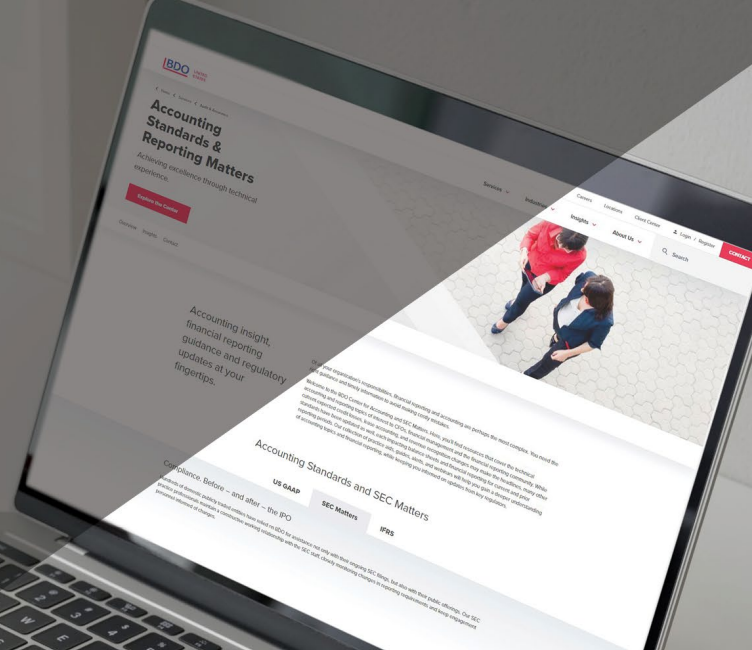




SEC CLAWBACK RULES: A SNAPSHOT



FEBRUARY 2025

This Snapshot summarizes the SEC's clawback rules and includes SEC staff guidance on the checkboxes found on the cover pages of annual reports and the clawback disclosure requirements in Item 402(w) of Regulation S-K (“S-K”).

OVERVIEW

Registrants listed on the New York Stock Exchange (NYSE) or Nasdaq Stock Market (Nasdaq) (“issuers”) must have policies in place to provide for the recovery of erroneously awarded incentive compensation (the “clawback” rules).

The rules require issuers to file their clawback policies as an exhibit to their annual reports and make several disclosures in annual reports and proxy and information statements.

CLAWBACK ANALYSIS

Upon preparing a financial statement restatement, an issuer must recover incentive-based compensation awarded to any current or former executive officers during the three years preceding the date of the restatement. A clawback analysis is triggered by an accounting restatement that corrects an error that:

- ▶ Is material to the previously issued financial statements (a “Big R” restatement)
- ▶ Would result in a material misstatement if the error was corrected or remained uncorrected in the current period (a “little r” restatement)

BDO INSIGHT: ASSESSING THE MATERIALITY OF AN ERROR

In making the materiality determination, an issuer must consider the quantitative and qualitative effect of the error from the perspective of a reasonable investor based on the totality of information that an issuer discloses. See our publication, [Accounting Changes and Error Corrections](#), for more guidance.

Once an issuer has determined an accounting restatement is necessary, the issuer must evaluate whether incentive-based compensation awarded to any current or former executive officers during the three years preceding “the date the issuer is required to prepare the restatement” must be recovered.

- ▶ The amount to be recovered is the difference between the amount of incentive-based compensation “received” by the executive and the amount that the executive should have received based on the restated financial reporting measure(s). Under the transition period, the clawback policy only applies to incentive-based compensation received on or after October 2, 2023, the effective date of the rule (even if the incentive compensation was granted before that date).
- ▶ Such recovery does not require misconduct by an executive or consideration of whether the executive had responsibility for the erroneous financial statements.

The following table describes some key terms in the rule:

TERM	DESCRIPTION
Executives ¹	<ul style="list-style-type: none"> ▶ Includes anyone who performs policy-making functions for the issuer. <ul style="list-style-type: none"> • For example, the issuer’s president, principal financial officer, and vice president in charge of a business unit, division, or function.
Incentive-based compensation	<ul style="list-style-type: none"> ▶ Applies broadly² to an issuer’s incentive-based compensation and includes bonuses, raises, and other equity or cash awards earned based on the achievement of a financial reporting measure.³ Bonuses, raises, and other equity awards that are not tied to a financial reporting measure are excluded. <ul style="list-style-type: none"> • Incentive-based compensation is received in the fiscal year in which the award is attained, regardless of when payment occurred, and is computed on a pre-tax basis.
Date the issuer is required to prepare the restatement	<ul style="list-style-type: none"> ▶ Occurs on the earlier of: <ul style="list-style-type: none"> • The date the issuer’s board (or committee thereof) or officer(s) concludes, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement. • The date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement.

There are limited exceptions whereby issuers are not required to collect erroneously awarded compensation, including:

- ▶ When expenses paid for collection would exceed the amount of the recovery and the issuer has made a reasonable attempt to recover.
- ▶ Recovery would violate home country law.
- ▶ Recovery would cause a tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

DISCLOSURES

Checkboxes

The clawback checkboxes appear on the cover page of annual reports on Forms 10-K, 20-F, and 40-F and require issuers to indicate whether:

- 1) The financial statements included in the filing reflect the correction of an error to previously issued financial statements (the “first checkbox”).
- 2) Any of the error corrections identified in 1) required an analysis for the recovery of incentive-based compensation from its executive officers (the “second checkbox”).

Disclosure Requirements



SEC REFERENCE

S-K Item 402(w)

¹ Compliance and Disclosure Interpretations (C&DIs) 121H.02 and 121H.03 provide guidance on which persons are considered named executive officers and require individualized disclosure pursuant to Item 6.F of Form 20-F and Item B.(19) of Form 40-F.

² Also refer to C&DI 121H.04.

³ Financial reporting measures are “measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements, and any measures derived wholly or in part from such measures.” This includes GAAP and non-GAAP measures or metrics, as well as stock price and total shareholder return (TSR).

Issuers must disclose:

- ▶ The date the accounting restatement was required to be prepared
- ▶ The total erroneously awarded compensation, including how the amount was calculated (or an explanation about why the amount has not been determined)
- ▶ The total erroneously awarded compensation outstanding at the end of the most recently completed fiscal year (including the name of the executive officer and the amounts that have been outstanding for 180 days or more since the determination of such amounts)
- ▶ Any estimates used in determining the amount to be recovered for incentive-based compensation tied to stock price or total shareholder return
- ▶ An explanation of any clawback analyses that did not result in the recovery of erroneously awarded compensation
- ▶ Recovered amounts that were deducted from the executive's compensation that is presented in the Summary Compensation Table pursuant to S-K Item 402(c)

SEC STAFF GUIDANCE

At the 2023 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff provided its view that issuers should check the first checkbox when the financial statements reflect the correction of an accounting error, as defined in U.S. GAAP (or IFRS), in the previously issued financial statements. This includes "Big R," "little r," and voluntary restatements. The SEC staff indicated that voluntary restatements include corrections of immaterial errors in the financial statement footnotes. However, issuers are not required to check the first checkbox for any out-of-period adjustments that are recorded in the financial statements of the current period.

The following table summarizes the types of error corrections and the applicability of the first checkbox based on the remarks of the SEC staff:

TYPE OF ERROR CORRECTION	SUMMARY	DOES CHECKBOX 1) APPLY?
Big R	An error is corrected through a Big R restatement when the error is material to the previously issued financial statements. A Big R restatement requires the entity to restate and reissue its previously issued financial statements.	Yes
little r	An error is corrected through a little r restatement when the error is immaterial to the previously issued financial statements, but correcting the error in the current period would materially misstate the current period financial statements. For example, an immaterial error that has been uncorrected for multiple periods and has aggregated to a material number in the current period may be corrected through a little r restatement.	Yes
Voluntary restatement	An error is corrected through a voluntary restatement if previously issued financial statements are corrected for errors that are not considered Big R or little r restatements. Examples of voluntary restatements include immaterial classification errors in the balance sheet and statement of cash flows, and corrections of immaterial errors in the financial statement footnotes.	Yes
Out-of-period adjustment	An error is corrected within the current period as an out-of-period adjustment when it is considered immaterial to both the current and prior period(s). The error correction is reflected in the current period, not the previously issued financial statements.	No

At the 2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff further addressed the application of the clawback checkboxes as well as the disclosures required when a restatement requires the recovery of erroneously awarded compensation. The SEC staff emphasized that the disclosures required by S-K Item 402(w) are not solely dependent on the use of the clawback checkboxes.

The clawback checkboxes apply to annual reports, not quarterly reports (such as Form 10-Q). In contrast, the S-K Item 402(w) disclosures apply to restatements during or after the last completed fiscal year that require the recovery of erroneously awarded compensation. Accordingly, the application of the clawback checkboxes depends on when a

restatement is reflected, whereas the application of the S-K Item 402(w) disclosures depends on when a restatement is determined. As such, the S-K Item 402(w) disclosures may apply to an issuer even when the clawback checkboxes do not. To illustrate this, the SEC staff provided the following example:

Before filing its 2024 Form 10-K, an issuer restates its first, second, and third quarter 2024 Form 10-Qs to correct an error. After filing the amended Form 10-Qs, the issuer files its 2024 Form 10-K and presents restated 2024 interim financial information in an unaudited footnote to comply with S-K Item 302. In this instance, the SEC staff indicated it would not object if the issuer does not check the first checkbox on the cover page of its 2024 Form 10-K because the previously issued financial statements included in the annual report do not reflect the correction of an error.⁴ However, the issuer must include the S-K Item 402(w) disclosures in its 2024 Form 10-K⁵ because the restatement occurred during or after its last completed fiscal year.

The SEC staff also addressed the application of the first checkbox in annual reports following a restatement. For example, assume an issuer identifies a material error to the financial statements included in its 2023 Form 10-K. The issuer amends its 2023 Form 10-K to correct the error and checks the first checkbox. In its 2024 Form 10-K, the issuer is not required to check the first checkbox for the same restatement because investors were made aware of the error when the issuer checked the first checkbox in its amended 2023 Form 10-K. However, if an issuer restates its previously issued financial statements in a filing other than an annual report (such as a registration statement or Form 8-K), the SEC staff believes the issuer must check the first checkbox in its annual report that reflects the correction of the error to the previously issued financial statements to inform investors of the error. For example, assume an issuer identifies an immaterial error to the financial statements included in its 2023 Form 10-K. Prior to filing its 2024 Form 10-K, the issuer corrects the error in its financial statements by filing them in an Item 8.01 Form 8-K. In this circumstance, the SEC staff believes the issuer should check the first checkbox when it files its 2024 Form 10-K as the issuer has not previously checked the first checkbox to inform investors of the error.

The second checkbox applies to Big R or little r restatements (it does not apply to voluntary restatements). When the first checkbox is checked due to a Big R or little r restatement, the second checkbox applies. This is true even if the executive officers did not receive incentive compensation during the relevant periods of the recovery analysis, and when the restatement has no impact on incentive compensation received, as an analysis for the recovery is required.

Lastly, the SEC staff shared observations from its review of the disclosures required by S-K Item 402(w). First, issuers must comply with the disclosure requirements when a restatement requires a clawback analysis, even when recovery is not required. In these instances, the issuer must briefly explain why the application of its recovery policy did not require recovery. The SEC staff also reminded issuers that the clawback disclosures must be tagged using Inline XBRL.

BDO INSIGHT: CHECKBOXES

We encourage issuers to work closely with legal counsel regarding the applicability of the checkboxes to their particular facts and circumstances.

⁴ This is consistent with the SEC staff's view detailed in June 2024 CAQ SEC Regulations Committee Highlights, Topic III.A.

⁵ Or its definitive proxy statement if the issuer forward incorporates Part III information into its Form 10-K.

Contacts

TIMOTHY KVIZ

National Managing Principal, SEC Services
703-245-8685 / tkviz@bdo.com

PAULA HAMRIC

Professional Practice Principal, SEC Services
312-616-3947 / phamric@bdo.com

BRANDON LANDAS

Professional Practice Principal, SEC Services
312-233-1887 / blandas@bdo.com

MEGHAN DEPP

Professional Practice Principal, SEC Services
248-688-3368 / mdepp@bdo.com

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