DHG

VIEWS

December 2020

Highlights: 2020 AICPA Conference on Current SEC and PCAOB Developments

The format of the annual American Institute of Certified Public Accountants (AICPA) Conference on Current U.S. Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) Developments may have looked a little different this year (as everyone attended virtually) but continued to include a wide range of presentations by senior leadership and other representatives from the SEC, PCAOB, Financial Accounting Standards Board (FASB), the Center for Audit Quality (CAQ) and the AICPA. There were also a number of other stakeholders such as preparers, audit committee members and audit professionals that served as panelists throughout the conference.

Speakers shared their views on trending accounting, financial reporting and auditing topics with attendees. However, one topic affecting everyone was the COVID-19 pandemic and the related challenges facing preparers, auditors and regulators.

This publication is not meant to be all inclusive of the topics discussed at the conference. Rather, it is intended to focus on the highlights and key themes that may be relevant to our clients. The following topics were discussed this year:

COVID-19 IMPACTS

As mentioned, the impact of the COVID-19 pandemic was addressed by various speakers focused on the areas of accounting, reporting and auditing. In particular, speakers noted that many entities may have changed their business strategies, processes and internal controls due to the COVID-19 pandemic environment – especially if they moved to a virtual environment during the year.

Companies and auditors should evaluate the impact of any changes to existing contracts, such as revenue, leases, compensation or financing arrangements, and then consider the application of any contract modification accounting models that may be applicable. Auditors may have to adjust their audit approaches, which may include reassessing materiality or performing additional procedures to accommodate client changes that occurred throughout the year. Auditors should have heightened professional skepticism and consider incentives or pressures that could be present due to the pandemic when assessing fraud risks. There should also be consideration of additional uncertainty related to estimates used in areas such as valuation or forecasting.

In particular for auditors, the PCAOB noted a focus on audit risks associated with the COVID-19 pandemic during next year's inspections – especially industries that were hit hardest by the pandemic (e.g., hospitality, etc.). The SEC noted the expectation of robust COVID-19 disclosures and the effects on companies, including their businesses, liquidity and capital resources. The SEC also discussed the use of non-Generally Accepted Accounting Principles (GAAP) measures reflecting adjustments for the effects of the pandemic, strongly encouraging companies to make sure they are following the guidance in Regulation G and item 10(e) of Regulations S-K, which the SEC noted has not changed.

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The PCAOB issued a COVID-19 Spotlight publication on Staff Observations and Reminders during the COVID-19 Pandemic providing additional advice to auditors as they complete their 2020 audits in this environment. This publication may also be of interest to companies to obtain insight into what to expect from their auditors this busy season.

The SEC representatives from the Division of Enforcement shared their recent approach to comparing filings between companies in the same industry to identify similarities and differences in disclosures. They noted an expectation that companies in the same industry would likely be making company-specific disclosures around the same COVID-19 related issues, and that the absence of disclosure around a common theme in an industry could cause them to look more closely at that registrant.

ACCOUNTING ISSUES

FASB

Rich Jones delivered his first address to the Conference as Chair of the FASB. He shared his three criteria for changing standards in the future (i.e., creating a new standard or amending an old) as being:

a. to provide investors with better and more useful information;
b. to remove unnecessary cost and complexity from the system; and,
c. to maintain and improve the Codification.

Hillary Salo, the FASB's new Technical Director, emphasized the importance of the FASB's post-implementation reviews for new standards. She shared that they were in the process of those reviews for the new standards on the current expected credit loss (CECL) model and lease accounting.

She noted that FASB staff observed through its outreach and research that users and preparers alike find different aspects of the CECL model challenging with regard to purchase accounting and the accounting for loans not purchased credit deteriorated. Companies that have adopted CECL noted the costs for adoption were generally higher than expected, and financial institutions often needed outside resources. Financial institutions also challenged the need for the continued use of the troubled debt restructuring (TDR) model, suggesting at a minimum to consider modifications to the TDR model to better coexist with the CECL model. Non-financial institutions noted that generally the effects of CECL on their financial statements were not significant, yet some encouraged the FASB to consider amending the scope to exclude trade accounts receivable, either for all entities retrospectively or at least for smaller entities yet to adopt the new standard. Analysts felt that more consistent and detailed disclosures were needed across the board.

Regarding leases, financial statement users provided the FASB staff with varying degrees of support for the new standard and suggested improvements for the accounting under Accounting Standards Codification (ASC) 842, with those comments often influenced by how the analyst used the reported results in their particular modeling. Preparers noted some challenges in determining an incremental borrowing rate, identifying embedded leases and accounting for modifications. Ms. Salo noted that the FASB issued an exposure draft in October with targeted improvements that may address some of the preparers' concerns.

SEC Office of the Chief Accountant

Consistent with past years, staff members of the Office of the Chief Accountant (OCA) at the SEC took to the virtual stage and shared perspectives on selected accounting questions that have been addressed over the year. They noted that a considerable number of issues related to COVID-19 were addressed and considered in the first half of the year in conjunction with the FASB, the SEC's Division of Corporate Finance (DCF) and the U.S Department of the Treasury (Treasury). The OCA staff also observed that the consultations were returning to the more traditional topics and there were a significant number of issues related to revenue recognition, CECL, debt and equity issuances, reference rate reform, income taxes and hedging. The specific issues discussed related to the following:

- *Revenue recognition - Performance obligations* – The OCA staff did not object to a conclusion that a company providing a software license and committing to subsequent monitoring and updating of the software could combine those promises into a single performance obligation given the interdependence between the license and updates.

- *Revenue recognition - Principal versus agent* – The OCA staff shared two fact patterns. In the first, the staff did not object to a conclusion that the operator of a digital platform for auctioning advertising space was an agent for its customers' purchases of advertising space from a publisher (Griffin speech). In the second, the staff did object to a conclusion that the seller of a commodity, with access to several production sources including that of a related party, was an agent despite receiving only a fixed commission on the sales.

- *Leases – Abandonment of a right-to-use asset* – For a company with an extended time between identifying certain leases to abandon and the actual abandonment date, and where the applicable impairment models did not trigger an impairment at the point of identification, the OCA staff did not object to a conclusion to amortize the remaining right-to-use asset over the period from identification to abandonment.
- *Equity method investment – Application to an entity with less than 20 percent ownership* – After considering contractual relationships among several members of the ownership group, and despite holding less than 20 percent of the ownership, the OCA staff objected to a company's conclusion that it would not apply the equity method of accounting because it did not have significant influence.
- *Voting interest entity consolidation – Consideration of substantive participating rights* – The OCA staff considered a fact pattern where a company held the majority holdings in a voting interest entity that had only one other investor, but where certain operating and budgeting decisions required the consent of both parties with a buy/sell arrangement to be used in the event of a stalemate. The company consolidated the entity on its evaluation of a lack of participating rights by the other investor, but the staff objected to that conclusion.
- *Cash flow statement – Consideration received from a vendor* – The OCA staff objected to a conclusion by a company to net, within the investing section of the statement of cash flows, the cash inflows from a vendor against its cash payments to the vendor for fixed assets.
- *Discontinuation of LIBOR – Embedded derivatives for interest reset features* – The OCA staff did not object to a conclusion that certain interest rate reset features added in response to reference rate reform and based on iterations of the Secured Overnight Financing Rate (SOFR) were not embedded interest rate features requiring analysis for bifurcation as they represented expected market conventions.

Forecasting and Impairment

A panel consisting of several stakeholders, including an audit committee chair (and former FASB board member), a global technology company chief accounting officer, and an auditor and a valuation specialist from a large accounting firm, discussed the challenges of forecasting in this uncertain environment, specifically for impairment testing purposes. They observed the difficulty in forecasting when senior management may still be contemplating several business strategies for emerging from the pandemic as well as recognizing the need to potentially consider multiple possible future scenarios.

The panel highlighted the need to bring together informed points of view from varying perspectives relevant to the company, its industries and its geographies. They stressed this is especially true for expectations around revenue recovery, future expense structure and workplace-of-the-future dynamics. The group further emphasized the need for both stress and sensitivity testing of the various forecast inputs given the current economic uncertainty in addition to the need for clear documentation of management's concluded assumptions and appropriate disclosures.

In addressing current year registrant challenges, a second panel also discussed impairment. That group of primarily public company accounting and financial reporting executives noted the difficulty in developing assumptions for multi-year valuation models when just the next quarter was difficult enough to predict. They also discussed the difficulty in finding and evaluating comparable market multiples given the extreme volatility in the markets. Finally, they stressed the importance of documentation around assumptions and valuations given that there would likely be less cushion, if any, between fair values and recorded values this year relative to prior years in impairment tests.

AUDITING CONSIDERATIONS

The PCAOB emphasized their continued focus on audit quality and continued communications to auditors and audit committees. PCAOB inspections of audit firms have continued remotely with a recently released communication on some of the more recent inspection observations in Spotlight: Staff Observations and Reminders During the COVID-19 Pandemic. This publication covered not only observations but also overarching reminders and key takeaways associated with auditing in the current pandemic environment.

The PCAOB will also be considering a number of other matters in addition to COVID-19 implications, some of which are listed below:

- Implementation of the new auditing standards related to accounting estimates, using the work of a specialist, and the second phase of adoption of critical audit matters (e.g., non-large accelerated filers)
- Going concern considerations
- Inventory procedures, including performing virtual inventory observations
- Impairment analyses
- Risk assessment and fraud procedures
- Maintaining PCAOB and SEC independence
- Impact to the firm's system of quality control

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While many of the matters listed here are related to public companies, they may apply to broker-dealer inspections as well. At this time, the broker-dealer interim inspection program will continue, but the PCAOB is looking to finalize the broker-dealer inspection program, however, no set date was discussed.

SEC UPDATE

The staff of the SEC's Division of Corporation Finance discussed a number of new rules and amendments the SEC has adopted during the year to ease the burden of preparing disclosures, provide more useful information to investors and modernize auditor independence rules.

- *Amendments to Financial Disclosures about Acquired and Disposed Businesses* – The SEC's amendments to Regulation S-X Rules 3-05, 3-14 and Article 11 are meant to reduce the cost of providing information about significant acquisitions and disposals of businesses and real estate operations, improve the information provided to investors and facilitate more timely access to capital. The amendments, among other things, modify the significance tests – investment, asset and income – used in the determination of whether registrants need to file separate audited financial statements of acquired businesses. The amendments are effective for fiscal years beginning after Dec. 31, 2020.
- *Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities* — The SEC staff noted that they released a no-action letter on Nov. 10, 2020, stating that after the amendments are effective, issuers of certain trust-preferred securities may continue to omit their separate financial statements if they meet all the conditions.
- *Modernization of Regulation S-K Items 101, 103 and 105* — The SEC amendments are meant to improve readability of disclosures and discourage repetition and information that is not material to investors. These S-K items specifically related to the description of business, legal proceedings and risk factors and the amendments are heavily principles-based. The SEC staff noted that they issued Transitional FAQs Regarding Amended Regulation S-K Items 101, 103 and 105 to address certain transition matters.
- *Management's Discussion and Analysis, Selected Financial Data and Supplementary Financial Information* — These rules, once effective, will address a registrant's disclosure of selected financial data (the "five-year table," which is being eliminated), supplemental financial information (related to quarters in a reporting period) and management's discussion and analysis broadly (including several prescribed disclosures replaced with principles-based equivalents). While many registrants are eager to apply the new rule under its early adoption provisions, they must wait for its effective date, which will be 30 days after its publication in the Federal Register.

IN SUMMARY

There were a number of topics discussed at the conference, but the topics discussed in this publication were the trending topics that repeated throughout and kept attendees talking after the day ended. If you have questions, or wish to discuss further, reach out to your DHG advisor, visit [dhg.com](dhg.com) or contact us at assurance@dhg.com.