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

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 hosted over 1,800 attendees, which included both in-person and virtual participants, speakers, and panelists. The conference included 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 and panelists shared their views on trending accounting, financial reporting and auditing topics with attendees. Throughout the conference, there was a shared sentiment of how the profession continues to evolve through innovation and changing investor needs to make capital allocation decisions in the market.

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.

FINANCIAL REPORTING MATTERS

Environmental, Social and Governance (ESG)

The evolution of investor needs to be addressed through high-quality financial reporting was prevalent throughout the conference. One topic of interest that was discussed in several panels during the conference was ESG reporting and disclosure. In recent years there has been a rapid acceleration of investor demand for relevant ESG information, and an increasing need for a global framework to promote comparable and consistent ESG information reporting. Panelists noted that while ESG has been around for decades, there has been "more activity in the last ten months than the last ten years."

The reporting landscape in this area is rapidly evolving to meet stakeholder demands for simplification and clarity, including through the formation in June 2021 of the Value Reporting Foundation through the merger of the International Integrated Reporting Council and the Sustainability Accounting Standards Board, and their related Integrated Reporting Framework and SASB Standards. In addition, at the 2021 UN Climate Change Conference of the Parties (COP26) meeting in November 2021, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) to deliver a comprehensive global baseline of sustainability-related disclosure standards. It is anticipated that the ISSB will begin standard-setting activities in 2022, with a goal to achieve an approach that has global consistency, including core metrics that can be evaluated for use in various jurisdictions.

Panelists also acknowledged that in the past, sustainability reporting had been generally outside of the financial reporting groups and may have not been subject to the same rigors of controls over financial reporting. However, given the increased stakeholder interest, companies are developing enhanced controls around sustainability reporting that mimic those in financial reporting and including the consideration as to whether sustainability information should be included in certain items of Form 10-K. Adding to the importance of enhanced disclosure considerations is the September 2021

"Dear Issuer" letter from the SEC regarding climate change disclosures. This sample letter contains example comments that the Division of Corporation Finance (Corp Fin) may issue to companies regarding their climate-related disclosure or the absence of such disclosures, based on the Corp Fin's observations during recent filing reviews. The SEC staff also reminded participants of its 2010 **Commission Guidance Regarding Disclosure Related to Climate Change** and noted that the Commissioners have directed its staff to write additional guidance.

We expect sustainability disclosures and related assurance guidance to evolve rapidly over the next few years.

Special Purpose Acquisition Companies

Another topic of interest throughout the conference included recent record-breaking levels of merger and acquisition transactions fueled by Special Purpose Acquisition Companies (SPACs) and traditional initial public offerings (IPOs). For instance, according to SEC staff, the number of IPOs reviewed by Corp Fin has doubled compared to the previous fiscal year.

While SPACs have been around for over 20 years, a shift occurred in 2019 with the entrance of high-profile institution-led SPACs acquiring high-profile targets. Prior to this, SPACs had largely been seen as the province of less-well-known companies seeking to go public but not having a sufficiently compelling story to tell to attract buyers in a traditional IPO. One of the perceived advantages of SPAC transactions is the ability to include projections for the target in the filing, which is typically prohibited in a traditional IPO. This difference, combined with the lack of a requirement for any type of attestation (e.g., a fairness opinion) creates conditions that could lead to future rulemaking. Currently, there are several hundred (estimated around 550 through November 2021) SPACs seeking targets for a de-SPAC transaction, so there is a large volume of potential acquisition transactions on the horizon.

This increased level of transaction activity has drawn heightened scrutiny of the related required filings. In particular, SEC staff discussed the range of accounting and reporting issues that entities have been working through related to SPAC transactions, including issues relating to warrant accounting, earnings per share, temporary versus permanent equity classification, compensation, business combinations, and derivatives.

Panelists cautioned that SPACs and their targets need to have appropriate governance and internal control structures in place, as the private operating company will be immediately subject to 1934 Act reporting requirements upon the close of the de-SPAC transaction (i.e., the acquisition of the private target company by the SPAC). Panelists reiterated the importance of ensuring that appropriate personnel and processes are in place to produce compliant financial statements, which includes the reversal of any previously-elected Private Company Council accounting alternatives. One panelist commented that the filing review process of the SEC for the de-SPAC transaction would be comparable to that of a traditional IPO.

Comment Letter Trends / Non-GAAP Measures

Representatives from both the Office of the Chief Accountant (OCA) and Corp Fin discussed recent consultations and comment letter trends. Corp Fin specifically highlighted two areas that continue to be frequently discussed in comment letters: non-GAAP measures and segment reporting. The SEC staff reminded participants that it is important to understand why the use of a non-GAAP measure is useful to investors. For instance, when presenting a non-GAAP measure, it should be presented with the most relevant financial statement measure, with the financial statement measure having greater prominence. In short, the GAAP financial information should be the focus of the disclosure. Comment letters in this area tend to be related to either the prominence of the non-GAAP measure being greater than that of the GAAP measure, or the non-GAAP measure not being presented with the most relevant financial statement GAAP measure. In addition, the staff reminded issuers of the importance of how the measure is labeled in the disclosure. Labels should not be misleading, and clear descriptions of the non-GAAP measure and adjustments should be utilized.

Comment Letter Trends / Segment Reporting

The second area the Corp Fin staff focused on was segment reporting. The comment letters in this area have stemmed from either an issuer's identification of reportable segments or the aggregation of reportable segments. The staff reminded issuers that they should factor in changes to their company's business operations and consider what impact this may have on their current reportable segments. In addition, ASC Topic 280, Segment Reporting, allows reportable segments to be aggregated when certain criteria are met. The staff reminded issuers that they should carefully consider the nature of the business for each reportable segment in determining whether they meet all the characteristics of being similar as defined in ASC Topic 280 and therefore whether it would be appropriate to aggregate.

Little r vs. Big R Restatements / SAB 99 Assessment

Corp Fin also discussed the recent swing in the number of "Little r" restatements (or "corrections of an immaterial error, commonly not resulting in an amended filing") compared to "Big R" restatements and provided examples of two recent objections to issuer conclusions that an identified misstatement resulted in a "Little r" restatement through the application of Staff Accounting Bulletin No. 99 (SAB 99). Specifically, the SEC staff stated that the guidance in SAB 99 should be carefully considered with the individual facts and circumstances, and Paul Munter (OCA Acting Chief Accountant) noted that SAB 99 requires consideration of qualitative factors that may result in a quantitatively immaterial error being considered material. Further, assessing whether an error is material to prior periods is not a mechanical exercise, and should not be based solely on quantitative analysis. The total mix of information and facts and circumstances must be considered to reach such a conclusion. Furthermore, SAB 99 is not a checklist and should not be evaluated in a vacuum. The qualitative factors listed in the staff guidance explicitly state that it is not an exhaustive list of the circumstances that may affect the materiality of a quantitatively small misstatement.

The SEC staff also stated that they struggled when issuers supported their qualitative analysis by suggesting that investors only focus on the most recent financial statements and do not consider a registrant's financial history. SEC staff disagreed with such conclusions, stating that there is clear evidence that investors focus both on current and historical company information. When performing a SAB 99 analysis over an identified misstatement, issuers should identify the error, determine whether it is a material accounting restatement (regardless of restatement type), and consider both the quantitative and qualitative factors in determining the level of restatement necessary. In addition, the analysis should be performed from an objective perspective, and qualitative factors applied should not be biased to result in a certain conclusion.

ACCOUNTING MATTERS

FASB Update

At the 2020 AICPA Conference on Current SEC and PCAOB Developments, Rich Jones (FASB Chair) announced the FASB would undertake an agenda consultation process in 2021, which kicked off in the first quarter of 2021. The FASB conducted numerous outreach efforts and received over 500 responses to their Invitation to Comment. Of the themes running through the outreach efforts and ITC, Mr. Jones commented it was clear that investors want more disaggregated information, but preparers often do not based on their perception of the cost versus benefit. The current FASB priorities include the agenda consultation project, post-implementation review of recently effective standards (credit losses, leases and revenue recognition), and making progress on current projects. Current projects that are nearing completion include targeted improvements to accounting for troubled debt restructurings for creditors and credit loss vintage gross write-offs and recoveries disclosures as well as portfolio layer hedge accounting. Projects in the exposure draft phase include the interim reporting disclosure framework and supplier finance program disclosures. Projects on evaluating changes to goodwill accounting and impairment testing and reporting significant expense categories of reportable segments are in the pre-exposure draft stage, and the FASB is considering a project on the accounting for acquired financial assets.

Digital Assets

The conference included a panel discussion on a number of issues regarding the accounting for and auditing of digital assets, including the various types of digital assets, legal questions regarding ownership and collateralizing, and treatment for regulatory capital purposes. While there are far more questions than answers currently in this space, the AICPA is "DAWGing" (Digital Assets Working Group) the issues, and has published and is updating their **Accounting for and Auditing of Digital Assets Practice Aid**. The original group of Q&As was published in December 2019 and covered topics including classification, measurement, recognition, derecognition and third-party hosted wallets. The practice aid was updated October 2020 to add accounting questions on certain industry-specific topics (investment companies and broker-dealers), fair value considerations, and stable coins. Current topics under development include derivatives, crypto lending, and mining. The auditing content includes July 2020 and May 2021 topics covering client acceptance and continuance, risk assessment and processes and controls, and laws and regulations and related parties.

Other areas discussed by the panel included fraud implications and the focus on management controls. The nature of digital assets presents risks associated with misappropriation or misuse of digital assets, and it is important for the entity to have appropriate controls, some of which are unique to digital assets, in place. In some cases, auditors may not be able to obtain sufficient evidential matter from substantive procedures alone and may be required to test internal controls over digital assets during the audit. The evaluation of controls may include the controls outside of the entity if, for example, a third-party is used to having custody of the private key. Use of SOC reports by third-party custodians has been slow to develop, so understanding and testing controls there may be challenging.

The FASB staff acknowledged that their agenda consultation effort resulted in a clear demand for standard-setting in this area, while the SEC staff noted that generally these assets are currently being accounted for under an intangible asset model. In addition, the DAWG is continuing to identify and work through accounting and auditing issues in this space, so be sure to follow their work for future updates.

AUDITING MATTERS

PCAOB Standard-Setting Update

Barbara Vanich, PCAOB Acting Chief Auditor and Director of Professional Standards in the Office of the Chief Auditor discussed current standard-setting and research projects, which include an update on the Quality Control and Supervision of Audits Involving Other Auditors. The current Quality Control standards were adopted in 2003 and do not reflect relevant developments affecting audit and assurance practices and firms' quality control systems. A concept release was issued in 2019 to solicit stakeholder feedback on ways to modernize the standards, including the consideration of using the International Auditing and Assurance Standards Board's analogous firm-level quality control standard, International Standard on Quality Management 1, as a starting point for a future PCAOB quality control standard. The PCAOB staff is currently working on a proposed standard for board review.

As it relates to Supervision of Audits Involving Other Auditors, the PCAOB is evaluating ways to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors. In September 2021, the PCAOB issued a second request for comment on the proposed amendments to the related standards. The PCAOB received 19 comment letters and the staff will be working with the new board in 2022 for next steps.

Current research agenda topics include Data and Technology and Audit Evidence. The PCAOB staff recently issued **guidance** as it relates to the use of information obtained from external sources outside the company, specifically focused on the relevance and reliability of the evidence obtained. The PCAOB staff is also looking at how auditors are using technology and how technology is being used in the financial reporting process. In May 2020, the PCAOB issued a spotlight **publication**, providing an update on its Data and Technology Research Project. The PCAOB is also looking at AS

1105, Audit Evidence, AS 2315, Audit Sampling, and AS 2305, Substantive Analytical Procedures, to determine whether future amendments are needed.

The PCAOB staff also noted that they had not seen any themes in the adoption of Critical Audit Matters or the Estimates and Specialists standards that would require additional guidance to be provided. Once the new PCAOB board have all started their tenure (occurring over the next several weeks), they will look at the current standard-setting agenda to ensure that priorities align with the board and will modify the agenda if necessary.

PCAOB Inspections

George Botic, the Director of the Division of Registration and Inspections, provided an update on PCAOB inspections. The 2020 inspections (i.e., inspections conducted in 2021 of audits performed for the year ended in 2020) focused on the effects of the COVID-19 pandemic and audits selected for review were from industries that experienced significant disruptions or increased risk as a result of the pandemic and included, but was not limited to, entertainment and hospitality, retail, transportation, and commercial real estate.

In their 2020 inspections, there was an increase in the percentage of both random engagement selections and frequency of non-traditional focus areas for review such as cash. The five areas with the highest frequency of comment forms included business combinations, inventory, revenue, internal controls over financial reporting (ICFR), and the allowance for loan losses. The details of the PCAOB's inspection findings in these areas can be found in its publication, **Staff Update and Preview of 2020 Inspection Observations**. The PCAOB staff also highlighted their areas of focus for 2022 inspections (i.e., inspections of fiscal year 2021 audits) as it relates to audit risks currently being driven by the current economic environment. These include IPOs, merger and acquisition activities, widespread disruption in supply chains, negative effects from COVID-19 on certain industries, and a continued focus on audits of SPACs and de-SPAC transactions. In addition, in its broker-dealer inspections, the PCAOB will focus on audits of broker-dealers with responsibility for holding customer funds, maintaining custody of customer securities, and providing customer account statements.

Finally, as auditors prepare for year-end and the new year, Mr. Botic provided three key takeaways from this challenging year:

1. The continued importance of exercising due professional care and professional skepticism in all aspects of the audit. While both should be applied at all times, the continued disruption from the pandemic and the risks associated with the current economic climate only heighten their importance. Further, with continued remote audit environments and extensive use of virtual meetings with management, audit engagement teams should focus on their responsibility to ensure professional skepticism is being maintained and applied throughout all aspects of the audit.

2. The importance of performing a thorough and continuous risk assessment throughout the audit, including understanding a company's business and the impact of known and / or potential changes due to the current economic climate. As part of this continued assessment, it is important to reconsider the initial assessment of risks and modify planned audit procedures as circumstances evolve. Attention must also be given to ensure specific audit procedures are properly performed to address all identified risks of material misstatement.

3. A continued focus on fraud procedures and, in particular, how the auditor incorporates a degree of unpredictability in the audit that is new and different year over year.

Auditor Independence

The importance of auditor independence was another topic highlighted during several sessions throughout the conference. OCA representatives noted that monitoring and assuring auditor independence is the joint responsibility of the audit committee, management, and the auditor. They also discussed the SEC's recent targeted amendments to the independence requirements in Rule 2-01 of Regulation S-X (issued in October 2020 and effective in June 2021) that in part aligned certain rules between domestic registrants and foreign private issuers regarding the "look back period" for registration statements. These amendments appeared to offer some dispensation of non-audit services in the look back period. However, SEC staff iterated that the Commission views the text of Rule 2-01(b) of Regulation S-X together with the four guiding principles laid out in the Introductory Text of Rule 2-01 as a framework to be applied when considering matters that are not directly addressed in other parts of Rule 2-01. Therefore, regardless of the revisions to the "look back period," when considering non-audit services provided, auditors must also consider the general independence principles in the introductory text of Rule 2-01(b) of Regulation S-X. These principles require consideration of whether the non-audit service either:

a. creates a mutual or conflicting interest between the accountant and the audit client,

b. places the accountant in the position of auditing his or her own work,

c. results in the accountant acting as management or an employee of the audit client, or

d. places the accountant in a position of being an advocate for the audit client.

In applying the guiding principles, SEC staff also iterated that it has consistently provided the view that it would be a high hurdle to reach a conclusion that the accountant could be viewed as objective and impartial under the general standard when an auditor has provided services in any of the periods included in the filing that are contrary to one of these guiding principles. As a result, despite the revisions to the rules, an auditor may find itself not independent during the look back period.

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** or contact us at **assurance@dhg.com**.