
Disclosure and Financial Reporting Issues Facing Smaller Issuers

**National Conference on Current SEC & PCAOB Developments
December 7 , 2011**

Gerry Laporte

Kevin Woody



Disclaimer

The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. Therefore, the views expressed today are our own, and do not necessarily reflect the views of the Commission or the other members of the staff of the Commission.

Speaker Biography

Gerald J. Laporte
U.S. Securities and Exchange Commission

Gerald J. Laporte has served as Chief of the Office of Small Business Policy at the U.S. Securities and Exchange Commission since 2002. He has practiced law in both the public and private sectors in Washington, D.C. since 1976. Before rejoining the SEC in 2002, he practiced securities and corporate law with the firm of Hogan & Hartson LLP. He had worked at the SEC from 1982 to 1987 as Senior Special Counsel for the Legislation and Investment Management Group in the Office of the General Counsel and as Counsel to SEC Commissioner Joseph A. Grundfest. In the 1970's, he had worked as Legislative Assistant to a U.S. Congressman and served as Law Clerk to U.S. District Judge John H. Pratt in Washington, D.C. Mr. Laporte served as Chairman of the Corporation Finance and Securities Law Section of the District of Columbia Bar from 1997 to 1998.

Mr. Laporte holds a law degree, awarded with honors, from the George Washington University Law School, where he was Managing Editor of the law review. He also holds an M.A. degree in Political Science from Georgetown University, and degrees from the University of Ottawa, Canada, and Sacred Heart Seminary College, Detroit.

Speaker Biography

Kevin Woody
U.S. Securities and Exchange Commission

Kevin Woody is a Accounting Branch Chief in the Office of Real Estate and Business Services within the Division of Corporation Finance. Mr. Woody joined the Division of Corporation Finance in September 2003 as a Staff Accountant in the Office of Health Care and Insurance and was a Branch Chief in that office from April 2005 until joining the Office of Real Estate and Business Services in January 2007. Prior to joining the staff of the SEC, Mr. Woody was an Audit Manager with Ernst & Young LLP. Mr. Woody received his B.S. in Commerce in 1995 from the University of Virginia.

SEC Advisory Committee on Small and Emerging Companies

- **SEC announced formation in September 2011**
- **21 members, from smaller public and private companies; investors; legal, accounting and investment banking firms; state securities regulators; SBA**
- **Operates under Federal Advisory Committee Act**
- **Three in-person meetings annually anticipated, but may also meet by teleconference**

SEC Advisory Committee on Small and Emerging Companies (Cont'd)

- **First meeting held on October 31, 2011**
- **Four in-depth discussions at meeting:**
 - **Triggers for registration and public reporting and suspension of reporting obligations**
 - **Scaling of regulations**
 - **New capital raising strategies**
 - **Restrictions on general solicitation**
- **Committee expected to provide periodic recommendations on issues related to small and emerging companies**

Triggers for Registration and Public Reporting and Suspension of Reporting Obligation

- **More than 500 security holders and \$10 million in assets trigger reporting obligation under Section 12(g) of Securities Exchange Act of 1934**
- **Fewer than 300 security holders permits “going dark”**
- **Some observers say current tests require private companies to report too soon and allow reporting companies to go dark too easily**
- **Commission staff conducting study**

Scaling of Regulations for Reporting Companies

- **SEC set up framework to better scale regulations for reporting companies in early 2008**
- **Continued pressures to raise current \$75 million public float ceiling to qualify for scaling or adopt alternative revenue test**
- **Continued efforts to identify regulatory requirements for scaling**
- **Recent focus on scaling regulations for newly public companies**

New Capital Raising Strategies

- **Crowdfunding**
- **Secondary trading markets for restricted securities**
- **“Regulation A+”**

Restrictions on General Solicitation

- **General solicitation and advertising not permitted for non-public securities offerings conducted under SEC Rule 506**
- **Some observers view these restrictions as undue constraint on small business capital formation and unnecessary to protect investors**
- **SEC Chairman has requested staff to draft concept release on this issue and staff is working on this release**

Frequent Staff Comment Areas

Frequent Staff Comment Areas

- ❖ MD&A Disclosure
- ❖ Reverse Mergers & “Back Door” Registrations
- ❖ Business Combinations
- ❖ Equity Transactions
- ❖ Disclosure Controls and Procedures
- ❖ Internal Control over Financial Reporting
- ❖ Form 8-K

Management's Discussion & Analysis (MD&A)

Release Nos. 33-6835 and 33-8350

Results of Operations

- ❖ What has happened during the period and why?

Liquidity

- ❖ Sources and uses of cash
 - What are our bills and how will we pay them?
 - Prospective sources of and need for capital
- ❖ Going concern matters

Early warning disclosures – Item 303(a)(3)(ii) of Regulation S-K

Reverse Mergers & “Back Door” Registrations

Required Form 8-K items not filed

Form 10-type information in Form 8-K

- **Financial Statements due within 4 business days (no 71-day extension)**

Financial statement updates on Form 8-K

- **Staff Interpretation of Exchange Act Rule 13a-1**

Internal Control over Financial Reporting

- **Regulation S-K Compliance and Disclosure Interpretation 215.02**

Reverse Mergers & “Back Door” Registrations

Accounting acquirer’s audited F/S presented for all historical periods in subsequent reports

- ❖ Earnings per share recast to reflect exchange ratio
- ❖ Eliminate retained earnings of shell or legal acquirer
- ❖ Common stock of shell or legal acquirer continues

Audit Issues

- ❖ PCAOB Standards

New Guidance

- ❖ CF Disclosure Guidance Topic 1
- ❖ Update to FRM

Business Combinations

- ❖ **Determination of Accounting Acquirer**
 - **Consideration of all factors (ASC 805-10-55-11 to 15)**
- ❖ **Purchase Price Allocation**
 - **Allocated to all assets and liabilities acquired generally based upon fair value**
 - **Consider all separately identifiable intangible assets**
 - **Fair value of securities issued**
- ❖ **Contingent Consideration**
- ❖ **Disclosures and Separate Financial Statements**
 - **Business vs. Asset Determinations**
 - **Rule 3-05/8-04 of Regulation S-X**
 - **Pro Forma requirements**

Equity Transactions

Fair Value Determination

- ❖ If publicly traded in an active market, use quoted market price
 - If discounts are appropriate under the circumstances, they should be supported by objective evidence
- ❖ If stock not publicly traded in active market
 - Contemporaneous equity transactions with third parties
 - Fair value of the services or goods provided may be used to measure the transaction, if more reliable
 - Consider management's judgment -- ASC 820-10-35 (FSP SFAS 157-3 and 157-4)

Disclosure

- ❖ All major assumptions used to value stock options, warrants and other equity instruments
 - Footnotes
 - MD&A (critical accounting estimates)

Disclosure Controls & Procedures

Conclusions

- ❖ Disclosure should state DC&P conclusion in clear and unqualified language – effective or not effective
- ❖ “Adequate” or “Effective except for...” are inappropriate
- ❖ “Effective” DC&P conclusion when ICFR conclusion is “ineffective”
- ❖ Consider reassessing conclusions upon the filing of any amendments

Incomplete definition of DC&P

Internal Control over Financial Reporting (ICFR)

Management Reports under Item 308(a) of Regulation S-K

- ❖ Separate evaluation *and assessment* from evaluation of disclosure controls and procedures
- ❖ All four elements in Item 308(a) must be addressed in disclosure
- ❖ ICFR cannot be “effective” if material weakness exists
- ❖ Clear conclusion (either “effective” or “ineffective”)

SOX Section 302 Certifications should not deviate from specific form and content in Item 601(b)(31)(i) of Regulation S-K

- ❖ Include all paragraphs (including paragraph 4(b))

Internal Control over Financial Reporting (ICFR)

Disclosures that companies should consider when material weakness exists (see SEC Release No. 33-8810)

- ❖ Nature of the material weakness (i.e., identification of the deficiency) as opposed to the accounting
- ❖ Impact of control deficiency on the company's financial reporting and its ICFR
- ❖ Disclosures should be detailed and specific for each material weakness identified

Material changes in ICFR

- ❖ Changes in circumstances without disclosures of changes in internal controls
- ❖ Change in conclusion on effectiveness should be accompanied with some change in internal control
- ❖ Avoid boilerplate disclosure

Form 8-K – Item 4.01

- ❖ **New CDI – Regulation S-K Section 111 and 211; Exchange Act Form 8-K, Section 114 and 214; and Section 4530 of the FRM**
- ❖ **Failure to specify whether former accountants resigned, declined to stand for re-election, or were dismissed and the date**
- ❖ **Disclosure of disagreements through termination date**
- ❖ **Exhibit 16 letter**
- ❖ **Reverse acquisitions**
- ❖ **Accounting firm mergers**

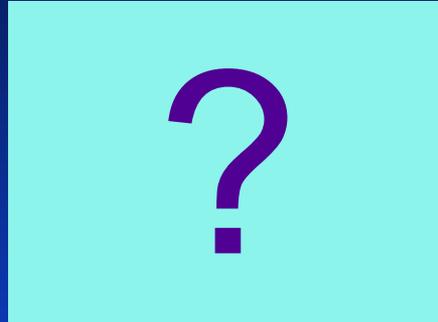
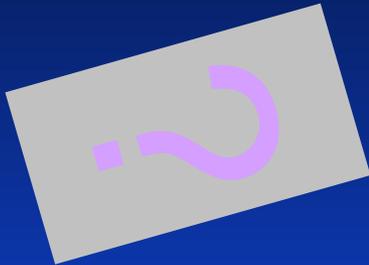
Form 8-K – Item 4.01

Section 4530 of the FRM:

- Subsequent interim period
- No reportable events
- Remediation of internal control deficiencies
- Material weakness or significant deficiency in ICFR
- Going concern
- Explanatory paragraph in report on ICFR
- Revocation of accountant's PCAOB registration
- Time period preceding resignation, declination or dismissal

Form 8-K – 4.02

- ❖ **Triggering event other than non-reliance conclusion (e.g., completion of restatement)**
- ❖ **Unclear statement regarding non-reliance**
- ❖ **Brief description of facts lacking or unclear**
- ❖ **“Stealth Restatements”**
 - ❖ **See Exchange Act Form 8-K Compliance and Disclosure Interpretation 215.01**



Questions

