New Developments Summary

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Highlights of the 2021 AICPA & CIMA Conference on Current SEC and PCAOB Developments

Thriving amid disruption

Contents

The AICPA in conjunction with the Chartered Institute of Management Accountants (CIMA) held the 2021 Conference on Current SEC and PCAOB Developments on December 6-8, featuring representatives from the SEC, PCAOB, FASB, IASB, AICPA, and Center for Audit Quality (CAQ), along with others from the accounting profession.

A perennial focus of the conference was the shared dedication of all stakeholders to develop and uphold high-quality financial reporting. Additionally, speakers and panelists emphasized the following themes:

- Accelerated opportunities for innovation stemming from macro-economic disruptions
- Enhanced focus on environmental, social, and governance matters

This publication provides a summary of these themes and other important topics highlighted at the conference.

A. Conference overview

The AICPA & CIMA held the 2021 Conference on Current SEC and PCAOB Developments both virtually and in-person in Washington, D.C. on December 6-8, featuring representatives from regulatory and standard-setting bodies, as well as industry professionals, financial statement preparers, auditors, legal practitioners, decision-makers, and analysts.

Speakers and panelists shared their views on current accounting, financial reporting, auditing, and other important topics, which focused on one overarching theme—stakeholders' shared responsibility for developing and upholding high-quality financial reporting for the benefit of both investors and the capital markets.

The speakers and panelists also emphasized the following themes:

- Accelerated opportunities for innovation stemming from macro-economic disruptions
- Enhanced focus on environmental, social, and governance matters

Accelerated opportunities for innovation stemming from macro-economic disruptions

Due to the ongoing impact of COVID-19, the audit profession, regulatory bodies, and capital markets have endured an accelerated pace of change in 2021. Staff from the AICPA and SEC, along with other speakers and panelists, echoed the sentiment that constant change is now our "normal." Many speakers also believe that the profession's use of technology has advanced exponentially in response to the aftershocks of COVID-19, quickly shifting the world to a remote working environment.

During a conversation between Acting SEC Chief Accountant Paul Munter and CAQ Chief Executive Officer Julie Bell Lindsay, along with a statement issued by the staff of the SEC's Office of the Chief Accountant (OCA), Mr. Munter noted that despite all the recent disruptions, the U.S. financial reporting system remains strong due to stakeholders' ability to be resilient and adaptable, while maintaining their focus on high-quality financial reporting. He emphasized that high-quality financial reporting requires high-quality (1) accounting standard-setting and Commission rules, (2) implementation and application of those standards and rules, and (3) audits of financial statements.

In her prepared remarks, Ms. Lindsay discussed auditing in a period of transformation, including challenges and opportunities for the profession. She mentioned that burgeoning technologies, such as artificial intelligence and data analytics, are transforming how audits are being conducted and are improving audit quality and effectiveness. She believes that audits are about trust and comprise the backbone of capital markets and investor protection. Further, she noted that both independence and expertise are critical to maintaining high-quality audits and referred the audience to the CAQ's "Value of the Audit: A Brief History and the Path Forward," which discusses how audited financial statements contribute to well-functioning capital markets and the economy, among other topics.

In the AICPA welcome address, the immediate past AICPA Chair Tracey Golden, who spoke on behalf of the current AICPA Chair William Pirolli, stated that the accelerated change in technologies, regulations, competition, and innovation has created opportunities in (1) new service offerings, (2) business development, (3) hiring for new skills, (4) career progression, and (5) business growth. In order to support these opportunities, the AICPA is focused on attracting and retaining talent, upskilling and advancing professionals, and providing certification and badge programs.

In order to respond to evolving technology and its increased use in auditing environments, the PCAOB is focused on two research projects: one on data and technology and one on audit evidence, as noted by PCAOB Acting Chief Auditor and Director of Professional Standards Barbara Vanich.

Ms. Lindsay also reminded the audience that there is a shared responsibility among all members of the financial reporting supply chain to deter and detect fraud, considering the potential for fraud is especially heightened in the remote work environment. She referred the audience to the activities of the Anti-Fraud Collaboration (AFC), a group that explores fraud conditions and develops resources to provide insights for the entire financial reporting supply chain, as well as resources produced jointly by the AFC and CAQ that promote the deterrence and detection of financial reporting fraud.

Enhanced focus on environmental, social, and governance matters

At the start of the conference, Ms. Golden stated that in order to thrive in the current environment, the profession must adapt to changing consumer and investor expectations. Additionally, she said that we are seeing a shift in corporate reporting, with greater attention on environmental, social, and governance (ESG) matters. Ms. Golden emphasized that the profession must embrace this call to action and recognize the opportunities to be leaders in the area of providing assurance over ESG information.

Ms. Lindsay also reported that ESG is top of mind for investors, regulators, and the profession. She noted that investors are increasingly asking for, and relying on, ESG information. A CAQ-led research project found that 95 percent of S&P 500 companies currently provide ESG information publicly, with a majority of the ESG information presented outside of SEC filings in separate reports. The study also found that only 6 percent of companies received assurance from a public company auditing firm on their ESG information. As the SEC develops rulemaking in this area, Ms. Lindsay indicated that auditors are well-positioned to provide assurance on ESG information since the audit profession has long played a role in the flow of reliable information.

Ms. Lindsay emphasized that a lack of global ESG standards makes the consistency and comparability of ESG information challenging. However, she shared her support for the recently formed International Sustainability Standards Board and noted that the Board will serve as a global foundation to create a globally accepted set of ESG reporting standards.

Talent and diversity, equity, and inclusion initiatives

One speaker at the conference reported on the state of the economy and, in particular, the current labor shortages. The speaker emphasized that the labor shortages driven by COVID-19 are forcing employees to reconsider their connection with employers, careers, or geographic locations and have prompted many of them to make a shift in lifestyle, a behavior that was coined as the “great re-arrangement.” The speaker further mentioned that the lack of individuals moving through the employment pipeline stems in part from the decrease in birth rates over the years, contributing to current labor shortages. In order to attract and retain talent in the current environment, several speakers said that employers need to be creative and competitive and to provide flexibility to employees.

The conference also featured a panel discussing how to effectively advance diversity, equity, and inclusion (DE&I) in the workforce. The panelists agreed that advancing DE&I initiatives in any organization is a shared commitment between board members and management. One panelist suggested that organizations perform a candid assessment of current diversity statistics and create an intentional and effective plan to advance DE&I initiatives. Further, the panelists agreed that early exposure to the profession through engagement with students from underrepresented groups is a key consideration in advancing diversity in accounting.

Ms. Golden stated that the AICPA is "laser focused" on enhancing the attractiveness of the profession to young adults and minorities in order to increase their representation in the CPA pipeline. Because attracting and retaining talent has become increasingly challenging, she stressed the importance of a "people-first" profession, which includes building a diverse, equitable, and inclusive workforce; developing and retaining talent; enhancing skillsets; and paving the way for the next generation. Ms. Golden stressed that investing in human capital is critical to sustaining the profession.

Ms. Lindsay also noted that talent and diversity are key topics for the CAQ and its leadership. She claimed that improving diversity in the accounting profession is a multifaceted issue with many causes and is a collective effort. She reminded the audience that the SEC's Regulatory Flexibility Agenda includes disclosure projects on climate change, human capital management, and corporate board diversity.

B. Accounting matters

Accounting standard-setting initiatives

In his remarks, FASB Chair Richard R. Jones addressed the FASB's future direction and highlighted the upcoming meeting where the Board will begin to review the feedback received from stakeholders on the June 2021 Invitation to Comment focusing on the FASB's future agenda. According to Mr. Jones, the FASB staff's extensive outreach to various stakeholders in the first half of 2021 identified four main areas of potential standard-setting activities:

1. Providing more disaggregation of financial information;
2. Providing more guidance for emerging areas of financial reporting;
3. Evaluating specific areas of U.S. GAAP to reduce unnecessary costs and complexity; and
4. Improving existing FASB internal processes and procedures.

FASB Technical Director Hillary Salo noted that, in addition to the agenda consultation process, FASB staff is focused on performing post-implementation reviews of existing Codification guidance and on making progress on projects on the FASB technical agenda.

SEC and FASB staff views on specific accounting matters

Determining materiality of financial statement errors

Several presenters touched on the topic of materiality as it relates to financial statement errors, including references to the Supreme Court's definition of materiality and SEC staff's views in Staff Accounting Bulletin Topic 1.M, *Materiality* (also referred to as SAB 99).

OCA staff discussed recent observations relating to errors identified in previously issued financial statements. They noted that if management identifies an error and determines that previously issued financial statements are materially misstated, management must file a report on such non-reliance on Form 8-K. Further, management must restate and reissue the previously issued financial statements that contain the error.

Conversely, if the error is determined to be immaterial to previously issued financial statements, management may correct the error in the current period so long as the error is also immaterial to the current period. Otherwise, management would correct the error in the prior-year financial statements when such periods are next presented in an SEC filing and disclose details of the immaterial error correction in the notes to the financial statements (this is also known as a "little r" restatement).

Mr. Munter noted that over the past few years, there has been a decline in the total number of restatements of previously issued financial statements resulting from both material and immaterial error corrections. However, he highlighted a significant upward trend in the percentage of conclusions that an identified error correction was immaterial to previously issued financial statements. Mr. Munter encouraged registrants to perform an objective evaluation of the impact of the error on the total mix of information, taking into consideration both quantitative and qualitative factors to determine whether the error is material to investors and other financial statement users.

He also reminded registrants that the fact pattern discussed in SAB 99 relates to evaluating quantitatively small errors, given that these errors may be material to the financial statements due to qualitative considerations. While he acknowledged that quantitatively large errors are not always material, he noted that as the magnitude of the error increases, it becomes more difficult for qualitative factors to be sufficient to conclude that the error is immaterial to previously issued financial statements.

Lindsay McCord, Chief Accountant of the SEC's Division of Corporation Finance (CorpFin), reminded the audience that the concept of materiality has not changed and is grounded in SAB 99, which states that the evaluation of materiality is based on the consideration of all relevant facts and circumstances, requiring an evaluation of both quantitative and qualitative factors.

Ms. McCord discussed two recent fact patterns in which CorpFin staff objected to registrants' materiality conclusions with respect to financial statement errors. In both instances, the error was quantitatively large, but both registrants concluded that it was immaterial due to the following qualitative factors:

a. The error did not relate to the most recently completed fiscal period included in the filing, and the information for the current period was most useful to investors; and

b. The error was isolated to specific line items, such as discontinued operations or equity.

The staff characterized these qualitative factors as "passage of time" factors and did not believe that they were enough to overcome the error's quantitative impact on the financial statements. Ms. McCord also noted that asserting that investors focus only on the financial statements of the most recent fiscal year may not be an appropriate assertion.

Matthew Jacques, Chief Accountant of the SEC's Division of Enforcement, emphasized the importance of an objective determination rather than solely relying on qualitative factors, such as those included in SAB 99, to achieve an intended conclusion.

Further, CorpFin staff noted that as part of the filing review process, they will likely issue a comment when the registrant asserts that there is no material weakness in internal control over financial reporting (ICFR), even though the financial statements were restated to correct a material accounting error. The staff reminded registrants that an immaterial error might be indicative of a material weakness in ICFR and referred the audience to staff speeches on this topic delivered at the AICPA Conference on Current SEC and PCAOB Developments in 2014 and in 2018.

Digital assets

OCA staff noted a steady volume of consultations related to digital assets, including evolving business models and transactions in that area. The related consultations cover a number of specific matters, such as evaluating whether the digital asset represents an asset or liability and determining the cost basis for measurement. In recent consultations, registrants have concluded that their specific assets meet the definition of an intangible asset under U.S. GAAP, and OCA staff did not object to that conclusion. However, the staff indicated that not all digital assets are the same and that companies need to consider the nature of the particular asset to determine the appropriate accounting model. For example, a digital asset may be recognized as either a security or an intangible asset, depending on its specific characteristics and obligations. Once the company has identified the appropriate model to use, it must be followed in all respects. For instance, a company cannot apply the intangible asset accounting model and subsequently measure the asset at fair value.

AICPA's digital asset working group update

The conference featured a digital asset panel where the co-chairs of the AICPA's Digital Assets Working Group, which is divided into two subgroups—accounting and auditing—provided an update on the group's activities. They noted that the AICPA's practice aid, *Accounting for and auditing of digital assets*, was recently updated to reflect the following auditing topics: (1) risk assessment and processes and controls, and (2) laws and regulations and related parties.

They further mentioned the following accounting and auditing topics earmarked for inclusion in the practice aid: (1) derivatives, crypto lending, and mining; (2) staking and decentralized finance; (3) service organization considerations as well as existence, rights, and obligations assertions; and (4) valuation assertions, crypto lending/borrowing, as well as presentation and disclosure assertions.

Transactions involving SPACs

Consistent with the increased volume of special purpose acquisition company (SPAC) activity noted by CorpFin Director Renee Jones, OCA staff has received a growing number of accounting consultation requests related to SPACs on various topics, including the accounting for warrants, EPS, temporary versus permanent equity classification, compensation, business combinations, and derivatives.

Ms. Jones reminded companies that the following disclosures around SPACs, both at the SPAC IPO and de-SPAC stage, should be prominent, complete, and accurate:

- Financial incentives that SPAC sponsors and their directors and officers receive upon completing a business combination transaction and how these incentives do not necessarily align with those of the non-redeeming shareholders
- Conflict-of-interest issues involving projections, valuation, assumptions, and the non-redeeming shareholders' risks

She further mentioned that CorpFin is working on making recommendations to the Commission for rulemaking to address these disclosure matters and other SPAC-related issues.

Grant Thornton publications related to SPAC and de-SPAC transactions

- Viewpoint, "Merging with a special purpose acquisition company (SPAC)," focuses on the information required in SEC filings for a private operating company being acquired by a SPAC and addresses certain key accounting considerations for the U.S. GAAP financial statements of the combined company following a de-SPAC transaction.
- Snapshot 2021-02, "CorpFin issues disclosure guidance for SPACs," discusses CF Disclosure Guidance: Topic 11, *Special Purpose Acquisition Companies*, which provides CorpFin's views on certain disclosure considerations for a SPAC IPO and subsequent business combination transactions.
- Snapshot 2021-07, "SEC staff issues statements on SPAC mergers," summarizes statements issued by OCA and CorpFin addressing certain accounting, financial reporting, and governance issues in relation to mergers of private operating companies with SPACs.

Revenue recognition

Revenue recognition remains a top accounting topic for consultations with OCA staff. The most common revenue recognition consultations related to

- Identifying performance obligations
- The principal versus agent analysis
- Identifying the customer
- Accounting for consideration payable to a customer

OCA staff noted that since the revenue guidance is largely principles-based, entities might encounter difficulties in applying the guidance especially in areas where they are required to use significant judgment, and they may find it helpful to consult with OCA.

The staff explained that they take a "well-reasoned and supportable judgments" approach to reviewing these consultations. The accounting must be grounded in, and supported by, relevant accounting principles, the staff said, and companies should also consider the usefulness and transparency of the resulting information to investors. The staff observed that before reaching an accounting conclusion, a company should have a clear understanding of the guidance and carefully consider all specific facts, including the substance of the arrangement. Companies are encouraged to work through the ASC 606 framework step by step to identify all the applicable accounting considerations rather than starting with any preconceived conclusions.

Companies were also reminded that the indicators of control do not replace an assessment based on the definition of control. In other words, the indicators listed in the guidance do not serve as a checklist to assess control without consideration of how and to what extent the facts around an indicator support the control definition.

Segment reporting reminders

OCA staff provided several reminders related to segment reporting, noting that the management approach is fundamental to segment reporting and that each evaluation requires careful consideration of the specific facts and circumstances. When determining segments to be reported, entities should also carefully consider all of the information that the chief operating decision maker (CODM) uses on a regular basis to manage the business, as well as any evolution in the information that the CODM uses to make decisions, according to the staff.

CorpFin Deputy Chief Accountant Melissa Rocha also noted that segment reporting continues to be a focus area in filing reviews. The staff reviews information about segments in the notes to the financial statements and compares those notes to other information available both within and outside of the financial statements, such as in earnings releases, on the company’s website, in Management’s Discussion and Analysis (MD&A), in the description of the business section, and in revenue disclosures. Other factors that might raise questions about a company’s segment presentation include reporting one segment that constitutes the vast majority of the business; changes in management or changes to the business (for example, restructuring, acquisition, or disposition); and the aggregation of operating segments. The staff emphasized that companies should meet all the aggregation criteria in the guidance before combining operating segments.

For example, Ms. Rocha presented a fact pattern where two reportable segments were identified: one was a mature business operation representing a substantial portion of the company’s revenue, and the other was a group of start-up operations reporting significant losses. The aggregated operating segments’ products and services, customers, and economic characteristics of both the mature business operation and the group of start-up operations all appeared dissimilar, and ultimately the staff objected to the combined presentation because the aggregation criteria were not met. As a result, the company was required to restate its financial statements to report the segments separately.

CorpFin staff has also issued comments when a company disclosed more than one measure of a segment’s profit or loss in its financial statements. The staff noted that if the CODM uses more than one measure of a segment’s profit or loss, ASC 280 requires the company to report the measure that it believes is determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in its consolidated financial statements. The staff has not objected to the disclosure of additional measures of segment profit or loss outside of the financial statements, as long as the disclosures comply with the rules and regulations applicable to non-GAAP financial measures.

Reference rate reform

FASB staff explained that the Board is considering extending the sunset date for the reference rate reform guidance in ASC 848, which provides temporary relief for companies transitioning away from a reference rate that is being discontinued (for example, LIBOR). The current accounting relief and the various expedients are set to expire as of December 31, 2022. However, the LIBOR secession date was pushed back to June 30, 2023 after the issuance of the reference rate reform guidance in ASC 848. As a result, the FASB is currently evaluating different alternatives to extend the relief under ASC 848.

Ms. McCord alerted the audience to the recently issued SEC staff statement on the LIBOR transition, which highlights key considerations for market participants in light of the transition away from LIBOR. She indicated that companies should disclose the steps taken to mitigate the risks or potential impact of the transition and indicate where they are in the process of the transition.

C. SEC compliance and reporting

SEC rulemaking and initiatives

During the CorpFin panel, Ms. Jones discussed the key challenges the division is currently facing, including the volume and pace of disclosure filing reviews and rulemaking initiatives. In the area of filing reviews, Ms. Jones stated that the volume of transactions is extremely high compared to prior year, noting that the Commission has seen twice the number of traditional IPOs, four times the number of SPAC IPOs, and six times the number of de-SPAC transactions.

In addition, Ms. Jones, along with Mr. Munter during the OCA panel, referred the audience to the SEC's Regulatory Flex Agenda for a summary of future rulemaking and highlighted the following initiatives:

1. Climate risk disclosures
2. Trading prohibitions under the Holding Foreign Company Accountable (HFCA) Act
3. Reopening of the comment period for the 2015 Proposed Rule on the listing standards for recovering erroneously awarded compensation
4. The Final Rule, *Universal Proxy*
5. The Proposed Rule, *Proxy Voting Advice*

Mr. Munter summarized the recently adopted Final Rule, *Holding Foreign Companies Accountable Act Disclosure*, to implement the disclosure and submission requirements of the HFCA Act. He stated that the Act requires the PCAOB to identify the jurisdictions where the PCAOB is not allowed to inspect or investigate, which has historically included China and Hong Kong. The Commission is required to annually identify Commission-Identified Issuers, which are issuers that use audit firms in those PCAOB-identified jurisdictions. If a company is identified as a Commission-Identified Issuer for three years in a row, the Commission is required to suspend trading of that issuer's securities under the HFCA Act. Mr. Munter informed the audience that for calendar-year companies, the three-year clock begins with audit reports issued on 2021 financial information in calendar year 2022. Further, he mentioned that the Senate has passed legislation to accelerate the delisting deadline from three years to two years, but the legislation is still subject to approval in the House.

The Final Rule also requires Commission-Identified Issuers to submit documentation to the SEC through Edgar, prior to the annual report due date, establishing that they are neither owned nor controlled by a government entity in the public accounting firm's foreign jurisdiction, if accurate. Further, Commission-Identified Foreign Issuers are required to provide certain other disclosures in their annual report.

Ms. Jones provided her insights on monitoring China-based issuers, reminding registrants to focus on providing prominent disclosures around the risks associated with variable-interest entities located in China and the potential delisting of a company.

Considerations for the 2021 reporting period

COVID-19

In light of companies rearranging their workforce or business operations permanently due to the impact of COVID-19, Ms. McCord reminded the audience of the CorpFin disclosure guidance topics issued in 2020. She stated that this guidance is still relevant and provides CorpFin's views on disclosure and other securities law obligations that companies should consider when preparing their upcoming annual reports:

- CF Disclosure Guidance: Topic 9, *Coronavirus (COVID-19)*
- CF Disclosure Guidance: Topic 9A, *Coronavirus (COVID-19) – Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources*

In light of significant changes to many company's operations due to COVID-19, OCA staff reminded financial statement preparers that any material change in a company's ICFR, such as changes to its financial reporting processes in a remote work environment, must be disclosed in quarterly filings in the fiscal quarter when the changes occur. Mr. Jacques encouraged companies to identify risks stemming from operational changes, such as remote work environments, and to assess whether necessary changes were made to ICFR so that they continue to be designed and operate effectively.

Cybersecurity

The conference dedicated a panel to discussing the current cybersecurity landscape. The panelists noted an uptick in cyberattacks and stated that such attacks are expected to continue in the current environment. They emphasized the importance of having the right processes, technology, and talent to be able to manage and mitigate cybersecurity risks. The panelists also highlighted the auditors' responsibility when considering cybersecurity risk to the extent it could result in a material financial statement misstatement.

CorpFin's cybersecurity guidance

For information related to disclosure obligations regarding cybersecurity risks and incidents, refer to CF Disclosure Guidance: Topic No. 2, *Cybersecurity*.

Implementation of 2020 rules

Craig Olinger, CorpFin Senior Advisor to the Chief Accountant, discussed the following implementation reminders relating to the adoption of the 2020 Final Rule, *Amendments to Financial Disclosures about Acquired and Disposed Businesses:*

- The investment test requires the use of aggregate worldwide market value if the registrant has aggregate worldwide market value. This is true even if the registrant was not a public company at the end of the most recent fiscal year but was public and had aggregate worldwide market value at the time of the probable or consummated acquisition or disposition. Mr. Olinger provided the following example:
  - A registrant that consummated its IPO in June 2021 acquired a business in November 2021. The registrant used the aggregate worldwide market value as of the last five trading days of October 2021 as the denominator in the investment test, even though the December 2020 historical amounts were used in the income and asset tests.
- Aggregate worldwide market value includes the value of voting and nonvoting common equity that is publicly traded. The value does not include (1) other classes of common stock that are exchangeable into the class of common equity that is traded, or (2) preferred stock that can be converted to common stock.

- For acquisitions consummated shortly after year-end, Regulation S-X, Article 11, *Pro forma financial information*, allows a registrant to use amounts for its most recently completed fiscal year as the denominator in the significance tests, if the annual report for that fiscal year will be filed before the date when the acquired business's financial statements and pro forma financial information must be filed on Form 8-K. Mr. Olinger clarified that if a registrant elects to use such financial statements as the denominator in the significance tests in this situation, it is not required to use the corresponding year's financial statements for the acquired business and may instead use the acquired business's financial statements that were available on the date the acquisition was consummated as the numerator.

- In connection with spin-off transactions, the registrant may need to include autonomous entity adjustments in the pro forma financial information presented in its initial registration statement. Mr. Olinger noted that changes in costs evidenced by agreements, such as lease agreements or transition service arrangements, will ordinarily qualify to be autonomous entity adjustments. Other changes in costs not evidenced by agreements will ordinarily not be autonomous entity adjustments; however, these could represent synergies or dis-synergies resulting from the transaction, and the registrant may have the option to present those as management's adjustments.

- The Final Rule did not amend S-X Rules 3-09 and 4-08(g). However, given that the significance tests in S-K Rule 1-02(w) were amended, the staff has received questions on how to apply the significance tests for equity method investments accounted for using the fair value option. Mr. Olinger clarified that the guidance in Section 2435 of CorpFin's *Financial Reporting Manual* (FRM) continues to provide analogous guidance in light of the amendments to the significance tests.

Mr. Olinger also informed the audience that the FRM has not yet been updated for this Final Rule and guided the group to the adopting release, unless otherwise specified.

Ms. McCord discussed the adoption of the 2020 Final Rule, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, which eliminated Regulation S-K, Item 301, *Selected financial data;* streamlined the requirements in Item 302, *Supplementary financial information*; and updated certain requirements in Item 303, *Management's discussion and analysis.* The Final Rule became effective on February 10, 2021, and registrants are required to apply the amended rules in annual reports, initial registration statements, and prospectuses that include financial statements for the fiscal year ending on or after August 9, 2021.

Ms. McCord emphasized that even though the new rule codifies the existing 2003 MD&A interpretive guidance as it relates to critical accounting estimates, companies should take a fresh look at their current disclosures.

In regards to the requirement to present the selected quarterly financial data when a company loses its emerging growth company status and is required to adopt new accounting standards, it should look to footnote #70 in the adopting release for additional guidance, she noted.

Non-GAAP financial measures and key performance indicators

In a panel featuring accounting and legal professionals, the panelists emphasized that non-GAAP financial measures and key performance indicators (KPIs) presented in earnings releases or in periodic filings should

- Meet investors' demands;

- Be consistent with measures used by management; and

- Reflect the economics of the business.

Further, CorpFin staff shared certain observations and reminders related to non-GAAP financial measures and KPIs, as follows:

- *Prominence:* The staff emphasized that GAAP information is the foundation of the Commission's financial information disclosure requirements, yet the staff continues to experience instances where registrants gave undue prominence to non-GAAP financial measures. Examples include
  - A discussion of non-GAAP results without comparable GAAP measures
  - A detailed discussion of non-GAAP financial measures, including charts and graphs that overshadow the comparable GAAP information
  - A presentation of a full non-GAAP income statement
  - A reconciliation of the non-GAAP financial measure to a measure other than the most directly comparable GAAP measure
- *Mislabeling:* The staff noted that the title of non-GAAP financial measures must be consistent with their description. For instance, labeling contribution margin or non-GAAP gross margin as net revenue, or labeling a measure that excludes material components of costs of revenue or other expenses that are directly tied to the business's core operations, might not be appropriate. Given the lack of consistency and comparability of similarly titled non-GAAP financial measures among registrants, the staff expects a clear description of adjustments in sufficient detail, so that investors can understand all material components of the measure.
- *Non-GAAP measures versus other metrics:* The staff reminded registrants to evaluate whether the disclosed measure is a non-GAAP financial measure, a KPI, or other metric, and to provide disclosures consistent with the applicable framework. The staff also indicated the importance of disclosing how a metric is calculated, including any underlying estimates or assumptions used, in order for it to not be misleading. The staff encouraged registrants to consider whether metrics disclosed in earnings calls or investor presentations should also be included in their annual or quarterly reports.

Finally, the staff stressed the importance of maintaining effective controls and procedures over the disclosure of non-GAAP financial measures as well as KPIs and other metrics.

Filing reviews

Waiver requests to omit or substitute financial statements

During the CorpFin panel, Mr. Olinger discussed recent waiver requests under Regulation S-X, Rule 3-13, *Filing of other financial statements in certain cases*, noting that the staff continues to receive waiver requests due to the high volume of IPOs, SPAC transactions, and acquisitions, even though the 2020 Final Rule on acquired and disposed businesses has reduced the volume of waiver requests related to anomalous significance results under the income test.

Recent waiver requests have taken longer to process due to the complexity of the fact patterns and significant judgment involved, particularly in transactions where the pre-IPO registrant's size has changed significantly since year-end, he said. In these situations, Mr. Olinger explained that CorpFin staff considers the total mix of information related to the company and the transaction when evaluating such waiver requests, focusing on the size of the acquisition relative to the registrant. Additional observations included

- When an individual component of the significance tests is higher than the other components, it is not automatically anomalous. In some instances, this result might be a good indicator of the relative size of the acquired business.
- In considering whether a significance test result is truly an anomaly, the staff considers such aspects as
  - Whether the factors driving the significance result are one-time or likely to reoccur;
  - How the acquisition will impact the registrant's financial statements;
  - The composition of the acquired assets, including whether they will amortize over time; and
  - What other relevant financial measures and operating metrics indicate in terms of the acquired business's relative size.

Attendees were reminded that CorpFin staff also considers requests to substitute required financial statements. In an example where an acquiree has grown rapidly subsequent to its most recent year-end, Mr. Olinger said that the staff might consider the most recent interim stub period (such as seven-months ended July 31, 2021), if audited, as a substitute for an earlier audited annual period (such as December 31, 2019). In addition, when two years of audited financial statements are required, a registrant may ask to provide only one audited year instead of two if comparative interim periods are required and the registrant also requires relief for an earlier interim period.

S-X Rule 3-13 best practices

Mr. Olinger provided the following insights into best practices for registrants submitting an S-X Rule 3-13 waiver request:

- Make the initial request as complete as possible and include all relevant facts to avoid follow-up questions from the staff. Specific data points to include are the results of each significance test (including both components of the income test), the details of the transaction including its structure, a description of the seller, and the purchase price.
- If less than 100 percent of the target's business is acquired, explain the portion of the business being purchased, including which operations are being acquired, whether the acquired assets are tangible or intangible, and how the acquired assets relate to the acquiree's historical assets.
- If the significance tests are not straightforward, explain how significance was calculated.
- Explain why the registrant believes the significance tests do not reflect the size of the acquisition, why the required financials are not material to investors, and other pertinent information, including existing and future disclosures.

Income statement presentation

CorpFin Deputy Chief Accountant Sarah Lowe reminded the audience that CorpFin staff reviewers closely examine the statement of comprehensive income, one of the primary GAAP financial statements, considering it within the context of other disclosures in the filing, such as MD&A or non-GAAP financial measures. Ms. Lowe reminded the audience that the following articles include guidance on financial statement presentation for particular industries:

- Regulation S-X, Article 5, *Commercial and Industrial Companies*
- S-X Article 7, *Insurance Companies*
- S-X Article 9, *Bank Holding Companies*

While these articles have not been updated recently, she said that most of the line items prescribed in the industry-specific guidance remain relevant. Ms. Lowe noted that some companies, particularly those whose business is evolving over time, may not fit solely within one industry's prescribed income statement format. In some situations, CorpFin has not objected to a hybrid income statement presentation that applies conventions from more than one industry. As an example, Ms. Lowe described a fintech company with a material loan business that uses a hybrid income statement presentation that combines S-X Articles 5 and 9.

Disaggregation of income statement captions and cost of revenue

Ms. Lowe explained that CorpFin has not generally objected to registrants using more than the five sub-captions within S-X Article 5 to disaggregate net sales and gross revenues, as long as the revenue is consistent with U.S. GAAP.

While similar disaggregation may be appropriate for expense line items, in some examples, it is not clear whether the expenses are sub-captions of costs and expenses applicable to sales and revenue or another category of operating expenses, such as general and administrative expenses. During 2021, CorpFin staff noted an increase in comments questioning which of the S-X Article 5 primary expense line items are related to the disaggregated expense, depending on the type of expense and whether it was included in gross margin. For example, Ms. Lowe cited an income statement caption titled "technology costs," which may include expenses to enhance or maintain a technology platform or technology products or services.

In addition, Ms. Lowe said that CorpFin staff reviews other sections of the filing to ensure that such disclosures are consistent with the income statement presentation. For example, the staff might question instances where the filing states that investments in technology are important for revenue growth, but those expenses are not classified as a cost of revenue.

Ms. Lowe went on to say that it should be clear to financial statement users whether an expense is related to the cost of revenue. Accordingly, when an expense line item combines expense captions under the guidance in S-X Article 5, the registrant should clearly disclose the portion of expense related to the cost of revenue.

Lastly, Ms. Lowe indicated that CorpFin staff has issued comments during the year to remind registrants of the SEC staff's views in SAB Topic 11.B, *Depreciation And Depletion Excluded From Cost Of Sales*, which explains that the financial statement caption should indicate when depreciation and amortization are excluded from the cost of revenue or sales. In addition, if the income statement includes both the cost of product and the cost of service, then the staff expects the registrant to disclose the amount of depreciation and amortization related to both the cost of product and the cost of service.

Spin-off transactions

Mr. Olinger said that spin-off transactions are often complex and may be structured in several ways, including, but not limited to, a transfer of assets and operations into a newly formed registrant or a transfer of pre-existing subsidiaries into a newly formed registrant. In some instances, the transaction may be a reverse spin transaction. Further, the operations that were spun off may not align with a particular segment or an individual or group of subsidiaries. He also noted that the financial statements to be included in an initial registration statement for the spin-off requires balancing the past history of the business with the composition of the business going forward. The staff referred the audience to the guidance in SAB Topic 1.B, *Allocation Of Expenses And Related Disclosure In Financial Statements Of Subsidiaries, Divisions Or Lesser Business Components Of Another Entity,* and to SAB Topic 5.Z.7, *Accounting for the spin-off of a subsidiary,* and encouraged registrants to preclear with the staff when they have a complex fact pattern.

D. Audit and corporate governance

PCAOB standard-setting update

Ms. Vanich provided a standard-setting update for the PCAOB, noting that a second supplemental request for comment on proposed amendments to the requirements related to the supervision of audits involving other auditors was issued during 2021. Ms. Vanich noted that the staff is evaluating the comment letters received on this topic to determine the Board's next steps.

She mentioned that quality control, data and technology, and audit evidence are currently the other top projects of the PCAOB. As the Board reconstitutes and the remaining new members are sworn in, the Office of the Chief Auditor plans to work closely with new Board members to evaluate the standard-setting and research agendas in light of new priorities.

PCAOB inspection update

George Botic, Director of the PCAOB's Division of Registration and Inspections, reinforced the importance of audit quality and discussed the Board's inspection activities and recent inspection results, along with 2022 focus areas. He noted that the most recent inspection cycle was the first cycle where the effects of COVID-19 were visible across the majority of audits inspected. He also stated that the PCAOB inspections focused on certain industries that have experienced significant disruptions or emerging risks, including SPACs. Mr. Botic discussed the continued importance of firms' systems of quality control, including policies and procedures over engagement acceptance, personnel management, and independence, particularly as the economic and workforce disruptions continue. Looking ahead to the 2022 inspections, Mr. Botic indicated the division's planned focus areas are primarily driven by the current environment, such as mergers and acquisitions, disruptions in supply chains, negative effects from COVID-19, as well as SPAC and de-SPAC transactions.

Auditor independence

During the OCA panel, OCA staff highlighted the importance of auditor independence, in both fact and appearance, and noted that it is foundational to the credibility of the financial statements. The staff also reminded the audience that independence is a shared responsibility between the auditor, the audit committee, and management.

Auditors and prospective registrants are encouraged to consult with OCA staff on a pre-IPO and pre-filing basis to potentially avoid costly re-audits if the auditor's independence is later determined to be impaired. The staff reiterated that the consultation process fosters greater consistencies across audit firms over time and assists in effectively applying the auditor independence rules and interpretative guidance. In addition, OCA staff emphasized the importance of the audit committee's role in the consultation process, including the expectation that the auditor will obtain the audit committee's conclusions on the matter. The staff evaluates each consultation on the specific facts and circumstances, while considering the nature, timing, and scope of activities performed and the auditor's ability to remain objective and impartial.

OCA staff reiterated that given the increase in mergers and acquisitions of public companies or private entities that plan to go public, auditors and audit clients need to plan accordingly to manage risks associated with certain services and business relationships that might create an independence violation. The staff stressed that independence should not be an afterthought.

Implementation of the 2020 independence rule

As a result of the SEC's adoption of certain amendments to the independence requirements in Regulation S-X, Rule 2-01, OCA staff has witnessed a rise in independence consultations, specifically related to the application of the general standard of independence in Rule 2-01(b). The SEC views the general standards, together with the Commission's four guiding overarching principles, as a framework to apply when considering matters that are not directly addressed elsewhere in Rule 2-01. Those four overarching principles refer to whether or not the professional service or relationship (1) places the accountant in a position of auditing its own work, (2) results in the accountant acting as management or an employee of the audit client, (3) places the auditor in a position of being an advocate for the audit client, or (4) creates a mutuality or conflicting interest between the auditor and the audit client.

To further illustrate the application of the amendment on the revised definition of "audit and professional period," OCA staff shared an example that focused on the auditor's provision of bookkeeping and financial preparation services for a private audit client that files an initial registration statement. Given the principles-based nature of the guidance in S-X Rule 2-01, the SEC has consistently stated that it is a high hurdle to conclude that an auditor can remain objective and impartial when it provides bookkeeping services that include, but are not limited to, tax provision preparation, payroll, or financial statement preparation in any of the periods included in the filing.

OCA staff described the scenario as follows:

- A firm's existing U.S. private audit client is going public and will include in its IPO registration statement financial statements for the periods ending December 31, 2020 and December 31, 2021, audited in accordance with PCAOB standards.
- For the year ending December 31, 2020, the company's auditor, conducting the audit in accordance with AICPA standards, had previously assisted in preparing the company's tax provision for the 2020 audit period, performing that work in January and February of 2021. The tax provision work was (1) performed based on the information and assumptions provided by company management, (2) reviewed by management, and (3) booked to the general ledger by company personnel. No tax provision services were provided by the company's auditor for the year ending December 31, 2021.
- The company asked to engage the same auditor to perform audits for 2021 and 2020 in accordance with PCAOB standards. The current-period financial statements are for 2021 and the look-back period involves the 2020 financial statements. S-X Rule 2-01 requires the auditor to be independent

in its entirety for 2021 and in 2020 under both AICPA standards and the SEC's general standard of independence.

In this example, the staff pointed out that two of the SEC's guiding principles would be violated: (1) the auditor would be placing themselves in a position of auditing their own work for 2020, and (2) in 2021 the auditor would be acting as management or an employee of the audit client by providing these services in either the look-back period or in the current period for which the financial statements are presented.

Further, OCA staff shared the view that it would be a high hurdle to overcome or cure a violation of the SEC's four guiding principles by applying safeguards to mitigate the threat that are allowed under the AICPA's and IESBA's joint conceptual framework approach. According to the staff, even if management reviews the tax provision and is responsible for bookkeeping, the staff would still view this activity as an independence violation, since the auditor would be in the position of auditing its own work.

OCA staff also clarified how to apply the guidance in Question 4 of Section E of the OCA FAQs to the illustrative example provided above. The FAQ in question relates specifically to a predecessor/successor audit relationship where there is no existing or continuing audit relationship and no requirement to be independent under either PCAOB or local independence requirements when providing the nonaudit services. Therefore, as long as the service is terminated prior to beginning the professional engagement period, no management function violation exists. However, this is not the case when an audit firm has an existing audit relationship with a client, so the guidance in Question 4 does not apply to the illustrative example above.

E. Environmental, social, and governance matters

Recent trends

Throughout the conference, various panelists cited institutional investors' growing use of ESG factors in investment decisions as well as their mandates for investees to report on ESG issues. Panelists emphasized that ESG is not a passing trend, but is here to stay. According to many investors, ESG risks and opportunities are simply business risks and opportunities relevant to the company's long-term value; therefore, investors want to understand the company's strategy, plans, and performance on relevant ESG issues.

Anticipated SEC proposed rules on climate change disclosure and ESG topics

As previously mentioned, Mr. Munter referred the audience to the SEC's Regulatory Flexibility Agenda, which includes several ESG-related proposed rules expected in 2022, including rules on (1) corporate board diversity, (2) climate change disclosure, (3) human capital management disclosure, and (4) cybersecurity risk governance. Mr. Munter also referred the audience to SEC Chair Gary Gensler's July 2021 remarks during a webinar on climate and global financial markets for insight into what might be included in the proposed rules.

SEC focus on climate change disclosures

SEC staff discussed the Commission's ongoing focus on climate change–related disclosures. In February, then-acting SEC Chair Allison Herren Lee issued a statement directing CorpFin staff to enhance its focus on climate-related disclosures and, in particular, to review how public companies are currently applying the related 2010 guidance. Stemming from this review, CorpFin issued a sample letter to companies in September on climate-change disclosures. Many of the example comments illustrate how CorpFin staff might apply the 2010 guidance in the filing review process.

CorpFin staff encouraged preparers to consider the sample comments when preparing upcoming periodic reports and registration statements.

Grant Thornton publications related to ESG

- Snapshot 2021-09, "SEC undertakes climate and ESG-related activity," reviews recent SEC developments related to climate change and ESG matters and provides an overview of the 2010 guidance on climate-related disclosures.
- Snapshot 2021-12, "CorpFin releases sample comments on climate change," summarizes CorpFin's sample letter illustrating potential comments that companies might receive on either climate-related disclosures or the absence of such disclosures.

International Sustainability Standards Board

Panelists representing both regulators and standard-setters remarked on the momentum to rationalize the numerous, voluntary sustainability reporting standards and frameworks. In particular, attention was given to the recent announcement from the IFRS Foundation Trustees regarding the formation of a new standard-setting board, the International Sustainability Standards Board (ISSB).

Mr. Munter explained that the ISSB will consolidate the Climate Disclosure Standards Board (an initiative of the Carbon Disclosure Project) and the Value Reporting Foundation (a combination of the Integrated Reporting Framework and the Sustainability Accounting Standards Board Standards) by June 2022. Panelists noted that all preparers, including those that prepare financial statements in accordance with U.S. GAAP, may prepare sustainability reporting using the standards of the ISSB when issued.

Next steps for preparers

While the SEC has not yet issued proposed or final rules on ESG topics, SEC staff, securities counsel, and financial statement preparers have discussed steps that companies can take now with respect to ESG disclosures. As discussed above, preparers should review CorpFin's sample comments on climate change and consider any potential updates to upcoming periodic reports or registration statements. Several panelists also mentioned the need to consider whether any information in a stand-alone ESG report should be included in SEC filings, as noted in the sample comments.

Grant Thornton insight: Materiality within the context of ESG

Today, many companies report ESG information in stand-alone reports and might not include this ESG information in SEC filings. While it is important to consider whether information in an ESG report should be included in the company's SEC filings, a different concept of materiality might apply to SEC filings compared to ESG reports.

Often stand-alone ESG reports are prepared for stakeholders that include investors as well as other constituents, such as employees, customers, and community members. Information of interest to these stakeholders that is disclosed in an ESG report might not be considered material under the U.S. securities laws, which focus on how a reasonable investor may consider the "total mix" of information available. As companies consider what information from their ESG reports should potentially be included in SEC filings, they may find it helpful to consult with qualified securities counsel.

Some panelists noted that ESG information that must be included in Exchange Act reports is subject to disclosure controls and procedures (DCP). Accordingly, preparers should ensure that DCP are designed so that ESG information is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Before reporting ESG information externally, even outside of an SEC filing, companies could benefit from involving their accounting or internal audit teams in the preparation and review of ESG disclosures.

Financial statement preparers should also monitor SEC rulemaking activity to understand what disclosure information may be required in the future so that they are ready to comply with any future requirements.

Addressing stakeholder needs and preparing for the future

Stakeholders' expectations for transparency and progress on ESG issues are rapidly evolving. Grant Thornton's ESG and Sustainability Services includes guidance and updates on a variety of ESG topics that are intended to help your companies' focus on the most impactful and actionable areas.

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