2019 SEC YEAR END UPDATE AND REPORTING REMINDERS
SEC Update and Reporting Reminders - Agenda

2019 SEC Activities and Rulemaking

Comment Letter Topics

- Revenue Recognition (Topic 606)
- Non-GAAP Measures
- Management Discussion and Analysis ("MD&A")
- Other

SEC Reporting Reminders

- Internal Control over Financial Reporting
- SAB 74 Disclosures - Current and Expected Credit Losses
- Reference Rate Reform - LIBOR Transition Disclosures
- Contractual Obligations Table Reporting
- Form 10-K Process Reminders
2019 SEC ACTIVITIES AND RULEMAKING
People Developments

► Commission Developments
  - New Commissioner
    - Allison Lee (D) - September
  - Pending Commissioner changes
    - Robert Jackson (term expired in 2019)

► Staff Developments
  - Chief Accountant, Wes Bricker, departs
  - Sagar Teotia (former Deputy Chief Accountant in OCA) named Chief Accountant
SEC Rulemaking - Focus Areas

- Capital Formation
- Disclosure Effectiveness
- Investor Protection
SEC Rulemaking - *FAST Act Modernization & Simplification of Regulation S-K* (Final Rules)

- Streamline and simplify disclosure requirements, discourage repetition and disclosure of immaterial information

- Include changes to:
  - MD&A
  - Confidential treatment requests
  - Cross-referencing
  - Property Disclosures
  - Risk Factors
  - XBRL and hyperlink
SEC Rulemaking - *FAST Act Modernization & Simplification of Regulation S-K (Final Rules)*

- **Effective Dates:**
  - Confidential treatment requests - April 2, 2019
  - Use of XBRL tags on the cover pages of certain filings - phased in over a three years
  - All other amendments - May 2, 2019

SEC Rulemaking - Solicitations of Interest Prior to a Registered Public Offering (Final Rules)

- Extends the “test-the-waters” accommodation currently only available to emerging growth companies to ALL issuers

- Enables issuers to gauge market interest in possible offering with certain institutional investors prior to, or following, the filing of a registration statement

- Final Rule is effective December 3, 2019

Refer to Press Release for more information
SEC Rulemaking - Proposed Amendments to Accelerated and Large Accelerated Filer Definitions

- Proposed May 9, 2019
- Would amend the definitions of an accelerated filer (AF) and large accelerated filer (LAF)
- Would reduce the number of issuers that qualify as accelerated filers and reduce compliance costs for smaller reporting companies.
- Certain low-revenue issuers would not be subject to the Sarbanes Oxley auditor attestation requirements regarding internal control over financial reporting (ICFR)
SEC Rulemaking - Proposed Amendments to Accelerated and Large Accelerated Filer Definitions

Proposal would change the definitions of an accelerated and large accelerated filer to exclude issuers that otherwise qualify as a smaller reporting company and have annual revenues of less than $100 million in their most recently completed fiscal year.

- Maintain the existing initial qualification thresholds for accelerated and large accelerated filer status based on public float
- Add a conforming revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status
- Increase the public float transition thresholds for exiting accelerated and large accelerated filer status to 80% of the initial qualification thresholds
SEC Rulemaking - *Proposed Amendments to Accelerated and Large Accelerated Filer Definitions*

**Proposed Changes to Definition of AF and LAF**

- Would **exclude** from those AF and LAF definitions an issuer eligible to be an SRC under the SRC **revenue** test:
  - Issuers that have a public float between $75 million and $250 million would not be considered accelerated filers if their annual revenues were $100 million or less; **or**
  - Issuers with no revenue and public float between $75 million and $700 million

- These issuers would be SRC's and therefore **exempt** from the requirements applicable to accelerated filers (auditor attestation of ICFR and accelerated due dates for Exchange Act reporting)
SEC Rulemaking - Proposed Amendments to Financial Disclosures About Acquired and Disposed Businesses

- Change the calculations for measuring the significance of acquired and disposed businesses
- Change the financial statement requirements for a significant acquired business
- Align certain financial statement requirements of S-X Rule 3-14 for acquired real estate operations with S-X Rule 3-05 for acquired businesses
- Amend Article 11, Pro Forma Financial Information, to permit the use of “Management Adjustments”

Refer to BDO SEC Alert

Cooley BDO
SEC Rulemaking - *Proposed Amendments to Financial Disclosures About Acquired and Disposed Businesses*

► Updates to Significance Tests

- Investment Test - **current requirement** is to compare the registrant’s investment in the target business (generally, the purchase price) to the registrant’s total assets

- Investment test - **proposed requirement** would be to compare the registrant’s investment in the target to the registrant’s aggregate world wide market value of voting and non-voting common equity

- WW market value would be determined as of the last business day of the registrant’s most recently completed FYE

- Where a registrant does not have an aggregate WW market value, the existing investment test would be used
SEC Rulemaking - Proposed Amendments to Financial Disclosures About Acquired and Disposed Businesses

Updates to Significance Tests

- Income Test - current requirement is to compare the target’s net income from continuing operations before taxes to the Registrant’s net income from continuing operations before taxes

- Income test - proposed requirement would (1) add a revenue component and (2) change the net income
  - Revenue of target compared to revenue of registrant
  - Net income/loss from continuing operations after taxes of target compared to net income/loss from continuing operations after taxes of registrant

- Significance is based on the lower of these two ratios

- If registrant or target does not have revenue, only the income component would apply

- 5-year averaging would use absolute value for losses instead of -0-
SEC Rulemaking - Proposed Amendments to Financial Disclosures About Acquired and Disposed Businesses

Significance Thresholds and Tests for Dispositions

- Dispositions - current requirement is to provide pro forma financial information upon a disposition or probable disposition of a significant portion of a business by sale, abandonment, or spin-off. Significance is determined using the significance tests in S-X 1-02(w) using a 10% threshold

- Dispositions - proposed requirement would raise the threshold from 10% to 20%

- In addition, the tests used to determine significance of a disposed business would be conformed to those used to determine significance of an acquired business
## SEC Rulemaking - Proposed Amendments to Financial Disclosures About Acquired and Disposed Businesses

### Acquiree Financial Statements - Number of Years to be Presented

<table>
<thead>
<tr>
<th>Significance</th>
<th>Current</th>
<th>Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20%</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>&gt; 20% but &lt; 40%</td>
<td>One year audited plus interims for current and comparable prior year</td>
<td>One year audited plus interims for current year with no comparable prior interim period</td>
</tr>
<tr>
<td>&gt; 40% but &lt; 50%</td>
<td>Two years audited plus interims for current and comparable prior year</td>
<td>Two years audited plus interims for current and comparable prior year</td>
</tr>
<tr>
<td>Greater than 50%</td>
<td>Three years audited plus interims for current and comparable prior year</td>
<td></td>
</tr>
</tbody>
</table>
SEC Rulemaking - *Proposed Amendments to Regulation S-K Items for 101, 103, and 105*

- Includes proposed changes to the Description of Business, Legal Proceedings, and Risk Factors disclosure requirements

- Other than changes to Legal Proceedings, would emphasize a more principles-based approach to disclosure

Refer to [BDO SEC Alert](#)
SEC Rulemaking - *Proposed Amendments to Update Disclosure Requirements for Banking Registrants*

- Add new subpart 1400 of Regulation S-K and replace Guide 3
- Codify certain Guide 3 disclosures and eliminate overlapping or redundant disclosures
- Require some new disclosures

Refer to [BDO SEC Alert](#)
COMMENT LETTER TOPICS
Comment Letter Topics

High Focus Areas

- Revenue Recognition ("Topic 606")
- Non-GAAP Financial Measures
- MD&A
Revenue Recognition ("Topic 606")

- Comment letters seek clarity on Topic 606 accounting and disclosures, including:
  - The identification of performance obligations
  - The type and nature of variable consideration, including whether any variable consideration is constrained
  - Information regarding the method used to recognize revenue for performance obligations and why the method is appropriate
  - The analysis for presenting revenue on a gross vs. net basis (i.e. principal vs. agent considerations)
  - Disaggregation of revenue that reflect how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows
Revenue Recognition (example)

With respect to your ABC and XYZ licensing agreements, please address the following:

- Identify for us the promised goods and/or services under the agreement.
- Tell us how you determined which promised goods and services were material and distinct, and thus performance obligations, as well as which promises may have been combined.
- Quantify for us the total transaction price, how it was determined as well as the items (i.e. milestones, royalties, etc.) included/excluded and the reasons therefore, the amounts allocated to the various performance obligations, and the amounts recognized during the year ended December 31, 2018 and the three months ended March 31, 2019.
- Provide us a breakout of the regulatory milestones you may be eligible to receive by type and amount.
Revenue Recognition (example)

- Your timing of revenue recognition from when the product is delivered to when the product quality release testing procedures are completed changed upon adoption of ASC 606, as it appears this is the point in time you have determined that control has been transferred to the customer. Please address the following:

  - Confirm that our understanding of your revenue recognition policy for manufacturing and supply of commercial product, as noted in the first sentence of this comment, is accurate. If not, please clarify your policy for us in your response.

  - It appears that shipping and handling activities are performed after a customer obtains control of the product. Provide us proposed disclosure to be included in future filings under ASC 606-10-25-18B with regards to the disclosure requirements in paragraphs 50-1 through 50-6 of ASC 235-10 or tell us why you do not believe this disclosure is required.

  - Tell us the approximate time from when you have completed the quality assurance process to when the product is shipped to the customer.
Revenue Recognition (example)

Your disclosure on page F-26 related to your ABC Innovation Platform indicates that license revenue is recorded at a point-in-time given your determination that delivery of the intellectual property to the licensee is a distinct performance obligation. You also disclose that you record the associated milestone payment portions of transaction prices as revenue at a point-in-time. Please address the following as it specifically relates to your License and Development Agreement with XYZ, Inc.:

- Identify for us the promised goods and/or services under the agreement;
- Explain to us how you considered the development services you are required to perform in determining that the license was a distinct performance obligation;
- Quantify for us the total transaction price, how you determined it, and the amounts allocated to the various performance obligations;
- Tell us the method (ASC 606-10-32-8) you use to estimate variable consideration for reaching development and regulatory milestone events and the nature, amount and trigger for each constrained milestone; and
- Provide us your accounting analysis supporting your accounting policy of recognizing milestones at a point-in-time.
Revenue Recognition (example)

Your MD&A disclosures on pages 28 and 29 as well as statements made in your earnings releases suggest that quantitative information about revenue by nature of service (such as advertising, licensing, subscription) may be both presented outside of the financial statements and used by investors and analysts to evaluate your financial performance.

For example, in the shareholder letter filed as an exhibit to your November 7, 2018 Form 8-K, you indicated that nearly two-thirds of the increase in platform revenue for the three months ended September 30, 2018 was due to "advertising services such as video ads, audience development and brand sponsorship advertising on the XYZ user interface. Please tell us how you considered providing disaggregated revenue disclosures by type of service. Please refer to ASC 606-10-55-89 through 55-91."
Non-GAAP Financial Measures

- Comments focus on measures that appear to:
  - Modify GAAP recognition and measurement principles (i.e. constitute an individually tailored accounting principle)
  - Exclude normal cash operating expenses from performance measures
  - Be applied inconsistently period to period (i.e. changing measures over time)

- Expense associated with the reduction of the right-of-use asset for operating leases over time is a component of rent expense and should not be reflected as “amortization” in EBITDA or Adjusted EBITDA performance measures.
Non-GAAP Measures (example)

Refer to your response to our prior comment 7. We believe that recognizing the $15.1 million adjustment within your calculation of your non-GAAP measures of Adjusted EBITDA and Adjusted Net Income represents revenue that was not earned during the period as presented. Including the adjustment would effectively follow two different revenue recognition models within the same period, which would represent the use of an individually tailored recognition method. Refer to question 100.04 of the Compliance & Disclosure Interpretation for non-GAAP Financial Measures. Please represent to us that, beginning with your fourth quarter 2019 earnings release, you will revise your future presentations of Adjusted EBITDA and Adjusted Net Income to exclude this adjustment.
Non-GAAP Measures (example)

Your response to comment 1 indicates that you believe that the upfront and milestone payments made to ABC do not represent your ongoing operating activities and their exclusion from the financial results on a Non-GAAP basis provides investors with useful information about your ongoing operating activities. Please tell us how you considered Question 100.01 of the Division's Non-GAAP Financial Measures Compliance and Disclosure Interpretations in determining whether these adjustments represent normal, recurring, cash operating expenses necessary to operate your business. Your analysis should separately address the license fees, option fees and milestone payments made to ABC that have been included in your adjustments to arrive at your Non-GAAP measures.
Non-GAAP Measures (example)

We note your response to comment 1. Please provide a discussion of your consideration of question 100.04 of the Division's Non-GAAP Financial Measures Compliance and Disclosure Interpretations and your rationale for inclusion of the adjustments related to your upfront and milestone payments to ABC in determining that they do not substitute individually-tailored income or expense recognition methods for those of GAAP.
Non-GAAP Measures (example)

Please tell us whether you have included the tax effects on the adjustments presented to arrive at Non-GAAP net income (loss). To the extent these adjustments are disclosed net of taxes, please revise to present the effect of income taxes as a separate adjustment and expand your disclosure to clearly explain how the tax effects of non-GAAP adjustments are calculated. Refer to Question 102.11 of the Division's Non-GAAP Financial Measures Compliance and Disclosure Interpretations.
The staff frequently commented on MD&A disclosures. The nature of these comments:

- Increasing specificity in describing “why” changes have occurred period over period.
- Seeking more information about the underlying causes and effects of known trends, events, and uncertainties.
- Focusing the discussion of critical accounting estimates on the significant judgements and estimates that, if changed or varied, will significant impact their results.
- Providing more detail about performance indicators, financial or nonfinancial that are used to manage the business.
MD&A (example)

- Given the significance of goodwill and intangible assets to your balance sheet, please tell us your consideration of expanding your disclosure to provide a robust and comprehensive discussion regarding your impairment testing policies. This discussion should include a description of key assumptions used and how the key assumptions are determined, a description of the uncertainties associated with the key assumptions and any potential events and/or circumstances that could have a negative effect on the key assumptions.
We note your response to comment 2 from our letter dated May 1, 2019. We believe that the quantification of the dollar impact of the ABC acquisition within MD&A allows for a thorough understanding and evaluation of your operating results for the periods presented including any impact from organic operating results. Please expand your MD&A to include the information you highlight in paragraph 3 of your response and include similar information to the extent that the ABC acquisition materially impacted any additional segment results of operations.
Other Comment Letter Topics

- Other perennial favorites
  - Fair value measurements
  - Intangible assets and goodwill
  - Income taxes
  - Segment reporting

- Other potential topic areas
  - Accounting and disclosures related to ASC 842 (Leases)
  - SAB 74 Disclosures related to CECL
  - LIBOR transition
  - Cybersecurity
  - Brexit
  - Tariffs (risk factors too)
Cybersecurity (example)

- You state here, "In the normal course of ABC's business, ABC has been the target of malicious cyber-attack attempts." Please revise to discuss here any material cybersecurity breaches you have experienced, and quantify the related costs you have incurred and reasonably expect to incur here or elsewhere as appropriate. Alternatively, please confirm to us that you have not experienced any material cybersecurity breaches.
Brexit (example)

- Considering your operations in the United Kingdom ("U.K.") as well as the U.K. pension plan, please tell us what consideration was given to including risk factor disclosure for Brexit.
Internal Control over Financial Reporting

- Takeaways from recent SEC enforcement actions against companies with long-outstanding material weaknesses in internal control over financial reporting
  - Disclosure of material weaknesses isn’t enough without meaningful remediation
  - Refer to press release for more information
SAB 74 Disclosures - Current and Expected Credit Losses (CECL)

- ASU 2016-13 *Financial Instruments - Credit Losses (Topic 326)* will be effective for SEC filers excluding Smaller Reporting Companies for periods beginning after December 15, 2019 (December 15, 2022 for all other entities).
  - Final ASU deferring effective dates for certain companies pending as of November 1

- Standard will require companies to measure all expected credit losses for financial assets (including trade receivables) based on historical experience, current conditions and reasonable supportable forecasts about collectability.

- SAB 74 disclosures are to provide investors with information about the impact that recently issued accounting standards will have on the financial statements.
Reference Rate Reform - LIBOR Transition Disclosures

- The London Interbank Offered Rate (LIBOR) is expected to be replaced by an alternative rate after 2021.

- The staff encourages registrants to disclose (in MD&A):
  - Status of Company’s efforts and significant matters to be addressed related to the expected discontinuation of LIBOR.
  - When the Company does not yet know or cannot yet reasonably estimate the impact.
  - Information used by management and the board in assessing and monitoring how transitioning from LIBOR may affect the Company.
Contractual Obligations Table Reporting

- Disclosure of the future maturities of operating lease obligations is required in the financial statement footnotes.

- ASC Topic 842 defines what should be included in the future minimum lease payments disclosure. For example, Topic 842 requires lessees to include renewal options that are reasonably certain of being exercised. This is a change from Topic 840 which did not provide such guidance.

- The payment obligations included in the contractual obligations table in MD&A should be consistent with the future minimum lease payments schedule.
Form 10-K Process Reminders

Completion of the financial reporting process requires careful attention to detail. Processes should ensure that:

- The EDGARized version of the 10-K is complete and accurate (i.e., no missing paragraphs or columns from tables, no truncation of information in tables, etc.)
- All relevant dates appear within the audit reports, consents, and signatures
- The form and content of registrants’ annual certifications are accurate
- All material contracts are included within the exhibits to the filing
- New cover page regarding market/trading symbol and delinquent section 16 reports
- New Item 601(b)(4)(vi) requires an exhibit with Item 202 information (description of securities)
Selected Proxy topics

- New Item 407(i) requires disclosure about hedging policies (EGCs and SRCs have one more year until compliance)
- SEC Hot Topics:
  - Proxy Access
  - Proxy Advisory Firms
- Shareholder Hot Topics:
  - Diversity
  - Other Environmental, Social, Governance proposals
  - Compensation
- Compensation-related shareholder litigation continues to be a cause for concern
  - Pay careful attention to completeness and accuracy of all CD&A disclosure
  - KPIs
THANK YOU!