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Key Takeaways From the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments

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Introduction

> *The annual AICPA & CIMA Conference on Current SEC and PCAOB Developments was held in Washington, D.C. from December 12-14, 2022. It kicked off with a celebration, as the 2022 edition represented the 50th anniversary of the conference.*

The conference featured over 60 speakers from the Securities and Exchange Commission (SEC), Public Company Accounting Oversight Board (PCAOB), Center for Audit Quality (CAQ), Financial Accounting Standards Board (FASB), International Accounting Standards Board (IASB), public registrants and legal firms, who each weighed in on emerging topics expected to impact the profession. Key stakeholders in attendance include auditors, company accounting officers, legal firms, investors and many others. Several key themes and important updates emerged from these discussions.

Focus on Environmental, Social and Governance

It's abundantly clear that ESG reporting is a priority for many investors, companies, auditors and other stakeholders, as it was a topic in nearly every panel discussion. Much of ESG reporting is focused on environmental and climate-related matters. However, there are many other topics that pique stakeholders' interests, including, but not limited to, diversity and inclusion, executive compensation, human capital and cybersecurity. The "E," the "S" and the "G" are all very different, and companies and other stakeholders are realizing that they need experts in each of these categories on their teams.

Throughout the conference, we heard perspectives from regulators, investors, preparers, auditors and other stakeholders related to risks, challenges and opportunities associated with companies' ESG initiatives and the need for more consistent, comparable and reliable information. The message was clear. Investors want the information, regulators are making rules to protect investors, auditors are building out their practices and capabilities and preparers are feeling the pressure to provide information to meet investor, regulator and other stakeholder expectations.

Regulators' Perspectives

SEC Commissioner Hester Peirce mentioned in her remarks that, among other things, (1) investors are demanding ESG information, (2) many companies already providing voluntary disclosures based on stakeholder demand, (3) ESG scoring companies are putting pressure on public companies to provide more transparent disclosures and (4) there may be unique demands by stakeholders based on industry or personal preferences.

The elephant in the room seemed to be the SEC's March 2022 proposed rule, **The Enhancement and Standardization of Climate-Related Disclosures for Investors.** Although it received much attention during many of the panel discussions, there was not much coverage of the specifics of the proposed rule or stakeholders' input.

There were over 14,000 **comment letters** from stakeholders related to the proposed rule, which are still being assessed by the SEC. Even though this rule has not been finalized, nor was there discussion as to when a final rule would be released, the SEC staff within the Division of Corporation Finance (Corporation Finance) re-emphasized its focus on ensuring that companies comply with existing disclosure requirements, including its 2010 Interpretive Release, **Commission Guidance Regarding Disclosure Related to Climate Change** (2010 Interpretive Release) and 2021 **Sample Letter to Companies Regarding Climate Change Disclosures** (2021 Sample Letter).

The CAQ also discussed its ESG-related initiatives during its panel. Its response to the SEC's proposed rule on climate-related disclosures included, among other things, an alternative phased-in approach that would provide preparers with additional time to adopt certain disclosures, such as greenhouse gas emissions.

The SEC received over 14,000 comment letters from stakeholders related to its climate-related disclosures proposed rule.

The CAQ also highlighted its **S&P 500 10-K Analysis**, which analyzes S&P 500 companies' Annual Reports on Form 10-K (Form 10-K) to understand what is included in their disclosures regarding climate-related information, greenhouse gas emissions and net-zero and carbon neutral commitments.

Investors' Perspectives

Many investors are highly focused on companies' ESG efforts and initiatives. A common frustration among investors is the lack of consistent, comparable and reliable ESG data when it comes to making informed investment decisions.

Investors are aware of the SEC's proposed rule on climate-related disclosures and arriving at the right level of disclosure that is reliable will be challenging until a final rule is issued and industry best practices are established.

> Additionally, investors need to be "multilingual" regarding regulations, as U.S. disclosure requirements may differ from international reporting standards.

Deciphering the information presented could also be a challenge as there may be a lack of industry standards or companies may not provide information certain investors are seeking, which leads to comparability issues.

Investors' analyses become much more difficult when data is not consistent or comparable. Investors are seeking more standardization to effectively analyze and compare ESG information. In this sense, investors see any improvements to companies' policies and procedures, methodologies and ESG disclosures as an incremental victory in terms of identifying risks in their portfolios and understand that the road to these improvements will be lengthy.

Regardless of individual investors' opinions, the themes are the same — they want consistent and comparable information with some level of assurance from auditors to ensure information is reliable.

Preparers' Perspectives

Preparers of ESG disclosures are feeling the pressure to comply with stakeholder demands and realize there is much work to be done. Companies are building out their ESG functions and preparing analyses to identify gaps in their systems, processes and internal controls. A cross-functional team that understands the financial and operational aspects of ESG reporting, combined with the requisite skill sets and experience, is essential for establishing a successful ESG reporting program.

In anticipation of a final climate-related disclosures rule from the SEC and existing guidance in the 2010 Interpretive Release and 2021 Sample Letter, preparers are trying to find the balance between what they should be doing now versus waiting on the issuance of a final rule. Preparers voiced concerns regarding the aggressive timing of implementing the new disclosure requirements and alignment (or lack thereof) of U.S. and international rules. Also, the requirements under the European Union's Corporate Sustainability Reporting Directive (CSRD) are more stringent than the requirements under the SEC's proposed rule on climate-related disclosures.

Determining the quality and sourcing of data, including identifying the potential benefits of improvements to internal information infrastructure or the need for outsourcing data gathering, were among the suggested actions preparers can engage in now to ensure that their disclosures contain the best possible information.

> "We've had a pretty bold ESG strategy centered around four pillars, healthy people, healthy business, healthy community, and healthy planet."
>
> — Sheryl Burke,
> Senior Vice President of Corporate Social Responsibility at CVS Health

Auditors' Perspectives

Audit firms are investing significantly in building out their ESG practices, including creating globally organized sustainability and climate practices, hiring and training specialists, acquiring boutique firms, building fully dedicated ESG teams from the core assurance and advisory practice to work alongside ESG specialists and gearing up National Office support to have subject matter experts. These investments aim to address the concerns of stakeholders and preparers as they do their best to adapt to new and existing rules as well as regulations and investor expectations.

Auditors are seeing first-hand the concerns and potential pain points that preparers face as they continue to think about how to comply with ESG reporting, **including:**

- finding the right resources to navigate each of these areas,
- identifying system capabilities and technology solutions that allow data collection,
- ensuring data is being properly collected across the company and validated,
- complying with reporting requirements in multiple jurisdictions,
- addressing the concept of double materiality,
- implementing a system of internal control around ESG data and disclosures,
- getting the right disclosures into public filings.

To best tackle these concerns, the panel **advised companies to proactively:**

- develop a cross-functional team that leverages the expertise of various departments, while having a liaison such as a dedicated ESG expert to provide appropriate oversight,
- identify gaps in their systems, processes and internal controls,
- create practices and methodologies to allow effective data collection and validation,
- understand existing and new disclosure requirements and lean on advisory firms when needed.

The panel also noted that practices and methodologies are understandably going to change as expectations, initiatives, efforts and disclosure requirements evolve. It is important for companies to be transparent with investors regarding the types of uncertainties that are present and estimates used to prepare ESG disclosures.

Cybersecurity Defense and Disclosures

Cyber risks are now omnipresent for businesses and pervasive across all industries. These risks can disrupt supply chains, order processing, the production of goods and services and the protection of employee and customer data. Pete Cordero, a panelist with experience in FBI cybersecurity operations, noted that an average cyber breach costs companies $9.5 million, in addition to the negative impacts on organizations' brands and reputations.

Creating a system within organizations to prepare for and respond to cyber breaches is now critical, with the panelists even noting that staging mock breaches is an excellent way to be prepared. The SEC's recently proposed rule, **Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure,** would require timely and transparent disclosure of material cybersecurity incidents and address disclosure requirements for cybersecurity risks.

Economic Update

The conference convened a specific panel to discuss the current economic environment and provide insights into the future outlooks. Worldwide events set the stage, such as the war in Ukraine, supply chain challenges, volatility in the prices of commodities, heightened cybersecurity risks, pressure on wage rates and the lingering effects of COVID-19.

Simultaneously, Federal Reserve Chair Jerome Powell provided his summary remarks at the Federal Open Market Committee's meeting and the decision to raise the federal funds rate target range to 4.25–4.50%.

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There were many economic challenges highlighted by the panel and throughout the conference, including:

- Tightening credit market.
- Rising inflation.
- Rising interest rates.
- Strong U.S. dollar.
- Declining residential real estate valuations.
- Transitioning commercial real estate.
- Challenges in supply chains.

With an understanding of these macroeconomic conditions, preparers and investors can better communicate financial statement disclosures, analyze business trends and results of operations, assess liquidity and capital resources and identify relevant risk factors. While there are many ways that changing and negative economic factors can impact financial reporting, companies should remain alert when conducting asset impairment assessments, monitoring credit risk, modifying contracts and controlling their treasury function and liquidity.

Asset Impairment Assessments

Many worldwide events impact the value of assets, most notable are inflation and the increased interest rate environment. Decreases in a company's share price may be a triggering event for impairment analysis and cause challenges for a company in ensuring consistency in their public market value and amounts used in fair value calculations. Negative economic conditions may also drive the need for more frequent impairment assessments. These changes will also put additional scrutiny on key assumptions in estimates, their proximity to the reporting date, and other qualitative factors.

Our take:

Public companies that prepare Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and risk factors should be diligent in identifying trends and provide clear disclosure about results of operations. The SEC has also made clear to investors the value of early warning disclosures in MD&A and refreshing risk factors to the current environment, while avoiding boilerplate language.

Discount Factors

The discounted cash flow model is commonly used for quantitative goodwill impairment assessments and present values are also used in determining lease liabilities, the realizability of deferred tax asset, a company's ability to continue as a going concern and actuarial liabilities, such as pension and OPEB liabilities, among other areas. Higher interest rates will cause a higher discount rate and therefore lower present values.

Our take:

Companies should identify the valuations they require and assess the sensitivity of the models to increasing interest rates.

Contract Modifications

Contract modifications can broadly be expected in stock compensation, revenue recognition and debt agreements. If a company's share price has declined, share-based awards may be repriced or performance conditions re-level to align with the company's current condition. Companies may amend contract terms with customers responding to inflation and credit risk. Reduced liquidity and ability to pay may force modifications in debt agreements. All of these situations would require changing terms to be evaluated against the appropriate U.S. GAAP.

Our take:

Companies should have discussions with members of their sales and legal teams and revisit the design of internal controls over financial reporting to ensure contract negotiations and modifications are promptly identified and communicated to the accounting function and the impacts are properly assessed.

More broadly, companies should thoroughly consider if worldwide events have an impact on the liquidity of their assets and their ability to access additional funds to support capital requirements and operations.

SEC Priorities and Initiatives

The Office of the Chief Accountant (OCA) supports the SEC's oversight of the PCAOB and FASB and has jurisdiction over matters related to auditing and accounting policy determinations, the form and content of financial statements and ICFR matters for SEC registrants. During the OCA session, the panel emphasized the theme that collaboration with all stakeholders, such as investors, employees and preparers, is crucial when identifying and developing new standards. This theme was repeated by various divisions of the SEC throughout the conference, who noted that stakeholder outreach was a priority during 2022. The panel also reiterated the importance of auditor independence, and that auditor independence must be a joint effort between the auditor, the audit committee and a company's management. Another key priority was the OCA's collaboration and involvement with international regulators on the topic of climate change, such as the IASB and International Sustainability Standards Board (ISSB).

The OCA is available to assist registrants with complex accounting matters prior to filing, and this process is especially beneficial when a registrant is dealing with a unique fact pattern that is not specifically addressed by existing authoritative literature. **Frequent consultation topics with the OCA during 2022 were as follows:**

- Business combinations;
- Consolidation issues;
- Accounting for crypto assets;
- Segment reporting; and
- Revenue recognition.

Hardly a day goes by that crypto assets are not mentioned in the news, and any company involved with crypto has had to adjust its accounting frameworks to the evolving landscape. The OCA acknowledged that this is a hot topic and is focused on providing timely guidance that will benefit investors and registrants alike. Crypto assets have unique risks and uncertainties, and the uniqueness of crypto lending and crypto custodian agreements between entities results in widely varying rights and obligations. The OCA has issued Staff Accounting Bulletin (SAB) No. 121 to discuss its views on the accounting and disclosure of obligations to safeguard crypto assets and has received positive feedback from investors.

The OCA noted that the accounting for crypto safeguarding and lending arrangements has diversity in practice, and companies do not always faithfully illustrate the related transactions in their financial statements. Companies must implement tailored processes, controls, and managerial expertise to account for crypto arrangements and provide transparent disclosures. Management should begin with a robust risk assessment and build their controls and processes from there.

Finally, the OCA noted that estimates, projections and disclosures should be consistent with management's own internal reporting. Registrants should focus on transparency regarding economic uncertainty and disclose how this uncertainty may impact estimates included within the financial statements.

SEC Comment Letter Trends

The Corporation Finance review process is designed to monitor and enhance compliance with applicable disclosure and accounting requirements. **Corporation Finance conducts selective and required reviews of filings made under the:**

- Securities Act of 1933 (e.g., Forms S-1, S-4 and S-3) and
- Securities Exchange Act of 1934 (e.g., Forms 10-K, 10-Q and 20-F). Section 408 of the Sarbanes-Oxley Act mandates the SEC to review companies' filings at least once every three years, with many larger companies being reviewed more frequently.

The extent of Corporation Finance's review may be:

- a full cover-to-cover review.
- a review of the financial statements and related disclosures, or
- a targeted review of one or more specific items of disclosure (e.g., disclosures related to climate change or board oversight and governance). In addition, crypto assets may be a topic for targeted reviews based on the December 8, 2022, issuance of the **Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets**.

The SEC's website includes an overview that explains the **Filing Review Process**. The overview aims to increase transparency in the review process and expresses the SEC staff's willingness to discuss issues with registrants. The overview indicates that Corporation Finance focuses "on critical disclosures that appear to conflict with Commission rules or applicable accounting standards and on disclosure that appears to be materially deficient in explanation or clarity." In addition, the overview notes that the "Division completes many filing reviews without issuing comments." When performing reviews, the SEC staff reviews many items, including the SEC filings, as well as information available in the public domain, including websites, analyst reports, transcripts of earnings calls, statements by directors and officers and other social media. Comment letters and responses get posted to Edgar roughly 20 days after the completion of the entire review process.

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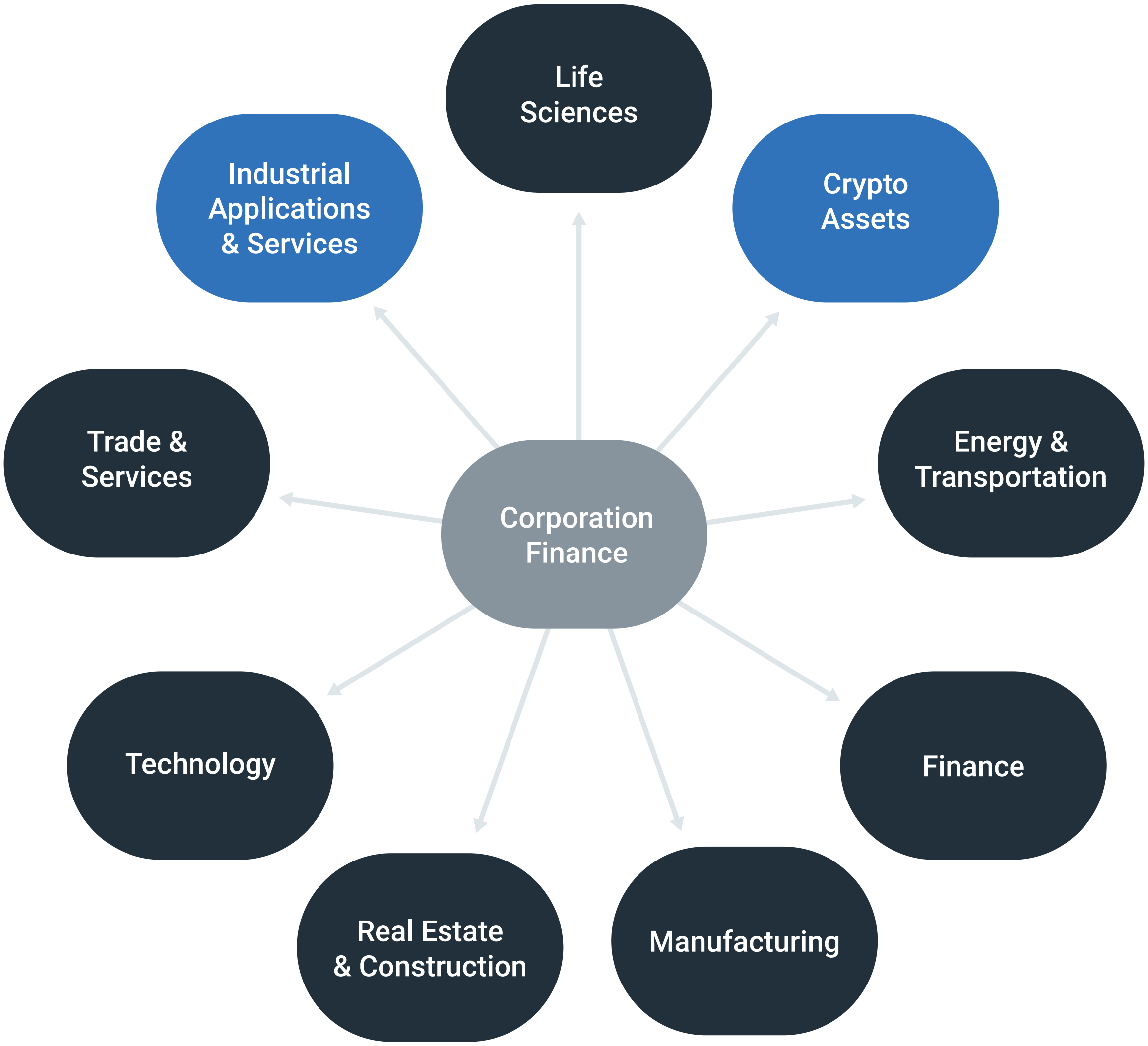
Corporation Finance's disclosure review program performs most of the selective and required reviews through the following nine review offices, with two new industry offices established in September of 2022. The Office of Crypto Assets will provide more specialized support for this emerging area. Many reviews related to this topic were previously conducted by the Office of Finance. The Office of Industrial Applications and Services will review non-pharma, non-biotech and non-medicinal products companies previously assigned to the Office of Life Sciences, given the growth in life sciences registrants.



The panel that discussed SEC Comment Letters focused on frequently issued SEC comments during the twelve months ended July 31, 2022, including many recurring themes from previous years as well as two new themes related to climate change and acquisitions, mergers and business combinations. **The following represents the top ten trends the panel discussed:**

1. MD&A,
2. Non-GAAP Measures,
3. Segment Reporting,
4. Revenue Recognition,
5. Signatures, Exhibits and Agreements,
6. Fair Value,
7. Internal Control Over Financial Reporting,
8. Climate Change,
9. Inventory and Cost of Sales,
10. Acquisitions, Mergers and Business Combinations.

Some highlights of certain trends are **as follows:**

MD&A

Corporation Finance stated that registrants should include discussion of key metrics used by management in assessing performance, known trends or uncertainties reasonably expected to impact near and long-term results, identification and quantification of key drivers causing changes in the results of operations and cash flows analyses, and key judgments and assumptions used to prepare critical accounting estimates and related sensitivities.

Non-GAAP Measures

Corporation Finance identified issues associated with the discussion of why management believes the non-GAAP presentation provides useful information to investors, undue prominence, reconciliation to the most comparable GAAP measure, tailored accounting principles, inappropriate labeling and exclusion of normal and recurring cash expenses. Additionally, Corporation Finance stated there were three new Compliance and Disclosure Interpretations (C&DIs) on **Non-GAAP Financial Measures** issued on December 13, 2022, to address the issues of tailored accounting principles, inappropriate labeling and exclusion of normal and recurring cash expenses.

Segment Reporting

Corporation Finance stressed the importance for investors to be able to see how management runs their business through the eyes of management, including determination of the CODM, identification of operating segments, aggregation, entity-wide disclosures and segment performance measures.

Climate Change

Corporation Finance noted inconsistencies between a registrant's corporate social responsibility (CSR) report and its SEC filings and disclosures, based on existing guidance in the 2010 Interpretive Release and the 2021 Sample Letter. Refer to CFGI's separate publication, **Environmental, Social and Governance: Climate-Related Comment Letter Themes**, for further information.

In addition, the SEC staff encouraged companies to appropriately evaluate and disclose emerging risks to the extent material, such as Russia's war on Ukraine, COVID-19, effects of inflation, rising interest rates, changes in energy prices, supply chain issues and investing in China-based companies, and the impacts on financial position, results of operations and cash flows.

FASB Chair and Accounting Standard Setting Update

Consistent with the SEC's approach, 2022 marked another year that the FASB was focused on bringing investors into the standard-setting process and determining the key information used in capital allocation decisions. The table below presents the ASUs issued during 2022.

ASU #	Title	Effective Date for Calendar Year-End Public Companies
2022-01	Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method	2023*
2022-02	Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures	2023*, if an entity has adopted ASU 2016-13
2022-03	Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions	2024*
2022-04	Liabilities – Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations	2023* (rollforward in 2024*)
2022-05	Financial Services – Insurance (Topic 944): Transition for Sold Contracts	Effective with ASU 2018-12 in 2023*
2022-06 (forthcoming)	Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848	Topic 848 in effect through December 31, 2024

*includes interim periods within these years

Based on recent stakeholder feedback, the FASB is also considering accounting standard updates related to many diverse topics and has issued several **Exposure Documents**. The most important message from stakeholders has been to expand disclosures and provide more information at a disaggregated level to enhance the clarity of disclosures and investment decision-making. This presents itself in the ongoing projects for segment reporting, the disaggregation of income statement expenses and the **enhanced income tax disclosures described below.**

Segment Reporting

The FASB's exposure document on this topic recommends targeted improvements that would require disclosure of significant segment expenses, expand segment disclosures within interim filings, clarify that more than one measure of segment profit or loss may be disclosed and mandate segment disclosures for entities with a single reportable segment.

Disaggregation of Income Statement Expenses

The FASB expects to issue an exposure document on this area during the first half of 2023. The FASB expects to pursue an approach that would disaggregate specific amounts in the statement of operations, such as employee compensation, depreciation and amortization. Capitalizable items such as inventory could be disaggregated based on costs capitalized during the period, such as raw materials and labor.

Targeted Improvements to Income Tax Disclosures

The FASB expects to issue an exposure document in Q1 2023 that will propose a disaggregation of income taxes paid by federal, state and other jurisdictions, as well as increased disaggregation within the rate reconciliation disclosure.

Other projects

FASB has also been actively deliberating the accounting for crypto assets and software costs. Regarding the project for crypto assets, the FASB has recently announced tentative conclusions that crypto assets should be accounted for at their fair value. The FASB's aim is to modernize standards for accounting for software costs that have evolved over the past few decades to allow for more direct responses to the current software development methods.

The FASB also has many other current projects on its technical agenda that are either in deliberations or exposure documents subject to public comment, **including:**

- Common Control Leases,
- Joint Venture Formations,
- Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method,
- Accounting for Environmental Credit Programs,
- Government Grants ITC,
- Accounting for Financial Instruments with ESG-Linked Features.

IASB Update

Even though the U.S. does not allow international financial reporting standards (IFRS) for domestic reporting, the U.S. investors are prolific users of IFRS based financial statements, as foreign private issuers are allowed to report using IFRS accounting standards in the U.S. Differences in accounting standards can create complexities with global cross-border capital flows. Therefore, Dr. Andreas Barckow, Chair of the IASB highlighted that it's in everyone's interest that the U.S. accounting literature and IFRS remain closely aligned, even though the former IASB and FASB convergence program has concluded.

The current projects on IASB's agenda include intangible assets (with current standards being more than 20 years old), the statement of cash flows and climate-related risks and financial reporting. The first two are intended to refresh existing guidance and make it timelier for the current and emerging issues.

The third project is devoted to climate-related risks where IASB will collaborate and will review a proposal issued by ISSB.

IASB did not include a crypto assets project on its agenda, based on the IFRS interpretations committee's view that crypto assets should either be accounted for as an intangible asset at cost — with an option to measure at fair value if the item is traded on a liquid market — or as inventory at fair value for broker-dealers. Thus it is IASB's view that the existing IFRS accounting literature provides adequate guidance for accounting treatment.

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PCAOB Areas of Focus and Observations

Erica Y. Williams, who was appointed as Chair of the PCAOB by the SEC, and sworn in on January 10, 2022, noted that President George W. Bush signed the Sarbanes-Oxley Act into law 20 years earlier, establishing the PCAOB. The PCAOB sets clear standards to uphold the integrity of public audits, inspects for compliance with those standards and enforces them to help restore trust in U.S. capital markets. In addition to inspecting U.S. audit firms, the PCAOB's inspections include audit firms located in foreign jurisdictions that participate in the audits of companies listed on U.S. securities exchanges. The PCAOB has historically met resistance from audit firms located in China and Hong Kong. In a milestone **announcement** shortly after the conference concluded, Chair Williams stated, "For the first time in history, the PCAOB has secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong."

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— Erica Y. Williams,
Chair of the PCAOB

Coming out of a pandemic, many audit firms continue to navigate challenges and uncertainties that may, unfortunately, be moving trends on audit quality in the wrong direction. On December 8, 2022, the PCAOB released a staff spotlight report, **Audits With Deficiencies Increased in 2021, According to New PCAOB Staff Report**, which included a preview of the 2021 inspection findings. Audits with Part I.A deficiencies are expected to increase by 4% in 2021 to 33%, compared to 29% in 2020, and audits with Part I.B deficiencies are expected to increase by 14% in 2021 to 40%, up from 26% in 2020.

Audits with Part I.A deficiencies are expected to increase by 4% in 2021 to 33%, compared to 29% in 2020, and audits with Part I.B deficiencies are expected to increase by 14% in 2021 to 40%, up from 26% in 2020.

That means over one third of the audits the PCAOB staff inspected during 2021 either had (1) deficiencies of such significance that PCAOB staff believed the audit firms failed to obtain sufficient appropriate audit evidence to support their opinions or (2) other significant instances of non-compliance with PCAOB rules or standards. At the same time, the PCAOB is seeing increased comment forms for both U.S. and non-U.S. firms in their 2022 inspections. The increase is mostly attributed to the combination of the COVID-19 pandemic and remote auditing, making it difficult to maintain stable audit teams and provide training to new hires given increased employee turnover.

During the past year, the PCAOB has been actively working to update more than 30 standards within 10 standard-setting projects. On November 18, 2022, the PCAOB issued a new quality control standard, **PCAOB Proposes a New Quality Control Standard**, for public comment. The PCAOB views quality control as a critical foundation for firms' approaches to audits. Stakeholder feedback is critical and the deadline for comment is February 1, 2023. Earlier this year, the PCAOB finalized amendments that strengthen the requirements that apply to audits involving multiple audit firms, which will take effect for audits of financial statements for fiscal years ending on or after December 15, 2024. Refer to **PCAOB Adopts New Requirements for Lead Auditor's Use of Other Auditors** for further information.