Preparing Your 2018 Form 20-F

December 17, 2018

This memorandum highlights some considerations for the preparation of your 2018 annual report on Form 20-F. As in previous years, we discuss both disclosure developments and continued areas of focus for the U.S. Securities and Exchange Commission (**SEC**). In addition, we highlight certain U.S.-related enforcement matters and other developments of interest to foreign private issuers (**FPIs**).

Disclosure Developments for 2018 Form 20-F

There have been a few updates to the Form 20-F requirements this year, including those stemming from the SEC's updated disclosure rulebook.

SEC's Updated Disclosure Rulebook

On August 17, 2018, the SEC finalized a **series of amendments** to its rules and forms designed to eliminate requirements that have become *"redundant, duplicative, overlapping, outdated, or superseded"* in light of other SEC or GAAP disclosure requirements and changes in the information environment. With one or two exceptions, the review did not result in significant changes to remove disclosure that many view as unnecessary for lack of materiality. Many of the changes reflected in the amendments merely clean up references or cross-references that have become outdated as accounting terminology has changed (such as replacing references to "income statement" with "statement of comprehensive income" and removing the concept of "extraordinary" charges) or as the SEC has over time revised its various forms and rules. Please also see our **Client Memorandum** on this topic. The changes became effective on November 5, 2018. Some of the relatively notable changes are as follows:

- *Ratio of Earnings to Fixed Charges*. FPIs that register debt or preference equity securities are no longer required to disclose the historical and pro forma ratios of earnings to fixed charges and combined fixed charges and preference dividends to earnings, respectively, or to file an exhibit setting forth the computation of any ratio of earnings to fixed charges.
- *Market Price Information*. Since daily market prices and daily historical data of most publicly traded common equity securities are readily available on the internet, companies will no longer need to disclose high and low trading prices for their common stock in the last two years. Instead, Item 9.A.4 of Form 20-F now only requires FPIs to identify the principal host market(s) and principal market(s) outside the principal host market and corresponding trading symbol(s) for those markets for each class of the registrant's common equity. If significant trading suspensions occurred in the prior three years, they must be disclosed and if the securities are not regularly traded in an organized market, information must be provided about any lack of liquidity.
- *Research and Development Disclosure*. Item 5.C of Form 20-F previously required FPIs to disclose the amount spent on company-sponsored research and development (R&D) activities. This is no longer necessary, as FPIs are already required to disclose the amount of research and development expenses in the notes to the financial statements.
- *References to SEC's Website*. Form 20-F now requires references to the SEC's website and a statement that electronic SEC filings are available there.
- *References to Company's Website.* FPIs are now required (whereas they were previously encouraged) to disclose their website addresses in their Form 20-F.

- *Exchange Rate Data*. FPIs are no longer required to provide exchange rate data in their Form 20-Fs when financial statements are prepared in a currency other than the U.S. dollar as exchange rate information is readily available free of charge on the internet.
- *Dividend Restrictions*. Item 10.F and Item 14.B of Form 20-F no longer require disclosure of any dividend restrictions and limitations on the payment of dividends, respectively, because such restrictions and limitations are required to be disclosed under U.S. GAAP, IFRS or elsewhere in Form 20-F.
- *Earnings Per Share Calculation*. The requirement to disclose the computation of earnings per share in annual filings (to be filed as an exhibit) was deleted in Instruction 6 to "Instructions as to Exhibits" of Form 20-F. However, it continues to be a requirement under U.S. GAAP and IAS 33.

XBRL and Related Changes to Form 20-F

As discussed in our **Prepare Your 2017 Form 20-F** memorandum, in March 2017 the SEC **proposed amendments** to change eXtensible Business Reporting Language (**XBRL**) data formatting to Inline XBRL for operating company financial statement information and mutual fund risk/return summaries. Inline XBRL allows tagging information within an HTML document rather than in a separate document file. XBRL requirements apply to operating companies that prepare their financial statements in U.S. GAAP or in accordance with International Financial Reporting Standards (**IFRS**). As a consequence, with effect from September 17, 2018, the new Inline XBRL rules also led to conforming changes to the cover page of Form 20-F (i.e., references to Interactive Data Files being "posted" were removed).

We further discussed in our **Prepare Your 2017 Form 20-F** memorandum that the SEC **specified** the long-awaited taxonomy (i.e., the electronic dictionary of business reporting data) used for XBRL reporting applicable to IFRS and adopted rules requiring hyperlinks to filed exhibits listed in the exhibit indexes of most SEC current and periodic reports and registration statements, including Form 20-F. While the rules generally became effective for filings submitted on or after September 1, 2017, smaller reporting companies and non-accelerated filers are only required to comply with the rule since September 1, 2018, which requires filings to be submitted in HTML.

FPIs who were first-time XBRL filers with respect to the fiscal year ending on or after December 15, 2017 are no longer permitted to take advantage of the one-time 30-day grace period afforded to first-time filers.

SEC Disclosure Focus Areas

SEC Guidance on Cybersecurity Disclosure

On February 21, 2018, the SEC approved a statement and updated its **interpretive guidance** on cybersecurity disclosure, to assist public companies in preparing disclosures about cybersecurity risks and incidents by providing more detailed guidance, by advising companies to ensure that their disclosure controls and procedures take account of cybersecurity risks and by noting the implications of cybersecurity incidents for insider trading prohibitions and Regulation FD compliance.

The updated guidance does not create a new line-item disclosure requirement and, like the **2011 staff guidance**, takes a principles-based approach that disclosure of cybersecurity risks and incidents should be assessed in light of overall materiality. It notes that while detailed disclosure of technical information about systems and vulnerabilities is not necessary, companies should consider disclosure of, among other things:

- prior occurrences of cybersecurity events (the guidance notes that it may be inappropriate to disclose the risk of such events without mentioning actual occurrences);
- the probability and potential magnitude of cybersecurity events; and
- limits on the company's ability to prevent or mitigate such events.

The SEC notes that initial disclosure of an incident may be required before all relevant facts are available, and cautions that the fact that an internal investigation is ongoing would not by itself be a permissible basis for delaying otherwise required disclosure of a material event. The guidance also addresses the need to revisit or refresh prior disclosure during investigation of a cybersecurity incident and reminds companies that they may have a duty to correct or update disclosure in light of subsequent developments.

The updated guidance does not create any new control requirement relating to cybersecurity risk, but it does note that disclosure controls and procedures must be designed to identify cybersecurity risks and incidents, assess their impact on the business, and facilitate the flow of information concerning such risks and incidents to senior management responsible for disclosure decisions and certifications. Accordingly, when a company discloses its conclusions with respect to the effectiveness of disclosure controls and procedures, the conclusions should be informed by management's consideration of cybersecurity risks and incidents, although a specific reference to cybersecurity in the conclusions is not required. The SEC also notes that public company principal executive and financial officers responsible for certifying effectiveness of disclosure controls and procedures should take into account the degree to which the effectiveness of such controls and procedures may be impacted by cybersecurity risks.

See our **Client Memorandum** for further information. Please also note the SEC's enforcement actions with respect to cybersecurity cases which we discuss below.

SEC Guidance on Non-GAAP Financial Measures

In our **Prepare Your 2017 Form 20-F** memorandum we discussed the SEC's updated non-GAAP financial measures guidance given in its **Compliance and Disclosure Interpretations** (**C&DIs**) with respect to the exemption from Regulation S-K Item 10(e) and Regulation G for financial measures included in forecasts provided to a financial advisor and used in connection with a business combination transaction. These C&DIs affect filings made in connection with business combination transactions rather than Form 20-F. On April 4, 2018, the SEC further updated the C&DI to address such forecasts being provided to the board of directors or board committee (question 101.02) and bidders in a business combination transaction (question 101.03).

At the 2018 SEC Speaks, the SEC's staff branch chiefs also discussed non-GAAP measures and metrics:

- While noting that the staff has seen improved disclosures since the release of the 2016 non-GAAP C&DI, areas that warrant continued attention include tailored accounting principles, equal or greater prominence and non-GAAP measures that are similarly titled to GAAP measures.
- The majority of issues with tailored accounting principles relate to revenue recognition but C&DI question 100.04 applies more broadly to the use of non-GAAP recognition and measurement principles that are substituted for GAAP, including unique inventory valuation methodologies and unique consolidation methodologies. IFRS filers should be similarly mindful of SEC concerns regarding the use of alternative accounting principles in lieu of what IFRS requires.
- The staff continues to question any presentation that emphasizes the non-GAAP metric. Titles of non-GAAP measures cannot be similar to GAAP measures; instead, the prefix "Non-GAAP" or "Adjusted" should be used.
- Companies should clearly define each metric used and explain how it is calculated, discuss any material limitations associated with each metric, describe any important assumptions, present a balanced discussion that ties back to as-reported GAAP or IFRS amounts (e.g., how do metrics relate to revenue) and consider providing metric information separated by segment, geography or revenue stream.

SEC Intends to Move Forward with FAST Act Rule Release Affecting Redactions

In October 2017, the SEC **proposed rules** to implement its mandate under the FAST Act to modernize and simplify disclosure. At the 2018 Practicing Law Institute's Annual Institute on Securities Regulation, William Hinman, Director of the SEC's Division of Corporation Finance, expressed the SEC staff's plans to move forward with the FAST Act rule release. Of particular interest is the proposed new approach to confidential treatment of certain documents and information. Currently, if a company wants to redact portions of its public filings, it has to file a request with the SEC. Under the proposed FAST Act rule, companies will be allowed to redact certain portions of filings by omitting, without submitting a confidential treatment request, (i) schedules and attachments that are not material, (ii) personally identifiable information, and (iii) confidential information in material contract exhibits that is both (x) not material and (y) competitively harmful if publicly disclosed. For material contract exhibits, the SEC would continue its selective review of filings and would assess whether redactions appear to fulfill these requirements. Upon the SEC's request, companies would have to provide supplemental materials, including unredacted paper copies and an analysis of why the redacted information is not material and would cause competitive harm if disclosed. The SEC could request the filing of an amendment if the supplemental materials do not support the redactions.

Hot Topics to Consider When Preparing Risk Factors and Other Disclosure

Brexit

The United Kingdom's decision to leave the European Union following a referendum in June 2016 (**Brexit**) has in the past two years caused many companies located or doing business in Europe to update their disclosure and discuss Brexit, particularly with respect to risk related to Brexit's potential impact on the global economy, international trade, production and supply chains, European regulation, availability of qualified employees and other aspects of a company's business operations. In light of the UK's withdrawal from the EU scheduled to become effective on March 29, 2019 and ongoing uncertainty as to whether the withdrawal agreement reached with the EU, or a variation thereof, will be approved by the UK parliament, companies with an EU nexus should continue to consider a discussion of Brexit when preparing their disclosure. In particular, risk factors should be reviewed in light of Brexit depending on the final outcome of the UK/EU negotiations.

SEC Chairman Jay Clayton, speaking at a recent meeting hosted by Financial Executives International, said that the SEC will be focusing on companies' disclosure about Brexit. Clayton expressed his views that the potential risk stemming from Brexit has been understated. In addition, at a recent financial reporting conference, Kyle Moffat, Chief Accountant at the SEC's Division of Corporation Finance stated that the SEC will be focused on Brexit disclosure and will be looking for "tailored disclosure describing not only the risks associated with Brexit but also the potential impact on the business."

Legal and Other Developments

Recent legal developments with more than just national implications included the United States' tax reform in January 2018 and the European Union's new General Data Protection Regulation (**GDPR**), which became effective in May 2018. Companies with business operations in the United States and Europe, respectively, should consider the impact the U.S. tax reform (and related U.S. Treasury regulations and administrative guidance) as well as the GDPR had, and may have, on their business and update disclosure accordingly.

Companies with lending facilities or securities tied to, or exposure to LIBOR should also consider appropriate risk factor language, fallback mechanisms and other disclosure necessary to reflect the discontinuation of LIBOR after 2021. Risks could also arise from the need to renegotiate lending and Swap/ISDA arrangements or even indentures, which can be difficult and costly to obtain.

Companies should also consider recent developments with respect to tariffs and other global trade barriers when preparing their disclosure. The U.S. administration's decisions throughout 2018 to increase certain tariffs as well as other countries' reactions and countermeasures, particularly in the European Union and the People's Republic of China, and such developments' impact on the global economy and a company's business operations should be evaluated and, if necessary, reflected in updated disclosure.

Enforcement Matters

SEC Enforcement Action regarding Cyber Incidents

On April 24, 2018, the SEC charged Altaba Inc., formerly Yahoo! Inc., with misleading shareholders by waiting almost two years to disclose its 2014 data breach. Consenting to a cease-and-desist order, Altaba agreed to pay a $35 million penalty in the first SEC enforcement action against a public company relating to cyber breach notification. The SEC's action follows a trend by state attorneys general and other regulators in exacting significant penalties from companies that fail to provide timely breach notification. The **SEC's order** provides helpful insight into when it will view a company's cybersecurity disclosures as warranting enforcement action. See our **Client Memorandum** for more information.

On October 16, 2018, the SEC issued a **Section 21(a) report of investigation** emphasizing the importance of assessing the likelihood of cyberattacks when designing internal accounting controls and conducting training for personnel responsible for their implementation. The SEC warned that internal accounting controls "*may need to be reassessed in light of emerging risks, including risks arising from cyber-related frauds.*" The report thus effectively serves as notice that in the future, a company experiencing a cyber-event could later find itself subject to an SEC enforcement proceeding for inadequate controls. Our Client Memorandum on this topic can be found **here**.

SEC Charged SeaWorld for Misleading Investors

On September 18, 2018, the SEC announced in a **press release** that SeaWorld Entertainment Inc. and its former CEO have agreed to pay more than $5 million to settle fraud charges for misleading investors about the impact the documentary "Blackfish" had on the company's reputation and business. The SEC's complaint alleged that from approximately December 2013 through August 2014 the company and its former CEO made untrue and misleading statements or omissions in SEC filings, earnings releases and calls, and other statements in the press about the documentary's impact. According to the SEC's complaint, when SeaWorld first acknowledged that its declining attendance (which had been previously disclosed) was partially caused by negative publicity, the company's stock price fell, causing significant loss to shareholders.

Other Matters That May Be of Interest to FPIs

Modernized Property Disclosure Requirements for Mining Registrants

On October 31, 2018, the SEC adopted **final rules** modernizing disclosure requirements for companies with material mining operations (excluding oil and gas) as part of its ongoing "disclosure effectiveness initiative" launched in 2013. The rules will implement extensive changes to the existing disclosure regime and are intended to align U.S. disclosure requirements more closely with current industry and global regulatory practices and standards, specifically the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). The rules will replace the SEC's 30-year old Industry Guide 7 with a single standard applying to SEC filings by companies with mining operations that are material to their business or financial condition, and will cover U.S. companies as well as foreign private issuers that file reports with the SEC. Generally, we believe the changes are welcome and bring U.S. practice into line with practice elsewhere, although there are some aspects of the new regime that are problematic.

The final rules provide a two-year transition period so that a registrant will not be required to begin to comply with the new rules until its first fiscal year beginning on or after January 1, 2021. A company may voluntarily comply with the new rules prior to the compliance date, subject to the SEC's completion of necessary EDGAR programming changes. Please also see our **Client Memorandum** for further information.

PCAOB Rule Expanding Auditor's Report

As discussed in our **Prepare Your 2017 Form 20-F**, on October 23, 2017, the SEC **approved** a new PCAOB **audit standard** that requires the auditor's report to identify and discuss critical audit matters (**CAMs**) encountered in the audit, and on December 4, 2017, the PCAOB **published staff guidance** on implementing these changes to the auditor's report. A CAM is defined as a matter that was communicated or required to be communicated to the audit committee, and that (a) relates to accounts or disclosures that are material to the financial statements and (b) involves especially challenging, subjective or complex auditor judgment. The new CAM disclosure requirements, applicable to audit reports filed by FPIs, apply to large accelerated filers beginning with fiscal years ending on or after June 30, 2019, and to others beginning with fiscal years ending on or after December 15, 2020.

The new audit standard also moves the auditor's opinion paragraph on fair presentation to the lead section and includes section titles to improve readability. Revisions to the content of the auditor's report include the addition of a statement that the auditor is required to be independent, the inclusion of shareholders and directors (or their equivalents, as well as any other addressee parties) as addressees and new standardized language about the role and responsibilities of the auditor.

For further information see our Client Memoranda **PCAOB Adopts New Standard Expanding Auditors' Reports** and **SEC Approves PCAOB Rule Expanding Auditor's Report**.

SEC Lowers Threshold to Qualify as a Smaller Reporting Company

As part of the SEC's continuing effort to streamline disclosure for smaller companies, it announced on June 28, 2018 that it had adopted a final rule to relax the thresholds required to qualify as a "smaller reporting company." Many newly public companies and other existing registrants will fit within the new definition of smaller reporting company and will be able to take advantage of more abbreviated disclosures in their periodic filings. See our **Client Memorandum** for more information.

FinCEN's New Customer Due Diligence Rule

On May 11, 2018, the U.S. Financial Crimes Enforcement Network's (**FinCEN**) new **Customer Due Diligence Rule** (**CDD Rule**) became effective. Under the CDD Rule, financial institutions are required to identify, and verify the identity of, key individuals (i.e., "beneficial owners") who own or control legal entity customers of the financial institutions and to obtain a certification from the legal entity customers as to their beneficial owners (the "beneficial ownership requirement"). The beneficial ownership requirement applies whenever a new account is opened.

The definition of "beneficial ownership" includes the "control prong" – requiring financial institutions to identify a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer, a senior manager or any other individual who regularly performs similar functions – and the "ownership prong" – requiring financial institutions to identify each individual (if any) who directly or indirectly owns 25% or more of the equity interests of a legal entity customer (financial institutions may opt to use a beneficial ownership threshold lower than 25%).

For further information, see FinCEN's **FAQs** as well as a **memorandum** published by the Securities Industry and Financial Markets Association in the United States (SIFMA).

Toshiba: Ninth Circuit Holds Morrison Does Not Preclude Claims Against Issuers With Unsponsored ADRs

On July 17, 2018, the U.S. Court of Appeals for the Ninth Circuit issued a **decision** holding that an overseas company with unsponsored ADRs trading in the United States on the over-the-counter market could be subject to claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. As explained in our **Client Memorandum**, the decision eliminates, at least within the Ninth Circuit, the distinction between sponsored and unsponsored ADR programs with respect to the territorial reach of Section 10(b) and could result in expanded securities law liability for overseas companies whose ADRs trade in the United States.

New Accounting Standards

At the 2018 SEC Speaks, the SEC's staff discussed certain matters related to new accounting standards:

- The staff called attention to new and updated discussion in the Financial Reporting Manual about adoption dates for the new revenue recognition standard (ASC Topic 606) for emerging growth companies and public business entities. The staff clarified that registrants who adopt the standard on a full retrospective basis do *not* have to restate the first two years of the five-year selected financial information but should disclose the lack of comparability between the two groups of periods. See IFRS 15 for the International Accounting Standards Board's (**IASB**) guidance on revenue recognition.
- Equity investees and other public business entities are permitted to have different transition dates and methods from the registrant and registrants are *not* required to re-compute the significance tests in Rule 3-05 and Rule 3-09 of Regulation S-X. However, pro forma financial information for business combinations would need to be conformed to the registrant's transition dates and transition methods.
- The new accounting standard for leases will bring many leases on the balance sheet as a right of lease asset and lease liability. Companies should take care to identify all contractual arrangements that are leases in substance, including contracts that contain both lease and service components.

IASB Clarifies Definition of "Material"

On October 31, 2018, the IASB updated its definition of "material" to make it easier for companies to make materiality judgements in the context of IFRS Standards. Under the new definition, information is material "*if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity*." The changes are effective from January 1, 2020, but companies can decide to apply them earlier.

Information Relevant to U.S. Public Securities Offerings

SEC Filing Fee Decrease

Effective October 1, 2018, the fee to register securities with the SEC will decrease to $121.20 per million dollars. The SEC's fee rate advisory press release can be found **here**.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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