



Securities Quarterly Update

January 2022 | Winter Edition

Welcome to the winter edition of Securities Quarterly Update, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at ongoing disclosure developments, including those related to environmental, social, and governance (ESG) issues, that public companies should consider as they prepare their annual reports on Form 10-K.

Climate Change, Impact on People, Board Diversity and Other ESG-Related Disclosures

Anticipated SEC Rulemaking on ESG Topics

The SEC continues to focus on environmental and climate change disclosures, with proposed rulemaking expected in the coming weeks. It is anticipated that the SEC's proposed rules will include qualitative and quantitative disclosure requirements, such as industry-specific metrics and metrics related to greenhouse gas emissions, financial impacts of climate change, and progress toward climate-related goals.

It remains to be seen to what extent, if any, the SEC will draw from the TCFD and other third-party ESG frameworks and whether rulemaking will require reporting of Scope 3 greenhouse gas emissions.

The SEC's rulemaking is also expected to include enhanced requirements regarding human capital disclosures, including disclosures regarding board and workforce diversity and cybersecurity risk oversight, among others.

If the proposed rulemaking is released before Forms 10-K are filed, it may, to some degree, influence disclosures in the Forms 10-K, even though any proposed rules will still be subject to a comment period and, most likely, a lengthy transition period, particularly for climate-based disclosure requirements.

SEC Comment Letters Regarding Climate-Related Disclosures

Perhaps not surprisingly given the increasing investor sentiment that climate change is material for *all* companies, in 2021 some companies received multiple rounds of comments from the SEC relating solely to climate-related disclosures (or the lack thereof) in their SEC filings, and such SEC reviews seem to still be ongoing. On [September 22, 2021](#), the Division of Corporation Finance released a form comment letter, which we reviewed in our [Fall 2021 Securities Quarterly Update](#). For the most part, the comments include materiality qualifiers and are consistent with the SEC's [2010 Guidance Regarding Disclosure Related to Climate Change](#), which outlines the SEC's views with respect to existing disclosure requirements as they apply to climate change matters. Notably, the sample comment letter also includes an inquiry regarding discrepancies in the level of disclosure in sustainability reports compared to SEC filings.

What to Do Now

Consistency of Disclosure Across All Forums

When preparing Form 10-K disclosures, companies should review their sustainability/corporate citizenship reports, supplemental ESG reports, and other ESG disclosures on their websites and elsewhere to ensure that such disclosures are consistent in all forums. They should also evaluate their disclosures relating to climate change and other ESG topics to determine whether any of such disclosures are material to

the company and require disclosure in SEC filings – or develop a contemporaneous analysis supporting the company’s determination not to include.

For any ESG-related information included in Form 10-K, consider what assumptions and cautionary language should accompany it. For example, the recent class action certification, which we have reviewed [here](#), provides a cautionary tale to companies making broad ESG pronouncements in their public disclosures.

Risk Factors

ESG topics may also need to be addressed in risk factor disclosures, such as risks relating to physical and transitional climate risks, increasing ESG-related demands and regulation, cybersecurity and data privacy, supply chain management, labor shortages, and other workforce issues. Such disclosures are in addition to any updates relating to the current economic situation, inflation, COVID-19 impacts, [LIBOR transition](#), and other risks, some of which may have already been discussed in quarterly reports on Form 10-Q filed since the last Form 10-K and may now need to be added to Form 10-K and potentially updated.

Where material impacts have materialized or are on the horizon, related Management’s Discussion and Analysis (MD&A) disclosure updates may also be needed. Recall also that the SEC does not find hypothetical risk factors adequate where actual risks have materialized (e.g., consider cybersecurity incidents, among others).

Impact on People

For many companies, this year’s Form 10-K will be the second one including human capital disclosures. The amended Item 101 (Business) of Regulation S-K added a requirement to describe human capital resources to the extent such disclosures are material to understanding the business. This includes human capital measures or objectives used in managing the company’s business (e.g., those addressing the development, recruitment and retention of personnel). These disclosures have been evolving as a result of great investor interest, as well as expected SEC rulemaking that would enhance these disclosure requirements.

In his [remarks](#) on June 23, 2021, SEC Chair Gary Gensler provided some additional color regarding the SEC’s expected rulemaking, noting that he had asked SEC staff to develop recommendations on additional human capital disclosure that “could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.”

Companies should revisit their disclosures with these remarks in mind, as well as consider any issues raised by investors during their shareholder engagement process.

For most companies, people-related data is usually much easier to obtain than the data needed for certain environmental-related disclosures, including climate impacts and waste and water management. However, if your company is not currently reporting people-related data, either externally or internally, consider where such information is located and implement processes so that it can be easily collected and analyzed.

Nasdaq Board Diversity Rules, Related Disclosures and D&O Questionnaires

On [August 6, 2021](#), the SEC approved Nasdaq’s proposed [diversity rules](#), pursuant to which Nasdaq-listed companies are now required to disclose board diversity statistics and, for most companies, to have, or explain why they do not have, at least two diverse directors on their board of directors, including one who self-identifies as female and another who self-identifies as either an underrepresented minority or LGBTQ+. (There are certain exceptions for smaller reporting companies, foreign companies, and companies with five or fewer board members.)

In short, Nasdaq-listed companies are required to disclose their diversity statistics pursuant to a [board diversity matrix](#) at least once a year. The matrix, which is required to be searchable, can be included in a proxy statement or on a company’s website, in which case the company will need to submit the matrix concurrently with the proxy statement and submit a URL link through the Nasdaq Listing Center within one business day after posting. Companies are required to provide the matrix by the later of August 8, 2022 or the date they file their proxy statement for the

annual shareholders' meeting during 2022. For more information, see our [Fall 2021 Securities Quarterly Update](#).

Given investors' increasing interest in board diversity, as well as the SEC's anticipated rules requiring heightened board diversity disclosures, more non-Nasdaq-listed companies are also considering including similar disclosures.

While Nasdaq-listed companies will need to include questions soliciting information required to complete the new diversity matrix described above, all companies should consider including such questions (including information required by any applicable state law diversity requirements) – as well as questions soliciting information about directors' experience regarding various ESG and cybersecurity topics – in their D&O questionnaires to the extent they do not already do so. Companies should also ensure that their D&O questionnaires include consent to public disclosure.

Financial Statements

ESG Commitments

Companies should consider whether their financial statements adequately address the impact of environmental and climate change matters. For example, do the company's ESG commitments and related actions toward ESG goals trigger any impairments?

The FASB released an educational paper in [March 2021](#) regarding the intersection of ESG matters with financial accounting standards; FASB staff also issued an invitation to comment in [June 2021](#) that requested input on the effects of ESG matters on financial statement line items, among other topics.

Equity Compensation

In addition, consider taking a look at the SEC's [November 2021 guidance](#) (with examples) on how to recognize the cost of "spring-loaded" equity compensation grants (i.e., granted while in possession of positive material nonpublic information). In those cases, the SEC believes companies "should consider whether adjustments to the current price of the underlying share or the expected volatility of the price of the underlying share for the expected term of the share-based payment award are appropriate when applying

a fair-value-based measurement method to estimate the cost of its share-based payment transactions." In addition to the accounting impact, if any such awards were granted, notes to the financial statements included in Form 10-K may need to disclose how the company determined the expected volatility assumptions, and other disclosures may also be necessary in the notes to the financial statements and the MD&A (e.g., disclosures regarding critical accounting estimates).

In the guidance, the SEC is also "reminding companies of their corporate governance obligations and disclosure obligations under U.S. GAAP with respect to share-based payment transactions, as well as the need to maintain effective internal control over financial reporting."

Disclosure Controls and Procedures

It is becoming increasingly important to build out controls and procedures for the collection, measurement and verification of ESG-related data and to ensure that ESG-related data and disclosures are incorporated into the enterprise risk management program, insider trading controls, disclosure review, and the board's risk oversight process. The COSO framework may be instructive in designing those controls, but for many companies, it is quite a lengthy process.

With the continual expansion of the information that is being included in Form 10-K, companies should ensure that appropriate board committees are involved with the review of the applicable parts of Form 10-K. For example, in addition to the audit committee, it may be warranted to have the compensation committee review human capital disclosures, and the governance committee and/or the ESG committee review other ESG-related disclosures.

Consider also revisiting controls related to cyber incidents and insider trading, which continue to be focus areas for the SEC, as demonstrated by recent enforcement actions.

SEC Rule Changes to MD&A

The SEC's [amended MD&A requirements](#) are now applicable to all Forms 10-K – for the first time for many companies – and include the following changes:

1. **Revision to Item 303(a)(3)(ii) (Capital Resources) of Regulation S-K**, now requiring companies to describe “material cash requirements, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements.”
2. **Revision to Item 303(a)(3)(ii) (Results of Operations)**, now requiring companies “to disclose known events that are reasonably likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustment.”
3. **Revision to Item 303(a)(3)(iii) (Results of Operations)**, clarifying that “a discussion of material changes in net sales or revenue is required (rather than only material increases)” (which represents codification of the SEC’s interpretative guidance).
4. **Revision to Item 303(a)(3)(iv) (Results of Operations – Inflation and Price Changes)**, eliminating the express requirement to discuss the effects of inflation and instead encouraging companies “to focus on material information that is tailored to a company’s businesses, facts, and circumstances” (inflation and price changes may still need to be discussed if material).
5. **Revision to Item 303(a)(4) (Off-Balance Sheet Arrangements)**, now requiring companies “to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such [company’s] financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources even when the arrangement results in no obligation being reported in the [company’s] consolidated balance sheets.”
6. **Revision to Item 303(a)(5) (Contractual Obligations) and Revised Item 303(b)(1) (Liquidity and Capital Resources)**, eliminating the previously required contractual obligations table and instead requiring discussion of material contractual obligations as part of the company’s discussion of its liquidity and capital resources.

Smaller reporting companies, in particular, should note that material cash requirements from contractual and other obligations are required to be discussed in

MD&A, without an exception for smaller reporting companies that were already not required to include a contractual obligations table. Note also that liquidity disclosures are required on both a short-term (up to 12 months) and long-term (more than 12 months into the future) basis. Some companies are choosing to retain a contractual obligations table on a voluntary basis.

7. **Revised Item 303(b) (Material Changes in Results of Operations Line Items)**, codifying the SEC’s interpretative guidance requiring disclosure of the underlying drivers for the changes, including when material changes within a line item offset one another. Segment, product line and geographical information may also be required, if material.
8. **Revision to Item 303(b)(2)(iii) (Net Sales and Revenues)**, now requiring narrative discussion of material changes in net sales and revenues, including underlying drivers (qualitatively and quantitatively).
9. **New Item 303(b)(3) (Critical Accounting Estimates)**, now requiring disclosure of critical accounting estimates, changes in estimates, sensitivity disclosure, and related assumptions and uncertainties.
10. **Form 10-Q – Revision to Item 303(b) (Interim Periods)**, permitting some flexibility in the comparison of interim periods by allowing companies to compare their most recently completed fiscal quarter to either the corresponding quarter of the prior year (as required in the past) or to the immediately preceding fiscal quarter. Some companies are already utilizing this flexibility.

If the comparison is to the immediately preceding fiscal quarter, summary financial information for that quarter is required, either by directly including it in the filing or identifying the prior report where such information was provided. Similarly, if the company changes the period used for comparison, comparisons to both periods and the reasons for the change are required.

Selected Financial Data

Item 301 (Selected Financial Data), which had required companies (other than smaller reporting companies) to provide five-year comparative tabular financial data, was eliminated. Nevertheless, the SEC encourages companies to consider whether trend information for periods earlier than those presented in the financial statements should be included as part of the MD&A’s objective to “provide material information relevant to an assessment of the financial condition and results of operations” and whether a

tabular presentation of relevant financial or other information in an introductory section may improve a reader's understanding of the MD&A.

In either case, companies should remember to update Part II, Item 6 of Form 10-K to state "Item 6. [Reserved]," per the SEC's updated form.

Supplementary Financial Information

The amendments to Item 302(a) replace the past requirement for two-year quarterly tabular disclosure with a principles-based requirement for disclosure regarding material retrospective changes, such as changes in accounting principles, reorganizations, discontinued operations or corrections of errors.

In the past, Item 302(a)(1) required disclosure of selected quarterly financial data of specified operating results and Item 302(a)(2) required disclosure of variances in these results from amounts previously reported on Form 10-Q. The SEC's amendments clarify that the disclosure of summary financial information may vary, as appropriate, to conform to the nature of the company's business and to eliminate duplicative disclosures.

The amendments retain Item 302(a), "streamlining its requirements to require disclosure only when there are one or more retrospective changes that pertain to the statements of comprehensive income for any of the quarters within the two most recent fiscal years and any subsequent interim period for which financial statements are included or required to be included by Article 3 of Regulation S-X and that, individually or in the aggregate, are material."

The amendments require companies "to provide an explanation of the reasons for such material changes and to disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to the statements of comprehensive income (as specified in Rule 1-02(bb)(ii) of Regulation S-X) and earnings per share reflecting such changes."

Smaller reporting companies are not required to provide disclosures under Item 302.

Non-GAAP Financial Measures and Key Performance Indicators (KPIs)

Non-GAAP Financial Measures

Non-GAAP financial measures continue to be scrutinized by the SEC. Accordingly, companies should carefully review their use of non-GAAP financial measures, related reconciliations to GAAP and narrative disclosures. Companies should also check for compliance with GAAP prominence requirements and monitor their consistency in the use and calculation of non-GAAP financial measures from period to period and from one forum to another (e.g., SEC filings, earnings releases, investor presentations, earnings calls and website disclosures).

KPIs

Similarly, the SEC's [guidance](#) regarding KPIs may come in handy when preparing Form 10-K. The SEC expects KPIs used by management in managing business (e.g., operating margins, same-store sales, sales per square foot, total number of customers or subscribers, etc.) to be discussed in the MD&A.

When KPIs are used, the narrative disclosure should include the definition of the metric, explanation of the calculation, reasons why the metric is useful to investors and how it is used by management, and any material estimates and assumptions.

The SEC also expects an explanation, as described in its guidance, if the calculation or presentation of such metric is changed from one period to another. The requirements are similar to those for non-GAAP financial measures and can also be instructive in describing certain ESG-related indicators.

Holding Foreign Companies Accountable Act Disclosures for All Companies – New Item 9C and Inline XBRL Tagging

To implement the congressionally mandated disclosure requirements of the Holding Foreign Companies Accountable Act, Item 9C (Disclosure Regarding Foreign Jurisdictions that Prevent Inspections) has been added to Part II of Form 10-K. The [SEC's related rules](#) impact

companies that the SEC identifies as having filed an annual report with an audit report issued by a foreign accounting firm that the Public Company Accounting Oversight Board is unable to inspect completely because of a position taken by a governmental authority in that jurisdiction. Item 9C requires subject companies to electronically provide to the SEC “on a supplemental basis documentation that establishes that the [company] is not owned or controlled by a governmental entity in the foreign jurisdiction.”

While the rules are not applicable to most companies (and the earliest the SEC will be able to identify any subject companies will be after the upcoming Forms 10-K are filed), all companies are required to include the new Item 9C in their Form 10-K and should indicate “not applicable” where appropriate. In addition, all companies are subject to new Inline XBRL tagging requirements identifying the name of the company’s auditors, the auditors’ location (usually the city and state), and auditors’ PCAOB ID number (which in the past was not part of Form 10-K).

To date, the SEC has not prescribed in which section of Form 10-K this information should be located. However, if it is not included and properly tagged, the Form 10-K will be suspended by the SEC’s EDGAR filing system.

Section 13(r) Disclosures/Iran Notices

In 2021, the U.S. Secretary of State [designated](#) various organizations affiliated with the Russian government (including the Russian Federal Security Service (FSB)) as parties subject to Executive Order 13382 for undertaking “activities or transactions that have materially contributed to, or pose a risk of materially contributing to, the proliferation of weapons of mass destruction,” which may trigger Form 10-Q/K disclosure requirements (and an accompanying “Iran Notice” filing under Section 13(r) of the Exchange Act) for some companies importing products to Russia.

In addition, companies that use their D&O questionnaires (or other questionnaires) to collect information for compliance with Section 13(r) of the Exchange Act should review the recent additions to Executive Order 13382 to ensure their questions cover all relevant parties.

SEC Proposed Rules Regarding Stock Repurchases and Insider Trading

In December 2021, the SEC issued proposed rules regarding [stock repurchases](#) and [Rule 10b5-1 plans and insider trading](#), which we reviewed [here](#). Any final rules are unlikely to be effective for Forms 10-K filed this year.

Among other things, if adopted, the proposed rules would add disclosures to Form 10-K, including those listed below, and could require additional iXBRL tags.

- *Stock repurchases:* Item 703 of Regulation S-K would be revised to require additional information regarding stock buybacks in annual and quarterly reports on Forms 10-K and 10-Q, as applicable, including the objective or rationale for the buybacks and the process or criteria used to determine the amounts repurchased; any policies and procedures, including any restrictions, relating to transactions by officers and directors during a repurchase program; and whether the repurchases were made pursuant to a Rule 10b5-1 insider stock trading plan (and, if so, the date of the plan’s adoption or termination) and/or in reliance on Rule 10b-18. A check box would also be added above the Item 703 share repurchase table, indicating whether any officers or directors purchased or sold securities that are the subject of a repurchase plan or program within 10 business days before or after the announcement of such plan or program.
- *Insider trading policies and procedures:* Companies would be required to disclose whether or not (and if not, why not) they have adopted insider trading policies and procedures in their annual report on Form 10-K/proxy statement. Any such policies and procedures would also need to be disclosed.
- *Stock option grants:* In light of concerns relating to “spring-loaded” option grants, companies would be required to include, as part of their compensation disclosures in their annual report on Form 10-K/proxy statement, (i) a description of their stock option grant policies and practices and (ii) a new table providing certain information about option grants made within 14 calendar days of the release of material nonpublic information.
- *Rule 10b5-1 insider stock trading plan adoption or termination:* Information regarding the adoption, modification or termination and material terms of any Rule 10b5-1 or other trading arrangements by

directors, officers or companies would be required in Forms 10-Q (under Item 5. Other Information) and 10-K (under Item 10. Directors, Executive Officers and Corporate Governance).

Comments are due on both proposals within 45 days after publication in the *Federal Register*.

Form 10-K Exhibit Index

As every year, the exhibit index to Form 10-K should be reviewed to determine if any exhibits can be eliminated (such as equity plan documentation under which no awards remain outstanding or contracts that have been fully performed with no remaining obligations), to add exhibits filed with the Forms 10-Q and/or 8-K since the last Form 10-K, to update registration statement references in the auditors' consent, to update dates and check the signatories and titles on certifications, and to confirm if any updates are needed to the "securities description" exhibit or the registered debt exhibit. Companies should also remember to include the exhibit index, with hyperlinks to the referenced exhibits, before the signature page, in accordance with the relatively recent SEC rule changes. (Also note that companies may be able to have their directors and officers sign Form 10-K electronically if they have complied with the applicable rule requirements. See our [January 2021 Securities Quarterly Update](#).)

FOR MORE INFORMATION

For more information, please contact:

[Jurgita Ashley](#)

216.566.8928

Jurgita.Ashley@ThompsonHine.com

[Julia Miller](#)

216.566.5831

Julia.Miller@ThompsonHine.com

[Jaewon Suh](#)

216.566.5672

Jaewon.Suh@ThompsonHine.com

or another member of our [Securities, Capital Markets & Corporate Governance](#) team. For ESG matters, please contact a member of our [ESG Collaborative](#).

2021 Editions of *Securities Quarterly Update*

- [Q1 | January 2021](#)
- [Q2 | April 2021](#)
- [Q3 | July 2021](#)
- [Q4 | October 2021](#)

This publication may be reproduced, in whole or in part, with the prior permission of Thompson Hine LLP and acknowledgment of its source and copyright. This publication is intended to inform clients about legal matters of current interest. It is not intended as legal advice. Readers should not act upon the information contained in it without professional counsel. This document may be considered attorney advertising in some jurisdictions.

© 2022 THOMPSON HINE LLP. ALL RIGHTS RESERVED.