2022 AICPA SEC & PCAOB Conference Highlights

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Table of Contents

OVERVIEW 3

MACROECONOMIC FACTORS 4

- COVID-19 4
- Inflation 5
- Supply Chain 5
- The War in Ukraine 5

EMERGING TRENDS 6

- Digital Assets 6
- Cybersecurity 8
- Climate 8

SEC MATTERS 9

- Financial Disclosures About Acquired and Disposed Businesses 9
- Comment Letter Topics 11
- New Accounting Standard – Date of Initial Application 13
- Pay vs. Performance 13
- Clawback 14
- Best Practices When Communicating with the Staff 14
- Board Leadership Structure and Risk Oversight 14

AUDIT MATTERS 15

- PCAOB Inspections 15

CONTACT US 16

Consistent with prior years, the annual AICPA & CIMA Conference on Current SEC and PCAOB Developments was held in Washington D.C. on December 12-14, 2022, where representatives from the Securities and Exchange Commission and the Public Company Accounting Oversight Board shared their views on various accounting, reporting and auditing issues.

Overview

The current macroeconomic environment, including inflation, supply chain constraints, the war in Ukraine, and COVID-19, as well as emerging trends, such a digital assets, cybersecurity, and climate, were key themes at this year's Conference. The staff emphasized the importance for disclosures to provide decision useful information to investors, including how changes and uncertainties may affect the predictive value of historical financial information. Conference panelists highlighted some of the key matters related to these areas and others, including:

- Macroeconomic Factors – reminders and guidance for registrants to consider related to COVID-19, inflation, supply chain, and the war in Ukraine.
- Emerging Trends – complexities involved in reporting and accounting for digital assets, including Staff Accounting Bulletin ("SAB") No. 121, crypto lending arrangements, and crypto asset securities. The staff also emphasized the importance of accurately disclosing cybersecurity threats and breaches. The Conference would not be complete without a discussion on climate change, which focused on the proposed rules and provided reminders to registrants to revisit previously issued disclosure guidance.
- SEC Matters – reminders and best practices when communicating with the staff and frequent SEC comment letter topics. More specifically, the staff provided additional clarity on misleading non-GAAP measures, and discussed the holistic review approach for segment disclosures. The staff provided guidance on the new pay vs. performance rule, specifically for the calculation of "compensation actually paid" for equity-based awards. The staff also addressed the new checkboxes to be included in annual reports from the final rule on clawbacks and questions about financial disclosures for acquired and disposed businesses. Questions on the date of initial application of the new long-duration contracts standard as well as boiler plate disclosures observed in corporate governance disclosures required in proxy statements were also discussed.
- Audit Matters - the Public Company Accounting Oversight Board (PCAOB) staff shared inspection findings and areas of focus for the coming year.

This publication provides insight into these matters and other accounting and reporting issues addressed at the Conference. Our companion publication, 2022 SEC Reporting Insights, may be referenced for a more comprehensive discussion of SEC rulemaking, developments, and related staff activities, many of which were highlighted at the Conference.

Macroeconomic Factors

The impact of the current macroeconomic environment is far reaching, affecting nearly all registrants whether it be directly or indirectly. During the Conference, the staff reminded registrants to revisit and update their disclosures to clearly communicate each of the factors contributing to significant volatility or risks to their operations. For example, a registrant should clearly describe whether challenges in sourcing the commodities used in its products or services resulted from inflation, supply chain issues, or suppliers impacted by the war in Ukraine. To the extent multiple factors apply, the registrant should individually address each issue and its resulting impact on operations.

The staff also emphasized the need for registrants to revisit their critical accounting estimates, noting such disclosures include estimates that have had or are reasonably likely to have a material impact on the registrant's financial condition. Interest rates, which are often used in the estimates of fair value required under GAAP, have continued to rise, and may have significant implications on a registrant's results of operations. For example, a continued rise in interest rates may result in future goodwill impairment, even though the quantitative analysis did not indicate any impairment for the current period. In this case, registrants should disclose the sensitivities in the underlying the estimate and assumptions and consider early warning disclosures about the possibility of a future impairment.

Lastly, the SEC staff reminded registrants to consider the requirement to disclose valuation and qualifying accounts in Schedule II. Rule 12-09 of Regulation S-X details the form and content of the schedule which may include a roll forward of an allowance for doubtful accounts and valuation allowances for inventory and deferred tax assets to the extent such disclosures are not included in the financial statements. The staff noted that this schedule may be important to an investor's understanding of the quality of earnings in the current economic environment. However, it is important to note that disclosures of the roll forward of the allowance for doubtful accounts is a required footnote disclosure under Accounting Standards Codification ("ASC") Topic 326, *Financial Instruments - Credit Losses*, and a roll forward of the deferred tax valuation allowance is a required footnote disclosure under ASC Topic 740, *Income Taxes*.

Below is a summary of the staff guidance provided for disclosures of the current macroeconomic environment impact.

COVID-19

The SEC staff encouraged registrants to consider the relevance of their existing COVID-19 disclosures given the current state of the pandemic. Registrants should review the Disclosure Guidance **Topic 9** and **9A** issued in 2020 to ensure the completeness of disclosures related to the impact of COVID-19 on operations, liquidity, and capital resources. The staff also encouraged registrants to consider the following when updating COVID-19 disclosures:

- The impact COVID-19 has had on business operations, including whether operations have evolved directly or indirectly in response to the impact of COVID-19.
- The "new normal" of conducting business, including costs incurred to return to the office, or costs associated with implementing a hybrid work environment to provide additional flexibility in how and where people within the business operate.

INFLATION

Registrants should review their disclosures related to the impact of inflation on business operations discussed in previous SEC filings and consider the need to update those disclosures. If past disclosures addressed potential or future effects of inflationary increases, the registrant should consider if those effects are now actively impacting the company. The SEC staff provided the following questions for consideration in upcoming filings:

- How has inflation changed the company's outlook or business goals?
- Has inflation had a negative effect on the company's long-term or short-term liquidity?
- Has the company experienced labor inflation?
- Is the business absorbing any increased costs or are they passing them along to customers?
- Has the company renegotiated contracts with customers?

When previous public statements indicated the Inflation Reduction Act had or would have a positive effect on a registrant's business, such impact should be reflected in the registrants' operating results. Conversely, a registrant should also include disclosures if the previously stated positive impact did not materialize.

SUPPLY CHAIN

Like inflation, the SEC staff also encouraged registrants to take a renewed look at their existing supply chain disclosures and consider whether previously indicated potential risks are now actively impacting the business. The staff also provided the following questions for disclosure consideration:

- How have supply chain disruptions affected the registrant's business outlook or business goals?
- Are the company's margins experiencing pressure due to increased costs or delays?
- Is the company experiencing issues sourcing materials?
- Has the company's backlog increased, or output decreased?
- Has customer demand changed?
- Any significant changes in staffing or wages?

THE WAR IN UKRAINE

Registrants should consider the impact of the war in Ukraine on their business as spillover effects have a global impact, regardless of whether a registrant has direct or indirect operations in the affected region. The SEC staff encouraged all registrants to consider the **Sample Letter** issued in May 2022 for potential disclosure considerations, specifically disclosures in MD&A and risk factors.

Emerging Trends

With the recent volatility of the digital asset market, the SEC's pending proposals on climate and cybersecurity disclosures rules, and the expansion of the SEC's Crypto Assets and Cyber Unit, it comes as no surprise that the Conference discussion centered around these emerging trends.

DIGITAL ASSETS

The SEC staff discussed the accounting for, and disclosure of, registered crypto asset securities. Additionally, the staff provided two examples to illustrate the unique risks and complexities for certain arrangements involving crypto assets.

REGISTERED OFFERING OF CRYPTO ASSETS

The accounting for registered crypto assets may vary depending on the facts and circumstances. As such, registrants should consider the terms and conditions of the offered security, including the rights of the crypto asset holder and the obligations of the issuer of the crypto asset, and disclose the related accounting policy. The staff noted that the issuer's obligations, including any implied obligations, are the primary consideration when determining the appropriate accounting framework. Additionally, the staff shared questions to consider when assessing the accounting and related disclosures for a crypto offering, including the following:

- Are there minimum sale or issuance requirements?
- Is the offering for cash, and if so, is it in exchange for goods or services, compensation to customers, or a dividend to shareholders or crypto asset holders?
- Do any events impact the consideration the issuer receives?
- Can the holder transfer the crypto asset, or put it back to the issuer?
- Are there any agreements for the sale of future tokens which may be triggered if or when the crypto asset is created?
- Do the rights and obligations change over time or upon a triggering event, such as the completion of the platform under which the crypto asset will operate?
- Are there any other relevant features, such as vesting terms, conversion features, voting or dividend rights, including other distribution features such as waterfalls?

The staff also noted instances when the obligation of the issuer is linked to the development of the technology used to create and support the crypto asset being registered. In these instances, disclosures should clearly describe the status of the technology's development and related crypto assets as well as the estimated time to completion.

SAFEGUARDING CRYPTO ASSETS

In April 2022, the staff released **SAB No. 121**, which discussed the accounting for an entity's obligation to safeguard crypto assets it does not own. The obligation to safeguard the crypto asset is recognized as a liability and measured at fair value each reporting period. The entity also records a corresponding indemnification-type asset, which does not represent the crypto asset itself. SAB 121 also includes the staff views on the disclosure of the unique risks presented in an arrangement to safeguard crypto assets. Additionally, the staff noted the importance of considering the specific terms and economics of each arrangement in determining whether the arrangement is within the scope of SAB 121.

LENDING ARRANGEMENTS

Existing accounting guidance does not contemplate an arrangement to lend crypto assets, and as such, the staff noted complexities in the judgement required to conclude on the accounting for such arrangements. The staff emphasized the need to faithfully depict the economics of the arrangement and discussed the accounting for the following lending arrangement fact pattern.

A lending entity loaned an agreed upon quantity of crypto assets to a borrower over a specified period of time and earned a fee in the form of a percentage of the crypto asset over the loan term. The borrower is required to return the same quantity and type of crypto asset to the lender at the end of the loan. The borrower may use the crypto asset at its sole discretion, including selling or pledging the borrowed crypto asset to a third party. The staff concluded that it would not object to the following accounting by the lending entity:

- Derecognize the crypto asset loaned to the borrower as the lender no longer has the right to receive the economic benefits associated with the crypto asset and, therefore, does not control the crypto asset.
- Recognize an asset for its right to receive the crypto asset back at the end of the loan term. This asset is measured at fair value at inception, and at each reporting period, with changes in fair value reflected within the income statement as a gain or loss presented separately from revenue.

The lending entity may also need to recognize an allowance for expected credit losses pursuant to the guidance in ASC 326 as the arrangement exposes the lender to the credit risk of the borrower.

The staff reiterated the importance of clear and comprehensive disclosures for these transactions. Sufficient disclosures ensure a financial statement user understands the risks and terms of the transaction. Additional disclosures to consider include:

- The type and amount of collateral held, the lender's ability to liquidate the collateral, and changes in the fair value of the collateral;
- How the lender monitors its exposure to credit risk, factors considered in the evaluation and management of credit risk; and
- Changes in expected credit losses or recovery of losses during the period.

Additionally, the staff released a **sample comment letter** in response to recent distress in the crypto asset market. For further detail on the sample comment letter, refer to our **Flash Report**.

CYBERSECURITY

The SEC staff discussed the importance of cybersecurity disclosures at a level that allows investors to accurately price for risk, and they emphasized the importance of being forthright with investors and customers. Additionally, a registrant's preparation and ability to respond to a cybersecurity event or threat is important to investors and customers.

The SEC's cybersecurity **proposal** requires consideration of materiality in both quantitative and qualitative terms. As an example, a registrant may determine that a cybersecurity incident impacting a single laptop may not be quantitatively material, but if the CEO uses the affected laptop, the incident may be qualitatively material. The staff reminded registrants to avoid vague or allusive cybersecurity disclosures when an incident is known to have occurred and refrain from presenting outdated or inaccurate information on the status of a cybersecurity incident. Oftentimes, insufficient communication between the technical team addressing the cybersecurity incident and the financial team reporting the incident may lead to deficient disclosures.

While the cybersecurity rules remain in the proposal stage, registrants should refer to the previously published staff **interpretive release** and **guidance** when considering cybersecurity disclosures.

CLIMATE

SEC comments on climate-related disclosures have increased over the past year, especially following the release of the SEC staff's **sample comment letter** in late 2021. Registrants should also consider the **staff's guidance** on climate change disclosure released in 2010.

The staff reiterated the need to consider the impact of climate-related risk on a registrant's financial statements, in addition to climate-related disclosures. For example, the development of green technologies, a commitment to be carbon neutral within a certain timeframe, or new energy efficient technology may impact the useful life of long-lived assets. Additionally, climate-related factors may impact the going concern analysis, with changing technologies or weather patterns affecting the demand for products or services. The staff reminded registrants of its **educational paper**, published in 2021, as a source for climate-related accounting considerations.

SEC Matters

FINANCIAL DISCLOSURES ABOUT ACQUIRED AND DISPOSED BUSINESSES

SIGNIFICANCE TEST

The SEC staff clarified how to calculate significance when a registrant's non-wholly owned consolidated subsidiary acquires a business. In an example provided by the staff, a registrant controlled and consolidated a 60%-owned subsidiary ("OpCo") and the OpCo acquired 100% of the target. Based on this scenario, the significance tests are computed as follows:

	Numerator	Denominator
Asset Test[1]	100% of the target's assets	100% of the registrant's assets
Income Test - Revenue Component[1]	100% of the target's revenue	100% of the registrant's revenue
Income Test - Income Component	60% of the target's pre-tax income or loss	Registrant's income or loss from continuing operations before income tax attributable to controlling interest (i.e., exclude pre-tax earnings or loss attributed to the non-controlling interest).
Investment Test[2]	100% of the consideration transferred by OpCo.	Registrant's aggregate worldwide market value (WWMV). If no WWMV is available, 100% of the registrant's total assets.

[1] *The fact that the registrant does not wholly own the OpCo does not impact the asset test or the revenue component of the income test.*

[2] *The SEC staff reiterated that a registrant's WWMV consists solely of the value of the registrant's common stock traded on a market. The SEC staff has denied requests for alternative WWMV calculations related to multiple classes of stock.*

The SEC staff also addressed questions on the revenue component of the income test. The revenue component does not apply if either the registrant or the acquired business did not have material revenue in each of the two most recently completed fiscal years. The material revenue assessment should be analyzed separately for the registrant and the acquired business (i.e., the determination of material revenue of the acquired business is made on a standalone basis in the context of its specific business irrespective of the registrant's revenue).

Additionally, the SEC staff confirmed that the revenue component of the income test applies to investees accounted for under the equity method and those accounted for using the fair value option.

Finally, the SEC staff reminded registrants that offerings from an existing effective shelf registration statement may not be made after completing an acquisition that exceeds the 50% significance threshold unless all the required filings, including Regulation S-X Rule 3-05 financial statements and Article 11 pro forma financial information, have been filed. However, certain types of offerings, such as dividend reinvestment plans, secondary offerings, employee benefit plans, and the sale of securities pursuant to Rule 144, are permissible.

PRO FORMAS

Implementation Issues

The SEC staff clarified the presentation of pro forma adjustments for transaction expenses associated with business combinations. Article 11 of Regulation S-X requires transaction accounting adjustments to the pro forma statement of comprehensive income to reflect those adjustments as of the beginning of the fiscal year presented. As transaction expenses may occur in multiple periods, the staff has received questions on the treatment of such expenses in the pro forma financial statements. The presentation depends on whether the transaction expenses are reflected in the historical annual and interim periods or will be incurred after those periods and whether the transaction expenses are, or will be, recognized by the registrant or the target. The SEC staff outlined the following treatment of transaction expenses in the pro forma statement of comprehensive income:

	Reflected in the historical financials	Not reflected in the historical financials
Registrant	Do not adjust or remove the transaction expenses (e.g., do not move the transaction expenses from the interim period to the annual period).	Adjust to add the transaction expenses to the annual period.
Target	Do not adjust or remove the transaction expenses.	Do not adjust to add the transaction expenses as the pro forma financial statements give effect to the registrant's transaction accounting, not the target's accounting.

Presentation When a Range of Results is Possible

When significantly different results may occur based on the structure of a transaction, Article 11 of Regulation S-X requires additional pro forma presentation to illustrate the range of possible results. The introductory paragraph to the pro forma information should also explain the facts and circumstances related to the range of possible results.

The SEC staff highlighted that ranges are often required in pro forma financial statements related to special purpose acquisition company (SPAC) merger transactions. However, registrants must consider such presentation for all transactions. For example, the following assumptions may necessitate additional pro forma financial information:

- Range of securities sold in a minimum/maximum transaction;
- Range of possible redemption scenarios in a SPAC merger;
- Post-merger minimum cash levels; and
- Ability of certain requirements to be waived by either party or removed by a shareholder vote.

COMMENT LETTER TOPICS

NON-GAAP FINANCIAL MEASURES

The SEC staff discussed the recently released updates to the Compliance and Disclosure Interpretations (C&DIs) for non-GAAP financial measures and provided additional clarity on what constitutes a misleading non-GAAP measure. The staff emphasized that no amount of disclosure can cure a misleading measure, and when the staff determines that a measure is misleading, the registrant must remove, or update the measure in the next filing that includes the non-GAAP measure. If comparable periods are presented in the filing, the misleading non-GAAP measure should also be removed or updated for the comparable period. Below is a summary of the discussion and related updated C&DIs.

Normal, Recurring Cash Operating Expenses

The staff updated C&DI 100.01 to provide additional insight into their views on normal and recurring cash operating expenses. The staff highlighted that the C&DI does not include a comprehensive or extensive list of examples because the permissibility of non-GAAP adjustments depends on the facts and circumstances of the company. When considering a normal operating expense, registrants should assess the nature and effect of the non-GAAP adjustment and how it relates to their operations, revenue generating activities, business strategy, industry, and regulatory environment. Operating expenses that occur repeatedly or occasionally are typically considered recurring, even if they occur at irregular intervals. The staff provided the following two examples related to the determination of normal, recurring operating expenses:

- In the retail and restaurant industry, costs incurred to open and close stores are a fundamental part of the business strategy, and rent expense is integral to the operations of a retailer or restaurant. Therefore, these costs should not be excluded in non-GAAP measures.

- Restructuring expenses may be appropriate to include as a non-GAAP adjustment in certain circumstances. However, the following factors should be considered:
  - Is restructuring part of the company's business strategy?
  - Is the company generating revenue by restructuring?
  - Is restructuring pervasive across the company's industry?

  If yes, the restructuring is likely a normal, recurring expense and should not be excluded from a non-GAAP financial measure.

Labeling

The staff has observed non-GAAP reconciliations that contain new and unique adjustments that are not clearly labeled or described, which may potentially mislead investors. The newly issued C&DI 100.05 addresses misleading non-GAAP financial measures, including measures that are not described as non-GAAP measures, lack a cleared detailed description, or use the same or similar title as a GAAP measure. Such examples include:

- Net revenue calculated as GAAP revenue less certain expenses;
- Gross profit not calculated in accordance with GAAP; and
- Pro forma information not calculated in a manner consistent with the requirements of Article 11 of Regulation S-X (e.g., disclosing the combined results of a target company and its acquirer).

Additionally, the staff added C&DI 100.06 to clarify that detailed labeling and descriptions alone do not prevent a non-GAAP measure from being misleading.

Individually Tailored Accounting Principles

The staff updated C&DI 100.04 to provide additional examples of individually tailored accounting principles and further clarify that such measures are not limited to revenue. These additional examples of individually tailored accounting principles were previously communicated by the staff and include:

- Accelerating revenue recognition to present revenue when billed. Registrants may present this metric as a key performance indicator (KPI) referred to as "billings." The presentation of KPIs should follow the Commission's previously issued guidance on the disclosure of KPIs and metrics in MD&A.
- Presenting revenues on a basis inconsistent with GAAP, such as deducting transaction costs to disclose revenue on a net basis, when the company is the principal, or adding transaction costs to present revenue on a gross basis when the company is the agent.
- Presenting the measure on a cash or modified basis rather than the accrual basis of accounting.

Prominence

The staff updated C&DI 102.10 to expand guidance related to the prominence of non-GAAP measures, the non-GAAP reconciliation, and the presentation of a non-GAAP income statement. The updated C&DI includes three separate sections as follows:

C&DI 102.10(a) contains two additional examples of non-GAAP financial measures with undue prominence, including:

- Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence.
- Presenting charts, tables, or graphs of non-GAAP financial measures without presenting charts, tables, or graphs of the comparable GAAP measures with equal or greater prominence or omitting the comparable GAAP measures altogether.

C&DI 102.10(b) provides examples of disclosures that give undue prominence to non-GAAP measures in the required non-GAAP reconciliation, including starting the reconciliation with a non-GAAP measure, and presenting a non-GAAP income statement in the reconciliation.

C&DI 102.10(c) prohibits the presentation of a non-GAAP measure that includes most, if not all, of the line items and subtotals found in an income statement prepared in accordance with GAAP. Previously the C&DI referred to a "full" income statement, which was often misinterpreted whereby registrants inappropriately presented a summarized non-GAAP income statement or excluded certain income statement line items.

SEGMENTS

Segment disclosures in the financial statements not only drive the discussion included in MD&A, but also provide investors with a meaningful view of the company through the eyes of management. Due to the importance of segment disclosures to investors, the SEC staff continues to focus on these disclosures, which remain one of the most common SEC comment letter topics. Many comments in the Staff's review of segments result from inconsistencies between the financial statement disclosures and the information presented or discussed outside of the SEC filing, such as the company's website, earnings call transcripts, and social media channels.

The SEC staff also emphasized the importance of correctly identifying operating segments, noting that failing to do so may result in significant financial reporting implications, such as the level at which the company assesses goodwill for impairment.

NEW ACCOUNTING STANDARD – DATE OF INITIAL APPLICATION

The SEC staff addressed questions received regarding registration statements filed in the year of adoption of the new standard on long-duration contracts (ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts*, and IFRS 17, *Insurance Contracts*). The standard is effective January 1, 2023, with a transition date of January 1, 2021, under US GAAP, and January 1, 2022, under IFRS. The staff noted that filing a registration statement does not change the transition date of the new standard.

For example, a registrant that files a registration statement in 2023 which includes or incorporates a period reflecting the adoption of the new standard is not required to retrospectively revise financial statements for periods prior to the transition date. Specifically, a registrant that adopted the new standard would not retrospectively revise the 2020 period, and a foreign private issuer would not retrospectively revise the 2021 period, as these periods precede the applicable transition date. This guidance is consistent with previous staff guidance on the adoption of the new leasing standard, included in **Topic 11** of the Financial Reporting Manual (FRM). As a reminder, portions of the FRM are outdated and accordingly, should be referenced with caution.

Additionally, if a foreign private issuer is not required to include or incorporate its 2023 interim financial statements that reflect the adoption of IFRS 17 in the registration statement but has filed or otherwise made such financial statements public in its home market, it is not required to retrospectively recast its annual financial statements for 2022 as such information has only been used and made available to the foreign shareholders.

PAY VS. PERFORMANCE

The calculation of compensation actually paid in the disclosures required by the SEC's final rule on pay vs. performance require the measurement of the fair value of equity-based awards on a recurring basis, which US GAAP may not otherwise require. During the Conference, the SEC staff addressed implementation questions on the fair value of equity-based awards used in the calculation of compensation actually paid in the required pay vs. performance disclosures, highlighting:

- Item 402 of Regulation S-K requires consideration of market conditions to determine when an award vests. This same principle, which may differ from US GAAP, should be applied in the determination of compensation actually paid.
- Dividends should not be included in the compensation actually paid when the fair value of the award reflects dividends. However, when the dividends are paid and the fair value of the award no longer reflects the dividends, the dividends paid are included in executive compensation actually paid, separate from the fair value of the equity award.
- The equity-based award fair value will be determined in accordance with the principles in ASC Topic 718, *Compensation – Stock Compensation*. For example, a registrant may not determine the expected term of the award under a methodology that is inconsistent with GAAP, such as subtracting the elapsed life from the grant date expected term assumption.
- Footnote disclosure to the table is required when the assumptions used to calculate the fair value of the award in the calculation of compensation actually paid materially differs from the assumptions used to determine the grant date fair value of the award. The SEC staff noted that a registrant may consider the assumptions to materially differ when the assumptions used in the determination of compensation actually paid are applied as of the grant date and result in a material change to the fair value of the award on the grant date. The disclosures required under the final rule are not prescriptive, and therefore the staff has indicated that a range or weighted average of assumptions, similar to the required disclosure under GAAP, may be appropriate.

CLAWBACK

The SEC's final rule on recovery of erroneously awarded compensation, or clawback, introduces two new checkboxes to annual reports on Form 10-K, 20-F, and 40-F to indicate:

1. Whether the financial statements included in the filing reflect the correction of an error to previously issued financial statements, and
2. Whether such error corrections triggered the registrant's clawback policy.

The final rule requires the registrant to recover erroneously awarded compensation for "Big R" and "little r" restatements, and in such instances, the registrant will check both boxes. The staff noted that when a registrant voluntarily adjusts prior period financial statements to correct a clearly immaterial error (i.e., an error that does not rise to a Big R or little r restatement), the registrant will indicate that the financial statements reflect the correction of an error, but such correction does not trigger its clawback policy. Additionally, registrants would not check either box due to the retrospective revision of financial statements upon the adoption of a new accounting standard or other required retrospective revisions that are not errors.

BEST PRACTICES WHEN COMMUNICATING WITH THE STAFF

The SEC staff reminded registrants that they may submit consultation requests for complex accounting and auditor independence issues through their **website.** The staff emphasized that requests should be submitted well in advance of the anticipated filing date and include a robust accounting analysis to clearly identify the scope of the request, the registrant's conclusion on the accounting, a detailed description of the accounting alternatives, and an explanation of why the registrant rejected those alternatives.

Additionally, registrants may submit requests for relief under Rule 3-13 of Regulation S-X following the contact information available on the SEC **website**. To minimize the number of follow up questions, the staff advised registrants to ensure the completeness of the initial waiver request, including the disclosures that will be made to convey the transaction to investors in lieu of the required financial information. The SEC provided additional recommendations for registrants considering waiver requests for financial statement required by Rules 3-05, 3-09 and 3-14 of Regulation S-X. For example, if a registrant requests relief to present one year of financial statements when the significance test otherwise requires two years, the registrant should also specifically request relief for any required comparative interim periods, as the waiver of annual financial information does not extend to required interim periods.

BOARD LEADERSHIP STRUCTURE AND RISK OVERSIGHT

The SEC staff discussed its recent focus on corporate governance disclosures required under Item 407 of Regulation S-K. In response to boiler plate disclosures, the staff has solicited additional transparency in the disclosures made pursuant to Item 407(h) of Regulation S-K. Specifically, the staff has asked registrants to disclose why the current leadership structure is appropriate and how the board administers its oversight function. The staff referenced the **adopting release** of the rule as helpful guidance when considering such disclosures.

Audit Matters

The PCOAB staff discussed its standard setting projects, including the proposed new audit quality control (QC) standard, which will require public accounting firms to evaluate their QC systems on an annual basis and report the results on a new Form QC, as well as additional forthcoming proposals related to:

- Illegal acts by clients;
- Going concern;
- The PCAOB's attestation standards; and
- Due professional care and other topics addressed by AS 1000.

The standard setting projects focus on observations made during the PCAOB inspection process.

PCAOB INSPECTIONS

The PCAOB discussed its recently issued Spotlight highlighting 2021 inspection observations and noted a continued increase in audit deficiencies during the 2022 inspection cycle, with findings in the areas of revenue, inventory, business combinations, long-lived assets, allowance for credit losses, and equity. Consistent with prior year's findings, these deficiencies were often concentrated in the testing of internal controls over financial reporting (ICFR) over such accounting topics. The staff also noted a continued trend in deficiencies related to critical audit matters, communications to the audit committee, and Form AP filings.

During the 2023 inspection cycle, the PCAOB staff plans to continue its focus on audit risk factors driven by the current economic and geopolitical environment including:

- Financial statement areas that are complex, require significant judgment, and may be susceptible to change;
- SPAC and de-SPAC transactions;
- Risk assessment:
    - Understanding business operations and strategy,
    - Changes in control environment, and
    - Material misstatements, including risk of fraud;
- Auditor independence, particularly in evaluating non-audit services and private equity investments.

KEY TAKEAWAYS

As inspection results continue to result in increased deficiency findings, the PCAOB staff emphasized quality, and provided five key takeaways to prepare for upcoming audits:

1. Exercise professional skepticism, especially in the remote work environment and in the context of training new staff.
2. Fraud procedures, noting the current environment provides additional incentives, opportunities, and pressure to commit fraud.
3. Review and supervision of the audit, ensuring sufficient time for a meaningful review.
4. Back to the basics, focusing on understanding the substance of related party transactions.
5. A renewed focus on critical audit matters, highlighting areas subject to uncertainty in the current macroeconomic environment, such as going concern, and goodwill impairment.

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