CURRENT FINANCIAL REPORTING ISSUES - 2023

KAPLAN

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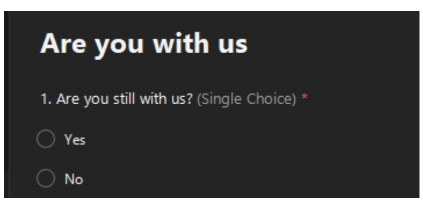

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Objectives of This Program

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- Identify and describe FASB's guidance applicable to selected current topics identified in annual reports and 10k filings as complex or difficult to apply
- Identify the types of financial and non-financial metrics reported by companies that would be considered non-GAAP financial performance measurements
- Describe the SEC's recent disclosure updates for Pay vs. Performance and Climate Change disclosures

Program Topics

Program Topics

- Revenue – Topic 606
- Leasing by Lessees – Topic 842
- Credit Losses – Topic 326
- Fair Value – Topic 820
- Asset Impairments – Topic 360
- Business Combinations – Topic 805
- Income Taxes – Topic 740
- Non-GAAP Performance Measurements
- SEC Disclosure Updates

Revenue – Topic 606

Revenue – Topic 606

Six-Step Approach

1. Identify the contract with the customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue as performance obligations are satisfied
6. Disclose information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the reporting entity's contracts with customers

Revenue – Topic 606

Definitions

- Contract
- Contract Asset
- Contract Liability
- Performance Obligation
- Revenue
- Transaction Price

Revenue – Topic 606

Selected Revenue Implementation and Reporting Issues

- Variable consideration
- Comparative periods
- Disclosures
- Costs to obtain a contract
- Contract term
- Identifying performance obligations
- Principal versus agent considerations

Revenue – Topic 606

Selected Revenue Implementation and Reporting Issues (cont'd)

- Customer options
- Variable consideration (including the constraint)
- Variable consideration allocation exceptions
- Residual method
- Performance obligations satisfied over time
- Contract costs (costs of obtain)
- Contract costs (costs to fulfill)

Leasing by Lessees – Topic 842

Leasing by Lessees – Topic 842

- The core principle of Topic 842 is that a reporting entity should recognize assets and liabilities arising from a lease
- A lessee will recognize a liability to make payments and a right-of-use (RoU) asset representing its right to use the leased asset for the lease term

Leasing by Lessees – Topic 842

Lease Classification

- Finance Lease
- Operating Lease

Leasing by Lessees – Topic 842

Lease Classification – Finance Lease

- Transfer of ownership
- Option to purchase the underlying asset
- Lease term is for a major part of the remaining economic life of the asset
- Present value of the lease payments equals or exceeds substantially all of the fair value of the underlying asset
- Asset is of a specialized nature

Leasing by Lessees – Topic 842

Lessee Initial Measurement

At the lease commencement date, a lessee should recognize in the statement of financial position both of the following:

- A lease payment liability based on the present value of the lease payments, discounted using the discount rate for the lease, and
- A right-of-use (RoU) asset representing the lessee's right to use the underlying asset for the lease term

Leasing by Lessees – Topic 842

Lessee Subsequent Measurement

- Finance lease
- Operating lease

Leasing by Lessees – Topic 842

Lease Implementation and Reporting Issues

- Transition
- Embedded leases
- Practical expedients
- Discount rate

Leasing by Lessees – Topic 842

<u>Lessee</u>

1. Information about the nature of the entity's leases
2. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee, including the nature of any involvement with the construction of the underlying asset.
3. Information about significant assumptions and judgments made in applying Topic 842
4. Lessee's total lease cost
5. Maturity analysis
6. Other lessee disclosures

Leasing by Lessees – Topic 842

<u>Lessee (cont'd)</u>

Other lessee disclosures:

- Lease transactions between related parties
- If the lessee elects the accounting policy option for short-term leases, the lessee must disclose that fact
- If the short-term lease expense for the period does not reasonably reflect the lessee's short-term lease commitments, the lessee must disclose that fact and the amount of its short-term lease commitments

Leasing by Lessees – Topic 842

Lessee (cont'd)

Other lessee disclosures (cont'd):

- A lessee that elects the practical expedient on not separating lease components from non-lease components must disclose its accounting policy election and which class or classes of the underlying assets it has elected to apply the practical expedient
- Main terms and conditions of any sales-leaseback transactions

Knowledge Check

- What represents the lessee's right to use the underlying asset for the lease term?

Credit Losses – Topic 326

Credit Losses – Topic 326

Introduction

The Topic's objective is to provide financial statement users with more decision-useful information about a reporting entity's:

- Expected credit losses on financial assets, and
- Other commitments to extend credit

This is accomplished by changing the measurement and presentation of estimated credit losses on assets involving contractual cash flows

Credit Losses – Topic 326

Introduction (cont'd)

- The biggest change from legacy GAAP is the manner in which credit losses (in essence, uncollectible amounts) are estimated
- In the past, losses were recorded when it became probable that all contractual amounts would not be collected, based on information known at the balance sheet date - this is referred to as an incurred loss model
- In Topic 326 a reporting entity records estimated losses based on expected losses over the contractual life of the instrument - this approach is referred to as the current expected credit loss (CECL) model

Credit Losses – Topic 326

Scope

- Loans receivable
- Debt securities
- Trade receivables
- Net investment in leases
- Off-balance sheet credit exposure
- Reinsurance receivables

Credit Losses – Topic 326

Provisions – Financial Assets Measured at Amortized Cost

- Topic 326 requires using a current expected credit loss (CECL) model to estimate credit losses over the financial asset's life
- Because this is forward-looking, it is based on forecasts of future economic conditions, which is a significant change from legacy guidance. - the result will be earlier credit loss recognition
- Because the forecast is over the financial asset's life, the result will also generate greater loss amounts than in legacy guidance
- The CECL model requires if losses exist, the carrying value of the investment equals amortized cost minus the allowance for credit losses, that is, the amount expected to be collected - contractual life should incorporate expected prepayments, but possible extensions should not be included

Credit Losses – Topic 326

Provisions – Financial Assets Measured at Amortized Cost (cont'd)

In estimating credit losses, all relevant information should be considered:

- Past events
- Current conditions
- Reasonable, supportable forecasts

Credit Losses – Topic 326

Implementation Considerations of ASU 2016-13-Credit Losses

- Impacts any that has financial assets not measured at fair value
- Historical information
- Early adoption
- Modify the existing credit risk model
- Extended customer payment terms
- Non-financial indicators

Credit Losses – Topic 326

Implementation Considerations of ASU 2016-13-Credit Losses (cont'd)

- Legacy trade receivable expected losses
- Modify accounting policies, processes, and controls
- Enterprise and information technology systems
- Secondary impact
- Disclosures
- Transition Resource Group (TRG)

Fair Value – Topic 820

Fair Value – Topic 820

<u>Definition</u>

- Fair value is defined *as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date*

Fair Value – Topic 820

Definition (cont'd)

- Exit price
- Orderly transaction
- Market
- Active market
- Market participants
- Consider - Highest and best use of a non-financial asset

Fair Value – Topic 820

Valuation Techniques

- Market Approach - Observable sales of identical or comparable assets - valuation techniques using market multiples derived from a set of comparables
- Income Approach - PV future cash flows or income - use of current market expectations about future cash flow amounts
- Replacement Cost Approach - amounts required to replace the current service capability of an asset

Fair Value – Topic 820

Fair Value Hierarchy

- Observable Inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed, based on market data obtained from sources independent of the reporting entity
- Unobservable Inputs are inputs that reflect the reporting entity's own assumptions about assumptions market participants would use in pricing the asset or liability developed, based on the best information available in the circumstances
- Valuation techniques to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs

Fair Value – Topic 820

Fair Value Hierarchy (cont'd)

- Level 1 Inputs are observable quoted market prices for identical assets or liabilities in an active market
- Level 2 Inputs are observable market inputs, directly or indirectly, not included in Level 1, including quotes for similar but not identical assets or liabilities
  - If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability
- Level 3 Inputs are unobservable, developed internally from the perspective of market participants. They require more extensive disclosure

Fair Value – Topic 820

The objective of the fair value disclosure requirements are to provide users of financial statements with information about assets and liabilities measured at fair value in the statement of financial position or disclosed in the notes to the financial statements including:

- The valuation techniques and inputs that a reporting entity uses to arrive at its measures of fair value, including judgments and assumptions that the entity makes
- The measurement uncertainty in the fair value measurements as of the reporting date
- How changes in fair value measurements affect an entity's performance and cash flows

Fair Value – Topic 820

Fair Value Disclosures

- Recurring
- Non-Recurring

Fair Value – Topic 820

Fair Value Disclosures - Recurring

1. The fair value measurement at the end of the reporting period
2. The level of the fair value hierarchy where the fair value measurements are categorized in their entirety (Level 1, 2, or 3)
3. For fair value measurements categorized within level 2 and level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement
4. When a change in either or both a valuation approach and a valuation technique, the reporting entity must disclose that change and the reasons for making it

Fair Value – Topic 820

Fair Value Disclosures – Recurring (cont'd)

5. For fair value measurements categorized in Level 3 of the fair value hierarchy, a reporting entity must provide quantitative information about the significant unobservable inputs used in the fair value measurement
    - This quantitative information must include the range and weighted average (or median or arithmetic average) of significant unobservable inputs used to develop Level 3 fair value measurements. (Note: range and weighted average not required for non-public entities)

Fair Value – Topic 820

Fair Value Disclosures – Recurring (cont'd)

6. For fair value measurements categorized in Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately the following:

   - Total gains or losses for the period recognized in earnings and or other comprehensive income and the line item(s) in the statement of income or other comprehensive income which these gains or losses are recognized
   - Purchases, sales, issues, and settlements each disclosed separately
   - The amount of any transfers into or out of Level 3 of the fair value hierarchy and the reasons for those transfers - transfers into Level 3 must be disclosed and discussed separately from transfers out of Level 3

Fair Value – Topic 820

Fair Value Disclosures – Recurring (cont'd)

7. For fair value measurements categorized in Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period included in earnings and included in other comprehensive income that is attributable to the change in unrealized gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in the statement of comprehensive income which those unrealized gains or losses are recognized. (Note: not required by non-public entities)

Fair Value – Topic 820

<u>Fair Value Disclosures – Recurring (cont'd)</u>

8. For fair value measurements categorized in Level 3 of the fair value hierarchy, a narrative description of the measurement uncertainty of the fair value measurement from the use of significant unobservable inputs if those inputs reasonably could have been different at the reporting date. (Note: not required by non-public entities)

Fair Value – Topic 820

<u>Fair Value Disclosures – Recurring (cont'd)</u>

9. If the highest and best use of a non-financial asset differs from its current use, a reporting entity must disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use

10. For each class of assets and liabilities not measured at fair value in the statement of financial position but fair value is disclosed, a reporting entity must disclose the information required by 2, 3, and 9 above

Fair Value – Topic 820

Fair Value Disclosures – Non-Recurring

1. The fair value measurement at the relevant measurement date and the reasons for the measurement
2. The level of the fair value hierarchy where the fair value measurements are categorized in their entirety (Level 1, 2, or 3)
3. For fair value measurements categorized within level 2 and level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement

Fair Value – Topic 820

Fair Value Disclosures – Non-Recurring (cont'd)

4. When a change in either or both a valuation approach and a valuation technique, the reporting entity must disclose that change and the reasons for making it
5. For fair value measurements categorized in Level 3 of the fair value hierarchy, a reporting entity must provide quantitative information about the significant unobservable inputs used in the fair value measurement
   - This quantitative information must include the range and weighted average (or median or arithmetic average) of significant unobservable inputs used to develop Level 3 fair value measurements. (Note: range and weighted average not required for non-public entities)

Fair Value – Topic 820

Fair Value Disclosures – Non-Recurring (cont'd)

6. If the highest and best use of a non-financial asset differs from its current use, a reporting entity must disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use

7. For each class of assets and liabilities not measured at fair value in the statement of financial position but fair value is disclosed, a reporting entity must disclose the information required by 2, 3, and 6 above

Asset Impairments – Topic 360

Asset Impairments – Topic 360

- Topic 360, *Property, Plant, & Equipment,* requires that impairment tests are performed on depreciated (or amortized) assets that are held and used only upon the occurrence of triggering events that suggest the assets may be impaired
- When performed, the tests are "cash-flow based," i.e., impairment exists when carrying values exceed undiscounted cash flows expected from those assets during their remaining economic life
- This approach is appropriate for both fixed assets and definite-lived intangibles
    - It makes sense that impairment is addressed only when there are adverse events because these assets' carrying values already decline as they are depreciated or amortized

Asset Impairments – Topic 360

- Definite-lived assets are reviewed for impairment only when certain triggering events occur that indicate their values are likely to be impaired
- Consequently, any "test" for impairment is not a routine evaluation performed annually or at each balance sheet date, but one "triggered" by events such as:

Asset Impairments – Topic 360

Triggering Events

- Significant decrease in the market value of an asset
- Significant change in the way an asset is to be used
- Significant changes in the business or legal environment
- Significant cost overruns incurred for self-constructed assets
- Continued (or anticipated) operating losses and/or cash flow deficiencies associated with identifiable assets
- A current expectation that it is more-likely-than-not the asset will be sold or otherwise disposed of before the end of its useful life

Asset Impairments – Topic 360

The Impairment Analysis for Property, Plant and Equipment is a 2-step Approach

1. Determine if Impaired - An asset is impaired under Topic 360 when net future cash inflows expected to be generated by the asset (undiscounted and without subtracting any related interest charges) are less than the carrying value of the asset

2. Determine Amount of impairment loss – The impairment loss is measured based on the difference between the asset's carrying value and its fair value

Asset Impairments – Topic 360

Required Disclosures for Impaired Assets Held and Used

- A description of the assets impaired and the facts and circumstances leading to the impairment
- The amount of the impairment loss along with the caption in the income statement (or statement of activities) which includes the impairment loss, if the loss is not separately disclosed
- How fair value was determined (i.e., Level 1, 2, or 3)
- The business segments affected, if applicable

Group Discussion

- What constitutes a triggering event for PP&E impairment?

Business Combinations – Topic 805

Business Combinations – Topic 805

Introduction

- A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses
- Transactions sometimes referred to as true mergers or mergers of equals also are business combinations
- The objective of the Topic 805, *Business Combinations,* is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects

Business Combinations – Topic 805

Introduction (cont'd)

- Topic 805 requires that acquisitions (net assets) be recorded based on their fair values
- Under this guidance, the acquirer in a business combination must identify and determine fair value for all identifiable assets acquired, liabilities assumed, and non-controlling interests, as well as consideration paid at the acquisition date

Business Combinations – Topic 805

Introduction – Complicating Factors

- Determining whether the acquirer has actually purchased a business or a group of assets
- Recording fair values for assets or liabilities acquired that were not recognized on the acquiree's balance sheet prior to the transfer
- Dealing with subsequent changes in fair values recorded, such as when amounts collected on receivables differs from the fair value recorded for them
- Accounting for a controlling interest acquired in stages

Business Combinations – Topic 805

Acquisition Method

1. Identify the acquirer
2. Determine the acquisition date
3. Recognize and measure at fair value the identifiable assets acquired, the liabilities assumed, and any non-controlling interests as of the acquisition date
4. Recognize and measure goodwill or a gain from a bargain purchase

Business Combinations – Topic 805

Acquisition Method (cont'd)

- Measurement period
- One year

Business Combinations – Topic 805

Measuring Selected Assets and Liabilities Acquired at Fair Value

- Accounts Receivable
- Finished Goods or Merchandise Inventory
- Raw Materials or Work in Process Inventory
- Machinery and Equipment
- Land

Business Combinations – Topic 805

Measuring Selected Assets and Liabilities Acquired at Fair Value (cont'd)

- Intangibles Assets in General
- Software
- In-Process Research and development
- Liabilities

Business Combinations – Topic 805

Step Acquisitions

- As updated by the issuance of ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, in a business combination achieved in stages, the acquirer must re-measure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in earnings

Business Combinations – Topic 805

Step Acquisitions (cont'd)

- In prior reporting periods, with respect to its previously held equity method investment, the acquirer may have recognized amounts in other comprehensive income. If so, the amount that was recognized in other comprehensive income must be reclassified and included in the calculation of gain or loss as of the acquisition date

- If the business combination achieved in stages relates to a previously held equity method investment that is a foreign entity, the amount of accumulated other comprehensive income that is reclassified and included in the calculation of gain or loss must include any foreign currency translation adjustment related to that previously held investment

Business Combinations – Topic 805

Additional Considerations

- Asset with a Restriction on Sale
- Asset with a Restriction on Use
- Contingent Assets and Liabilities
- Contingent Consideration
- Measuring Non-Controlling Interest at Fair Value
- Reacquired Rights

Income Taxes – Topic 740

Income Taxes – Topic 740

- Deferred Taxes
- Uncertain Tax Positions

Income Taxes – Topic 740

<u>Deferred Taxes</u>

Topic 740 applies the liability method to a reporting entity's financial accounting for the effects of income taxes – under this method:

- A current liability for income taxes payable is recognized for financial accounting ("book") purposes based on current taxable income computed in accordance with the applicable tax code (e.g., the U.S. Internal Revenue Code)
- A deferred income-tax effect is recognized for book purposes as either an asset or a liability based on temporary differences between the book and tax bases of assets and liabilities, i.e., differences that will "reverse" in the future

Income Taxes – Topic 740

Deferred Taxes (cont'd)

- Deferred tax liabilities are recognized for future taxable amounts
- Deferred tax assets are recognized for future deductible amounts (future tax benefit), as well as operating loss and tax credit carryforwards
- Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or a portion of the future tax benefit will not be realized

Income Taxes – Topic 740

Deferred Taxes Calculation

1. Identify future taxable items (deferred tax liability)
2. Identify future deductible items (deferred tax asset)
3. Tax effect all future taxable/deductible items
4. Compare the beginning balances of deferred tax asset to the ending balance and calculate the difference
5. Compare the beginning balances of deferred tax liabilities to the ending balance and calculate the difference
6. Determine the need for a valuation allowance against deferred tax assets
7. Derive income tax expense

Income Taxes – Topic 740

Uncertain Tax Positions

- GAAP requires financial statement recognition of the possibility that certain tax positions reflected on an reporting entity's tax returns that avoid or defer income taxes may not be sustainable upon examination by taxing authorities
- In applying these provisions, a reporting entity must presume that any and all tax positions on its returns will be examined, regardless of the likelihood this will actually occur

Income Taxes – Topic 740

Uncertain Tax Positions (cont'd)

- The amount of tax benefits reflected in both the current and deferred tax provisions is therefore reduced by any amount where it is more-likely-than-not (MLTN) that, upon an assumed examination by taxing authorities, the entity would pay "more taxes"
- Consideration of uncertain tax positions is required for all entities that are potentially subject to income taxes, including not-for-profits and pass-through entities such as LLCs and S Corporations

Income Taxes – Topic 740

Uncertain Tax Positions (cont'd)

What Constitutes a Tax Position?

The concept of "tax positions" is broad, and can relate to previous returns or items that affect current or deferred taxes of the current period. Tax positions can involve a permanent reduction of taxes or a deferral of tax, and also include matters such as (next slide):

Income Taxes – Topic 740

Uncertain Tax Positions (cont'd)

What Constitutes a Tax Position (cont'd)?

- An entity's tax status
- A decision not to file returns (such as a conclusion that the entity need not file in certain states outside its home state)
- Allocations of income and tax among jurisdictions (including issues such as transfer pricing)
- Characterization or exclusion of certain taxable income on returns
- Classification of income as exempt from tax

Income Taxes – Topic 740

Topic 740 requires the following disclosure for income taxes:

- Grossed-up amounts of deferred tax assets and liabilities netted on the balance sheet
- The components of income tax expense related to continuing operations each year
- The types of temporary differences and carryforwards resulting in significant deferred tax assets and liabilities; this is usually disclosed in the policy footnote
- Reconciliation of taxes provided on continuing operations to taxes based on regular statutory rates applied to pre-tax income from continuing operations

Income Taxes – Topic 740

Topic 740 requires the following disclosure for income taxes (cont'd):

- The amounts and expiration dates for loss carryforwards for tax purposes (they are often already recognized for book purposes as deferred tax assets)
- Any portion of the valuation allowance for deferred tax assets for which subsequently recognized tax benefits will be allocated to reduce goodwill or other noncurrent intangible assets of an acquired company or directly to contributed capital
- Intra-period tax allocation

Income Taxes – Topic 740

- Additional disclosures required for uncertain tax positions include:
- Classification policy for interest and penalties as a component of the liability for unrecognized tax benefits, or separately with interest and administrative costs
- At the end of each annual reporting period:
  - The amount of interest and penalties recognized on the income statement (expense) and the balance sheet (liability)
  - Significant estimate disclosures when related amounts meet the related criteria in Topic 275, *Risks and Uncertainties*, namely that it is reasonably possible that amounts will change by a material amount in the next 12 months
  - A description of tax years remaining open for examination, by major tax jurisdictions

Non-GAAP Performance Measurements

Non-GAAP Performance Measurements

- GAAP has been developed over time to provide financial information to user groups that can be interpreted and compared on a consistent basis from period to period and from company to company
- In recent years, many companies have also been reporting non-GAAP financial performance measures in reports that accompany the financial statements including press releases, conference calls with securities analysts, and security offerings prospectuses

Non-GAAP Performance Measurements

- Non-GAAP financial and non-financial measurements are supplemental information to GAAP provided by companies to often create a more accurate view of a company's performance
- Non-GAAP measurements often provide users with additional information and insight into a company's past and future performance

Non-GAAP Performance Measurements

- Many companies believe this non-GAAP information, both financial and non-financial, complements and, in some cases, completes the financial reporting based on GAAP
- In other words, companies frequently use non-GAAP financial and non-financial performance measures to tell a company's story providing users with additional insight as to how management is evaluating the operating performance and liquidity of a company from its internal reporting perspective

Non-GAAP Performance Measurements

- Non-GAAP financial performance measures are any quantitative measures of reporting a reporting entity's historical or future financial performance position or cash flows whose determination and/or presentation is not prescribed by GAAP
- Internally companies use financial and non-financial key performance measures (KPIs) to assist management in measuring progress towards achieving corporate goals and objectives and improving decision making processes

Non-GAAP Performance Measurements

SEC - A non-GAAP measurement is a numerical measure of a company's historical or future performance, financial position, or cash flow that:

1. Excludes amounts, or is subject to adjustments that have the effect of excluding amounts that are included in the most directly comparable measure calculated and presented in accordance with GAAP, or
2. Includes amounts, or is subject to adjustments that have the effect of including amounts that are excluded from the most directly comparable GAAP measure

Non-GAAP Performance Measurements

Adjustments are often made to GAAP results – for:

- One-time, unusual or non-recurring revenues or expenses
- Non-cash items
- Non-business operations items (acquisitions, litigations)
- Adjustments to present core earnings
- Non-GAAP measurements needed to calculate compensation or incentive payments
- Comply with non-GAAP measurements for debt covenant purposes

Non-GAAP Performance Measurements

Examples

- Adjusted operating income – eliminates one or more expenses
- Adjusted revenue or adjusted earnings
- Core earnings – revenue and expenses from the company's main or principal business
- Contribution margin – revenue less variable expenses
- Acquisition revenue and costs – reclassify certain items
- Free cash flow – GAAP operating cash flow less fixed recurring capital expenditures

Non-GAAP Performance Measurements

Examples (cont'd)

- Same store sales (retail)
- EBIT – earnings before interest and taxes
- EBITDA – earnings before interest, taxes, depreciation, and amortization
- Adjusted EBITDA – adjusted for other financial measures
- Funds from operations (FFO) – adds depreciation and amortization to GAAP earnings and subtracts any one time gains or losses

SEC Disclosure Updates

SEC Disclosure Updates

- Pay vs. Performance Disclosures
- Climate Disclosure Proposals

SEC Disclosure Updates

Pay vs. Performance Disclosures

- The Securities and Exchange Commission adopted on August 25th 2022 amendments to its rules to require registrants to disclose information reflecting the relationship between executive compensation actually paid by a registrant and the registrant's financial performance
- The rules implement a requirement mandated by the Dodd-Frank Act
- The amendments add new Item 402(v) of Regulation S-K

SEC Disclosure Updates

Pay vs. Performance Disclosures (cont'd)

- The amendments require registrants to provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years
- With respect to the measures of performance, a registrant will be required to report its total shareholder return (TSR), the TSR of companies in the registrant's peer group, its net income, and financial performance measures chosen by the registrant

SEC Disclosure Updates

Pay vs. Performance Disclosures (cont'd)

This table will include the following:

- Principal executive officer's (PEO) actual compensation and the average actual compensation paid to other named executive officers (NEO)
- Total executive compensation reported in the summary compensation table for the principal PEO and an average for the other NEOs
- Total shareholder return (TSR) of the registrant and its peer group
- The registrant's net income or loss
- Financial performance measures chosen by the registrant for the most recent fiscal year

SEC Disclosure Updates

Pay vs. Performance Disclosures (cont'd)

- Using the information presented in the table, registrants will be required to describe the relationships between the executive compensation actually paid and each of the performance measures, as well as the relationship between the registrant's TSR and the TSR of its selected peer group
- A registrant will also be required to provide a list of three to seven financial performance measures that it determines are its most important performance measures for linking executive compensation actually paid to company performance
- Smaller reporting companies will be subject to scaled disclosure requirements under the rules

SEC Disclosure Updates

Pay vs. Performance Disclosures (cont'd)

- Registrants must begin to comply with these pay vs. performance disclosures in proxy and information statements that are required to include Item 402 executive compensation disclosure for fiscal years ending on or after December 16, 2022
- For example, Item 11. Executive Compensation in Part 3 of Form 10-k

Trivia Question

- Do you know what requirement mandated within the Dodd-Frank Act the pay versus performance disclosure?

Trivia Question

Do you know what requirement mandated within the Dodd-Frank Act the pay versus performance disclosure?

Section 953(a) of the Dodd-Frank Act added the directive to the SEC to adopt a rule requiring companies to disclose information about the relationship between executive compensation and financial performance.

SEC Disclosure Updates

Climate Disclosure Proposals

- The Securities and Exchange Commission on March 21, 2022 proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports
- These disclosures include information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements
- The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks

SEC Disclosure Updates

Climate Disclosure Proposals (cont'd)

The proposed rule changes would require a registrant to disclose information about:

1. The registrant's governance of climate-related risks and relevant risk management processes
2. How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short, medium, or long-term

SEC Disclosure Updates

Climate Disclosure Proposals (cont'd)

The proposed rule changes would require a registrant to disclose information about (cont'd):

3. How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook
4. The impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements

SEC Disclosure Updates

Climate Disclosure Proposals (cont'd)

- The proposed rules also would require a registrant to disclose information about its direct greenhouse gas (GHG) emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2)
- In addition, a registrant would be required to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3), if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions

SEC Disclosure Updates

Climate Disclosure Proposals (cont'd)

- As of the time of writing this course the proposed rules have been put on hold due to technical glitches that created the need for the comment period to be extended.

Reminders

- **Post event evaluation:** Please complete the course evaluation that will be viewable once the session ends. We welcome your feedback!

KAPLAN