2023 AICPA SEC & PCAOB Conference Highlights

December 2023

OVERVIEW

This year's Conference emphasized clear and transparent disclosure tailored to registrants. As macroeconomic conditions remain uncertain and registrants implement new disclosure requirements to comply with recent rulemaking, conference panelists, including members from the Division of Corporation Finance and the Office of the Chief Accountant (collectively, "SEC staff"), discussed the role of the registrant, auditor, and regulators in giving investors meaningful disclosure. Conference panelists shared valuable guidance, insights, and reminders in areas related to:

- SEC Reporting Matters — SEC staff offered guidance on segment disclosures, the new clawback checkboxes, and non-GAAP measures. The SEC staff also discussed their observations on errors in the statement of cash flows, identified areas for improvement in pay versus performance disclosures, and shared reminders in other areas, such as the waiver process and critical accounting estimates.
- Accounting Matters — SEC staff discussed fair value measurements and related disclosures related to crypto assets and collateral dependent loans, and shared their views on recent consultations from special purpose acquisition companies (SPACs). The FASB staff highlighted recent accounting standard updates.
- Audit Matters — SEC staff highlighted the importance of auditor independence and professional skepticism, while the PCAOB staff shared updates to the audit standards, inspection findings, and focus areas for the upcoming year.

This publication shares insight into these matters and other accounting and reporting issues addressed at the Conference. Reference our companion publication, [2023 SEC Reporting Insights], for a more comprehensive discussion of key disclosure and reporting reminders for upcoming filings, the SEC's rulemaking, and other activities that affect financial reporting, many of which were highlighted at the Conference.

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The annual AICPA & CIMA Conference ("Conference") on Current SEC and PCAOB Developments was held in Washington, D.C. on December 4-6, 2023, where representatives from the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB), and the Public Company Accounting Oversight Board (PCAOB) shared their views on various accounting, reporting, and auditing issues.

SEC REPORTING MATTERS

Segment Disclosures

Disclosure of Optional Measures of Segment Performance

New FASB Accounting Standards Update (ASU) 2023-07, *Segment Reporting – Improvements to Reportable Segment Disclosures* ("ASU 2023-07"), permits, but does **not require**, additional measures of segment profit or loss within the financial statements.[1] ASU 2023-07 does not require these additional measures to be consistent with the recognition and measurement principles of U.S. GAAP, which may otherwise result in the disclosure of multiple measures of segment performance that are considered to be "non-GAAP" financial measures. The SEC's definition of a non-GAAP financial measure excludes a measure that is required or "expressly permitted" by U.S. GAAP. Consequently, questions arise about the interaction of the SEC's non-GAAP rules, regulations, and guidance with these optional disclosures of segment performance within the financial statements.

At the Conference, the SEC staff expressed its view that an optional measure of segment performance that is not calculated in accordance with U.S. GAAP is not "expressly permitted" for the purpose of evaluating whether the measure meets the SEC's non-GAAP definition. As a result, an optional non-GAAP measure of segment performance is subject to the SEC's rules, regulations, and guidance for non-GAAP financial measures. Item 10(e)(1)(ii)(C) of Regulation S-K states that "A registrant must not… present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes." Accordingly, the SEC's existing non-GAAP rules technically prohibit the inclusion of optional non-GAAP measures of segment performance.

Registrants that wish to early adopt the provisions of ASU 2023-07 should contact the SEC staff in advance of filing if they plan to disclose optional non-GAAP measures of segment performance. The SEC staff offered the following considerations for such registrants:

- At a minimum, the registrant must continue to disclose the measure of segment profit or loss that is most consistent with GAAP
- Any measure of segment performance disclosed by the registrant should be regularly reviewed by the Chief Operating Decision Maker (CODM) and used by the CODM to allocate resources and assess performance
- Any optional measure of segment performance that is a non-GAAP financial measure must not be misleading and must:
  - Comply with Regulation G and Item 10(e) of Regulation S-K
  - Include a statement disclosing why the non-GAAP measure is useful to investors
  - Include the required reconciliations to the nearest U.S. GAAP measure

BDO INSIGHTS — SEC STAFF GUIDANCE IS NEEDED

The directive for registrants to call the SEC staff in advance of adopting ASU 2023-07 and disclosing optional non-GAAP measures of segment performance is not a long-term solution. We anticipate that the SEC staff will issue further guidance with its views on this topic in the coming months before the ASU's mandatory effective date.

Single Reportable Segment Considerations

ASU 2023-07 requires new disclosures for registrants with a single reportable segment, including the measure of segment performance used by the CODM that is most consistent with U.S. GAAP. The SEC staff expects the measure of segment performance for such entities that are managed on a consolidated basis to be consolidated net income.

[1] Under the current guidance in Accounting Standards Codification Topic 280, *Segment Reporting* ("ASC 280"), before the adoption of ASU 2023-07, registrants may only disclose the measure of segment performance that is most consistent with the measurement and recognition principles in U.S. GAAP.

Regularly Reviewed and Provided

A registrant must assess whether the CODM "regularly reviews" the operating results of a component when identifying operating segments. Additionally, when segment profit or loss measures are "regularly provided" to the CODM, registrants must disclose specified information for each reportable segment. Since Accounting Standards Codification (ASC) 280 does not define "regularly reviewed" or "regularly provided," the SEC staff clarified that a quarterly frequency is "regular" in this context. However, the SEC staff also cautioned that information reviewed or provided less frequently may constitute a "regular" review or provision of information.

Revenue From External Customers

U.S. GAAP and International Financial Reporting Standards (IFRS) require disclosure of revenues from external customers for each reportable segment when the measure of profit or loss reviewed by the CODM or otherwise regularly provided to the CODM includes such revenues. The SEC staff reminded registrants that these disclosures must reflect revenues from external customers computed in accordance with U.S. GAAP or IFRS, as applicable. The SEC staff has objected to segment revenues to external customers presented on an adjusted or alternative basis.

Statement of Cash Flows

During the Conference, the SEC's Chief Accountant, Paul Munter, released a **statement** highlighting the importance of the statement of cash flows and emphasized the following related matters.

Errors

The SEC staff noted that the statement of cash flows is a leading area of restatement and observed that most registrants conclude such restatements represent immaterial error corrections. The SEC staff cautioned registrants to thoroughly evaluate errors in the statement of cash flows, noting that the classification of cash flows is fundamental to the presentation of the entity's activities to generate or use cash. As such, the SEC staff has not found the conclusion that an error in the statement in cash flows is immaterial because it's an error in classification only to be persuasive.

Presentation and Disclosure

The SEC staff encouraged registrants to provide supplemental disclosure to, and enhance information in the statement of cash flows to help investors evaluate the entity's liquidity. The SEC staff provided examples such as further disaggregating cash flows and applying the direct method, noting U.S. GAAP also encourages the use of such method.

BDO INSIGHTS — INCREASE IN SEC STAFF COMMENTS ON THE STATEMENT OF CASH FLOWS

We expect an increase in volume of SEC staff comment letters related to the statement of cash flows, focusing on significant judgments in the classification of cash flows, as well as the presentation and disclosure both within and supplementing the statement of cash flows. We encourage registrants to revisit their presentation and classification of cash flows, especially in areas that require significant judgment.

Clawback

In connection with the SEC's newly effective rules requiring the recovery of erroneously awarded compensation (the "clawback rules"), NYSE and Nasdaq listed registrants ("issuers") are required to evaluate two new checkboxes that appear on the cover pages of annual reports on Forms 10-K, 20-F, and 40-F. The checkboxes require NYSE and Nasdaq issuers to indicate whether:

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

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

We encourage issuers to work closely with legal counsel regarding the applicability of the checkboxes to their particular facts and circumstances. The SEC staff encourages issuers to also discuss the applicability of the first checkbox with their independent registered public accounting firm.

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

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

Non-GAAP

The SEC staff provided additional guidance on non-GAAP financial measures because such measures continue to be a focus area of comment letters. Oftentimes, SEC staff comments seek to understand the nature of, and adjustments to, the non-GAAP measure, and what information the registrant is trying to convey to its investors. As such, the SEC staff emphasized the importance of clear and transparent disclosure to both label and describe the non-GAAP measure and its related adjustments. The SEC staff encouraged registrants to involve their auditor when reviewing the SEC staff comment letter responses on non-GAAP financial measures.

Normal, Recurring, Cash Operating Expenses

The SEC staff views normal, recurring, cash operating expenses as costs incurred repeatedly or occasionally as part of the registrant's operations and strategy to generate revenue. Excluding such costs from non-GAAP measures may be misleading. The SEC staff emphasized the need for registrants to consider whether costs are normal, recurring, cash operating expenses relative to their operations rather than to an individual transaction. For example, registrants operating medical centers have excluded costs incurred prior to opening new locations from non-GAAP financial measures on the basis that these costs do not recur at each specific location. The SEC staff observed that opening new locations is often integral to the registrant's operations and strategy to generate revenue and therefore, excluding these costs from non-GAAP financial measures is misleading. The SEC staff shared more examples of normal, recurring cash operating expenses, such as increases to the allowances for receivables and inventory, start-up costs, and losses on purchase commitments.

Individually Tailored Accounting Principles

The SEC staff reminded registrants that presenting non-GAAP financial measures that adjust the measurement and recognition principles required by U.S. GAAP or IFRS ("individually tailored accounting principles") may be misleading. For example, the SEC staff has commented when registrants present non-GAAP financial measures that adjust inventory to an internal basis of accounting inconsistent with U.S. GAAP. Additionally, the SEC staff continues to object to non-GAAP measures that deduct transaction costs to present non-GAAP revenue on a net basis when the registrant is the principal, or add transaction costs to present revenue on a gross basis when the registrant is the agent.

Macroeconomic Conditions

Macroeconomic conditions such as rising interest rates, global conflicts, supply chain challenges, and inflationary pressures, among others may affect financial reporting, including financial statement estimates. Registrants should consider how these conditions impact or are reasonably likely to impact their operations, financial condition, and cash flows in their disclosures. The SEC staff referred to boilerplate disclosures in this area as "the investor's enemy" and encouraged registrants to avoid applying a check-the-box mentality to disclosure compliance. Accordingly, such disclosures should be sufficiently tailored to allow investors to understand the impact that these macroeconomic conditions have had on the registrant and whether they present significant risks in future periods.

The SEC staff discussed other specific observations on disclosures of interest rate risk as well as inventory and supply chain challenges.

Interest Rate Risk

Item 305 of Regulation S-K ("Item 305") requires quantitative and qualitative disclosures about market risk. Disclosures about interest rate risk, a commonly disclosed market risk, should be assessed on a recurring basis and adjusted, as necessary, based on changes in facts, circumstances, and the macroeconomic environment. Registrants who elect to provide an interest rate sensitivity analysis to satisfy the Item 305 requirements must disclose a description of the model (or methodology) it used and the key assumptions (that is, those that have the most significant effect on the model). The SEC staff believes these disclosures help investors better understand the results of the sensitivity and evaluate changes to the assumptions over time.

Inventory and Supply Chain

In response to expected supply chain constraints, some registrants purchased excess inventory over the past several years, which led to higher amounts of outdated and obsolete inventory. Other registrants have recognized material inventory losses due to higher inventory shrinkage. The SEC staff observed that some of these registrants had limited, if any, disclosures about the circumstances associated with these inventory losses.

The SEC staff reminded registrants to clearly and robustly disclose the following within management's discussion and analysis (MD&A):

- Material inventory losses that affect year-over-year financial results
- Material known trends and uncertainties related to inventory that result in, or are reasonably likely to result in, a material change to liquidity

The SEC staff emphasized that it also expects disclosure of any specific inventory risks within risk factors.

Critical Accounting Estimates

Critical accounting estimates (CAEs)[2] remain an area of SEC staff focus within MD&A. Registrant disclosures of CAEs often repeat or refer to significant accounting policies in the financial statements. However, CAEs represent estimates that involve a significant level of estimation uncertainty and have had, or are reasonably likely to have, a material impact on the financial condition or results of operations of the registrant. Consequently, CAE disclosures should **supplement, not duplicate** the descriptions of significant accounting policies. The SEC staff provided the following questions for registrants to consider when they assess the appropriateness and adequacy of their CAE disclosures:

- Can an investor understand why the estimate is critical to the financial statements, the level of estimation uncertainty, and the past variability of the estimate?
- Does the disclosure:
  - Discuss the methods and assumptions underlying the calculation of the estimate?
  - Qualitatively **and** quantitatively describe the sensitivity of the reported amount to the methods, assumptions, and estimates underlying its calculation?

[2] The definition of a CAE and the related disclosure requirements are set forth in Item 303(b)(3) of Regulation S-K.

- Provide incremental information to the related accounting policy disclosed in the financial statements?

With continued macroeconomic and geopolitical uncertainties that have had or are reasonably likely to have a significant impact on accounting estimates, we encourage registrants to revisit their CAE disclosures for completeness and accuracy as they head into year-end reporting season (and on a periodic basis).

Pay versus Performance

The SEC staff discussed the Compliance and Disclosure Interpretations (C&DIs) released in 2023, and shared areas for improvement in pay versus performance disclosures, focusing on clear and meaningful disclosure to describe:

- The relationship between executive compensation paid and the financial performance of the registrant. The SEC staff observed that describing the relationship graphically, rather than narratively, often provided more meaningful information.
- How to calculate a non-GAAP Company-Selected Measure from the registrant's audited financial statements. The SEC staff stated that the registrant may cross-reference to disclosure elsewhere within, or as an appendix to, the filing, but did not find it appropriate to cross reference to a separate filing, such as the registrant's Form 10-K.
- Whether the assumptions used to determine the fair value of equity awards used in the calculation of compensation actually paid materially differed from those used at the grant date. The SEC staff noted instances when it was unclear if the registrant provided disclosure because the assumptions materially differed, or simply to supplement the calculation.

Additionally, the SEC staff noted that the "most important" financial measures to link executive compensation actually paid to the performance of the registrant should be consistent with the measures disclosed in Compensation Discussion and Analysis and must include the Company-Selected Measure. Lastly, the SEC staff reminded registrants that the pay versus performance disclosures require the use of Inline XBRL, noting several instances in which registrants did not tag their disclosures.

The SEC staff encouraged registrants to involve their accountants in the preparation and review of the pay versus performance disclosures as the Company-Selected Measure and the determination of compensation actually paid are derived from U.S. GAAP.

For further information on the C&DIs and pay versus performance disclosures, refer to BDO's **Pay versus Performance Disclosures: A Snapshot**.

Waivers

In accordance with Rule 3-13 of Regulation S-X, the SEC staff may waive or modify certain financial statement requirements when such requests are consistent with investor protection. Registrants may submit such requests for relief using the **online submission form** available on the SEC's website.

The SEC staff evaluates each waiver request using the total mix of information related to the registrant and the relevant transaction, including the size of an acquisition relative to the size of the registrant, both components of the income test (that is, the income and revenue components), and various other financial statement and operating metrics.

To expedite the waiver process, the SEC staff suggested the following best practices:

- Ensure the completeness of the initial waiver request
- Describe the details about the background and structure of the transaction, including the nature of the acquired operations and assets and the expected impact on the registrant
- Include the results of all the significance tests, including the inputs to the calculations which are not readily apparent
- Explain why the registrant believes the results of the significance tests are anomalous
- Provide the intended disclosures that the registrant will make to convey the transaction to investors in lieu of the required financial information

Significance Tests

The SEC staff also provided general reminders about the significance test calculations, noting that they will not waive the performance or substitution of the required significance tests. The amounts used in significance test calculations must be based on financial statements that comply with U.S. GAAP or IFRS, as applicable, and follow the accounting standards of registrant. For example, a domestic registrant with U.S. GAAP financial statements may acquire a foreign business that prepares its financial statements under IFRS. The registrant must convert the acquiree financial statements to U.S. GAAP for purposes of the significance computation. Additionally, the SEC staff noted that acquiree financial statements do not require an audit for significance test purposes. However, a registrant must update the significance tests when it subsequently determines that the amounts previously used were not compliant with the applicable accounting standards.

The SEC staff also reiterated the following views related to the investment test:

INVESTMENT TEST	GUIDANCE
Numerator	▶ Reflect 100% of the consideration transferred ▶ Include the fair value of contingent consideration measured at fair value in accordance with U.S. GAAP ▶ Include contingent consideration not measured at fair value in accordance with U.S. GAAP, unless the likelihood of payment is remote ▶ Include any capitalized acquisition-related costs
Denominator(1)	▶ Reflect a registrant's aggregate worldwide market value (WWMV) ▶ Use 100% of the registrant's total assets if no WWMV is available ▶ Include only the value of common stock traded in the registrant's principal public market, which may include a foreign market ▶ Exclude the value of other classes of non-traded common or preferred stock, such as convertible stock

(1) The SEC staff has denied requests for alternative WWMV calculations related to multiple classes of stock and the use of net asset value (NAV) or private valuations.

Interpretive Requests

The SEC staff also helps with requests on how to interpret or apply a rule. Examples of interpretive requests the SEC staff receives include:

- Determination of the predecessor and related financial statement requirements in advance of a registration statement
- Assessment of whether an acquisition qualifies as a business under Regulation S-X (for example, pre-revenue entities)

Loss of FPI Status

The SEC staff discussed two topics related to a registrant's loss of foreign private issuer (FPI) status: reporting material quarterly changes, and for FPIs that also qualify as emerging growth companies (EGCs), the application of the extended transition period for complying with new accounting standards.

Material Quarterly Event

The SEC staff affirmed that the loss of FPI status is a material quarterly change that requires a registrant to present summarized financial information in accordance with Item 302(a) of Regulation S-K (Item 302(a)). The SEC staff stated it would not object if a registrant presents summarized financial information for each quarter in the most recent fiscal year (rather than the two most recent fiscal years, as required by Item 302(a)) in the first Form 10-K filed following the loss of FPI status because only those quarters will be presented in future Form 10-Q filings.

Extended Transition Period

The SEC staff clarified that an EGC that loses its FPI status may apply the extended transition period for complying with new accounting standards when it has not previously disclosed or elected to opt-out of such accommodation.

Other Reminders

The SEC staff shared additional reminders in areas, including:

Article 11 Pro Forma Financial Information

The SEC staff noted that the presentation of costs incurred after the closing of the transaction (such as costs incurred to integrate an acquired business to the registrant's information system) are management's adjustments. Management's adjustments, if presented, must be in an explanatory note to the pro forma financial information and not presented on the face of the pro forma financial statements.

SEC Staff Accounting Bulletin No. 74 ("SAB 74")[3]

SAB 74 disclosures provide investors with information about the effect that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period. The SEC staff reminded registrants to disclose:

- The quantitative impact of the new accounting standard if it can be reasonably estimated
- If the quantitative impact cannot be reasonable estimated:
  - A statement indicating as such
  - A qualitative description of the expected financial statement impact of the new standard
- The status of implementation
- A comparison of accounting policies before and after adoption

Share Repurchase Disclosure Rules

The SEC staff encouraged registrants to monitor the status of the share repurchase disclosure rules following its recent announcement to postpone the effective date (see **BDO Bulletin: SEC Postpones Effective Date Of Share Repurchase Disclosure Rules** for further detail).

ACCOUNTING MATTERS

Fair Value

The SEC staff continues to focus on fair value measurements and the related disclosures in accordance with ASC Topic 820, *Fair Value Measurement* ("ASC 820"), because of the significant judgments required.

Crypto Assets

Currently, registrants account for most crypto assets as indefinite-lived intangible assets, which are initially recorded at cost and subsequently assessed for impairment. Registrants must determine the fair value of crypto assets as part of the impairment assessment.

The SEC staff emphasized the importance of identifying the principal or most advantageous market when evaluating the fair value of crypto assets. This determination drives the identification of market participants as well as the information and assumptions that a market participant uses in estimating fair value. Traditional investments, such as commodities and equities, may have a limited number of venues where entities transact and the characteristics of those markets, including pricing, regulatory oversight, and the availability and reliability of information, are generally consistent. The SEC staff observed that the rapid evolution of crypto markets may make the identification of the principal or most advantageous market for crypto assets more difficult. The principal market may change over time or differ between various crypto assets. Given these challenges, the SEC staff reminded registrants to continuously evaluate the facts and circumstances relevant to the identification of the principal market.

Collateral Dependent Loans — Allowance for Credit Losses

Registrants record loans held for investment at amortized cost less an allowance for credit losses in accordance with ASC Topic 326, *Financial Instruments - Credit Losses* ("ASC 326"), unless the loans qualify as debt securities, or the

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[3] Staff Accounting Bulletin No. 74, Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant is codified in Topic 11.M.

registrant elects the fair value option. However, ASC 326 provides a practical expedient for measuring the allowance for collateral-dependent loans when the borrower is experiencing financial difficulty and the sale or operation of the underlying collateral is expected to substantially provide for the repayment of the loans.

Under this expedient, a registrant estimates the allowance for credit losses based on the fair value of the underlying collateral. Additionally, the SEC staff noted that ASC 326 requires the use of the fair value of the collateral when a foreclosure of the collateral dependent loan is probable. Evaluating the fair value of the underlying collateral from a market participant perspective requires significant judgments, especially during difficult economic times and when the collateral assets are illiquid.

Valuation Techniques

The SEC staff shared reminders about identifying, and consistently utilizing, appropriate valuation techniques in accordance with ASC 820. Numerous variables, such as the specific asset or liability being valued and the availability and reliability of relevant inputs, may affect the valuation techniques selected. The SEC staff highlighted that valuation techniques for fair value measurements maximize the usage of observable inputs. Additionally, ASC 820 requires a registrant to calibrate valuation techniques to ensure they adequately reflect current market conditions or necessitate adjustments to the fair value technique. When an initial transaction price represents fair value and a subsequent fair value measurement uses significant unobservable inputs, a registrant should calibrate the valuation technique so the valuation results, if applied at initial recognition, would equal the original transaction price.

Disclosures

The SEC staff also discussed the importance of fair value measurement disclosures, including critical accounting estimate disclosures in MD&A. Providing an appropriate level of detail in fair value disclosures, especially when level 3 inputs are used, allows investors to understand the valuation techniques and inputs used in fair value measurements on both a recurring and non-recurring basis as well as the financial statement impact of recurring fair value measurements.

SPACs

The SEC staff shared its position on recent accounting consultations from SPAC registrants related to financial instruments and deferred offering costs.

Financial Instruments

SPACs may enter into backstop arrangements to secure the financing necessary to close the business combination. Typically, the SPAC repurchases its shares directly from redeeming shareholders. In one fact pattern, a SPAC entered into a backstop arrangement whereby a financing entity repurchased the shares directly from the redeeming shareholders so that all shares remained outstanding following the close of the business combination (the “close”). At close, the SPAC was required to transfer cash equal to the value of the shares purchased by the financing entity into an escrow account controlled by the financing entity. The financing entity was required to remit cash (less a financing fee) to the registrant (the newly combined company following the close of the transaction) for any shares it subsequently sold. The financing entity was entitled to the cash it held in escrow for the shares it purchased and did not subsequently sell, and those shares were returned to the registrant.

In this consultation, the SEC staff objected to the registrant’s conclusion to account for the backstop arrangement in accordance with ASC Topic 480, *Distinguishing Liabilities and Equity*. The SEC staff shared its view that the arrangement was more akin to a subscription receivable and should therefore be presented as a reduction of equity in accordance with Rule 5-02 of Regulation S-X. The SEC staff did not share its position on the accounting for the instrument after its initial recognition and encouraged registrants to consult with the Office of the Chief Accountant on the accounting for similar arrangements.

Deferred Offering Costs

Incremental costs directly attributable to an offering may be deferred and charged against the proceeds of the offering (“deferred offering costs”).[4] The SEC staff objected to a SPAC’s proposed treatment of costs related to the preparation and audit of its financial statements as deferred offering costs. Although the financial statements were prepared solely

[4] See SAB Topic 5.A for further detail on deferred offering costs.

for the purpose of pursuing an initial public offering (IPO), the SEC staff did not consider these costs directly attributable to the offering because financial statements may be prepared and audited for various other reasons.

Investment Company Accounting

A fund must satisfy specific criteria to meet the definition of an investment company and apply the specialized reporting and disclosure requirements in ASC Topic 946, *Financial Services — Investment Companies* ("ASC 946"). The SEC staff shared a recent fact pattern related to an investment advisor that held an investment in a real estate fund (a third party held the limited partner interest). The investment advisor's wholly owned subsidiaries provided services to develop, construct, and manage the underlying investment properties of the real estate fund, and were compensated for such services. The investment advisor also provided a guarantee to the limited partner.

The SEC staff objected to the registrant's conclusion that the real estate fund met the criteria to apply investment company accounting because its business purpose and only substantive activities were not to invest funds solely for capital appreciation or investment income. The SEC staff considered the following factors in reaching its conclusion:

- The real estate fund's activities to develop, construct, and manage the underlying properties were indistinguishable from the services provided by the investment advisor. Consequently, investors received returns other than capital appreciation or investment income.
- The investment advisor's guarantee limited the limited partner's risk to downside exposure.

The SEC staff encouraged registrants to consult when evaluating whether they meet the investment company reporting and disclosure requirements in accordance with ASC 946.

Accounting Standard Updates

The FASB staff summarized recent accounting standards updates, including:

- The final standards on Segment Reporting. Refer to BDO Bulletin: **FASB Updates Segment Reporting Disclosures** for further detail.
- Other proposed standards that will be finalized in 2023:
  - Improvements to Income Tax Disclosures
  - Accounting for and Disclosure of Crypto Assets

AUDIT MATTERS

Throughout the Conference, regulators emphasized the importance of auditor independence, applying professional skepticism, and firm culture. The PCAOB staff discussed recent inspection trends, and audit standard updates, including:

- The final standard on the auditor's use of confirmation (AS 2310, *The Auditor's Use of Confirmation*)
- The proposed:
  - Quality control (QC) standard (QC 1000, *A Firm's System of Quality Control*), which requires public accounting firms to evaluate their QC systems annually and report the results on a new Form QC
  - AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, to address auditor responsibilities, including professional skepticism and due professional care
  - AS 2405, *A Company's Noncompliance with Laws and Regulations* (NOCLAR), replacing the existing standard related to illegal acts

The PCAOB's 2024 strategic plan has three key goals: to modernize standards, enhance the usefulness of inspection reports and the timeliness of issuance, and strengthen enforcement.

PCAOB Inspections

The PCAOB discussed its recently issued **Spotlight** highlighting 2022 inspection observations and noted a continued increase in audit deficiencies during the 2023 inspection cycle, with findings in the areas of revenue, inventory, long-lived assets, business combinations, allowance for credit losses, and equity. Consistent with previous years' findings, these deficiencies were concentrated in the testing of internal controls over financial reporting (ICFR) as well as testing estimates. Refer to BDO's insight **PCAOB Spotlight on Staff Priorities for 2023 Inspections** for further detail.

Key Takeaways

As inspections continue to result in increased deficiency findings, the PCAOB staff emphasized audit quality, and its interdependence with the culture of an audit firm.

The PCAOB highlighted the following three elements necessary in firm culture to attain audit quality:

- Behavior, such as the tone at the top
- Decisions on how to reward or penalize certain behaviors
- Systems and structures, including policies and procedures, and the code of conduct, among others

2024 Priorities

During the 2024 inspection cycle, the PCAOB staff plans to focus on business risk factors identified during the 2023 inspection cycle, including:

- Macroeconomic factors, including interest rates, credit availability, and inflation
- Financial statement areas with high fraud risk, including estimates subject to complex models or processes and the disclosures affected by risks to the registrant's operations
- Changing technologies
- Audit firm staffing issues, including the availability of talent, training, and mentoring

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