

12 Common 10-K Mistakes — And How To Find Them

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So, fortune has smiled upon you. A partner has handed you a draft Form 10-K for a client and asked you to do a “rule check” or “form check” to confirm that no required disclosures are missing.

Most often, the Form 10-K template for a reporting company has evolved over a number of years, with significant input from the company’s accounting and legal professionals, and is generally in pretty good shape.

However, mistakes get made — and it’s your job to find them!

Here is a list of 12 items that even seasoned reporting clients frequently omit or prepare incorrectly when drafting the Form 10-K.

All references to Part [●], Item [●] are to Form 10-K and all references to Item [●] are to Regulation S-K.

1. Financial Information About Geographic Areas

Item 101(d)(1) requires companies to disclose in Part I, Item 1 (business), for each of the last three fiscal years (or such shorter time as the company has been in existence), (1) revenues from external customers attributable to domestic and foreign operations and (2) long-lived assets (other than certain specified assets) that are located domestically and in all foreign countries. Information for individual foreign countries is also required, if material.

The disclosure required by Item 101(d) is frequently omitted in the body of the Form 10-K, though it may appear in the notes to financial statements. Assuming the required information is set forth in the notes to financial statements, it is easy to comply with Item 101(d) by including a simple cross-reference to the applicable note(s), in accordance with the last sentence of Item 101(d)(2).

2. Risk Factors

Item 503(c) requires the risk factors set forth in Part I, Item 1A to be “concise and organized logically,” and also that companies should not present risks that could apply to any company. Frequently, a company’s risk factors will not comply with Item 503(c) because they are too long — sometimes a page or more. Such risk factors can and should be tightened up. This can potentially be done with cross-references to Form 10-K sections with duplicative disclosures, such as the business and management



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discussion and analysis (MD&A) sections. Companies should also consider deleting risk factors that are universally applicable to all companies, such as outbreaks of war or acts of God, unless the company's situation is somehow special, in which case that special situation should be described appropriately (e.g., headquarters located on the San Andreas Fault).

3. Description of Property

In Part I, Item 2 (properties), it is not enough to identify the company's material properties. Pursuant to Item 102, you also must make sure to indicate whether the company owns or leases these properties, as well as any major encumbrances on such properties.

For property owned in fee simple that is subject to a mortgage, you should indicate the amount of the applicable loan and material terms of the loan, such as the maturity date and interest rate. For property that is leased, you should indicate the term of the lease and other material terms, such as renewal options.

4. Market Price Information

In Part II, Item 5 (market for registrant's common equity and related stockholder matters), companies with shares listed on an exchange are required to present high and low sales prices for the two most recent fiscal years, while companies with shares not listed on an exchange are required to present high and low bid information for such periods.

You should check the prices in the chart against the prices as reported on Yahoo! Finance or Google Finance (or similar service) to confirm that the company did not accidentally make the common mistake of including high and low closing prices.

5. Restrictions on Payment of Dividends

Most companies have some form of credit facility, and almost every credit facility has negative covenants that materially limit the borrower's ability to pay dividends and otherwise effectuate distributions and redemptions. That said, many companies forget to disclose these restrictions in Part II, Item 5, as required by Item 201(c)(1), or to cross-reference to MD&A or the notes to financial statements if responsive disclosure is separately located there. Such cross-references are expressly permitted by Item 201(c)(1).

6. Issuer Purchases of Equity Securities

In Part II, Item 5, when presenting the issuer purchases of equity securities table required by Item 703, many companies forget to indicate in a footnote to the table when a particular share repurchase plan was "announced," as required by instruction 2.a. to Item 703(b)(3).

7. Compensation Plan Table

The compensation plan table required by Item 201(d) is often, but should not be, presented in Part II, Item 5. Instead, it should appear in Part III, Item 12 (security ownership of certain beneficial owners and management and related stockholder matters), which section is usually included in the company's proxy statement and incorporated by reference into the Form 10-K pursuant to general instruction G(3). See compliance and disclosure interpretation question 106.01.

8. Selected Financial Data

In the presentation of selected financial data for Part II, Item 6, companies frequently forget to include one or more of the following line items required by instruction 1 to Item 301.

- Net sales or operating revenues;
- Income (loss) from continuing operations;
- Income (loss) from continuing operations per common share;
- Total assets;
- Long-term obligations and redeemable preferred stock (including long-term debt, capital leases and redeemable preferred stock as defined by Rule 5-02.27(a) of Regulation S-X); and
- Cash dividends declared per common share.

If no cash dividends were paid or no redeemable preferred stock is outstanding, for example, the disclosure should so state in response to instruction 1 (perhaps in a footnote or as part of the lead-in paragraph).

9. Explanation of Increases in Revenue Between Periods

In the results of operations section of MD&A in Part II, Item 7, companies often disclose significant increases in revenues without quantifying the material trends underlying such changes. The U.S. Securities and Exchange Commission staff frequently issues comments on this point, and directs management's attention to Item 303(a)(3)(iii), which requires companies to provide a narrative discussion of the extent to which such increases are attributable to increases in prices or increases in the volume or amount of goods or services being sold or to the introduction of new products or services.

10. Disclosure Controls and Procedures

In Part II, Item 9A, companies often forget to indicate that the conclusion of the principal executive officer and principal financial officer (or persons performing similar functions) regarding the effectiveness of disclosure controls and procedures was "as of the end of the period covered by the report," in accordance with Item 307.

Additionally, when defining "disclosure controls and procedures," companies sometimes forget to include the full definition of disclosure controls and procedures set forth in Exchange Act Rule 13a-15(e), particularly the portion regarding controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including the principal executive officer and principal financial officer (or persons performing similar functions) as appropriate to allow timely decisions regarding required disclosure. The SEC staff has issued numerous comments on this point.

11. Other Information

For Part II, Item 9B, you should review all of the company's press releases issued during the applicable reporting period to confirm that no Form 8-K trigger event occurred that was not adequately reported. You may find that a company announced the entry into or termination of a material contract or an exit

or disposal plan under a plan of termination, for example, but did not yet file a Form 8-K. To the extent disclosure would be required on Form 8-K for any such event, it should be provided here.

12. Exhibit Index

Preparing and cleaning up the exhibit index set forth in Part IV, Item 15 could be an article unto itself. However, here are a few frequently missed items:

- If a company amends its articles of incorporation or bylaws, the next periodic report must contain a “complete copy” of the amended articles of incorporation or bylaws, as applicable. See Item 601(b)(3)(i) and (ii).
- Sometimes a company will not file an offer letter or similar document specifying the employment terms of an executive officer because it is not styled as an “employment agreement.” This is a mistake. Any such agreement should be filed, and if the agreement is oral, it should be summarized and the summary should be filed as an exhibit. See Item 601(b)(10)(ii)(A) and Item 601(b)(10)(iii). Also see compliance and disclosure interpretation question 146.04.
- When reviewing the consent of the independent registered public accounting firm for Exhibit 23, you should double-check all references to effective Securities Act registration statements, typically on Form S-3 and Form S-8, because these sometimes have errors. Additionally, you should search for filings tagged as “POS” because sometimes a Form S-1 registration statement for a delayed or continuous offering will be post-effectively amended on Form S-3; however, such Form S-3 will not show up if you search EDGAR for an “S-3” tag.

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