., without establishing new totals or subtotals), those disclosures are not considered non-GAAP measures. If a registrant provides disclosure that does not adjust a GAAP measure but instead describes unusual or significant activities that occurred during the period, the disclosure would not be subject to the SEC's requirements and interpretations related to non-GAAP measures. When presenting disclosure alternatives, a registrant should disclose individually material financial statement impacts stemming from the current environment separately.

# Appendix B — Titles of Standards and Other Literature

## AICPA Literature

### Accounting and Valuation Guides

*Assets Acquired to Be Used in Research and Development Activities*

*Valuation of Privately-Held-Company Equity Securities Issued as Compensation*

### Clarified Statements on Auditing Standards

AU-C Section 501, "Audit Evidence — Specific Considerations for Selected Items"

AU-C Section 620, "Using the Work of an Auditor's Specialist"

## FASB Literature

### ASC Topics

ASC 105, *Generally Accepted Accounting Principles*

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 440, *Commitments*

ASC 450, *Contingencies*

ASC 460, *Guarantees*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 705, *Cost of Sales and Services*

ASC 710, *Compensation — General*

ASC 712, *Compensation — Nonretirement Postemployment Benefits*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 830, *Foreign Currency Matters*

ASC 832, *Government Assistance*

ASC 835, *Interest*  
 ASC 840, *Leases*  
 ASC 842, *Leases*  
 ASC 845, *Nonmonetary Transactions*  
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 ASC 860, *Transfers and Servicing*  
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 ASC 930, *Extractive Activities — Mining*  
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 ASC 948, *Financial Services — Mortgage Banking*  
 ASC 954, *Health Care Entities*  
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## Appendix C — Abbreviations

Abbreviation	Description
<b>AETR</b>	annual effective tax rate
<b>AFS</b>	available for sale
<b>AFSI</b>	adjusted financial statement income
<b>AI</b>	artificial intelligence
<b>AICPA</b>	American Institute of Certified Public Accountants
<b>AIN</b>	AICPA Accounting Interpretation of an APB Opinion
<b>AMT</b>	alternative minimum tax
<b>ANDA</b>	abbreviated new drug application
<b>APB</b>	Accounting Principles Board
<b>API</b>	active pharmaceutical ingredient
<b>ARO</b>	asset retirement obligation
<b>ASC</b>	FASB Accounting Standards Codification
<b>ASR</b>	accelerated share repurchase
<b>ASU</b>	FASB Accounting Standards Update
<b>AUD</b>	Australian dollar
<b>BCF</b>	beneficial conversion feature
<b>BEAT</b>	base erosion anti-abuse tax
<b>BEMTA</b>	base erosion minimum tax amount
<b>BPD</b>	branded prescription drug
<b>C&amp;Dis</b>	Compliance and Disclosure Interpretations
<b>CAM</b>	critical audit matter
<b>CAQ</b>	Center for Audit Quality
<b>CARES Act</b>	Coronavirus Aid, Relief, and Economic Security Act
<b>CCF</b>	cash conversion feature

Abbreviation	Description
<b>CECL</b>	current expected credit loss
<b>CFC</b>	controlled foreign corporation
<b>CIMA</b>	Chartered Institute of Management Accountants
<b>CMO</b>	contract manufacturing organization
<b>CRO</b>	contract research organization
<b>CSRD</b>	Corporate Sustainability Reporting Directive
<b>DTA</b>	deferred tax asset
<b>DTL</b>	deferred tax liability
<b>EBITDA</b>	earnings before interest, taxes, depreciation, and amortization
<b>ED</b>	exposure draft
<b>EDGAR</b>	SEC electronic data gathering, analysis, and retrieval system
<b>EGC</b>	emerging growth company
<b>EITF</b>	Emerging Issues Task Force
<b>ELOC</b>	equity line of credit
<b>EPS</b>	earnings per share
<b>ESA</b>	energy service agreement
<b>ESG</b>	environmental, social, and governance
<b>ESPP</b>	employee stock purchase plan
<b>ESRS</b>	European Sustainability Reporting Standards
<b>EUR</b>	euros
<b>Exchange Act</b>	Securities Exchange Act of 1934
<b>FASB</b>	Financial Accounting Standards Board
<b>FAST Act</b>	Fixing America's Surface Transportation Act

Abbreviation	Description
<b>FDA</b>	U.S. Food and Drug Administration
<b>FDII</b>	foreign-derived intangible income
<b>FOB</b>	free on board
<b>FPI</b>	foreign private issuer
<b>FRM</b>	SEC Division of Corporation Finance Financial Reporting Manual
<b>FVO</b>	fair value option
<b>FVTOCI</b>	fair value through other comprehensive income
<b>GAAP</b>	generally accepted accounting principles
<b>GenAI</b>	generative artificial intelligence
<b>GHG</b>	greenhouse gas
<b>GILTI</b>	global intangible low-taxed income
<b>GloBE</b>	Global anti-Base Erosion
<b>GPO</b>	group purchasing organization
<b>HAFWP</b>	how and for what purpose
<b>HFI</b>	held for investment
<b>HFS</b>	held for sale
<b>HVAC</b>	heating, ventilation, and air conditioning
<b>IAS</b>	International Accounting Standard
<b>IASB</b>	International Accounting Standards Board
<b>IBNR</b>	incurred but not reported
<b>ICFR</b>	internal control over financial reporting
<b>IFRIC</b>	IFRS Interpretations Committee
<b>IFRS</b>	International Financial Reporting Standard
<b>IIR</b>	investigator-initiated research
<b>IP</b>	intellectual property
<b>IPO</b>	initial public offering
<b>IPR&amp;D</b>	in-process research and development
<b>IRC</b>	Internal Revenue Code
<b>IRS</b>	Internal Revenue Service
<b>ISO</b>	incentive stock option

Abbreviation	Description
<b>ISSB</b>	International Sustainability Standards Board
<b>IT</b>	information technology
<b>ITC</b>	invitation to comment
<b>JOBS Act</b>	Jumpstart Our Business Startups Act
<b>LCD</b>	liquid-crystal display
<b>LIBOR</b>	London Interbank Offered Rate
<b>LIFO</b>	last in, first out
<b>M&amp;A</b>	merger and acquisition
<b>MD&amp;A</b>	Management's Discussion & Analysis
<b>MNE</b>	multinational enterprise
<b>MSL</b>	medical science liaison
<b>NDA</b>	new drug application
<b>NFP</b>	not-for-profit (entity)
<b>NIH</b>	National Institutes of Health
<b>NOL</b>	net operating loss
<b>NOPA</b>	notice of proposed adjustment
<b>NQSO or NSO</b>	nonqualified stock option
<b>OCA</b>	SEC's Office of the Chief Accountant
<b>OCI</b>	other comprehensive income
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OEM</b>	original equipment manufacturer
<b>PBE</b>	public business entity
<b>PCAOB</b>	Public Company Accounting Oversight Board
<b>PCC</b>	Private Company Council
<b>PIPE</b>	private investment in public equity
<b>PP&amp;E</b>	property, plant, and equipment
<b>PRV</b>	priority review voucher
<b>PTRS</b>	probability of technical and regulatory success
<b>Q&amp;A</b>	question and answer
<b>QIP</b>	qualified improvement property

Abbreviation	Description
<b>R&amp;D</b>	research and development
<b>R&amp;E</b>	research and experimental
<b>REC</b>	renewable energy certificate
<b>REMS</b>	risk evaluation and mitigation strategy
<b>RIM</b>	retail inventory method
<b>ROU</b>	right of use
<b>SaaS</b>	software as a service
<b>SAB</b>	Staff Accounting Bulletin
<b>SEC</b>	U.S. Securities and Exchange Commission
<b>Securities Act</b>	Securities Act of 1933
<b>SEPA</b>	standby equity purchase agreement
<b>SOX</b>	Sarbanes-Oxley Act of 2002
<b>SPAC</b>	special-purpose acquisition company

Abbreviation	Description
<b>SPPI</b>	solely payments of principal and interest
<b>SRC</b>	smaller reporting entity
<b>S&amp;P 500</b>	Standard & Poor's 500 Index
<b>TD</b>	Treasury Decision
<b>TDR</b>	troubled debt restructuring
<b>TRG</b>	transition resource group
<b>TRWG</b>	IFRS Foundation Technical Readiness Working Group
<b>TSA</b>	transition services agreement
<b>USD</b>	U.S. dollars
<b>UTB</b>	unrecognized tax benefit
<b>VIE</b>	variable interest entity
<b>VWAP</b>	volume-weighted average daily market price
<b>XBRL</b>	eXtensible Business Reporting Language

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