



Audit Committee Quarterly Update

FOURTH QUARTER 2022

In this newsletter, we highlight some important 2022 fourth 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 chief accountant discusses auditor's responsibility for fraud detection

In October 2022, SEC Acting Chief Accountant Paul Munter made a **statement** regarding the auditor's responsibility for fraud detection. He stated that "... independent auditors play an important gatekeeper role in supporting high-quality financial reporting and the protection of investors. A critical aspect of this role is an independent auditor's responsibilities with respect to fraud detection during the financial statement audit, or, in other words, the auditor's use of the fraud lens."

Mr. Munter’s statement addressed:

- The auditor’s responsibilities with respect to fraud, including observations of some auditor shortcomings.
- How the auditor’s responsibilities are incorporated currently in the PCAOB standards, including the PCAOB’s quality control standards.
- Reminders on good practices.

Compensation recovery listing standards and disclosure rules

In October 2022, the SEC adopted **rules** to require securities exchanges to adopt listing standards that require issuers to develop and implement a policy providing for the recovery of erroneously awarded incentive-based compensation received by current or former executive officers. The final rules require a listed issuer to file the policy as an exhibit to its annual report and to include disclosures related to its recovery policy and recovery analysis where a recovery is triggered.

The new rules implement Section 10D of the Securities Exchange Act of 1934, a provision added by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

New Exchange Act Rule 10D-1 directs national securities exchanges and associations to establish listing standards that require a listed issuer to:

- Adopt and comply with a written policy for the recovery of erroneously awarded incentive-based compensation received by its current or former executive officers in the event it is required to prepare an accounting restatement due to its material noncompliance with any financial reporting requirement under the securities laws, during the three completed fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement.
- Disclose those compensation recovery policies in accordance with SEC rules, including providing the information in tagged data format.

The rules also require specific disclosure of the listed issuer’s policy on recovery of incentive-based compensation and information about actions taken pursuant to such recovery policy. The amendments also require all listed issuers to:

- File their written recovery policies as exhibits to their annual reports.
- Indicate by check boxes on their annual reports whether the financial statements included in the filings reflect correction of an error to previously issued financial statements and whether any of those error corrections are restatements that required a recovery analysis.
- Disclose any actions they have taken pursuant to such recovery policies.

The final rules become effective 60 days following publication of the adopting release in the *Federal Register*. Exchanges will be required to file proposed listing standards no later than 90 days following publication of the release in the *Federal Register*, and the listing standards must be effective no later than one year following such publication. (Publication occurred Nov. 28, 2022.) Issuers subject to such listing standards will be required to adopt a recovery policy no later than 60 days following the date on which the applicable listing standards become effective.

SEC staff issues guidance on crypto assets

In December 2022, the SEC’s Division of Corporation Finance (Corp Fin) issued a “Sample **Letter** to Companies Regarding Recent Developments in Crypto Asset Markets” for companies that may be affected by widespread disruptions in the crypto asset market.

Corp Fin noted that recent bankruptcies and financial distress among crypto asset market participants have caused widespread disruption in those markets and companies may have disclosure obligations under the federal securities laws related to the direct or indirect impact that these events and collateral events have had or may have on their business.

It was noted that, in addition to the information expressly required to be included in a statement or report, companies must disclose “such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.”

The sample illustrative letter contains sample comments that Corp Fin may issue to companies depending on their particular facts and circumstances. The sample comments don’t address an exhaustive list of the issues that companies should consider.

Corp Fin recently established the Office of Crypto Assets (OCA) within its Disclosure Review Program to provide more specialized support for this emerging area.

Updates to compliance and disclosure interpretations

During the fourth quarter, the staff in Corp Fin updated its Compliance and Disclosure Interpretations (C&DI), related to the following:

Revised beneficial ownership reporting:

- Exchange Act Section 16 and Related Rules and Forms (updated Oct. 7, 2022) Section 109. Rule 16a-1 — Definition of Terms (new Questions 109.02 and 209.06)
- Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting (updated Oct. 7, 2022) Section 105. Rule 13d-3 — Determination of Beneficial Ownership (new Question 105.07)

SEC staff revised these C&DIs to reflect Corp Fin’s views on certain aspects of the calculation and reporting of beneficial ownership status.

New questions for certain non-GAAP financial measures:

- 100.01
- 100.04–100.06
- 102.10(a)(b)(c)

This updated guidance provides views on when certain non-GAAP financial measures may violate Rule 100(b) of Regulation G.

Proxy rules:

- SEC staff added new questions 139.04-139.06 that provide various views on Rule 14a-19.

Impact of critical audit matters

In December 2022, the PCAOB published a **second report** on the initial impact of its critical audit matter (CAM) requirements (the **first report** was released in October 2020). Key findings of the follow-up report include:

- Average number of CAMs per audit report has declined over time, and the proportion of audit reports that communicate a single CAM has increased.
- Investor awareness and use of CAMs continues to develop.
- PCAOB staff hasn’t found evidence of significant unintended consequences from auditors’ implementation of the CAM requirements.

For more information, see the **post-implementation review page** on the PCAOB’s website.

Center for Audit Quality: 2022 Audit Committee Transparency Barometer Report

Over the past nine years, the Center for Audit Quality (CAQ) and Ideagen’s Audit Analytics have tracked disclosure of several key areas of audit committee oversight within the proxy statements of companies in the S&P Composite 1500 (S&P 1500). The results of the ninth annual **Audit Committee Transparency Barometer** reflect a trend of increased transparency in several areas by audit committee members. The report also identifies areas where audit committees can provide more tailored disclosures.

The report began tracking disclosure of audit committee oversight related to environmental, social, and governance (ESG) in the current year. Audit committees will likely continue to have an increased role in ESG oversight given their expertise and experience in oversight of internal controls and financial reporting.

The report includes examples of effective disclosures and questions to consider when preparing the audit committee disclosures. The CAQ noted that it encourages audit committees to continue to improve disclosures and enhance transparency of the critical oversight work they perform.

Center for Audit Quality's second annual analysis of S&P 500 ESG reporting

In December 2022, the CAQ published its **updated analysis** of the publicly available ESG data for companies listed on the S&P 500 for periods ending in 2020.

The analysis identified a few trends:

- Most S&P 500 companies publish annual sustainability or ESG reports. These companies continue to reference commonly used standards and frameworks for their reporting, with the Sustainability Accounting Standards Board (SASB) Standard utilized most often, followed by the Global Reporting Initiative (GRI) Standards and the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.
- There was an increase in the number of companies receiving assurance over this information with over 60% of S&P 500 companies that issued an ESG report disclosing the data received some form of assurance or verification from a third party. As demand for assurance from regulators and others continues to grow, the CAQ expects this number to continue to increase.
- 15% of the assurance providers engaged were accounting firms. The CAQ expects the type of assurance provider companies engaged could evolve as more companies disclose ESG information and decide to seek assurance over that information.

SEC hot topics

Calendar year companies, including audit committees, should consider certain SEC concerns and suggestions when preparing and reviewing 2022 annual financial statements and disclosures. At the 2022 AICPA and CIMA Conference on Current SEC and PCAOB Developments, SEC staff discussed matters related to accounting, financial reporting, and disclosures. A summary of some of the matters not discussed earlier follows.

UNCERTAIN ECONOMIC ENVIRONMENT

SEC staff focused on disclosures regarding current uncertain economic times, including COVID-19, inflation, increasing interest rates, continued supply chain issues, labor challenges, and Russia's invasion of Ukraine. These challenges also impact estimates and judgments, and staff noted estimates should be internally consistent. In addition, disclosures around key judgments should be transparent, including the related uncertainty of the estimates. Paul Munter, acting chief accountant, also noted that the current environment makes the likelihood of fraud significant.

A panel discussing SEC comment letters urged companies to review Sample Letters issued publicly by Corp Fin, including:

- *Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues*
- *Sample Letter to Companies Regarding Climate Change Disclosures*
- *Sample Letter to China-Based Companies*
- *Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets*

Companies should also review previously issued guidance on the COVID-19 pandemic, including the following Corp Fin Disclosure Guidance topics:

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

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE

Most speakers discussed ESG; however, there was no update on the proposed release of the SEC's previous proposal on climate risk disclosures. The SEC is currently in the process of reviewing comment letters on the proposal.

There was consensus that there is demand for a global set of ESG standards. Most speakers noted companies should take steps now to be ready when the reporting requirements are finalized. Challenges include gathering of ESG information, ownership as well as controls over the process and preparation of the information, and the appropriate level of governance and oversight.

There was also much discussion on the value of attestation as well as the potential requirement including the role of auditors in sustainably reporting.

Human capital disclosures were also discussed. The SEC previously issued principle-based human capital disclosure requirements and is expected to issue more expanded prescriptive guidance in the future.

NON-GAAP MEASURES

SEC staff discussed topics that continue to be an issue and subject to Corp Fin comments: prominence, reconciliation to GAAP, segment information, business combination related, and EBIT and EBITDA. As discussed earlier, revised CD&I guidance provides guidance on many of these issues.

Corp Fin also noted that non-GAAP measures should be used based on the specific company facts and circumstances.

DISAGGREGATION OF FINANCIAL INFORMATION

SEC and FASB staff, as well as an investor panel, discussed requests from investors and stakeholders for more disaggregation of components of the income statement and more segment reporting. The FASB has several projects related to these issues, including disaggregation of components of the income statement (income and expenses) and more details on entity income tax provision calculations and disclosures. Paul Munter, acting chief accountant, urged companies to consider providing disaggregated financial information and he encouraged companies to consider using the direct method of preparing the statement of cash flows, as this method provides more decision-useful data.

SEC staff also continue to focus on segment reporting and how registrants apply the guidance in ASC Topic 280, *Segment Reporting*, to the identification and aggregation of operating segments. The FASB's recent proposed ASU would require enhanced disclosures.

DIGITAL ASSETS

SEC Commissioner Hester Peirce noted that regulation of digital assets remains uncertain with more rules expected in the future. Paul Munter encouraged companies to consider the SEC staff's guidance in Staff Accounting Bulletin No. 121, which provides guidance on accounting for obligations to safeguard crypto assets an entity holds for platform users. She also noted that OCA has generally found digital asset lending arrangements to be consistent with lending transactions. In these situations, companies should follow that accounting treatment.