2022 SEC Reporting Insights

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INTRODUCTION

After a relatively quiet rulemaking period in 2021, following the change in administration and appointment of Chair Gary Gensler, 2022 has been marked by a flurry of proposed and final Securities and Exchange Commission ("SEC") rules. The SEC advanced many rules at the top of Chair Gensler's regulatory agenda, including the highly anticipated climate change disclosure proposal. The volume and nature of the new and proposed rules demonstrate the SEC's focus on highly prescriptive (not principles-based) rules designed to enhance comparability across all registrants, among other objectives. While not yet final or effective, some of the rule proposals have already influenced market practices and SEC reporting in 2022. For example, the SEC's rule proposal applicable to special purpose acquisition companies (SPAC) and related mergers has had a chilling effect on the number of SPAC initial public offerings and mergers with operating companies in 2022. Additionally, many registrants have enhanced, or are enhancing, their disclosures about environmental, social and governance issues, particularly climate change matters in response to SEC staff comment letters or other investor demands. We anticipate the heavy rulemaking period will continue in the coming year as the SEC analyzes feedback on the proposals and advances them to the final rulemaking stage.

While the COVID-19 pandemic has continued to evolve and impact registrant disclosures, other macroeconomic factors, such as inflation, supply chain constraints and other geopolitical uncertainties brought on by Russia's invasion of Ukraine have created incremental disclosure considerations for SEC registrants. Our publication provides some key disclosure and reporting reminders for upcoming filings and summarizes the SEC's rulemaking and other activities that affect financial reporting.

SEC REPORTING REMINDERS

In the sections that follow, we have summarized some key reporting topics to be mindful of, particularly as the annual reporting season approaches for calendar year-end SEC registrants.

Macroeconomic Factors

Following the World Health Organization's declaration of COVID-19 as a global pandemic in early 2020, the SEC staff released Disclosure Guidance Topics 9 and 9A to address the staff's views on disclosures and securities law obligations for registrants to consider in making COVID-19 related disclosures in their SEC filings. Depending on the facts and circumstances, such disclosures have appeared within the footnotes to the financial statements to highlight the impacts on recorded amounts, estimation uncertainties and business impacts, as well as throughout SEC filings since 2020. While the shutdowns, "stay-at-home-orders" and substantial curtailment of business activities because of COVID-19 have subsided in many jurisdictions, the impact of such events has resulted in weakened economic conditions, market volatility and bottlenecks in global supply chains. Moreover, inflation rates in 2022 hit a 40-year high and the Federal Reserve has dramatically increased interest rates to combat inflationary pressure. All of these macroeconomic factors may have consequences on SEC filings which registrants may wish to consider, including:

- **Regulation S-K Item 101, *Description of business***

  The Business section focuses on a description of an entity's business and how it operates. It may also include discussion of recent events, competition, regulation, and seasonality. COVID-19, supply chain challenges, inflation and rising interest rates may have caused an entity to change the way its business operates, its strategy, how it engages with its customers, or changes its approach to its supply chain (such as where it sources its raw materials). If an entity has changed how the business operates, or if the entity plans to make changes in response to macroeconomic conditions and challenges, the disclosures should address such changes.

- **Regulation S-K Item 105, *Risk Factors***

  Risk Factors should include information about material risks an entity faces. Some of these risks may relate to the overall economy, some to the industry or geographic area in which an entity operates, and some may be unique to the entity itself. Entities may have already included general risk factors that address economic conditions, inflation, or geopolitical matters; however, each of the macroeconomic factors may present more specific risks that entities should consider explicitly disclosing.

- **Regulation S-K Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)***

  MD&A focuses on management's perspective on the business results, or where the entity tells its own story. Known trends and uncertainties that have had, or are reasonably likely to have, a material impact on the entity's operations should be discussed. The impacts of COVID-19, supply chain challenges, inflationary pressure, rising labor costs, and higher interest rates may present known trends for certain types of organizations and likely present a myriad of uncertainties for other organizations. Entities that have experienced material effects to date, or reasonably expect a material impact in the future, on their financial condition, results of operations, or liquidity due to these factors should include robust discussions of these circumstances.

- **Regulation S-K Item 305, *Quantitative and Qualitative Disclosures about Market Risks***

  S-K Item 305 disclosure focuses on an entity's exposure to market risks, such as interest rate risk, credit risk, foreign currency risk, and commodity price risk, and how the entity manages these risks. COVID-19 and the economic consequences have resulted in significant market disruption, market volatility and higher interest rates. Entities should consider disclosing how these issues are affecting the entity, and how they are managing these risks.

- **Financial Statement Disclosures**

  Accounting Standards Codification (ASC) Topic 275, *Risks and Uncertainties*, requires disclosure of risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term. Risks and uncertainties can stem from the nature of an entity's operations, the use of estimates in the preparation of the financial statements, or significant concentrations in an entity's operations. Many entities' operations have been affected by COVID-19, inflation, and supply chain challenges, though the extent varies. If information becomes known prior to the issuance of the financial statements that it is at least reasonably possible that significant estimates will change in the near future and the change would be material, entities should add incremental disclosure.

  There are many financial statement areas that could potentially be affected by the prevalent macroeconomic factors and market volatility, most of which involve impairment or valuation analyses. Further supply chain disruptions, soaring inventory and other costs, and reduced sales volumes may impact significant estimates and could warrant incremental disclosure. Stock market volatility may cause an entity's stock price to fall below book value, which may trigger the need for an interim goodwill impairment analysis. Entities may have concentrations that present greater risk to the financial condition or results of operations, such as customers, suppliers, geographic locations, products, etc. When an entity is aware that a concentration exists that makes it vulnerable to a risk of loss in the near term and it is at least reasonably possible that events or circumstances may occur that could cause a severe impact in the near term, incremental disclosure is required. If an entity has a concentration in an activity or areas affected by certain macroeconomic trends (e.g., supply chain disruption from a major supplier, meaningful change in customer buying behaviors or cancelling of orders, etc.), disclosure of the potential near-term impact should be disclosed. These disclosures are essentially "early-warning" disclosures designed to draw attention to areas of risk or known trends or uncertainties. These disclosures are similar to the SEC's requirement to discuss known trends or uncertainties within MD&A as highlighted above, as well as to provide "early-warning" disclosures in the disclosures of critical accounting estimates.

BDO INSIGHT: The impact of inflation, supply chain challenges and residual effects of COVID may each present unique risks and uncertainties as well as specific operational and financial statement impacts. The recent stock market declines and volatility may require additional impairment considerations as well. Registrants are encouraged to carefully evaluate the impact of each macroeconomic factor separately to determine the appropriate reporting and disclosure consequences. The staff may comment on disclosures that commingle these factors into one risk, uncertainty, or impact.

Russia's Invasion of Ukraine

In addition to inflation, supply chain challenges and worsened economic conditions, Russia's invasion of the Ukraine has also created uncertainties and negative effects for registrants that have direct or indirect exposure to the war or impacted countries (e.g., Ukraine, Belarus, and Russia). In May, the SEC staff issued a sample letter detailing potential comments to registrants regarding the impact of Russia's invasion of Ukraine. The Division noted that companies should provide detailed disclosures, as applicable and to the extent material, of any direct and/or indirect exposure to the registrant because of the invasion. While not an exhaustive list, such disclosures may include:

- exposure to a registrant's employee base, investments, or reliance on goods or services sourced from the impacted areas;
- actual or potential disruptions in the supply chain;
- business relationships or material assets located in the impacted areas;
- impact of US-imposed and other sanctions;
- new known trends or uncertainties;
- changes to critical accounting estimates;
- risks related to cybersecurity; and
- changes in disclosure controls and procedures or internal controls over financial reporting.

Companies should consider the need to reflect such exposure to loss in the financial statements. Financial statement disclosures may include impairment of assets, changes in inventory valuation, deferred tax asset valuation allowance, disposal or exiting of a business, de-consolidation, changes to exchange rates, and changes in contracts with customers or the ability to collect because of the conflict. The staff also reminded registrants not to adjust for estimated lost revenue or exclude normal, recurring cash operating expenses when presenting their non-GAAP financial measures.

Climate-Change Disclosures

While the SEC's proposal on climate change disclosures has not yet been finalized, the SEC staff continues to comment on climate-related matters in filings. Some of the key focus areas in the comment letters relate to:

- Inconsistencies between climate-related disclosures in other reports, such as a registrant's corporate social responsibility report, and its SEC filings;
- Lack of disclosure of the direct or indirect impacts from climate-related legislation, regulations, and/or business trends; and
- Lack of disclosure of the physical impacts of climate change, such as the severity of weather and the associated financial and operational impacts (and whether such impacts are material).

In general, these comments draw from the staff's sample letter to companies regarding climate change disclosures. The sample letter emphasized the Commission level interpretive guidance from 2010 on climate change disclosures and the duty to disclose material information even if not expressly required by any rules. When material, disclosures should address:

- The impact of pending or existing climate-change related legislation, regulations, and international accords.
- The indirect consequences of regulation or business trends, including (for example):

- decreased demand for goods with significant greenhouse emissions;
- increased competition to develop new climate friendly products; or
- decreased demand for services related to carbon based energy sources.

- The actual or potential physical impacts of climate change, including the severity of weather and the corresponding effect on the business.

To the extent a registrant has released a separate corporate social responsibility report with more expansive climate-related disclosures, it will want to carefully consider the potential need to provide similar disclosure in its Form 10-K filing. Registrants may also need to revisit their disclosure controls and procedures to consider whether material climate-related information is appropriately considered for inclusion in the SEC filing. When a registrant concludes that the disclosures are not material, management should prepare documentation of their materiality assessment to support their conclusions.

Pay Versus Performance Disclosures

In August, the SEC adopted amendments to Item 402 of Regulation S-K to implement requirements mandated by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act that are effective for registrants with fiscal years ending on or after December 16, 2022. The final rules add Item 402(v) of Regulation S-K and will require registrants to disclose the relationship between executive compensation actually paid and financial performance of the registrant. The SEC initially proposed the amendments in 2015, though they were finalized in August after re-opening the comment period on the proposal earlier in 2022. The new disclosure requirements are intended to provide more transparent and readily comparable disclosures for investors to evaluate a registrant's executive compensation policies. The fact sheet is available here.

Summary and Key Highlights

S-K Item 402(v) requires registrants to provide a table (see Pay Versus Performance table below) to disclose executive compensation actually paid to executives for whom disclosure is currently required in the Summary Compensation Table (SCT),[1] as well as the following financial performance measures:

- Cumulative total shareholder return (TSR) for the registrant;
- TSR for the registrant's chosen peer group;
- The registrant's net income; and
- Measure used by registrant to measure financial performance (company-selected measure).

[1] Persons covered under the named executive officers in the SCT are specified in Item 402(a)(3) of Regulation S-K.

Pay versus Performance

Year	Summary Compensation Table for Total Principal Executive Officer (PEO)	Compensation Actually Paid to PEO (a)	Average Summary Compensation Table Total for Non-PEO Named Executive Officers (NEOs)	Average Compensation Actually Paid to Non-PEO NEOs	Value of Initial Fixed $100 Investment Based On:		Net Income	Company-Selected Measure (c)
					Registrant TSR (b)	Peer Group TSR		

a. Executive compensation "actually paid" during a year is adjusted for certain amounts related to equity-based compensation and defined benefit and actuarial pension plans.

b. TSR is defined in Item 201(e) of Regulation S-K (i.e., dividends plus or minus the change in share price over the measurement period).

c. If a registrant does not compare executive compensation actually paid to any financial performance measures, or if it only uses a financial measure required by S-K Item 402(v), the registrant would not be required to disclose a company-selected measure.

Registrants are required to provide a clear description of the relationships between the financial performance measures and the compensation actually paid to the registrant's NEOs. The description, which may be presented narratively, graphically, or a combination of the two, should include a discussion of:

- the relationship between the executive compensation actually paid and registrant's TSR, net income, and company-selected measure; and
- the relationship between the registrant's TSR and peer group TSR.

In addition to the company-selected measure above, registrants are required to include a tabular list of three to seven financial performance measures that they believe to be the "most important"[2] to link executive compensation actually paid to the performance of the company for the most recently completed fiscal year.

Scope and Effective Date

S-K Item 402(v) is effective for fiscal years ending on or after December 16, 2022, in proxy and information statements that require S-K Item 402 disclosures. The rule applies to all reporting companies except for:

- Foreign private issuers;
- Registered investment companies (other than business development companies); and
- Emerging growth companies.

While smaller reporting companies (SRCs) are not exempt from the requirements, they are permitted to scale their disclosures. SRCs may omit disclosures of the registrant's peer group TSR, company-selected metric, and the tabular list of the "most important" financial performance measures.

[2] The "most important" determination should be made considering only the most recently completed fiscal year. While disclosure of the measure's methodology is not required, registrants should consider whether it would be helpful to an understanding of the measure. If fewer than three measures were used by the registrant, the tabular list must include all measures used. If the registrant considers a non-financial measure to be one of the "most important" measures, the rule permits, but does not require, it to be included in the tabular list.

Transition

Registrants are required to provide the pay versus performance disclosures for the five most recently completed fiscal years (three for SRCs) following a transition period. The transition period permits registrants to disclose:

- Three years of information (two for SRCs) in the first proxy or information statement that requires compliance with S-K Item 402(v); and
- An additional year of information added to the disclosure in each of the next two annual proxy or information statement filings (next year's annual proxy filing for SRCs).

Newly public companies may provide the disclosures for the most recently completed fiscal year in their first proxy or information statement and add a subsequent year of information in future filings until all required years are presented.

BDO INSIGHT: The calculation of executive compensation "actually paid" is a new concept and will require adjustments to compensation for certain pension amounts and equity-based awards. The calculations related to equity-based awards will require valuations of certain awards to be performed as of fiscal year end, an exercise that has historically not been necessary. Consideration of changes in fair value for awards that vest over time will also impact the calculation. Due to the short timeframe before these disclosures will be required (i.e., proxies filed in early 2023), we recommend that companies prepare the required disclosures for prior fiscal years well in advance of year end and proxy reporting season.

Regulation S-K Reminders

In November 2020, the SEC released amendments to the disclosure requirements of Regulation S-K that became effective for fiscal years ending on or after August 9, 2021. In addition to eliminating requirements that may have resulted in duplicative disclosures, the amendments clarified the overall objective of MD&A and promote a principles-based approach to certain disclosures.

Registrants are reminded to consider that:

- S-K Item 303(b) explicitly requires disclosure of the underlying reasons, in quantitative and qualitative terms, for material changes in financial condition and the results of operations, including when offset by another material change. Moreover, if the statement of operations reflects material changes in revenue year over year, registrants are required to describe the extent to which such changes are attributable to changes in prices, changes in volume, or the introduction of new products.
- S-K Item 303(b)(1) requires a discussion of liquidity and capital resources focused on the material short- and long-term cash requirements from known contractual and other obligations.
- S-K Item 303(b)(3) defines a critical accounting estimate as one that involves "a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the registrant's financial condition or results of operations." The disclosures should supplement rather than repeat the significant accounting policy footnotes. For each such estimate, a registrant should disclose (to the extent material):
  - Why the estimate is subject to uncertainty;
  - How much each estimate has changed during the relevant period; and

- The sensitivity of the reported amounts to the material methods, assumptions, and estimates underlying the estimate's calculation.

For a more detailed summary of the November 2020 Regulation S-K amendments, refer to our 2021 Reporting Insights publication.

Select Staff Comment Letter Topics

The Sarbanes-Oxley Act of 2002 requires the staff to review registrant filings at least once every three years. The staff reviews may vary from a cover-to-cover review for compliance with the applicable rules and regulations, a financial statement review for compliance with the applicable accounting standards and the disclosure requirements, or a targeted review focused on specific disclosures within the footnotes and MD&A for compliance with the relevant accounting standards and related disclosure requirements. Events such as a material restatement, significant volatility in the registrant's stock price as compared to its peers, or significant business combinations (among other events) may trigger more frequent reviews.

Other than climate-change disclosure matters discussed above, staff comments in 2022 have focused on the following areas:

- Non-GAAP Financial Measures;
- MD&A;
- Segment Reporting; and
- Revenue Recognition (Topic 606).

While the overarching themes have remained consistent year over year, the comments, especially recently, have focused on the impact and consequences of macroeconomic factors, such as inflation, discussed earlier.

Non-GAAP Financial Measures

The staff continues to frequently comment on registrants' use of non-GAAP financial measures in their earnings releases and filings (the staff may also comment on measures appearing on company websites and investor presentations). Comments remain focused on disclosures that do not adhere to applicable rules and regulations[3] or staff guidance,[4] the prominence of the non-GAAP measure, and the nature of the adjustments.

A key area of focus is on measures that are perceived to be misleading to investors, particularly those that:

- Exclude normal, recurring cash operating expenses.[5] Examples of such costs may include acquisition-related costs for a highly acquisitive registrant, start-up or pre-opening costs that are customary in certain industries, as well as certain costs specific to the pharmaceutical industry, as further discussed below.

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[3] Refer to Regulation G, and Item 10(e) of Regulation S-K.

[4] Refer to staff guidance within Non-GAAP Financial Measures C&DIs, and Topic 8 (Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth) of the Financial Reporting Manual.

[5] Refer to C&DI 100.01 for Non-GAAP Financial Measures for further guidance.

- Use an "individually tailored accounting principle"[6] by adjusting a GAAP figure to include or exclude an amount not recognized in accordance with GAAP. Examples of individually tailored accounting principles may include:
  - Presenting the measure on a cash or modified basis rather than an accrual basis of accounting, such as presenting revenues on a cash receipts basis;
  - Presenting "gross revenues" or "adjusted gross revenues" which adjusts GAAP revenues by adding back sales incentives (e.g., returns, allowances and/or discounts). The staff has noted that such a measure may represent amounts invoiced to customers and, as such, may be a metric described as a key performance indicator ("KPI") and referred to as "billings" or "bookings." The presentation of KPIs should follow the Commission's previously issued guidance on the disclosure of KPIs and metrics in MD&A;
  - Including the results of an entity that does not qualify for consolidation, or vice versa; and
  - Adjusting for select parts, but not all, of an accounting concept, such as excluding amortization of certain, but not all intangibles.

As a reminder, the presentation of a non-GAAP margin, such as an adjusted gross margin, is required to be reconciled to gross margin, which is the most directly comparable GAAP measure. When a registrant does not present gross margin in its financial statements,[7] the staff expects the non-GAAP gross profit or margin figure to be reconciled to a "fully loaded" gross margin calculated in accordance with GAAP.

Lastly, the staff has highlighted the importance of effective disclosure controls and procedures over non-GAAP figures and KPIs presented in filings, including those presented within the earnings release furnished in Form 8-K. The staff noted that non-GAAP figures and KPIs are often derived directly from GAAP figures or amounts that are included within the registrant's information systems subject to ICFR and as such, should be considered when presenting such measures.

Additional Non-GAAP Considerations For The Pharmaceutical Industry

Certain common non-GAAP adjustments across registrants in the pharmaceutical industry have historically included:

- Acquired in-process research and development (IPR&D) costs in an asset acquisition, and
- Upfront and contingent milestone payments in connection with collaborative and licensing arrangements (or, research and development (R&D) arrangements).

Earlier in 2022, the SEC staff provided its views on these non-GAAP adjustments to certain large pharmaceutical registrants, the views of which apply holistically to all registrants in the pharmaceutical industry. The staff communicated that it is not appropriate to present a non-GAAP financial measure that excludes expenses related to acquired IPR&D in an asset acquisition or upfront and contingent milestone payments in connection with R&D arrangements. The staff's objections are premised on the notion that such expenses are normal, recurring operating expenses for pharmaceutical companies (companies outside of the pharmaceutical industry should not apply this guidance by analogy).

The staff recognizes that these expenses are often material and important to communicate to investors. Registrants are welcome to supplementally disclose the expenses incurred in a particular

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[6] Refer to C&DI 100.04 for Non-GAAP Financial Measures for further guidance.

[7] The presentation of gross margin is not required by Regulation S-X. A registrant may not present gross margin in its financial statements when the cost of sales does not include all related costs (e.g., if depreciation and amortization is not appropriately allocated to cost of sales). See Staff Accounting Bulletin ("SAB") Topic 11.B *Depreciation and Depletion Excluded from Cost of Sales*.

reporting period in a footnote below their non-GAAP reconciliations. Moreover, in addition to disclosure of such amounts in the financial statement footnotes or elsewhere in a filing (e.g., management's discussion and analysis), registrants may choose to separately classify these costs on the face of the income statement.

In most circumstances, if the staff objects to a registrant's particular non-GAAP adjustment or performance measure, the registrant is permitted to amend its presentation in future filings. However, we understand that the staff may take a different approach for registrants in the pharmaceutical industry that continue to make non-GAAP adjustments for these items. If registrants are made aware of the staff's views about these adjustments and continue to make them in their filings, the staff may require companies to amend and restate their filings to correct the non-GAAP presentation (we do not believe the requirement to restate will extend to filings made prior to the staff's communication in April 2022).

Registrants in the pharmaceutical industry are advised to consider the staff's guidance and make any corresponding changes to their non-GAAP financial measures in upcoming filings.

Management Discussion and Analysis ("MD&A")

The staff continues to comment on MD&A disclosures and encourages registrants to focus on communicating material information to investors. The nature of these comments typically:

- Focus on the discussion of the results of operations and cash flows and the need for more specificity in describing "why" changes have occurred period over period. As a result of the macroeconomic factors discussed earlier, many comments have focused on the impact of supply chain constraints, especially when there are significant changes to the operating assets and/or liabilities within the operating section of the statement of cash flows, including, for example:
    - Significant increases in inventory. The staff has questioned whether inventory purchases are the result of signed contracts, specifically when there is not a corresponding increase to revenues, or to alleviate potential delays to future anticipated orders. If the latter, the staff has questioned whether there is an increased risk of obsolescence if future orders do not come to fruition.
    - Significant increases in deferred revenue and whether such increases are a result of the registrant's inability to fulfill orders, whether due to an issue in the supply chain, or personnel constraints.
- Seek more information about the underlying causes and effects of known trends, events, uncertainties. For example, the staff may ask whether there are any known trends that have had or that the company reasonably expects will have a material favorable or unfavorable impact on revenues or results and whether those changes are expected to continue. As a result of the current economic environment, many registrants have included a risk factor related to inflation. The staff has asked registrants to clarify whether inflation has, or is reasonably likely to have, a material effect on their operations. For example, if the registrant has disclosed an increase in the price of inventory or employee-related costs, the staff will often inquire whether such costs will be passed on to customers, or if the registrant expects margins to change in the future as a result.
- Request that registrants focus their discussion of critical accounting estimates on the significant judgments and estimates that, if changed or varied, will significantly impact their results. As highlighted earlier, the discussion should supplement, not repeat, the critical accounting policy disclosure. For example, the staff will often seek clarity about a registrant's impairment analysis, both for long-lived assets as well as goodwill and indefinite lived intangibles, when a registrant's

stock price has decreased significantly, and the critical accounting estimate disclosures do not disclose relevant impairment considerations.

Segment Reporting

The staff often identifies inconsistencies between information disclosed by registrants outside of their financial statements, such as in earnings calls or investor presentations, and the segment disclosures in the financial statement footnotes. As a result, the staff will often seek clarity on:

- The role of the Chief Operating Decision Maker (CODM), how often the CODM meets with the individuals who report to him or her, the information provided to the CODM for such meetings, as well as the budgeting process;
- The determination of operating segments, and, when the registrant reports one operating and reportable segment, but discusses the business on a more disaggregated basis elsewhere;
- The conclusion to aggregate operating segments into reportable segments;
- The performance measure used by the CODM to make decisions and allocate resources, especially when other measures are presented or discussed elsewhere;
- The basis for the entity-wide disclosures related to products and services, revenues attributable to individual foreign countries and revenues from major customers when such disclosures do not align to other information presented. Additionally, the staff will object to the presentation of segment revenues on a non-GAAP basis.[8]

In addition to seeking further clarity on the performance measure used by the CODM, the staff reminds registrants:

- When more than one performance measure is used by the CODM in evaluating segment performance, the performance measure disclosed is the one that is most consistent with the amounts measured and reported in the consolidated financial statements,[9] and
- Although ASC Topic 280 does not require a registrant to calculate such measure in accordance with GAAP, presentation of a consolidated non-GAAP performance measure within the footnotes is prohibited.[10] For example, when reconciling an EBITDA segment performance measure to pre-tax income, a consolidated EBITDA subtotal may not be presented. A consolidated total may be presented outside of the financial statements but must be labeled non-GAAP and follow the rules and regulations applicable to non-GAAP measures.

Revenue Recognition (“Topic 606”)

Year after year, accounting and disclosures related to revenue recognition are one of the key focus areas of staff comments.

The staff continues to issue comment letters that seek clarity on:

- The identification of performance obligations – i.e., understanding the analysis of whether certain promised goods or services are or are not separately identifiable.

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[8] Entity-wide revenue disclosures under ASC 280 are required to be presented on the same basis as “the financial information used to produce the public entity's general-purpose financial statements.”

[9] For example, if the CODM measures segment performance based on segment gross profit and segment Adjusted EBITDA, only segment gross profit should be disclosed in the financial statement footnotes.

[10] Item 10(e)(1)(ii)(c) of Regulation S-K states that “A registrant must not… Present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes”.

- The type and nature of variable consideration, including whether any variable consideration is constrained.
- Information regarding the method used to recognize revenue for performance obligations (over time or point-in-time) and why the method is appropriate.
- The analysis for presenting revenues on a gross vs. net basis (i.e., principal/agent considerations).
- Disaggregation of revenue into categories that reflect how economic factors affect the nature, amount, timing, and uncertainty of revenue and cash flows. The staff will often review publicly available information, such as in MD&A and earning calls, and question when the revenue information in the financial statements is disaggregated differently than in other public communications.

While many of these comments relate to estimates or judgements in revenue recognition policies, other comments also focus on explicit disclosure requirements for contract assets and liabilities, such as:

- The opening and closing balances of contract assets and liabilities;
- An explanation for significant changes in the balances of contract assets and liabilities; and
- The amount of revenue recognized during the period that was included in the opening contract liability.

BDO INSIGHT: We expect all of these comment letter topics, including climate-related matters, to remain focus areas of the staff in its review of upcoming and next year's filings. We also expect an increase in staff comments related to disclosures of the impact that macroeconomic factors have had or will have on the registrant (i.e., known impacts, trends and uncertainties related to inflation, supply chain challenges, market, and currency volatility, rising interest rates and geopolitical uncertainties related to the war in Ukraine).

COMMISSION AND STAFF ACTIVITIES

Listing Standards For Recovery Of Erroneously Awarded Compensation

Background

The Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010 required the SEC to direct national securities exchanges[1] to implement listing standards that will require issuers to develop and implement policies regarding the recovery (or "clawback") of erroneously awarded compensation. After initially proposing the rules in 2015 and re-opening the comment period on the proposal in 2021 and 2022, the SEC adopted rules and amendments to implement the clawback requirements on October 26, 2022. The press release is available here and the fact sheet is available here.

Summary and Key Highlights

The clawback provisions of new Rule 10D-1 will require a listed company, upon preparing a financial statement restatement, to recover incentive-based compensation awarded to any current or former executive officers during the three years preceding the date of the restatement. The recoverable amount is calculated as the difference between the amount received by the executive and the amount that should have been received based on the restated financial measure. Such recovery does not require misconduct by an executive or consideration of whether an executive had responsibility for the erroneous financial statements.

The population of "executives" from which recovery will be required is broad and includes any person who performs policy-making functions for the company. For example, roles such as the company's president, principal financial officer, principal accounting officer, any vice-president in charge of a principal business unit, division or function, and any other officer who performs a policy-making function are included. Moreover, a "restatement" necessitating a clawback analysis includes restatements for material errors (i.e., "Big R" restatements) and immaterial errors (i.e., "little r" restatements).

The final rules provide very limited exceptions whereby issuers are not required to collect erroneously awarded compensation including: when expenses paid for collection would exceed the amount of the recovery and the issuer has made a reasonable attempt to recover; recovery would violate home country law; or recovery would cause a tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

Additionally, issuers are required to disclose their clawback policies and any actions taken in response to those policies, file them as exhibits to their annual reports, and indicate by a new checkbox on their annual report whether the financial statements reflect the correction of errors and necessitated a clawback analysis.

The rules and amendments become effective 60 days following publication of the release in the Federal Register. Exchanges must file proposed listing standards within 90 days following publication of the release in the Federal Register, and the proposed listing standards must be effective within one year following publication. Issuers subject to the listing standards are required to adopt a recovery policy within 60 days of the effective date of the applicable listing standards.

Amendments to EGC Filer Status Determination

The Jumpstart Our Business Startups (JOBS) Act of 2012 created "emerging growth company" (EGC) filer status, which permits reduced disclosures in an initial registration statement and provides a temporary exemption from certain financial reporting and governance requirements thereafter. The JOBS Act requires the SEC to index to inflation the annual gross revenue amount used to determine EGC status every five years. Pursuant to this requirement, the SEC issued final rules that increase the annual gross revenue used to determine EGC status from $1,070,000,000 to $1,235,000,000. Similar inflation adjustments were made to certain offering and investment limits in the Regulation Crowdfunding rules as well (refer to the SEC's Fact Sheet for a detailed summary).

The rules became effective on September 20, 2022, upon publication of the release in the Federal Register.

Proposed Rules and Amendments

Climate-Related Disclosures Proposal

Background

As investor demand for environmental, social, and governance (ESG) information has increased, the SEC's focus on such matters, including climate-related risks, has also increased. In 2021, the SEC laid much of the groundwork for the proposal by seeking public input on how it could best regulate or monitor climate change disclosures to provide more consistent and decision-useful information for investors. The staff of the Division of Corporation Finance also enhanced its focus and review of climate-related disclosures in filings to better understand how registrants applied the Commission's 2010 interpretive release on climate change disclosures. The proposal, issued in March, aims to meet investor demands for such information and provide registrants with a standardized framework for disclosures.

Summary of Proposed Requirements

The proposed rules, applicable to both domestic and foreign registrants, would require significantly enhanced climate-related disclosures in registration statements and annual reports (e.g., on Form 10-K). The proposed financial statement disclosures would be presented in a footnote to the consolidated financial statements, while the other disclosures enumerated below would be presented in a separately captioned section of the filing prior to management's discussion and analysis (MD&A). Registrants would be required to electronically tag both the qualitative and quantitative disclosures in Inline XBRL. The proposed requirements include:

Quantitative Disclosures Within the Financial Statements

- *The impact of climate-related events and transition activities on the line items of a registrant's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities.*

  In a note to the audited financials, the proposed rules would require certain disaggregated climate-related financial metrics that are derived from financial statement line items, including the following:

  - **Financial impact metrics** – the impact of severe weather and other natural conditions (including physical risks) and transition activities (including transition risks) on each financial statement line item unless the aggregate impact (i.e., the absolute value of impacts) is less than one percent of the total line item for the relevant fiscal year.

  - *Physical risks* - the risks associated with severe weather events or changing climate conditions
  - *Transition risks* - the risks associated with regulatory, policy, and market shifts toward low-carbon or zero-carbon objectives

- **Expenditure metrics -** amounts expensed and capitalized during the fiscal years presented that are associated with climate-related events and transition activities subject to the same disclosure threshold above.
- **Financial estimates and assumptions -** whether estimates and assumptions used in the financial statements were impacted by exposure to risks and uncertainties associated with, or known impacts from, climate-related events.

BDO INSIGHT: The proposed financial statement disclosures would require registrants to expand their processes and system of internal control over financial reporting ("ICFR") to capture the data relevant to report the financial statement metrics and impact of climate-related events or transition activities in the financial statements. Incremental controls will likely be required to monitor items such as external weather events, transition activities, and the cost differentials between the choice of maintaining currently acceptable operations versus the cost of transitioning to green alternatives. For certain companies and industries, this process may be quite challenging and costly.

Moreover, the scope of the financial statement audit would expand to incorporate the impact of external weather-related events on the financial statements. The impacts of certain events may affect revenue, cost of revenue, reserves, insurance, and litigation (among others). These impacts may not occur in the same period as the event itself, which we expect will increase complexity for both registrants and auditors.

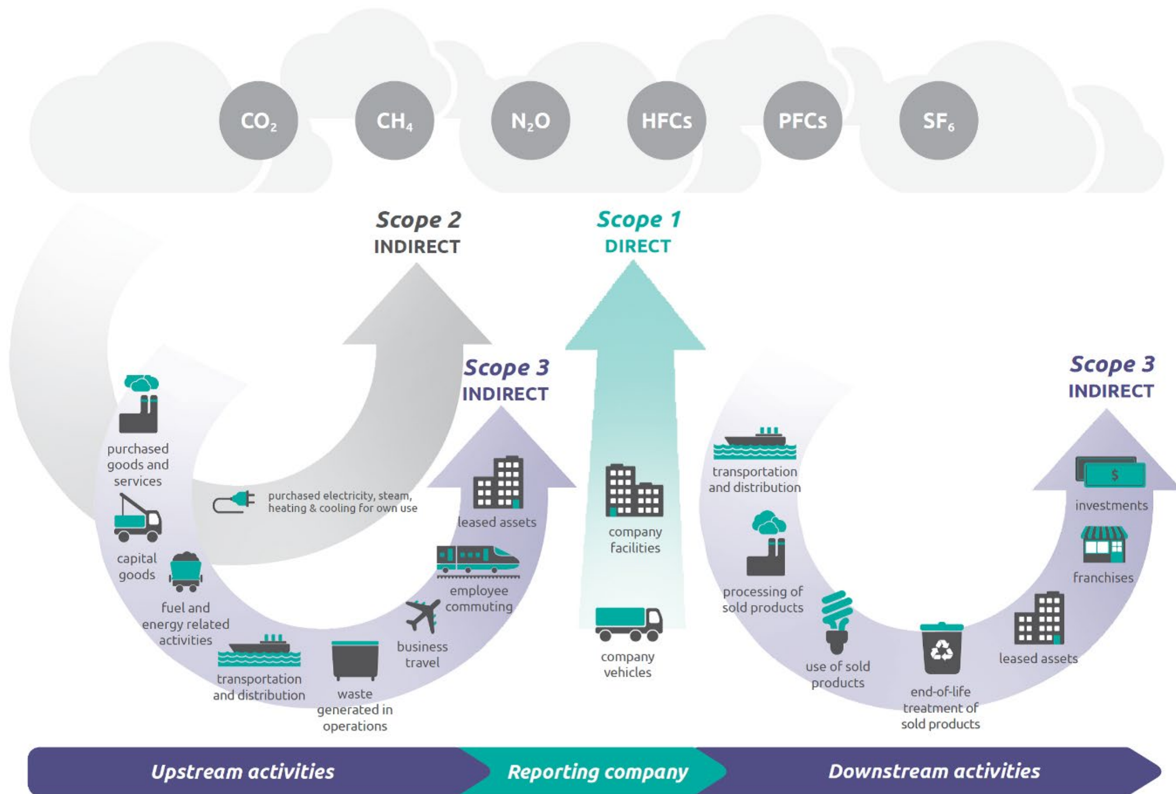
Quantitative Disclosures Outside of the Financial Statements

- *Direct GHG emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2), separately disclosed.*

  Large accelerated and accelerated filers would be required to obtain a third-party attestation report over their Scope 1 and Scope 2 GHG emissions disclosures to include in their registration statements and annual reports. While the attestation provider would need to meet certain minimum standards (and incremental disclosures would be required about the provider), as proposed, the provider would not be required to be a registered public accounting firm.

- *Indirect GHG emissions from upstream and downstream activities in a registrant's value chain (Scope 3), if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.*

  Significant inputs and assumptions used in computing the Scope 3 emissions would also be disclosed. When included, such disclosures would be subject to a safe harbor from liability under the federal securities laws. Smaller reporting companies (SRCs) would be exempt from the Scope 3 GHG emissions disclosure requirements.



Source: [WRI/WBCSD Corporate Value Chain (Scope 3) Accounting and Reporting Standard (PDF)]

BDO INSIGHT: While some larger companies have been reporting their Scope 1 and 2 GHG emissions outside of SEC filings, the incremental effort to disclose the metrics within an SEC filing and subject such disclosures to an audit, if one had not been voluntarily obtained in the past, may still be substantial (even more so for those companies that have not historically tracked or determined GHG emissions). Moreover, as Scope 3 GHG emissions are the result of activities not owned or controlled by a reporting organization, companies will need to consider and assess how to implement the appropriate disclosure controls and procedures to enable disclosure of such information in an SEC filing.

Additionally, the scope of Scope 3 disclosures is broad, and is likely to touch private entities that are not subject to the SEC's reporting and attestation requirements. This would increase the complexity of the process required to obtain the necessary information to disclose and prepare for third-party attestation.

Many companies will need to engage consultants to assist in the measurement of their carbon footprint and in the development and implementation of mitigation strategies to reduce such footprint. Those resources may be scarce and costly.

Qualitative Disclosures

- *How any climate-related risks have had or are reasonably likely to have a material impact on the business and consolidated financial statements, which may manifest over the short-, medium-, and long-term.*

  The proposal did not define "short-, medium-, or long-term" so registrants would have the flexibility to decide and disclose their definition for each category. The materiality threshold would be applied in a consistent manner with other MD&A disclosure.

- *How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook.*

  Such disclosures would include the short-, medium-, and long-term material impacts on the business operations, products or services, suppliers and other parties in the value chain, activities to mitigate or adapt to climate-related risks, and expenditures for research and development related to climate-related risks, as well as disclosure of the registrant's scenario analysis, internal carbon price, and carbon offsets or renewable energy credits (if applicable or used).

- *The registrant's process for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes.*

  Disclosure of processes for identifying, assessing, and managing climate-related risks would include how the registrant:

  - Determines the relative significance of climate-related risks compared to other risks;
  - Considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;
  - Considers shifts in customer preferences, technological changes, or changes in market prices in assessing potential transition risks;
  - Determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk;
  - Decides whether to mitigate, accept, or adapt to a particular risk;
  - Prioritizes addressing climate-related risks;
  - Determines how to mitigate high-priority risks; and
  - Integrates climate-related risks into the registrant's overall risk management system or processes.

  Disclosure of the registrant's transition plan, if any, adopted as part of the registrant's overall risk management strategy. Elements to disclose would include:

  - Details of the plan, including relevant metrics and targets used to identify and manage physical and transition risks;
  - How the registrant plans to mitigate or adapt to any physical risks identified in the filing, such as sea level rise, extreme weather events, wildfires, and droughts;
  - How the registrant plans to mitigate or adapt to any identified transition risks, including laws, regulations, and policies, imposition of carbon prices, and changing demands or preferences of consumers, investors, employees, and business counterparties.

- *Information about a registrant's publicly set climate-related targets and goals (if applicable).*

  Disclosures related to publicly available climate-related targets and goals would include:

  - The scope of activities in the target, the time horizon over which the target is intended to be met, and any interim targets;
  - How the registrant intends to meet the target and any relevant data about a registrant's progress (with updates each fiscal year); and
  - Certain information about the carbon offsets or renewable energy certificates ("RECs") that have been used as part of the registrant's plan to achieve the target (if applicable).

- *The oversight and governance of climate-related risks by the registrant's board and management.*

  Board-related disclosures would include which board members are responsible for the oversight of climate-related risks; which board members, if any, have expertise in climate-related risks and the nature of their expertise; the process and frequency by which the board discusses climate-related risks; whether and how the board or committee considers climate-related risks as part of its business strategy, risk management, and financial oversight; and how the board sets and monitors climate-related goals.

  Management-related disclosures would include management's role in assessing and managing climate-related risks; management's process for being informed about and monitoring climate-related risks; and management's process and frequency for reporting to the board.

BDO INSIGHT: Considering the significance and scope of the climate-related disclosures that would be required in an SEC filing, public companies may need to seek new board members who have expertise in climate-related matters and risks. While expertise at the board level is not required, companies will need to consider any impact on the internal control environment if that expertise is not present. Further, this may require expansion of the discussion of board governance over climate-related disclosures in Form 10-K.

Boards and management will need to educate themselves as to sustainability concepts and, if they have not already done so, engage in deep analysis as to the near, mid, and long-term impact of climate risks related to the registrant's financial statements, business, and value chain. This will require a significant amount of time, expertise, and resources during a period where boards and management are already saddled with significant demands on their time, some of which include cyber risk exposure, human capital scarcity, supply chain issues, and stakeholder demands.

Phase-In Period of Proposed Rules

The proposed rules offer phased-in compliance dates dependent on a registrant's filer status. The level of assurance required for GHG emission disclosures would also be phased in over time. The following tables from the SEC's Fact Sheet illustrate the compliance deadlines for a calendar year-end registrant if the rules were adopted and effective in December 2022:

REGISTRANT TYPE	COMPLIANCE DATE		
	All Disclosures, Except for Scope 3	Scope 3 GHG Emission Disclosures	Assurance on Scope 1 and 2 GHG Emission Disclosures
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Limited Assurance – 2024 Reasonable Assurance – 2026
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Limited Assurance – 2025 Reasonable assurance – 2027
Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Exempt
Smaller Reporting Company	Fiscal year 2025 (filed in 2026)	Exempt	Exempt

BDO INSIGHT: The SEC observed that the proposed amendments are similar to those that many companies already provide based on other disclosure frameworks, like the **Task Force on Climate Related Financial Disclosure**. However, we note that many organizations do not fully comply with the Task Force on Climate Related Financial Disclosure framework, so additional work will likely be required. Further, we anticipate that even some of these companies will likely incur considerable time, effort, and expense to comply with the specified disclosure requirements in their SEC filings and obtain the required attestation reports. Likewise, for the many registrants that have not followed another climate-related framework and may have historically concluded that such disclosures were not material in the context of their SEC filings, the time, effort, and expense to implement the amendments will be even greater.

The proposal goes well beyond the Commission's 2010 interpretive guidance and more recent climate-related SEC staff comment letters. Due to the extensive nature of this proposal, registrants, their auditors, boards, and sustainability officers should begin to evaluate the impact of the proposal on their policies and procedures as well as their system of internal control, and if they have not done so already, begin the process of assessing their organization's full climate impact and determine the magnitude of materiality on their business.

Our other observations on the proposal can be found in our **comment letter**. The comment period ended on June 17, 2022.

Special Purpose Acquisition Company Proposal

Background

SPACs are companies with no commercial operations that are formed to raise capital through an initial public offering for the sole purpose of acquiring one or more target businesses (when completed, referred to as the "de-SPAC transaction"). Although SPACs first emerged in the 1990s, their popularity has increased substantially in the past few years, particularly as a mechanism for private companies to go public. This recent surge has led to increased regulatory scrutiny and concerns about various aspects of the SPAC structure and investor protection matters. The proposal follows multiple public statements and staff guidance to alert investors and other stakeholders about the financial reporting, auditing, and liability considerations specific to SPACs and de-SPAC transactions. While some of the amendments would codify aspects of this guidance that are already applied in practice, other amendments would significantly enhance disclosure and liability of the parties involved and will likely result in fewer SPAC-related transactions in the future.

Summary

Enhanced Disclosure Requirements

The amendments would add a new Subpart 1600 of Regulation S-K that would require specialized disclosures in connection with initial public offerings by SPACs and de-SPAC transactions. These disclosure requirements include:

- Disclosure of the sponsor of the SPAC, potential conflicts of interest, and dilution;
- A statement on whether the SPAC reasonably believes that the de-SPAC transaction is fair or unfair to investors and whether it has received any outside report, opinion, or appraisal relating to the fairness of the transaction; and
- Certain disclosures regarding the unique nature and risks of the offering (among others) on the prospectus cover page and in the prospectus summary of registration statements filed in connection with SPAC initial public offerings ("IPOs") and de-SPAC transactions.

Other requirements of the proposal intended to align the disclosure requirements for de-SPAC transactions more closely with traditional IPOs would:

- Add Article 15 of Regulation S-X to largely codify existing staff views and guidance about the financial statement requirements (including the required periods, age of financial statements, and applicable audit standards) for private operating companies that merge with shell companies, like SPACs. However, some amendments would expand the circumstances in which two years of financial statements would be permissible for the target company and address when SPAC financial statements are required in filings following the de-SPAC transaction.
- Require additional disclosures about the private operating company in the registration statement related to a de-SPAC transaction (e.g., the description of the business and property, legal proceedings, and changes in and disagreements with accountants, among others). Currently, this information is not required until the Form 8-K that is due within four business days of the completion of the de-SPAC is filed.
- Amend the definition of a smaller reporting company (SRC) to require re-determination of SRC status following the completion of a de-SPAC transaction. Currently, the combined company retains the SRC status of the SPAC until the next required determination date. If adopted, this may impact the ability of the combined company to file a new or amended registration statement for a period after the merger if the loss of SRC status results in the need to provide another year of audited annual financial statements.

- Require that disclosures related to de-SPACs be distributed to investors at least 20 days in advance of a shareholder meeting.

The proposal includes incremental disclosure requirements related to projections of future performance by:

- Adding new Item 1609 of Regulation S-K that would require disclosure of:
  - The purpose of any projections disclosed by the registrant and the party that prepared the projections;
  - All material assumptions underlying the projections and any factors that may materially impact the assumptions; and
  - Whether the projections still reflect the view of the board or management of the SPAC or target company as of the filing date. If not, discuss the purpose of disclosing the projections.
- Amending Item 10(b) of Regulation S-K to state that:
  - Any projections that are not based on historical financial results or operational history should be clearly distinguished from those that are based on historical financial results or operational history;
  - In general, if projections that are based on historical financial results or operational history are presented, the underlying historical measure or operational history should be presented with equal or greater prominence; and
  - If non-GAAP projections are presented, the company should also include a definition of the non-GAAP measure, a description of the most closely related GAAP financial measure, and an explanation as to why the non-GAAP financial measure was used instead of the GAAP measure.

Enhanced Liability Provisions

The proposal includes several amendments that would significantly expand the liability of certain parties associated with SPAC and de-SPAC transactions by:

- Adding new Rule 145a that would deem a business combination transaction involving a shell company (including a de-SPAC transaction) to involve a sale of securities to a reporting shell company's shareholders such that Securities Act disclosure and liability provisions would apply to de-SPAC transactions.
- Deeming the private operating company in a de-SPAC transaction to be a co-registrant in a registration statement on Form S-4 or Form F-4.
- Amending the definition of a "blank check company" to encompass SPACs so that SPACs will no longer be covered by the Private Securities Litigation Reform Act of 1995 (PSLRA) safe harbor for forward looking statements.
- Adding new Rule 140a that would deem anyone who has acted as an underwriter of the securities for a SPAC's IPO and participates directly or indirectly in the de-SPAC transaction (via any related financing transaction or otherwise) to be an underwriter in the de-SPAC transaction, subjecting them to Section 11 liability.

Status of SPACs under the Investment Company Act of 1940

To assist SPACs in understanding when their activities may be subject to investment company regulations, the proposal would provide a safe harbor from the definition of an "investment company" for SPACs that satisfy certain conditions that limit a SPAC's duration, asset composition, business purpose, and activities, as follows:

- *Duration*: the SPAC must file a Form 8-K to announce it has entered into an agreement to engage in a de-SPAC transaction no more than 18 months after the effective date of the SPAC's IPO registration statement and complete the de-SPAC transaction within 24 months of the same effective date;
- *Asset composition*: SPAC assets must consist solely of government securities, government money market funds, and cash items prior to the completion of the de-SPAC transaction; and
- *Business purpose and activities*: the SPAC must seek to complete a single de-SPAC transaction and the surviving public entity will be primarily engaged in the business of the target company (or companies).

BDO INSIGHT: Despite the proposal's efforts to align traditional IPOs and de-SPAC transactions, differences remain particularly with respect to certain reporting requirements following de-SPAC transactions. Additionally, the proposal lacks explicit transition guidance for existing SPACs and certain entities that are currently engaged in completing their de-SPAC transactions.

Cybersecurity Disclosures Proposal

To enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting, the SEC proposed enhanced and new cybersecurity disclosure requirements in March. Most significantly, the proposed rules would require: current reporting about material cybersecurity incidents on Form 8-K; periodic disclosures regarding a registrant's policies and procedures to identify and manage cybersecurity risk, management's role in implementing cybersecurity policies and procedures, board of directors' cybersecurity expertise and its oversight of cybersecurity risk, and updates about previously reported material cybersecurity threats; and Inline XBRL tagging of the required disclosures.

Background

In response to the increasing significance of cybersecurity incidents, the SEC issued an interpretive release in 2018 that outlined the Commission's views with respect to cybersecurity disclosure requirements under the existing federal securities laws. The release reinforced and expanded the guidance on reporting and disclosing cybersecurity risks and incidents that the Division of Corporation Finance issued in 2011. In addition, the release addressed the importance of cybersecurity policies and procedures and the application of insider trading prohibitions in the cybersecurity context. As the SEC has observed inconsistent disclosure practices, the proposed rules are intended to provide more consistency and comparability of cybersecurity disclosures by public companies across industries.

Summary

Incident Disclosures in Form 8-K

Form 8-K would be amended to require disclosure of information about a material cybersecurity incident within four business days after it is determined that a cybersecurity incident is material. A cybersecurity incident would be defined as "an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein." In some cases, the date of the materiality determination may coincide with the date of discovery. However, in other cases, the date of materiality determination may come after the discovery date. In the event of the latter, registrants are expected to be diligent in making a materiality determination as promptly as feasible. To the extent the information is known at the time of filing, Form 8-K would include the following disclosures:

- When the incident was discovered and whether it is ongoing;
- A brief description of the nature and scope of the incident;
- Whether any data was stolen, altered, accessed, or used for any other unauthorized purpose;
- The effect of the incident on the registrant's operations; and
- Whether the registrant has remediated or is currently remediating the incident.

Updates to Previously Filed Form 8-K Disclosure in Periodic Reports

Forms 10-Q and 10-K would be amended to require registrants to provide updated disclosures related to previously disclosed cybersecurity incidents as additional information may become available after the initial Form 8-K is filed. If the disclosures made in the initial Form 8-K become inaccurate or materially misleading because of subsequent developments, an amended Form 8-K may be required. Forms 10-Q and 10-K would also be amended to require disclosure of circumstances when a series of previously undisclosed individually immaterial cybersecurity incidents have become material in the aggregate (when known).

Risk Management and Strategy Disclosure

Regulation S-K would be amended to require disclosure of a registrant's policies and procedures for the identification and management of risks from cybersecurity threats, including whether the registrant considers cybersecurity as part of its business strategy, financial planning, and capital allocation. Disclosures would include, among others, whether the registrant has a cybersecurity risk assessment program (including a description, if applicable) and policies and procedures to oversee and identify the cybersecurity risks associated with its use of any third-party service providers.

Governance Disclosures

Regulation S-K would also be amended to disclose the board's oversight of cybersecurity risk and management's role and expertise in assessing and managing cybersecurity risk and implementing the registrant's cybersecurity policies, procedures, and strategies. To the extent applicable, the disclosures would include the following:

- Board of Directors' Role in Overseeing Cybersecurity Risks
  - Whether the entire board, specific board members or a board committee is responsible for the oversight of cybersecurity risks;
  - The processes by which the board is informed about cybersecurity risks, and the frequency of its discussions on this topic; and
  - Whether and how the board or board committee considers cybersecurity risks as part of its business strategy, risk management, and financial oversight.
- Management's Role in Assessing and Managing Cybersecurity-Related Risks
  - Whether certain management positions or committees are responsible for measuring and managing cybersecurity risk, specifically the prevention, mitigation, detection, and remediation of cybersecurity incidents, and the relevant expertise of such persons or members;
  - Whether the registrant has designated a chief information security officer, or someone in a comparable position, and if so, to whom that individual reports within the registrant's organizational chart, and the relevant expertise of any such persons;
  - The processes by which such persons or committees are informed about and monitor the prevention, mitigation, detection, and remediation of cybersecurity incidents; and
  - Whether and how frequently such persons or committees report to the board of directors or a committee of the board of directors on cybersecurity risk.

Cybersecurity Expertise Disclosure

Item 407 of Regulation S-K and Form 20-F would be amended to require disclosure regarding board member cybersecurity expertise. Under the proposal, registrants must disclose in annual reports and certain proxy filings whether any member of the registrant's board of directors has expertise in cybersecurity and, if so, the names of any such directors and any detail necessary to fully describe the nature of the expertise.

BDO INSIGHT: The proposal lacks clarity in the application of the proposed rules, particularly with respect to the requirement to disclose when a series of previously undisclosed and individually immaterial cybersecurity incidents have become material in the aggregate. Absent clarifying guidance, we believe registrants may face significant challenges making such a requirement operational.

Rule 10B5-1 Insider Trading Proposal

In January, the SEC proposed amendments to Rule 10b5-1 of the Securities Exchange Act of 1934 to address concerns of insider trading. The proposed rules include mandatory cooling-off periods, insider certification, enhanced and new disclosures, and limit the affirmative defense afforded under the current rule.

Background

Company insiders, such as officers and directors, often hold material nonpublic information ("MNPI") which may present a barrier to trading due to the perceived notion of insider trading. Rule 10b5-1 provides a defense against claims of insider trading, allowing the establishment of a plan to dictate the trading of shares by insiders. In accordance with Rule 10b5-1, an insider must act in good faith and without knowledge of MNPI when the plan is established. A trade made in accordance with a plan established in accordance with Rule 10b5-1 provides an insider with an affirmative defense against insider training. The SEC's proposed amendments are intended to deter perceived abuse of such defense as cited in academic studies, and statements made by district courts, commentators, and a member of Congress.

Summary

The proposed amendments include mandatory cooling-off periods, which are not required under the current rule. Under the proposed amendments, upon the adoption of, or modification to, a trading arrangement, and prior to trade commencement, insider plans would require a 120-day cooling off period and company buyback plans would require a 30-day cooling off period. The amendments also include a certification requirement for officers and directors. The certification must be furnished to the company upon the adoption of, or modification to, a trading plan, and affirm that such plan was adopted, or modified, in good faith, and without knowledge of MNPI. While this notion is required under the current rule, such certifications are not required to be furnished.

Additionally, the proposed amendments would not provide an insider with an affirmative defense for multiple overlapping plans for the same security. There are also several enhanced, and new disclosure requirements included in the proposal, such as disclosure of equity grants to named executive officers made within 14-days of filing or furnishing MNPI.

Share Repurchase Disclosures Proposal

Background

Share repurchases made by, or on behalf of the company, or an affiliate purchaser are required to be disclosed within the issuer's periodic report. Item 703 of Regulation S-K requires tabular disclosure of issuer purchases of equity securities by month, including the number of shares repurchased and average price paid per share, as well as information about the repurchase plan or program. These disclosures do not include the specific date of the repurchase. As these disclosures are required in an issuer's periodic reports, investors may be unaware of the repurchase for months. The SEC proposed rules in December 2021, that, if implemented, are intended to benefit investors by improving "the quality, relevance, and timeliness of information related to issuer share repurchases."

Summary

The proposed rules would require an issuer to report any share repurchase on Form SR, which is to be furnished no later than the end of the first business day following the repurchase. The form would require tabular disclosure, similar that required under Item 703 of Regulation S-K; however, additional information such as the specific date of sale as well as whether the share repurchases were made pursuant to the Rule 10b-18 safe harbor, or Rule 10-b5-1. The SEC also proposed enhanced disclosure requirements under Item 703 of Regulation S-K to include similar detail as well information about the objective and process of the share repurchase program, and any policies and procedures in place for officers and directors during the program.

Under the proposed rules, the information disclosed within Form SR and under the enhanced disclosures within Item 703 of Regulation S-K would be required to be tagged using Inline XBRL.

Proposed Rules Applicable To Certain Investment Companies And Advisors

In May, the SEC proposed rule amendments applicable to registered investment companies, investment advisors, and business development companies ("BDCs") concerning their incorporation of environment, social, and governance ("ESG") factors into their strategies, services and/or names:

Enhanced disclosures regarding ESG investment practices

To standardize disclosure and provide comparable information across ESG related investments, the proposed amendments would require a fund that considers ESG factors in its investment process to disclose additional information about its strategy. The amount and location of the required disclosures would depend on how prevalent ESG factors are to the fund's investment strategy. Additionally, certain ESG-Focused[11] funds that consider greenhouse gas emissions as part of their investment strategy would be required to disclose the carbon footprint and weighted average carbon intensity associated with their portfolios.

The proposed rules would be applicable to registered investment companies, BDCs, registered investment advisers, and certain unregistered advisers. The fact sheet is available here.

Investment company names

The "names rule" under the Investment Company Act of 1940 requires certain funds to adopt a policy to invest at least 80 percent of their assets in investments suggested by their name. To help ensure a fund's name accurately reflects the fund's investments and risks, the proposed amendments would expand this rule to include funds that have terms such as "growth," "value," or certain ESG characteristics. Among other items, the proposal would also require disclosure that defines the terms

[11] The SEC considers "ESG-Focused Funds" to be funds for which ESG factors are a significant or main consideration.

used in a fund's name and enhances the recordkeeping requirements regarding its compliance with the rules. The fact sheet is available here.

Other Staff Guidance

Staff Accounting Bulletin

In April, the staff issued Staff Accounting Bulletin (SAB) No. 121 to address the accounting for entities that have obligations to safeguard crypto assets for their platform users. The SAB, which was codified into SAB Topic 5.FF, contains guidance for how entities who safeguard crypto assets for platform users should account for the assets and liabilities associated with their holdings as well as the staff's expectations for disclosures of such arrangements. It also provides insights into the technological, legal, and regulatory risks associated with safeguarding crypto assets for platform users. The views expressed in the SAB are solely related to the safeguarding of crypto assets and related obligations and should not be analogized to for other custody arrangements.

When an entity is responsible for safeguarding crypto assets, the SEC staff believes the entity should present both an asset and a corresponding liability on its balance sheet. The asset and liability should be recorded at fair value at initial recognition and at each reporting date. At each reporting date, the entity should also consider whether there were any loss events, such as the theft or loss of a cryptographic key. The staff expects registrants to disclose the nature and amount of crypto assets held by the entity and any vulnerabilities that arise due to concentrations in crypto assets. The entity must also include standard fair value measurement disclosures since the asset and liability are recorded at fair value.

The staff also expects additional disclosures outside of the financial statements, such as within the description of the business, risk factors, and in MD&A. Such disclosures may include the types of losses that could occur because of the risks associated with holding crypto assets, the entity's assessment of legal ownership of crypto assets and the treatment of those assets in the event of bankruptcy, and the potential effects of loss or theft of cryptographic key information.

Further details can be found in SAB No. 121.

Materiality And Error Corrections

Background

The staff has issued statements over the years about materiality and how registrants, auditors and audit committees should think about materiality in the context of error assessments and the related disclosures. The message has been clear -- a matter is considered material if there is "a substantial likelihood that the ... fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

The materiality of an error in previously issued financial statements determines how a registrant must correct the error. A material error requires a restatement and reissuance of previously issued financial statements (i.e., a "Big R" restatement). When an error is not material to the historical financial statements, a registrant should evaluate whether the error may be corrected in the current period. If the error correction would result in a material misstatement to the current period, the registrant would instead correct the comparative prior period information within the current period financial statements (i.e., a "little r" revision).

Statement by Acting Chief Accountant

In March, the SEC's Acting Chief Accountant, Paul Munter, released a statement on assessing the materiality of errors and again emphasized the need to focus on the views of the reasonable investor. The statement cites the staff's observations that "little r" revisions as a percentage of all restatements have increased substantially between 2005 and 2020 and that the materiality analyses appear to be biased toward supporting an outcome that an error is not material to previously issued financial statements.

The statement includes several key considerations when assessing errors:

- Objectivity is the key to making good decisions when assessing errors. Be intentional about overcoming natural biases and view things through the lens of a reasonable investor when assessing materiality, which includes thorough and objective consideration of the total mix of available information.
- As the quantitative magnitude of an error increases, it is increasingly difficult for qualitative factors to overcome the quantitative significance of the error.
- Errors impact management's assessment of internal controls over financial reporting (ICFR). While a material error in previously issued financial statements signifies the existence of a material weakness, an immaterial error may also result in the identification of a material weakness (i.e., management is required to perform an objective assessment of whether the immaterial error *could have* been material).

Arguments that the staff has encountered and not found to be persuasive in the materiality of error assessments include:

- The portions of the financial statements to which the error relates are not useful to a reasonable investor so therefore the error cannot be material. Phrased another way, specific line items or information included within the financial statements are irrelevant to investors and therefore an error related to those items is not material.
- The error was also made by other SEC filers, suggesting that it was an innocent mistake and not an intentional attempt to manipulate the financial statements. While SAB 99 states that intent may provide significant evidence of materiality, it does not say that the lack of an intentional misstatement provides evidence that an error is not material.
- The identified errors, while material individually, net against one another and are no longer material. SAB 99 states that errors must be evaluated individually and in aggregate.

Financial Reporting Manual

The Division of Corporation Finance has historically maintained the Financial Reporting Manual, an internal SEC staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues, particularly for significant business acquisitions. However, as of the date of this publication in November 2022, the FRM has not been updated since November 2020, meaning that it does not contain new Rule 3-05 or Article 11 amendments that became effective in 2021. Accordingly, those who refer to the FRM for guidance on reporting matters should reference it with caution as portions are outdated.

BDO INSIGHT:

The rule amendments applicable to financial statements of acquired businesses and pro forma financial information are summarized in more detail in our 2020 SEC Reporting Insights publication. Additional information regarding Rule 3-05, 3-14 and Article 11 can be found in our Snapshot publications:

- Financial Statements of Acquired Businesses
- Financial Statements of Acquired Real Estate Operations
- Pro Forma Financial Information

Compliance And Disclosure Interpretations

In March, the staff of the Division of Corporation Finance updated several compliance and disclosure interpretations (CD&Is) applicable to business combinations reported in Form 8-K.

- Question 102.04 addresses the staff's views on the material terms and conditions of a business combination agreement that should be included in Item 1.01 of Form 8-K. These items generally include the amount and nature of consideration transferred, any related financing arrangements, material conditions to close, and the timeframe for filing any related registration statement or proxy.
- Question 102.05 addresses the staff's views on filing a material definitive agreement as an exhibit to the Item 1.01 Form 8-K. The staff believes it is generally feasible to file the agreement and, if companies do not, they should provide an explanation in the Form 8-K.

The updated CD&Is can be found here.

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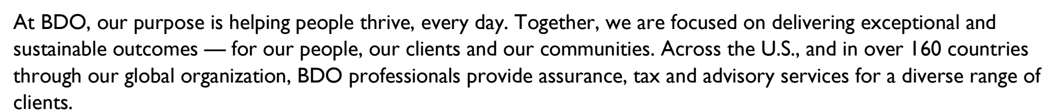

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