Governance & Securities Alert

Weil

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Need to Know: Disclosure Developments and 2023 Form 10-K Disclosure Locator

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This Alert is in the form of a Disclosure Locator for the 2023 calendar year-end Form 10-K to be filed in 2024 with the U.S. Securities and Exchange Commission. The Locator highlights disclosure considerations drawn from:

- Recent SEC Staff comments and guidance;
- Lessons learned from recent SEC enforcement proceedings and litigation;
- SEC rules and NYSE/Nasdaq corporate governance listing standards that recently took effect or are on the horizon; and
- Developments that companies face stemming from recent political, regulatory, and geopolitical events.

Selected Highlights from the Disclosure Locator

1. New Cybersecurity Disclosure
2. Climate Change and ESG Disclosures
3. MD&A and non-GAAP Financial Disclosures
4. SEC Focus on Internal Control Over Financial Reporting
5. Statement of Cash Flows, Segment Reporting, and Revenue Recognition Disclosures
6. Impacts of Global Events on Business, Risk Factors, and MD&A
7. Artificial Intelligence Disclosure
8. Human Capital Management
9. Legal Contingencies Disclosure
10. Disclosures of Rule 10b5-1 and non-10b5-1 Trading Arrangements
11. Financial Statement Error Correction and Clawback Analysis Checkboxes
12. New Exhibit for Clawback Policies and Related Clawback Disclosure

General

Climate Change

- Although the SEC has not adopted final rules on climate change disclosure, the SEC Staff continues to issue the following general comment in reviewing Form 10-Ks:
  - "We note that you provided more expansive disclosure in your Environmental Social & Governance Report ("ESG 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 ESG Report."
- See below for other recent SEC comments relating to climate change, in the relevant Form 10-K sections.

eXtensible Business Reporting Language ("XBRL")

- On September 7, 2023, the SEC's Division of Corporation Finance published a sample comment letter regarding XBRL and Inline XBRL disclosures ("XBRL Sample Letter"). One general comment was where a company did not include the required Inline XBRL presentation, and the Staff requested the company to file an amendment to include it. Although not mentioned in the letter, it is also noteworthy that omitting a required interactive data file in a filing could render a company not "current" with its Exchange Act reporting, and therefore the company would be ineligible to use Forms S-3 and S-8 and cause Rule 144 to be unavailable, at least until the missing data is filed. Also see other comments from the XBRL Sample Letter below in the relevant Form 10-K sections.

Crypto Asset Markets

- The SEC Staff is continuing to focus on disclosure of crypto asset market developments, in keeping with the sample comment letter published on December 8, 2022 ("Crypto Sample Letter"). One general comment in the Crypto Sample Letter is for companies to disclose any significant crypto asset market developments material to understanding or assessing their business, financial condition and results of operations, or share price since the company's last reporting period, including any material impact from the price volatility of crypto assets. See other comments below from the Crypto Sample Letter in the relevant Form 10-K sections

Cover Page

Check Boxes for Financial Statement Error Correction and Clawback Analysis

- Newly applicable for the Form 10-K are two checkboxes on the cover page for companies with securities listed on a stock exchange. The first box must be checked if the financial statements of the company included in the filing reflect the correction of an error to previously issued financial statements. The second box must be checked if any of those error corrections are restatements that required a recovery (or clawback) analysis of incentive-based compensation received by the company's executive officers during the relevant recovery period pursuant to SEC Rule 10D-1(b). This means that NYSE and Nasdaq listed companies with financial statement error corrections (including "little r" restatements) will be easy to identify (see also discussion of financial statements below).
  - A question has arisen on whether the error correction box should be checked if there is retrospective correction of a material error in a company's previously filed interim financial statements within an unaudited note to the annual financial statements included in a Form 10-K, and the error being corrected only existed in the interim periods. As summarized in Center for Audit Quality SEC Regulation Committee Highlights, the SEC Staff indicated it would not object in this circumstance if the box was not checked. The SEC Staff noted,

however, that the company still should provide the disclosures required by Regulation S-K Item 402(w) (discussed further below in Part III, Item 11).

XBRL

- The XBRL Sample Letter includes a comment that the common shares outstanding reported on the cover page and on the balance sheet are XBRL tagged with materially different values. The comment refers to the fact that the company presented the same data using different scales (the whole amount in one instance and the same amount in thousands in the second), and the SEC Staff asked the company to confirm that it will present the information consistently in future filings.

Part I, Item 1 – Business

Climate

- Companies should continue to discuss the impact of climate and climate disclosure legislation, regulation, and international agreements, including recent federal and state legislation.

Inflation and Supply Chain Disruption

- The SEC Staff continues to comment on the need to explain how inflation and disruptions in the supply chain have materially affected a company's business goals. For example, below is a recent SEC Staff comment:
  - "Your disclosures indicate that you continue to experience significant inflation in . . . costs as well as interruptions in the supply chain, particularly due to the global . . . shortages, and that the impact of supply chain disruptions . . . are expected to continue to have an adverse effect on your results but you are seeking to mitigate and minimize the impact. Please revise future annual and quarterly filings to quantify the impact these factors had on your operations during each period presented and more fully disclose and discuss the steps you are taking, if any, to mitigate them, including whether your mitigating efforts may introduce new material risks, including those related to product quality or reliability. In addition, revise future annual and quarterly filings to quantify the impact that changes in volume and average selling prices had on net sales during each period presented and more fully disclose and discuss the factors that resulted in such changes…"

Impact of Israel/Hamas and Russia/Ukraine Wars

- In keeping with the sample comment letter published on May 10, 2022 (the "Russia/Ukraine Sample Letter"), we expect that the SEC Staff will continue to look for disclosure about the impact of the Russia/Ukraine war. We also expect that the SEC Staff will look for similar disclosure regarding the Israel/Hamas war. For example, consider the following disclosures to the extent material:
  - direct or indirect exposure to Russia, Belarus, Ukraine, Israel or the Middle East through operations, employee base, investments in Russia, Belarus, Ukraine, Israel or the Middle East, securities traded in Russia or Israel, sanctions against Russian or Belarusian individuals or entities, or legal or regulatory uncertainty associated with operating in or exiting Russia or Belarus;
  - direct or indirect reliance on goods or services sourced in Russia, Ukraine, Israel, or the Middle East or, in some cases, in countries supportive of Russia;
  - actual or potential disruptions in the company's supply chain (including as a result of attacks on shipping vessels in the Red Sea); and
  - business relationships, connections to, or assets in, Russia, Belarus, Ukraine, Israel, or the Middle East.

Human Capital Management

- Although the SEC did not propose a rule on human capital management ("HCM") in 2023, the proposal is still on the SEC's Rulemaking Agenda, and we do expect the rule to be proposed in 2024. On September 21, 2023, the SEC's Investor Advisory Committee ("IAC") approved recommendations (here) to the SEC that the HCM section of the business disclosure be amended to require:
  - the number of people employed by the issuer, broken down by whether those people are full-time, part-time, or contingent workers;
  - turnover or comparable workforce stability metrics;
  - the total cost of the issuer's workforce, broken down into major components of compensation; and
  - workforce demographic data sufficient to allow investors to understand the company's efforts to access and develop new sources of talent, and to evaluate the effectiveness of these efforts.

  In addition, the IAC recommended that the SEC consider narrative disclosure, in Management's Discussion and Analysis, of how a company's labor practices, compensation incentives, and staffing fit within the broader company strategy. This recommendation is discussed below under Management's Discussion and Analysis.

  Though it remains to be seen whether the SEC will include any or all of the IAC's recommendations in a proposed rule, companies should take a fresh look at their HCM disclosures in light of these recommendations and also compare, for benchmarking purposes, their disclosures in Form 10-K, ESG (or similar) report, and company website to those of their peers.

Artificial Intelligence

- With the quick rise and increasing use by companies of artificial intelligence ("AI"), the Chair of the SEC has cautioned public companies making statements on AI to ensure that material disclosures are accurate and not misleading. Companies should consider making disclosures related to AI in the upcoming Form 10-K, including as a part of the discussion of the business and risk factors. Our informal survey of disclosures by S&P 500 and Russell 3000 companies between January 1, 2023 and October 31, 2023, discussed in our prior alert (here), indicated that over 40% of companies in the S&P 500 and 30% of companies in the Russell 3000 included disclosure regarding AI in their annual reports on Form 10-K. Companies that addressed AI in their business section disclosed AI-related products and initiatives; research and development efforts; the impact of AI on the company's products, services and relationships with customers or suppliers; and competitive conditions.
- We expect that future AI disclosure also will focus on compliance with new AI laws and regulations.
  - On October 30, 2023, President Biden issued an Executive Order on the Safe, Secure and Trustworthy Development and Use of Artificial Intelligence (here). The order requires federal agencies to develop standards and guidance in a variety of sectors to protect consumer safety and privacy.
  - According to the National Conference of State Legislatures (here), in the 2023 legislative session, at least 25 states, Puerto Rico and the District of Columbia introduced artificial intelligence bills, and 18 states and Puerto Rico adopted resolutions or enacted legislation.
  - In July 2023, the SEC issued a press release (here) proposing new rules that would require broker-dealers and investment advisers to take steps to address conflicts of interest associated with their use of predictive data analytics and similar technologies.
  - The European Union has recently reached political agreement (here) on rules governing the use of AI. The legislation is expected to be passed in 2024 and be effective within two years from then.

Crypto Asset Markets

- Companies should consider the need to address crypto asset market developments in their business descriptions. The Crypto Sample Letter specifically notes the need to discuss, to the extent material, both exposure to and how recent crypto company bankruptcies have impacted or may impact (directly or indirectly) a company's business, financial condition, customers and counterparties. In addition, consider describing any steps taken to safeguard customers' crypto assets, any policies and procedures in place to prevent self-dealing and other potential conflicts of interest, and describe any policies and procedures regarding the commingling of assets, including customer assets, company assets, and those of affiliates or others.

Privacy Laws

- Companies that include disclosure regarding state data protection laws and compliance programs in relation to such laws should update such disclosure to reflect the new states that have adopted these laws and also consider adding disclosure that the effectiveness of California's law (the California Privacy Rights Act) has been delayed.

Part I, Item 1A – Risk Factors

Market Conditions, Inflation and Rising Interest Rates

- Many companies elaborated on their market-related risk factors in their Form 10-K covering fiscal year 2022 in response to the volatility of the global economy. In our Disclosure Locator last year, we cautioned that such risk factors must describe specific (as opposed to generic) risks to a company's business, results of operations, and liquidity. As we expected, the SEC Staff continues to make comments to that effect, including the following:
  - "We note your risk factor indicating that inflation could affect your material costs, wages, energy and transportation costs. Please update this risk factor in future filings if recent inflationary pressures have materially impacted your operations. In this regard, identify the types of inflationary pressures you are facing and how your business has been affected."
  - "Tell us whether management considered a risk factor on inflation and the impact that higher interest rates and increased costs will have on interest expense, fuel cost and power procurement, and other aspects of your business operations that may be materially impacted by inflation."
- Other risks also deserve review and consideration for further specificity. For example, geopolitical and macroeconomic risks associated with the upcoming U.S. presidential election, continued uncertainty regarding the resolution of the U.S. government debt ceiling issue, and adverse conditions in the global banking industry.

Israel/Hamas and Russia/Ukraine Wars

- Companies should consider including risks relating to the Israel/Hamas war and potential escalations especially if the company does business with parties in the Middle East including Israel or is subject to supply chain disruptions from within the region (including as a result of attacks on shipping vessels in the Red Sea). Hundreds of companies already have included mention of the Israel/Hamas war in their Form 8-Ks and Form 10-Qs, describing the effect the war has or may have on company operations and as a potential risk in their forward-looking statement disclaimers. Additionally, if applicable, companies also should update risks relating to the Russia/Ukraine war and consider whether to mention rising tensions between China and Taiwan.

ESG and Anti-ESG

- Many companies have established and publicly announced climate-related goals, commitments, and targets. A company's inability to reach such targets may face risks that could have a material adverse impact on the company and its stock price. Such risks include enforcement and litigation claims alleging "greenwashing," inability to attract and retain customers or employees, inability to access certain types of capital, and unfavorable investor sentiment. Companies also should ensure that they have adequate internal controls for the monitoring and reporting of ESG data and should disclose risks related to the data collection process itself.
- Companies also should consider addressing "anti-ESG" sentiment and the scrutiny, reputational risk, lawsuits or market access restrictions they may face as a result.

Cybersecurity

- In July 2023, the SEC adopted new rules on cybersecurity disclosure (see our prior alert here) to enhance and standardize public company disclosures related to cybersecurity risk management, strategy, governance, and reporting. Companies should review their cybersecurity risk factors to ensure that the risk factor disclosure is consistent with the disclosure required by the new SEC cybersecurity rules under Regulation S-K Item 106, as discussed further below under Part I, Item 1C.
- Companies should review cybersecurity risk factors (and others as well) to confirm that the risk factors acknowledge not only that a potential vulnerability exists but also that it has occurred if the company already has experienced the relevant risk. In the case of the cybersecurity risk factor, that means adding phrases like "have occurred" in addition to "may occur" when discussing data breaches, threats, incidents, etc., and providing additional information if the incident was material.
- In the Russia/Ukraine Sample Letter, the SEC Staff requests that companies disclose any new or heightened risk of potential cyberattacks by state actors or others and whether the company has taken actions to mitigate such risks. An example of an SEC comment on such disclosure is as follows:
  - "We note your risk factor discloses the heightened risk of potential cyberattacks due to the conflict between Russia and Ukraine. Please revise your risk factor to disclose if you have experienced any cyberattacks, explain how cyberattacks could impact your business, and discuss any actions you have taken to mitigate the potential risks."

Artificial Intelligence

- Our informal survey of disclosures by S&P 500 and Russell 3000 companies between January 1, 2023 and October 31, 2023, discussed in our prior alert (here), indicated that 18% of S&P 500 companies and 12% of Russell 3000 companies discussed or mentioned AI in their risk factors, including regulatory risks, operational risks, competitive risks, cybersecurity risks, ethical risks, and third-party risks. See our survey for examples.

Crypto Asset Markets

- The SEC Staff included nine risk-factor related sample comments in the Crypto Sample Letter, focusing on the need for clear disclosure about the material risks of crypto asset market developments. Topics covered include risks related to: a company's liquidity and ability to obtain financing; legal proceedings, investigations, or regulatory impacts; reputational harm, loss of customers, and safeguarding assets; risk management; and disruptions in the crypto asset markets. In addition to addressing potential risks, the SEC Staff emphasized that companies should evaluate whether they have experienced or may be affected by matters characterized as potential risks and, if so, update their disclosures accordingly.

Risk of Intervention or Control by the PRC Government

- In July 2023, the SEC Staff published a sample letter for "China-based companies" (i.e., "companies based in or with a majority of their operations in the People's Republic of China") regarding disclosure of material impacts and risks to their businesses in their upcoming filings ("China-Specific Disclosure Sample Comment Letter"). The following risk factor related comment is included in the letter:
  - "Given the significant oversight and discretion of the government of the People's Republic of China ("PRC") over the operations of your business, please describe any material impact that intervention or control by the PRC government has or may have on your business or on the value of your securities. We remind you that, pursuant to federal securities rules, the term "control" (including the terms 'controlling,' 'controlled by,' and 'under common control with') means 'the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.'"

Part I, Item 1C – Cybersecurity

- As mentioned above, in July 2023 the SEC adopted new rules, which among other things, added Item 1C to Form 10-K to require certain disclosures concerning a company's risk management, strategy and governance of cybersecurity. See our prior alert (here) for more information. In light of the inevitability of cybersecurity incidents, companies should review and update their practices and controls as appropriate and ensure that company disclosures are consistent. Importantly, special attention should be given to known vulnerabilities and prior cybersecurity incidents.

SEC Enforcement

- On the heels of this new rulemaking, on October 30, 2023, the SEC announced an enforcement action against SolarWinds Corp. and its chief information security officer (collectively, "SolarWinds") involving alleged fraud and internal control failures relating to allegedly known cybersecurity risks and vulnerabilities. Specifically, the SEC's complaint alleges that SolarWinds misled investors by disclosing only generic and hypothetical risks at a time when the company knew of specific deficiencies in SolarWinds' cybersecurity practices as well as the increasingly elevated cybersecurity risks the company faced at the same time.

  Additionally, on March 9, 2023, the SEC announced that Blackbaud Inc. agreed to pay $3 million to settle charges for making allegedly misleading disclosures about a 2020 ransomware attack that impacted more than 13,000 customers. The SEC's order contended that within days of public disclosure that a ransomware attacker did not access donor bank account information or social security numbers, certain of the company's personnel learned that the attacker had in fact accessed such sensitive information, but did not communicate this discovery to senior management responsible for its public disclosure because the company failed to maintain disclosure controls and procedures. As a result, the SEC alleged that the company subsequently filed a Form 10-Q that omitted this information about the scope of the attack and misleadingly characterized as hypothetical the risk of an attacker obtaining such sensitive information.

Part II, Item 5 – Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

- On December 19, 2023, the U.S. Court of Appeals for the Fifth Circuit vacated the SEC's share repurchase modernization rule. This is the rulemaking, previously approved by the SEC, which would have required new detailed disclosures in Forms 10-K and 10-Q of daily issuer share repurchases, among other things. Compliance would have been first required in this Form 10-K for calendar year end companies. The court concluded that the SEC had not done a proper cost/benefit analysis regarding the rule. Accordingly, companies will continue to

provide disclosure based on the pre-existing rule, which requires issuers to provide certain information about their quarterly equity repurchases on an aggregated, monthly basis.

Part II, Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

- The SEC Staff continues to focus its review of periodic filings on MD&A.

MD&A (generally)

- *Results of Operations*. Companies should focus on providing more granular disclosure on the material factors affecting company performance (both quantitative and qualitative), including discussing the following:
  - macroeconomic factors (such as supply chain issues, inflation, interest rates, energy cost increases, and labor strikes);
  - specific quantification of multiple identified material factors impacting performance; and
  - discussion of known material trends and uncertainties (for example, if a material trend is known but unquantifiable, it should still be disclosed and noted as unquantifiable).
- *Critical Accounting Estimates.* Companies should discuss management's most significant judgments and assumptions (rather than just providing a repetition of the financial statement footnotes).
- *Liquidity and Capital Resources.* Companies should discuss:
  - Availability of cash to fund liquidity needs (identify any heightened risks of default, such as recent covenant waivers or debt that is maturing within 12 months, and the company's alternative plans in the event of a liquidity squeeze); and
  - Specific underlying facts or trends that caused (or may cause in the future) changes to operating, investing and finance activity affecting cash flows (for example, as a result of currency fluctuations, interest rates, or otherwise).

Climate

- Companies should discuss climate impact (or potential impact) on the company, to the extent material. For example, the SEC Staff regularly has provided the following comments:
  - "Please expand your disclosure to discuss the potential adverse consequences to your reputation resulting from your operations that produce greenhouse gas emission."
  - "To the extent material, discuss the indirect consequences of climate-related regulation or business trends, such decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources and increased demand for generation and transmission of energy from alternative energy sources."
  - "Revise your disclosure to identify any past and/or future capital expenditures for climate-related projects."
  - "Please discuss the physical effects of climate change on your operations and results."

Human Capital Management

- The SEC's Investor Advisory Committee recommended that the SEC consider narrative disclosure how a company's labor practices, compensation incentives, and staffing fit within the broader company strategy. The IAC gave as specific examples the need for disclosure of the portion of labor costs management views as an

investment and why, including how labor is allocated across areas designed to promote growth (e.g., R&D) and those necessary to maintain current operations rather than increase sales revenue (e.g., compliance).

Non-GAAP Financial Measures

SEC Staff Comments on Non-GAAP Financial Measures

- The most recent round of SEC Staff comments principally relate to the Staff's last update to its non-GAAP Compliance and Disclosure Interpretations ("CDIs") from December 2022 (available here). Companies should therefore consider:
  - Whether exclusion of recurring or normal expenses from non-GAAP measures is appropriate, including costs for being a public company, certain ongoing legal and regulatory expenses, and frequent restructurings and acquisition expenses;
  - Whether non-GAAP adjustments are "individually tailored" and potentially misleading, including eliminating amortization of only a portion of acquired intangibles, accelerating the recognition of deferred revenue, changing from accrual to cash and from gross to net, and deconsolidating one or more subsidiaries or combining consolidated and unconsolidated results or balance sheet amounts;
  - Whether non-GAAP figures are clearly identified and their usefulness explained to investors, that GAAP figures are presented with equal or greater prominence with their non-GAAP counterparts, and that the non-GAAP reconciliation begins with the GAAP figure first.

Process for Evaluation of Non-GAAP Financial Measures

- The SEC enforcement proceeding against DXC Technology Company in 2023 (announced here) provides lessons to every company regarding the process for the use of non-GAAP financial measures, including the need to implement an appropriate non-GAAP policy or have adequate disclosure controls and procedures specific to evaluate the company's non-GAAP disclosures.

Crypto Asset Markets

- The following SEC Staff comments are included in the Crypto Sample Letter on MD&A:
  - "Disclose whether you have experienced excessive redemptions or withdrawals, or have suspended redemptions or withdrawals, of crypto assets and explain the potential effects on your financial condition and liquidity."
  - "We note that you own or have issued crypto assets and/or hold crypto assets on behalf of third parties. To the extent material, explain whether these crypto assets serve as collateral for any loan, margin, rehypothecation, or other similar activities to which you or your affiliates are a party. If so, identify and quantify the crypto assets used in these financing arrangements and disclose the nature of your relationship for loans with parties other than third-parties. State whether there are any encumbrances on the collateral. Discuss whether the current crypto asset market disruption has affected the value of the underlying collateral."
  - "To the extent material, explain whether, to your knowledge, crypto assets you have issued serve as collateral for any other person's or entity's loan, margin, rehypothecation or similar activity. If so, discuss whether the current crypto asset market disruption has impacted the value of the underlying collateral and explain any material financing and liquidity risk this raises for your business."

Russia/Ukraine and Israel/Hamas Wars

- Companies should evaluate and update or add disclosures regarding the Russia/Ukraine and Israel/Hamas wars. Review the Russia/Ukraine Sample Letter to see if any comments now apply regarding: (i) known trends or uncertainties as a result of the wars; (ii) critical accounting estimates relating to impairment of assets, valuation of inventory, allowance for bad debt, deferred tax asset valuation allowance, or revenue recognition; (iii) material impact of import or export bans on any products or commodities; and (iv) material impacts on business segments by supply chain disruptions.

Uyghur Forced Labor Prevention Act (China-specific)

- The following SEC Staff comment is included in the China-Specific Disclosure Sample Comment Letter on MD&A:
  - "We note that you appear to conduct a portion of your operations in, or appear to rely on counterparties that conduct operations in, the Xinjiang Uyghur Autonomous Region. To the extent material, please describe how your business segments, products, lines of service, projects, or operations are impacted by the Uyghur Forced Labor Prevention Act ("UFLPA"), that, among other matters, prohibits the import of goods from the Xinjiang Uyghur Autonomous Region."

Part II, Item 8 – Financial Statements and Supplementary Data

Statement of Cash Flows

- In December 2023, the SEC's Chief Accountant Paul Munter issued a statement expressing concern that company financial statement preparers and auditors might not be applying the same rigor to the statement of cash flows as they do for the income statement and balance sheet – as evidenced by the statement of cash flows being a leading area for restatements.
- Mr. Munter gave the following reminders:
  - *Materiality*. The SEC Staff is not always persuaded that a restatement of the statement of cash flows is a "little r," which seems to be a common conclusion. Mr. Munter gave as an example that the SEC Staff does not agree that a restatement is not material to prior periods just because it is an error in classification. Mr. Munter stated that accurate classification between operating, investing or financing activities is paramount to an investor's understanding of a company's generation and use of cash.
  - *Presentation and Disclosure*. Mr. Munter urged companies to identify both routine and nonroutine transactions that may raise challenging cash flow classification issues early enough in the financial statement reporting process to allow sufficient time for the company and its auditor to properly evaluate such classifications. Citing relevant accounting standards, Mr. Munter noted that cash flow classifications is included in the requirement to disclose significant accounting policies and that companies are required to supplement the statement of cash flows with disclosure of noncash investing and financing activities.
  - *Internal Controls*. While Mr. Munter acknowledged that controls designed around income statement activity and balance sheet changes may indirectly address risks in the statement of cash flows, more direct controls are critical and should not be overlooked, such as those regarding the classification of cash flows and the disclosure of noncash items.
  - *Improving Cash Flow Information for Investors*. Mr. Munter encouraged companies to consider whether additional information should be disclosed to facilitate an investor's understanding of the statement of cash flows and the financial statements as a whole. He provided the following examples: (i) further disaggregation of amounts; (ii) additional information on relationships between amounts reported in the statement of cash

flows and those in the statement of financial position, and (iii) reporting operating cash flows under the direct method.

Segment Reporting

- The SEC Staff continues to focus on segment reporting, particularly in light of the upcoming segment standard change, FASB ASU 2023-07 (discussed below). The focus historically has been on how registrants identify operating segments and how registrants aggregate operating segments into reportable segments (for example, if there are diverging trends into two businesses, then the SEC may question whether one segment reporting for both businesses is appropriate). The SEC has also been focused on whether registrants provide appropriate entity-wide disclosures and whether registrants have inappropriately included non-GAAP measures in their segment disclosures.
- The Financial Accounting Standards Board adopted ASU 2023-07, which is effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024 (with early adoption permitted). Even though the standard is not effective for the 2023 calendar year Form 10-K, the SEC Staff has always focused on how companies identify operating segments and how they aggregate operating segments into reportable segments, and companies should expect that focus to continue.
  - Questions are arising with respect to the new standard, and we expect clarifications over time. For example, because the new standard permits companies to use multiple measures of segment profit or loss to be considered by the chief operating decision maker ("CODM"), there may be questions of which of those measures is considered GAAP and which are non-GAAP financial measures when used in MD&A. Current CDI 104.01 permits companies to use the measure of segment profit or loss in MD&A without treating it as non-GAAP. If a company discloses multiple measures in the segment footnote under the new standard, we expect, based on informal SEC Staff statements, that only one of the measures will be considered to be GAAP and the rest will be treated as non-GAAP measures.
  - We understand that the SEC Staff also has informally indicated that if a company has one reportable segment and its CODM evaluates the business and makes capital allocation decisions on a consolidated basis, consolidated net income is the segment measure that is most consistent with GAAP.

Revenue Recognition

- The SEC Staff continues to comment on the need for company disaggregated revenue disclosures and identification and satisfaction of performance obligations disclosures (such as the level of detail regarding performance obligations in contracts).

Contingencies

- Companies should be wary of disclosing that a claim against them is "without merit." In *City of Fort Lauderdale Police & Firefighters' Retirement Sys. v. Pegasystems, Inc.* (D. Mass. July 24, 2023) (available here), the plaintiffs argued that the defendants knowingly engaged in the conduct underlying a certain action but falsely stated in the Form 10-K that claims regarding such actions were "without merit." The court denied the company's motion to dismiss on the basis that the disclosure that the claims were "without merit" was misleading when the defendants possessed substantial information about the viability of those claims. In contrast, the court observed that an issuer could disclose that it had "substantial defenses" to a claim if it reasonably believes that to be true.

Restatements and NYSE/Nasdaq Compensation Clawbacks

- As discussed above, incentive-based compensation clawback policies designed to comply with NYSE/Nasdaq listing standards are required to cover both "Big R" restatements and "little r" restatements. If either type of restatement occurred, disclosure will now need to be addressed both by checking boxes on the front cover of the Form 10-K and by including directly or by incorporation by reference the disclosure discussed below in Part III, Item 11 of the Form 10-K.
  - A "Big R" restatement occurs when an error was material to previously issued financial statements.
  - A "little r" restatement occurs when an error was not material to previously issued financial statements, but would result in a material misstatement if (i) the error was left uncorrected in the current period or (ii) the correction of the error was recognized only in the current period.
  - Certain retrospective accounting changes to an issuer's financial statements do not trigger compensation recovery under the rules, including: (i) application of a change in accounting principle; (ii) revisions to reportable segment information due to a change in the structure of an issuer's internal organization; (iii) reclassification due to a discontinued operation; (iv) application of a change in reporting entity, such as from a reorganization of entities under common control; and (v) revisions for stock splits, reverse stock splits, stock dividends or other changes in capital structure, etc.
  - Furthermore, an "out-of-period adjustment" (i.e., when the error is immaterial to the previously issued financial statements and the correction of the error is immaterial to the current period) should not trigger a clawback analysis under the rules because it is not an "accounting restatement."

XBRL

- The XBRL Sample Letter has the following comments regarding financial statements and supplementary data:
  - "You have used different XBRL elements to tag the same reported line item on the income statement from period to period. Please provide us your analysis as to how you concluded that the results reported necessitated the change in the element. Alternatively, if you conclude that the change from period to period was not necessary to communicate a change in the nature of the line item, confirm that you will ensure that your choice remains consistent for line items from period to period."
  - "We note that instead of using an XBRL element consistent with current U.S. GAAP in your income statement, you instead used a custom tag. Custom tags are to be used by filers when an appropriate tag does not exist in the standard taxonomy. See Item 405(c)(1)(iii)(B) of Regulation S-T. Please tell us why the current U.S. GAAP tag is not applicable, or alternatively revise your disclosure, beginning with your next filing, to correctly tag this disclosure."

Part II, Item 9A – Controls and Procedures

- In August 2023, the SEC's Chief Accountant Paul Munter issued a statement addressing the SEC's concern that management and auditors appear to be disregarding "broader, entity-level issues" when evaluating the effectiveness of the company's internal control over financial reporting ("ICFR"), and instead only narrowly focusing on information and risks that directly impact financial reporting.
  - Mr. Munter stated that a company's ICFR should instead be "dynamic" and look beyond the company's financial statements, including considering how business risks and seemingly isolated incidents impact ICFR and whether a non-ICFR deficiency could nonetheless impact ICFR conclusions.

- Mr. Munter provided the following examples of business risks and/or isolated incidents flagged by the SEC that could significantly impact a company's system of internal controls:
  - loss of financing;
  - customer concentrations;
  - declining conditions affecting the company's industry;
  - a data breach in a system not part of ICFR;
  - non-financial reporting-related regulatory findings of lower risk;
  - a "little r" restatement; or
  - a counterparty risk limit breach.
- Mr. Munter further stated that management should conduct a holistic enterprise risk assessment (whether annually or on a quarterly basis) to confirm that internal controls are designed with procedures for the communications of findings beyond those that just impact financial reporting. He stated that effective internal controls should be able to identify and assess any new business risk or isolated incident impacting the company, and management and/or auditors must avoiding evaluating each such risk or incident in isolation or by "rationalizing away potentially disconfirming evidence."

SEC Enforcement

- On February 3, 2023, the SEC announced settled charges against Activision Blizzard Inc. in which the company agreed to pay a $35 million penalty relating to, among other things, its alleged failure to maintain appropriate disclosure controls and procedures relating to workplace misconduct. Importantly, the SEC did not allege that the company's risk factor disclosure or any other disclosure was in fact misleading (i.e., no Section 10(b) of the Exchange Act and Rule 10b5-1 violations), and instead cited Exchange Act Rule 13a-15, which requires public companies to have disclosure controls related to their public filings.
- In November 2023, the SEC announced that Charter Communications, Inc. agreed to pay a $25 million fine to settle SEC charges alleging that the company violated its ICFR when it engaged in improper stock buybacks. Specifically, Charter's board had authorized the company to conduct stock repurchases using Rule 10b5-1 compliant plans, but the SEC contended that Charter's repurchase plans contained a provision that permitted too much discretion. By alleging that Charter maintained ineffective ICFR because Charter's repurchase plans were deemed not to satisfy Rule 10b5-1 and thereby exceeded the authorization provided by the Charter board, the SEC is advancing Mr. Munster's position that ineffective ICFR can occur even when not directly involving accounting or financial reporting.

Part II, Item 9B – Other Information

- This is the third quarter for some companies (and first period for calendar year smaller reporting companies) that are required by new Item 408(a) of Regulation S-K to provide quarterly disclosure of adoption or termination (including most modifications) of director/Section 16 officer Rule 10b5-1 and non-Rule 10b5-1 trading arrangements. The disclosure must include a description of the material terms of the arrangement (other than price). In addition, a modification or change (e.g., change to the amount, price, or timing of the purchase or sale) also would be required to be disclosed as it constitutes the termination of an existing plan and the adoption of a new plan. Item 408(a) disclosure must be tagged in Inline XBRL.

Part II, Item 9C – Commission-Identified Issuers

- In the China-Specific Disclosure Sample Comment Letter, as part of the SEC's ongoing monitoring of China-based companies under the Holding Foreign Companies Accountable Act ("HFCAA"), the SEC Staff indicated issuers are required to provide more prominent and specific disclosures that are tailored to their individual facts and circumstances.
- The SEC is focused on three areas of disclosure related to China-specific matters: (i) disclosure requirements under the HFCAA (to be disclosed under this item of the Form 10-K); (ii) material risks related to the role of the government of the PRC (to be disclosed in Item 1A Risk Factors); and (iii) material impacts to their business segments, products, lines of service, projects, or operations by the UFLPA, which became law in the United States on December 23, 2021 (to be disclosed in MD&A).

Part III, Item 10. Directors, Executive Officers and Corporate Governance

Insider Trading Policies and Disclosure

- Not required in this calendar year end Form 10-K, but as a reminder for next year, the company will be required to disclose pursuant to Regulation S-K Item 408(b), in Form 10-K and proxy and information statements, whether it has adopted insider trading policies and procedures governing the purchase, sale and/or other dispositions of the company's securities by directors, officers, and employees, or the company itself, that are reasonably designed to promote compliance with insider trading laws and applicable listing standards. If a company has not adopted such policies or procedures, it must explain why not. We expect that companies will comply with this requirement by incorporating this information by reference from its annual proxy statement as generally done with all or nearly all of Part III of the Form 10-K. Item 408(b) also will require next year that a company file its insider trading policies and procedures as a Form 10-K exhibit.

Part III, Item 11. Executive Compensation

Disclosure of a Registrant's Action to Recover Erroneously Awarded Compensation

- New Item 402(w) of Regulation S-K requires disclosure of actions to recover erroneously awarded compensation (i.e., a clawback) pursuant to the company's NYSE/Nasdaq mandated clawback policy. Companies are required to provide disclosure if at any time during or after the last completed fiscal year they have prepared an accounting restatement that triggered the recovery of erroneously awarded compensation pursuant to their clawback policy. Companies also must include this disclosure if there is an outstanding balance as of the end of the last completed fiscal year of erroneously awarded compensation to be recovered from the application of the policy to a prior restatement. We expect that companies will comply with this new requirement by incorporating this information by reference from their annual proxy statement as generally done with all or nearly all of Part III of the Form 10-K.

Part IV, Item 15. Exhibit and Financial Statement Schedules Exhibits

- New Exhibit 97 (Policy Relating to Recovery of Erroneously Awarded Compensation). Companies that had at any time during their last completed fiscal year securities listed on a national securities exchange (e.g., NYSE or Nasdaq) must file as exhibit 97 to Form 10-K the clawback policy adopted to satisfy the exchange's listing standards.
- Exhibit 19 (Insider Trading Policies and Procedures). As indicated above, not required in this calendar year end Form 10-K, but as a reminder for next year, the company will be required to file its insider trading policies and procedures as exhibit 19 to Form 10-K.

- Regulation S-K CDI 146.18 clarifies that the exception included in Item 601(a)(2) of Regulation S-K, which notes that exhibits that are filed in XBRL do not need to include an active hyperlink, does not apply to exhibits filed in Inline XBRL.

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If you have questions concerning the contents of this Alert, or would like more information, please speak to your regular contact at Weil or to any of the following authors:

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