MAYER | BROWN

Preparing for the 2021 US Proxy and Annual Reporting Season

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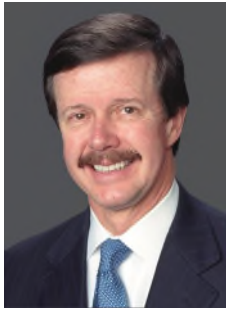

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COVID-19 related guidance from the SEC Staff

- The SEC staff has issued guidance in various forms:
  - CF Disclosure Topic #9 – March 2020
  - Joint Statement regarding earnings releases – April 2020
  - CF Disclosure Topic #9A – June 2020
  - Statements from SEC's Chief Accountant – April and June 2020
  - Comment letters issued to registrants

CF Disclosure Guidance Topic #9

- Division of Corporation Finance issued CF Disclosure Guidance Topic #9 (“CF #9”) on March 25, 2020
  - Views on disclosures and securities law obligations impacted by COVID-19
- Three key topics
  - Assessing and disclosing the evolving impact of COVID-19
  - Trading prior to dissemination of material non-public information
  - Reporting earnings and financial results

COVID-19: forward-looking disclosure

- On April 8, 2020, SEC Chair Jay Clayton and the Director of the SEC's Division of Corporation Finance issued a joint statement providing guidance for the earnings release season
- Statement urged companies to provide as much information as is practicable regarding their current financial and operational status, as well as their future operational and financial planning
- Company disclosures should reflect the current state of COVID-19 affairs and outlook
  - Historical information may be relatively less significant

COVID-19: forward-looking disclosure *(cont'd)*

- Good faith attempts to provide appropriately framed forward-looking statements would not be second-guessed by the SEC
- Statement noted that investors may be particularly interested in detailed discussions of current liquidity positions and expected financing needs, whether the company is receiving or intends to apply for financial assistance under various COVID-19 related federal and state programs, including the CARES Act, and how such assistance has had or may have a material effect on the company
- Companies are advised to take advantage of the safe harbor provisions of the U.S. federal securities laws

CF Disclosure Guidance: Topic No. 9A

- Division of Corporation Finance issued CF Disclosure Guidance Topic No. 9A ("CF #9A") June 2020, supplementing CF #9
- CF #9A emphasizes that operational adjustments in response to COVID-19 could be material to an investment or voting decision
  - Transition to telework
  - Supply chain and distribution adjustments
  - Suspension/modification of operations for health and safety
- CF #9A advises companies to carefully consider disclosure obligations in this context

CF Disclosure Guidance: Topic No. 9A *(cont'd)*

- CF #9A focuses on financing activities
  - Entry or amendments of credit facilities and public and private financings
  - Novel terms and structures
- Provide robust and transparent disclosure regarding short- and long-term liquidity and funding risks, especially new risks or uncertainties
- Evaluate whether such information, in light of its potential materiality, should be discussed in MD&A

Guidance from the Chief Accountant

- In two public statements, the Chief Accountant has addressed the significance of high quality financial information
- The Chief Accountant focused on:
  - Significant judgments and estimates
  - The effects of the pandemic and work from home on disclosure controls, financial reporting and internal control over financial reporting
  - Going concern assessments
  - The importance of the audit committee's oversight role

Proxy statement disclosures

- Compensation disclosures
  - Changes to named executive officer (NEO) compensation
    - Has the NEO agreed to forgo salary, bonus or perquisites?
    - Have any of these amounts been adjusted? Or has compensation been paid in stock?
    - Has the company repriced options?
    - Has the company changed the metrics used to evaluate performance, eligibility for bonuses, or other aspects of compensation?
  - Revising the CD&A section this year may require close consideration of historical and expected financial performance

Proxy statement disclosures *(cont'd)*

- Corporate governance disclosures
  - Board oversight of risk during the pandemic period:
    - How has the board addressed its oversight role?
    - Additional meetings?
    - Consideration by board of reductions in force, closures or other similar measures
    - Consideration by board of workplace safety and human capital measures
    - Has the board or has the audit committee undertaken additional measures with respect to cybersecurity oversight?

Proxy statement disclosures *(cont'd)*

- Audit committee reports
  - Consider the statements made by the Chief Accountant, as well as the PCAOB's conversations with audit committee chairs
  - How has the audit committee responded to:
    - Complexities of company staff and audit teams working from home
    - Changes to audit procedures or to the company's accounting policies
    - Challenges relating to the company's control environment
  - Has the committee vetted non-GAAP COVID-19 adjustments? Impairments? Changes to estimates or to policies requiring judgment?
- Letters to shareholders
  - The letter provides an opportunity for the company's management to address, to the extent it would like to do so, the effects on the company, its business, its workforce of the pandemic as well as other recent developments

Form 10-K disclosures

- Principles-based disclosure may require an issuer to address the actual and potential impacts of COVID-19 on the issuer's business, results of operations and prospects in various areas, including:
  - Risk factors
  - Business
  - Legal proceedings
  - Management's discussion and analysis
  - Disclosure controls and procedures
  - Internal control over financial reporting
  - Financial statements

Assessing and disclosing COVID-19 impacts

- CF #9 posed a series of questions for an issuer to consider, including:
  - How has COVID-19 impacted your financial condition and results of operations?
  - How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook?
  - How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets?
  - Do you anticipate any material impairments, increases in allowances for credit losses, or changes in accounting judgments?
  - Have COVID-19-related circumstances adversely affected your ability to maintain operations, including controls and procedures?
  - Have you experienced challenges in implementing your business continuity plans?

Assessing and disclosing COVID-19 impacts *(cont'd)*

- Do you expect COVID-19 to materially affect the demand for your products or services?
- Do you anticipate a material adverse impact of COVID-19 on your supply chain or distribution methods?
- Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?
- Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

Risk factors

- At the beginning of the pandemic, many companies addressed their risk factor disclosures by including a generic pandemic related risk. As time has passed, the expectation is that an issuer will include specific, tailored risks

Sample SEC comment
We note your disclosure that the extent to which your operations may be impacted by the COVID-19 pandemic will depend largely on future developments, which are highly uncertain and cannot be accurately predicted, including new information that may emerge concerning the severity of the outbreak and actions by government authorities to contain the outbreak or treat its impact. Please amend your risk-factor disclosure to provide more detailed risks related to the COVID-19 pandemic, tailored to your specific facts and circumstances. For guidance, see CF Disclosure Guidance: Topic No. 9 (25 March 2020)

- Review and consider each of the company's risk factors, and whether these should be revised to address events that already have come to pass, and to address new risks that have been identified as the pandemic has become more prolonged and its effects more wide-reaching
- Particular consideration should be given to cybersecurity risks, risks related to legal proceedings and litigation, risks relating to impairment, losses, reserves, workforce changes

Business

- While issuers may now have more flexibility with respect to the presentation in the Business section, given the pandemic's effect on the issuer's business, its workforce, actual or potential changes in its business model or its policies regarding work from home, changes in demand for its products or services, and similar matters, this year, it may make sense to present a more detailed (*rather than a summary*) discussion

MD&A

- The SEC Staff's guidance has been particularly detailed regarding expectations for disclosure in the MD&A section that is specific to the issuer, the effects of the pandemic on the issuer's actual results of operations, the effects on liquidity (*including modifications to its debt obligations, recent financing transactions, access to credit lines, going concern issues*), and the need to provide investors with insight regarding the trends and expectations regarding future performance

Sample SEC comment
We note your disclosure that your overall revenues since 1 January 2020, were below expectations by approximately X% primarily due to COVID-19, and your revenues from providing services were below expectations by approximately Y%. Because investors do not know your expected revenue for this period, please revise to present the impact based on your historical financial performance. In this regard, please discuss how COVID-19 has impacted operations as compared to prior financial periods. Please refer to CF Disclosure Guidance: Topic No. 9 (25 March 2020).

Sample SEC comment
We noted that, given the uncertainty of the impacts of COVID-19, you are monitoring your ability to comply with debt covenants in future periods and are in discussions with certain counterparties to your debt obligations. In future filings, please expand your disclosures to include the significant debt covenants and the particular subsidiaries affected.

MD&A *(cont'd)*

- The SEC has highlighted certain areas for further consideration in MD&A:
  - Fair value and impairment
  - Debt modification
  - Revenue recognition
  - Credit losses standard
  - Leases
  - Hedging
  - Going concern

Sample SEC comment
To provide investors with information to better assess the probability of future goodwill impairment charges, please disclose, if accurate, that the estimated fair values of the intangible assets you quantitatively tested for impairment substantially exceeded their carrying values. For any asset whose estimated fair value did not substantially exceed its carrying value, please disclose the percentage by which air value exceeded carrying value at the date of the most recent test.

SEC comments – MD&A – COVID-19

- Future trends, impacts
  - Failure to disclose
- *Sample SEC comments:*

> – On your first quarter earnings call, you indicate that you currently anticipate second quarter revenue to be down as much as 50% to 60% with approximately 80% of your global business having been closed since April 1, 2020. Revise your future periodic filings to disclose known trends and uncertainties related to COVID-19. For example, disclose how you expect COVID-19 to impact your future operating results and near-and-long- term financial condition and how that compares to the current period. See Item 303 of Regulation S-K, SEC Release No. 33-8350, and CF Disclosure Guidance Topic No. 9.
>
> – We note your disclosure regarding the . . . grounding and your recognition of a . . . liability for potential concessions and other considerations to customers for disruptions related to the grounding. In future filings, please provide enhanced disclosures to better clarify the nature and amounts of the various concessions you are providing. It appears your concessions may be in the form of cash, in-kind consideration and other forms of concessions. Please consider providing a tabular presentation of the concessions by type, so that investors can better understand the expected impacts to your cash flows and operating results.

SEC comments – MD&A – COVID-19 *(cont'd)*

- Trends and uncertainties
  - Failure to disclose

Sample SEC comment
– On your first quarter earnings call, you indicate that you currently anticipate second quarter revenue to be down as much as 50% to 60% with approximately 80% of your global business having been closed since April 1, 2020. Revise your future periodic filings to disclose known trends and uncertainties related to COVID-19. For example, disclose how you expect COVID-19 to impact your future operating results and near-and-long- term financial condition and how that compares to the current period. See Item 303 of Regulation S-K, SEC Release No. 33-8350, and CF Disclosure Guidance Topic No. 9.

COVID-related non-GAAP adjustments

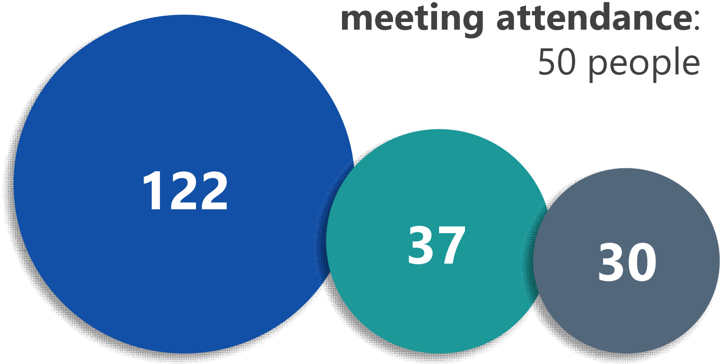
- Issuers may want to present financial results while giving effect to the consequences of the coronavirus
- The SEC Staff has addressed non-GAAP measures:
  - Include non-GAAP measures that have been provided to management and that are being used by the management team in order to assess the effects of the pandemic on financial results
  - "Estimated" or "provisional" items may be reflected
  - However, items should be directly related to the effects of the pandemic; these can be based on a reasonable estimate if COVID-19 charges are not yet finalized
- Sometimes referred to as **EBITDAC**
  - Earnings Before Interest, Taxes, Depreciation, Amortization, and Coronavirus

COVID-related non-GAAP adjustments *(cont'd)*

- Originally, may have been presented as a one-time adjustment:
  - PPE, cleaning supplies, dividers, retrofitting,
  - Lease termination costs
  - Supply chain disruptions
  - Workforce issues such as severance or bonuses for working onsite
- As pandemic lasts, consider if treating COVID-19 adjustments as temporary may imply ongoing costs are lower

Virtual Annual Meetings

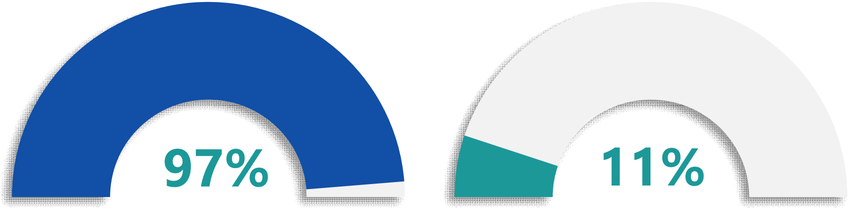
Average virtual annual meeting attendance: 50 people



Large cap companies | Mid cap companies | Small cap companies

Attendance by market cap (by number of people)

Average number of questions asked during virtual annual meetings: 5 questions



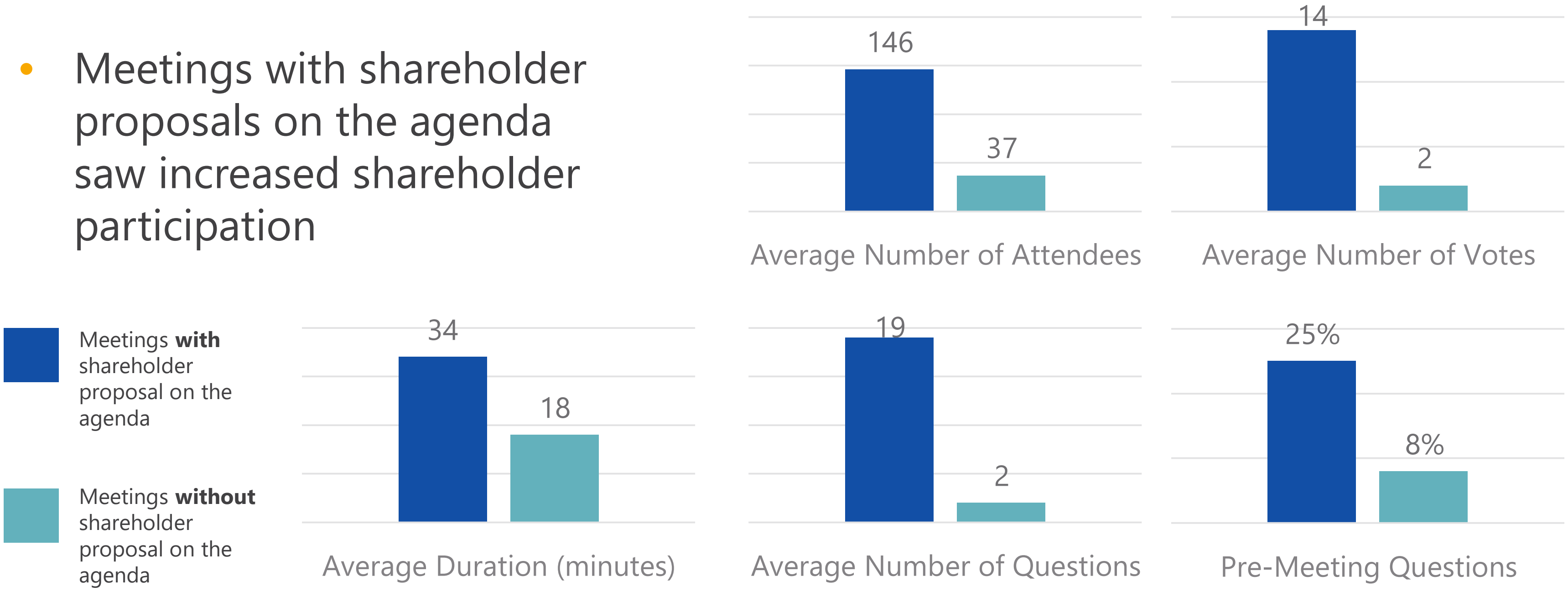
Took live questions | Required advance submissions

Highest number of questions asked at a meeting 316

Source: Broadridge Virtual Shareholder Meetings 2020 mid-year facts and figures

Virtual Annual Meetings *(cont'd)*

- Meetings with shareholder proposals on the agenda saw increased shareholder participation



Source: Broadridge Virtual Shareholder Meetings 2020 mid-year facts and figures

Virtual Annual Meetings *(cont'd)*

- Planning for 2021
  - **Permissibility**: Confirm whether state law permits virtual-only annual meetings or requires hybrid meetings
  - **Notice**: 2020 saw companies issuing press releases to cure defective notice where proxy statement was mailed before virtual format was adopted
  - **Logistics**:
    - Make shareholder lists available before and during the meeting, as required by Bylaws
    - Consider how to allow for shareholder questions and proponent statements
  - **Timing**: Shifting to virtual-only format led to service provider issues with date availability, but providers do not expect to have these issues in 2021

D&O Questionnaires

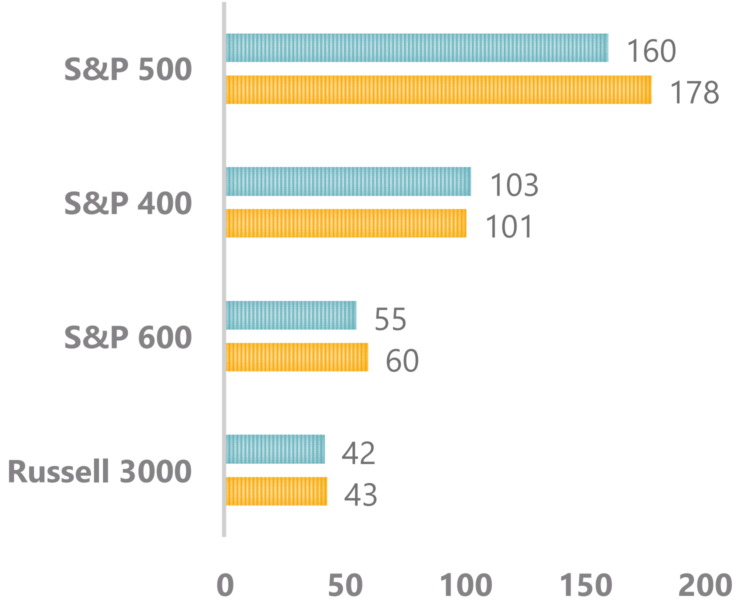
- Update dates and lookback periods
- No relevant rule/regulatory updates for 2020
- Pre-population:
  - Most companies partially pre-populate questionnaires with biographical, compensation and board participation information
  - Benefits to requiring affirmative responses to substantive questions
- Carefully review responses and request follow-up information, if needed

CEO Pay Ratio

<u>2020 Median Pay Ratio Data</u>

Among all companies, median pay ratio was 76 to 1

- S&P 500 median rose from **160** to **178**
- S&P 400 median declined from **103** to **101**
- S&P 600 median increased from **55** to **60**
- Russell 3000 (*excluding S&P 1500*) median increased from **42** to **43**



Sources: Compensation Advisory Partners, CEO Pay Ratio Tracker; ISS U.S. Compensation, 2020 Proxy Season Review

CEO Pay Ratio *(cont'd)*

- Re-using the median employee
  - Required to identify the median employee only once every three years
    - 2020 disclosure (*based on 2019 compensation*) was the third year of pay ratio disclosure
    - If the median employee has been re-used since the 2018 disclosure, must be re-identified for the 2021 disclosure
  - Where the median employee is no longer employed, may substitute another employee
    - Must have substantially similar compensation as the previous median employee, using the same consistently applied compensation measure as was previously used
  - Have there been any changes (*including COVID-related changes*) in the employee population or compensation program that would significantly change the pay ratio?

Say-on-Pay Proposals

- Shareholder support was down in 2020, compared to 2019
  - S&P 500: 79% of companies received 90%+ support in 2019 vs. 74% in 2020
  - S&P 1500: 78% of companies received 90%+ support in 2019 vs. 75% in 2020

	2017	2018	2019	2020
Average Shareholder Support*	91.8%	90.5%	90.6%	90.7%
Total Voted	1446	1411	1403	1447
Total Below 50% Support*	18	38	30	26
Total Failed	18	35***	30	25**

*Vote calculations count abstentions as AGAINST votes

**GameStop passed with over 50% support as voting requirement did not include abstentions as AGAINST votes

***Customers Bancorp, PetMed Express and Jefferies Financial passed with over 50% support as voting requirement did not include abstentions as AGAINST votes

Source: Georgeson Annual Corporate Governance Report

Say-on-Pay Proposals *(cont'd)*

- Say-on-Pay proposals failed at 10 companies in the S&P 500
  - Special equity awards in consecutive years or excessive annual LTI awards
  - Accelerating grants of PSU awards
- Fewer companies in the "Red Zone" in 2020, compared to 2019
- ISS negative vote recommendations
  - Increased 1.1% among S&P 500
  - Decreased 2.1% among S&P 1500
  - Excess discretionary compensation and weak performance goals lead to CEO pay-for-performance misalignment

COVID-19 Pay Adjustments

- Most companies implemented employee, director and executive officer reductions to cash compensation
  - Many have already restored or plan to restore salaries to their pre-COVID-19 levels
- Very few companies have taken action on their annual and long-term incentive programs
  - 78% are operating their annual incentive plan for executives on a broadly similar basis to last year
  - 25% have taken action on their annual incentive plan; 40% are planning or considering changes
  - 8% have taken action on long-term incentive programs; 16% are planning or considering doing so

Source: Willis Towers Watson, Actions to Restore Stability Survey

COVID-19 Pay Adjustments *(cont'd)*

Compensation committees should consider Proxy Advisor views when making changes:

- ISS
  - Disfavors changes to outstanding long-term incentive awards; *Glass Lewis shares this view*
  - Other changes will be evaluated on a case-by-case basis
  - Recommends that any changes be disclosed contemporaneously and clearly state rationales
  - Disfavors "retention" awards; *Glass Lewis shares this view*
  - ***ISS recently announced the elimination of the draft proxy research report review process***

COVID-19 Pay Adjustments *(cont'd)*

- Glass Lewis
  - Does not favor payouts above target, where 2020 performance metrics were changed
  - Prefers actions that take a proportional approach to the impacts on shareholders and employees
  - Companies with strong governance, performance, and appropriate use of board discretion prior to the pandemic have more leeway

Perquisites

- The SEC published new C&DI 219.05
  - Certain COVID-19 related expenses paid by issuers to enable NEOs to work from home are not considered perquisites
  - Must continue to apply SEC's long-standing perquisite test
    - Enhanced technology needed to make the NEO's home his or her primary workplace due to local stay-at-home orders is not a perquisite because it is integrally and directly related to the performance of the executive's duties under perquisite test
    - C&DI does not provide clarity on other reimbursed work-from-home expenses
    - New COVID-19-related health and transportation benefits may be a perquisite unless they are generally available to all employees
  - There may not be the same outcome from a tax perspective

Human Capital

- Heightened interest in human capital
  - COVID-19
  - Focus on social and racial justice
- Existing human capital proxy disclosures
- Board diversity
- Pay ratio
- Board oversight of risk
- Human capital-related shareholder proposals

Impetus for Human Capital Disclosures

- Institutional investors are making human capital a priority for engagement
  - BlackRock held 750 engagements on human capital-related topics between July 1, 2019 and June 30, 2020
- ISS has requested companies to disclose the self-identified race and ethnicity characteristics of members of their board of directors
- Follow through on diversity and inclusion statements
- SEC rule change regarding human capital in business description

Enhanced Human Capital Disclosure

- Human capital management as a separate proxy statement section
  - Workforce diversity
  - Gender-based pay ratios
  - Health, safety and wellness
  - Employee recruitment, training, development and promotion
- Board's role in human capital management
- Human capital management shareholder engagement
- Board or CEO letters

Environmental, Social and Governance

- Human capital has not eclipsed other ESG issues
  - Environment and climate change are recognized issues
- Institutional investors have ESG proxy voting/engagement guidelines
- Environmental shareholder proposals gaining traction
- Multiple ESG frameworks
  - Sustainability Accounting Standards Board (SASB)
  - Task Force on Climate-Related Financial Disclosures (TCFD) frameworks

Environmental, Social and Governance *(cont'd)*

- SEC's Investment Advisory Committee recommended ESG disclosure requirements
- Growing interest in ESG investments
  – ESG bonds or funds
  – Stock ownership as a platform for ESG engagement
- Viewing ESG as a governance matter
  – Board oversight
  – Executive compensation metrics

Types of ESG Proxy Disclosures

- Environmental and sustainability
  - Climate change
  - Renewable energy
  - Green products and product sourcing
- Corporate culture and values
- Political contributions and lobbying
- Social and community commitments
  - Human rights
  - Charitable contributions and initiatives

Voluntary Human Capital and ESG disclosures

- Be mindful of securities law ramifications
  - Goals versus commitments
- Consider adding disclosure controls/internal controls
- Begin drafting early
- Coordinate proxy message with other disclosures
  - Form 10-K
  - Website
  - Shareholder engagement presentations
  - Press releases

Board Diversity – California law

- New law requires publicly held corporations headquartered in California to have at least one person from an "underrepresented community" on their boards by the end of 2021 and two to three, depending on board size, by the end of 2022
  - Person self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, gay, lesbian, bisexual or transgender
- California already requires publicly held corporations headquartered in California to have at least one woman on their boards and two to three, depending on board size, by the end of 2021

Board Diversity – Institutional Investors

- State Street Global seeks disclosure of diversity characteristics, including racial and ethnic makeup, of the board of directors
- NYC Comptroller has sought commitments to consider both women and people of color for open board seat and CEO appointments
- Vanguard urging boards to seek greater diversity across a wide range of personal characteristics, such as gender, race, ethnicity, national origin, and age
- BlackRock may vote against the nominating/governance committee members if company has not adequately accounted for board diversity within a reasonable timeframe

Board Diversity – ISS Position

- For Russell 3000 *or* S&P 1500 companies, ISS generally votes against/withholds from the chair of the nominating committee (or other directors on a case-by-case basis) if no women are on the company's board
- Mitigating factors include:
  - Only until February 1, 2021, a firm commitment to appoint at least one woman to the board within a year
  - The presence of a woman on the board at the preceding annual meeting and a firm commitment to appoint at least one woman to the board within a year
  - Other relevant factors, as applicable

Shareholder Proposals – Procedural Changes

- Staff no longer automatically responds with no-action letters in response to Rule 14a-8 no-action requests
- Staff posts a chart on SEC website indicating whether or not it concurs or declines to state a view
  - Also indicates if Staff issued a letter, regulatory basis, names of parties, links to initial submissions
  - In future, Staff may make chart more interactive and sortable https://www.sec.gov/divisions/corpfin/shareholder-proposals-2019-2020.pdf

2020 Shareholder Proposals Receiving Majority Support

- **Governance**
  - Elimination of supermajority voting requirements
  - Elimination of classified boards of directors
  - Majority voting for the election of directors
- **Social**
  - Board and workforce diversity proposals
  - Reports on political spending/lobbying
- **Environmental**

Possible Shareholder Proposal Topics for 2021

- Topics similar to those that received majority or significant minority support in 2020
- Topics that garnered attention as a result of COVID-19
  - Employee health and safety
  - Other human capital issues
- Topics related to social and racial justice concerns
  - Workforce diversity and equal opportunity
  - New York City Comptroller push for disclosure of annual EEO-1 report data

Amendments to Rule 14a-8

- Amendments do not apply to 2021 shareholder meetings
- Submission threshold updated
  - Range of amount voting securities/holding period, with aggregation prohibited
  - Administrative requirements, including availability to meet
- Resubmission threshold updated
  - Increased levels of support to be resubmitted at company's future meetings
- One person/one proposal clarified
  - Cannot submit multiple proposals for the same meeting, whether as a shareholder or as a representative of other shareholder(s)

Proxy Voting Advice Amendments

- SEC adopted amendments codifying its position that proxy voting advice is solicitation
  - Failure to disclose material information regarding proxy voting advice could cause advice to be misleading, violating proxy rules
- New conditions to exemptions from to the proxy information and filing requirements that proxy advisors rely on
  - prominently disclose conflicts of interest in their proxy voting advice
  - establish procedures to allow all companies to access that proxy advice prior to or simultaneously with the release of that advice
  - provide mechanism for clients to access any written company responses before they vote

Proxy Voting Advice Amendments *(cont'd)*

- Proxy voting advice as solicitation is already effective
  - No material omissions standard for proxy voting advice applies during 2021 proxy season
- Transition period for the new conditions to the exemptions
  - Proxy advisors not required to disclose conflicts in their voting advice, provide companies with the voting advice reports by release date or make company responses available to their clients until the 2022 proxy season
- ISS/SEC litigation on the proxy voting advice amendments has resumed

Considerations for this Year's Annual Report

Four key areas for consideration when preparing this year's annual report.

- Risk Factors;
- Critical Accounting Matters ("CAMs");
- Recent Amendments to the Business, Risk Factors and Litigation Items of Regulation S-K; and
- Recent SEC Guidance and Amendments to MD&A.

Risk Factors

In addition to COVID-19, there are **four other** trending risk topics this year that companies should evaluate from a risk factor perspective:

- Cybersecurity;
- LIBOR;
- Brexit; and
- Intellectual Property and Technology Risks [*See* Staff C.F. Disclosure Guidance Topic No. 813].

Amendments to S-K Item 105 Risk Factor Disclosure

As part of the SEC modernization amendments to Regulation S-K adopted this past August, the amendments to Item 105 regarding risk factors were adopted:

- Requirement of a summary of not more than two pages in the "forepart" of the annual report if the discussion exceeds 15 pages;
- Change to the disclosure standard from "most significant" risks to "material" risks;
- Required organization of risks under relevant headings; and
- Requirement that generic risks (not specifically relevant to a company's investors) be placed at the end of the discussion under a heading entitled "**General Risk Factors**."

Business Description (Item 101(c))

In addition to the amendment to the general approach to the business disclosure requirements of S-K, the requirements for this Item have several notable specific amendments.

- New human capital disclosure;
  - The company's human capital resources; and
  - Human capital resources that the company focuses on in managing its business.
- Government regulations – not just environmental anymore; and
- Other prescriptive disclosure Items – any item that is material to investment and voting decisions, rather than current quantitative thresholds.

Legal Proceedings (Item 103)

The amendments to legal proceedings disclosure also raise the threshold for disclosure of environmental proceedings to which a governmental authority is a party from $100,000 to $300,000, with the flexibility for the company to select a different threshold so long as such threshold:

- Is reasonably designed to disclose any material proceeding;
- Does not exceed the lesser of (**i**) $1 million or (**ii**) 1% of the current assets of the company and its subsidiaries on a consolidated basis; and
- Is disclosed, together with any changes, in **each** annual **and** quarterly report.

SEC Transitional FAQs re Items 101 and 103

On November 5, 2020, the Staff issued FAQs with respect to the amendments to modernize Regulation S-K with the following points of clarification:

- For prospectus supplements filed after November 9 for registration statements effective prior to November 9, issuers do not need to comply with new Items 101 and 103 or amend the Form 10-K currently incorporated by reference in the registration statement to comply with the amended Items 101 and 103.

  In addition, although 401(a) requires a prospectus supplement conform to applicable rules on the initial file date of the supplement and Item 3 of Form S-3 expressly requires Item 105 disclosure, the Staff has stated that it will not object if the prospectus supplement complies with previous Item 105 until the next update to the registration statement for Section 10(a)(3) purposes.

- The amendments do not require Form 10-K disclosure of new 101 business developments for more than the fiscal year covered by the current Form 10-K.

SEC Transitional FAQs re Items 101 and 103 *(cont'd)*

- A registrant may omit the full discussion of the general development of its business in a Form 10-K or registration statement if the registrant:
  - Discloses all material developments since the most recent report or registration that included the full discussion;
  - Includes a hyperlink to the report or registration statement that included the full disclosure; and
  - Incorporates the full discussion by reference to the report or registration statement.

The Staff has stated that it anticipates that this updating method will apply mainly to registration statements.

Critical Audit Matters ("CAMs")

CAMs are matters arising from the audit of a company's financial statements that are required to be communicated to the audit committee that:

- Relate to accounts or disclosures that are material to the financial statements; and
- Involve an especially challenging, subjective or complex judgment by the company's auditor.

Examples of Topics that Constitute CAMs

Depending upon the facts and circumstances, CAMs should include:

- Goodwill impairment;
- Intangible asset impairment;
- Business combinations;
- Revenue recognition;
- Income taxes;
- Legal contingencies; and
- Hard to value financial instruments.

Practical Advice to Ensure a Smooth Implementation of CAM Disclosure

Completing "dry runs" with the auditors helps in this regard and is highly recommended. Such dry runs, often entail:

- The auditors evaluating matters that might qualify as CAMs;
- Considering how CAMs should be drafted; and
- Discussing potential CAMs with management and audit committees to help them understand and prepare for the disclosures and their impact.

Recent SEC Guidance re MD&A

- Issued in January 2020;
- Addresses **non-financial** key performance indicators and metrics ("KPIs");
- Requires that a KPI in MD&A must be accompanied by:
  - A clear definition of the KPI and how it's calculated;
  - A statement indicating the reasons why the KPI provides useful information to investors; and
  - A statement indicating how management uses the KPI in managing or monitoring the performance of the business.

Recent SEC Guidance re MD&A *(cont'd)*

The MD&A Guidance contains this **non-exclusive** list of examples of KPIs and metrics to which this guidance applies:

- Operating margin;
- Same store sales;
- Sales per square foot;
- Total customers/ subscribers;
- Average revenue per user;
- Daily/monthly active users/usage;
- Active customers;
- Net customer additions;
- Total impressions;
- Number of memberships;
- Traffic growth;
- Comparable customer transactions increase;
- Voluntary and/or involuntary employee turnover rate;
- Percentage breakdown of workforce (e.g., active workforce covered under collective bargaining agreements);
- Total energy consumed; and
- Data security measures (e.g., number of data breaches or number of account holders affected by data breaches).

Recent SEC Guidance re MD&A *(cont'd)*

When changing the calculation method or presentation of a KPI from one period to another, companies must disclose:

- The differences in the way the metric is calculated or presented compared to prior periods;
- The reasons for the change;
- The effects of the change on the amounts or other information being disclosed or previously reported; and
- Other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects.

Recent SEC Guidance re MD&A *(cont'd)*

What else should companies that disclose KPIs in their MD&A consider this coming year? They should consider:

- Ensuring disclosure controls and procedures cover these KPIs;
- Reviewing the KPI disclosure with the Audit Committee – methodology, calculation, any significant changes – early **<u>before</u>** the next annual or quarterly report; and
- Taking the same steps for KPIs in investor presentations and earnings statements.

MD&A Compliance and Disclosure Interpretations ("C&DIs")

In January of this year, the Staff issued three C&DIs to provide guidance to companies with respect to the SEC's May 2019 MD&A amendment. The amendment allows companies to omit a discussion of the earliest of the three years covered to the extent that (**A**) the discussion was already included in a filing and (**B**) the MD&A identifies the location in the prior filing:

- C&DI 110.02 clarifies that a "statement merely identifying the location in a prior filing where the omitted discussion can be found does not incorporate such disclosure into the filing unless the registrant expressly states that the information is incorporate by reference." [*Emphasis added*]

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MD&A Compliance and Disclosure Interpretations (“C&DIs”) *(cont’d)*

- C&DI 110.03 explains that a company may not omit the discussion of the earliest of the three years if it believes it is “necessary to an understanding of its financial condition, changes in financial condition and results of operations.”
- C&DI 110.04 addresses the situation where a company files a Form 10-K in which (**A**) the discussion of the earliest of the three years of financial statements is omitted from the MD&A and (**B**) that Form 10-K thereupon becomes incorporated into a registration statement that is already effective.
  - According to this C&DI, the filing of a Form 10-K for a newly completed fiscal year establishes a new effective date for the registration statement and, as of the new effective date, the registration statement incorporates by reference only the latest Form 10-K, which does not contain the company’s discussion of results for the earliest of the three years unless, as indicated in C&DI 110.02, the information is expressly incorporated by reference.

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Additional Resources

- 2021 Proxy and Annual Report Season: Time to Prepare
- Market Trends 2019/20 COVID-19 from a Securities Law Perspective
- SEC Staff Guidance on Disclosures and Financial Reporting in Light of COVID-19
- SEC Amends Business, Legal Proceedings and Risk Factor Disclosures

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