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Preparing for 10-K and Proxy Season

Securities Law Breakfast Series

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November 28 & 29, 2018

EXPECT EXCELLENCE®

Agenda

- 2017 & 2018 Recap
- New and Proposed Rules from 2018
- Form 10-K: Comment Letter Trends
- Governance and Shareholder Issues

2017 & 2018 Recap

Say-on-Pay Votes

Say-on-Pay Votes - 2018 Proxy Season

- 67 say-on-pay votes failed in the 2018 proxy season
  - Significant increase from 38 in prior season
  - Record number, but still less than 2.5%
- Notable failures:
  - Rite Aid (payment of retention awards in connection with failed deals)
  - Halliburton (high turnover among executives caused proxy advisory firm pushback)
  - Mattel (poor performance, i.e. vote may have been a "say on performance")
  - Wynn Resorts (CEO Steve Wynn made high-profile departure)

Sources: Steven Hall & Partners, Short Takes, Oct. 19, 2018; Center on Executive Compensation; "Proxy Insight" newsletter, July 2018; Bloomberg

Say-on-Pay/Say-on-Frequency Votes - SRCs and EGCs

- Smaller reporting companies were exempt from holding a say-on-pay or say-on-frequency vote until the first annual or other meeting of shareholders occurring on or after January 21, 2013
- Issuers are not required to hold a say-on-frequency vote until the sixth anniversary of the first vote (i.e., many SRCs will hold a say-on-frequency vote in 2019)
- EGCs exempt from holding either vote until they cease to be classified as EGCs

Revenue Recognition

Revenue Recognition—Effective January 1, 2018

- Effective for annual reporting periods beginning after December 15, 2017
- Effective January 1, 2019 for EGCs that elected to apply the private company transition requirements
- Two methods of adoption
  - Full retrospective method—all periods presented using the new standard
  - Modified retrospective method—year of adoption applies the new standard with a catch-up adjustment and disclosures (most companies used this method)

Revenue Recognition—SAB 74 Requirements

- Comparison of the current accounting policies to the new accounting policies under the new standard
- Status of implementation, including significant matters not yet addressed
- Consideration of the effect of new footnote requirements in addition to the effect on the balance sheet and income statement
- Disclosure of the quantitative impact of the new accounting standard if it can be reasonably estimated
- Disclosure if the expected financial statement impact cannot be reasonably estimated
- Qualitative disclosures if the expected financial statement impact is not yet known

New Auditor Reporting Standard

New Auditor Reporting Standard—Effective Dates

- Generally effective for audits for fiscal years ending on or after December 15, 2017
- With respect to critical audit matters (CAMs)
  - 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
- CAMs requirement does not apply to EGCs

New Auditor Reporting Standard—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

New Auditor Reporting Standard—CAMs

- Determining whether a matter involved especially challenging, subjective or complex auditor judgment:
  - Auditor's assessment of the risks of material misstatement
  - Degree of auditor judgment
  - Nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions
  - Degree of auditor subjectivity in applying audit procedures
  - Nature and extent of audit effort required
  - Nature of audit evidence obtained regarding the matter

New Auditor Reporting Standard—CAMs

- 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

New Auditor Reporting Standard—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
- Proxy disclosure—Consider additional proxy statement disclosure regarding long-tenured auditors

Pay Ratio Disclosure

Overview

- Required pay ratio disclosure:
  - Median of the annual total compensation of all employees other than the CEO
  - The annual total compensation of the CEO
  - The ratio of these amounts
- Pay ratio may be described numerically or narratively

Key Observations from First Year of Pay Ratio Disclosures

- Average pay ratio of 144:1; median of 69:1
- Average median employee pay was approximately $81,000
- No correlation between pay ratio and company performance
- Disclosures have been brief (approximately 3 paragraphs) and focused on complying with the rule
- Most disclosures were not included in CD&A but instead were included after the last compensation table
- Less than 10% of companies filed a supplemental ratio (may increase in 2019)

Source: Pearl Meyer, Research Report: The CEO Pay Ratio: Data and Perspectives from the 2018 Proxy Season

Applicability

- Pay ratio required in registration statements, annual reports and proxy statements in which Item 402 executive compensation disclosure is included
- Not required for EGCs, SRCs, foreign private issuers or US-Canadian multijurisdictional disclosure system filers

Definition of Employee

- Encompasses full-time, part-time, seasonal and temporary employees for the registrant and its consolidated subsidiaries
- Defined as an individual employed on any date of the registrant's choosing within the last 3 months of the last completed fiscal year
- Independent contractors are not employees under the rule
  - Allowed to rely on existing characterization as long as based on "widely recognized test under another area of law that the registrant otherwise uses to determine whether its workers are employees"

Exemptions

- Data Privacy Exemption
  - Can exclude workers in foreign jurisdictions in which the company is unable to obtain compensation data without violating data privacy laws
  - Requires reasonable efforts and additional disclosure obligations, including filing a legal opinion from local counsel
  - Counts against the de minimis exemption
  - Virtually unused during the 2018 proxy season
- De Minimis Exemption
  - May exclude non-U.S. employees up to 5% of total employees
  - Must exclude all employees located in a particular jurisdiction
  - Requires additional disclosure
  - Used by approximately 25% of companies

Source: Pearl Meyer, Research Report: The CEO Pay Ratio: Data and Perspectives from the 2018 Proxy Season

Frequency

- Only required to identify median employee once every 3 years
- Must update if there has been a change in the employee population or compensation arrangements creating reasonable belief that there would be a significant change to pay ratio disclosure (this will be a key question for 2019 proxy statement disclosures)

Flexibility

- Company has flexibility in choosing the method of identifying its median employee based on its own facts and circumstances
  - Disclosure—method chosen, including material assumptions, adjustments or estimates
- Use of reasonable estimates, assumptions and methodologies and statistical sampling permitted
  - Allowed to use reasonable estimates in identifying the median employee, including using statistical sampling and a consistently applied compensation measure (CACM)
  - Companies may specifically describe their pay ratios as an estimate in their disclosures
- Companies may use internal records to identify the median employee, even if every element of compensation is not included in those records

Transition Periods

- Acquired Businesses—permitted to omit from calculation any employees obtained in a business combination or acquisition during that year
  - Required to identify the acquired business and disclose the approximate number of employees being omitted
  - Less than 10% of companies used this exclusion in 2018
- New Registrants—the first pay ratio disclosure must follow a new registrant's first full fiscal year beginning after the company (i) has been subject to the reporting requirements of the Exchange Act for at least 12 calendar months beginning on or after January 1, 2017 and (ii) has filed at least one annual report under the Exchange Act that does not contain the pay ratio disclosures
- Former SRC or EGC—a company that ceases to be a smaller reporting company or an emerging growth company will not be required to provide pay ratio disclosure until the first full fiscal year on or after the date the company ceased to be an SRC/EGC

Source: Pearl Meyer, Research Report: The CEO Pay Ratio: Data and Perspectives from the 2018 Proxy Season

Tax Cuts and Jobs Act (TCJA)

TCJA: Repeal of 162(m) Performance-Based Compensation Exception

- TCJA repealed exception that previously allowed performance-based compensation to be excluded from the $1,000,000 deduction limitation for public company compensation of "covered employees"
- Only exception relates to grandfathered plans—remuneration provided pursuant to a written binding contract in effect on November 2, 2017 and that was not modified in any material respect on or after such date

TCJA: Covered Employee Definition

- Principal executive officer
- Principal financial officer
- Three other most highly compensated executive officers
- Any person that has ever been a covered employee

IRS Notice 2018-68

- IRS issued guidance clarifying the definition of covered employees and the operation of the grandfather rule
- Regulations have not yet been issued

TCJA: 2018 Proxy Disclosure Impact

- Compensation Discussion and Analysis (CD&A) sections in 2018 proxy statements were revised, often to state that the compensation committee was evaluating the impact of the change in the law

162(m) Action Items for the Upcoming Proxy Season

- Confirm whether any grandfathered arrangements are still in place and do not inadvertently degrandfather them
- Track covered employees and carefully evaluate which employees are executive officers going forward
- Update proxy disclosure accordingly (e.g., presence of grandfathered plans, continued use of performance-based awards, impact of deductibility (or nondeductibility) on compensation committee's decisions)
- Make appropriate changes to new and amended plans going forward (e.g., remove out-of-date 162(m) references)

New and Proposed Rules from 2018

FAST Act - Disclosure Simplification

FAST Act: SEC Rule Amendments

- The Fixing America's Surface Transportation ("FAST") Act was enacted Dec. 2015 primarily for highway funding
  - FAST Act also authorized SEC to simplify disclosure requirements in Regulation S-K
- SEC adopted rule amendments in response to FAST Act
  - Published in Federal Register with November 5, 2018 as effective date

FAST Act: Disclosure Simplification

- Eliminates disclosure requirements similar to or that overlap with GAAP, IFRS, other required disclosures
- Eliminates requirements seen as outdated due to technology, regulatory, or business changes
- Updates and supersedes requirements inconsistent with recent legislation, SEC disclosure requirements, or GAAP updates

FAST Act: S-K Item 101 (Business) Revisions

- The following disclosures in the business description have been deleted:
  - Financial information about segments
  - R&D spending
  - Financial information about geographic areas (but if material, MD&A must cover)
  - Risks of foreign operations, dependence of segments on foreign operations (but if material Risk Factors must cover)
- Issuer's Internet address must now be disclosed by all filers
- Registration statement disclosures about SEC filings being available in public reference room at SEC headquarters no longer required

FAST Act: Other Changes

- S-K Item 201 (Included in Item 5 of Form 10-K) revised to:
  - Require disclosure of ticker symbol when identifying trading markets for equity securities
  - Eliminate the requirement to disclose high and low trading prices for each quarter in last two full fiscal years/interim periods where there is an established trading market for a class of common equity
  - No longer require disclosure regarding dividend history for the previous two fiscal years/interim periods or restrictions on payment of dividends (covered in financial statements)
- Ratio of earnings to fixed charges eliminated

FAST Act: Selected Financial Statement Revisions

- A number of duplicative Regulation S-X requirements were eliminated
- A number of requirements in Regulation S-X were referred to FASB for consideration for inclusion in GAAP
- Regulation S-X amended to require inclusion of interim period statement of stockholders' equity information

Inline XBRL

Final Inline XBRL Rule Published

- Final rule published in 2018 requires operating companies and funds 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 - Transition

- 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

Inline XBRL Practical Considerations

- Work processes and timing of filing may need to be re-evaluated
- Coordinate with outside vendors to prepare for new Inline XBRL requirements

Change in Smaller Reporting Company Definition

Change in SRC Definition

- New smaller reporting company ("SRC") definition effective Sept. 10, 2018 expands eligibility
- SEC expects about 1,000 companies to qualify as SRC from the revised rule

SRC Thresholds: Initial qualification

- Must meet one of two thresholds:
  - Public float – **Less than $250 million**
    - Old rule was less than $75 million
  - Annual revenues – **Less than $100 million *and* either (i) no public float or (ii) public float less than $700 million**
    - Old rule was less than $50 million, no public float

SRC Thresholds: Initial Qualification - Existing Public Companies

- For first fiscal year ending after Sept. 10, 2018, existing public companies can use the new initial qualification thresholds
  - For a calendar year based fiscal year, use revenues based on Dec. 31, 2017 year-end
  - For a calendar year based fiscal year, use public float as of June 29, 2018

SRC Thresholds: Initial Qualification - IPO Companies

- Annual revenues based on the most recently completed fiscal year for which audited financial statements are available
- Public float is measured within 30 days of the date of filing the registration statement and can be redetermined at the conclusion of the offering based on the actual offering price and number of shares sold

SRC Thresholds: Subsequent Qualification

- Existing public company must meet one of the following thresholds to subsequently qualify as an SRC:
  1. Public float of less than $200 million, if previously had $250 million or more
  2. Less than $80 million of annual revenue, if previously had $100 million or more; *and* less than $560 million of public float, if previously had $700 million or more

Revisions to Cover Page

- XBRL and SRC rule changes also include revisions to cover pages
- Effective Sept. 17, 2018, cover page of Form 10-K (and 10-Q) is slightly revised to reflect these rule changes

Mining Company Property Disclosure Rules

- SEC amendments adopted on Oct. 31, 2018 are intended to modernize property disclosure requirements for mining company registrants
- Two-year transition period: registrant will not be required to comply until first fiscal year beginning on or after Jan. 1, 2021
- New amendments rescind Industry Guide 7 and consolidate disclosure requirements in Regulation S-K
- Rule changes meant to align with Committee for Reserves International Reporting Standards (“CRIRSCO”)

Mining Company: Property Disclosures

- Registrants must now make new disclosures about mineral resources and material exploration results in addition to mineral reserves
  - Currently, disclosure of non-reserve estimates, such as mineral resources, permitted only in limited circumstances
- Disclosure of exploration results, mineral resources, and mineral reserves must be based on information and documentation prepared by a mining expert, i.e. "qualified person," who must be named in the filing
  - Amendments require registrant to obtain a dated and signed technical report summary from the qualified person, which identifies and summarizes information reviewed and conclusions reached about the registrant's mineral resources or mineral reserves

Form 10-K:
SEC Comment Letter Trends

Comment Letters - Volume and Composition

- Comment letters on Forms 10-K and 10-Q declined 13% from 2016 to 2017
- Comment letters on Form 8-Ks decreased by 30% from 2016 to 2017
- Number of days it takes to resolve comments in 2017 was 44, down from 86 in 2010
- Non-accelerated filers only received 16% of comment letters during 2018, reflecting the SEC Staff's focus on larger issuers

Source: Ernst & Young; Audit Analytics

Most Frequent Comment Areas

1. MD&A
2. Non-GAAP
3. Fair value measurements
4. Segment reporting
5. Revenue recognition

Source: Ernst & Young; Audit Analytics

Most Frequent Comment Areas (cont.)

6. Intangible assets and goodwill
7. State sponsors of terrorism
8. Income taxes
9. Acquisitions and business combinations
10. Contingencies

Source: Ernst & Young; Audit Analytics

MD&A - Key Performance Indicators - Example Comment

- We note from your response to prior comment 5 that you disclose a series of operating data [((i) the average monthly number of active content creators; (ii) the number of video submissions; (iii) the number of monthly active users for mobile games; (iv) the average daily time spent per active user on mobile app; (v) the monthly active users who participated in social interactions; (vi) the number of average monthly social interactions; and (vii) the percentage of PUG video views)] throughout the prospectus with an aim to present to investors various aspects of the Company's business model and operations. Please explain whether management uses any of these measures or operating data to manage the business. Revise your disclosures to provide a comparative discussion and analyses of the changes in such operating data for each period presented or explain to us why you do not believe the comparative operating data contributes meaningfully to understanding and evaluating your company. Please consider disclosing this information in tabular format in an appropriate section of the prospectus to provide context for investors. We refer you to Part I, Items 5A and 5D of Form 20-F and Section III.B of SEC Release 33-8350.

MD&A - Quantification of Variables - Example Comment

- You state that the increase in revenue "was primarily due to increased subscription sales to business customers, including larger enterprises." Please revise to separately quantify the contribution of sales to existing customers and sales to new customers to this result, in each case to the extent material. In this regard, we note your disclosure on page 85 that billings reflect subscription renewals and "upsells" to existing customers plus sales to new customers. Refer to Instruction 4 to Item 303(a) of Regulation S-K and Section III.D of SEC Release No. 33-6835.

MD&A - Critical Accounting Estimates - Example Comment

- Please tell us why you believe that incorporating by reference all of the significant accounting policies you disclose in your consolidated financial statements, in lieu of discussing your critical accounting estimates is in accordance with the requirements of Item 303 of Regulation S-K. Critical accounting estimate disclosures are designed to supplement the description of accounting policies in the notes to the financial statements and provide greater insight into the quality and variability of information regarding financial condition and operating performance. Typical disclosures discuss the types of assumptions underlying the most significant and subjective estimates, provide a sensitivity analysis of those assumptions to deviations of actual results; and disclose the circumstances that have resulted in revised assumptions in the past. As an example, regarding your adjustments to gross sales, a typical disclosure would explain the provision for each type of adjustment related to sales made in prior periods versus sales made in the current period in order to understand the impact that changes in estimates had on results of operations.

MD&A Comment Letters - Key Takeaways

- Review the SEC's 2003 MD&A Interpretive Release
- Focus on analysis, not recitation
- Use tabular disclosure
- Review the 2003 MD&A Interpretive Release again

Most Common Non-GAAP Comments Issued to Companies

As a Percentage of Unique Companies That Received Any Non-GAAP Comment

C&DI Question	Description	July 2016 - Dec. 2016	2017	Jan. 2018 - June 2018
Question 102.10	Presentation of non-GAAP measurements with undue prominence	37.6%	37.0%	22.1%
Question 102.11	Presentation of non-GAAP measurements on a "net of tax" basis	13.7%	10.7%	12.3%
Question 100.04	Presentation of measures that use individually tailored recognition and measurement methods	6.5%	7.6%	12.3%
Question 100.01	Presentation of a performance measure that excludes normal, recurring, cash operating expenses	12.7%	6.0%	9.0%
Question 102.07	Presentation of "free cash flow" metric	2.3%	2.4%	9.0%
Question 103.02	Reconciliation of EBIT or EBITDA used as a performance metric to lines other than Net Income	3.1%	2.0%	5.7%
Question 102.06	Presentation of the three major categories of the statement of cash flows should be presented when a non-GAAP liquidity measure is presented	1.3%	1.2%	4.1%
Question 102.03	Presentation of measure that could eliminate/smooth items identified as non-recurring when nature of charge or gain likely to recur within 2 years	4.4%	2.2%	3.3%

NOTES:

1) This table presents the top 8 percentages for the 16 non-GAAP items examined in this review

2) 2016 and 2018 data are 6-month periods

www.AuditAnalytics.com

Segment Reporting - Comment Letter Trends/Takeaways

- Continued focus on segment disclosures and application of ASC 280
- Companies should regularly assess their conclusions and internal controls regarding the identification of their operating and reportable segments
- Consider any perceived inconsistencies between segment disclosures and organizational structure, other public information, changes in the business environment and the CODM's evaluation of performance and allocation of resources

Segment Reporting - Example Comment

- Comment: Please explain to us your statement that you operate in one business segment. Reconcile your term business segment to operating segment and reportable segment as used in ASC 280-10. Clarify for us that the Company's business segment is its only operating segment. If not, please explain. Further, your business section and website discuss three business units (i.e. orphan, primary care and rheumatology) through which you market nine medicines. Please provide us with the following information as it relates to the Company's operating segments, the CODM, and the three business units:
  - The title and roles of the Chief Operating Decision Maker (CODM) and each individual who reports to the CODM.
  - How often the CODM meets with direct reports, the financial information the CODM reviews to prepare for those meetings, the financial information discussed in those meetings, and who else attends those meetings.
  - Describe the information regularly provided to the CODM including whether and, if so, to what extent the information includes budgets and discrete information for the business units.
  - If budgets are prepared for the business units, explain who approves the budget at each step of the process, the level of detail discussed at each step, and the level at which the CODM makes changes to the budget.
  - For the business units, describe the level of detail communicated to the CODM when actual results differ from budgets and who is involved in the meetings with the CODM to discuss budget-to-actual variances.
  - Describe the basis for determining the compensation for each of the individuals that report to the CODM and, for the heads of the business units, the extent to which the determination relates to their respective business unit.

Revenue Recognition - Comment Letter Trends

- SEC Staff has commented on disclosures regarding the adoption of new revenue recognition standard
- Comments have focused on:
  - Identification of performance obligations
  - Satisfaction of performance obligations
  - Presentation of disaggregated revenue

Governance and Shareholder Issues

ISS Updated Proxy Voting Policies for 2019

- Board Composition – Attendance: For poor director attendance without reasonable justification, ISS may recommend against not only director with poor attendance, but also other directors including chair of nominating/governance committee
- Board Accountability – Management Proposals to Ratify Existing Charter or Bylaw Provisions: Generally recommend a vote against/withhold from individual directors, members of the governance committee, or the full board where boards ask shareholders to ratify existing charter or bylaw provisions, considering certain factors

ISS Updated Proxy Voting Policies for 2019 (cont.)

- Board Composition – Diversity: Beginning in 2020, Chair of nominating committee, or other director, will receive “against” recommendation when no women serve on company’s board, absent mitigating factors
- Reverse Stock Splits - ISS will perform more of an individualized evaluation of reverse stock splits, legitimate reasons for them
- Other – Other more technical changes

Glass Lewis Updated Proxy Voting Policies for 2019

- Board Gender Diversity: Will generally recommend voting in favor of shareholder proposals requesting additional information on employee diversity
- Conflicting and Excluding Proposals: Will generally recommend against members of nominating/governance committee when company excludes a shareholder proposal for a management proposal ratifying an existing special meeting right and will generally recommend for the lower threshold required for calling a special meeting

Glass Lewis Updated Proxy Voting Policies for 2019 (cont.)

- Auditor Ratification: New factors considered, including auditor's tenure, pattern of inaccurate audits, any ongoing litigation, or significant controversies
- Virtual Shareholder Meetings: Companies opting to hold annual meeting virtually, without in-person option, Glass Lewis will examine whether shareholders will receive same rights as an in-person meeting
- Written Consent Shareholder Proposal: Where companies have adopted proxy access and a special meeting right of 15% or lower, Glass Lewis will generally recommend against shareholder proposals requesting companies adopt a shareholder right to action by written consent

Environmental, Social and Governance ("ESG") reporting

- If mismanagement of environmental, social risks negatively affects shareholder value, Glass Lewis may now recommend against directors
- On August 7, 2018, BlackRock announced plans to require all of its fund managers consider ESG factors when they invest

Additional Questions and Discussion

Thank You

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