

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

SEC MATTERS



SUBJECT

SEC ADOPTS RULE REQUIRING PAY RATIO DISCLOSURES

On August 5, 2015, the SEC adopted, by a 3-2 vote, a rule mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rule amends Item 402 of Regulation S-K and requires issuers to disclose the following:

- ▶ The median annual total compensation of all employees except the chief executive officer;
- ▶ The annual total compensation of the CEO; and
- ▶ The ratio of the median annual total compensation of all employees to the annual total compensation of the CEO.

These disclosures are collectively referred to as the “pay ratio” disclosures and are intended to help inform shareholders when evaluating a CEO’s compensation. The rule is generally consistent with the one the SEC proposed in 2013. The adopting release is available [here](#) on the SEC’s website.

The pay ratio disclosures are required in any annual report, proxy, or registration statement that requires disclosure of executive compensation pursuant to Item 402 of Regulation S-K. However, emerging growth companies, smaller reporting companies, foreign private issuers, Multijurisdictional Disclosure System filers, and registered investment companies are exempt from the requirements. In addition, companies filing initial registration statements (whether in an initial public offering or on Form 10) are not required to provide the pay ratio disclosures. Certain transition relief is available for newly public companies, companies with business combination activity, and those exiting smaller reporting company or emerging growth company status.

BDO USA CORPORATE GOVERNANCE PRACTICE

BDO USA’s Corporate Governance Practice was developed to provide guidance to corporate boards. The firm works with a wide variety of clients, ranging from entrepreneurial businesses to multinational Fortune 500 corporations, on a myriad of accounting, tax, risk management and forensic investigation issues.

CONTACT

JEFFREY LENZ
(312) 616-3944 / jlenz@bdo.com

PAULA HAMRIC
(312) 616-3947 / phamric@bdo.com

Companies are required to provide the pay ratio disclosures for their first fiscal year beginning on or after January 1, 2017. For example, a registrant with a fiscal year ending on December 31 would be first required to include the pay ratio information relating to compensation for fiscal year 2017 in its proxy or information statement for its 2018 annual meeting of shareholders and to include or incorporate by reference this information in its 2017 Form 10-K.

The rule requires a registrant to (1) identify the employee whose annual total compensation level is the median of all of its employees except its CEO, (2) compute the median employee's total compensation, and (3) compute a ratio in which the median employee's total compensation is equal to 1 and the CEO's total compensation is a calculated number. For example, if the of the median employee's total compensation is \$45,790 and the CEO's total compensation is \$12,260,000, then the pay ratio disclosed would be "1 to 268". The ratio could also be expressed narratively, such as "the CEO's annual total compensation is 268 times that of the median of the annual total compensation of all employees".

Subject to certain exceptions described below, the median employee is identified by an analysis of the annual compensation of all persons, including all U.S. and non-U.S. full-time, part-time, seasonal, and temporary workers, employed by the registrant and its consolidated subsidiaries as of any date within the last three months of its fiscal year.¹ The individual compensation amounts used to identify the median employee may be annualized for permanent employees who were employed for less than the full fiscal year. Such amounts for seasonal and temporary workers may not be annualized. Similarly, such amounts for part-time workers may not be adjusted to the full time equivalent amount. The rule permits registrants to identify the median employee in a variety of ways. For example, a registrant is permitted to analyze its entire employee population, use a statistical sampling methodology, or any other reasonable method. Moreover, the median employee can be determined using a consistently applied compensation measure (e.g., amounts derived from the registrant's payroll or tax records), rather than each employee's total compensation. Once the median employee is identified, that person's annual total compensation pursuant to Item 402(c)(2)(x)² must be calculated and disclosed. The rule permits companies to make estimates when calculating the elements of annual total compensation in accordance with Item 402. Disclosure of the methodology and material assumptions and estimates used to identify the median employee and/or determine the compensation amounts is required. Registrants are permitted to supplement the disclosure with additional narrative discussion or other ratios as long as the information is clearly identified and is not given greater prominence than the pay ratio disclosures.

The final rule contains changes from the proposal that are intended to provide companies with flexibility to meet the rule's requirements in a number of other ways, including the ability to:

- ▶ Identify the median employee only once every three years. However, if there has been any change in the employee population or employee compensation arrangements which may result in a significant change to the pay ratio, the median employee should be re-identified. If the median employee's compensation significantly changes during the three year period, the company may use another employee with substantially similar compensation as the median employee.
- ▶ Exclude non-U.S. employees from countries in which obtaining the required information to calculate the pay ratio would violate the particular jurisdiction's data privacy laws or regulations (i.e., the data privacy exception). This exception can only be applied if the Company obtains a legal opinion supporting the assertion that obtaining the necessary information violates the local laws.

¹ Independent contractors and leased employees are excluded from this population.

² Total compensation per Item 402(c)(2)(x) includes salary, bonus, the aggregate grant date fair value of options or stock awarded during the period, earnings for services performed under non-equity incentive plans and all earnings on any outstanding awards, certain amounts related to defined benefit and actuarial pension plans, and any other compensation not included in the aforementioned categories.

- ▶ Exclude up to 5% of its total employees who are non-U.S. employees (i.e., the de minimis exception), which includes any non-U.S. employees excluded under the data privacy exception. This exception can only be applied on a jurisdiction by jurisdiction basis, so that if one employee in a jurisdiction is excluded all must be excluded.
- ▶ Apply an adjustment to account for differences between the cost-of-living in the CEO's jurisdiction and the cost-of-living in other jurisdictions when identifying the median employee. If applied, the same adjustment would be made to the median employee's annual total compensation used to calculate the pay ratio. However, disclosure of the compensation amount and pay ratio without the cost-of-living adjustment is still required.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and over 450 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,328 offices in 152 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.