



# SEC

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## Investor Bulletin: How to Read a 10-K

If you want to follow or invest in a U.S. public company, you can find a wealth of information in the company's annual report on Form 10-K. Among other things, the 10-K offers a detailed picture of a company's business, the risks it faces, and the operating and financial results for the fiscal year. Company management also discusses its perspective on the business results and what is driving them.

Most U.S. public companies are required to produce a 10-K each year and file it with the U.S. Securities and Exchange Commission (SEC). (Non-U.S. public companies usually file their annual reports with the SEC on different forms.) SEC rules require that 10-Ks follow a set order of topics.

SEC rules also require companies to send an annual report to their shareholders when they are holding annual meetings to elect members of their boards of directors. There is a lot of overlap in the requirements for the 10-K and the annual report to shareholders, but there are also important differences. The 10-K typically includes more detailed information than the annual report to shareholders. The annual report to shareholders, unlike the 10-K, sometimes appears as a colorful, glossy publication. A number of companies, however, simply take their 10-K and send it as their annual report to shareholders. In those cases, the 10-K filed with the SEC and the annual report to shareholders are the same document.

*The “Business” section is a good place to start to understand the company.*

### The Roles of Companies and the SEC

The company writes the 10-K and files it with the SEC. Laws and regulations prohibit companies from making materially false or misleading statements in their 10-Ks. Likewise, companies are prohibited from omitting material information that is needed to make the disclosure not misleading. In addition, the Sarbanes-Oxley Act requires a company's CFO and CEO to certify the accuracy of the 10-K.

The SEC neither writes the 10-K nor vouches for its accuracy. The SEC sets the disclosure requirements – the topics that all companies must cover in their 10-Ks, and how the information should

be presented.

The SEC staff reviews 10-Ks to monitor and enhance companies' compliance with the requirements. Both the SEC and the staff also provide interpretive advice about the disclosure requirements. The SEC staff reviews 10-Ks and may provide comments to a company where disclosures appear to be inconsistent with the disclosure requirements or deficient in explanation or clarity.

The Sarbanes Oxley Act requires the SEC to review every public company's financial statements at least once every three years. The SEC staff may review the 10-Ks of certain companies more frequently. All 10-Ks filed with the SEC are available to the public on the SEC's EDGAR website. Most companies also post their 10-Ks on their own websites.

# Items in the Annual Report on Form 10-K

## Part I

**Item 1** “**Business**” requires a description of the company’s business, including its main products and services, what subsidiaries it owns, and what markets it operates in. This section may also include information about recent events, competition the company faces, regulations that apply to it, labor issues, special operating costs, or seasonal factors. This is a good place to start to understand how the company operates.

**Item 1A** “**Risk Factors**” includes information about the most significant risks that apply to the company or to its securities. Companies generally list the risk factors in order of their importance. In practice, this section focuses on the risks themselves, not how the company addresses those risks. Some risks may be true for the entire economy, some may apply only to the company’s industry sector or geographic region, and some may be unique to the company.

**Item 1B** “**Unresolved Staff Comments**” requires the company to explain certain comments it has received from the SEC staff on previously filed reports that have not been resolved after an extended period of time. Check here to see whether the SEC has raised any questions about the company’s statements that have not been resolved.

**Item 2** “**Properties**” includes information about the company’s significant properties, such as principal plants, mines and

other materially important physical properties.

**Item 3** “**Legal Proceedings**” requires the company to include information about significant pending lawsuits or other legal proceedings, other than ordinary litigation.

**Item 4** This item has no required information, but is reserved by the SEC for future rulemaking.

## Part II

**Item 5** “**Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**” requires information about the company’s equity securities, including market information, the number of holders of the shares, dividends, stock repurchases by the company, and similar information.

**Item 6** “**Selected Financial Data**” provides certain financial information about the company for the last five years. You can find much more detailed financial information on the past three years in a separate section – Item 8, “Financial Statements and Supplementary Data.”

**Item 7** “**Management’s Discussion and Analysis of Financial Condition and Results of Operations**” gives the company’s perspective on the business results of the past financial year. This section, known as the MD&A for short, allows

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company management to tell its story in its own words. The MD&A presents:

- The company's operations and financial results, including information about the company's liquidity and capital resources and any known trends or uncertainties that could materially affect the company's results. This section may also discuss management's views of key business risks and what it is doing to address them.

- Material changes in the company's results compared to the prior period, as well as off-balance sheet arrangements and the company's contractual obligations.
- Critical accounting judgments, such as estimates and assumptions. These accounting judgments – and any changes from previous years – can have a significant impact on the numbers in the financial statements, such as assets, costs, and net income.

## Discussion of Risk in the MD&A

Here are examples of how an MD&A may discuss risks that the company faces.

- A consumer company might discuss ways in which it seeks to meet changing tastes.
- A manufacturing company that relies on natural resources may discuss how it assesses commodity risks and conducts resource management programs.
- A financial institution may discuss ways that management monitors liquidity and assures adequate capital under various scenarios, such as a rise in interest rates or a ratings downgrade.
- A global company may discuss how it handles exchange rate risks.
- Companies may discuss how they handle competition, build their brands, or manage in an economic downturn.
- Companies also may discuss how they ensure compliance with laws and regulations, or how they are addressing the impact of new or anticipated laws and regulations.

## Item 7A

**“Quantitative and Qualitative Disclosures about Market Risk”** requires information about the company's exposure to market risk, such as interest rate risk, foreign currency exchange risk, commodity price risk or equity price risk. The company may discuss how it manages its market risk exposures.

## Item 8

**“Financial Statements and Supplementary Data”** requires the company's audited financial statements. This includes the company's income statement (which is sometimes called the statement of earnings or the statement of operations), balance sheets, statement of cash flows and statement of stockholders' equity. The financial statements are accompanied by notes that explain the information presented in the financial statements.

U.S. companies are required to present their financial statements according to a set of accounting standards, conventions and rules known as Generally Accepted

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Accounting Principles, or GAAP. An independent accountant audits the company's financial statements. For large companies, the independent accountant also reports on a company's internal controls over financial reporting.

The auditor's report is a key part of the 10-K. Most audit reports express an "unqualified opinion" that the financial statements fairly present the company's financial position in conformity with GAAP. If, however, an auditor expresses a "qualified opinion" or a "disclaimer of opinion," investors should look carefully at what kept the auditor from expressing an unqualified opinion. Likewise, investors should carefully evaluate material weaknesses disclosed on internal controls over financial reporting.

In addition, the Sarbanes-Oxley Act of 2002 requires the company's CEO and CFO to certify that the 10-K is both accurate and complete. These are called Sections 302 and 906 certifications, and you can usually find them in Exhibits 31 and 32.

You may also find "non-GAAP financial measures" in the 10-K. That means that the numbers do NOT conform to GAAP. While companies are permitted to present non-GAAP measures, they must also show how they differ from the most comparable corresponding GAAP financial measure. As an investor, it is up to you to

decide how much weight to give to non-GAAP measures.

**Item 9** "*Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*" requires a company, if there has been a change in its accountants, to discuss any disagreements it had with those accountants. Many investors view this disclosure as a red flag.

**Item 9A** "*Controls and Procedures*" includes information about the company's disclosure controls and procedures and its internal control over financial reporting.

**Item 9B** "*Other Information*" includes any information that was required to be reported on a different form during the fourth quarter of the year covered by the 10-K, but was not yet reported.

## Part III

These items cover the following topics.

**Item 10** "*Directors, Executive Officers and Corporate Governance*" requires information about the background and experience of the company's directors and executive officers, the company's code of ethics, and certain qualifications for directors and committees of the board of directors.

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**Item 11**      “**Executive Compensation**” includes detailed disclosure about the company’s compensation policies and programs and how much compensation was paid to the top executive officers of the company in the past year.

**Item 12**      “**Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**” requires information about the shares owned by the company’s directors, officers and certain large shareholders, and about shares covered by equity compensation plans.

**Item 13**      “**Certain Relationships and Related Transactions, and Director Independence**” includes information about relationships and transactions between the company and its directors, officers and their family members. It also includes information about whether each director of the company is independent.

**Item 14**      “**Principal Accountant Fees and Services**” requires companies to disclose the fees they paid to their accounting firm for various types of services during the year.

Although these disclosures are required by the 10-K, most companies meet this requirement by providing the information in a separate document called the proxy statement, which companies provide to their shareholders in connection with annual meetings. If the information is provided through the proxy statement, the 10-K would include a statement from the company that it is incorporating the information from the proxy statement by reference – in effect directing readers to go to the proxy statement document to find this information. Keep in mind that the proxy statement is typically filed a month or two after the 10-K.

## Part IV

**Item 15**      “**Exhibits, Financial Statement Schedules**” requires a list of the financial statements and exhibits included as part of the Form 10-K. Many exhibits are required, including documents such as the company’s bylaws, copies of its material contracts, and a list of the company’s subsidiaries.

## Additional Resources

- For more information on the annual report to shareholders, please visit [www.sec.gov/answers/annrep.htm](http://www.sec.gov/answers/annrep.htm)
- For information on how to find company proxy statements on the SEC's EDGAR database, please visit [www.sec.gov/answers/proxyhtf.htm](http://www.sec.gov/answers/proxyhtf.htm)
- For our "Researching Public Companies Through EDGAR: A Guide for Investors," please visit [www.sec.gov/investor/pubs/edgar-guide.htm](http://www.sec.gov/investor/pubs/edgar-guide.htm)
- For the SEC General Instructions for Form 10-K, please visit <http://www.sec.gov/about/forms/form10-k.pdf>
- For more information on proxy statements, please visit the SEC's Spotlight on Proxy Matters at <http://www.sec.gov/spotlight/proxy-matters.shtml>
- For additional educational information for investors, see the SEC Office of Investor Education and Advocacy's website for investors, [www.investor.gov](http://www.investor.gov).

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

