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Foreign Private Issuers: Annual Report Issues to Look For in 2020-21

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Client Advisory
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As companies continue to file their annual reports for fiscal 2019, we thought it would be a good idea to highlight what appears to be on the mind of the SEC staff these days as well as current trends. Specifically, we will only discuss issues that pertain to Foreign Private Issuers, or "**FPIs**." There are additional issues that domestic issuers should look out for.

As a reminder, Foreign private issuers filing annual reports on Form 20-F must file their reports within four months after their fiscal year-end. For companies with a calendar year-end, the deadline this year is April 30, 2020.

For Canadian companies that are eligible to file a Form 40-F, if they file their audited financial statements and MD&A before the date on which the Annual Information Form, or "**AIF**," is filed in Canada, they are required to file their Form 40-F in the U.S. on the day the audited financial statements and MD&A are due to be filed in Canada. These companies should then file a 40F/A to add the AIF on the day the AIF is due to be filed in Canada. In any event the Form 40-F must be filed no later than the date that the relevant information is filed in Canada.

I. Current Risk Factors:

a. Possible Trade War

FPIs, especially those with significant business in China, are starting to include a Trade War risk factor. This risk factor is not limited to companies with significant business in China, as trade wars could escalate with other countries. Some companies have described how recent events, including the policies introduced by the current U.S. administration, have resulted in substantial regulatory uncertainty regarding international trade and trade policy. Several China-based FPIs have provided enhanced disclosure with respect to the related risks in their annual reports and other public disclosure documents.

b. Cybersecurity

Cybersecurity continues to be a very hot topic. FPIs must evaluate whether to disclose any cybersecurity risks or incidents in the MD&A (Item 5 of Form 20-F) as events reasonably likely to have a material effect on the FPI's results of operations, liquidity, or financial condition. FPIs are encouraged to describe material cybersecurity risks that are specifically related/applicable? to each FPI's situation.

c. Brexit

FPIs are encouraged to pay attention to Brexit-related disclosures that disclose how they are dealing with Brexit's impact on the company's operations. The focus of the disclosure should be how management is dealing with Brexit risks, including new regulatory risks given the

uncertainty of the legal framework that will apply to each industry, including, supply chain risks due to potential trade disruptions, the risk of losing customers and revenue, exposure to exchange rate risks and contractual risks.

d. LIBOR

LIBOR is expected to be phased out by 2021. FPIs are beginning to take notice of disclosures related to the discontinuation of LIBOR and the potential impact of the discontinuation and the use of alternative benchmarks in the U.S. and elsewhere.

II. SEC Simplification of Disclosure and Compliance Requirements

As discussed in our advisory dated April 2019, the SEC has adopted several amendments designed to simply rules, reduce costs and burdens, improve the readability of documents, and discourage repetition and disclosure of immaterial information. FPIs should remember to use the new cover pages for both forms 20-F and 40-F, include as an exhibit to the 20-F a brief description of all registered securities, and follow the new guidelines of materiality for agreements and exhibits.

III. Inline XBRL

As discussed in a previous advisory, FPIs should be mindful of the upcoming inline XBRL requirement. Inline XBRL is a format that allows filers to embed XBRL data directly into a Hypertext Markup Language (HTML) document and is expected to reduce the likelihood of inconsistencies between HTML and XBRL filings and improve the quality of XBRL data.

FPIs will be required to comply with the Inline XBRL requirements based on their filer status and basis of accounting. For FPIs that prepare their financial statements in accordance with U.S. GAAP, the phase-in of the Inline XBRL requirements is determined based on its filer status: (i) large accelerated filers were required to comply with Inline XBRL for fiscal periods ending on or after June 15, 2019, and (ii) accelerated filers will be required to comply with Inline XBRL for fiscal periods ending on or after June 15, 2020. All other filers, including FPIs that prepare their financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB), will be required to comply with Inline XBRL for fiscal periods ending on or after June 15, 2021.

IV. Critical Audit Matters (CAMs):

The requirement for auditors to disclose CAMs. in their auditor's reports, is based on Public Company Accounting Oversight Board's (PCAOB) standard AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. Under the AS 3101, a CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (i) relates to accounts or disclosures that are material to the financial statements; and (ii) involves especially challenging, subjective, or complex auditor judgment. The inclusion of CAMs took effect for audits of fiscal years ending on or after June 30, 2019, for large accelerated filers; and will take effect on December 15, 2020 for other issuers. Audit reports of "emerging growth companies" are not required to include CAM disclosures.

The standard was adopted to inform investors and other financial statement users about challenging matters in the audit and how they were resolved. Some factors to consider in assessing the auditor's judgment include: the risk of material misstatement, the degree of auditor judgment related to areas that involved significant judgment or estimation by management, whether the transaction is significant and/or unusual, the degree of auditor subjectivity in applying audit procedures, the nature and extent of audit effort required to address the matter, whether specialized skill or knowledge is needed and the nature of audit evidence obtained.

The following must be included in the audit report where a CAM has been identified: (i) identification of the CAM, (ii) a description of the principal considerations that led the auditor to determine the matter is a CAM, (iii) a description of how the CAM was addressed in the audit

and (iv) a reference to the relevant financial statement accounts of disclosures. To date, all the audit reports that have been filed with the SEC by large accelerated filers have included at least one CAM.

V. New Mining Property Disclosure Rules

On October 31, 2018, the SEC adopted final rules that overhaul the technical disclosure requirements applicable to companies engaged in material mining operations. Upon effectiveness, the new rules will replace the SEC's decades-old guidelines, set forth in Industry Guide 7 (Guide 7), with new subpart 1300 of Regulation S-K, based on the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). As part of aligning disclosure requirements with the CRIRSCO standards, the rules require registrants with material mining operations to disclose, among other things, (i) information concerning mineral resources (the definition of which tracks CRIRSCO standards more closely and excludes oil and gas resources resulting from oil and gas producing activities, gases and water), which was previously only permitted in limited circumstances, (ii) material exploration results and related exploration activity and (iii) summary information concerning properties in the aggregate as well as more detailed information about individually material properties. Requiring the disclosure of mineral resources in addition to mineral reserves will provide investors with important information concerning the registrant's operations and prospects.

All SEC reporting companies, except those that file Form 40-Fs, will be required to comply with the new rules for their first fiscal year beginning on or after January 1, 2021. Foreign private issuers who file on Forms 20-F, F-1, F-3 or F-4 will no longer be permitted to include non-compliant disclosures in such filings. The SEC staff has explained that early voluntary compliance is permitted so long as a registrant satisfies all the provisions under Subpart 1300 of Regulation S-K and any required technical report is filed as an exhibit that meets existing EDGAR technical specification requirements. Industry Guide 7 will remain effective until all registrants are required to comply with the rules, at which time Industry Guide 7 will be rescinded. Registrants that do not voluntarily comply early with the new rules should use Industry Guide 7 for their mining property disclosures until compliance with the new rules is required.

VI. NYSE Revises Exceptions to Shareholder Approval Rules

In March 2019, the SEC approved an amendment to the NYSE requirement that listed companies must obtain shareholder approval for certain share issuances (e.g., for issuances when the number of company securities to be issued by the company exceeds 20% of the number of shares of shares outstanding or 20% of outstanding voting power.)

Like the previously changed NASDAQ rule, the NYSE modification:

- changes the definition of market value for purposes of the shareholder approval rule to the lower of the closing price and five-day average closing price; and
- eliminates the requirement for shareholder approval of issuances at a price less than book value where the issuance price is at least as great as market value.

The SEC observed that, even with these changes, the ability of NYSE-listed companies to issue securities without shareholder approval continues to remain limited by other important NYSE rules, such as the rules requiring shareholder approval for change-of-control transactions and discounted issuances to insiders. However, FPIs can continue, if applicable, to use home country rules, and not comply with shareholder approval rules. Use of home country rules by an FPI requires proper disclosure and a written statement by an outside counsel that the FPI's home country does not have an equivalent to NASDAQ's or NYSE rule and that its current practice is both legal and an accepted business practice in the FPI's home country.

VII. SEC Proposal to Amend Financial Disclosure Requirements for Acquisitions and Dispositions

On May 3, 2019, the SEC proposed changes to the financial disclosure requirements for business acquisitions and dispositions intended to reduce the difficulty and expenses of preparing historical financial statements and pro forma financial information by amending Rule 3–05 and Article 11 of Regulation S–X.

The proposed amendments would not apply to target company financial statements required to be included in a proxy statement or registration statement on Form S–4 but would apply to the pro forma information provided therein pursuant to Article 11 and any financial information for other acquisitions and dispositions that would be required to be disclosed in the registration statement pursuant to Rule 3–05 or Rule 3–14.

VIII. SEC Proposal to Modernize Disclosures of Business, Legal Proceedings and Risk Factors

On August 8, 2019, the SEC proposed amendments to modernize provisions of Regulation S-K generally applicable to U.S. domestic reporting companies requiring description of business, legal proceeding and risk factor disclosures. The proposed amendments intend to improve the readability of disclosures for investors and simplify compliance requirements for companies, emphasizing a more principle-based approach, by focusing on information that is material to an investor's understanding of a company's business and eliminating redundant disclosures.

Although the proposal contemplates potentially incorporating parallel changes across all forms filed by FPIs, including annual reports on Form 20-F, the proposed changes regarding risk factors would apply to FPIs filing registration statements on Forms F-1, F-3 and F-4.

IX. SEC Proposal to Disclose Payments Related to Extraction of Natural Resources

On December 18, 2019, the SEC proposed a rule to require resource extraction issuers to file an annual Form SD that includes information about payments related to the commercial development of oil, natural gas, or minerals that are made to a foreign government or to the U.S. federal government. This rule was mandated by the Dodd-Frank Act, but proposals were previously vacated by the courts and disapproved by Congress.

New proposed Rule 13q-1 requires that every issuer that files an annual report with the SEC on Form 10-K, Form 20-F or Form 40-F and engages in the commercial development of oil, natural gas, or minerals must furnish a report on Form SD.

Rule 13q-1 also provides that issuers may apply for the recognition by the SEC that an alternative reporting regime satisfies the transparency objectives of the Dodd-Frank mandate.

Rule 13q-1 exempts smaller reporting companies and emerging growth companies as well as issuers that have a conflict of law or a conflict with the provisions of a pre-existing contract, subject to meeting the stated conditions set forth in the rule.

X. SEC Proposal regarding ICFR Auditor Attestation Requirement

Currently, all public companies (including FPIs) are required to have their management review the effectiveness of their internal control over financial reporting, or ICFR, under Section 404(a) of the Sarbanes-Oxley Act (SOX). However, "accelerated" filers (market capitalization between $75 million and $700 million) and "large accelerated" filers (market capitalization greater than $700 million) are subject to an additional requirement under SOX 404(b). For these filers, including FPIs, an independent auditor must review and attest to management's internal assessment of the company's ICFR. Public companies that are not accelerated or large accelerated filers are exempt from ICFR auditor attestation requirement.

The SEC's proposed amendments, which were subject to public comment period until July 29, 2019, would provide a narrow carve-out from the current definitions of accelerated filer and large accelerated by excluding any company that both:

- Qualifies as a smaller reporting company; and
- Has less than $100 million in annual revenues during the most recent fiscal year for which audited financial statements are available.

Most significantly, these companies would no longer be subject to the SOX 404(b) auditor attestation requirement.

XI. SEC Proposal to Further Simplify Management's Discussion and Analysis of Financial Condition and Results of Operations

On January 30, 2020, the SEC proposed significant changes to MD&A by adding new requirements, deleting requirements, simplifying instructions and revamping other requirements in an effort to streamline, avoid duplication of disclosure and allow issuers to better focus on disclosure of material information based on its facts and circumstances. Some of the proposed changes include:

(a) requiring issuers to disclose material cash requirements, including commitments for capital expenditures, the anticipated source of funds needed to satisfy these cash requirements and the general purpose of the cash requirements. The goal behind this proposal is to revise the disclosure requirements to account for capital expenditures that are not necessarily capital investments, recognizing that expenditures for human capital or intellectual property have become more important. The proposal would also add product lines as an example of other subdivisions that may need to be discussed where necessary to understand the business.

(b) requiring issuers to disclose known events that are reasonably likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments. The change would use a disclosure threshold of "reasonably likely," which is consistent with the SEC's guidance on forward-looking statements.

(c) requiring issuers to disclose the reasons underlying material changes in net sales or revenues.

(d) eliminating the requirement to disclose off-balance-sheet arrangement in a separately captioned section. However, issuers would still be required to disclose material off-balance-sheet arrangements as part of the capital resources discussion.

(e) eliminating the Tabular Disclosure of Contractual Obligations. However, issuers would be required to discuss material cash requirements as part of their capital resources disclosure.

While these changes relate to Regulation S-K, the SEC is proposing conforming changes to Form 20-F and Form 40-F.

XII. SEC Proposal to Expand Accredited Investor Definition

On December 18, 2019, the SEC proposed amendments to the definition of "accredited investor" as set forth in Rule 501(a) of the Securities Act of 1933. The proposed amendments would add new categories of natural persons that may qualify as accredited investors based on their professional knowledge, experience or certifications, and would also expand the list of entities that may qualify as "accredited investors."

The accredited investor definition is a central component of commonly used private placement exemptions from registration under the Securities Act, such as Rules 506(b) and 506(c) of Regulation D, and plays an important role in other federal and state securities law contexts.

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