

SEC Disclosure and Compliance Developments:
What You Need to Know Now

Welcome to the Securities Breakfast Briefing

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SEC Disclosure and Compliance Developments:
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DODD-FRANK WHISTLEBLOWER RULES



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Whistleblower Rules

Adopted by SEC to implement the Dodd-Frank Whistleblower provisions

The Dodd-Frank Whistleblower provisions are among the most far-reaching changes enacted by the Act, and could have unpredictable effects

SEC Chairman Mary Schapiro commented, “Too many people remain silent in the face of fraud,” and the new rules “are intended to break the silence of those who see a wrong.”

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The Whistleblower Bounty

- ❑ A bounty paid to a whistleblower who voluntarily provides “original information” about a possible federal securities law violation that has occurred, is ongoing, or is about to occur
- ❑ 10 to 30 percent of any monetary sanctions collected if they exceed \$1 million

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The Whistleblower Bounty

(cont'd)

- ❑ A whistleblower will become eligible for an award by:
 - voluntarily providing information not previously known to the SEC
 - that leads to a successful enforcement action
 - in which the SEC or authorities obtain monetary sanctions totaling more than \$1 million

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Time Limit for the Complaint

No more than 6 years after the violation; or 3 years after facts material to the right of action are known or should have been known by the employee should have known of violation but in no event may the action be brought more than 10 years after the violation.

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Original Information

“Original Information” = derived from independent knowledge or independent analysis; also **not**:

- Already known to SEC;
- Derived from hearing, government report, audit, or investigation; or
- Derived from news media

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Submission Process

- ❑ Whistleblower must either submit the complaint either:
 - Online, through the SEC's website www.sec.gov ; or
 - By mailing or faxing a Form TCR (Tip, Complaint or Referral) to the SEC Office of the Whistleblower
 - Copy of TCR form is at <http://www.sec.gov/about/forms/formtcr.pdf>
- ❑ Must declare under penalty of perjury that information, to best of whistleblower's knowledge, is true and correct

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Persons Excluded from Whistleblower Awards

The rules exclude certain individuals from receiving awards (with certain exceptions), including:

- ❑ officers, directors, trustees, or partners of an entity who learn information about misconduct from another person or in connection with the company's processes for identifying misconduct;
- ❑ employees whose main duties involve compliance or internal audit, or persons associated with a firm hired to perform similar functions; and
- ❑ employees of public accounting firms performing an engagement required by the securities laws.

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Calculating the Award

The SEC has discretion to determine the amount of an award based on certain criteria. Factors that may increase the amount of an award include:

- The significance of the information provided to the success of the action.
- The degree of assistance provided in the action.
- The "programmatic interest" in deterring violations by making awards to whistleblowers.
- The whistleblower's participation in internal compliance systems.

Factors that may decrease the amount of an award include:

- The whistleblower's interference with the company's internal compliance and reporting systems.
- The culpability of the whistleblower.
- Any unreasonable delay by the whistleblower in reporting information.

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DODD-FRANK WHISTLEBLOWER PROTECTION



A close-up photograph of a white financial calculator on the left, with several gold coins scattered on a document. The document has the word 'FINANCIAL' at the top and 'st for' and 'RKET' visible below. The background is a solid blue color.

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New Whistleblower Protections Under the Dodd-Frank Act

The Dodd-Frank Act prohibits retaliation by any employer because of any lawful act done by a whistleblower in:

- Providing information to the SEC or the CFTC in any "covered judicial or administrative action," defined as any judicial or administrative action brought by the SEC or the CFTC under the securities laws or the commodities exchange act laws, respectively, resulting in monetary sanctions exceeding \$1 million.
- Initiating, testifying in or assisting in any investigation or covered judicial or administrative action of the SEC or the CFTC.
- Making disclosure required or protected under other provisions of Federal law including SOX.
- Providing information regarding violations of the Dodd-Frank Act or any other provision of law that is subject to the jurisdiction of the Bureau of Consumer Financial Protection.

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New Whistleblower Protections Under the Dodd-Frank Act

(cont'd)

Sections 922 and 748 also create a private cause of action for whistleblowers who are the subject of retaliation for their whistleblowing activities to sue their employers. Claims can be brought directly in federal court and if successful, plaintiffs are awarded:

- Reinstatement.
- Costs.
- Fees.
- Back pay with interest.

The Dodd-Frank Act also creates a new whistleblower protection specific to financial services employees

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Case Studies in Whistleblower

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Case Study

- ❑ Botch, Inc. had problems with its accounting systems that led to some errors. Staff accountant Jane thinks there were deliberate manipulations, but she's not sure. She places an anonymous call on Botch's internal complaint line, but after 2 months she's heard nothing back, so she submits a complaint to the SEC whistleblower office.
- ❑ Later internal audit manager Sue tells accounting manager Fred they have a problem with a complaint. Fred thinks he knows the problem - Jane has always been a "troublemaker." Fred writes up Jane for some unrelated minor problems, re-assigns her to the least desirable position in the department and tells her she's on probation.
- ❑ Then Fred complains to audit committee chair Sam that unless Botch spends the money to get a new accounting system, the company is going to have big problems. Upon discovering all this, Sue tells Sam that Fred's right about the system but he shouldn't have re-assigned Jane without consulting HR and legal.

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Implementing an Effective Corporate Whistleblower Program



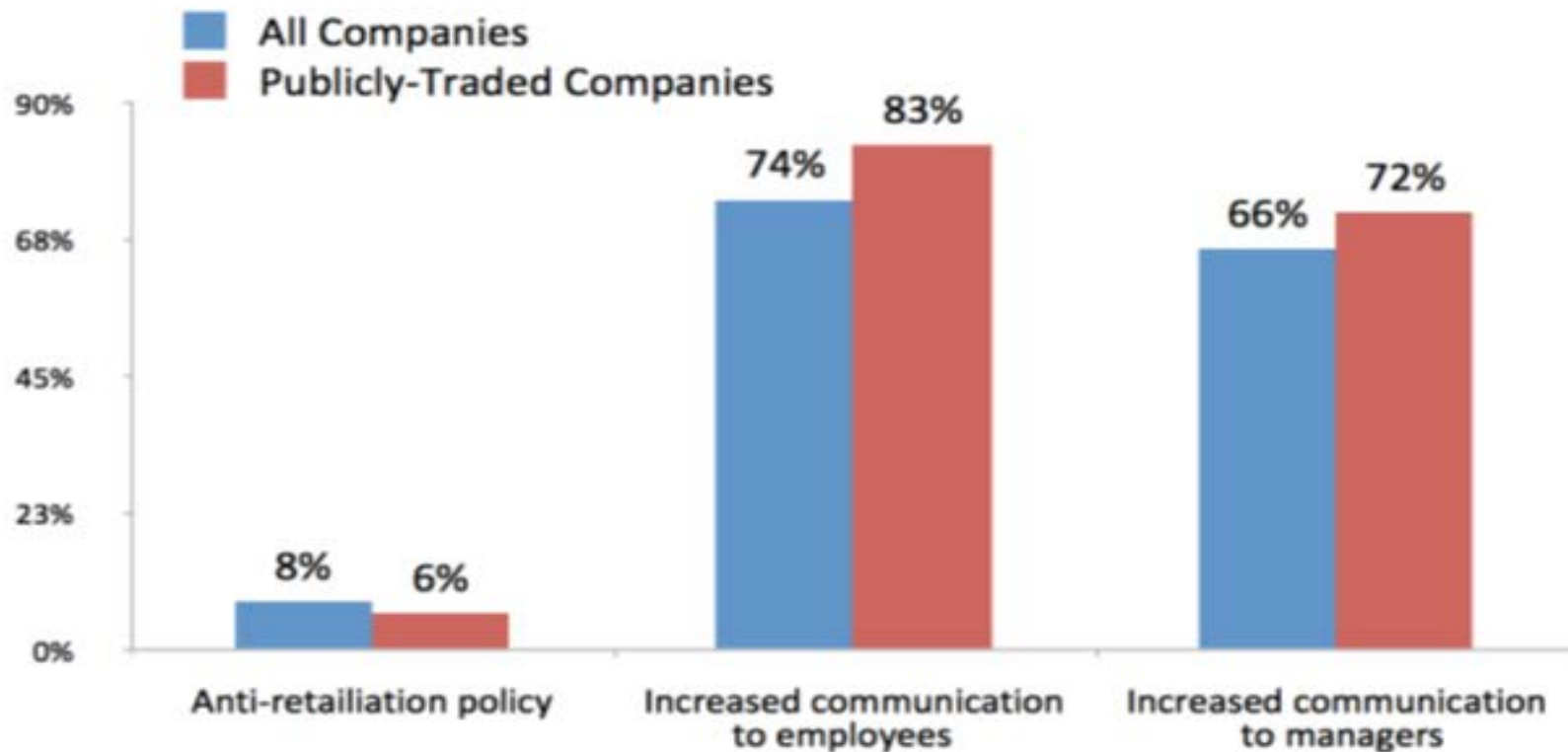
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Important Factors for an Internal Tips Hotline

- Tone at the top, and the middle!
- Ability to report anonymously
- No retaliation
- Perception that there will be no retaliation
- Clear and accessible communication about the program
- Simple, understandable process for reporting
- Process for objectively evaluating complaints

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Anticipated company changes as a result of Dodd-Frank



Society of Corporate Compliance and Ethics • corporatecompliance.org

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How to Respond to a Whistleblower Complaint

- Document everything and preserve evidence
- Objective person to run process
- Big challenge: who to tell
- Thorough investigation
- Maintain anonymity
- Take steps to prevent retaliation
- Consider informing WB of outcome (if appropriate)
- Ensure compliance with all applicable requirements:
laws and regulations; corporate governance and policy documents; stock exchange rules

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FORM 10-K UPDATES AND REMINDERS

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Form 10-K Planning

Some items to discuss:

- Cybersecurity guidance
- Contingencies
- Internal control
- Update to financial reporting manual
- Changes and disagreements with accountants
- MD&A
- Other frequent SEC comment topics

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SEC Cybersecurity Guidance

- ❑ Issued on 10/13/11
- ❑ Increasing risks and costs associated with cyber attacks and lack of security
- ❑ Review adequacy of disclosures
- ❑ Risk factor disclosure
 - consider probability of incidents
 - what costs and consequences?

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SEC Cybersecurity Guidance

(cont'd)

- ❑ MD&A
 - known trends and uncertainties
 - increases to expenditures
- ❑ Legal proceedings – any material proceedings regarding cyber attacks?
- ❑ Business – impact on business segments

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Costs of Cyber Attacks

Cyber attacks may cause substantial costs and other negative consequences, including:

- Liability for stolen assets or information and repairing system damage that may have been caused.
- Remediation costs may also include incentives offered to customers or other business partners in an effort to maintain the business relationships after an attack;
- Increased cybersecurity protection costs that may include organizational changes, deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants;
- Lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack;
- Litigation; and
- Reputational damage adversely affecting customer or investor confidence.

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Loss Contingencies Status Update

- ❑ FASB deferred action on proposed standard to supersede old FASB No. 5
- ❑ SEC staff discussed loss contingency issues at 2011 AICPA conference
 - Lack of disclosure for reasonably possible losses
 - Omission of loss estimate due to lack of certainty
 - Inconsistencies with other external communications
 - Lack of historical disclosures when settlements disclosed
 - Lengthy factual recitations

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GAAP Requirement: ASC 450, Contingencies

Disclose:

- Nature of the contingency
- Amount or range of reasonably possible losses in excess of amount accrued

Note: Lack of precision and confidence in estimate does not justify absence of disclosure

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**SEC Requirement:
S-K Item 103, Legal Proceedings**

Disclose certain facts of the material pending legal proceeding:

- Name of court
- Date instituted
- Principal parties
- Description of matter
- Relief sought

MD&A discussion also may be required

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SEC Requirement: Disclosures of Loss Contingencies

- ❑ SEC staff comments suggest they are skeptical of:
 - The reasonably possible loss extending to the amount claimed
 - Estimates not changing over time
 - Estimates that cannot be made even though the contingency is close to being satisfied

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New CDIs re Changes in and Disagreements with Accountants (July 2011)

If the former auditor did any of the following, it would be a “reportable event” for the Form 8-K, Form 10-K and proxy statement:

- advised the company that critical internal controls did not exist (even if the deficiency was subsequently remediated) [111.03]
- told the company there was a material weakness [111.04]
- gave an adverse opinion on internal control [111.06]
- issued a going concern opinion (treated similarly to other report modifications) [111.05]

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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 disclosures

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Update to SEC Financial Reporting Manual

During 2011 the SEC updated the Financial Reporting Manual for the following topics:

- Presentation of other comprehensive income
- Prospectus updating requirements for shelf offerings
- Acquisition and disposition by consolidated variable interest entities
- Subsidiary guarantee release provisions
- Reporting considerations in reverse acquisitions

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Additional Form 10-K Reminders

- XBRL
 - Detail tagging requirement
 - New 2011 US GAAP taxonomy
- Material agreements
- Certifications
- Auditor consents

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SEC Comment Process



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Levels of SEC Reviews

- Full review
- Financial statement review
- Targeted review

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Types of Comments

- Revise your financial statements
- Revise your disclosure
- Provide additional disclosure
 - Future filings vs. amend a past filing
- Your filing is too deficient to review
- Provide additional information
- No further comments

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Areas of SEC Comment Focus

- Management's Discussion and Analysis (MD&A)
- Executive compensation
- Compensation Discussion and Analyses (D&A)
- Internal controls
- Income taxes
- Contingent liabilities
- State sponsored terrorism
- Revenue recognition
- Goodwill impairments
- Going concern issues

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SEC Comment Letter Analysis

		2011*	2010	2009
1	MD&A	21%	12%	19%
2	Executive compensation & corporate governance	11%	18%	18%
3	Pro-forma	8%	7%	4%
4	Segment reporting	6%	1%	3%
5	Revenue recognition	5%	5%	5%
6	Equity	3%	5%	3%
7	Business combinations	3%	3%	4%
8	Non-GAAP measures	3%	2%	4%
9	Commitments & contingencies	3%	1%	2%
10	Oil and gas disclosures	3%	1%	0%

* 2011 figures are through August 31

Source: Grant Thornton

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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

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Frequent SEC MD&A Comments

- Explain the business reasons for trends
- Critical accounting estimates
 1. Discuss factors that cause variability in the estimates
 2. Discuss assumptions used
- Results of operations – discuss key drivers of changes
 - Quantify all causes for changes in key metrics
- Going concern
 1. What circumstances led to the going concern opinion
 2. How will we get out of this mess
- Address the need for capital and key liquidity indicators

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Comment Letter Trends – Income Taxes

- Discuss underlying factors included in net income tax
- Rate reconciliation
- Reversal of accrued taxes
- Events triggering adjustment to accrued taxes
- Considerations around valuation allowances
- FIN 48
 - Address whether it is reasonably possible that total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months.
 - Evaluation of impact of uncertain tax positions on contractual obligations (Item 303(b) of Regulation S-K)
- Indefinite reinvestment of foreign earnings (“trapped” cash)

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Comment Letter Trends – CD&A

- Describe the material elements of the compensation
- Provide an analysis of how the Company determined the particular levels and forms of compensation
- Explain the significant disparity of awards between executives
- Disclose any targets or formulas used to determine the compensation
- To the extent performance related factors could cause competitive harm, registrants are required to disclose how difficult it will be to achieve target levels
- Provide an explanation of why the Company believes the information could be excluded due to competitive harm
- Identify all of the companies that have been considered for purposes of benchmarking
- Discuss whether or not compensation policies are reasonably likely to cause management to take excessive risks which may have a material adverse effect (if not, state that fact)

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Goodwill Impairment – Areas of Staff Comment

Provide more disclosure in:

- Basis for determining reporting units
- Key assumptions need for testing
- Specific facts giving rise to impairment
- Sensitivity analysis
- Reporting units likely to have an impairment in next 12 to 24 months

A close-up photograph of a white financial calculator on the left, with several gold coins scattered on a document. The document has the word 'FINANCIAL' at the top and 'MARKET' at the bottom. The text 'Busy doing n' is also visible on the document.

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Sample SEC Comments – CD&A

In future filings, please provide more information regarding how you determined the amount of annual cash incentive compensation to pay each name executive officer. See Item 402(b)(1)(v) of Regulation S-K. Specifically, please disclose the actual EVA and target EVA, including the relevant numbers for determining these amounts pursuant to the formulas disclosed on pages 24 and 25, and how you evaluated the actual results achieved against the performance goals to determine the amount of compensation to award the named executive officers. Refer to Item 402(b)(2)(v) of Regulation S-K. Additionally, we note that targets are established for each operating unit and for the company as a whole. Please disclose whether the target annual incentive percent for each named executive officer is related to the performance goal for an operating unit, the company, or both. Using information for your most recently completed fiscal year, please show us in your response what your revised disclosure will look like.

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Sample SEC Comments – ICFR and DCP

We note your disclosure of several deficiencies that aggregate to a material weakness in internal control over financial reporting as a result of the accounting errors and irregularities discovered at the . . . business unit. Please tell us whether you reconsider the adequacy of management's previous conclusions regarding the effectiveness of disclosure controls and procedures and additionally, internal control over financial reporting as of [the current year-end] as previously disclosed in your Form 10-K filed.

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Sample SEC Comments – ICFR and DCP *(cont'd)*

We note that you indicate that you are a well-known seasoned issuer on the cover page of your Form 10-K. We also note that it appears that you failed to timely file two Forms 8-K [P]lease explain what consideration, if any, management gave to these late filings in concluding that your disclosure controls and procedures were effective as of the period presented.

We note that you identified a material weakness . . . related to the revenue cycle and your belief that you effectively remediated this material weakness as of [the current year-end]. Please explain to us: (i) what [the controls represent] and the purpose of such controls; (ii) who discovered the material weakness and how it was discovered; (iii) the nature of the material weakness, and how it affected the revenue cycle and your recognition of revenue; (iv) how long the material weakness existed; and (v) whether or not any adjustments to previously reported revenue were identified and made as a result of the material weakness, and if not, the basis for your conclusion that no adjustments were necessary.

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Sample SEC Comments – Exhibits

We direct your attention to Item 601(b)(10) of Regulation S-K. Please confirm that all material contracts have been filed. We note, in particular, that it does not appear that the agreements with your customer from whom you derive 10 percent or more of your annual total consolidated revenues [have been filed]. If you do not believe that such contracts fall within the purview of Item 601(b)(10), please explain why.

A close-up photograph of a financial magazine with the word 'FINANCIAL' at the top and 'MARKET' at the bottom. Several gold coins are scattered on the magazine's surface. To the left, a portion of a white calculator is visible.

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Sample SEC Comments – State Sponsored Terrorism

Please describe to us the nature and extent of your past, current, and anticipated contacts with Iran, Sudan, and Syria, if any, whether through subsidiaries, strategic partners, distributors, resellers, or other direct or indirect arrangements. Your response should describe any products, technology, software, or services that you have provided into Iran, Sudan, or Syria, directly or indirectly, and any agreements, commercial arrangements, or other contacts you have had with the governments of those countries or entities controlled by those governments.

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Sample SEC Comments – Guarantors

We note that . . . your domestic subsidiaries will guarantee the debt issued by [Parent Company]. Please note that at the time of its effectiveness, your registration statement must comply with the financial statement requirements for subsidiary guarantors set forth in Rule 3-10 of Regulation S-X. Please tell us how you intend to comply with these requirements. For additional guidance please see Release No. 33-7878.

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Sample SEC Comments

Please tell us what consideration you gave to providing a discussion of the need to repatriate undistributed earnings of foreign subsidiaries and the associated potential tax impact. We refer you to Item 303(a)(1) of Regulation S-K and Section IV of SEC Release 33-8350.

Please provide us with and confirm in future Exchange Act filings you will revise your disclosure here to quantify the impact of underlying variances (e.g. currency fluctuations, price increases, cost savings from your Seed to Feed initiative, supply chain, etc) to be consistent with the information provided in your quarterly earnings conference calls.

SEC Disclosure and Compliance Developments: What You Need to Know Now

Sample SEC Comments

(cont'd)

In future filings, please revise to include here the estimated amount spent during each of the last three fiscal years on company-sponsored research and development activities determined in accordance with generally accepted accounting principles. Refer to Item 101(c)(1)(xi) of Regulation S-K.

We note your disclosure in the first paragraph of this section of “[s]et forth below are certain risk factors related to the Company’s business. The risk factors described below may not include all of the risk factors that could affect future results.” All material risks should be discussed in this section. In future filings, please revise this paragraph to clarify that you have discussed all known material risks.

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SEC Disclosure and Compliance Developments: What You Need to Know Now

Sample SEC Comments

(cont'd)

We note your disclosures regarding various contingencies, both general and specific. If there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred, you must either disclose an estimate (or, if true, state that the estimate is immaterial) of the additional loss or range of loss, or state that such an estimate cannot be made with respect to your financial statements as a whole. Please refer to ASC 450-20-50 and Interpretive Response to Question 2 of SAB Topic 5Y.

We note your disclosure of “International” revenue and long-lived assets. Please tell us whether there are any individual countries to which material amounts of revenue or long-lived assets are attributable and what consideration was given to disclosing this information pursuant to ASC 280-10-50-41.

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Sample SEC Comments – Liquidity and Capital Resources

Please discuss your plans if you are not able to either refinance your maturing debt or have access to additional credit to meet your long-term liquidity needs. We note that your current credit ratings may impair your ability to raise additional capital under acceptable terms and conditions. Please provide us with your proposed disclosures.

Please revise your analysis of cash flows to provide your investors with insight into why your cash flows change from period to period, rather than simply repeating the numbers seen on the face of your cash flow statement. Refer to Section IV.B. of our Release 33-8350.

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Frequent SEC Staff Comments for Smaller Reporting Companies (SRC)

- MD&A – need more analysis
 - See discussion above and sample comment letters
- Internal control over Financial Reporting (ICFR)
 - “Effective” DC&P conclusion when ICFR conclusion is “ineffective”
 - “Adequate” or “Effective except for . . .” are inappropriate
- Certifications – conform to SEC format
- Business combinations – purchase price allocation and contingent consideration
- Equity transactions – fair value determination
- Related party transactions