



2019 Public Companies Update



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Agenda

- 2019 Technical Update
- Notable SEC Enforcement Actions
- Current SEC Proposals

2019 Technical Update

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- Critical Audit Matters (CAMs)
- Inline XBRL
- Regulation S-K Modernization
- Hedging Disclosure

Critical Audit Matters

CAMs—Effective Dates

- Large accelerated filers—audits for fiscal years ending on or after June 30, 2019
- All other filers—audits for fiscal years ending on or after December 15, 2020
- Does not apply to EGCs

CAMS—Definition

- Matter that was communicated or required to be communicated to the audit committee
- Relates to material accounts or disclosures
- Involved especially challenging, subjective or complex auditor judgment

CAMs—PCAOB Guidance

- No specific number of CAMs is expected or required
- CAMs may vary from year to year
- Differentiated from critical accounting estimates and key audit matters (KAMs)

CAMs—Communication

- Communication of each critical audit matter includes:
 - Identifying the CAM
 - Describing the principal considerations that led the auditor to determine the matter is a CAM
 - Describing how the CAM was addressed in the audit
 - Referring to the relevant financial statement accounts or disclosures

CAMs—Practical Guidance for Issuers

- Communication with auditors—Discuss with auditor how it intends to apply the standard and what matters may be CAMs
- Notification procedures—Establish procedures for the auditor to notify the company when the auditor intends to disclose a CAM and the disclosure the auditor intends to make
- Ensure consistency—Ensure that company disclosures are consistent with auditor disclosures
- Timetables—Establish timetables for the auditor to provide draft and final CAM disclosures to the company

Inline XBRL

Inline XBRL—Final Rule

- Operating companies and funds required to use Inline XBRL format
 - eXtensible Business Reporting Language (“XBRL”) assigns code (i.e., a “tag”) to each line-item in a financial statement
 - Inline XBRL requires companies to embed XBRL data directly into their HTML filings
- Inline XBRL requirements for operating companies apply to financial statements and cover pages of Forms 10-K, 10-Q, and 8-K (including Form 8-Ks without financial statements)

Inline XBRL—Phase-in Schedule

- Large accelerated filers: First Form 10-Q with financial statements ending on or after June 15, 2019
- Accelerated filers: First Form 10-Q with financial statements ending on or after June 15, 2020
- All other filers: First Form 10-Q with financial statements ending on or after June 15, 2021
- Early adoption: Permitted, and a number of companies have early adopted
- Form 10-Q is first filing: Inline XBRL does not apply to Form 10-K or other filings until the company is required to comply with Inline XBRL requirements for its first Form 10-Q

Inline XBRL—Exhibits

- Interactive Data Files containing financial statements and schedules: File as Exhibit 101; include “Inline” within the title description
- Cover Page Interactive Data File: File as Exhibit 104; include “Inline” within the title description

Inline XBRL—Practical Considerations

- Update company name with EDGAR if necessary
- Work processes and timing of filing may need to be re-evaluated
- Ensure that appropriate controls are in place to ensure the accuracy of Inline XBRL filings
- Coordinate with outside vendors to prepare for new Inline XBRL requirements

Regulation S-K Modernization

S-K Modernization—Effective Dates

- Adopted in March 2019
- Effective on May 2, 2019—Except:
 - Exhibit redaction provisions—effective on April 2, 2019
 - Inline XBRL cover page tagging—subject to phase-in requirements

S-K Modernization—Cover Pages

- All cover page data on Forms 10-K, 10-Q, and 8-K must be tagged with Inline XBRL
- Cover pages of Forms 10-K, 10-Q, and 8-K must include the company's securities exchange or principal U.S. market, trading symbol, and class of securities registered under Section 12
- For Form 10-K, the Section 16 report checkbox has been deleted

S-K Modernization—Form 10-K— Properties

- Prior Requirement: Item 102 formerly required disclosure of “the location of the principal plants, mines, and other materially important physical properties of the registrant and its subsidiaries”
- New Requirement: Item 102 now only requires disclosure “[t]o the extent material ... [of] the location and general character of the registrant’s principal physical properties”

S-K Modernization—Form 10-K— MD&A

| | Prior Requirement | New Requirement |
|---------------------|--|---|
| Periods covered | 3-year period covered by the financial statements (other than for SRCs, which only present 2 years of financial statements) | Discussion of the earliest year may be omitted if such discussion was already included in a prior filing and the registrant discloses the location of such disclosure |
| Discussion required | Period-to-period comparisons and reference to selected financial data specifically mentioned as potentially being appropriate or necessary | Entirely principles-based—“registrants may use any presentation that in the registrant’s judgment enhances a reader’s understanding” |

S-K Modernization—Technical Changes

- Various technical changes that will impact Form 10-Ks and proxy statements—disclosures regarding
 - Executive officers
 - Section 16(a) compliance
 - Audit committee report
 - Description of registrant's securities exhibit
- We will cover these at our 10-K/proxy update event in December

S-K Modernization—Confidential Treatment

- Companies are no longer required to submit confidential treatment requests to redact information from exhibits
- Redacted information:
 - Must not be material
 - Must be likely to cause competitive harm to the company if publicly disclosed

S-K Modernization—Confidential Treatment

- Exhibit index must indicate that portions of the exhibits have been omitted
- First page of the redacted exhibit must include a prominent statement on the first page that certain information has been excluded because it is both (i) not material and (ii) would be competitively harmful if publicly disclosed
- Redacted information must be indicated with brackets in the filed version of the exhibit
- SEC will continue to selectively review filings and may request supplemental information to determine if redacted information is appropriate

Hedging Disclosure

Hedging Disclosure—Compliance Deadline

- Companies (other than EGCs and SRCs) must comply with these disclosure requirements for proxy and information statements for elections of directors during fiscal years beginning on or after July 1, 2019
- SRCs and EGCs must comply for elections of directors during fiscal years beginning on or after July 1, 2020

Hedging Disclosure—New Reg. S-K Item 407(i)

- Public companies must describe any practices or policies regarding the ability of employees (including officers), directors or their designees to hedge or offset any decrease in the market value of registrant equity securities—must either:
 - Provide a fair and accurate summary of any practices or policies that apply, including the categories of persons covered and any categories of hedging transactions that are specifically permitted and any categories that are specifically disallowed; or
 - Disclose the practices or policies in full
- If the company does not have any such practices or policies, it must disclose that fact or state that hedging transactions are generally permitted

Hedging Disclosure—Broad Application

- The term “hedge” is to be applied as a broad principle
- The term “registrant equity securities” include equity securities issued by the company and its parents, subsidiaries, and subsidiaries of the company’s parents

Hedging Disclosure—Relationship to CD&A

- Reg. S-K Item 402(b) (CD&A) already required disclosure of any material policies on hedging by the company's named executive officers for companies subject to CD&A requirements
- Companies may now satisfy this obligation by cross-referencing the new hedging disclosure required by Reg. S-K Item 407(i)

Hedging Disclosure—Practical Guidance

- Review existing policies for hedging transactions to determine whether they remain appropriate or should be revised (these are often included in insider trading policies). For example:
 - Does the policy cover all employees, officers and directors? If not, should it?
 - Does the policy cover all registrant equity securities?
 - Are all types of hedging transaction covered? Should certain transactions, such as portfolio diversification transactions, be excluded?
- If the company does not have a hedging policy, consider adopting one
- Keep in mind that ISS and Glass Lewis are strongly opposed to any hedging by executives and directors

Notable SEC Enforcement Actions and Trends

Regulation FD—TherapeuticsMD— Background

- First Regulation FD action since September 2013
- Background
 - Regulation FD prohibits selective disclosure of material nonpublic information to (i) securities market professionals and (ii) shareholders under circumstances where it is reasonably foreseeable that such shareholders would trade on the information
 - If material nonpublic information is shared with such persons, it must be simultaneously shared with the public
 - Information is considered “material” if there is “a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or if the information would significantly alter the total mix of available information”

Regulation FD—TherapeuticsMD

- TherapeuticsMD received a complete response letter from the FDA on 5/5/17 with respect to its NDA for its drug product candidate TX-004HR
- TMD issued a press release and filed a Form 8-K on 5/8/2017 to disclose its receipt of the CRL and that the only approvability concern raised by the FDA in the CRL was the lack of long-term safety data
- On 5/31/2017, TMD publicly announced its scheduled 6/14/17 FDA meeting in a Form 8-K that described the contents of the CRL
 - TMD explained it had two paths forward: either the FDA would allow it to resubmit the NDA or TMD would pursue formal dispute resolution against the FDA

Regulation FD—TherapeuticsMD— First Selective Disclosure

- On 6/14/17, TMD met with the FDA
- On 6/15/17 TMD told at least 6 sell-side analysts that the meeting was “very positive and productive”
- On 6/16/17, TMD’s stock price increased 19.4%, causing the NYSE to inquire as to whether material nonpublic information was disclosed
- TMD informed the NYSE that none was disclosed because the official responding to TMD was not aware of the emails to the analysts
- TMD did not make public disclosure regarding the 6/14/17 meeting until 7/17/17

Regulation FD—TherapeuticsMD— Second Selective Disclosure

- On 7/15/17 TMD received the meeting minutes for the 6/14/17 FDA meeting
- In the early morning of 7/17/17, TMD issued a press release and filed a Form 8-K regarding the receipt of the meeting minutes (including a reference to new information TMD had presented to the FDA without disclosing what that information was), which triggered a sharp decline in its stock price
- At 7:30 am on 7/17/17, TMD held a conference call with sell-side analysts and identified the new information that TMD had submitted to the FDA (3 supporting studies)
- Following the call, the sell-side analysts published research notes including specific information about the FDA meeting and the newly submitted information
- The stock rebounded during the course of the day on 7/17/17
- TMD did not publicly disclose what new information it had provided to the FDA or its application to its product candidate until its 8/3/17 earnings call

Regulation FD—TherapeuticsMD— SEC Actions

- The SEC found that both sets of selective disclosure violated Regulation FD
- SEC also found that TMD did not have Regulation FD policies in place at the time
- SEC fined TMD \$200,000 and enjoined it from further violations of Section 13(a) of the Securities Exchange Act

Regulation FD—TherapeuticsMD— TMD Mitigating Factors

- TMD cooperated with the SEC in its investigation
- TMD established Regulation FD policies and procedures that, among other things:
 - Require public disclosure of material nonpublic information in connection with Regulation FD
 - Provide examples of types of material nonpublic information that may arise in light of TMD's business model
 - Establish specific review protocols for all external communications
- TMD now requires Regulation FD training for employees

Regulation FD—TherapeuticsMD— Takeaways

- Ensure you have up-to-date Regulation FD policies and procedures, with specific, relevant examples
- Ensure appropriate personnel within the company are designated as Regulation FD spokespersons
- Require employees to confirm receipt and review of these policies and procedures
- Conduct periodic Regulation FD training and document attendance

Facebook SEC Enforcement Action— Background

- Action arose out of the widely publicized Cambridge Analytica scandal
- Facebook learned about the misuse of user data by Cambridge Analytica and an academic researcher paid by Cambridge Analytica in December 2015
- In Facebook's quarterly and annual reports filed between January 2016 and March 2018, Facebook did not disclose the misuse of the data and instead presented the potential misuse as merely a hypothetical investment risk
- Facebook also falsely claimed to reporters in 2017 that it had found no evidence of wrongdoing

Facebook SEC Enforcement Action— SEC Findings

- Facebook's public filings were misleading because its risk factor disclosures misleadingly suggested that Facebook merely faced the risk of misuse of user data and resulting business harm, which created the false impression that no misuse had actually occurred
- Facebook did not maintain disclosure controls and procedures designed to analyze or assess incidents involving misuse of user data for potential disclosure in Facebook's filings
- Facebook was fined \$100 million dollars and enjoined from future violations of the securities laws

Facebook SEC Enforcement Action— Takeaways

- Companies should evaluate their disclosure controls and procedures periodically, including with respect to risk factor disclosure
- Risk factors should be carefully reviewed each quarter; if a material risk has actually occurred, that must be disclosed

Insider Trading—Enforcement Priority

- Insider trading remains an enforcement priority for the SEC and DOJ
- SEC's Market Abuse Unit uses sophisticated investigative techniques and technological tools to detect insider trading

Insider Trading—Actions Against Lawyers

- Enforcement actions charging insider trading in advance of earnings announcements against senior lawyers at Apple and SeaWorld
- Enforcement action against a friend of the GC of Cintas Corporation who allegedly stole information regarding a transaction from the GC's home office
- Enforcement action against the husband of a law firm associate
- Enforcement action against the father of a law firm associate (who himself was a lawyer)

Insider Trading—Takeaways for Legal Departments (and others)

- Revisit insider trading policies and procedures to ensure pretrade clearances are robust and for how material nonpublic information is handled (e.g., consistent use of project code words)
- Provide material nonpublic information on a need-to-know basis

Misrepresentation—Omega Protein— Background

- Omega financed its operations through a federal government loan program that required Omega to represent that it was in compliance with applicable federal laws and regulations relating to environmental matters and that Omega had not received any notices of violation of any federal laws and regulations relating to environmental matters

Misrepresentation—Omega Protein— Background

- Omega finance personnel engaged in a standardized process for testing the company's compliance with its loan covenants utilizing a checklist; however, none of the items on the checklist addressed environmental compliance
- At the quarterly close, Omega distributed a questionnaire to corporate officers and key management personnel designed to identify any material noncompliance with environmental requirements. Omega's VP for Operations also completed a quarterly certificate regarding the status of compliance with environmental obligations

Misrepresentation—Omega Protein— SEC Action

- In 2013 and again in 2017, Omega pleaded guilty in criminal felony counts of violating the Clean Water Act
- In its 2014 Form 10-K, Omega stated that it “was in compliance with all of the covenants contained” in its federal government loan arrangements. Omega repeated this representation in the three quarterly reports subsequently filed
- Following the 2013 guilty plea, Omega made no changes to its checklist and standardized process at the quarterly close for testing the company’s compliance with its loan covenants
- The SEC charged Omega with violating Section 17(a)(2) of the Securities Act and Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder. Omega agreed to settle these charges without admitting or denying the findings in the SEC’s order

Misrepresentation—Omega Protein— Takeaways for Legal Departments (and others)

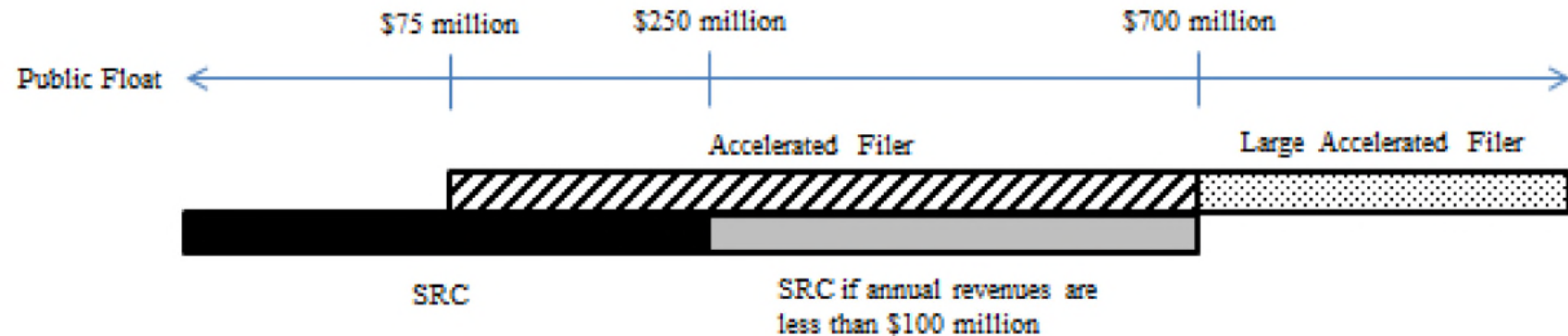
- Revisit internal compliance procedures to confirm that they are aligned with information being reported and are reasonably designed to elicit relevant information
- Maintain backup for factual assertions included in periodic reports

Current SEC Proposals

Accelerated/Large Accelerated Filer Definition

Relationship between SRC and (Non/Large) Accelerated Filer Status

Figure 1. Definitions of SRC, Accelerated Filer, and Large Accelerated Filer after the SRC Amendments



Accelerated/Nonaccelerated Filer— Proposed Revisions

- Companies that qualify as an SRC based on the revenue test (generally <\$100M revenues and <\$700M public float) would also automatically qualify as non-accelerated filers
- Transition thresholds would be increased for exiting accelerated and large accelerated filer status to align with the transition provisions for SRC status

Accelerated/Nonaccelerated Filer— Impact

- Companies with less than \$100M in revenue and less than \$700M in public float would (subject to transition rules):
 - Not be subject to ICFR audits
 - Enjoy longer deadlines for filing Forms 10-Q and 10-K

Financial Disclosures for Acquisitions and Disposals of Businesses

Financial Disclosures—Background

- SEC issued a 224-page release proposing significant changes to the financial statement requirements for acquisitions and disposals of businesses
- Purpose of the changes is to improve information for investors, facilitate access to capital, and reduce costs and complexity

Financial Disclosures—Significance Tests for Acquisitions

| Test | Current Rule | Proposed Rule |
|------------|--|---|
| Investment | Compare investment amount to carrying value of registrant's total assets | Compare investment amount to registrant's aggregate worldwide market value |
| Income | Compare registrant's and acquired company's income from continuing operations <u>before</u> income taxes | Compare registrant's and acquired company's revenue and income or loss from continuing operations <u>after</u> taxes (use the lower revenue/income); technical changes in calculations where there are losses |
| Asset | Compare carrying value of registrant's and acquired company's total assets | Compare carrying value of registrant's and acquired company's total assets |

Financial Disclosures—Reduced Requirements for Acquisitions

| Requirements | Current Rule | Proposed Rule |
|--------------------------------|--|---|
| Audited financial statements | Up to 3 years (2 years for SRCs) | Up to 2 years for all registrants |
| Interim financial statements | Comparative interim financial statements required (depending on staleness of audited financials) | Only most recent interim financial statements required if only one year of audited financial statements required (depending on staleness of audited financials) |
| Pro forma financial statements | Limited adjustments permitted | Simplified requirements to depict the accounting for the transaction and the reasonably estimable synergies and other transaction effects that are likely |

Financial Disclosures—Additional Burden Reductions

- Significance tests for disposals: Increased from 10% to 20%
- Multiple acquisitions: Only required to include financial statements for acquisitions individually exceeding 20% significance plus pro forma financial information regarding aggregate effect of all acquisitions
- Carve-out acquisitions: Formalized requirements for abbreviated financial statements
- Inclusion in post-acquisition results: Registration statements are not required to include pre-acquisition financial statements if the results of the acquired business have been included in the registrant's post-acquisition results for a complete fiscal year (most relevant to IPO companies)

Financial Disclosures—Takeaways

- The proposals generally will reduce the burdens on registrants
- Greater consistency between requirements for SRCs and non-SRCs
- More judgment will be required for pro forma financial statements

Business Description; Legal Proceedings; Risk Factors

Reg. S-K Item 101(a)—General Description of the Business

- Would make Item 101(a) largely principles-based
- Would require disclosure of information material to an understanding of the general development of the business and eliminate a prescribed timeframe for the disclosure
- After the company's initial (e.g., IPO) filing, would only require an update of the general development of the business with a focus on material developments in the reporting period and a hyperlink to the most recent filing

Reg. S-K Item 101(c)—Narrative Description of the Business

- Would clarify and expand the principles-based approach of Item 101(c), with disclosure topics drawn from a subset of Item 101(c)'s current topics
- Would include human capital resources, including any human capital measures that management focuses on in managing the business (e.g., measures or objectives that address the attraction, development, and retention of personnel), to the extent material to understanding the business
- Would require disclosure of material government regulations as a topic (essentially codifying current practice)

Reg. S-K Item 101(h)—SRC Business Description

- Alternative business disclosure permitted for SRCs is generally proposed to be retained
- SEC is proposing to delete the requirement that an SRC disclose the development of its business during the last 3 years

Reg. S-K Item 101—Practical Guidance

- Rules are not likely to be effective for the upcoming Form 10-K filing season
- Issuers should consider, however, updating their business disclosures with an eye towards using those disclosures as a “base” disclosure if the rules are adopted

Reg. S-K Item 103—Legal Proceedings

- Item 103 would be revised to expressly permit incorporation by reference from legal proceedings disclosure located elsewhere in the document (e.g., the financial statements)
- Disclosure threshold for environmental proceedings where the government is a party would be increased from \$100,000 to \$300,000

Reg. S-K Item 105—Risk Factors

- SEC is concerned about the length and generic nature of risk factors
- SEC proposed the following amendment to Item 105
 - Requiring summary risk factor disclosure if the risk factor section exceeds 15 pages
 - Replacing the requirement to disclose the “most significant” factors with the “material” factors
 - Requiring risk factors to be organized under relevant headings, generic risk factors to be disclosed at the end of the risk factor section under the caption “General Risk Factors”

Additional Questions and Discussion

Thank You

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