Grant Thornton

New Developments Summary

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Highlights of the 2023 AICPA & CIMA Conference on Current SEC and PCAOB Developments

Clarity in financial reporting

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The AICPA & CIMA held the 2023 Conference on Current SEC and PCAOB Developments on December 4-6, featuring representatives from the AICPA, SEC, PCAOB, FASB, IASB, and Center for Audit Quality (CAQ), along with others from the accounting profession. Two recurring themes that were consistently highlighted by conference speakers and panelists include (1) the importance of stakeholder engagement in fostering environments for high-quality audits and financial reporting, and (2) the need for companies to provide transparent and informative disclosures to investors especially regarding the impacts of a rapidly changing economic environment.

This publication provides a summary of these themes and other topics highlighted at the conference, including new standards and rules; recent consultations; segment disclosures; non-GAAP financial measures; auditor independence; and a continuing increase in PCAOB inspection findings. Grant Thornton publications related to topics discussed are featured in Appendix A.

A. Conference overview

The AICPA & CIMA held the 2023 Conference on Current SEC and PCAOB Developments in Washington, D.C. on December 4-6, featuring representatives from regulatory and standard-setting bodies, as well as industry professionals, financial statement preparers, auditors, legal practitioners, decision-makers, thought leaders, and analysts. Speakers and panelists shared their views on current accounting, financial reporting, auditing, and other important and emerging topics. A perennial theme focused on by speakers and panelists was that stakeholder engagement is key to fostering environments for both high-quality audits and financial reporting. In addition, regulators and other speakers stressed that transparent and granular disclosures allow investors to make more meaningful investment decisions, particularly in a dynamic economic environment.

Remarks by SEC Chief Accountant

The conference featured a conversation with SEC Chief Accountant Paul Munter who emphasized the importance of complete and transparent financial statement disclosures. Mr. Munter stressed that financial reporting is not just a compliance exercise, but is also a communication exercise. He stated that stakeholders need to focus on how risks and uncertainties are properly communicated to investors, especially given the uncertainty in interest rates, exchange rates, supply chain disruptions, and geopolitical events, among other considerations, and noted that risk assessment is the start of the financial reporting process.

According to Mr. Munter, the accounting profession, collectively, must focus on high-quality financial reporting, including high-quality audits, which is vital to the capital markets. He said that a high-quality environment includes the development of high-quality standards, with stakeholder engagement being a critical element throughout both the audit and accounting standard-setting process. He noted that this trend is evidenced by the SEC's oversight of both the PCAOB and FASB standard-setting processes and its engagement with investors and their advocates, audit firms, registrants, and other stakeholders in standard-setting.

Mr. Munter also highlighted the importance of firm culture and auditor independence when striving for high-quality audits and reminded the audience that auditor independence is the responsibility of the entire firm, not just the audit practice. He further stated that professionalism should permeate throughout a firm's DNA, adding that a firm's culture and commitment to auditor independence must start at the top and cascade throughout the entire firm and into its global networks.

Remarks by PCAOB Chair

In her remarks, PCAOB Chair Erica Williams emphasized the important role auditors play in maintaining trust and confidence in the capital markets and noted that the auditors' work and investors' expectations must be aligned to maintain that trust. She stated that the capital markets depend on investors and that investors depend on auditors to apply due care and skepticism. Because the world has changed dramatically over the past 20 years, she noted that the PCAOB is updating and modernizing the interim standards that the Board adopted in 2003, in order to keep investors protected.

Ms. Williams stated that inspection deficiencies have continued to trend in the wrong direction for the second year in a row. She reminded auditors that quality control systems lay the foundation for quality audits, including the enforcement of a firm culture marked by honesty and integrity. The common deficiencies found in 2022 inspections are summarized in the Board's July 2023 Spotlight.

Lastly, Ms. Williams highlighted the significant increase in the amount of penalties imposed this year by the PCAOB, which have amounted to more than $20 million, and noted that the PCAOB will not hesitate to take action to hold wrongdoers accountable to protect investors. She noted that sanctions in the current year related to ethics violations, failures to detect or prevent improper answer-sharing on tests, failures to maintain independence from issuer clients, and improperly altering or backdating information.

CAQ update and resources

The CAQ staff reminded the audience that the Center helps the profession to promote audit quality through the issuance of comment letters on proposals from the SEC, PCAOB, IAASB, and other standard-setting bodies; the development of resources and thought leadership to educate stakeholders on emerging issues affecting the accounting profession, such as talent retention and the changing regulatory environment; and collaboration with stakeholders through various tasks forces. Given evolving technologies, economic uncertainties, regulatory changes, and talent shortages, the CAQ staff stressed that trust and audit quality remain a focus for both the profession and the CAQ. A CAQ panelist also reminded the audience about the resources available through the CAQ and the Anti-Fraud Collaboration, which focuses on culture, fraud risks, skepticism, and technology.

Accounting profession's focus on technology

A panel of chief accounting officers and controllers reflected on the rapid developments in technology and noted that data is at the core of technological advancement in the accounting profession, including the use of artificial intelligence. They emphasized the importance of developing an intentional data strategy, with a large focus on data security, in order to leverage emerging, powerful tools in financial reporting.

B. Accounting matters

Accounting standard-setting initiatives

Leaders from the FASB and IASB provided an overview of the objectives and agendas of their respective organization, as well as highlighted the current state of active projects.

FASB

In his remarks, FASB Chair Richard R. Jones stated that the FASB's top priority is to provide decision-useful information for investors and other users of the financial statements by focusing on disclosure standards that provide more granularity and disaggregated information. In addition, he said that the FASB will continue to consult with various stakeholders when deciding topics for its future technical agenda and plans to issue an agenda consultation in 2024. Mr. Jones noted that the last agenda consultation process, which was performed in 2021, resulted in the FASB reprioritizing items on its technical and research agendas.

FASB Technical Director and Chair of the Emerging Issues Task Force (EITF) Hillary Salo highlighted upcoming changes to the EITF process, which will allow the Task Force to control its own agenda and deliberate issues; currently, the FASB manages the EITF's agenda with input from the Task Force. The EITF will now issue a FASB agenda request with a proposed solution, which will then be considered by the FASB through its due process, including seeking comments on the proposed solution.

Ms. Salo and FASB Deputy Technical Director Helen Debbeler provided an update on the FASB's current technical agenda and reviewed the recently issued standard on segment reporting. They also discussed two upcoming ASUs on crypto assets and income tax disclosures. The ASU on crypto assets was issued subsequent to the conference, whereas the ASU on income tax disclosures is expected to be issued before the end of 2023.

IASB

IASB Vice-Chair Linda Mezon-Hutter discussed the Board's current priorities, including the proposed guidance in *Presentation and Disclosure in Financial Statements*, which is expected to be issued as final in the first half of 2024. The objective of the project is to improve how information is communicated in the financial statements and to enhance the financial statements' comparability. Based on tentative decisions, the new guidance will (1) require the presentation of two new defined subtotals for operating profit as well as for profit before financing and income taxes in the statement of profit or loss; (2) require the classification of all expenses within one of three required categories—operating, investing, or financing activities; (3) require disclosure of management-defined performance measures in the notes to the financial statements that must be reconciled to related totals or subtotals specified by IFRS; (4) enhance the requirements for aggregation and disaggregation to provide decision-useful information to investors; and (5) make limited changes to the statement of cash flows by specifying a consistent starting point when reporting cash flows from operating activities under the indirect method. Given the significance of these changes, the new requirements are expected to be effective as of January 1, 2027, with early adoption permitted.

Ms. Mezon-Hutter also summarized preliminary feedback received during the post-implementation review (PIR) of IFRS 15. Overall, stakeholders expressed that the standard improves the information provided to financial statement users about an entity's revenue from contracts with customers. Similar to the feedback received by the FASB, stakeholders opposed making fundamental changes to the core revenue model, despite certain application challenges that often require significant judgment, such as applying the principal versus agent guidance. Stakeholders also expressed support in maintaining the convergence of IFRS 15 with ASC 606.

During the SEC's Office of the Chief Accountant (OCA) panel, OCA staff highlighted additional international accounting developments, including the following:

- The IASB's PIR of IFRS 9, for which stakeholders' feedback was similar to that for the PIR of IFRS 15, indicating that the new requirements generally work well in practice. However, to address some findings during the PIR process, the IASB exposed certain narrow-scope amendments on (1) settling financial liabilities using an electronic payment system, and (2) assessing contractual cash flow characteristics of financial assets, including those with environmental, social, and governance (ESG)–linked features. The narrow-scope amendments project remains ongoing.
- The International Organization of Securities Commissions' (IOSCO) engagement with a diverse range of stakeholders on the significant challenges faced in accounting for goodwill. Those challenges include the application of significant judgment when determining the recoverable amount of a cash-generating unit in times of economic uncertainty as well as delayed impairment losses, sometimes due to overly optimistic projections, resulting in a "too little, too late" outcome for investors once an impairment is recognized. OCA staff stated that an IOSCO report is forthcoming with recommendations for registrants, audit committees, and external auditors that will facilitate the subsequent accounting for, and disclosure of useful information related to, goodwill.

OCA remarks

Statement of cash flows

In a recently issued statement, Mr. Munter emphasized that the statement of cash flows should be subject to due professional care, effective internal controls, and robust, high-quality audit procedures, similar to other components of a complete set of financial statements. In his statement, he emphasized that when evaluating the materiality of an error in the cash flow statement, including a classification error, an entity should perform an objective analysis from the perspective of a reasonable investor. Mr. Munter noted that the staff has historically rejected arguments that prior-period errors are not material errors because they are errors in classification only, and he pointed out that "classification itself is the foundation of the statement of cash flows." His statement also highlighted that issuers should consider enhancing disclosures about cash flows to facilitate an investor's understanding of the statement of cash flows and the financial statements as a whole. Toward that end, the statement encourages an issuer to (1) further disaggregate amounts reported in the cash flow statement, (2) provide additional information to understand the relationships between amounts reported in the cash flow statement and those reported in the statement of financial position, and (3) disclose major classes of gross cash receipts and payments, including cash collected from customers, cash paid to employees, and cash paid to suppliers. In addition, he noted that entities must supplement the statement of cash flows with the disclosure of noncash investing and financing activities to facilitate an investor's understanding of how these activities affect recognized assets or liabilities, even when there are no resulting cash receipts or payments during the period. Issuers should also consider whether reporting operating cash flows using the direct method would better serve investors, he added.

Mr. Munter in his statement and Ms. Salo highlighted the statement of cash flows project recently added to the FASB's technical agenda. This project will focus on targeted improvements to the statement of cash flows for financial institutions. The FASB also has a project on its research agenda to explore further potential improvements to the statement of cash flows. Ms. Salo encouraged stakeholders to engage with the FASB on both of these projects.

Accounting for backstop agreements related to SPAC mergers

OCA staff reported that it continues to receive accounting questions related to special purpose acquisition companies (SPACs), including questions about the accounting for various financing arrangements designed to help SPACs manage equity redemption requests preceding a business combination. SPACs permit public shareholders to redeem their shares prior to closing a business combination, and a significant amount of shareholder redemption requests preceding a proposed acquisition may require the SPAC to liquidate rather than close the acquisition. SPACs employ various financing arrangements to avoid liquidation and to ensure that a business combination closes, some of which are referred to as "backstop agreements."

OCA staff described a fact pattern where a SPAC registrant's shareholders, who intended to redeem their shares ahead of a proposed business combination, were instead directed to sell their shares to a third-party financing entity. Shortly after the business combination closed, the registrant transferred cash into an escrow account controlled by the financing entity in an amount equal to the amount the financing entity paid to acquire the shares. For any shares sold by the financing entity into the public market during the term of the agreement, the financing entity transferred cash to the registrant equal to the amount the financing entity paid to acquire those shares. At the end of the agreement's term, the financing entity

transferred all of the remaining shares to the registrant, and to provide the financing entity with a minimum return on those shares, the registrant paid a cash fee to the financing entity based on the number of shares transferred.

OCA staff objected to the registrant's proposal to account for this arrangement as an asset under ASC 480. The registrant initially measured the arrangement at an amount equal to the cash it paid to fund the escrow account, and then adjusted that amount to reflect the fair value adjustment related to the financing entity's option to remit to the registrant either shares or cash over the term of the contract. In the staff's view, the substance of the registrant's initial payment is a subscription receivable, which the registrant should present in equity according to S-X Rule 5-02. The staff did not provide a view on subsequent accounting for the arrangement, but suggested that the registrant consider relevant guidance in other Codification Topics, including ASC 815. The staff noted that backstop and other similar arrangements have a variety of terms and conditions, and that registrants entering into such arrangements should consider consulting with OCA staff.

Fair value measurements and disclosures

OCA staff addressed several issues related to the application of the fair value measurement guidance in ASC 820.

Fair value of crypto assets

The staff noted that the guidance in the FASB's ASU on accounting for crypto assets will require entities to subsequently measure crypto assets at fair value in accordance with ASC 820. While ASC 820 does not specifically address the measurement of crypto assets, it does include guidance that may be helpful for crypto asset holders on (1) transactions with related parties, (2) assets with low trading volume, (3) identification of non-orderly transactions, and (4) use of quoted prices from third parties.

In addition, ASC 820 includes guidance on identifying the principal or most advantageous market for an asset, and specifies that, absent contrary evidence, the principal or most advantageous market is the market an entity would normally access to sell an asset. Identifying the principal or most advantageous market is important because it allows an entity to identify market participants from whose perspective fair value must be measured under ASC 820. Identifying the principal or most advantageous market may be particularly challenging for entities measuring the fair value of crypto assets due to the rapidly changing landscape for trading crypto assets. The staff stated that entities should keep in mind that facts and circumstances relevant to identifying the principal or most advantageous market might change over time and could differ based on the type of crypto asset being measured and the entity holding the asset.

Fair value of collateral-dependent loans

The staff addressed measuring fair value in connection with accounting for loans and the related allowance for credit losses. Under ASC 326-20, an entity may elect a practical expedient and, in some cases, be required to measure certain collateral-dependent loans based on the fair value of the collateral, as determined in accordance with ASC 820. The staff reminded entities to make reasonable and appropriate judgments in this area, noting that in the current economic environment, measuring the fair value of collateral may be particularly challenging due to limited liquidity in markets for certain types of assets, such as commercial real estate.

Appropriate valuation techniques

The staff emphasized the importance of identifying and consistently using an appropriate valuation technique when measuring fair value. The appropriate valuation technique depends on the type of asset being measured and on both the availability and reliability of the measurement inputs. Since ASC 820 requires entities to measure fair value from a market participant's perspective, entities should (1) understand what information a market participant in the entity's principal or most advantageous market has access to, and (2) maximize the use of observable inputs when measuring fair value under ASC 820.

Calibration of valuation techniques

The staff reminded the audience of the requirements of ASC 820 if both (1) an entity plans to utilize, for purposes of the subsequent measurement of an asset or liability, a valuation technique that uses unobservable inputs, and (2) the transaction price for that asset or liability is fair value upon initial recognition. In such circumstances, ASC 820 requires an entity to calibrate the valuation technique so that upon initial recognition, the result of the valuation technique is the transaction price.

Fair value disclosures

The staff emphasized the importance of disclosing the necessary amount of detailed information about fair value measurements that rely on unobservable inputs. Registrants should consider the critical accounting estimates disclosure requirements in S-K Item 303, which involve a significant amount of estimation uncertainty and either have, or are likely to have, a material impact on a registrant's financial condition or its results of operations. Critical accounting estimate disclosures related to fair value measurements should help financial statement users understand management's judgments used to measure fair value and how those judgments affect the measurement.

Scope of investment company guidance in ASC 946

OCA staff explained that they continue to receive questions about whether applying the investment company accounting guidance in ASC 946 is appropriate for funds that invest in nonfinancial assets.

In one fact pattern, the staff objected to the application of ASC 946 by a real estate fund. While no single factor was determinative in the objection, the staff noted that ASC 946-10-15-6, which describes an investment company's fundamental characteristics, specifies that an investment company "commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both." In this case, the fund's substantive activities included construction, development, and property management, all of which contributed to the fund's returns in addition to capital appreciation.

Further, the staff explained that one of the fund's investors was an investment adviser who, through its wholly owned subsidiaries, performed construction, development, and property management activities that were indistinguishable from those activities performed by the fund. Additionally, the investment adviser provided a guarantee to protect the fund's other investor from downside risk associated with the construction, development, and property management activities.

Deferred offering costs

According to SEC Staff Accounting Bulletin (SAB) Topic 5.A, *Expenses of Offerings*, a reporting entity may defer specific incremental costs directly attributable to a proposed equity securities offering (which are referred to as "deferred offering costs") and charge those costs against the gross proceeds of the

offering once the offering is completed. General administrative and management salary expenses are not eligible to be treated as deferred offering costs.

OCA staff objected to a registrant's proposal to defer costs incurred to initially prepare and audit its financial statements, which the registrant viewed as incremental costs incurred for the sole purpose of pursuing an IPO. While audited financial statements are necessary to pursue an IPO, the staff explained, entities may obtain audited financial statements for various other reasons; therefore, the costs incurred to prepare and audit financial statements are not directly attributable to a planned equity offering.

Contingency disclosures

OCA staff referred the audience to a recent administrative action filed by the SEC against a registrant for its alleged failure to disclose information required by ASC 450 related to a regulatory dispute. The staff noted its continuous work with the SEC's Division of Enforcement on contingency accounting and other financial reporting matters.

C. SEC compliance and reporting

SEC rulemaking and initiatives

During the SEC's Division of Corporation Finance (CorpFin) panel, CorpFin Director Erik Gerding mentioned the importance of the staff's engagement with registrants and other stakeholders to provide views and compliance guidance, especially on new rules. He echoed that the staff and the public have the same mission—that investors have the information needed to make informed investment and voting decisions.

Mr. Gerding stated that the staff continuously thinks about the challenges registrants are facing, what information investors need, and how the existing disclosure rules apply to new and emerging risks, such as inflation and other macroeconomic events. He reminded stakeholders that disclosures about these emerging risks need to be tailored to a registrant's specific circumstances in order to be meaningful to investors.

Observations regarding rulemaking

Cybersecurity

Mr. Gerding provided a summary of the SEC's cybersecurity final rule and reminded the audience that the provisions take effect later this month. In particular, the final rule's periodic reporting disclosures are required for registrants beginning with annual reports for fiscal years ended on or after December 15, 2023. Registrants other than smaller reporting companies (SRCs) are required to provide current reporting disclosures on Form 8-K about material cybersecurity incidents beginning on December 18, 2023. SRCs are required to comply with the current reporting requirements beginning on June 15, 2024.

He highlighted that some stakeholders were concerned that the proposal required too much detail about a cybersecurity incident and that those details could be used against companies by the bad actors who are threatening such cyberattacks. In response, the final rule included more streamlined disclosures based on materiality. He also noted that the current reporting for a material cybersecurity incident on Form 8-K is required within four business days of the materiality determination, rather than four business days after the incident occurs. He reminded the audience that the materiality determination is consistent with the

Supreme Court's definition of *materiality* and the SEC staff's views in SAB Topic 1.M, *Materiality* (also referred to as SAB 99). Mr. Gerding also emphasized that the final rule does not dictate the risk management practices that a registrant needs to implement. Rather, he noted that the objective of the requirements is to make sure that investors have sufficient information to evaluate a registrant's risk management processes in order to make their investment decisions.

Lastly, he stated that organizations need to have cross-functional teams focused on cybersecurity, risk management, and financial reporting.

Pay versus performance

CorpFin staff reminded registrants of the implementation guidance related to pay versus performance disclosures recently added to the Compliance and Disclosure Interpretations (C&DIs) section titled *Regulation S-K*. During the course of filing reviews, the staff observed that registrants have generally made a good faith effort in complying with the disclosure requirements. The staff also shared the following observations to assist registrants in improving disclosures in future filings:

- Disclosures describing the relationship between compensation actually paid and the company's performance should not be omitted either in part or in their entirety. Further, in the filings reviewed, the staff found the graphic presentation of such relationship to be more effective and useful than narrative disclosures.
- The company-selected performance measure (that is, a financial performance measure specified by the registrant that is linked to compensation paid) needs to be consistent with the requirements in S-K Item 402(v). Further, if the company-selected performance measure is a non-GAAP financial measure, the registrant needs to describe in the proxy the computation of such measure; simply referring to Form 10-K or other SEC filings for such computation is not sufficient.
- The tabular list of financial performance measures used by registrants to link compensation actually paid needs to be consistent with other executive compensation disclosures, including compensation discussion and analysis.
- Transparent disclosures are required when there are material changes to the valuation assumptions used to compute compensation actually paid compared to those disclosed at the time of the grant.
- Pay versus performance disclosures are required to be tagged in XBRL.

Clawback of erroneously paid executive compensation

The SEC's clawback final rule requires listed issuers to check a box on the cover page of their annual report to indicate whether (1) the financial statements included in the annual report reflect a correction of an error to previously issued financial statements, and (2) the corrections are restatements that triggered a recovery analysis. CorpFin Chief Accountant Lindsay McCord clarified that any revision to the previously issued financial statements, including the related footnotes, to correct an error as defined in ASC 250, requires the registrant to check the first box.

She also reminded the audience that the first box must be checked even if the registrant voluntarily corrects an immaterial error by revising prior-period financial statements and had the option to correct the error as an out-of-period adjustment. She clarified that out-of-period adjustments recorded in the current

period would not result in a change to previously issued financial statements, in which case, the registrant would not need to check the first box. In addition, Ms. McCord noted that the first checkbox should not be marked for a retrospective adjustment to previously issued financial statements for a change in accounting principle or for the disaggregation of financial statement line items.

Other 2023 SEC final rules

- *Prohibitions Against Conflicts of Interest in Certain Securitizations* – Compliance with this final rule will be required for any asset-backed securities of which the first sale closes 18 months after the final rule is published in the *Federal Register.*
- *Share Repurchase Disclosure Modernization* – On November 22, the SEC issued an order postponing the effective date of this final rule, which is stayed pending further action by the SEC.
- *Modernization of Beneficial Ownership* – Compliance with the shortened Schedule 13D filing deadlines under this final rule begins February 5, 2024, while compliance with the revised Schedule 13G filing deadlines begins September 30, 2024.

For a summary of planned future rulemaking, refer to the SEC's Regulatory Flexibility Agenda.

Filing review observations

CorpFin staff noted a significant increase in the volume of comment letters on Forms 10-K and 10-Q issued since 2021. The staff indicated that the most commented areas in filing reviews continue to be (1) information provided in Management's Discussion and Analysis (MD&A), (2) non-GAAP financial measures, (3) segment reporting, and (4) revenue recognition. The staff further reminded the audience that it looks at all information available in the public domain when reviewing filings.

Management's Discussion and Analysis and risk disclosures

Mary Beth Breslin, CorpFin Industry Office Chief of the Office of Real Estate & Construction, and Kevin Woody, CorpFin Accounting Branch Chief of the Office of Manufacturing, discussed comments in recent areas of focus, including MD&A, risk factors, and market risks disclosures.

Mr. Woody noted that the overall principle of the critical accounting estimates disclosure is to provide both qualitative and quantitative information that is necessary for a financial statement user to understand both the estimation uncertainty and the impact that the estimate either has had, or is reasonably likely to have, on a registrant's financial condition and its results of operations. When the estimates are material and reasonably available, he noted, the disclosure should also include the method and significant assumptions used to assess critical accounting estimates, the degree to which the estimate and the underlying significant assumptions have changed over the period or since the last assessment, and the sensitivity of the reported amount to the method and assumptions underlying the estimate. He stressed that the repetition of significant accounting policies in MD&A is not sufficient to meet the underlying disclosure requirements in Regulation S-K as it relates to critical accounting estimates. A panelist further noted that it is key to disclose the driver of change throughout the results of operations, and not just the math and the percentage change, in order to draw out information that is useful to investors.

Panelists encouraged registrants to avoid boilerplate disclosures, particularly within MD&A and risk factors. Mr. Woody said registrants should focus on providing clear and specific risks disclosures when describing the impact of global events, such as inflation. Ms. Breslin also pointed out that interest-rate risk is a commonly disclosed market risk that is particularly prevalent in the current environment. She encouraged registrants to consider the interest-rate sensitivity analysis disclosure option, which requires registrants to provide a description of the model along with the assumptions and the parameters that are necessary to fully understand the disclosure. CorpFin staff believes that the disclosure of the inputs and assumptions provides useful information to investors, particularly when assessed on a recurring basis and when evaluating changes.

The FASB's Ms. Salo reminded the audience during a Q&A session about the guidance in ASU 2022-04 for buyers using supplier finance arrangements in connection with purchases of goods and services. She emphasized that the required disclosures provide greater transparency for investors regarding the use of these programs and their related impact on liquidity. Therefore, registrants should consider including relevant impacts in the MD&A, which requires a discussion of liquidity and capital resources.

Non-GAAP financial measures

CorpFin Deputy Chief Accountant Sarah Lowe highlighted non-GAAP financial measures, which investors and analysts are increasingly relying on, as a continuing area of focus in filing reviews, as well as the potential for such measures to be misleading in the absence of a comprehensive basis of accounting.

Ms. Lowe reminded registrants that in 2022, CorpFin staff updated its C&DI, *Non-GAAP Financial Measures,* and stated that a measure that excludes normal recurring operating expenses could be misleading. She also reiterated that in determining what constitutes a normal, operating expense, the staff considers how the expense relates to the company's operations, revenue-generating activities, business strategy, industry, and regulatory environment. Further, she reminded registrants that operating expenses that occur repeatedly or occasionally, including at irregular intervals, are considered to be recurring expenses. Ms. Lowe also shared examples of certain adjustments to performance measures that the staff might comment on when they appear to be normal recurring operating expenses, including increases in allowances for receivables and inventory, startup costs, and losses on purchase commitments. In addition, Ms. Lowe reminded registrants that opening new locations or stores are often a part of a registrant's normal operations and strategy for revenue growth and are therefore considered to be recurring expenses.

She also emphasized that non-GAAP financial measures that change the recognition and measurement principles under U.S. GAAP may be misleading. One example includes presenting revenue on a net basis after deducting transaction costs, when GAAP requires revenue to be recognized on a gross basis.

Ms. Lowe encouraged registrants to make sure that each adjustment from a financial measure specified under U.S. GAAP to arrive at a non-GAAP financial measure is appropriately labeled and that the accompanying disclosures are sufficiently transparent so that investors can understand the nature of the non-GAAP financial measure and why the adjustments are being made to the most directly comparable U.S. GAAP financial measure.

Enforcement update

At the conference, the staff of SEC's Division of Enforcement discussed recent actions related to non-GAAP financial measures and cybersecurity disclosures and reminded registrants to provide true, complete, and accurate disclosures to investors in all material respects. The staff further noted that information communicated externally to investors should be consistent with information discussed internally.

Segments

More than one measure of segment profit or loss

The FASB recently issued ASU 2023-07 to expand the disclosures for reportable segments made by public entities. Under the amendments in the ASU, if the chief operating decision maker (CODM) regularly reviews more than one measure of segment profit or loss to evaluate segment performance and allocate resources, a public entity is required to disclose the measure of segment profit or loss that is most consistent with U.S. GAAP. The entity is also permitted, but not required, to disclose one or more additional measures of segment profitability that are regularly reviewed by the CODM. An entity is required to reconcile each disclosed measure to the entity's consolidated income before income taxes and discontinued operations.

CorpFin's Ms. McCord emphasized that registrants are permitted, but not required, to disclose these additional measures of segment profitability and that, pursuant to Item 10(e)(5) of Regulation S-K, these measures are considered to be non-GAAP financial measures if they are not computed in accordance with U.S. GAAP. Ms. McCord reminded registrants to make sure that such measures comply with the requirements of Regulation G and are not misleading. Further, registrants are expected to provide additional disclosures required for non-GAAP financial measures by S-K Item 10(e) in their filings. Registrants that intend to early adopt the amendments in ASU 2023-07 and to disclose such additional measures were encouraged to consult with CorpFin's OCA staff.

Grant Thornton insight

The rules do not specify where to present the disclosures required by S-K Item 10(e) when the annual or interim financial statements include a non-GAAP financial measure. Given that the disclosure requirements are described in Regulation S-K, we would expect to see these disclosures outside the annual or interim financial statements, and likely within the MD&A.

CorpFin Deputy Chief Accountant Melissa Rocha shared the staff's views on what constitutes "regularly provided" or "regularly reviewed" in the context of determining operating segments and the information that must be disclosed under ASC 280. The staff clarified that, ordinarily, information provided to or reviewed by the CODM on a quarterly basis constitutes "regularly" provided or reviewed. However, Ms. Rocha cautioned that information reviewed less frequently may still constitute "regularly reviewed," based on individual facts and circumstances.

Entity with a single reportable segment

The amendments in ASU 2023-07 also require a public entity with a single reportable segment to provide all required segment disclosures in its financial statements for both interim and annual periods. The guidance notes that a public entity's single operating segment may constitute less than all of the total consolidated entity if, for example, the entity has a corporate headquarters or functional departments that are neither part of the operating segment nor are regularly reviewed by the CODM. Alternatively, an operating segment may constitute the entirety of the consolidated entity.

When a reporting entity has a single reportable segment that is made of the entire consolidated entity, OCA staff shared its expectation that the measure of profit or loss regularly reviewed by the CODM and prepared in accordance with U.S. GAAP would be net income. The staff noted that this is because the CODM would be expected to also review the quarterly consolidated U.S. GAAP financial statements. A public entity intending to early adopt the amendments in ASU 2023-07 that reaches a different conclusion is encouraged to consult with OCA staff.

Other disclosures

The guidance in both ASC 280 and IFRS 8 requires the disclosure of revenues from external customers if such amounts are included in the measure of segment profit or loss reviewed by the CODM or are otherwise regularly provided to the CODM, even if they are not included in that measure of segment profit or loss. Ms. Rocha reminded registrants that the substitution of such amounts with segment revenue computed on a basis that is inconsistent with the measurement and recognition principles under U.S. GAAP or IFRS, as applicable, is not acceptable. She also shared an example where, in lieu of revenues from external customers, a registrant provided segment revenue that included adjustments to add back certain amounts to revenue determined based on applicable accounting standards. In that fact pattern, the staff objected to the registrant's presentation and required it to revise the disclosure.

Ms. Rocha also reminded registrants to provide transition disclosures related to adoption of ASU 2023-07 that are required by SAB Topic 11.M, *Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant when Adopted in a Future Period* (also referred to as SAB 74).

Waiver requests to omit or substitute financial statements in an acquisition

Senior Adviser to CorpFin Chief Accountant Craig Olinger noted that relief requests continue to trend downward since the implementation of the 2020 Final Rule; however, the staff is seeing more complex fact patterns with multiple considerations. Mr. Olinger emphasized that the staff evaluates the "total mix" of information related to the registrant and transaction in order to determine whether or not relief should be granted.

S-X Rule 3-13 waiver request best practices

Mr. Olinger provided insights into best practices for registrants submitting an S-X Rule 3-13 waiver request in relation to a business acquisition:

- Make the initial request as complete as possible by including all relevant facts, circumstances, and analysis. Pertinent details may include the purpose of the transaction, expected impact on the registrant, structure of the transaction, whether the acquiree is under common control, the nature of the operations, how those assets are being valued, and how the assets relate to the historical

results of the acquiree. Incomplete requests will result in follow-up questions and may delay the process.

- Provide results of all significance tests, including the inputs to the significance calculation, when the calculation is not clearly evident.
- Explain why the significance test results are anomalous.
- Outline the proposed disclosures the registrant will provide to investors in lieu of the required financial statements.

Measuring significance of acquired businesses

Mr. Olinger shared the following reminders for computing the significance of acquired businesses, real estate operations, and equity method investees, as applicable:

- Amounts used in the numerator of the significance tests must be determined in accordance with the same comprehensive basis of accounting (U.S. GAAP or IFRS) that is being used by the registrant. However, the acquiree's financial statements used for significance tests may be unaudited.
- For the investment test, the numerator should include the entire consideration transferred, including contingent consideration as described in S-X Rule 1-02(w). Acquisition-related costs should also be included if required to be capitalized by U.S. GAAP or IFRS.
- The aggregate worldwide market value of the registrant's voting and nonvoting common equity may be determined based on a foreign market if that market is the principal market where the equity is traded. Further, the denominator would not include classes of securities that are not traded, even if they are convertible to a class of common equity that is traded.

Mr. Olinger also reminded registrants that the definition of a *business* under U.S. GAAP or IFRS differs from the definition of a business in S-X Rule 11-01(d). Accordingly, he noted that an acquisition accounted for as an asset acquisition under U.S. GAAP or IFRS may still qualify as a business under Regulation S-X.

Real estate operations

Mr. Olinger reminded the audience that S-X Rule 3-14 applies to an acquired or to be acquired business when that business is a real estate operation that generates substantially all of its revenues through the leasing of real property. If the business also collects other revenues, such as revenue from hotels and golf courses, he noted that S-X Rule 3-05 would apply to the acquisition. When a company is acquiring a real estate operation that is off-lease at the time of the transaction, Mr. Olinger stated that the determination of whether substantially all of its revenues are through leasing activities depends on the facts and circumstances of the off-lease property, such as the rental history and how long the property has been off-lease.

Pro forma financial information

Mr. Olinger discussed the treatment of costs incurred by a registrant after a business combination that are not related to the completion of the acquisition, such as costs to change the intellectual property systems of a target, when preparing pro forma financial information pursuant to S-X Article 11. He noted that these

types of costs would most likely be treated as management adjustments, as defined in Article 11, which may be disclosed in the explanatory notes to the pro forma financial information, but not on the face of the pro forma statements.

Environmental, social, and governance reporting

Panelists throughout the conference discussed ESG reporting and rulemaking from the perspective of financial statement preparers, auditors, and investors. They also shared activities that preparers are taking to implement the Corporate Sustainability Reporting Directive and California's climate reporting and carbon market disclosure bills. Stakeholders are still awaiting the SEC's final rule on climate change disclosure, which is expected in spring 2024, according to the SEC's Regulatory Flexibility Agenda.

What's more, preparers noted that they are applying more rigor to the ESG information used to create disclosures and are integrating this ESG information into their financial reporting systems and processes. Supplemental guidance from the Committee of Sponsoring Organizations of the Treadway Commission was recently issued that illustrates how preparers can achieve effective internal control over sustainability reporting.

D. Audit and corporate governance

PCAOB standard-setting update

PCAOB Chief Auditor Barbara Vanich provided a standard-setting update for the PCAOB, focusing on the Board's recently proposed standards along with what to expect in 2024. In addition to finalizing a new auditing standard addressing the auditor's use of confirmations in 2023, the Board issued proposals relating to the auditor's general responsibilities in conducting an audit, the auditor's consideration of noncompliance with laws and regulations, and the auditor's use of technology-assisted analysis in performing audit procedures. Looking ahead to 2024, Ms. Vanich expects that the Board will approve a final standard on a firm's system of quality control and anticipates proposals related to going concern, substantive analytical procedures, and the attestation standards.

Ms. Vanich also highlighted that, based on feedback from the PCAOB's Investor Advisory Group, a new project was added to the Board's research agenda to consider why there has been a decrease in the average number of critical audit matters (CAMs) reported in auditors' reports and whether amendments to the definition of, and requirements for, CAMs are needed to be more responsive to investor needs.

The current standard-setting, research, and rulemaking agendas can be found here.

Audit quality and professional skepticism

Mr. Munter and OCA staff provided their views on audit quality as well as areas in need of attention for the upcoming audit cycle. In particular, the staff stressed the iterative nature of audit risk assessment and how risks may evolve over time. While an auditor is required to exercise professional skepticism when performing a risk assessment, the staff discussed the need for appropriate professional skepticism throughout the audit. Auditors were encouraged to remain alert to changes at the company and to understand, and possibly even challenge, how management responds to such changes. During her standard-setting update, Ms. Vanich also highlighted the potential need for changes in the auditor's

planned response to identified risks, stating that active involvement by audit committees could reduce barriers related to auditors' professional skepticism. This includes reinforcing the audit committee's support for the auditor to exercise professional skepticism as well as conducting open discussions with the auditor without management present.

Auditor independence

OCA staff highlighted independence consultations on the application of the (1) SEC's business relationship rule in S-X Rule 2-01(c)(3), and (2) the audit exception in S-X Rule 2-01(c)(4) stated in Question 3 in the SEC's FAQs Section E, "Non-audit services," as discussed below:

1. OCA staff noted that the rapid increase in accounting firms' service offerings and the complexity of business relationships requires auditors to perform a thorough evaluation to conclude on their independence. The staff advised auditors, registrants, and audit committees to consider the intent of a transaction when considering whether exceptions apply under the business relationship rule for professional services and vendor relationships in the ordinary course of business.
2. OCA staff cautioned auditors from taking a narrow view when evaluating whether services would be subject to audit. The staff encouraged auditors to consider all aspects of nonaudit services, their potential effects on the audit, and any ongoing consequences of the services to ensure that an objective and impartial evaluation is performed. The staff also reminded auditors that robust monitoring should be in place to safeguard against scope creep and the impairment of independence, and that materiality is not a factor when evaluating independence.

Further, OCA staff provided reminders on the audit committee preapproval requirements, particularly with respect to the audit to address questions raised on the level of work needed to prepare sufficient fee quotes to have the discussions necessary to obtain audit committee preapproval. The staff stated that auditors should have sufficient information to determine fee estimates for the next year's audit without embarking on audit procedures since the requirements prohibit commencing audit procedures in advance of obtaining audit committee preapproval.

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Appendix A

Grant Thornton publications

SEC Final Rules

- Snapshot 2022-13, "SEC enhances executive compensation disclosures"
- Snapshot 2022-15, "'Clawback' of executive compensation Final Rule adopted"
- Snapshot 2022-16, "Pay versus performance: Compensation 'actually paid'"
- Snapshot 2023-08, "SEC enhances cybersecurity disclosures"

Other SEC staff guidance

- Snapshot 2022-20, "CorpFin updates its non-GAAP financial measures guidance"
- Snapshot 2023-04, "SEC staff statement on lead auditor's responsibilities"

Accounting

- NDS 2023-02, "Israel-Hamas War: Accounting and financial reporting considerations"

Environmental, social, and governance reporting

- Snapshot 2022-19, "Impact of CSRD on non-EU entities"
- Snapshot 2023-11, "California climate reporting bills"
- Snapshot 2023-12, "California voluntary carbon market disclosure act"

Contacts

Kendra Decker
National Managing Partner of Professional Practice
Audit Services
T +1 202 521 1530
E Kendra.Decker@us.gt.com

Jennifer Cavanaugh
Chief Auditor
T +1 312 602 8715
E Jennifer.Cavanaugh@us.gt.com

Graham Dyer
Chief Accountant
Accounting Principles Group
T +1 312 602 8107
E Graham.Dyer@us.gt.com