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Legal Update
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# 10 Tips for 10-Ks and Proxy Statements

With preparations shifting into high gear for calendar-year companies that file annual reports on Form 10-K and proxy statements with the US Securities and Exchange Commission (SEC), here are tips to consider when drafting these documents.

## 10-K Tips

**1. Disclosure Update and Simplification.** The SEC adopted "Disclosure Update and Simplification" amendments on August 17, 2018, which became effective on November 5, 2018. The amendments were designed to address disclosure requirements that the SEC considered to be redundant, duplicative, overlapping, outdated or superseded in light of other SEC disclosure requirements, US generally accepted accounting principles or changes in the "information environment." Annual reports on Form 10-K now need to comply with these amendments.

Many of the disclosure update and simplification amendments impact financial statements and related footnotes and items required by Regulation S-X. In some cases, the new requirements move disclosure from outside to inside the financial statements and, in other cases, from inside to outside the financial statements. These location changes impact audit review, XBRL tagging requirements and the ability to rely on the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995.

The disclosure update and simplification amendments also affect non-accounting portions of the Form 10-K. For example, companies are no longer required to provide two years of high and low sale prices for their stocks. Similarly, the requirement to disclose the amount and frequency of cash dividends has been eliminated, as has the requirement to include disclosure of the ratio of earnings to fixed charges. Other changes to the Form 10-K include elimination of segment financial information, elimination of amounts spent on research and development and elimination of financial information by geographic area in the business section. In each case, it is important to remember that, although the disclosure was eliminated from specified portions of the Form 10-K, corresponding disclosure may be needed or required in the notes to the financial statements or in the management's discussion and analysis (MD&A). The amendments also eliminate the requirement for the business section to include the address of the SEC's public reference room, although companies must state that the SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC and must provide the address of that site. A company must also include its own Internet address, if it has a website, in the Form 10-K.

Companies should work closely with their accountants and counsel to be sure that their annual reports on Form 10-K comply with the new requirements. Companies should also consider whether they need to update their disclosure controls and procedures and/or their internal control over financial reporting in light of these amendments.

For further information about the disclosure update and simplification amendments, see our Legal Update "Capital Markets Implications of Amendments to Simplify and Update SEC Disclosure Rules," dated August 29, 2018.[1]

**2. Cybersecurity Disclosure.** Cybersecurity continues to grow as a global concern. Accordingly, companies should be sure that they are addressing this topic adequately in their annual reports on Form 10-K. In addition to discussing cybersecurity as a risk factor, companies should consider, based on facts and circumstances, whether they need to discuss cybersecurity more broadly in the context of their business and operations, legal proceedings, MD&A, financial statements, disclosure controls and procedures, and corporate governance. The SEC staff has been focusing on, and providing comments to companies regarding, cybersecurity disclosure. Due to the significance of cybersecurity issues, the SEC staff monitors press reports on cybersecurity incidents and may raise questions about the sufficiency of cybersecurity disclosure in SEC reports on that basis.

On February 21, 2018, the SEC published interpretive guidance to assist public companies in preparing disclosures about cybersecurity risks and incidents. For more information on the SEC's cybersecurity guidance, see our Legal Update "SEC Issues Updated Guidance on Cybersecurity Disclosures," dated February 28, 2018.[2]

**3. Brexit Disclosure.** Disclosures made in prior years of expectations regarding how "Brexit" (i.e., the United Kingdom's potential withdrawal from the European Union) will impact a company should be re-evaluated to determine if they are still current. Companies impacted by Brexit should include up-to-date disclosure in their annual reports on Form 10-K. Brexit disclosure should describe how Brexit is expected to impact the company and its operations, taking into account the current status of Brexit negotiations and agreements. For example, if a company relies on "passporting" to conduct its business, that should be discussed if the inability to passport is expected to have a material impact. Similarly, to the extent that Brexit is expected to have a material impact on a company's supply chain or employee base, that should be described.

Discussion of Brexit may be needed beyond the risk factor section of the Form 10-K. For example, Brexit disclosure might be appropriate in the business section or the MD&A. Given the impending March 2019 Brexit deadline and the uncertain and potentially changing landscape, Brexit disclosure may need to be reviewed and possibly revised to reflect new developments up to the time a company files its Form 10-K.

**4. LIBOR Phase-Out Disclosure.** The phase-out of the London Interbank Offered Rate (LIBOR) is another development that may have a significant effect on some companies. To the extent that the LIBOR phase-out presents a material issue for a company, the company should develop disclosure for its Form 10-K, not just as a risk factor but also for other sections of the Form 10-K, such as MD&A and business, as appropriate. For example, companies with outstanding floating rate notes based on LIBOR may need to address the events that trigger the substitution of the rate and implementation of the new rate. Although LIBOR disclosure considerations may evolve in the future as more information on the transition to alternative interest rate benchmarks becomes available, to the extent that the move away from LIBOR is a trend known to management that is expected to have a material impact on a company, disclosure is needed in the upcoming Form 10-K.

### 5. Technical 10-K Details.

*ITRA Compliance*. Although there is no corresponding SEC regulation, the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) continues to require Form 10-K disclosure if, during the period covered by the report, the company or any affiliate knowingly engaged in certain sanctionable activities, regardless of whether those actions violate US law and without any materiality threshold. Companies should evaluate ITRA compliance as part of their annual reporting process.

*Hyperlinks*. The SEC now generally requires the exhibits listed in the exhibit index of specified filings, including annual reports on Form 10-K, to be hyperlinked. It is worthwhile to double check the hyperlinks for exhibits that are being carried forward from the exhibit index contained in last year's annual report to confirm that each properly links to the identified document. SEC rules require that incorrect hyperlinks be fixed.

*Cover Page Changes*. Remember that there are two technical changes to the cover page of annual reports on Form 10-K this year. One change eliminates the instruction informing filers not to check the "Non-accelerated filer" box if the issuer is a smaller reporting company (the amendments to the thresholds for smaller reporting company status also were recently amended and should be considered in connection with preparation of the annual report on Form 10-K[3]), as shown in the struck-out text below:

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☐ |
| Non-accelerated filer<br>~~(Do not check if a smaller reporting company)~~ | ☐ | Smaller reporting company | ☐ |
| | | Emerging growth company | ☐ |

The second change, which relates to the SEC's adoption of the inline XBRL format for the submission of operating company financial statement information, reads as follows, with changes shown in struck-out text:

Indicate by check mark whether the registrant has submitted electronically ~~and posted on its corporate Web site, if any,~~ every Interactive Data File required to be submitted ~~and posted~~ pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit ~~and post~~ such files).

## Proxy Statement Tips

**6. Pay Ratio: Median Employee Determination.** The pay ratio rule, which requires disclosure of the ratio of the annual total compensation of a company's median employee to that of its chief executive officer, permits a company to identify its median employee only once every three years as long as the company reasonably believes there has not been a change in its employee population or compensation arrangements that would significantly change the pay ratio disclosure. The analysis of whether a new determination of the median employee is required is a company-specific matter. For example, in some situations, a significant acquisition or divestiture may affect workforce composition or compensation arrangements, but that is not always the case.

In any event, each company needs to review its employee composition and compensation practices in order to assess whether it is required to re-identify its median employee for pay ratio disclosure. Companies should perform this process sufficiently in advance of the date on which they will be filing their proxy statements in order to allow time for the median employee's compensation and the pay ratio for 2018 to be calculated and confirmed. If a company concludes that it does not have to re-identify its median employee for its 2019 proxy statement, it will need to disclose that it is using the same median employee in its pay ratio calculation and describe briefly the reason for its belief that there have not been any changes requiring a newly determined median employee.

If the rules do not require a new determination of the median employee, but the median employee identified for the 2018 proxy statement pay ratio disclosure has left the company or has had compensation changes, the company may substitute another employee with substantially similar compensation as the median employee previously identified. In addition, the rules do not preclude a company from voluntarily conducting a new determination of its median employee, even if it is not technically required to do so. In any event, a company must disclose the date it selected to identify the median employee.

**7. Hedging Disclosure.** On December 18, 2018, the SEC adopted its final rule requiring disclosure of a company's policies and practices with respect to hedging of company securities by employees, officers and directors by adding new Item 407(i) to Regulation S-K.[4] This rulemaking was mandated by Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Companies will not need to comply with the hedging disclosure rule during the 2019 proxy season. Most companies will not need to provide the new hedging disclosure until their proxy statements for election of directors during fiscal years beginning on or after July 1, 2019 (i.e., the 2020 proxy season). Smaller reporting companies and emerging growth companies will not need to comply with the new hedging disclosure rule until the 2021 proxy season. However, a company nevertheless may choose to include additional hedging disclosure in its 2019 proxy statement, whether or not such disclosure is fully compliant with Item 407(i). To the extent that a company has prohibited or restricted hedging, it may wish to voluntarily include disclosure in this year's proxy statement to call attention to this governance practice. The new hedging disclosure rule does not require companies to adopt or amend hedging policies. For more information on the hedging disclosure rules, see our Legal Update "SEC Adopts Dodd-Frank Hedging Disclosure Rule," dated December 27, 2018.[5]

**8. ESG Disclosure.** With growing interest in environmental, social and governance (ESG) issues among certain investors, some companies have chosen to discuss sustainability initiatives in distinct sections of their proxy statements. Enhanced ESG proxy disclosures may be well-received by institutional investors, proxy advisory firms and organizations that rate public company corporate governance. This approach may provide an opportunity for companies to control their ESG message and may provide a basis to guide shareholder engagement in this area.

Companies voluntarily adding ESG disclosure to their proxy statements should coordinate such disclosure with statements on their websites and other public statements to ensure consistency. Such disclosure needs to be carefully drafted. For example, aspirational efforts for ESG should not be presented as formal commitments by the company. Because ESG disclosure is multi-faceted, and, in some cases, quite specialized, it may make sense to involve personnel who do not otherwise assist with the proxy process in the drafting and review of the disclosure. Companies considering ESG proxy sections may need additional lead time to develop this disclosure.

**9. Shareholder Engagement Disclosure.** The compensation discussion and analysis (CD&A) must indicate whether—and, if so, how—the company took into account the prior year's say-on-pay vote. Because shareholder engagement on executive compensation can provide a basis for robust disclosure in response to this requirement, it is common for companies to discuss shareholder engagement in the CD&A section of their proxy statements.

Shareholder engagement, including engagement on issues other than compensation, is increasingly viewed as a positive governance measure. As a result, many companies are adding more comprehensive discussions of shareholder engagement in their proxy statements, including in sections outside of the CD&A. Such enhanced shareholder engagement disclosure may provide details, such as the scope of investors contacted and the actions taken as a result of shareholder feedback.

Expanding shareholder engagement disclosure in proxy statements gives companies the opportunity to present what they are doing to promote this significant corporate governance measure. Recognizing that some institutional investors and proxy advisory firms may judge companies based on their level of engagement with shareholders, companies may want to consider voluntarily expanding descriptions of their shareholder engagement in the proxy statement to get "credit" for what they are already doing.

**10. Perquisite Disclosure.** The SEC recently has focused on the adequacy of perquisite disclosure. Accordingly, it would be worthwhile for companies to confirm that they are properly disclosing and characterizing perquisites in their proxy statements. Companies should confirm that their disclosure controls and procedures are adequately identifying all perquisites being paid to their executive officers and directors. To the extent that companies include questions regarding perquisites in their director and officer questionnaires, they should be sure that complete responses have been provided to these questions.

## Additional Information

For additional information about preparing annual reports and proxy statements this year, see our Legal Update "2019 Proxy and Annual Reporting Season: Let the Preparations Begin," dated September 17, 2018.[6]

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## Endnotes

[1] Available at https://www.mayerbrown.com/Capital-Markets-Implications-of-Amendments-to-Simplify-and-Update-SEC-Disclosure-Rules-08-29-2018/.

[2] Available at https://www.mayerbrown.com/SEC-Issues-Updated-Guidance-on-Cybersecurity-Disclosures-02-28-2018/.

[3] For more information, see our Legal Update "SEC Expands Definition of Smaller Reporting Company," dated July 9, 2018, available at https://www.mayerbrown.com/SEC-Expands-Definition-of-Smaller-Reporting-Company-07-09-2018/.

[4] Available at https://www.sec.gov/rules/final/2018/33-10593.pdf.

[5] Available at https://www.mayerbrown.com/sec-adopts-dodd-frank-hedging-disclosure-rule-12-27-2018/.

[6] Available at https://www.mayerbrown.com/2019-Proxy-and-Annual-Reporting-Season-Let-the-Preparations-Begin-09-17-2018/.