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Audit Committee Quarterly Update

THIRD QUARTER 2022

In this newsletter, we highlight some important 2022 third quarter issues facing audit committees. The content is not all-inclusive. You may also be interested in our quarterly publication that summarizes accounting, financial reporting, and regulatory matters that may impact both public and private companies.

SEC amends whistleblower rules

In August 2022, the SEC adopted **two amendments** to the rules governing its whistleblower program. The amendments allow the SEC to pay whistleblowers for their information and assistance in connection with non-SEC actions in additional circumstances, and affirm the SEC's authority to consider the dollar amount of a potential award for the limited purpose of increasing an award but not to lower the amount.

SEC adopts pay versus performance disclosure rules

In August 2022, the SEC adopted **amendments** to its rules to require registrants to disclose information reflecting the relationship between executive compensation actually paid by a registrant and the registrant's financial performance. The rules implement a requirement mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The amendments require registrants to provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years. With respect to the measures of performance, a registrant will be required to report its total shareholder return (TSR), the TSR of companies in the registrant's peer group, its net income, and a financial performance measure chosen by the registrant. Then, using the information in the table, registrants will be required to describe the relationships between the executive compensation actually paid and each of the performance measures, as well as the relationship between the registrant's TSR and the TSR of its selected peer group. A registrant will also be required to provide a list of three to seven financial performance measures that it determines are its most important performance measures for linking executive compensation actually paid to company performance. Smaller reporting companies will be subject to scaled disclosure requirements under the rules.

Registrants must begin to comply with the new disclosure requirements in proxy and information statements that are required to include Item 402 executive compensation disclosure for fiscal years ending on or after Dec. 16, 2022.

Climate-related disclosures

The SEC's proposed rule changes that would require registrants to include **certain climate-related disclosures** in their registration statements and annual reports were discussed in the prior quarters' updates, and the SEC is expected to issue final rules in the fourth quarter 2022.

Meanwhile, the SEC has issued comment letters to registrants regarding climate disclosures required under existing disclosure rules.

PCAOB releases 2022 audit committee resource

In August 2022, the PCAOB released a new publication, **"Spotlight: Audit Committee Resource."** The Spotlight serves as a timely reference for auditors, audit committee members, investors, and others, and includes questions that audit committees of public companies might want to consider as part of their ongoing engagement and discussion with their auditors. Questions include how the auditors are responding to the financial reporting and audit risks posed by the current economic environment. We also encourage management to consider the Spotlight in preparing financial statements and disclosures and in communications with the audit committee.

Topics covered in the publication include:

- Fraud and other risks
- IPOs and mergers and acquisitions
- Audit execution
- Audit firms' quality control systems
- Compliance with auditor independence requirements
- Technology (auditing digital assets, responding to cyberthreats, and use of data and technology in the audit)

Impacts of inflation and rising interest rates on financial reporting

While most audit committee members are familiar with the impact that inflation and rising interest rates are having on company operations, it is also important to consider the financial reporting implications. We encourage audit committees to discuss these potential issues and discuss the reporting impacts with management.

Inflation

In addition to the impact inflation has on costs, companies also must take into account expectations of future inflation when they are required to use projected financial information. When developing projected financial information, those projections will need to take into account estimates of whether and how inflation will persist into the future. Some common areas where projected financial information is required to be used include:

- Goodwill impairment
- Long-lived asset impairment
- Loan or investment impairment
- Going concern assessments
- Valuations of assets acquired and liabilities assumed in a business combination or asset acquisition
- Fair value measurements of derivatives and other financial instruments
- Fair value measurements of share-based payment arrangements
- Realization of deferred tax assets
- Any other valuations that rely on financial projections

In some instances where there is significant uncertainty around the anticipated level of future inflation, entities may need to develop projections for multiple scenarios and weigh those scenarios by likelihood to account for the uncertainty.

Interest rates

Many companies have been impacted by the rising interest rates and the resulting increased borrowing costs and interest expense. In addition to these direct impacts, rising interest rates can also impact financial reporting by causing an increase in discount rates, which are a significant input into discounted cash flow models. Common areas where discounted cash flow models can affect financial reporting include:

- Goodwill impairment
- Long-lived asset impairment
- Calculation of lease liabilities and right-of-use assets
- Valuation of investments
- Valuations of intangible assets
- Valuation of share-based payment arrangements
- Valuations of debt and equity securities

The impact of increasing discount rates is a corresponding decrease in many valuations. As a result, more companies may be required to evaluate potential asset impairments in 2022 resulting from these potential declines in asset valuations.

Inflation Reduction Act

President Joe Biden signed the **Inflation Reduction Act of 2022** (Act) into law on Aug. 16, 2022. A summary and discussion of the key provisions is included in a Plante Moran article, **Congress completes reconciliation bill with key tax changes.**

The Act has potential accounting and financial reporting implications for provisions related to a new corporate minimum tax rate, public company excise tax on stock buybacks and various tax credits and incentives for clean energy technologies. We encourage management and audit committees to become familiar with the Act and assess the potential impacts.