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Preparing to Be a Public Company: Reporting Requirements

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Agenda

- Triggers for deeming a company "public" and thus subject to the Exchange Act's reporting requirements
- Tests for determining filer status and implications
- Overview of information required in periodic reports on Forms 10-K, 10-Q, and 8-K
- Officer certification requirements under the Sarbanes-Oxley Act of 2002
- Legal principles relating to the concept of "materiality"
- Regulation FD
- Requirements for Insiders (Section 16)

Operating as a Public Company

Operating as a Public Company

- As a publicly traded company with a class of securities listed on Nasdaq, the company will be required to comply with the following:
  - The Securities Act of 1933 (the "**Securities Act**"),
  - The Securities Exchange Act of 1934 (the "**Exchange Act**"),
  - The Dodd-Frank Wall Street Reform and Consumer Act ("**Dodd-Frank**"),
  - The Sarbanes-Oxley Act of 2002 ("**Sarbanes-Oxley**"), and
  - The Nasdaq corporate governance requirements.

Operating as a Public Company *(cont'd)*

- The Sarbanes-Oxley and the Dodd-Frank Acts implemented changes, either directly or through rules adopted by the national securities exchanges, to public company governance and disclosure requirements to enhance independent auditing, make directors more independent, empower shareholders, and provide increased transparency, primarily as it relates to executive pay and accounting matters.
- Some of these requirements that the company will be subject to include:
  - Audit committee requirements;
  - Nominating and governance committee requirements;
  - Compensation committee requirements;
  - Whistleblower protections; and
  - Code of ethics disclosures.

Sarbanes-Oxley

Compliance

- Sarbanes-Oxley requires that the management team of public companies assess the effectiveness of the internal controls over financial reporting ("**ICFR**"). Under Sarbanes-Oxley, the company is required to submit an annual assessment of the effectiveness of the company's ICFR to the SEC. Additionally, among other things, Sarbanes-Oxley requires all financial reports to include an internal controls report.
- The company must establish a financial accounting framework that can generate financial reports that are readily verifiable with traceable source data. These source data must remain intact and cannot undergo undocumented revisions. In addition, any revisions to financial or accounting software must be fully documented as to what was changed, why, by whom and when.

Sarbanes-Oxley *(cont'd)*

404(b) Exemption

- For so long as the company remains an EGC, the company is exempt from Section 404(b), which requires a publicly held company's auditor to attest to, and report on, management's assessment of its internal controls.

Violations

- In addition to potential lawsuits and negative publicity, a company officer who does not comply or submits an inaccurate certification is subject to a fine of up to $1 million and ten years in prison, even if done mistakenly. If a wrong certification was submitted purposely, the fine can be up to $5 million and 20 years in prison.

Exchange Act Reporting

- The Securities Act and the Exchange Act set forth requirements for periodic and current reports (*see below*) with the SEC that are also made public in order to keep stockholders informed, prohibit insider trading and restrict certain resales of company securities.
- The Exchange Act contains ongoing disclosure requirements for foreign private issuers ("**FPIs**") designed to keep investors informed on a rapid and current basis of information concerning material changes in the financial condition or operations of the company:
  - Annual Report on Form 20-F, and
  - Current Reports on Form 6-K.
- An FPI is not required under US federal securities laws to file or make public quarterly financial information, subject to certain exceptions.
- Missing, late or delinquent Exchange Act reporting could be subject to statutory fines and penalties on the company and its officers and directors.

Exchange Act Reporting *(cont'd)*

Annual Report on Form 20-F

- The information required to be disclosed in an Annual Report on Form 20-F includes (but not limited to) the following:
  - Operating results;
  - Liquidity and capital resources;
  - Trend information;
  - Off-balance sheet arrangements;
  - Consolidated financial statements and other financial information;
  - Significant business changes;
  - Selected financial data;
  - Risk factors;
  - History and development of the FPI;
  - Business overview; and
  - Organizational structure.

Exchange Act Reporting *(cont'd)*

Quarterly Report on Form 10-Q:

- The company must submit quarterly reports after each of the first, second and third quarters to the SEC on Form 10-Q. The fourth quarter is covered by the annual report on Form 10-K.
- Primary contents of the Form 10-Q include:
  - Unaudited financial data;
  - Analysis of the company's financial results of operations and liquidity for the last quarter; and
  - Descriptions of significant nonrecurring events which occurred during the quarter, such as the commencement of significant litigation or the submission of matters to a vote of stockholders.
- The due date for Form 10-Q initially will be within 45 calendar days of the end of each quarter (other than the company's fourth quarter), but as the company grows, it may drop to 40 calendar days.

Exchange Act Reporting *(cont'd)*

Current Reports on Form 8-K

- In addition to the periodic reporting requirements, the company must disclose on a current basis (within 4 business days) the occurrence of significant corporate events on Form 8-K. This acts as an update to stockholders to previously filed quarterly and/or annual reports.
- Significant events include, without limitation:
  - Changes in control of the company;
  - Bankruptcy;
  - Material acquisitions or dispositions;
  - Change in outside auditor;
  - Entry into material agreements;
  - Resignation of any director and executive officers;
  - Material news release or data presentation;
  - Appointment of directors and officers; and
  - The creation of a material direct financial obligation or a material financial obligation under an off-balance sheet arrangement, etc.

CEO and CFO Certifications

- Once public, the company's chief executive officer and chief financial officer must evaluate the company's internal controls and disclosure controls on a quarterly basis and certify the company's periodic reports that contain financial statements (Form 10-K and Form 10-Qs).
- The Exchange Act rules require the company's chief Executive officer and chief financial officer to include certifications in periodic reports filed with the SEC that address:
  - The accuracy, completeness and fair presentation of the report's disclosure;
  - The establishment and maintenance of "disclosure controls and procedures";
  - Deficiencies in, and material changes to, internal controls over financial reporting;
  - Compliance with the Exchange Act; and
  - That information contained in the periodic report fairly presents the financial condition of the company.
- The company must adopt disclosure controls and procedures to be able to satisfy these requirements.
- Criminal penalties can be levied against the chief executive officer and/or the chief financial officer personally, which could result in significant fines.

Disclosure Controls and Procedures

- "Disclosure controls and procedures" are controls and other procedures designed by companies to ensure that the information required to be disclosed in the reports filed by them under the Exchange Act, on a timely basis, is:
  - Recorded,
  - Processed,
  - Summarized, and
  - Reported.
- Disclosure controls and procedures include, but are not limited to, the controls and procedures designed to ensure that information required to be disclosed by a company in its Exchange Act reports is appropriately accumulated and communicated to the company's management, including its principal executive and financial officers, to allow timely decisions regarding required disclosure.
- Note: it's important to have an "up-the-chain" process of reporting from lower managers to the company's chief executive officer and chief financial officer.

Regulation FD

Regulation FD and Communications Policy

Purpose

- It is the company's policy to comply with all periodic reporting and disclosure requirements for a publicly traded company, including SEC Regulation FD (Fair Disclosure). It is the company's practice to disclose material information about the company in a public, timely, and non-selective manner.
- The Regulation FD and Communications Policy outlines the company's compliance policy and guidelines to ensure full, fair, accurate, timely and understandable disclosure of information about the company on a non-selective basis to be in compliance with Regulation FD.

Regulation FD and Communications Policy *(cont'd)*

Compliance

- Regulation FD provides that when an issuer discloses "material nonpublic information" to certain individuals or entities—generally, securities market professionals, such as stock analysts or holders of the issuer's securities who may well trade on the basis of the information—the issuer must make immediate public disclosure of that information.
- As a general rule, employees and directors of the company are not authorized to disclose material, non-public information about the company. Any inadvertent disclosure of material, non-public information on a selective basis should be reported to the company's Disclosure Committee.

Regulation FD and Communications Policy *(cont'd)*

Authorized Representatives of the Company

- The chief executive officer, the chief financial officer, and other identified officers will have authority to communicate on behalf of the company to:
  - Securities market professionals (i.e., brokers, dealers, analysts, investment advisors and banks, institutional investment managers, mutual funds, hedge funds, and other investment companies);
  - Shareholders of the company who may reasonably be expected to purchase or sell the company's securities based upon the communications; and
  - Persons associated with any of the above-mentioned persons.

Insider Trading and Blackout Policy

Insider Trading and Blackout Policy

Purpose

- The Insider Trading and Blackout Policy sets forth the policies of the company prohibiting "insider trading" and the procedures to be followed by directors, officers and employees of the company before engaging in any trading involving securities of the company.

Restrictions

- Insider trading is prohibited by federal law and company policy. Any director, officer or employee of the company, while having knowledge of material non-public information about the company, is prohibited from:
  - Trading in securities of the company;
  - Disclosing such information to anyone else, including family members (other than to another director, officer or employee of the company who has a need to know in order to perform his or her duties on behalf of the company); or
  - Recommending to anyone else that they trade in any of the company's securities (*i.e.,* "tipping").
- In an abundance of caution, the company, from time to time, communicated by the CFO, will impose a mandatory blackout period on all employees and directors from trading in securities of the company regardless of whether such persons know material, nonpublic company information.

Insider Trading and Blackout Policy *(cont'd)*

Other Restrictions

- This policy also prohibits all of the following activities generally (regardless of blackout periods):
  - Engaging in "short sales" and "selling against the box" (a variation of selling short) with respect to securities of the company;
  - Trading in puts, calls, straddles and options for the company's securities;
  - Trading in securities of the company on a short-term basis;
  - Holding company securities in a margin account; and
  - Entering into hedging or similar transactions with respect to company securities.

Insider Trading and Blackout Policy *(cont'd)*

Violations

- The criminal and civil penalties for illegal insider trading by any individual are extremely serious. These include, but are not limited to, a prison sentence of up to 20 years and a fine of up to $5 million; a civil penalty of up to three times the profits made (or losses avoided) by the trading; and disgorgement (payment to the government) of the profits made (or losses avoided) including profits (or losses avoided) by a "tippee" and can apply whether the person actually traded in company securities or made a profit therefrom while possessing material, nonpublic information on the company.

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