KPMG

HOT TOPIC

SEC guidance

Implementing compensation clawback requirements

March 2023 (updated January 2024)

Issuers face many questions in developing a recovery policy under the SEC's compensation clawback rules.

The SEC's compensation clawback rules require listed issuers (issuer(s)), with limited exceptions, to:

- develop and implement a recovery policy to clawback reasonably promptly the amount of incentive-based compensation previously received by executive officers determined to be erroneous; and
- disclose the recovery policy in an exhibit to each annual report along with specific information about any recovery events.

Issuers were required to adopt a final recovery policy by December 1, 2023 that complies with its national exchange's amended listing standards (see Background).

Elements of a recovery policy …	
Triggered when it is determined the issuer is required to prepare an accounting restatement that corrects an error in previously issued financial statements due to material noncompliance, including 'little r' restatements.	Applies to incentive-based compensation received by five categories of executive officers.
Recovers erroneously awarded incentive-based compensation during a recovery period when the accounting restatement changes financial reporting measures that affect the amount of such compensation.	Determines the recoverable amount that the issuer is required to pursue for recovery unless certain limited impracticability exceptions are met.

Required disclosures …

- Disclose the recovery policy as an exhibit to annual reports.
- Indicate by check boxes on annual reports:
  - if the financial statements included in the filing reflect a correction of an error to previously issued financial statements ('Tick Box 1'); and
  - if those corrections are restatements that required a recovery analysis ('Tick Box 2').
- Disclose any actions taken pursuant to the recovery policy.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

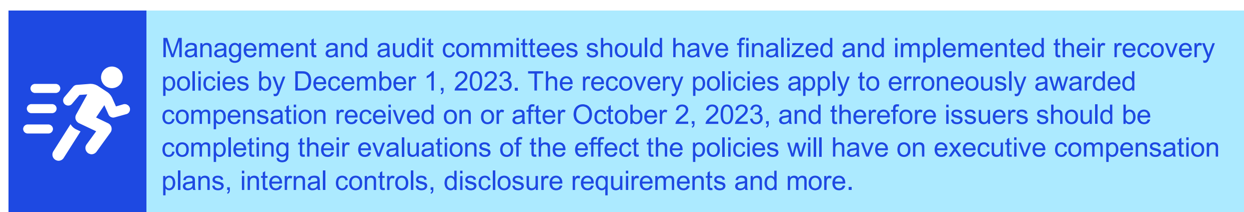
This Hot Topic has been updated to reflect new guidance issued since June 2023. New or revised substantive material in this document is marked with an *.

Background *

The 'clawback rules' comprise a new rule (Exchange Act Rule 10D-1) and amendments to existing rules and forms, all designed to implement the provisions required by Section 954 of the Dodd-Frank Act. The rules are intended to be applied broadly to any incentive-based compensation that is granted, earned or vested based wholly or in part on the attainment of any financial reporting measure.

In response to the requirements of the final clawback rules, on June 9, 2023 the SEC approved the national exchanges' (NYSE and Nasdaq) amended listing standards, with an effective date of October 2, 2023. Issuers were required to adopt a policy by December 1, 2023 and must now apply their recovery policy to erroneously awarded compensation received on or after the effective date of October 2, 2023.

The final listing standards closely align to the applicable text in the final rules and include cure periods in the event of noncompliance. They also outline existing and amended delisting proceedings in the event that an issuer has not implemented a recovery policy or fails to comply with its recovery policy.



The questions and answers below address key concepts in the clawback rules and the listing standards as of the publication date but are not intended to be an exhaustive list. The following terms used in this Hot Topic refer to how those terms are defined in the rules and listing standards: recovery policy, executive officers, incentive-based compensation, financial reporting measure, recoverable amount and recovery period.

Overview

Question	Interpretive response
What are the required elements of a recovery policy?	A recovery policy is required to claw back incentive-based compensation received by executive officers when an accounting restatement changes financial reporting measures that affect the amount of such compensation.
What event triggers a recovery policy?	A recovery policy must be triggered when an issuer is required to prepare an accounting restatement that corrects an error in previously issued financial statements that is material to those statements, or that would result in a material misstatement if corrected, or left uncorrected, in the current period.
To what types of issuers do the rules apply?	The rules apply to all types of issuers, including foreign private issuers, smaller reporting companies, and emerging growth companies, listed on an exchange with limited exceptions.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

‘Executive officers’

<table>
<tr><th>Question</th><th>Interpretive response</th></tr>
<tr><td>What levels of executives are in the scope of the rules?</td><td>The definition of ‘executive officer’ is intentionally broad and has been expanded beyond the definitions used in other SEC rules to include officers with an important role in financial reporting and policy making. The definition of current and former executive officers includes the issuer’s:
• president;
• principal financial officer;
• principal accounting officer (or equivalent);
• vice-presidents in charge of principal business units, divisions or functions (such as sales administration or finance); and
• other officers who perform a policy-making function or an important role in the preparation of the financial statements, or similar functions for the issuer, to the extent that such functions are significant to the issuer.
Issuers will need to determine who within their organization fits these categories. This may vary by entity depending on the issuer’s specific structure.</td></tr>
<tr><td>Do executive officers include the issuer’s parent or subsidiary officers?</td><td>Yes. The executive officers of the issuer’s parent or subsidiaries may be considered executive officers if they perform significant policy making functions for the issuer, because these officers play an important managerial role and help set the tone at the top.</td></tr>
<tr><td>Does the executive officer need to contribute to the error to be subject to the recovery policy?</td><td>No. A recovery policy established under the rules cannot be ‘fault-based’; issuers are required to recover incentive-based compensation erroneously received by executive officers regardless of fault. Due to the rule’s focus on shareholder protection, the officer need not contribute to, or play a direct role in, the accounting error that triggers the recovery policy.</td></tr>
</table>

‘Incentive-based compensation’

Question	Interpretive response
What incentive-based compensation is subject to a recovery policy?	A recovery policy applies to incentive-based compensation received by executive officers based on erroneous data, in excess of what would have been received based on the restated financial statements. The difference is considered to be the ‘recoverable amount’.
How is incentive-based compensation defined?	‘Incentive-based compensation’ includes any compensation granted, earned or vested based wholly or in part on attaining any financial reporting measure. For clarity, the incentive-based compensation does not need to be based solely on attaining a financial reporting measure. For example, compensation that is based in part on attaining a financial reporting measure (e.g. a revenue target) and in part on attaining an operational measure (e.g. number of new stores opened) would meet this definition.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
What types of compensation are not considered incentive-based compensation and are therefore not subject to a recovery policy?	Some examples are: • salaries; • bonuses paid solely at the discretion of the compensation committee or board based on achieving subjective or strategic measures tied only to operational or strategic goals; • non-equity incentive plan awards earned solely on satisfying operational or strategic measures; and • other equity awards for which granting and vesting are not based on achieving financial reporting measure performance goals and vesting is contingent solely on completion of a specified employment period and/or attaining nonfinancial reporting measures.

‘Financial reporting measure’

Question	Interpretive response
What is the definition of a financial reporting measure?	A ‘financial reporting measure’ is one that is determined and presented under the accounting principles used to prepare the issuer’s financial statements and measures derived wholly or in part from such measures, including: • measures taken directly from the financial statements; • stock price or total shareholder return that would be affected by accounting-related information and subject to disclosure requirements; and • non-GAAP and other measures, metrics and ratios (KPIs) that are not non-GAAP measures but are derived from and presented outside of the financial statements such as MD&A, results of operations or outside of an SEC filing.
What are examples of financial reporting measures included in or derived from the financial statements?	Examples include, but are not limited to: • financial ratios (accounts receivable turnover and inventory turnover rates); • liquidity measures (working capital, operating cash flow); • return measures (return on invested capital, return on assets); • leverage ratios (debt to equity); • EBITDA and adjusted EBITDA; • revenue per user or average revenue per user; • cost per employee; and • sales per square foot or same store sales.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
	For metrics and ratios, the focus is on whether either the numerator or denominator is a measure that is taken from, or derived from, a financial statement amount that has been the subject of a restatement.

'Recoverable amount'

Question	Interpretive response
What is the recoverable amount?	The 'recoverable amount' is the amount of awarded incentive-based compensation received by executive officers that exceeds the amount those officers would have received had the compensation been determined based on the restated financial results, without regard to taxes paid.
How does an issuer calculate the recoverable amount if the incentive-based compensation is based on stock price or total shareholder return?	When the incentive-based compensation is based on stock price or total shareholder return, and the issuer cannot simply recalculate the amount of erroneously awarded compensation from the information in the restatement, it must: • make a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return at the time the incentive-based compensation was received; and • provide the documentation of the reasonable estimate to the applicable exchange. For example, assume an executive has a goal of raising the Company's stock price to $5 as of December 31, 20X3, and the executive receives incentive-based compensation based on achieving that goal. Subsequently in 20X5, the issuer determines it must restate its December 31, 20X3 financial statements which triggers the issuer's recovery policy. Under the policy, the issuer would make a reasonable estimate of what the stock price would have been at December 31, 20X3 if the restated amounts had been known at the time. If the estimated effect of the accounting restatement would have reduced the stock price below $5 as of December 31, 20X3 such that the executive would not have received the award, the issuer would include the impact in its overall assessment of the recoverable amount.
Is any discretion permitted to recover erroneously awarded compensation?	No. Board discretion as to whether to recover erroneously awarded compensation is not allowed, but discretion as to how recovery is achieved is permitted.
Are there exceptions to when an issuer must collect the recoverable amount under its recovery policy?	Yes. While these circumstances are expected to be limited, an issuer is permitted an exemption from recovery when one of the following conditions is present and the issuer's committee responsible for executive compensation decisions, or equivalent, determines that recovery would be impracticable: • the expense of enforcing the policy would exceed the amount to be recovered after making a reasonable attempt of recovery, and this effort has been documented and provided to the relevant exchange;

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
	• recovery would violate a home country law of the issuer adopted before November 28, 2022, and the issuer has obtained an opinion of home country counsel and provided it to the relevant exchange; or • recovery would cause an otherwise tax-qualified retirement plan to lose its status.
Do the rules allow an issuer to indemnify its officers for amounts to be recovered?	No. Issuers are prohibited from insuring or indemnifying any executive officer or former executive officer against the loss of erroneously awarded compensation.

‘Recovery period’

Question	Interpretive response
What is the recovery period?	The ‘recovery period’ is defined as the three completed fiscal years immediately preceding the date it is determined that the issuer is required to prepare an accounting restatement. Therefore, if a calendar year-end issuer determines that it is required to prepare an accounting restatement in November 20X6, the recovery policy is triggered and the three-year recovery period includes the fiscal year-ends of 20X3 to 20X5. The date the restated financial statements are filed does not affect the determination of the recovery period. Issuer concludes restatement of prior years is required Nov 20X6 3-year look-back period 20X3 20X4 20X5 Dec 31, 20X3 Dec 31, 20X4 Dec 31, 20X5 Jan 20X7 Restated financial statement filed
What date is the issuer ‘required to prepare an accounting restatement’?	Exchange Act Rule 10D-1 did not define when an issuer is ‘required to prepare an accounting restatement’. The final rules and listing standards define this as the earlier to occur of: • the date the issuer’s board of directors or respective committee, or officer(s) authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that the issuer is required to prepare an accounting restatement, as defined; or • the date a court, regulator, or other legally authorized body directs the issuer to prepare an accounting restatement, as defined. If the issuer is restating its financial statements and triggers the requirement to file an Item 4.02(a) Form 8-K (Form 8-K) or equivalent filing, then this definition would be met.

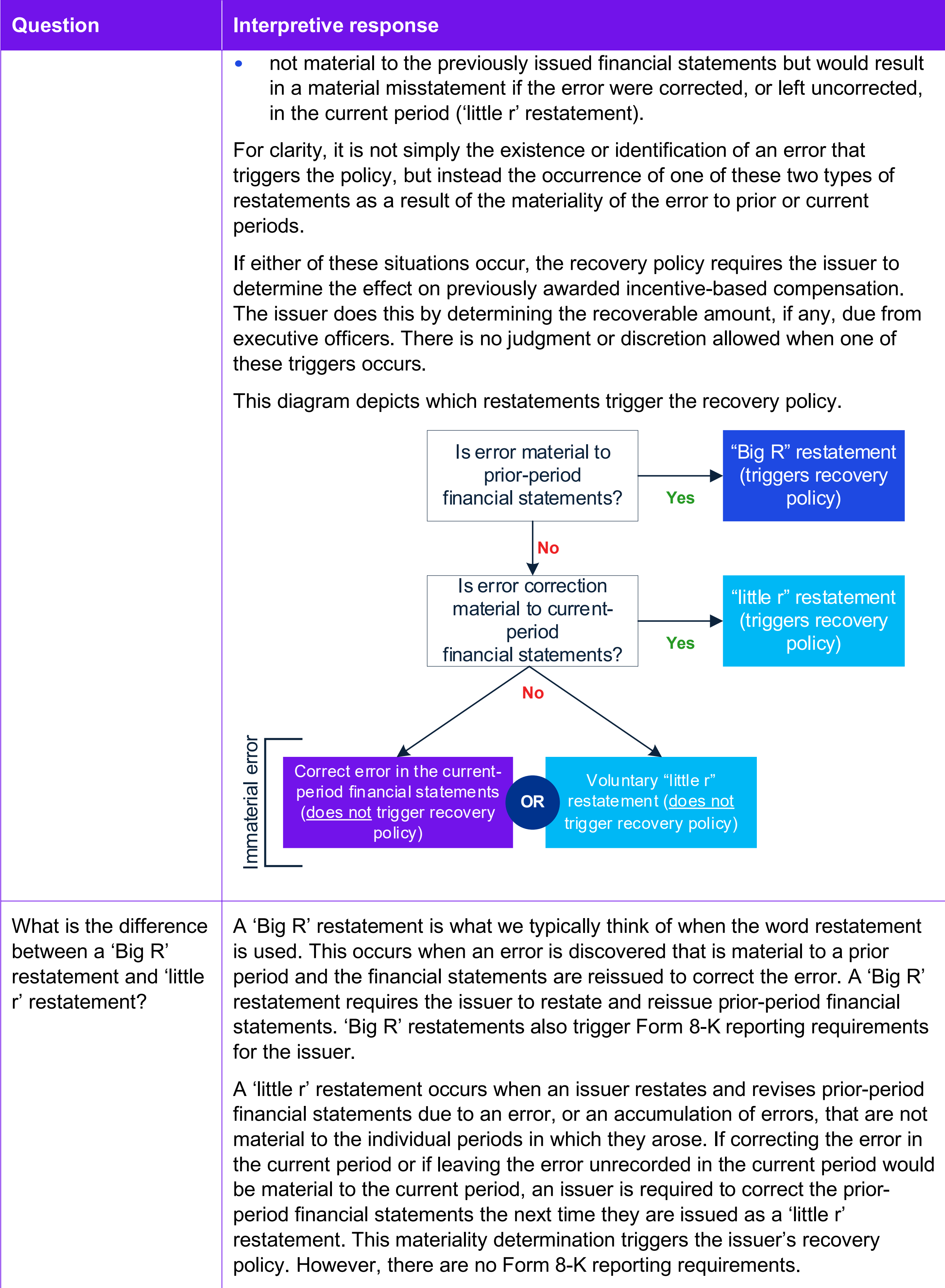
© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
	Absent the requirement to file a Form 8-K, we would expect this definition to be met at the time those persons authorized to do so determine, or reasonably should have determined, that an error is material to the current period, and therefore requires correction to a prior period through a 'little r' restatement. Once an issuer concludes, or reasonably should have concluded, that a restatement as defined in the rule is required, it should not delay triggering its recovery policy until the amount of the restatement is known or the restated financial statements are filed. The clawback policies should clearly define who is authorized to determine when an issuer is 'required to prepare an accounting restatement' for both 'Big R' and 'little r' corrections and the policies should include protocols for timely communication of those decisions to the appropriate governance bodies. These policies should consider impacts on related internal controls. It is important to note that an issuer's obligation to recover erroneously awarded incentive-based compensation is not dependent on if or when the restated financial statements are filed.
When is incentive-based compensation deemed to have been 'received' under the rules?	The fiscal year in which incentive-based compensation is deemed to have been 'received' is based on when the award's financial reporting measure goal is attained, not when the award is actually calculated, paid, issued or granted. Procedural acts or other conditions necessary to effect a payment or issuance (such as obtaining board approval for payment or calculating the amount earned) are not relevant for determining the date received. For example, if a revenue metric is met in November 20X3 and stock-option grant awards are tied to achieving that metric, then that incentive-based compensation is deemed to have been received during the fiscal year ended December 31, 20X3, even if the stock options are not approved and granted by the board until February 20X4.

Materiality, restatements and error corrections

Question	Interpretive response
Do the rules change how an issuer assesses materiality of an error?	No. The issuer's consideration of the qualitative and quantitative factors in the determination of the materiality of an error under SAB 99 (Topic 1M) is unchanged. However, the final rules may result in renewed emphasis on certain qualitative factors, including fraud, segment/component and executive compensation factors, that may lead the issuer to the conclusion that an error that would otherwise be quantitatively immaterial is material based on qualitative factors.
Which restatements trigger a recovery policy?	A recovery policy is triggered when an issuer is required to prepare an accounting restatement that corrects an error that is: • material to the previously issued financial statements ('Big R'); or

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

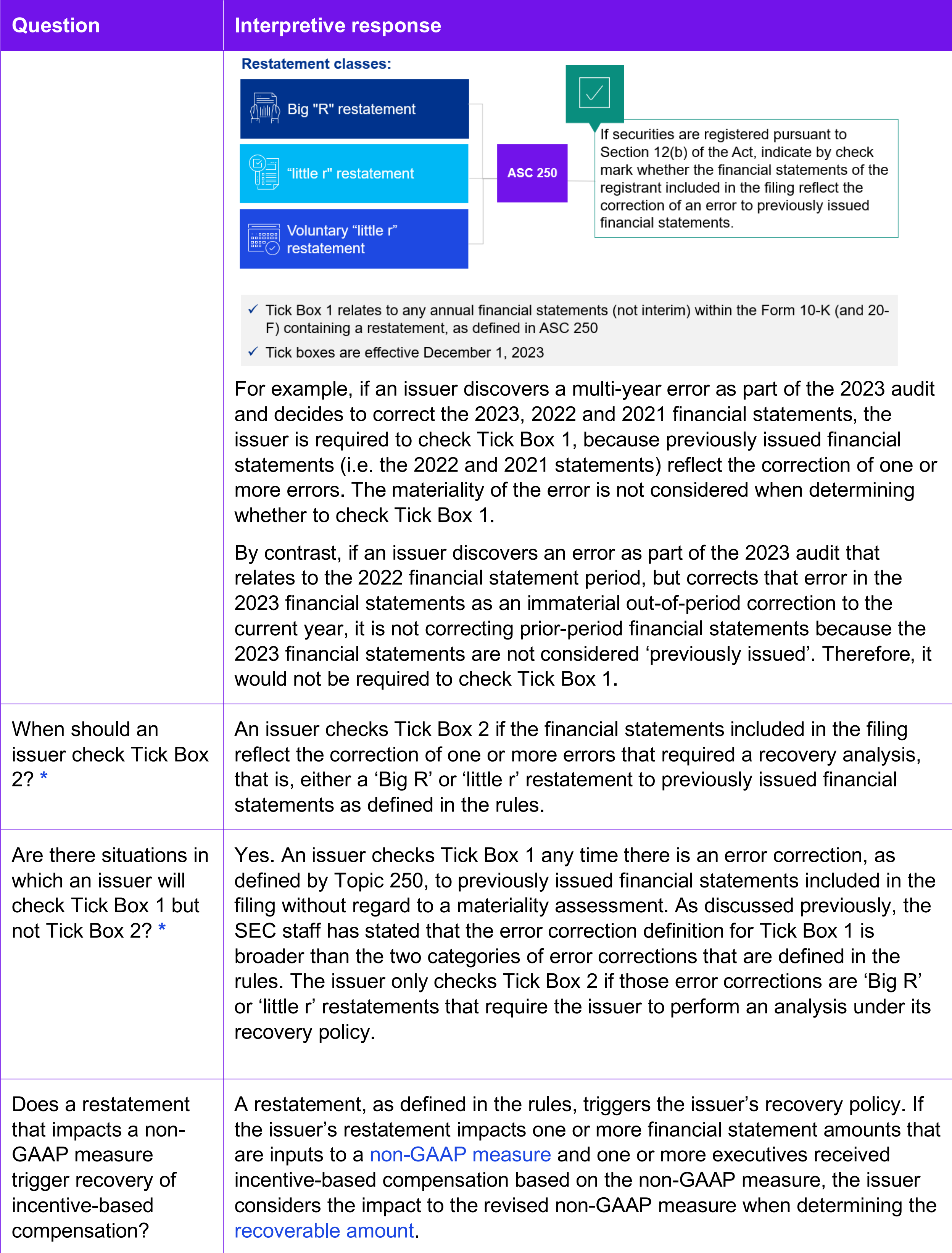


Question	Interpretive response
	• not material to the previously issued financial statements but would result in a material misstatement if the error were corrected, or left uncorrected, in the current period ('little r' restatement). For clarity, it is not simply the existence or identification of an error that triggers the policy, but instead the occurrence of one of these two types of restatements as a result of the materiality of the error to prior or current periods. If either of these situations occur, the recovery policy requires the issuer to determine the effect on previously awarded incentive-based compensation. The issuer does this by determining the recoverable amount, if any, due from executive officers. There is no judgment or discretion allowed when one of these triggers occurs. This diagram depicts which restatements trigger the recovery policy.
What is the difference between a 'Big R' restatement and 'little r' restatement?	A 'Big R' restatement is what we typically think of when the word restatement is used. This occurs when an error is discovered that is material to a prior period and the financial statements are reissued to correct the error. A 'Big R' restatement requires the issuer to restate and reissue prior-period financial statements. 'Big R' restatements also trigger Form 8-K reporting requirements for the issuer. A 'little r' restatement occurs when an issuer restates and revises prior-period financial statements due to an error, or an accumulation of errors, that are not material to the individual periods in which they arose. If correcting the error in the current period or if leaving the error unrecorded in the current period would be material to the current period, an issuer is required to correct the prior-period financial statements the next time they are issued as a 'little r' restatement. This materiality determination triggers the issuer's recovery policy. However, there are no Form 8-K reporting requirements.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
What if the error is not material to the prior- or current-period financial statements?	If the error is not material to the prior- or current-period financial statements, the error does not trigger the recovery policy. In this instance, an issuer may correct the error either (1) in the current-period financial statements (i.e. out of period adjustment) or (2) as a voluntary 'little r' restatement by correcting the prior-period financial statements the next time they are issued.
Are reclassifications and changes in presentation included in the definition of a restatement under the rules?	Regardless of how an issuer refers to a correction, if the classification or presentation was inappropriate in the prior year, then it is an error, which, if material, is subject to the recovery policy. Different issuers use different terminology but all issuers should look to the substance of what is being corrected to determine if the action triggers the recovery policy. An issuer's policy should be clear as to when it is triggered.
When is an issuer required to check Tick Box 1 in its annual report filing? *	Tick Box 1 is on the opening pages of the Form 10-K (and 20-F) and is labeled, "If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error that is reflected in previously issued financial statements." Lindsay McCord from the SEC's Division of Corporation Finance has stated that issuers should check that box for any annual financial statements that reflect an error in previously issued financial statements as defined in FASB Topic 250 (accounting changes and error corrections). Topic 250 defines an error in previously issued financial statements as "an error in recognition, measurement, presentation, or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of generally accepted accounting principles (GAAP), or oversight or misuse of facts that existed at the time the financial statements were prepared." This broad definition includes 'Big R' and 'little r' restatements as well as voluntary 'little r' restatements. Additionally, a change from an accounting principle that is not generally accepted to one that is generally accepted is also a correction of an error. Therefore, Tick Box 1 should be checked if any of these types of errors are included in a filing. Tick Box 1 is not checked (1) for changes in accounting principle or (2) if there is an out-of-.period adjustment reflected in current-year financial statements that does not change any prior-year financial statements. It is also not checked in a variety of other circumstances that are not error corrections, including items such as the retrospective application of a new accounting principle and the disaggregation of previously reported balances merely to provide more detailed information for investors. This diagram depicts which corrections require Tick Box 1 to be checked:

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.



Question	Interpretive response
	Restatement classes: Big "R" restatement "little r" restatement Voluntary "little r" restatement ASC 250 If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ✓ Tick Box 1 relates to any annual financial statements (not interim) within the Form 10-K (and 20-F) containing a restatement, as defined in ASC 250 ✓ Tick boxes are effective December 1, 2023 For example, if an issuer discovers a multi-year error as part of the 2023 audit and decides to correct the 2023, 2022 and 2021 financial statements, the issuer is required to check Tick Box 1, because previously issued financial statements (i.e. the 2022 and 2021 statements) reflect the correction of one or more errors. The materiality of the error is not considered when determining whether to check Tick Box 1. By contrast, if an issuer discovers an error as part of the 2023 audit that relates to the 2022 financial statement period, but corrects that error in the 2023 financial statements as an immaterial out-of-period correction to the current year, it is not correcting prior-period financial statements because the 2023 financial statements are not considered 'previously issued'. Therefore, it would not be required to check Tick Box 1.
When should an issuer check Tick Box 2? *	An issuer checks Tick Box 2 if the financial statements included in the filing reflect the correction of one or more errors that required a recovery analysis, that is, either a 'Big R' or 'little r' restatement to previously issued financial statements as defined in the rules.
Are there situations in which an issuer will check Tick Box 1 but not Tick Box 2? *	Yes. An issuer checks Tick Box 1 any time there is an error correction, as defined by Topic 250, to previously issued financial statements included in the filing without regard to a materiality assessment. As discussed previously, the SEC staff has stated that the error correction definition for Tick Box 1 is broader than the two categories of error corrections that are defined in the rules. The issuer only checks Tick Box 2 if those error corrections are 'Big R' or 'little r' restatements that require the issuer to perform an analysis under its recovery policy.
Does a restatement that impacts a non-GAAP measure trigger recovery of incentive-based compensation?	A restatement, as defined in the rules, triggers the issuer's recovery policy. If the issuer's restatement impacts one or more financial statement amounts that are inputs to a non-GAAP measure and one or more executives received incentive-based compensation based on the non-GAAP measure, the issuer considers the impact to the revised non-GAAP measure when determining the recoverable amount.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
If the SEC takes exception to one or more inputs into a non-GAAP measure, absent a restatement, would that trigger the recovery policy?	We believe changes to a non-GAAP measure alone, absent a restatement, would not trigger the recovery policy. If the SEC takes exception to one or more adjustments included in the calculation of a non-GAAP measure, or rejects the presentation of a non-GAAP measure altogether, such that the issuer is required to revise its disclosure, we do not believe this would trigger the recovery policy because there has been no restatement as defined by the rule.
Do the rules change how errors should be evaluated under Topic 250? *	No. The rules do not contain any additional considerations about how to evaluate the materiality of an error. However, the rules require issuers to evaluate the impact of errors on both current- and prior-period financial statements, as applicable. An issuer makes these assessments using the materiality thresholds determined for the relevant periods, considering both quantitative and qualitative factors.

Accounting for share-based payments

Question	Interpretive response
How are recoveries of share-based payments accounted for under FASB Topic 718 (stock compensation)? *	An issuer's recovery of earned share-based payments required under the rules will generally be considered a clawback feature in Topic 718. Clawback features that require an employee to return equity shares earned (or cash or other assets) are not considered in determining the grant-date fair value of the award or in recognizing compensation cost. Instead, they are generally recognized when the entity receives consideration triggered by the clawback provision. The entity recognizes the consideration received in the appropriate balance sheet account (e.g. treasury stock or cash) and records a credit in the income statement. The income recognized is equal to the lesser of the recognized compensation cost of the award clawed back and the fair value of the consideration received. Any excess fair value over the compensation cost is recorded to additional paid-in capital. If the issuer makes changes to existing plans as a result of the recovery policy being triggered, it also needs to consider the accounting effect on existing awards. We believe this same approach applies to the clawback of compensation outside of the scope of Topic 718 (e.g. an incentive plan in the scope of Topic 710).
How does a recovery policy affect grant date determinations under Topic 718?	One criterion to establish a grant date is a mutual understanding of key terms and conditions of an award between the grantor and grantee. Discretionary clawback policies can affect the determination of the grant date. If the discretionary provisions are so subjective, such that there is no shared understanding of terms, then there would not be a grant date until the discretionary period lapses.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
	We expect that recovery policies implemented solely to comply with the listing standards generally would not preclude a grant date. However, if an issuer includes additional subjective clawback provisions, those incremental policies need to be evaluated to determine the effect on reaching a grant date. If the grant date conditions are not met, the award would be remeasured until the grant date and the timing of recognition could differ depending on whether the conditions for a service inception date to precede the grant date are met.
Is adding a recovery policy considered a modification to a share-based award under Topic 718?	Generally, adding a recovery policy to comply with the listing standards would not result in a modification because it would not affect the awards' fair value. In contrast, if an entity made other changes to its plans that affect vesting conditions, fair value or classification, a modification would occur. For example, if an entity decides to change its performance metrics that generally would be considered a modification. Therefore, an entity making changes to its share-based compensation plans when implementing its recovery policy should consider the modification guidance.

Income tax and payroll considerations

Question	Interpretive response
What are the income tax implications if the recovery policy is triggered in the same year as the employee compensation payment?	The executive officer must repay gross performance-based compensation received, and not merely the amount received net of taxes withheld. The clawed back compensation is generally treated for income and FICA/payroll purposes as if it were reversed for both the employee and employer as long as the clawback was not triggered by a secondary event (e.g. malfeasance, etc.).
What are the employee's tax implications if the employee compensation payment and recovery policy trigger are in different years?	The executive officer must repay the gross performance-based compensation amount, either by reimbursing the employer or having the amount deducted from current compensation. An individual is not permitted to amend a prior year's income tax return for a clawback; section 1341 of the Internal Revenue Code may apply to permit the better of a deduction or refundable credit in the individual's current tax year. Alternatively, beginning in 2026, an itemized deduction may be available. Consultation with tax and legal counsel is advised.
What are the employer's tax implications if the employee compensation payment and recovery policy trigger are in different years?	Management should consider the following rules. • The employer may need to recognize income to the extent a prior deduction was realized under the tax-benefit rule. • The employer may recoup FICA/payroll taxes for open tax years if it chooses to do so. • The repayment by an employee does not alter the current year income reporting and withholding obligations with respect to the relevant employee's Form W-2 for compensation in the recovery year. Consultation with tax and legal counsel is advised.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

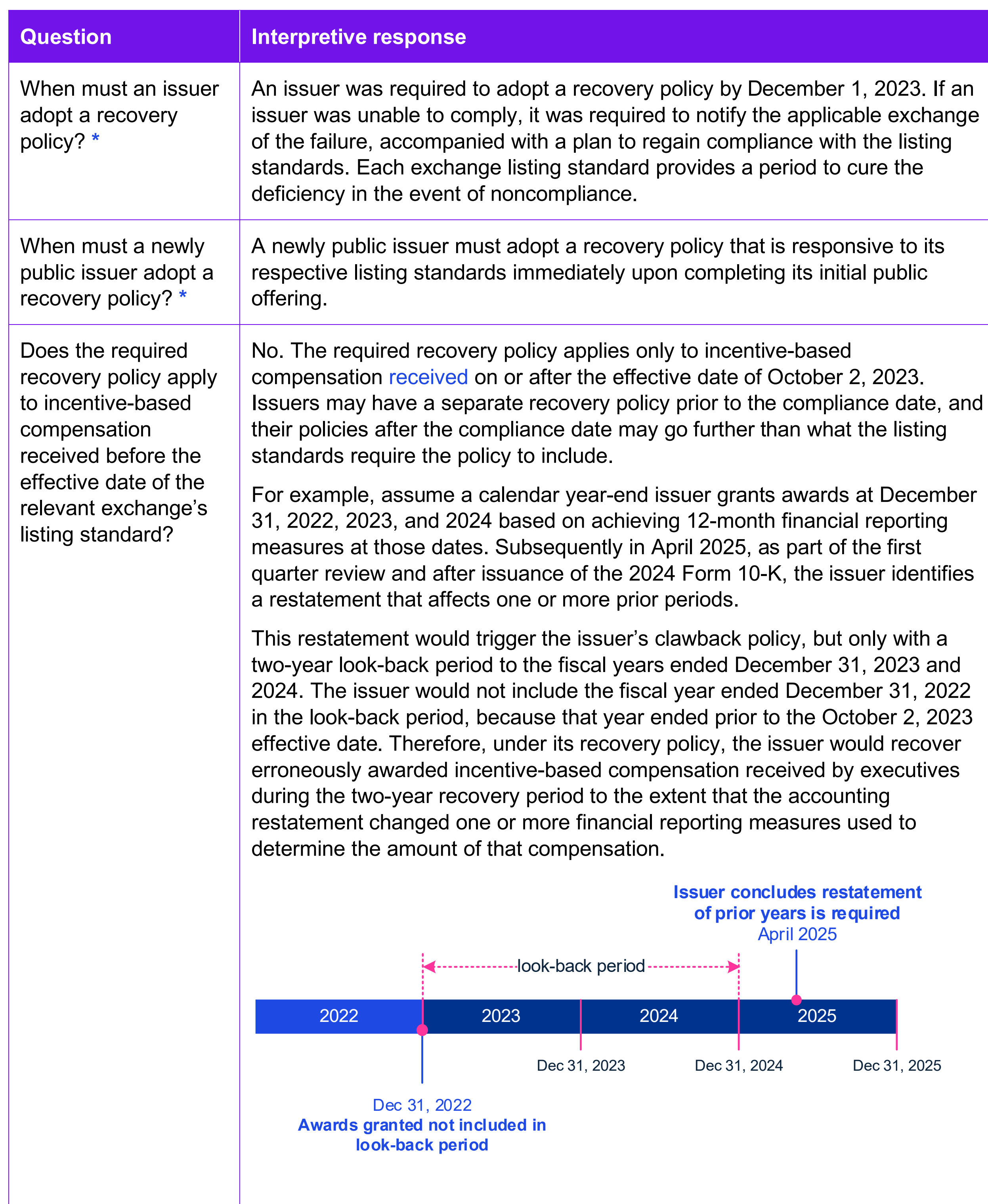
Internal controls

Question	Interpretive response
Should issuers assess the need to develop new or enhance existing controls or processes in response to the rules?	Yes. Issuers should evaluate their internal control over financial reporting (ICFR) and disclosure controls and procedures (DC&Ps) in light of the new rules and consider if new or enhanced controls are needed to address the requirements. This includes taking a fresh look at controls over how misstatements are identified throughout the organization, communicated for consideration in the aggregate, and evaluated, including segregation of duties related to these functions. Based on this evaluation, some issuers may determine they need one or more incremental financial reporting controls in this area. For example, some issuers currently may not have a process to evaluate whether errors are material to the current period because, once they conclude an error is not material to the prior periods, they do a 'little r' restatement to correct the error irrespective of whether they could have corrected the error in the current period. However, an issuer needs to determine whether the error would have been material to the current period because that conclusion will affect whether the restatement triggers the recovery policy. This situation would, therefore, require revisions to an issuer's processes and controls. In addition, as noted earlier in the Hot Topic, adoption of a recovery policy or changes made to compensation arrangements in connection with the adoption may affect aspects of issuers' accounting for compensation arrangements. Further, accounting for the recovery of certain compensation (e.g. share-based payments) may involve technical accounting complexities. To the extent such transactions and events create a reasonable possibility of a material misstatement to the financial statements, issuers may need to design and implement additional controls (or enhance existing controls) to address the related risks. As discussed earlier, qualitative factors, such as the fact that the above transactions and events affect executive compensation, may affect materiality considerations and lower the risk tolerance related to these transactions and events. That, in turn, may require an increased level of precision of the related controls. Issuers should adopt or enhance appropriate DC&Ps to provide reasonable assurance that the disclosures required under the compensation clawback rules are satisfied in their periodic filings, including disclosure of any actions taken pursuant to the adopted recovery policy. Lastly, to the extent issuers are making changes to ICFR in response to the new rules that materially affect, or are reasonably likely to materially affect, the issuer's ICFR, issuers should consider disclosure requirements of Regulation S-K Item 308(c).

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Effective dates and transition

Question	Interpretive response
When must an issuer adopt a recovery policy? *	An issuer was required to adopt a recovery policy by December 1, 2023. If an issuer was unable to comply, it was required to notify the applicable exchange of the failure, accompanied with a plan to regain compliance with the listing standards. Each exchange listing standard provides a period to cure the deficiency in the event of noncompliance.
When must a newly public issuer adopt a recovery policy? *	A newly public issuer must adopt a recovery policy that is responsive to its respective listing standards immediately upon completing its initial public offering.
Does the required recovery policy apply to incentive-based compensation received before the effective date of the relevant exchange's listing standard?	No. The required recovery policy applies only to incentive-based compensation received on or after the effective date of October 2, 2023. Issuers may have a separate recovery policy prior to the compliance date, and their policies after the compliance date may go further than what the listing standards require the policy to include. For example, assume a calendar year-end issuer grants awards at December 31, 2022, 2023, and 2024 based on achieving 12-month financial reporting measures at those dates. Subsequently in April 2025, as part of the first quarter review and after issuance of the 2024 Form 10-K, the issuer identifies a restatement that affects one or more prior periods. This restatement would trigger the issuer's clawback policy, but only with a two-year look-back period to the fiscal years ended December 31, 2023 and 2024. The issuer would not include the fiscal year ended December 31, 2022 in the look-back period, because that year ended prior to the October 2, 2023 effective date. Therefore, under its recovery policy, the issuer would recover erroneously awarded incentive-based compensation received by executives during the two-year recovery period to the extent that the accounting restatement changed one or more financial reporting measures used to determine the amount of that compensation.



© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
Does the recovery policy apply to incentive-based compensation received before an issuer is listed on, or after it is delisted from, one of the national exchanges?	No. The recovery policy applies only to incentive-based compensation received by executive officers while the issuer has a class of securities listed on the national securities exchange or a national securities association.

Other considerations

Question	Interpretive response
Are there differences in how to apply the clawback rules between US GAAP and IFRS® Accounting Standards? *	An issuer uses its applicable accounting standards to determine (1) if an error has occurred, (2) the recoverable amounts and (3) the required accounting for those amounts. While the application of the clawback rules does not depend on whether an issuer uses US GAAP or IFRS Accounting Standards, there can be different accounting results from their application due to differences between the accounting standards. Therefore, an issuer should be aware of the potential disparities between the standards.
Do the rules require issuers to hold back compensation of departing executives in the event of a restatement that triggers a clawback?	No. However, an issuer may decide, in consultation with its SEC counsel and compensation committee, that this is something it wants to do from a governance perspective.
What else should audit committees and management be thinking about as they evaluate the implications of the rules?	In addition to the above, audit committees and management should consider the following in light of the rules: • adequacy of existing governance structures; • development of policies or enhancements to existing policies that are responsive to the listing standards and the issuer's recovery policy; • enhancements of controls to be responsive to new/enhanced policies; • whether existing staffing resources are sufficient and appropriately trained to account for and implement the new policies; • how the audit committee can collaborate with the compensation committee to be responsive to the new requirements; and • what the issuer's disclosures will look like.

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.

Question	Interpretive response
How may an issuer's audit process change as a result of the new rules?	While this list is likely to evolve, changes may include: • more interaction between the audit team and the compensation committee to gain a full understanding of how incentive compensation is determined and granted; • obtaining an understanding of the controls involving the compensation committee; • additional risks being identified that require an audit response; • new controls becoming subject to the ICFR audit; and • more judgment and rigor around the assessment of the materiality of an error to the current period when that error is being pushed back to a prior period through a 'little r' restatement.

For further information

For further information on the clawback rules, see KPMG Defining Issues, Compensation clawback rules to create transparency.

Contact us

Timothy D. Brown
Partner, Audit
tdbrown@kpmg.com

Paulette A. DeFalco
Partner, Audit
pdefalco@kpmg.com

Megan M. Marshall
Associate Director, Audit
meganmarshall@kpmg.com

Ellen R. Russo
Managing Director, Audit
erusso@kpmg.com

kpmg.com/socialmedia

© 2024 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.