BDO BULLETIN

SEC STAFF INTERPRETIVE GUIDANCE FOR EXECUTIVE COMPENSATION DISCLOSURES

OCTOBER 2023

SUMMARY

New Compliance and Disclosure Interpretations (C&DIs) offer guidance for SEC registrants on:

- The computation of compensation actually paid ("the computation") in pay versus performance disclosures
- Non-GAAP financial information presented in Compensation Discussion and Analysis (CD&A)

PAY VERSUS PERFORMANCE DISCLOSURE INTERPRETATIONS

The disclosure of executive compensation "actually paid" during a year, as required under Item 402(v) of Regulation S-K, is adjusted for certain amounts related to equity-based compensation and defined benefit and actuarial pension plans. Determining the equity-based compensation adjustments can be challenging because registrants must determine the fair value of equity-based awards at the end of each fiscal year and at the date vested, which may not otherwise be required under U.S. GAAP.

The following table summarizes the SEC staff's guidance on the computation and disclosure of equity-based compensation adjustments used in the computation.

SUMMARY OF THE PAY VERSUS PERFORMANCE C&DIs Item 402(v) of Regulation S-K	
Awards granted prior to an equity restructuring or Initial Public Offering (IPO) (Questions 128D.14 and 128D.15)	▶ Outstanding awards modified in connection with an equity restructuring (for example, a spin-off), or otherwise retained after the transaction, are included in the computation. ▶ The change in fair value of awards granted before an IPO is calculated using the fair value as of the end of the prior fiscal year, which may precede the IPO date.
Market or performance-based conditions (Questions 128D.16, 128D.17, and 128D.19)	▶ Although a market condition is not a vesting condition under U.S. GAAP, the computation considers the change in fair value of an award with a market condition until the condition is satisfied.

SUMMARY OF THE PAY VERSUS PERFORMANCE C&DIs Item 402(v) of Regulation S-K	
	▶ Awards that vest based on market or performance-based conditions are not deducted in the computation until the award is forfeited, even if the condition is not met during the fiscal year. ▶ When other parties are required to certify that a performance-based condition was met and the certification is a substantive vesting condition, the award is not considered vested in the computation until such certification occurs, even if the performance condition itself is met at year-end.
Accelerated vesting upon retirement (**Question 128D.18**)	▶ When retirement accelerates vesting of an award and is the only vesting condition, it is satisfied when the holder reaches retirement age.
Computation of fair value and related disclosure (**Questions 128D.20**, **128D.21**, and **128D.22**)	▶ The use of methods and assumptions inconsistent with U.S. GAAP to fair value equity-based awards in the computation is not permissible. For example, the expected term may not be estimated by: • Subtracting the elapsed life of the award from the expected term at the grant date • Using the “simplified” method[1] when the award is not “plain vanilla” (such as those that are out-of-the-money at the valuation date) as these methodologies are inconsistent with U.S. GAAP. ▶ Although the fair value determination must be consistent with U.S. GAAP, the valuation technique used in the computation may differ from the technique used on the grant date. When assumptions used in the computation materially differ from those used at the grant date, additional disclosure is required. However, disclosure of quantitative or qualitative performance conditions that subject a registrant to competitive harm may be omitted.[2] It may be appropriate to disclose the range or weighted average assumptions and include a discussion of the effect of the performance condition on the fair value.

EXECUTIVE COMPENSATION DISCLOSURE INTERPRETATIONS

A registrant may disclose non-GAAP financial information in CD&A to describe levels of compensation or the relationship between pay and performance. The SEC staff’s guidance, summarized in the following table, clarifies the scope of non-GAAP financial information that must comply with Regulation G and Item 10(e) of Regulation S-K and the method in which a registrant may satisfy the requirements.[3]

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[1] The SEC staff’s view on using the “simplified” method for “plain vanilla” options is in **Staff Accounting Bulletin 14.D.2**.

[2] See Instruction 4 to Item 402(b) of Regulation S-K.

[3] Non-GAAP financial information has consistently been one of the SEC staff’s most frequent comment letter topics. Previously released SEC staff guidance on the presentation of non-GAAP financial information is summarized in our BDO Bulletin: **SEC Updates Compliance and Disclosure Interpretations on Non-GAAP Financial Measures**.

SUMMARY OF THE EXECUTIVE COMPENSATION C&DI Item 402(b) of Regulation S-K	
Non-GAAP financial information included in CD&A (Question 118.08)	▶ Non-GAAP financial measures in CD&A that describe pay structure or support a named executive officer's pay must be disclosed in accordance with Regulation G and Item 10(e) of Regulation S-K.[4] The exemption detailed in Instruction 5 to Item 402(b) only applies to non-GAAP disclosure of target levels. ▶ When non-GAAP financial measures disclosed in CD&A are subject to Regulation G and Item 10(e) of Regulation S-K, the SEC staff will not object if the registrant includes a prominent cross-reference to the required GAAP reconciliation and disclosure: • In an annex to the proxy statement • To the pages in the Form 10-K that incorporates the Part III information disclosed pursuant to Item 402 of Regulation S-K in the proxy statement

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For additional guidance on pay versus performance disclosures, see BDO's **Pay versus Performance Disclosures: A Snapshot.**

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[4] Except for disclosure made pursuant to Item 402(v)(2)(vi) of Regulation S-K, such as the Company-Selected Measure, or other financial performance disclosures.