



Audit Committee Quarterly Update

FOURTH QUARTER 2021

In this newsletter, we highlight some important 2021 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.

Importance of high quality independent audits and effective audit committee oversight to high quality financial reporting to investors

On Oct. 26, 2021, Paul Munter, the SEC's acting chief accountant, issued a **statement** regarding the significant contributions made by audit committees to the financial reporting system through their oversight of a company's internal control over financial reporting (ICFR) and related culture, the quality of financial reporting, and the quality of the independent, external audit process. He noted that audit committees are also responsible for overseeing other areas such as cybersecurity policies; environment, social and governance practices; legal and regulatory compliance; and tax risks. The SEC believes it's important that audit committees assess whether the scope of their responsibilities is appropriate, achievable, and aligned with the experience of its members, and importantly, not lose sight of their core responsibility, which is oversight of financial reporting, including ICFR, engagement of the independent auditor, and oversight of the external audit process.

He encouraged audit committees to consider the sufficiency of the auditor's and the issuer's monitoring processes, including those that address corporate changes or other events that could affect auditor independence. Mr. Munter also stated, "in addition to evaluating independence of the auditor, we believe it is foundational to high quality audits that audit committees give careful consideration to audit quality, and not merely focus on price, when appointing and retaining auditors."

High quality financial reporting in a complex environment

On Dec. 6, 2021, Paul Munter was the keynote speaker at the AICPA and CIMA Conference on Current SEC and PCAOB Developments and issued a **statement** on the Office of the Chief Accountant's (OCA) continued focus on high quality financial reporting in a complex environment. He discussed the roles of the preparer, auditor, and audit committee in ensuring high quality financial reporting and described the three elements necessary to support high quality financial reporting:

- High quality standard-setting
- High quality implementation and application of those standards
- High quality audits

Mr. Munter also highlighted the following rulemaking agenda items:

- Climate risk disclosures
- Trading prohibitions under the Holding Foreign Companies Accountable Act (HFCAA)
- Recovery of erroneously awarded compensation

Climate risk disclosures

"Given the dynamic nature of our capital markets, the total mix of information requested by investors continues to evolve to include new types of information, such as climate risk disclosures." To this point, SEC Chair Gary Gensler

has stated: "Occasionally, investors in our capital markets tell us that they ... want something a little bit different. When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more." Chair Gensler has since directed the staff to develop a climate risk disclosure rule proposal, taking into account feedback received earlier this year.

He also mentioned that the FASB staff published an educational paper in March 2021 to provide investors, issuers, and others with an overview of the intersections between environmental matters, including climate change, and existing U.S. GAAP requirements, and that the IASB staff issued similar educational materials in November 2020. Also, in September 2021, the staff in the Division of Corporation Finance (Corp Fin) published an illustrative letter containing sample comments that the Division may issue to companies regarding their climate-related disclosure or the absence of such disclosure. As stated in the sample comment letter, depending on the particular facts and circumstances, these disclosures may be required as part of a company's description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations.

Mr. Munter noted that OCA actively monitors international developments on these topics. The IFRS Foundation, which is also responsible for governance and oversight of the IASB, announced in November 2021 the formation of the International Sustainability Standards Board (ISSB) to set IFRS sustainability disclosure standards.

Trading prohibitions under the HFCAA

The SEC adopted final rules on Dec. 2, 2021, to specify disclosure and submission requirements for affected issuers under HFCAA. The Act also requires a trading prohibition for an issuer's securities if that issuer uses an audit firm that the PCAOB is unable to inspect or investigate completely for three consecutive years.

Recovery of erroneously awarded compensation

On Oct. 14, 2021, the SEC issued a release reopening the comment period for its 2015 proposed rules that would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery of incentive-based compensation received by current or former executive officers that was awarded based on financial information that required restatement and require disclosure of the issuer's policy. Under the proposed rules, incentive-based compensation received by an executive officer during the three fiscal years preceding the date on which the issuer is required to prepare an accounting restatement to correct a material error would be subject to recovery, or "clawback." The amount to be recovered is the incentive-based compensation that exceeds the amount the executive officer would have received had the incentive-based compensation been determined based on the restated financial statements.

Special purpose acquisition companies (SPACs)

On Dec. 9, 2021, SEC Chair Gary Gensler spoke at the Healthy Markets Association Conference where he shared his **thoughts** on the use of SPACs to go public. He expressed concerns that the investing public may not be getting like protections between traditional IPOs and SPACs. He noted that, "due to the various moving parts and SPACs' two-step structure, I believe these vehicles may have additional conflicts inherent to their structure. There are conflicts between the investors who vote then cash out, and those who stay through the deal — what might be called 'redeemers' and 'remainers.' In order to reduce the potential for such information asymmetries, conflicts, and fraud, I've asked staff for proposals for the Commission's consideration around how to better align the legal treatment of SPACs and their participants with the investor protections provided in other IPOs, with respect to disclosure, marketing practices, and gatekeeper obligations."

LIBOR transition: Key considerations for market participants

As a reminder, publication of the one-week and two-month USD LIBOR maturities and non-USD LIBOR maturities will cease immediately after Dec. 31, 2021, with the remaining USD LIBOR maturities ceasing immediately after June 30, 2023. In the United States, the preferred alternative rate is the Secured Overnight Financing Rate (SOFR), which is a measure of the cost of borrowing cash overnight, collateralized by U.S. Treasury securities, and is based on directly observable U.S. Treasury-backed repurchase transactions.

On Dec. 7, 2021, SEC staff issued a **statement** addressing various aspects of the forthcoming LIBOR transition. The SEC cautioned that investment professionals should be "mindful of their obligations when recommending LIBOR-linked securities (defined for purposes of this statement as any security that uses LIBOR as a benchmark) and, as applicable, investment strategy recommendations involving other LIBOR-linked investments such as interest rate swaps, municipal securities, or securitizations." This staff statement includes considerations for (1) broker-dealers regarding legal obligations when recommending LIBOR-linked securities; (2) broker-dealers underwriting primary offerings of municipal securities or recommending municipal securities; (3) investment advisers regarding legal obligations when recommending LIBOR-linked securities or otherwise providing advice regarding other LIBOR-linked investments; and (4) funds and investment advisers related to disclosure, valuation, and operational issues.

The statement also addresses certain issues that companies should consider related to the LIBOR transition, such as: applicable disclosure obligations with respect to the transition away from LIBOR; the likely impact that the LIBOR transition will have on valuation measurements using LIBOR as an input, including those valuations determined by investment companies; and operational complexities that the LIBOR transition is likely to introduce, which may require significant IT system changes and those in operational processes.

Companies are encouraged to provide qualitative disclosures and, when material, quantitative disclosures. To the extent that a company has or is taking steps to identify and assess LIBOR exposure and mitigate material risks or potential impacts of the transition, the company should consider providing investors insight into what the company has done, what steps remain, and the timeline for further efforts. The SEC noted that companies generally include disclosures about the LIBOR transition as part of risk factors, recent developments, MD&A, and/or quantitative and qualitative disclosures about market risk. The statement suggests that to the extent a company provides this disclosure in response to more than one disclosure requirement within a filing, consideration should be given to providing a cross-reference or otherwise summarizing or tying the information together, so an investor has a complete and clear view of the company's plan for the discontinuation of LIBOR, the status of the company's efforts, and the related risks and impacts. The staff expects disclosures to evolve over time as companies provide updates to reflect transition efforts and the broader market and regulatory landscape. Companies are encouraged to refer to the [July 2019 Staff Statement](#) as they prepare their disclosures to investors about the LIBOR transition and its potential impact on their businesses.

Spring-loaded awards

In December, the SEC issued Staff Accounting Bulletin (SAB) No. 120, which updates SAB Codification Topic 14, *Share-Based Payment*, and adds interpretive guidance for public companies to consider when entering into share-based payment transactions while in possession of material nonpublic information, including share-based payment transactions that are commonly referred to as being "spring-loaded." This SAB provides additional guidance to companies estimating the fair value of share-based payment transactions in accordance with Topic 718 regarding the determination of the current price of the underlying share and the estimation of the expected volatility of the price of the underlying share for the expected term when the company is in possession of material nonpublic information.

In addition, SAB No. 120 also rescinds portions of SAB Codification Topic 14 and conforms other portions of it to make staff interpretive guidance consistent with the guidance in FASB ASC Topic 718.