

# Snapshot

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SNAPSHOT 2022-15

## ‘Clawback’ of executive compensation Final Rule adopted

On October 26, 2022, the SEC adopted the [Final Rule, Listing Standards for Recovery of Erroneously Awarded Compensation](#), to implement Section 954 of the Dodd-Frank Act, which added Section 10D to the Exchange Act. Section 10D requires national securities exchanges and national securities associations to adopt listing standards that require all issuers with a class of securities listed on an exchange or an association to develop and implement a policy for recovering, under certain circumstances, erroneously awarded incentive-based compensation paid to executive officers (commonly referred to as a “clawback” policy).

In June 2023, the New York Stock Exchange and Nasdaq Stock Market adopted these required listing standards, which are effective on October 2, 2023. Each listed issuer is required to adopt a policy relating to the recovery of erroneously awarded compensation no later than December 1, 2023, which is 60 days following the effective date. The incentive compensation received by executives on or after October 2, 2023 is subject to the issuer’s recovery policies.

Issuers that do not adopt and comply with the compensation recovery policies or those that do not disclose the policy will be subject to delisting.

### ‘Clawback’ policy

The Final Rule amends certain rules and forms to require the issuer to (1) disclose and file its recovery policy as an exhibit to its annual report, (2) indicate by check boxes on its annual report whether the financial statements included in the annual report

reflect a correction of an error to previously issued financial statements and whether the corrections are restatements that triggered a recovery analysis, and (3) disclose any actions taken from the recovery analysis.

### Restatement determination

Under the new rules, an issuer is required to perform a recovery analysis when it has an accounting restatement that (1) corrects an error in previously issued financial statements that is material to the previously issued financial statements (a “Big R” restatement), or (2) would result in a material misstatement if the error was either corrected in the current period or left uncorrected in the current period (a “little r” restatement).

The Final Rule recognizes that U.S. GAAP permits certain retrospective changes to previously issued financial statements that do not represent error corrections and, therefore, would not trigger a recovery analysis. Examples include:

- Change in accounting principle
- Change in reportable segment information due to a change in the structure of an issuer’s internal organization
- Reclassification due to a discontinued operation
- Change in reporting entity
- Adjustment to provisional amounts in connection with a prior business combination
- Stock splits, reverse stock splits, stock dividends, or other changes in capital structure

## Date of restatement

The Final Rule requires an issuer to recover the erroneously awarded compensation from the three-year period preceding the date when the issuer is required to prepare an accounting restatement. The Final Rule defines this date as the earlier of when the board of directors, a committee of the board of directors, or officers have concluded, or should have concluded, that an accounting restatement is required,<sup>1</sup> or when a court, regulator, or other legally authorized entity directs the issuer to prepare an accounting restatement.

## Executive officers

Section 10D defines an “executive officer” as the issuer’s president; principal financial officer; principal accounting officer (or controller); vice presidents; or any other officer or person who performs a policy-making function, including executive officers of the issuer’s parent(s) or subsidiaries.

## S-K Item 402(w) disclosure

The Final Rule also adds new Item 402(w) to Regulation S-K to require an issuer to disclose actions taken to recover erroneously awarded compensation. When an accounting restatement occurs that requires recovery of erroneously awarded compensation, the issuer is required to disclose the following information:

- Date the accounting restatement was prepared;
- Aggregate dollar amount of erroneously awarded compensation and calculation of that amount; if the amount is not yet determined, an issuer must disclose this fact and include the known amount and other required disclosures in the next filing that is subject to S-K Item 402;
- Aggregate dollar amount of erroneously awarded compensation that remains outstanding at the end of the last completed fiscal year; and

- Estimates used in determining the erroneously awarded compensation and an explanation of the methodology used for the estimates if the financial reporting measure is related to a stock price or total shareholder return metric.

If recovery is impracticable, the issuer is required to disclose the amount of recovery forgone and to provide a description of the reasons why recovery is not being pursued. Additional disclosures are required when the recovery amount has been outstanding for 180 days or longer.

When an accounting restatement is prepared that does not require recovery of erroneously awarded compensation, the issuer is required to disclose the reasons for this conclusion.

### Grant Thornton insight

Materiality in error correction determinations continues to be a focus of the SEC staff, with heightened attention on the qualitative assessment. In a March 2022 [statement](#), SEC Acting Chief Accountant Paul Munter said that determining whether an error is material is an “objective assessment” focusing on whether there is a substantial likelihood that the error would be important to a reasonable investor.

Further, the Final Rule commentary reminds registrants, audit committee members, and auditors to apply a well-reasoned, holistic, and objective approach when assessing an error. When assessing the materiality of an error, any misstatement that positively impacted compensation should be considered as a qualitative factor.

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<sup>1</sup> For a “Big R” restatement, this date typically aligns with the restatement disclosure date in a non-reliance Form 8-K filed under Item 4.02.

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