COSO Framework/Internal Control Over Financial Reporting Disclosure Changes

**Speed read:** Many companies have adopted the 2013 COSO framework as a replacement for the 1992 COSO framework. Companies that have adopted the 2013 COSO framework should review the disclosures concerning their internal control over financial reporting in their Form 10-K and subsequent Form 10-Q reports and revise these disclosures as necessary.

Many companies adopted the 1992 COSO framework as part of their compliance with Section 404 of the Sarbanes-Oxley Act. The period for transition from the 1992 COSO framework to the 2013 COSO framework ended on December 15, 2014. Companies that have transitioned to the 2013 COSO framework should review their procedures for implementation and review of internal control over financial reporting and the related disclosures about internal control over financial reporting. Adoption of the 2013 COSO framework may affect three disclosure elements pursuant to Regulation S-K, Item 308 in Form 10-K and Form 10-Q reports:

- Form 10-K, Item 9A (Controls and Procedures) requires:
  - A statement identifying the framework used by management to evaluate the effectiveness of the company’s internal control over financial reporting (Regulation S-K, Item 308(a)(2)). This statement should be revised to refer to the 2013 COSO framework, if applicable.
  - Disclosure as to whether any change in the company’s internal control over financial reporting that occurred during the its last fiscal quarter (the fourth fiscal quarter, in the case of Form 10-K) that has materially affected, or is reasonably likely to materially affect, the company’s internal control over financial reporting. This disclosure should be included, to the extent applicable.

The staff of the SEC Division of Corporation Finance has been reviewing filings during 2014 and sending comment letters where the staff has concerns about a company’s Item 9A disclosure.

- Form 10-K, Item 15 (Exhibits, Financial Statement Schedules) requires that the CEO and CFO certify that they have disclosed any change in the company’s internal control over financial reporting that occurred during the company’s most recent fiscal quarter (the company’s fourth fiscal quarter in the case of Form 10-K) that has materially affected, or is reasonably likely to materially affect, the company’s internal control over financial reporting. Although adoption of the 2013 COSO framework will not result in changes to the certification, companies should ensure that this certification is accurate. This is especially important in light of recent SEC
enforcement activity relating to internal controls and the related CEO/CFO certifications, which is discussed in a separate article entitled “MD&A, Disclosure/Internal Controls and Cybersecurity Disclosure Developments” included in the Year End Tool Kit.

XBRL Update – Rule 406T Phase-Out

Speed read: Because Rule 406T has expired (and most companies had already reached the end of the transition period provided by Rule 406T), references to Rule 406T and the “not filed” status of XBRL exhibits in Form 10-K (and Form 10-Q) filings should be deleted.

Rule 406T of Regulation S-T provided a limited exemption from anti-fraud liability for interactive data file submissions, subject to certain conditions. Rule 406T was a temporary rule that applied to interactive data files submitted to the SEC less than 24 months after a company was first required to submit an interactive data file under the SEC rules, but no later than October 31, 2014. Because Rule 406T has now expired, the modified liability provisions of Rule 406T no longer apply. Companies should therefore review their Form 10-K annual reports and Form 10-Q quarterly reports to ensure that references to Rule 406T have been deleted. This includes the exhibit index and footnotes to the XBRL exhibits listed in Item 15 of Form 10-K to the effect that “[p]ursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.”

Proxy Voting Disclosure – NYSE Voting and Disclosure Requirement

Speed read: The NYSE changed its minimum shareholder approval requirements in 2013. NYSE-listed companies should review their proxy statement disclosure and vote-counting procedures to ensure that they correctly reflect current NYSE listing standards regarding shareholder votes and treatment of abstentions.

Historically, the NYSE has maintained minimum quorum and vote requirements for approval of matters by shareholders of NYSE-listed companies. These requirements frequently differed from the requirements of state law and listed companies’ charters and bylaws. This required a company to describe the NYSE requirements correctly, in addition to the applicable requirements of state law and the company’s organizational documents, in proxy statements relating to matters for which a listed company was seeking shareholder approval. It also required a company to apply the NYSE minimum voting standard, in addition to the requirements of state law and the company’s organizational documents, when counting shareholder votes upon these matters.

In 2013, the NYSE eliminated its quorum requirement for matters that required shareholder approval under NYSE rules. Thus, for purposes of proxy statement disclosure and annual meeting administration, state law and the company’s organizational documents will govern determination of whether a quorum is present at the meeting.

However, the NYSE did not change the minimum shareholder vote required to approve matters that were subject to shareholder approval under NYSE rules. Therefore, for purposes of complying with NYSE listing standards, shareholders will be deemed to have approved a matter only if votes cast “for” the matter exceed the sum of (1) votes cast “against” plus (2) abstentions, even if state law or the company’s
organizational documents require or permit a lower standard (such as a majority of shares present and voting on the matter).

As noted in the preceding paragraph, NYSE-listed companies should be aware that the NYSE treats abstentions as vote cast. This differs from treatment under some state laws and company organizational documents and means that, for purposes of both proxy statement disclosure and counting votes to determine whether the NYSE shareholder approval requirement has been satisfied, abstention have the effect of a vote against the matter.

Note that these requirements apply only to matters for which NYSE listing standards require shareholder approval. Thus, the proxy statement disclosure about minimum vote and treatment of abstentions, as well as actual vote-counting procedures, may vary from one proposal to another in the proxy statement.