

December 14, 2022

Key Considerations for Upcoming 2022 Form 10-K and 20-F Filings

Disclosure Trends and Additional Form Considerations

SUMMARY

As many companies prepare to file their annual reports on Form 10-K and Form 20-F for calendar year 2022, they should consider recent and upcoming changes to the disclosure rules of the Securities and Exchange Commission (“SEC”), recent SEC guidance and trending disclosure topics. This memorandum summarizes several of these disclosure considerations that will impact Form 10-K and Form 20-F filings this upcoming reporting season.

GENERAL DISCLOSURE TRENDS

Companies should consider a number of disclosure topics that continue to receive SEC and investor attention and evaluate whether their disclosures adequately address such matters.

Inflation and Interest Rate Risk: The SEC has expressed growing interest in disclosure surrounding a registrant’s exposure to inflation and interest rate risk. A registrant should consider disclosing (i) how inflation and rising interest rates have materially affected the registrant, including its operating results, sales, profits, cash flows, liquidity, financial position, wage expenses, employee retention and capital expenditures, (ii) the key factors contributing to inflationary pressure on its business and (iii) specific actions the registrant has taken or intends to take to mitigate these risks, including any evolutions in business goals, pricing strategies or interest rate hedging.

Impacts of the Inflation Reduction Act: The Inflation Reduction Act of 2022 (the “IRA”) was signed into law on August 16, 2022. Among other things, the IRA contained three key changes for corporations—a corporate minimum tax, a one percent excise tax on certain stock buybacks and certain clean energy incentives and initiatives. Registrants should consider whether any provisions of the IRA could be expected

SULLIVAN & CROMWELL LLP

to have an impact on their financial condition or results of operations. For example, companies with existing stock repurchase programs should consider disclosing whether the imposition of the excise tax is expected to have an impact on the use of any existing stock repurchase programs or the adoption of any additional programs.¹

Disclosure Surrounding Russia and Ukraine: As the conflict in Eastern Europe continues, the SEC continues to look for disclosures from registrants detailing both the direct and indirect ways the conflict and international responses impact their businesses. In May 2022, the SEC issued a [Sample Letter pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues](#), in which the SEC expressed that disclosure surrounding the conflict should discuss (i) direct or indirect exposure to Russia, Belarus or Ukraine through operations, employee base, investments in any such country, securities traded in Russia, sanctions against Russian or Belarusian individuals or entities or legal or regulatory uncertainty associated with operating in or exiting Russia or Ukraine, (ii) direct or indirect reliance on goods or services sourced in Russia or Ukraine, (iii) actual or potential supply chain disruptions and (iv) business relationships, connections to, or assets in Russia, Ukraine or Belarus. Companies should also refresh their existing disclosures to reflect any actual impact that the war and sanctions have had on their businesses.²

LIBOR Transition: In March 2021, the Intercontinental Exchange Benchmark Administration announced cessation dates for the wide majority of USD London Interbank Offered Rate ("LIBOR") tenors. The one-week and two-month USD LIBOR settings ceased on December 31, 2021, and the remaining USD LIBOR settings (including the overnight, one-month, three-month, six-month and 12-month USD LIBOR settings) will cease at the end of June 2023. As registrants turn to alternative USD reference rates, such as a Secured Overnight Funding Rate ("SOFR"), the risks imposed both during the transitional period and the relevant risks under the new reference rate should be disclosed to investors. Such risks include increased costs of raising funds and the implications of amending existing borrowing arrangements. In addition to discussing these items, registrants should consider a reference to the transitional period in their forward-looking statements, as well as within their debt disclosures and notes to financial statements.³

Human Capital: Item 101(c)(2)(ii) of Regulation S-K requires, to the extent material, a description of the registrant's human capital resources to be included in a company's Form 10-K within the Business section, including the number of employees and any human capital measures or objectives that the registrant focuses on in managing the business, such as personnel attraction and retention measures. Registrants should update their disclosures to reflect current labor conditions in their industries and markets. For example, certain industries continue to be impacted by ongoing labor shortages, whereas others, particularly in tech, are experiencing increased reductions in force. Registrants should consider the impact of these conditions, whether they affect compensatory practices, workplace culture, severance or other costs, litigation exposure, and ensure their disclosure remains current.⁴

SULLIVAN & CROMWELL LLP

COVID-19: As the pandemic continues, registrants should take a fresh look at their COVID-19 discussions as of the date of filing the Form 10-K or Form 20-F, with a view towards reflecting the current impacts of the pandemic in a continually changing environment. Changes in disclosure should reflect how the waning COVID-19 pandemic is impacting the registrant, which could be positively or negatively depending on the industry in which the registrant operates and other facts and circumstances. Potential items of discussion include the continued impact of the pandemic on supply chain and operations as well as changes in governmental regulations and vaccine requirements. These impacts may be different by geography. For instance, registrants with substantial operations in China should consider discussing whether China's COVID policies and related restrictions have or may continue to impact their supply chain, production capabilities and workforce.

Climate Change: On March 21, 2022, the SEC proposed expansive climate-related disclosure requirements in a [proposing release](#) that, if adopted, would require U.S. public companies and foreign private issuers to dramatically expand the breadth, specificity and rigor of climate-related disclosures in their SEC periodic reports and registration statements. Originally slated for adoption in 2022, the proposed rules are unlikely to be acted upon until 2023. Before releasing the proposed rules, the SEC published in 2021 a [Sample Letter to Companies Regarding Climate Change Disclosure](#) that highlights key considerations registrants should take into account when preparing annual reports and climate-related disclosure. These considerations remain relevant and include:

- Material “transition risks” related to climate change, including policy or regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks and technological changes;
- Material litigation risks related to climate change and the potential impact on a company’s business and operations;
- Material physical effects of climate change on a company’s operations and results;
- The costs and potential difficulties associated with adhering to any established or new environmental or compliance standards;
- Indirect consequences of climate-related regulation or business trends, such as decreased demand for goods producing significant greenhouse gas emissions (“GHG”), increased competition to develop innovative new products that result in lower GHG emissions, or any anticipated reputational risk resulting from operations or products that produce material GHG emissions; and
- Other ways in which climate change could impact a registrant’s business, such as supply chain, distribution, or purchase or sale of carbon credits.

Each registrant also should focus on the consistency in its disclosures, including between its SEC reports and any other publicly available information, such as corporate social responsibility or sustainability reports.⁵

Non-GAAP Financial and Other Performance Measures: The SEC staff continues to comment on issuers’ use of non-GAAP financial measures and compliance with related disclosure requirements. On

SULLIVAN & CROMWELL LLP

December 13, 2022, the SEC staff published updates to its [Non-GAAP Financial Measures Compliance and Disclosure Interpretations](#) (“C&DI”), reflecting recent views expressed by the SEC staff in their review of registrants’ SEC filings and registration statements. For example, updated C&DI 100.01 provides additional factors registrants may consider in evaluating whether the presentation of a non-GAAP financial measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant’s business may be misleading. In the updated C&DI, the SEC staff notes that they (i) would consider “the nature and effect of the non-GAAP adjustment and how it relates to the company’s operations, revenue generating activities, business strategy, industry and regulatory environment” and (ii) “would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring”. Registrants should carefully consider their use and disclosure of non-GAAP financial measures in light of the updated C&DI and evaluate whether any changes may be appropriate.

CHIPS Act and Recent Export Controls Relating to Technology in China: On August 9, 2022, President Biden signed the [CHIPS and Science Act of 2022](#) into law, which provides certain financial incentives with the intention of increasing American semi-conductor research, development and production and promoting domestic scientific and technological advances. A registrant operating in this sector should consider the impact the CHIPS Act could have on its business, including impacts on competitive positioning as well as any anticipated tax credits. For example, those registrants with planned expansion in accordance with the tax credit should also disclose those intentions in the “Liquidity and Capital Resources” section of the Management’s Discussion and Analysis of Financial Condition and Results of Operations. Further, the United States has [recently imposed](#) restrictions on the export of U.S.-regulated products and technology to certain Chinese technology companies and adopted controls on certain transactions involving items for semiconductor manufacturing end uses and advanced computing integrated circuits destined for China. Registrants operating in this sector should be particularly mindful of disclosing the impacts of these new controls, as well as risks associated with current and future business plans relating to China.

Cybersecurity: On March 9, 2022, the SEC [proposed new rules](#) for registrants regarding disclosure of material cybersecurity incidents, as well as cybersecurity risk management, strategy and governance. Although the proposed rules have not yet been adopted, registrants may consider revisiting existing disclosure and refreshing as needed, as cybersecurity matters continue to receive attention from the SEC. For example, recent enforcement actions have focused on inadequate disclosure controls and procedures, and highlighted that registrants who experience an actual, material data breach should update any hypothetical language around cybersecurity incidents in their public disclosures.⁶

Crypto Markets: Companies should also review their existing disclosure with respect to recent events and conditions in the crypto markets in light of a [Sample Letter to Companies Regarding Recent Developments in Crypto Assets](#) published by the SEC on December 8, 2022, if appropriate. These sample comments take

SULLIVAN & CROMWELL LLP

a principles- and materiality-based approach, with a focus on disclosures around exposures to crypto market participants, potential conflicts of interest and compliance and risk management processes.⁷

ADDITIONAL CONSIDERATIONS FOR THIS REPORTING SEASON AND BEYOND

Companies should also consider the following items when preparing reports now or in the future.

Disclosures on Board Oversight of Risk: The SEC has recently increased regulatory scrutiny surrounding internal controls, risk management and asset protection. The SEC has issued several comment letters requesting expanded disclosure as to how a registrant’s board administers its risk oversight function. Registrants should consider including the following information in their Form 10-K or incorporating by reference into their Form 10-K via their annual meeting proxy statement:

- the timeframe and process for risk identification and evaluation;
- how the risk oversight process aligns with disclosure controls and procedures;
- whether outside advisors and experts are consulted in anticipating future threats;
- how often the risk environment is assessed; and
- how the board interacts with management in addressing existing risk and identifying emerging risk.

Clawback Policies: On October 26, 2022, the SEC adopted [final mandatory clawback rules](#), directing national securities exchanges and associations to require policies mandating the recovery or “clawback” of excess incentive-based compensation earned by executive officers during the three fiscal years preceding a required accounting restatement, including an accounting restatement that corrects an error in previously issued financial statements that is material to the previously issued financial statements (commonly referred to as a “Big R” restatement) or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period (commonly referred to as a “little r” restatement). Depending on the implementation timeline for the clawback rules, 2023 reports may be affected by the SEC’s new disclosure requirements, which would require registrants to disclose whether their financial statements reflect a correction to statements previously issued, their clawback policies, whether any financial statement corrections are restatements that require analysis under their clawback policy, and information about any actions taken pursuant to a policy.⁸ Registrants should review their existing clawback policies and compensation plans and agreements and determine if any updates will be needed to comply with the new clawback rules.

SAB 121: Safeguarding Crypto Assets: On March 31, 2022, the SEC staff released [Staff Accounting Bulletin No. 121](#) (“SAB 121”), which provides interpretative guidance for entities to consider when they have obligations to safeguard crypto-assets for their platform users. SAB 121 describes unique technological, legal and regulatory risks that companies encounter when satisfying their safeguarding obligations. Such risks can have a significant impact on an entity’s operations and financial condition and, accordingly, must

SULLIVAN & CROMWELL LLP

be appropriately disclosed to investors. A liability must be presented on the balance sheet to reflect any obligation to safeguard crypto-assets for platform users. Additionally, the notes to the financial statements should include sufficient detail as to the nature and amount of crypto-assets an entity is responsible for safeguarding, with separate disclosure for each significant crypto-asset. Further disclosures pertaining to such obligation should also be considered in the Business section, Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations. The SEC expects all applicable registrants to have included such disclosure on or before June 15, 2022, and to apply it retrospectively. Registrants should consider including a reference to SAB 121 in the "Recently Adopted Accounting Standards" section of their Form 10-K, with an explanation as to when and how the registrant has implemented such guidance.

* * *

The topics addressed above discuss amendments and trends that have developed over the past year, as well as public statements from officials and staff at the SEC, that registrants should consider as they prepare their Form 10-Ks and Form 20-Fs for the upcoming reporting season. However, each registrant's disclosure is unique, and therefore needs to be tailored to its particular facts and circumstances.

* * *

ENDNOTES

- ¹ For further information, see our Client Memorandum: “New Excise Tax on Stock Repurchases: The Inflation Reduction Act Will Impose a One Percent Tax on Stock Repurchases, With Unique Implications for Banking Organizations” (August 15, 2022), *available at* <https://www.sullcrom.com/sc-publication-new-excise-tax-on-stock-repurchases> and our Client Memorandum: “Inflation Reduction Act – Energy Tax Credit and Climate-Related Funding Provisions: The Act Modifies and Expands Tax Credits for Renewable Energy Production, Clean Energy Investments and Use of Alternative Power and Fuel Sources, and it Provides Significant Funding for a Wide Variety of Programs Relating to Climate Change” (August 17, 2022), *available at* <https://www.sullcrom.com/sc-publication-inflation-reduction-act-energy-tax-credit-climate-related-funding-provisions>.
- ² For further information, see our Client Memorandum: “SEC Staff Highlights Review of Disclosures Pertaining to Russia’s Invasion of Ukraine” (May 9, 2022), *available at* <https://www.sullcrom.com/sc-publication-SEC-highlights-disclosures-Russia-Invasion-Ukraine>.
- ³ For further information, see our Client Memorandum: “LIBOR Transition: LIBOR Benchmark Administrator Proposes Extending Publication of Widely Used USD LIBOR Settings to June 30, 2023; Federal Banking Agencies Issue Guidance that Banks Should Generally Cease Entering Into New Contracts Referencing USD LIBOR by End of 2021, and Observes the Extended Date Will Facilitate the Roll-Off of Legacy Contracts” (December 1, 2020), *available at* <https://www.sullcrom.com/sc-publication-LIBOR-transition-2020>.
- ⁴ For further information, see our Client Memorandum: “SEC Adopts Amendments to Regulation S-K Disclosure Requirements” (August 31, 2020), *available at* <https://www.sullcrom.com/sc-publication-sec-adopts-amendments-regulation-disclosure-requirements>.
- ⁵ For further information, see our Client Memorandum: “SEC proposes Expansive Climate-Related Disclosure Rules” (March 28, 2022), *available at* <https://www.sullcrom.com/sc-publication-sec-proposes-expansive-climate-related-disclosure-rules>.
- ⁶ For further information, see our Client Memorandum: “SEC Proposes New Cybersecurity Disclosure Rules for Public Companies: Proposed Rules Would Require Disclosure of Material Cybersecurity Incidents, as well as Cybersecurity Risk Management, Strategy and Governance Disclosures” (March 11, 2022), *available at* <https://www.sullcrom.com/files/upload/sc-publication-sec-proposes-new-cybersecurity-disclosure-rules-for-public-companies.pdf>.
- ⁷ For further information, see our Client Memorandum: “SEC Staff Highlights Disclosures Regarding Crypto Market Developments” (December 9, 2022), *available at* <https://www.sullcrom.com/files/upload/sc-publication-sec-highlights-disclosures-crypto-market-developments.pdf>.
- ⁸ For further information, see our Client Memorandum: “SEC Adopts Final Mandatory Clawback Rules (October 31, 2022), *available at* <https://www.sullcrom.com/files/upload/sc-publication-sec-adopts-final-mandatory-clawback-rules.pdf>.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 900 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.