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Introduction

2021 has been a year of change at the SEC. The change in political administration in January followed by changes in key SEC leadership positions have significantly impacted the SEC's focus and agenda. Gary Gensler was sworn in as Chair of the SEC in April. The top issues on his regulatory agenda that may impact SEC reporting by public companies, like environmental, social and governance (ESG) matters, are a notable shift from those of the past few years, where capital formation and disclosure effectiveness activities were primary areas of focus. New rulemaking is a time-intensive process, so it is not surprising that significant proposals or amendments have not yet been released. Despite lighter rulemaking, there were still plenty of Commission and staff activities related to the SEC's focus areas, particularly as it relates to ESG reporting and special purpose acquisition companies (SPACs). The rise of SPAC mergers as a popular alternative to a traditional initial public offering has increased the SEC's scrutiny and focus on these transactions in 2021.

Our publication summarizes the Commission and staff activities related to the SEC's focus areas highlighted above and other select disclosure and reporting reminders.

2021 Reporting Reminders

In the sections that follow, we have summarized some key reporting topics to be mindful of, particularly as the annual reporting season approaches for calendar year-end SEC registrants.

CHANGES TO REGULATION S-K

The **amendments** to the disclosure requirements of Regulation S-K from November 2020 are now effective and must be applied in a registrant's first fiscal year ending on or after August 9, 2021. As such, a calendar year-end registrant must apply the new rules in its 2021 Form 10-K.[1] The amendments are intended to reduce disclosures that are duplicative and emphasize information within management's discussion and analysis (MD&A) that is material to the investors. The amendments clarify the overall objective of MD&A and promote a principles-based approach to certain disclosures. A summary of the more significant changes is detailed below.

Selected Financial Data (S-K Item 301):

The requirement to disclose selected financial data is eliminated. Previously, if S-K Item 301 was applicable to a registrant, selected financial data for the previous five fiscal years was required to be disclosed. The intent of the previous rule was to present information that highlights significant trends in a registrant's operations. However, MD&A already requires disclosure of material information pertinent to a trend, and information for previous fiscal years is publicly available elsewhere. As such, the staff eliminated the duplicative disclosure to provide selected financial data previously required under S-K Item 301.

Supplementary Financial Information (S-K Item 302):

The requirement to disclose quarterly supplementary financial data for the two most recent fiscal years under S-K Item 302(a) is now only required for periods that report a material retrospective change (or changes) within the two most recent fiscal years, along with an explanation of the reason for the change. Examples of a material retrospective change include a change in accounting principle, accounting for a discontinued operation, and corrections of errors. A smaller reporting company ("SRC") is not required to comply with S-K Item 302.

BDO Insight: In a reverse merger, the equity and earnings per share of the continuing entity is retroactively revised to reflect the exchange ratio and new capital structure. Registrants should consider whether such change is material to require disclosure of quarterly financial data. As noted above SRCs are not required to comply with such disclosure.

1 The "mandatory compliance date" is defined as "the first fiscal year ending on or after" August 9, 2021. As such, the final rules are not required to be adopted in the Form 10-Qs within the fiscal year of required adoption.

Management's discussion and analysis of financial condition and results of operations (S-K Item 303):

- **Objective:** S-K Item 303(a) now includes a stated objective of MD&A disclosure. The objective is focused on a principles-based approach to disclose information that is known or reasonably likely to materially impact current or future operations.
- **Results of operations:** S-K Item 303(b) now explicitly requires disclosure of the underlying reason, in quantitative and qualitative terms, for material changes in a line item, including when offset by another material change. Although the instructions previously alerted registrants to "not merely repeat numerical data contained in the consolidated financial statements," the staff observed that many registrants would do so. In an effort to provide a more meaningful analysis of material changes period over period, the staff amended the rule to explicitly mandate such disclosure. The amendments also require a registrant to discuss material changes in net sales or revenues, whereas previous rules required a discussion of material increases.

  Additionally, Item 303(b)(2) codified interpretative guidance from **1989** to include a discussion of known trends and uncertainties that are "reasonably likely" to have a material impact on a registrant's operations, whereas previously rules required the discussion if the event "will" have a material impact.

  Previously, a registrant was required to discuss the impact of inflation and prices changes on net sales or revenues, and income from continuing operations. While this particular requirement was removed, such discussion would still be required in the context of Item 303(b)(2), if the impact of inflation and price changes had, or is reasonably likely to have, a material impact to operations.
- **Liquidity and capital resources:** The requirement to disclose a contractual obligations table under S-K Item 303(a)(5) was replaced with an enhanced discussion of liquidity and capital resources focused on material short- and long-term cash requirements from known contractual and other obligations. Previously, if S-K Item 303(a)(5) was applicable to a registrant, known contractual obligations (regardless of materiality) were required to be disclosed in tabular format in prescribed categories and time periods. Now, a discussion of the material cash requirements for known short-term and long-term obligations, including the capital resources needed to cover such obligations is required.

BDO Insight: A registrant may voluntarily disclose such obligations in a table to supplement its discussion of liquidity and capital resources, as the rules require such discussion to be in an easy-to-follow format.

The discussion of material commitments for cash expenditures (previously required under S-K Item 303(a)(2)) is now expanded in S-K Item 303(b), codifying previous interpretive guidance from **2003** to require discussion for capital resources, focusing not only on capital expenditures, but also funds necessary, and the sources of such funds, to maintain current operations, complete projects underway, and achieve stated objectives or plans.

Previously, off-balance sheet obligations were required to be included in a separate caption under S-K Item 303(a)(4). While the separate caption is no longer required, S-K Item 303(b)(1) requires disclosure of material off-balance sheet obligations in the context of liquidity and capital resources.

Critical Accounting Estimates

S-K Item 303(b)(3) now defines a critical accounting estimate and codifies **2003** interpretative guidance for the required disclosure of such estimates. As defined, critical accounting estimates "involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the registrant's financial condition or results of operations." For each such estimate, a registrant should disclose (to the extent material):

- Why the estimate is subject to uncertainty;
- How much each estimate has changed during the relevant period; and
- The sensitivity of the reported amounts to the material methods, assumptions, and estimates underlying the estimate's calculation.

The disclosures should supplement rather than repeat the significant accounting policy footnotes.

Interim Periods

Under S-K Item 303(c), registrants are now permitted to discuss material changes in the results of operations for the most recent current quarter as compared to the immediately preceding quarter **or** corresponding quarter of the prior year.

BDO Insight: We believe registrants should carefully assess how their historical MD&A disclosures align with the new requirements to ensure appropriate updates are made. MD&A disclosure has been a frequent topic of SEC staff comment letters, a trend we expect will continue. As responding to comment letters can be time consuming and costly, any effort spent to ensure the disclosures are responsive to the requirements will be time well spent.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE DISCLOSURE MATTERS

As investor demand for environmental, social, and governance (ESG) information has increased, the SEC's focus on such matters has also increased. Earlier in the year, the SEC announced it would take an "all-agency" approach to the issues and created a dedicated **webpage** that includes information about the SEC's response to climate and ESG risks and opportunities. The SEC's response has resulted in:

- The appointment of a Senior Policy Advisor for Climate Change and ESG to advise the Commission on ESG matters and advance related initiatives across the agency.
- The creation of a Climate and ESG Task Force within the Division of Enforcement that will identify gaps or misstatements in issuers disclosures on ESG and climate change matters and work on initiative to identify any misconduct related to ESG disclosures.
- Multiple speeches and public statements by Chair Gensler, other SEC commissioners, and senior staff members that support the view that the SEC should help lead the creation of an effective ESG disclosure system.
- The **request for public input** on how the SEC can best regulate or monitor climate change disclosures to provide more consistent, comparable, and decision useful information for investors.
- An enhanced focus and review of climate-related disclosure in filings by the Division of Corporation Finance — a program intended to gain a better understanding of how registrants are applying the **2010 interpretive release on climate change disclosure**. This focus led to the release of a **sample comment letter** sent to companies seeking to understand how they thought about climate change disclosures in their SEC filings.
- The inclusion of climate change and human capital management disclosures on Chair Gensler's short-term list of rulemaking topics in the **SEC's Regulatory Agenda** (or "Reg Flex Agenda," as it's commonly referred to) released in June.

While we wait for ESG-related rulemaking that will likely be more prescriptive in nature, registrants are advised to focus on existing rules and guidance which may elicit disclosure on climate change and human capital-related matters. The staff's sample comment letter on climate change disclosures and the related 2010 Commission-level interpretive guidance are great resources to consider when drafting upcoming 10K filings. The **interpretive guidance**, which was largely leveraged by the staff in issuing its climate change-related comments, highlights the multiple sections of an SEC filing where such information may appear when the information is considered material.[2] Based on a registrant's specific facts and circumstances, such disclosures may appear within the description of the business, legal proceedings, risk factors, and management's discussion and analysis under existing rules and guidance. When material, disclosures should address:

- The impact of pending or existing climate-change related legislation, regulations, and international accords.
- The indirect consequences of regulation or business trends, including (for example),
  - Decreased demand for goods with significant greenhouse emissions
  - Increased competition to develop new climate friendly products, or
  - Decreased demand for services related to carbon based energy sources.
- The actual or potential physical impacts of climate change, including the severity of weather and the corresponding effect on the business.

To the extent a registrant has released a separate corporate social responsibility report with more expansive climate-related disclosures, it will want to carefully consider the potential need to provide similar disclosure in its Form 10-K filing. Registrants may also need to revisit their disclosure controls and procedures in order to give careful consideration to whether material climate-related information is appropriately considered for inclusion in the SEC filing.

2 In accordance with existing SEC rules, the staff reminded companies of the requirement to disclose "such material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading." As we understand it, the standard of applying materiality in the context of the federal securities laws and SEC filings may not be the same standard used when such information is provided to investors.

Separately, existing SEC rules with respect to human capital management matters are largely principles-based. They reflect an expectation that disclosures will be tailored to a company's own business or industry using management's judgment and evolve over time in response to changes in a company's business environment. While amendments to Regulation S-K that became effective in 2020 added "human capital" as a potential disclosure topic within the business section of SEC filings, Regulation S-K does not define "human capital" or include a prescriptive list of requirements. In addition to the number of employees, registrant should also consider disclosing:

- A description of human capital resources, if material to the business as a whole (and as it relates to a particular segment); and
- Any human capital measures or objectives, if material, that the registrant focuses on in managing its business, such as those related to the development, attraction, safety, engagement, and retention of employees.

BDO Insight: Chair Gensler has indicated that disclosure of workforce statistics is one of his top priorities. He has asked the staff to put together recommendations for mandatory disclosures on human capital given in response to investors that have said they want to better understand one of the most critical assets of the company, its people. He has said these disclosures could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.

CYBERSECURITY DISCLOSURES

Unfortunately, cyber breaches and attacks like the widely publicized cyberattack involving the compromise of software made by SolarWinds Corporation in December 2020 (the "SolarWinds Compromise"), have become commonplace. Given the severity and widespread nature of attacks like the SolarWinds Compromise, the SEC's Division of Enforcement has increased its attention on how registrants respond to such attacks. In 2021, the Division of Enforcement **announced an investigation** into companies affected by the SolarWinds Compromise. As part of this investigation, the staff issued a letter[3] to certain registrants requesting information to be provided on a voluntary basis about the impact of the cyberattack, how the company responded, and the related impact on disclosures and disclosure controls and procedures. While responses were voluntary, the Division announced that it would not pursue enforcement actions against those that meet the requirements set forth in the letter and cure any potential prior disclosure failures.

This widespread investigation by SEC Enforcement, accompanied by the prevalent cyber risks in today's environment, highlight the need for registrants to consider the existing cybersecurity disclosure guidance. While cybersecurity risk governance disclosures appear on the SEC's latest Reg Flex Agenda, the timing of such rulemaking is not clear. In the meantime, registrants are advised to consider the latest **Commission-level interpretive guidance** on cybersecurity disclosures was released in 2018 and outlined the SEC's views with respect to cybersecurity disclosure requirements under the federal securities laws as they apply to public operating companies.[4] The release reinforced and expanded the **guidance on reporting and disclosing cybersecurity risks and incidents** that the Division of Corporation Finance issued in 2011. In addition, the release addressed the importance of cybersecurity policies and procedures and the application of insider trading prohibitions in the cybersecurity context.

3 The letter (including questions therein) was considered an information request, not a formal subpoena.

4 This release does not address the specific implications of cybersecurity to other regulated entities under the federal securities laws, such as registered investment companies, investment advisers, brokers, dealers, exchanges, and self-regulatory organizations.

The Division's 2011 guidance reminded registrants that although existing disclosure requirements do not explicitly include cybersecurity risks or cyber incidents, registrants may nonetheless be obligated to make such disclosures. The specific disclosure obligations within the Division's 2011 guidance included risk factors, MD&A, business, legal proceedings, financial statement disclosures, and disclosure controls and procedures. Each of those specific disclosure obligations was reinforced within the 2018 release. Additionally, the release expanded upon the Division's 2011 guidance by including a focus on the following topics:

- **Stressing the importance of cybersecurity policies and procedures:** Companies were reminded that establishing and maintaining effective disclosure controls and procedures must include considerations for cybersecurity. The Commission also reminded companies to consider the materiality of cybersecurity risks and incidents when preparing their disclosures and included the relevant obligations companies have related to periodic reports, Securities Act and Exchange Act filings, and current reports.
- **Application of insider trading prohibitions in the cybersecurity context:** Cybersecurity risks and incidents may create material nonpublic information. The Commission encouraged companies to not only consider federal securities laws related to insider trading, but to also review their own insider trading policies and procedures already in place to prevent trading on the basis of material nonpublic information related to cybersecurity risks and incidents. In addition, the Commission expects companies to have policies and procedures to ensure that any disclosures of material nonpublic information related to cybersecurity risk and incidents are not made selectively, and that they comply with the Regulation FD disclosure requirements.
- **Board risk oversight disclosures:** Disclosure requirements were expanded to include cybersecurity risks when disclosing how the board of directors administers its risk oversight function.

Consistent with the Division's 2011 guidance, the Commission's release reinforced the notion that companies are not to provide a "roadmap" on how to compromise their systems. Instead, companies are to provide meaningful disclosures that are company-specific (not boilerplate) that would be material to an investor and to provide such disclosures in a timely fashion.

LATE FILINGS

A registrant that is unable to timely file its Form 10-Q or Form 10-K is required to file Form 12b-25 "Notification of Late Filing" (referred to within the Edgar system as NT 10-K or NT 10-Q). Properly filing Form 12b-25 allows such registrants to file their Form 10-Ks and Form 10-Qs up to fifteen and five calendar days past the required due date of the report, respectively, without being characterized as untimely filers (and therefore, avoiding the consequences of a late filing). Form 12b-25 must contain certain disclosures, including:

- In reasonable detail, why the periodic report could not be filed on time without unreasonable effort or expense; and
- Any anticipated significant changes in the results of operations from the corresponding period for the last fiscal year. Changes should be described both quantitatively and qualitatively. If quantitative information is not disclosed, registrants should state the reasons why reasonable estimates of the results could not be made.

In 2021, the **SEC charged eight registrants** for failing to disclose within their Form 12b-25 filings that their delayed quarterly or annual report was caused by an anticipated restatement or correction of prior financial reporting and for failing to disclose a significant anticipated change in financial results. The staff uncovered the disclosure violations by using data analytics to examine companies that announced restatements or corrections to their financial reporting within four — fourteen days of their Form 12b-25 filings. Form 12b-25 should not be used as a mechanism to delay the reporting of "bad news." Companies that are unable to timely file are advised to carefully consider and comply with the Form's disclosure requirements to remain timely filers, communicate appropriately with investors about the nature of the delay and any anticipated changes in results, and lower their risk of SEC Enforcement scrutiny.

SELECT STAFF COMMENT LETTER TOPICS

As required by the Sarbanes-Oxley Act, the staff reviews registrant filings at least once every three years. The staff reviews may vary from a cover-to-cover review for compliance with the applicable rules and regulations to a targeted review focused on specific disclosures within the footnotes and MD&A for compliance with the relevant accounting standards and related disclosure requirements. Events such as a material restatement, significant volatility in the registrant's stock price as compared to its peers, or significant business combinations (among other events) may trigger more frequent reviews.

Staff comments in 2021 have continued to focus primarily on the following areas:

- Non-GAAP Financial Measures;
- Management Discussion and Analysis ("MD&A");
- Segment Reporting; and
- Revenue Recognition (Topic 606).

BDO Insight: The Division of Corporation Finance issued **Disclosure Guidance Topic No. 9** and **Disclosure Guidance Topic No. 9A** in 2020, providing the SEC staff's views on disclosures and securities law obligations that registrants should consider related to COVID-19. Staff comments related to COVID-19 have largely been focused on requesting additional disclosure specific to the registrant's facts and circumstances, when the current disclosure is limited to general statements. We suggest registrants reassess their COVID-19 related disclosures to ensure that they are updated to reflect recent developments, address the current and potential impact of the ongoing pandemic, and are specific to the company's facts and circumstances.

NON-GAAP FINANCIAL MEASURES

The staff remains focused on registrants' use of non-GAAP financial measures in their earnings releases and filings (the staff may also comment on measures appearing on company websites and investor presentations). Registrants are reminded to adhere to the **non-GAAP Compliance and Disclosure Interpretations** issued in May 2016 when they elect to present such measures.

The staff continues to focus on measures that are perceived to be misleading to investors, particularly those that include "individually tailored accounting principles." Identifying these measures and adjustments can be very subjective. Some questions to consider when evaluating whether a measure might be considered an individually tailored accounting principle include:

- Does the adjustment shift the measure from an accrual basis of accounting to a cash or modified basis of accounting, such as presenting revenues on a cash receipts or billings basis?
- Does the adjustment change the presentation of revenue from a gross to net basis (or vice versa)?
- Does the adjustment consolidate the results of an entity that does not qualify for consolidation?
- Is an adjustment limited to only select parts, but not all, of an accounting concept?
- Is an adjustment inconsistent with the economics of a transaction or an agreement?

Additionally, due to the perceived importance of revenues to investors, the SEC staff continues to challenge non-GAAP measures presented as an alternative to GAAP revenues. The staff objects to the inclusion of the term "revenues" in the description of such non-GAAP measures. For example, the staff would likely take exception to a non-GAAP measure labeled as "gross revenues" or "adjusted gross revenues" which adjusts GAAP revenues by adding back sales incentives (e.g., returns, allowances and/or discounts). However, such a measure may represent amounts invoiced to customers. As such, the metric may be referred to as "billings" or "bookings" and be described as a key performance indicator, as discussed further below.

KEY PERFORMANCE INDICATORS AND METRICS IN MD&A

The staff also continues to issue comments on performance indicators, financial or nonfinancial, that are used to manage the business and disclosed in MD&A. The nature of the comments is largely consistent with the staff's previously issued **guidance** on the disclosure of key performance indicators and metrics in MD&A. The guidance provides considerations and disclosures that are expected to accompany non-financial and financial metrics used to describe the performance or status of the business. Specifically, the staff reminds registrants to:

- Define the metrics used;
- Discuss how the metric is calculated;
- Discuss any limits on the usefulness of the metric;
- Disaggregate the metric (where applicable); and
- Explain how the metric or period-to-period change in the metric links to the operating results to reveal trends.

Registrants should also consider:

- The extent to which an existing regulatory framework applies, such as GAAP or, for non-GAAP measures, Regulation G or Item 10 of Regulation S-K;
- Whether there are estimates or assumptions underlying the metric or its calculation, and whether disclosure of such items is necessary for the metric not to be misleading; and
- Additional information that may be necessary to provide adequate context for an investor to understand the metric presented.

Lastly, registrants are reminded of the importance to maintain effective disclosure controls and procedures when disclosing material key performance indicators or metrics that are derived from the company's own information.

MANAGEMENT DISCUSSION AND ANALYSIS ("MD&A")

The staff continues to comment on MD&A disclosures and encourages registrants to focus on communicating material information to investors. The nature of these comments include:

- Focus on the discussion of the results of operations and the need for more specificity in describing "why" changes have occurred period over period.
- Seek more information about the underlying causes and effects of known trends, events, uncertainties. For example, the staff may ask whether there are any known trends that have had or that the company reasonably expects will have a material favorable or unfavorable impact on revenues or results and whether those changes are expected to continue.
- Request that registrants focus their discussion of critical accounting estimates on the significant judgments and estimates that, if changed or varied, will significantly impact their results (which generally is accomplished by supplementing, not repeating, critical accounting policy disclosure).

BDO Insight: We expect the staff to continue to comment on the disclosure matters above, particularly because the Regulation S-K amendments discussed above codified previous staff guidance on MD&A disclosure. Compliance is mandatory for a calendar year-end registrant in its upcoming 2021 Form 10-K.

SEGMENT REPORTING

The staff's comments on segment reporting seek clarity on:

- How registrants identified operating segments;
- How registrants aggregate operating segments into reportable segments;
- Whether registrants have inappropriately included non-GAAP measures in their segment disclosures; and
- Whether registrants provide appropriate entity-wide disclosures related to products and services, revenues attributable to individual foreign countries and revenues from major customers.

The staff often identifies inconsistencies in how the business is described in earnings calls, websites, and industry or analyst presentations and how it is described in their segment reporting footnotes.

The SEC staff also discussed non-GAAP measures in the context of segment reporting. A registrant must disclose the measure of profit or loss used by its chief operating decision maker. ASC 280 does not require a registrant to calculate such measure in accordance with GAAP. When a registrant presents multiple measures of segment profit or loss which are not calculated in accordance with GAAP, the staff may question the rationale for, and may ultimately object to, such disclosures. Additionally, the staff will object to the presentation of segment revenues on a non-GAAP basis.[5]

5 Entity-wide revenue disclosures under ASC 280 are required to be presented on the same basis as "the financial information used to produce the public entity's general-purpose financial statements."

REVENUE RECOGNITION ("TOPIC 606")

Year after year, accounting and disclosures related to revenue recognition are one of the key focus areas of staff comments. The staff continues to issue comment letters that seek clarity on:

- The identification of performance obligations – i.e., understanding the analysis of whether certain promised goods or services are or are not separately identifiable.
- 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 (over time or point-in-time) and why the method is appropriate.
- The analysis for presenting revenues on a gross vs. net basis (i.e., principal/agent considerations).
- Disaggregation of revenue into categories that reflect how economic factors affect the nature, amount, timing, and uncertainty of revenue and cash flows.

BDO Insight: We expect all of these comment letter topics to remain focus areas of the staff in comment letters on upcoming and next year's filings. Additionally, we expect comments on ESG matters, especially climate change related disclosures, based on the staff's release of the **sample comment letter** about climate change disclosures discussed earlier.

Over-The-Counter Market Rule Changes

On September 28, 2021, U.S. companies whose securities trade on the over-the counter (OTC) markets are required to comply with amended **SEC Rule 15c2-11** to be eligible for trading. If a company does not comply with the requirements of Rule 15c2-11, its stock is no longer eligible for quotation. Amended Rule 15c2-11 effectively requires companies on the lower OTC market tiers (i.e., below Pink Current) to make current and public disclosures (including financial information) available to brokers and investors, subject to certain exceptions.[6] Prior to these rule changes, brokers could maintain a quoted market for an issuer's securities even if the issuer did not provide current and public financial information. The SEC made these rule changes in 2020 to promote investor protection for those that buy and sell securities on these markets and curb the incidents of fraud or manipulation.

As a result of these changes, smaller companies that previously traded on the lower OTC market tiers without providing current and publicly available information may lose the ability for their securities to be quoted (and therefore, investors may not be able to buy or sell their stock). Affected companies may refer to the **OTC's 15c2-11 Resource Center** for further information about the new information requirements.

6 Companies trading on the OTCQX or OTCQB markets were already required to provide current and public reporting, so they (nor companies traded on the NASDAQ or NYSE) are affected by these rule changes.

Commission and Staff Activities

SPAC ACCOUNTING AND REPORTING CONSIDERATIONS

Special Purpose Acquisition Companies ("SPACs") are companies with no commercial operations that are formed to raise capital through an initial public offering (IPO) for the sole purpose of acquiring one or more target businesses. Although SPACs have been around for many years, their popularity increased exponentially in late 2020 and throughout 2021 leading the SEC staff to release several public statements in March and April 2021 to alert investors and other stakeholders about the financial reporting, auditing and liability considerations specific to SPACs and SPAC merger transactions:

- Financial Reporting and Auditing Considerations of Companies Merging with SPACs
- SPACs, IPOs and Liability Risk under the Securities Laws
- Staff Statement on Accounting and Reporting Considerations for Warrants Issued by SPACs

The statement on the accounting and reporting considerations for warrants issued by SPACs included the staff's position that SPAC warrants frequently contain features that required the warrants to be accounted for as liabilities. Historically, the warrants issued by SPACs were accounted for as equity instruments. Upon issuance of the staff's statement, SPAC activity came to a near halt as companies, their advisors, and auditors reassessed the terms of the warrants and related implications. While the specific terms of each warrant may vary between SPACs, the provisions that result in liability classification were relatively consistent, and therefore, the warrants, were required to be recognized at fair value upon issuance and each subsequent reporting period. As a result, SPACs were required to assess the materiality of errors in their previously issued financial statements to determine if the financial statements should be restated. The staff's statement also had rippling effects on the financial statements of companies that had already completed their SPAC merger transactions, as the accounting for the warrants often impacted the financial statements of the combined entity post-merger.

Accounting and presentation of redeemable common stock issued to SPAC investors is another area that has resulted in restatements of SPAC financial statements. This redeemable common stock will be redeemed or become redeemable, so it should be presented as temporary equity and accreted to redemption value. Some SPACs have classified $5 million of the redeemable common stock as permanent equity on the basis of provisions stated within the corporate charter included to presumably meet stock exchange listing requirements. These SPACs should restate previously issued financial statements, and evaluate the impact on internal controls over financial reporting and disclosure controls and procedures. For target operating companies that are in the process of merging with a SPAC, they should be aware of the potential impacts to timelines as the SPAC evaluates the impact of such errors.

The staff has also been focused on conflicts of interests present in a SPAC transaction. The SPAC is formed by sponsors (sometimes also referred to as founders), who fund the offering costs of the SPAC's IPO. The sponsors typically receive 20% ownership in the SPAC for funding the offering costs, which generally equates to a negligible price per unit, while the units sold in the IPO are typically priced at $10. Given this disparity in price, the sponsors economically benefit from a SPAC merger, even when the public shareholders receive a negative rate of return following the merger. A conflict of interest is created as the sponsors only benefit if the SPAC closes a merger. The staff expects transparent disclosure in the SPAC's IPO and the SPAC's merger proxy or registration statement used to vote on the proposed merger.

Staff comment letters issued in both SPAC IPOs and de-SPAC transactions often request the analysis of the accounting for warrants that are treated as equity instruments, as well as disclosure of the economic disparity between the sponsors and public shareholders and the corresponding conflicts of interest.

BDO Insight: Historically, one of the benefits of the SPAC IPO was the minimal time and effort until the registration statement was declared effective. With the increased SPAC IPO and merger activity (and SEC scrutiny of such transactions), the time and effort to complete such transactions is no longer minimal. Moreover, the SPAC merger is usually partially funded with a private investment in a public entity ("PIPE"). With the increased volume of SPAC mergers, the availability of private funding has decreased. Consequently, SPACs are utilizing new methods to fund the transaction, often with different financial instruments that can lead to additional time in the process to analyze the accounting implications.

SPACs appear on the SEC's latest **Reg Flex Agenda**. While the timing of such amendments is unknown, we anticipate that the reporting and disclosure requirements associated with such transactions will be enhanced.

NASDAQ'S BOARD DIVERSITY DISCLOSURES

In August, the SEC **approved** the Nasdaq's proposed rule changes related to board diversity disclosures and board recruiting services. Subject to certain exceptions, the rule changes will require all Nasdaq-listed companies to have at least two diverse board members or disclose and explain why they do not. Nasdaq will verify whether the company has provided an explanation but will not assess the merits of the explanation. That is, there is no "right or wrong" reason that a company may give for not having at least two diverse directors. The new listing standard will also require annual disclosure, in an aggregated form, of information on the voluntary self-identified gender, racial characteristics, and LGBTQ+ status of the company's board (using a specified **Board Diversity Matrix**, or a format substantially similar). If such information is not voluntarily provided, companies may indicate that the directors' diversity characteristics are not disclosed. These disclosures may be made in the company's proxy or information statement (or if the company does not file a proxy, its Form 10-K or 20-F), or on the company's website. The rules provide for certain cure measures and periods if a company fails to comply with the new disclosure requirements.

In addition to the disclosure rules, the board recruiting service proposal gives certain companies access to Nasdaq's and their partners' board recruiting services for one year, on a complimentary basis. This service is intended to provide companies with access to a network of board-ready diverse candidates for companies.

Effective Dates and Transition

Disclosure of board diversity data will be required annually. Companies have until the later of August 8, 2022 or the date the company files its proxy statement or information statement for its annual shareholder meeting during 2022 to comply with the new disclosure requirements.

The effective date and transition with respect to the board member diversity objective depends on several factors, including the entity's listing tier and type of filer:

- Nasdaq Global Select Market or Global Market companies are required to have (or explain why they don't have) one diverse director by August 7, 2023 and two diverse directors by August 6, 2025; and
- Nasdaq Capital Market companies are required to have (or explain why they don't have) one diverse director by August 7, 2023 and two diverse directors by August 6, 2026.
- All companies with boards that have five or fewer directors are required to have (or explain why they don't have) one diverse director by August 7, 2023.
- Smaller Reporting Companies can meet the diversity objective with two female directors, or with one female director and one director who is an underrepresented minority or LGBTQ+.
- Newly listed companies (e.g., including IPOs and direct listings) and SPACs (including the post-merger registrant) have special phase-in rules.
- Foreign Issuers can meet the diversity objective with two female directors, or with one female director and one director who is an underrepresented individual based on national, racial, ethnic, indigenous, cultural, religious or linguistic identity in the country of the company's principal executive offices, or LGBTQ+.

CLAWBACK PROPOSAL

In October, the SEC **re-opened** the comment period for its 2015 **proposed rule** which would require national securities exchanges to establish standards for listed companies that would require the clawback of erroneous executive compensation. The rule, as proposed, would implement provisions mandated by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring listed companies to establish and enforce policies that require executives to pay back certain incentive-based compensation that was erroneously awarded.

The clawback provisions of Rule 10D-1 would require a listed company, upon restating its financial statements, to calculate the difference between the amount of incentive-based compensation awarded to an executive and the amount that would have been awarded had the financial statements properly reflected the restated amounts, with any such excess to be recovered from both current and former executives of the company. The population of "executives" from which recovery would be required is broader than under the Sarbanes-Oxley Act and includes any person who performs policy-making functions for the company. For example, roles such as the company's president, principal financial officer, principal accounting officer, and any vice-president in charge of a principal business unit, division or function would be included in the definition of an executive. The proposal takes a "no fault" approach, meaning there is no consideration of whether there was any misconduct by an executive or whether an executive had responsibility for the erroneous financial statements. Under the proposed rules, a company that does not adopt a policy for the recovery of erroneously awarded incentive-based compensation, enforce the policy, and comply with the disclosure provisions of the rule would be subject to delisting.

The SEC's latest request for comment on the proposal includes questions about whether "an accounting restatement due to the material noncompliance" should be interpreted to include all required restatements made to correct an error in previously issued financial statements (i.e., include immaterial error corrections). Comments on the proposal are due 30 days after publication in the Federal Register.

For additional highlights on the initial proposal, refer to our Alert **here**.

S-X RULE 3-13 WAIVER REQUESTS

Rule 3-13 of Regulation S-X allows the staff to waive certain financial statements that are otherwise required by SEC rules in circumstances when the disclosures may not be material to the total mix of information available to investors. One of the most common Rule 3-13 waiver requests relates to the historical financial statement requirements of acquired businesses under S-X Rule 3-05. Former SEC Chairman Jay Clayton vocally supported Rule 3-13 during his tenure at the SEC, encouraged companies to consider whether modifications to some of their reporting requirements would be helpful in connection with their capital raising activities and assured them that the SEC staff would place a high priority on responding with timely guidance to such waiver requests.

In 2021, with a new administration, active capital markets, and new rules applicable to financial statements of acquired businesses that were partly designed to reduce the anomalous results of the prior rules, the process and time required to obtain a Rule 3-13 waiver has lengthened (moreover, the staff may be less receptive to granting the request). If a registrant intends to seek a Rule 3-13 waiver in connection with a particular transaction or filing, it should build in several weeks to the process (or even more, for complex fact patterns).

In connection with Rule 3-13 waiver requests, registrants are reminded that:

- Waiver requests must be in writing and should be as comprehensive as possible when the initial request is sent to the staff;
- The letter should clearly articulate why the company believes that the excluded financial statements are not considered material for investors. As the SEC's rules are designed to capture material information, a thoughtful consideration and description of why an investor isn't missing material information by not seeing such financial information is an important aspect of the letter;
- If the request relates to S-X Rule 3-05 financial statements for acquired businesses, ensure that all measures of significance under the existing rules are included (e.g., the income test has both a revenue and income component. The letter should contain the outcome of both calculations); and
- The company should describe the consequences of not obtaining the waiver in the letter. The consequences may extend beyond cost considerations of providing the required financial statements – e.g., what are the business ramifications, like the inability to complete the transaction or offering, etc.

OTHER STAFF GUIDANCE

Staff Accounting Bulletin

In late November, the staff issued Staff Accounting Bulletin (SAB) No. 120 (codified into SAB Topic 14) to address the accounting for "spring-loaded awards" made to executives. Spring-loaded awards are share-based compensation awards granted shortly before a registrant's announcement of market-moving information such as a significant transaction (e.g., business combination) or earnings release with better-than-expected results. The SAB contains guidance for companies about how to properly recognize and disclose compensation expense related to these awards. Further details can be found in our **BDO Alert**.

SEC Regulations Committee

The Center for Audit Quality's (CAQ's) SEC Regulations Committee meets with the staff periodically throughout the year to discuss a myriad of SEC reporting matters. The minutes of such meetings can be a useful resource in understanding the staff's view on emerging and technical issues. The following summarizes the topics discussed in the March 2021 meeting[7], refer to the **meeting minutes** for a more comprehensive discussion:

- Staff observations on pro forma financial information prepared under the new Article 11 rules, including their view on how to compute pro forma earnings per share in an IPO registration statement when convertible securities will automatically convert into common shares at the IPO date.
- Financial statements used to measure significance under Rule 3-05, including when acquisitions have been consummated after fiscal year end, but the most recent fiscal annual period has not yet been filed.
- Staff observations on Rule 3-13 waivers (included in summary under **S-X Rule 3-13 Waiver Requests**).
- Transition matters when adopting the Regulation S-K amendments described under **Changes to Regulation S-K**.
- The staff's views about disclosure of critical audit matters in audit reports of emerging growth companies.
- Financial statement requirements in a Form S-4 and/or merger proxy for a non-reporting target merging with a public operating company, shell company or SPAC in a reverse merger, particularly as it relates to the adoption of certain new accounting standards.
- A staff reminder that the draft or initial registration statements must be complete when they are submitted/filed except for items which may be omitted pursuant to the FAST Act or confidential submission process.

FINANCIAL REPORTING MANUAL

The Division of Corporation Finance has historically maintained the **Financial Reporting Manual**, an internal SEC staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues, particularly for significant business acquisitions. However, the FRM has not been updated for any of the new Rule 3-05 or Article 11 amendments that became effective in 2021. Accordingly, those who refer to the FRM for guidance on reporting matters should reference it with caution as portions are now outdated. With a heavy rulemaking agenda that involves staff within the Division of Corporation Finance and continued heavy capital markets activity (e.g., initial public offerings, SPAC IPOs and SPAC mergers), we understand that the FRM may not be updated for quite some time.

BDO Insight: The rule amendments applicable to financial statements of acquired businesses and pro forma financial information are summarized in more detail in our **2020 SEC Reporting Insights publication**. Additional information regarding the new Rule 3-05, 3-14 and Article 11 can be found in our Snapshot publications:

- **Financial Statements of Acquired Businesses**
- **Financial Statements of Acquired Real Estate Operations**
- **Pro Forma Financial Information**

7 Minutes of the June and September meetings have not been published as of the date of this publication. When available, they will be published **here** on the CAQ's website.

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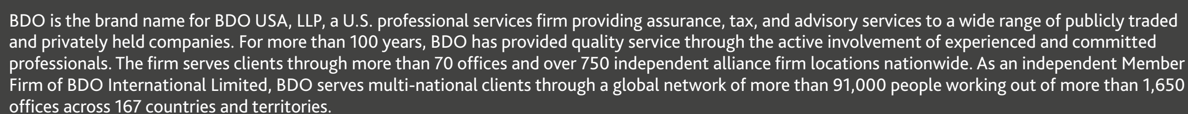

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