

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

SEC MATTERS



► SUBJECT

SEC PROPOSES RULE REQUIRING PAY RATIO DISCLOSURES

► SUMMARY

On September 18, 2013, the SEC proposed a rule required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposal would amend Item 402 of Regulation S-K and require 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. The SEC’s press release announcing this rulemaking can be accessed [here](#), and the proposing release can be accessed [here](#).

The pay ratio disclosures would be 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 filing on Form 20-F, and Multijurisdictional System filers would be exempt from the requirements. In addition, companies filing initial registration statements would not be required to provide the pay ratio disclosures, and a newly public company would first be required to provide them for the year that commences after the date on which it became subject to Exchange Act reporting.

Under the proposal, a registrant would be required 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

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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". The median employee is to be identified using the annual total 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 subsidiaries as of the last day of the registrant's 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 proposal allows registrants to identify the median employee in a variety of ways. For example, a registrant is permitted to analyze its entire employee population or use a statistical sampling methodology. 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 total compensation pursuant to Item 402(c)(2)(x)² must be calculated and disclosed.

In addition to the pay ratio disclosures described above, the proposal would also require disclosure of the methodology and material assumptions and estimates used to identify the median or determine the compensation amounts.

The SEC has proposed that an issuer report the pay ratio disclosures for its first fiscal year commencing on or after the effective date of the final rule. For example, if the final requirements were to become effective in 2014, a registrant with a fiscal year ending on December 31 would be first required to include pay ratio information relating to compensation for fiscal year 2015 in its proxy or information statement for its 2016 annual meeting of shareholders and to include or incorporate by reference this information in its 2015 Form 10-K. The proposal is subject to a 60-day public comment period.

¹ Independent contractors and leased employees are not included in 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.

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