

# Ten Key Considerations for the 2023 Annual Reporting and Proxy Season

## Part I: Form 10-K Considerations

January 5, 2023

**Authors:** [Era Anagnosti](#), [Colin J. Diamond](#), [Maia Gez](#), [Scott Levi](#), [Taylor Pullins](#), [Michelle Rutta](#), [Melinda Anderson](#), [Amanda Maki](#), [Danielle Herrick](#)

Part I of our two-part series identifies our Public Company Advisory Group's 10 important considerations when preparing Annual Reports on Form 10-K in 2023, organized in two categories:

(1) [Six Housekeeping Considerations](#): (i) [Confirming Filing Status](#), (ii) [Exhibit Index Reminders](#), (iii) [Recent Form Check Items](#), (iv) [Stock Repurchase Table Reminder](#), (v) [Considerations for Outstanding Registration Statements](#), and (vi) [D&O Questionnaires](#); and

(2) [Four Disclosure Considerations](#): (i) [Non-GAAP Financial Measures - Five Key Reminders](#), (ii) [Management's Discussion & Analysis \(MD&A\) Considerations](#), (iii) [Recent Developments to Consider for Annual Report Disclosure](#), and (iv) [ESG](#).

Part II of our series will describe key considerations for annual meeting proxy statements.

### Six Housekeeping Considerations

- 1. Confirm Filing Status:** First, confirm your filing status in order to determine your filing deadlines, whether you are eligible for scaled reporting, and to appropriately complete the checkboxes on your Form 10-K cover page.

This year's [Form 10-K](#) is due on **Wednesday, March 1, 2023** for large accelerated filers, **Thursday, March 16, 2023** for accelerated filers, and **Friday, March 31, 2023** for non-accelerated filers.<sup>1</sup>

For companies that experienced stock price volatility in the recently completed fiscal year, re-assessing filing status is even more important. To confirm your filing status, keep in mind that:

- *Determining Public Float:* Public float is central to calculating your filing status and is computed as of the last business day of the company's most recently completed second fiscal quarter (June 30, 2022 for calendar year end companies) by multiplying (a) the number of shares of common stock on that day *held by non-affiliates*<sup>2</sup> by (b) the closing stock price on that day. As a result, confirming the identity and holdings of affiliates and subtracting out those shares is critical for an accurate calculation of "public float."

<sup>1</sup> See the SEC's helpful [information on filing deadlines](#).

<sup>2</sup> The term "affiliate" is defined under Rule 12b-2 of the Exchange Act as "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." An individual or entity's status as an "affiliate" is a fact-specific inquiry which must be determined by considering all relevant facts and circumstances; however, the Commission has indicated that status as an officer, director or 10% stockholder is one fact which must be taken into consideration in such inquiry. See American-Standard, SEC No-Action Letter (October 11, 1972).

- *Large Accelerated, Accelerated and SRC Thresholds:* If a company previously qualified as a “large accelerated filer” or an “accelerated filer” or did not qualify as a “smaller reporting company” (SRC) under Rule 12b-2 of the Exchange Act, the thresholds to now move into accelerated filer, non-accelerated filer or SRC status are different and lower than those required for the initial qualification (e.g., less than \$560 million as opposed to \$700 million for accelerated filer status, less than \$60 million as opposed to \$75 million for non-accelerated filer status, or for the SRC public float test, less than \$200 million as opposed to \$250 million).<sup>3</sup>

In addition, you should also determine whether you continue to qualify as an emerging growth company (EGC) based on: (i) your total annual gross revenues on the last day of fiscal year 2022, (ii) the passage of time, (iii) the issuance of more than \$1 billion in non-convertible debt in the previous three years, or (iv) becoming a large accelerated filer. Effective September 20, 2022, the SEC increased the revenue threshold to qualify as (or remain) an EGC from \$1.07 billion to \$1.235 billion.

2. **Exhibit Index Reminders:** For the exhibit index, companies should: (i) review the exhibit list and confirm inclusion of all required exhibits in accordance with Item 601 of Regulation S-K, including (a) exhibits that were filed since last year’s Form 10-K on Forms 8-K and 10-Q, and (b) the description of securities for each class of securities registered under Section 12 of the Exchange Act;<sup>4</sup> and (ii) remove outdated exhibits no longer required to be filed, such as material contracts that have been fully performed.

In addition, with respect to exhibit redactions, keep in mind that there are three separate avenues for omitting information from exhibits, each with separate requirements under Item 601 of Regulation S-K:

- 1) *Personal Privacy:* Companies should make sure to omit information in exhibits that would constitute a clear unwarranted invasion of personal privacy (e.g., disclosure of bank account numbers, social security numbers, home addresses, and similar information). For these redactions, no additional steps or disclosure (such as inclusion of legends specifying the redacted information) is needed. The private information may simply be removed.<sup>5</sup>
- 2) *Schedules or Similar Attachments:* Companies may omit schedules or similar attachments to exhibits, provided that such schedules or attachments do *not* contain material information and the information is not otherwise disclosed in the exhibit. Each exhibit must contain a list of the omitted contents, but this list is not required if the exhibit already conveys the subject matter of the omitted schedules, such as in a table of contents included in the exhibit.<sup>6</sup> Notably, there is no requirement under Item 601(a)(5) of Regulation S-K for a company using this avenue to provide any other language or header either in its exhibit index or the exhibit itself.
- 3) *Confidential Business Information:* Lastly, a company may omit information that it “customarily and actually treats. . . as private or confidential” and that “is not **material**” to the company.<sup>7</sup> In this case, companies must (i) mark the exhibit index to indicate that portions of the exhibit have been omitted and (ii) include a prominent statement on the first page of the redacted exhibit that certain identified information has been excluded because it is not material and is the type that the company treats as private or confidential.

<sup>3</sup> See Rule 12b-2 of the Exchange Act for the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company,” and the SEC’s helpful guides for [determining filing status](#) and [smaller reporting company status](#). Each issuer should run this calculation as facts and circumstances vary depending on prior qualifications. For example, if a company had previously been a large accelerated filer, the subsequent qualification thresholds to become an accelerated filer are less than \$560 million but \$60 million or more, or to become a non-accelerated filer, less than \$60 million, in each case, in public float. In addition, for the revenue test to qualify as an SRC, as opposed to the public float test, the lower thresholds also differ and are 80 percent of the prior thresholds that were failed (i.e., less than \$560 million in public float (if it previously had more than \$700 million in public float under the public float prong of the revenue test) and less than \$80 million in revenue (if it previously had more than \$100 million in revenue under the revenue prong of the revenue test)).

<sup>4</sup> Item 601(b)(4)(iv) of Regulation S-K.

<sup>5</sup> Item 601(a)(6) of Regulation S-K.

<sup>6</sup> Item 601(a)(5) of Regulation S-K.

<sup>7</sup> The SEC updated the standard for redacting confidential information in exhibit filings under Item 601(b)(2) and 601(b)(10) to remove the “competitive harm” standard. Information may now be redacted if it is (1) not material and (2) the type that the company both “customarily and actually treats as private or confidential.” See our [2021 Housekeeping Items](#) for a further discussion these changes.

3. **Recent Form Check Items:** As part of this year's Form 10-K form check, focus on the following items, which were new last year:
- 1) Remember to update Item 6 in Part II to state "**Item 6. [Reserved]**" (instead of "Item 6. Selected Financial Data" from the prior Form 10-K) due to the SEC's elimination of the disclosure requirement for selected financial data in 2021.<sup>8</sup>
  - 2) Remember to add new "Item 9C" in Part II of the Form 10-K with the caption "Disclosure Regarding Foreign Jurisdictions that Prevent Inspections". As background, new Item 9C was added to the Form 10-K in 2021 pursuant to the Holding Foreign Companies Accountable Act (HFCAA) (as explained in our [prior alert](#)) in order to identify any issuers that retain auditors that the PCAOB is unable to inspect completely. Given the PCAOB's [recent announcement](#) that it "has secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong," this year companies should not have any disclosure (beyond "Not applicable" or "None") under this item in their upcoming Form 10-Ks.
  - 3) Remember to tag in inline XBRL the independent auditor's: (i) name, (ii) location (i.e., city and state, province or country) and (iii) PCAOB ID number.<sup>9</sup> Practices vary as to the location of this tagging in annual reports, but a commonly used option is to tag the auditor's name and PCAOB ID number in the Index to the Financial Statements and the auditor's location at the end of the audit report. Companies should coordinate this tagging with the financial printer.
4. **Stock Repurchase Table Reminder.** While not a new requirement for 2023, it is important to remember that Item 703 of Regulation S-K requires disclosure of the company's repurchases of its equity securities during the period covered by the report. For this purpose, keep in mind that the withholding of restricted stock (or the tendering of outstanding shares owned by an employee) to pay taxes due upon vesting must be disclosed under Item 703 because the issuer is acquiring its own outstanding shares. However, if the equity at issue was never outstanding (for example, in the case of withholdings of restricted stock units, or forfeitures of restricted stock when vesting conditions have not yet been satisfied), then no such disclosure is required.<sup>10</sup>
5. **Considerations for Outstanding Registration Statements:** Consider how the filing of the Form 10-K may impact any outstanding registration statements. Specifically, if you have an outstanding registration statement on Form S-1, a post-effective amendment to the Form S-1 must be filed in order to incorporate the annual financial statements and other information from the Form 10-K into the Form S-1. You should also consider if you have become Form S-3 eligible, so that you can convert the Form S-1 into a Form S-3 and avoid future post-effective amendments for as long as you remain S-3 eligible. If you have an outstanding registration statement on Form S-3, ensure that you continue to meet the eligibility requirements for using the Form S-3 when filing your Form 10-K: (i) if you previously filed as a well-known seasoned issuer (WKSI), confirm that you are still a WKSI in order to use that registration statement (otherwise, it will need to be re-filed (if eligible) as a non-WKSI shelf); or (ii) if you previously filed a non-WKSI shelf registration statement, confirm that you still meet the requirements to use that registration statement; otherwise, you will need to re-file as a Form S-1. In addition, remember to update your auditor consent to include any newly filed registration statements and remove any registration statements that are no longer effective.
6. **D&O Questionnaires.** Ahead of your Form 10-K filing, review and update your D&O questionnaires, which provide back-up and support for the disclosures to be included in your Form 10-K and proxy statement. In particular:

<sup>8</sup> For more information, see "[Considerations for the Form 10-K in 2022: Mandatory Compliance with SEC's Rule Amendments to Items 301, 302 and 303](#)" in our prior memo.

<sup>9</sup> This requirement is a result of the SEC's December 2021 [amendments](#) implementing the HFCAA for all auditors that provide their opinions related to financial statements, in accordance with [Section 6.5.54 of the EDGAR Filing Manual](#).

<sup>10</sup> See Regulation S-K Compliance and Disclosure Interpretations, Questions 149.01 and 149.02.

- 1) Consider updates to state that a director nominee consents to being named in the proxy statements of both the company and of any dissident shareholder, in order to comply with the [new universal proxy rules](#);
- 2) If you are a Nasdaq-listed company subject to the board diversity requirements or otherwise plan to voluntarily disclose the diversity of your directors, include a question to elicit information on your directors' diversity characteristics that covers the potential diversity categories that you may want to disclose (under Nasdaq and/or investor policies) and to obtain their consent to disclose this information;
- 3) Consider adding a question to elicit information from directors on their expertise with respect to ESG, human capital and/or cybersecurity in light of both SEC and investor focus on board qualifications in these areas;
- 4) Consider adding or refining questions on outside directorships or officerships to identify any potential antitrust concerns, given recent Department of Justice [focus on potential violations of Section 8 of the Clayton Act](#); and
- 5) Consider building out (or adding) Iran-related activities questions to cover potentially problematic transactions with Russian entities.<sup>11</sup>

## Four Disclosure Considerations

1. **Non-GAAP Compliance – Five Key Reminders:** On December 13, 2022, the SEC posted an update to its Non-GAAP Measures Compliance and Disclosure Interpretations (C&DIs) Questions,<sup>12</sup> as non-GAAP financial measures remained one of the most frequent topics in SEC staff comment letters over the last year. Given these developments, companies should review their non-GAAP disclosures and consider the following five key reminders:

- 1) ***Nature of Adjustments Can Be Misleading.*** The nature of the adjustments made to calculate a non-GAAP measure has been a focus of the SEC since Regulation G was adopted in 2003. For SEC filings, certain types of adjustments are specifically prohibited by Item 10(e) of Regulation S-K.<sup>13</sup> However, even when not specifically prohibited by SEC rules, adjustments may result in a misleading non-GAAP measure, such as when a company “cherry-picks” adjustments by inconsistently adjusting between periods or excluding charges, but not gains, to GAAP measures.

The 2016 C&DI 100.01 addressed misleading non-GAAP adjustments, cautioning companies that “presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant’s business...could be misleading.” Moreover, one of the most frequent comments issued by the Staff in the past fifteen months requested that companies defend the exclusion of expenses that appear to be “normal, recurring operating expenses” from non-GAAP performance measures.<sup>14</sup>

The December 2022 C&DI updates reflect a heightened SEC focus on this issue. In particular, updated C&DI 100.01 now states that the determination of whether adjustments result in a misleading non-GAAP measure will depend on the facts and circumstances, and also notes the following:

- The “nature and effect of the non-GAAP adjustment and how it relates to the company’s *operations, revenue generating activities, business strategy, industry and regulatory environment*” are factors that will be considered by the Staff when evaluating what is a “normal” operating expense; and
- Operating expenses that occur repeatedly or occasionally, even at “*irregular intervals*”, would

<sup>11</sup> Since February 2022, the US has imposed sweeping sanctions on Russia, bringing a number of high-net-worth individuals and companies with substantial investments in the US within scope of the of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA). Companies should undertake diligence to determine whether any sanctioned individuals or entities may be involved in their activities to assess compliance and potential disclosure requirements, as the ITRA requires Form 10-K and Form 10-Q disclosure if the company (or any affiliate) knowingly engaged in certain sanctionable activities.

<sup>12</sup> Specifically, the SEC updated Non-GAAP Financial Measures C&DIs Questions 100.01, 100.04-100.06, and 102.10(a), (b) and (c), which can be found [here](#). A redlined version of the updated C&DIs to the prior version is included in **Appendix A**.

<sup>13</sup> See [Item 10\(e\)](#) of Regulation S-K for specifically prohibited adjustments in SEC filings. In addition to the prohibitions under Item 10(e), the SEC’s C&DIs prohibit disclosure of non-GAAP liquidity measures on a per share basis.

<sup>14</sup> Between September 2021 and the end of 2022, the Staff issued 86 comments that specifically referenced C&DI 100.01.

be viewed as “recurring” by the Staff.

Moreover, the Staff added new C&DI (100.06) stating that a non-GAAP measure can still be misleading even if there is “extensive, detailed disclosure about the nature and effect of each adjustment.” In light of these developments, companies should reconsider the disclosures around the reasons for their adjustments (as discussed below) and also whether the Staff may object to adjustments that may be considered normal operating expenses based on the company’s operations, revenue generating activities, strategy, industry and regulatory environment.

- 2) **Greater Prominence to GAAP Measure.** When non-GAAP measures are included in SEC filings and in earnings releases furnished under Item 2.02 of Form 8-K, the most directly comparable financial measure calculated in accordance with GAAP *must be presented with equal or greater prominence*. In particular, the Staff has issued comments when the results of operations discussion primarily focused on the period-over-period changes in the non-GAAP measures as opposed to, or without, a discussion of movements in the comparable GAAP measures.

In line with these Staff comments, updated C&DI 102.10(a) provides that the greater or equal prominence requirement specifically applies to *any related discussion and analysis of a non-GAAP measure*, and not just to the presentation of the measure itself.<sup>15</sup> Moreover, the Staff added two new C&DIs that largely reorganized and provided further detail regarding the Staff’s existing guidance on prominence.<sup>16</sup> The new C&DIs provide, among other things, that:

- presenting a ratio where the non-GAAP measure is the numerator or denominator also requires presenting the ratio calculated using the most directly comparable GAAP measures with equal or greater prominence;
- presenting a reconciliation table that starts with a non-GAAP measure (instead of the comparable GAAP measure) provides greater prominence to the non-GAAP measure; and
- presenting an income statement of non-GAAP measures is prohibited (not just a *full* income statement of non-GAAP measures, as listed under the prior C&DI), and a “non-GAAP income statement” is one that includes “all or most of the line items and subtotals found in a GAAP income statement.”<sup>17</sup>

- 3) **Clear Explanations of Non-GAAP Measures.** Companies are reminded that when disclosing non-GAAP measures, the reasons why management believes the non-GAAP measure provides useful information and any additional purposes for which management uses the non-GAAP measure must be disclosed.<sup>18</sup> The Staff has issued comments regarding disclosures that are boilerplate or overly generic for this purpose, and has also noted the importance of providing a clear explanation for each adjustment.<sup>19</sup> Moreover, in December 2022, the Staff issued a new C&DI emphasizing the importance of clear disclosure, noting that without an appropriate label and clear description, a non-GAAP measure or any particular adjustment could be misleading to investors.<sup>20</sup>
- 4) **Forward Looking Non-GAAP Measures.** Item 10(e) requires a quantitative reconciliation, “to the extent available without unreasonable efforts,” for forward-looking non-GAAP financial measures. If the most directly comparable GAAP measure is not accessible on a forward-looking basis, this fact must be disclosed, along with the specific reconciling information that is unavailable and its probable significance.

<sup>15</sup> See [C&DI 102.10\(a\)](#).

<sup>16</sup> See [C&DIs 102.10\(b\)](#) and [102.10\(c\)](#).

<sup>17</sup> See [C&DI 102.10\(b\)](#) and Item 10(e)(1)(i)(B) of Regulation S-K.

<sup>18</sup> Item 10(e)(1)(i)(C) of Regulation S-K.

<sup>19</sup> Approximately 20 comments of this type have been issued since September 2021. For example, in August 2022, the Staff issued the following comment: “We note your explanation of the purpose for the various non-GAAP measures and adjustments...appears to be generic and non-specific to each individual adjustment. Please tell us and consider the need to revise your disclosures, in future filings, to provide a clearer explanation of each individual adjustment and the Company’s basis for exclusion.”

<sup>20</sup> See [C&DI 100.05](#).

These required additional disclosures must be in a location *of equal or greater prominence* to the forward-looking non-GAAP measure.<sup>21</sup> While companies generally disclose what information *is unavailable*, in several recent comment letters the SEC has been requesting that companies also provide any reconciling information that *is available*.<sup>22</sup>

- 5) ***Individually Tailored Accounting Principles Inconsistent with GAAP.*** The Staff has long held that a non-GAAP measure that uses an individually tailored recognition or measurement principle inconsistent with GAAP may be misleading. Historically, the focus has been on adjustments to revenue recognition that are prohibited by GAAP, and updated C&DI 100.04 provides additional examples of adjustments to revenue that may be misleading. Notwithstanding this focus, companies should carefully consider whether *any* of their non-GAAP measures may involve individually tailored accounting principles. Updated C&DI 100.04 includes the following non-exclusive examples of misleading adjustments: (i) changing the pattern of recognition, including the acceleration of revenue recognized ratably over time; (ii) deducting transaction costs from revenue when gross presentation as a principle is required by GAAP (or the inverse, presenting revenue on a gross basis when net presentation is required by GAAP); and (iii) changing the bases of accounting for revenue or expenses from an accrual basis to a cash basis.

- (2) **MD&A Considerations:** MD&A has continued to be one of the most frequent targets of SEC Staff comments in the last year, following the SEC's comprehensive rule changes to MD&A, as described in our [prior alert](#). SEC comments concerning MD&A disclosures primarily focus on greater transparency regarding: (i) the drivers of period-to-period changes in financial statement line items; (ii) known events, uncertainties and trends; (iii) liquidity and capital resources, including material cash requirements; and (iv) critical accounting estimates. The Staff has also focused on consistency across company disclosures, targeting companies that disclose trends or other material information impacting their financial results in earnings releases or earnings calls, but not referencing such information in their MD&A.<sup>23</sup>

As noted in Item 303(a) of Regulation S-K, MD&A disclosures should “better allow investors to view the registrant from management’s perspective” and companies should consider the following four items as they prepare their MD&As:

- 1) ***Discussion of Drivers in Period-to-Period Changes:*** Item 303(b)(2) requires disclosure of the underlying reasons for period-to-period material changes in a line item of a company’s financial statements in quantitative and qualitative terms, including where material changes within a line item offset one another. A discussion, with specificity, of both the “how” and the “why” of any material changes to financial statement line items is therefore needed.
- ***“How” factors impacted results.*** The Staff has continued to request that companies *quantify* the factors that impact results, including reminding companies that when multiple factors are cited as the cause of material fluctuations, *each* factor should be quantified to allow investors to understand the magnitude and relative impact of each factor. Additionally, describing a change as having been “primarily” caused by, or a factor as “predominantly” causing the change, may not meet the requirement to describe the quantitative nature of the reason for the change.
  - ***“Why” factors impacted results.*** The Staff has noted that more informative disclosures may be required by companies, including explanations of the underlying reasons for the factor that caused material changes in financial statement line items. For example, disclosure that cost of revenues

<sup>21</sup> See [C&DI 102.01\(c\)](#).

<sup>22</sup> See, e.g., Staff comment issued in April 2022: “Please include quantitative reconciliations of the differences between your forward-looking non-GAAP measures, such as pro forma diluted earnings per share, and the comparable GAAP measures. If the GAAP measure is not accessible on a forward-looking basis, disclose that fact and provide reconciling information that is available without an unreasonable effort. Furthermore, identify the specific information that is unavailable and disclose its probable significance.”

<sup>23</sup> For example, the SEC issued the following comment in September 2022: “Your quarterly earnings releases furnished in Form 8-K’s include meaningful supplemental information on revenues and expenses including trends and quantification of key drivers impacting your results of operations. Please tell us how you considered including such information in your Form 10-K and Form 10-Q filings. Please ensure that you quantify the key drivers of changes for each of the factors that you cite in your MD&A discussion. Refer to Item 303(a) and (b) of Regulation S-K.” Also see our [prior alert](#) on the importance of including KPIs in MD&A, “[SEC Releases New Guidance on KPIs](#).”

increased due to higher distribution costs may not be sufficient without an explanation as to *why* there was an increase in the distribution costs.

- 2) **Known Events, Uncertainties and Trends Disclosure:** Item 303(a) requires disclosures of material events and uncertainties known to management reasonably likely to cause reported information not to be necessarily indicative of future results, including matters that have had or are reasonably likely to have a material impact on future operations.
- The Staff has recently issued several comments requesting enhanced disclosures relating to known trends and uncertainties resulting from inflation, labor markets, supply chain issues and other macroeconomic factors.
    - For example, a frequent comment requests companies to identify the principal factors contributing to macroeconomic issues, their impact, and any known trends or uncertainties regarding these issues that are reasonably likely to have a material impact.
    - SEC comments also focused on issues related to mitigation efforts undertaken to address such risks. For example, when companies disclosed that their results of operations had been impacted by supply chain uncertainties, the Staff asked companies to discuss known trends or uncertainties resulting from their mitigation efforts, and whether such mitigation efforts introduce any new material risks, such as those related to product quality, reliability or regulatory approval of products.<sup>24</sup>
  - In addition, although a number of companies disclosed that Russia's actions in Ukraine had a negative impact on their businesses, the Staff requested that these companies disclose trends and uncertainties, if material, not just the historical impact.<sup>25</sup>
- 3) **Liquidity and Capital Resources Disclosure:** Item 303(b)(1) provides the overarching requirement to analyze a company's ability to generate and obtain adequate cash to meet its requirements and plans for cash in the short term (i.e., the next 12 months) and separately in the long term. In light of the increasing macroeconomic uncertainties in recent months, it becomes crucial for companies to assess their liquidity and capital resources disclosure ahead of their annual report filings.
- **Material Cash Requirements.** As part of their capital resources disclosures:
    - Companies are required to describe material cash requirements from known contractual and other obligations under Item 303(b)(1). One recent focus of Staff comments in this area has been consistency, e.g., companies that disclose information about their business that could involve material cash requirements elsewhere in their disclosures, but not addressing any cash requirements in the liquidity and capital resources section.<sup>26</sup>
    - Since 2021, companies are no longer *required* to include the contractual obligations table that was previously required under Item 303(a)(5). Notably, the contractual obligations

<sup>24</sup> For example, the SEC issued the following comment in September 2022: "We note your disclosure...of supply chain disruptions in the second half of the year. Please specify whether these challenges have materially impacted your results of operations or capital resources and quantify, to the extent possible, how your sales, profits, and/or liquidity have been impacted. Discuss any known trends or uncertainties resulting from mitigation efforts undertaken, if any. Explain whether any mitigation efforts introduce new material risks, including those related to product quality, reliability, or regulatory approval of products."

<sup>25</sup> For example, one comment issued in August 2022 noted: "In light of your disclosure that the conflict between Russia and Ukraine has had a negative impact on your earnings before interest and taxes, please...[d]isclose any known trends or uncertainties that have had or are reasonably likely to have a material impact on your cash flows, liquidity, capital resources, cash requirements, financial position, or results of operations arising from, related to, or caused by the global disruption from, Russia's invasion of Ukraine. Trends or uncertainties may include impairments of financial assets or long-lived assets; declines in the value of inventory, investments, or recoverability of deferred tax assets; the collectability of consideration related to contracts with customers; and modification of contracts with customers."

<sup>26</sup> For example, one comment issued in August 2022 noted: "It does not appear you have disclosed all the material cash requirements of your anticipated...business. For example, we note that [you disclose entering into] a strategic sales contract .... and that the first set was to be delivered. Tell us why this was not discussed as a material cash requirement or revise your disclosure as necessary."

table previously required by Item 303(a)(5) may not meet the new principles-based requirement to disclose all known *material* cash requirements (including capital investments, human capital, intellectual property, contractual obligations, and any off-balance sheet arrangements), as well as material trends, commitments or uncertainties reasonably likely to affect liquidity and capital resources, so companies should not merely retain the previous table without assessing if it meets the new requirements.

- 4) **Critical Accounting Estimates:** Companies are reminded that Item 303(b)(3) requires disclosures that are necessary to an understanding of critical accounting estimates that had or are reasonably likely to have a material impact on a company's financial condition or results of operations. The Staff has recently issued comments reminding companies that this disclosure should not be a repetition of significant accounting policies disclosed in the footnotes to the financial statements.<sup>27</sup> Instead, the disclosure in MD&A should address the uncertainties associated with assumptions underlying the critical accounting estimates, risks related to using different assumptions and an analysis of the company's sensitivity to changes based on outcomes that are reasonably likely to occur.

### (3) Recent Developments to Consider for Annual Report Risk Factor and MD&A Disclosure

**Macroeconomic Developments:** Management should assess the impacts on the company's business from the recent volatile economic conditions and approach the company's disclosure in an organized manner across annual report risk factors, MD&A, as well as the earnings release and earnings call, in order to provide a consistent message to investors. Impacts should be assessed both for 2022 and for expectations going into 2023, and may include the following:

- *Inflation, Interest Rates, Capital Markets:* As a result of the high levels of inflation in the US, increased supply costs may impact pricing and consumer demand, both of which may impact companies' revenues and earnings. In addition, rising interest rates have increased the cost of borrowing for many companies, while volatility in the capital markets presents challenges to companies seeking to raise funds. This may impact a company's business plans, such as adopting strategies that may be less capital-intensive in the near term. Companies should therefore consider disclosure regarding how inflation and rising interest rates have materially affected them, including their operating results, sales, profits, cash flows, liquidity, financial position, wage expenses, employee retention and capital expenditures.

The Inflation Reduction Act of 2022 (the IRA), passed in August 2022, included several changes for corporations – a corporate minimum tax, a one percent excise tax on certain stock buybacks and certain clean energy incentives and initiatives.<sup>28</sup> Companies should consider whether any provisions of the IRA could be expected to materially impact their financial condition, results of operations or capital allocation strategies.

- *Currency Exchange Rates:* The relative value of the U.S. dollar is currently at its highest level since 2000, appreciating sharply against many foreign currencies. As a result, companies with substantial foreign operations may experience vulnerability when converting results in foreign currencies to U.S. dollars for financial reporting purposes, which may impact companies' results of operations.

**COVID-19:** It may still be too early to entirely eliminate COVID-19 specific disclosure, but companies may be able to significantly streamline their disclosures. Companies should take a fresh look at their

<sup>27</sup> For example, one comment issued in September 2022 stated: "The disclosures of your critical accounting policies and estimates appear to be a repetition of certain of your significant accounting policies. Please revise your disclosures to address the material implications of the uncertainties that are associated with the methods, assumptions and estimates underlying your critical accounting estimates. Your expanded disclosure should address the risk related to using different assumptions and analyze their sensitivity to change based on outcomes that are deemed reasonably likely to occur. Refer to Item 303(b)(3) of Regulation S-K and the related Instruction 3 to paragraph (b) of Item 303."

<sup>28</sup> For more information, see our alert, "[New 1% Excise Tax on Stock Buybacks May Have Far-Reaching Consequences for Capital Markets, SPAC and M&A Transactions.](#)"



existing COVID-19 disclosure and update it to account for the current environment, including by eliminating or de-emphasizing risks that are no longer expected to be material.

- **Ukraine/Russia:** The SEC's [sample letter](#) provides guidance on disclosure obligations related to developments in Ukraine. In particular, companies should consider (i) impacts of import or export bans on products and commodities used or sold by the company, (ii) whether and how supply chain disruptions have materially impacted the business, including mitigation efforts, and, where possible, a quantification of the impact, and (iii) any changes in internal control over financial reporting resulting from the situation in Ukraine and/or supply chain disruptions.
- **Exposure to Crypto Asset Market Participants:** In light of the dislocation experienced by the crypto industry in recent months, the SEC issued a [sample comment letter](#) asking companies to evaluate how the distress among crypto asset market participants may, directly or indirectly, impact the company's business and, potentially, investors. Companies should consider the need to address crypto asset market developments, including disclosure of a company's exposure to counterparties and other market participants; risks related to a company's liquidity and ability to obtain financing; and risks related to legal proceedings, investigations or regulatory impacts in the crypto asset markets.

For more information on these and other developments as well as tips for drafting risk factors, see our recent client alert [Updating Annual Report Risk Factors: Key Developments and Drafting Considerations for Public Companies](#).

- (4) **Consider Climate Change, Human Capital Management and Other ESG Disclosure:** With continued focus from the SEC and investors on climate-related and other environmental, social and governance (ESG) disclosures, companies should consider disclosure on ESG ahead of their Form 10-Ks.

#### **Climate Change and Sustainability Disclosure**

Climate change remains a particularly strong focus of both the SEC and investors. In March 2022, the SEC [proposed extensive climate-related disclosure requirements](#) that, if adopted, would require U.S. public companies to dramatically expand the climate-related disclosures in their SEC filings. While these rules are pending (action is expected in the spring of 2023), companies should continue to consider their existing climate-related disclosure in light of the SEC's [2010 climate change disclosure guidance](#), as well as the [SEC's sample comment letter on climate disclosure](#).<sup>29</sup>

In light of this focus, companies should confirm whether any additional information regarding climate change is material for their business and should consider their risk factors, business description, legal proceedings and MD&A when assessing this potential disclosure. In addition, companies should assess (1) whether pending regulatory requirements or developments in the area of ESG or sustainability pose any material risks or challenges to their businesses, (2) whether any material risks related to their ESG goals and commitments are appropriately disclosed, and (3) whether any of the ESG information contained in their sustainability reports is or has become material and therefore required to be included in their Form 10-K.<sup>30</sup>

<sup>29</sup> Our 2022 survey of Fortune 50 companies found a significant increase in climate-related disclosure, including an increase in disclosure as a result of SEC comments. Forty-three of the 50 surveyed companies increased their climate-related disclosure in their 2022 Form 10-Ks, compared to 2021, seven addressed climate-related disclosure in their Form 10-K for the first time in 2022, fifteen added entirely new risk factors devoted to climate related impacts and five added new sections discussing ESG, sustainability and climate change in their MD&A. Four of the surveyed companies received comments from the SEC in 2021 on climate-related disclosure, two of which agreed to additional risk factor and/or MD&A disclosure. Many other surveyed companies included additional Form 10-K disclosure that appeared, based on content, to be directly influenced by the SEC's sample comment letter. See our prior alert, "[ESG Disclosure Trends in SEC Filings \(2022\)](#)."

<sup>30</sup> One comment issued by the staff in this regard is the following: "We note that you provided more expansive disclosure in your corporate social responsibility report (CSR report) than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report."

## Human Capital Management (HCM) Disclosures<sup>31</sup>

The fiscal year 2022 Form 10-K is the third annual report in which US public companies must comply with amended Item 101 of Regulation S-K, including a description of human capital resources and human capital measures or objectives that the company focuses on in managing its business, to the extent material to the company as whole.<sup>32</sup> The amended rule retains the requirement to provide the total number of persons employed and provides that measures or objectives that address the attraction, development and retention of personnel are non-exclusive examples of items that may be material, depending on the nature of the company's business and workforce.

Now that companies have had more time to assess this disclosure, they may consider what, if any information, should be added to the previous year's disclosure, taking into account the following:

- *Update HCM Disclosure to Reflect Developments Within the Company:* Companies should consider which human capital measures or objectives the board and senior management focused on during fiscal 2022, and how these should be discussed in the company's disclosure. They should also consider whether recent developments in their operations and industry, including those related to COVID-19 and economic conditions, among other things, warrant updates to their HCM disclosures. Companies have covered a broad range of topics in their HCM disclosure, including employee engagement, employee health and wellness, flexible work arrangements, pay equity and diversity, equity, and inclusion (DEI).
- *Keep in Mind Disclosure Trends in the Market:* Companies should consider market trends in HCM disclosure, which reflect investors' heightened focus on diversity disclosures. For example, a review of the 2022 Form 10-Ks of Fortune 50 companies found that 41 companies increased the HCM disclosure in their 10-Ks between 2021 and 2022. Further, 44 companies included disclosure on DEI in their 2022 Form 10-Ks, and overall there was an increase in the use of quantitative human capital metrics, such as information on (i) the percentage of employees who are women or people of color, (ii) information on corporate investments to improve gender and ethnic/racial diversity in their workforce, and (iii) employee turnover and retention rates.<sup>33</sup>
- *Recent SEC Comment Letters:* Over the past year, the SEC issued comment letters to several companies that did not comply with the baseline rule requirements for HCM disclosures.<sup>34</sup> While companies that included fulsome HCM disclosures in their Form 10-Ks do not appear to be the target of these SEC comments, the comments signal that the SEC is paying attention to this area and that companies should continue to assess their disclosures in 2022 to ensure they are rule compliant.

<sup>31</sup> For more information, see our alert, "[SEC Adopts Amendments to Modernize Disclosures and Adds Human Capital Resources as a Disclosure Topic: Key Action Items and Considerations for US Public Companies.](#)"

<sup>32</sup> SRCs are not technically required to provide HCM disclosures, but some may do so for investor relations purposes.

<sup>33</sup> For information, see our prior alert, "[ESG Disclosure Trends in SEC Filings \(2022\).](#)"

<sup>34</sup> For example, in November 2021, the SEC commented: "Please expand your disclosure to include a description of your human capital resources, including any human capital measures or objectives that you focus on in managing your business. Refer to Item 101(c)(2)(ii) of Regulation S-K for guidance."

## Appendix A

## New and Updated Non-GAAP C&amp;DIs

## Question 100.01

**Question:** Can certain adjustments, although not explicitly prohibited, result in a non-GAAP measure that is misleading?

**Answer:** Yes. Certain adjustments may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP measure to be misleading. For example, presenting a Whether or not an adjustment results in a misleading non-GAAP measure depends on a company's individual facts and circumstances.

Presenting a non-GAAP performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business is one example of a measure that could be misleading. [May 17, 2016]

When evaluating what is a normal, operating expense, the staff considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment.

The staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring. [December 13, 2022]

## Question 100.04

~~**Question:** A registrant presents a non-GAAP performance measure that is adjusted to accelerate revenue recognized ratably over time in accordance with GAAP as though it earned revenue when customers are billed. Can this measure be presented in documents filed or furnished with the Commission or provided elsewhere, such as on company websites?~~

~~**Question:** Can a non-GAAP measure violate Rule 100(b) of Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP?~~

~~**Answer:** No. Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. Other measures that use individually tailored recognition and measurement methods for financial statement line items other than revenue may also violate Rule 100(b) of Regulation G. [May 17, 2016]~~

~~**Answer:** Yes. By definition, a non-GAAP measure excludes or includes amounts from the most directly comparable GAAP measure. However, non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading. Examples the staff may consider to be misleading include, but are not limited to:~~

- ~~• changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;~~
- ~~• presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse, presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and~~

- changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis. [December 13, 2022]

### Question 100.05

Question: Can a non-GAAP measure be misleading if it, and/or any adjustment made to the GAAP measure, is not appropriately labeled and clearly described?

Answer: Yes. Non-GAAP measures are not always consistent across, or comparable with, non-GAAP measures disclosed by other companies. Without an appropriate label and clear description, a non-GAAP measure and/or any adjustment made to arrive at that measure could be misleading to investors. The following examples would violate Rule 100(b) of Regulation G:

- Failure to identify and describe a measure as non-GAAP.
- Presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure, such as:
  - a contribution margin that is calculated as GAAP revenue less certain expenses, labeled “net revenue”;
  - non-GAAP measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as “Gross Profit” or “Sales”; and
  - a non-GAAP measure labeled “pro forma” that is not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X. [December 13, 2022]

### Question 100.06

Question: Can a non-GAAP measure be misleading, and violate Rule 100(b) of Regulation G, even if it is accompanied by disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure?

Answer: Yes. It is the staff’s view that a non-GAAP measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each adjustment would not prevent the non-GAAP measure from being materially misleading. [December 13, 2022]

### Question 102.10

Question 102.10(a): Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence. This requirement applies to non-GAAP measures presented in documents filed with the Commission and also earnings releases furnished under Item 2.02 of Form 8-K. Are there examples of disclosures that would cause a non-GAAP measure to be more prominent?

Answer: Yes. ~~Although whether~~This requirement applies to the presentation of, and any related discussion and analysis of, a non-GAAP measure. ~~Whether~~ a non-GAAP measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, ~~the~~. The staff would consider the following to be examples of ~~disclosure of~~ non-GAAP measures ~~as that are~~ more prominent than the comparable GAAP measures:

- Presenting a ~~full~~an income statement of non-GAAP measures ~~or presenting~~. See Question 102.10(c).
- ~~a full~~Presenting a non-GAAP income statement when reconciling non-GAAP measures ~~to~~measure before the most directly comparable GAAP measures;

- ~~measure or omitting the~~ ~~comparable GAAP measures from~~ ~~measure altogether, including in~~ an earnings release headline or caption that includes ~~a non-GAAP measures; measure.~~
- ~~Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence.~~
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font, etc.) that emphasizes the non-GAAP measure over the comparable GAAP measure~~;~~
- ~~A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);~~
- Describing a non-GAAP measure as, for example, “record performance” or “exceptional” without at least an equally prominent descriptive characterization of the comparable GAAP measure~~;~~
- ~~Presenting charts, tables or graphs of a non-GAAP financial measures without presenting charts, tables or graphs of the comparable GAAP measures with equal or greater prominence, or omitting the comparable GAAP measures altogether.~~
- ~~Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;~~
- ~~Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the “unreasonable efforts” exception in Item 10(e)(1)(i)(B) without disclosing that fact and identifying the information that is unavailable and its probable significance in a location of equal or greater prominence; and~~
- Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence. [~~May 17~~ December 13, 20162022]

**Question 102.10(b):** Are there examples of disclosures that would cause the non-GAAP reconciliation required by Item 10(e)(1)(i)(B) of Regulation S-K to give undue prominence to a non-GAAP measure?

**Answer:** Yes. The staff would consider the following examples of disclosure of non-GAAP measures as more prominent than the comparable GAAP measures:

- Starting the reconciliation with a non-GAAP measure.
- Presenting a non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures. See Question 102.10(c).
- When presenting a forward-looking non-GAAP measure, a registrant may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence. [December 13, 2022]

**Question 102.10(c):** The staff considers the presentation of a non-GAAP income statement, alone or as part of the required non-GAAP reconciliation, as giving undue prominence to non-GAAP measures. What is considered to be a non-GAAP income statement?

**Answer:** The staff considers a non-GAAP income statement to be one that is comprised of non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement. [December 13, 2022]

White & Case LLP  
1221 Avenue of the Americas  
New York, New York 10020-1095  
United States

**T** +1 212 819 8200

White & Case LLP  
3000 El Camino Real  
2 Palo Alto Square, Suite 900  
Palo Alto, California 94306-2109  
United States

**T** +1 650 213-0300

White & Case LLP  
701 Thirteenth Street, NW  
Washington, District of Columbia 20005-3807  
United States

**T** +1 202 626 3600

White & Case LLP  
609 Main Street  
Suite 2900  
Houston, Texas 77002  
United States

**T** +1 713 496 9700

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