

Highlights from AICPA's SEC Conference

The American Institute of CPAs (AICPA) and Chartered Institute of Management Accountants (CIMA) recently held their annual Conference on SEC and PCAOB Developments. Below is a summary of selected comments from various conference speakers focusing on accounting and financial reporting topics. This summary does not capture all conference discussions; it is intended to highlight trending issues and recurring themes relevant to our clients. Topics included cryptocurrency; environmental, social, and governance (ESG); non-GAAP measures; and the economy.

Overview

Presenters included a wide range of representatives from the SEC, PCAOB, FASB, the Center for Audit Quality (CAQ), and the AICPA. The PCAOB focused on audit quality and announced a five-year plan to overhaul more than 30 standards that accountants must follow in auditing public companies. FASB provided an update on recent standard setting.

Resource from FORVIS: [Quarterly Perspectives: FASB 4Q 2022](#)

1. Cryptocurrency

Global regulators have long called for unified regulation and oversight of the cryptocurrency market, but due to unique aspects of this asset class, enforcement has been piecemeal. The sudden collapse of FTX has created increasing pressure for regulators to act.

Background

Unlike the securities and derivatives market, no single regulator oversees cryptocurrency or crypto-brokers. Securities are defined in the *Securities Act of 1933* and the traditional benchmark interpretation is based on a 1946 Supreme Court case that established the Howey Test. Whether a digital asset qualifies as an investment contract largely depends on whether there is an expectation of profit to be derived from the efforts of others. This answer is subject to interpretation and—not surprisingly—there is a sharp divide between crypto entrepreneurs and the SEC. On March 31, 2022, the SEC published [Staff Accounting Bulletin \(SAB\) No. 121](#), which expresses the views of the Division of Corporation Finance (Corp Fin) and the Office of the Chief Accountant (OCA) regarding the accounting for obligations to safeguard crypto assets that an entity holds for platform users. The SAB addresses two key questions:

- How should an entity account for its obligations to safeguard crypto assets held for platform users?
- What disclosures would the SEC staff expect for safeguarding obligations for crypto assets held for platform users?

U.S. GAAP offers no authoritative guidance for reporting the value of digital assets. Currently, digital assets generally do not meet the definitions of cash, inventory, or financial assets under existing guidance. Nonauthoritative guidance from the AICPA recommends classifying cryptocurrency as indefinite-lived intangible assets, which means these assets are measured at cost less any impairments, *i.e.*, lower of cost or market measurement model. Once a holding is written down, companies cannot revise the value back up if the price recovers. FASB recently added a narrow-scoped project to address accounting and disclosures for certain digital assets and created a separate research project to address the accounting for exchange-traded commodities.

Conference Highlights

Paul Munter, U.S. SEC chief accountant, encouraged conference participants to consider guidance in [SAB 121](#), which provides guidance on accounting for obligations to safeguard crypto assets that an entity holds for platform users. SAB 121 provides guidance on various topics associated with these types of arrangements, including how entities that hold crypto assets should account for liabilities associated with these arrangements, and consideration of financial and nonfinancial disclosures associated with these types of arrangements.

Jonathan Wiggins, representing the OCA, has consulted on a number of digital asset lending arrangements and generally found that these transactions are consistent with lending transactions and should follow that accounting treatment even if cryptocurrencies do not meet the definition of financial instruments under existing accounting rules. Wiggins emphasized the importance of disclosing information to satisfy the overall principle of providing investors with information regarding the arrangement's terms, nature, and risks and uncertainties. Entities should look to existing accounting guidance as a starting point in identifying other relevant disclosures to meet the overall principle. He listed some examples of disclosures that the staff would expect:

- Collateral – Lending arrangements may require the borrower to post collateral to the lender and the following should be disclosed:
 - A description of the type and amount of collateral posted by the borrower
 - Any requirement for the borrower to pledge additional collateral during the term of the loan
 - How the lending entity monitors its ability to liquidate the collateral in the case of the borrower's default
 - Changes in the collateral's fair value during the term of the loan
- Credit risk – The OCA staff would expect disclosure of information that would give investors insight into how the lending entity monitors and manages its credit risk exposure. Accounting Standards Codification (ASC) 326 provides a meaningful starting point for considering which disclosures would be important for investors. Specific disclosures the staff would expect include:
 - Factors that management considers in evaluating and managing the entity's credit risk exposure at inception and on an ongoing basis
 - Qualitative and quantitative factors influencing estimates of expected credit losses
 - Changes during the period in the allowance for expected credit losses, including current-period provisions, write-offs, and recoveries of previous write-offs
 - Crypto asset loans that are past due and the determination of such status

Lending entities should consider providing disclosures if a lending arrangement involves a related party or concentration of credit risk.

These examples are not intended to represent a comprehensive list, and entities should think about how to provide decision-useful information.

SEC Commissioner Hester Peirce also encouraged conference participants to consider traditional finance lessons that can be applied to the financial reporting and auditing of digital assets, even if no specific regulations apply. Counterparty risk, proof of reserves, conflicts of interest, and other risks should be considered. Currently, regulators are focusing on enforcement more than regulation, but further regulation is coming. Peirce cautioned the SEC that future digital asset rules should not be so stringent that only large entities would be able to comply.

Corp Fin also discussed the guidance in its previously issued [Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets](#). Companies should evaluate their disclosures with a view toward providing investors with specific, tailored disclosure about market events and conditions, the company's situation in relation to those events and conditions, and the potential impact on investors. Companies with ongoing reporting obligations should consider whether their existing disclosures should be updated. Areas within SEC filings that may warrant disclosures regarding crypto assets include:

- General disclosure of any significant crypto asset market developments material to understanding or assessing an entity's business, financial condition, and results of operations, or share price
- Description of business
- Management's discussion and analysis (MD&A) of financial condition and results of operations
- Risk factors

The sample letter comments "do not address an exhaustive list of the issues that companies should consider. As always, companies should evaluate whether they have experienced or may be affected by matters characterized as potential risks and, if so, update their disclosures accordingly."

Corp Fin reviews the specific terms and conditions of a crypto asset to determine the rights of the holder and obligations of the issuer, which may include implied obligations that could impact the accounting for the crypto asset. Disclosure and discussion of the terms and conditions of the crypto asset must be included in the financial statements to provide adequate disclosure to stakeholders and should include any rights to the holder and obligations to the issuer such as voting rights, vesting, conversion features, ability to return crypto asset to the issuer, and others. Rigorous review should be undertaken of the offering prior to SEC filing. The disclosure documents must include adequate accounting policy disclosures regarding the crypto asset and all other required SEC disclosures.

Resource from FORVIS: [Cryptocurrency Regulation – September 2022 Update](#)

2. ESG

Peirce provided an update on the SEC's climate change disclosure proposal and the record-setting stakeholder feedback received. In many cases, companies are already providing climate-related disclosures using nonstandard reporting or based on requests from third parties. This makes comparing ESG difficult, but the ability to pass a single global set of standards on ESG reporting may be unrealistic. Peirce cautioned that if an SEC requirement is implemented for climate change disclosures, new reporting liability would be created. Compliance with all of the SEC climate change or ESG disclosures would be mandatory and would require disclosures related to the specific company and other entities/processes in the value chain. Noncompliance could result in potential SEC enforcement action. Peirce did remind conference participants that current disclosure rules do not prohibit the disclosure of climate change or ESG items, such as required disclosure of significant risks and uncertainties. Peirce indicates that the final rules on ESG reporting must support the reporting standards within the financial reports and not just be "good enough." Peirce fears that ambiguity inherent in ESG standards may creep into other financial reporting estimates or judgments.

Resource from FORVIS: [4Q 2022 ESG Regulation & Financial Statement Updates](#)

3. Accounting & Financial Reporting Hot Topics

Disaggregation of financial information. Investors and stakeholders are requesting more disaggregation of components of the income statement and more segment reporting. FASB has a number of projects on these issues, including disaggregation of components of the income statement (income and expenses) and more details on entity income tax provision calculations and disclosures. Munter urged conference participants to consider providing disaggregated financial information even absent any specific rules from FASB or the SEC. Nothing in the current standards or rules prevents entities from providing disaggregation of components of the income statement or the tax provision.

Segments. FASB has issued a proposal that would require additional information on segment-specific expenses or single segment entities. The OCA receives a significant amount of inquiries from investors regarding appropriate disaggregation and segment reporting. Munter cautioned that current segment reporting standards permit aggregation of segments but entities should consider whether that provides the best reporting information to the public.

Resource from FORVIS: [New Segment Details Coming for Public Companies?](#)

Improvement in cash flow information. FASB Codification Topic 230 permits the use of the direct method of reporting cash flows. However, nearly all entities use the indirect method of reporting. Munter encouraged entities to consider whether reporting the cash flow statement or details thereof using the direct method would provide more useful information.

Corp Fin also indicated that it has focused on company board of director structure and risk management. Corp Fin reviews proxy statement materials to see how companies are disclosing the “whys” related to their structure and oversight. Its comments and guidance focused on whether certain corporate governance disclosures could be improved. Item 407(h) of Regulation S-K requires disclosure about a company’s leadership structure, including disclosure regarding:

- Whether the company has combined or separated the chief executive officer and board chair positions
- The basis for the board of directors’ view that the company’s particular leadership structure is appropriate for the company
- Where the chief executive officer and chairman positions are combined, whether and why the company has a “lead independent director” and the specific role the lead independent director plays in the leadership of the company

Companies should provide disclosure of why a certain leadership structure has been chosen and how related risk is associated, avoiding boilerplate language within Item 407(h). Disclosures should be tailored to a company’s specific facts and circumstances and should highlight challenges facing the specific company. Corp Fin did not encourage a particular structure for Item 407(h) disclosures, but it should be made specific to the particular company’s facts and circumstances. Preparers may want to revisit the adopting release, which provides helpful guidance on Item 407(h) disclosure requirements. At a minimum, companies should take a fresh look at their leadership structure disclosures given the current environment.

Non-GAAP Measures

Non-GAAP measures are defined as a numerical measure that includes or excludes amounts from the comparable GAAP measure. Corp Fin’s Disclosure Review Program (DRP) selectively reviews company filings and must review all public companies once every three years. Significant issues that remain a focus of the DRP are non-GAAP financial measures and management’s discussion and analysis. The [Compliance & Disclosures Interpretation](#) updated several questions on December 13, 2022. See [Appendix](#).

No one non-GAAP measure fits all and these measures should be used based on specific company facts and circumstances.

4. Economy

A panel discussed emerging issues the SEC staff has commented on with a focus on more disclosure given the current uncertain economic times. These topics include inflation, supply chain issues, and Russia's invasion of Ukraine. Recent sample letters issued publicly by Corp Fin include:

- [Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues](#) – All companies should consider this guidance even if they do not have material operations in Russia, Ukraine, or Belarus. This guidance discusses possible disclosures regarding supply chain issues and heightened cybersecurity risks.

The panel also urged conference participants to review previously issued guidance on the COVID-19 global pandemic, including the following CF Disclosure Guidance topics published by Corp Fin:

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

While the COVID-19 pandemic has evolved, companies should still consider for disclosure information about:

- How their business has evolved or operates post-COVID-19
- Changes made to business operations as a result of the pandemic
- Resulting macroeconomic impacts on the business and a discussion of the “new normal”
- Impacts on wage costs, return to work plans or issues, liquidity debt levels given higher interest rates, and the impacts of higher energy costs

Corp Fin urged companies to disclose information about the impacts of inflation, which may include discussion of higher costs or lower customer demand for products due to a reduction in discretionary income. The inflation discussion also may include the impacts of higher interest rates on company operations, uncertainties, and potential future plans. Corp Fin reminded conference participants that these disclosures may have been made in general form as potential risks in the past but now should be revisited and, if necessary, made more specific given new facts and circumstances.

5. Comment Letter Process

A panel consisting of current and former SEC staff provided insights into the SEC comment letter process. The SEC must review all public companies once every three years. Initial public offering registration statements do not follow this filing review mandate and are always reviewed before becoming effective. The SEC generally will not issue an initial comment letter on a filing for a prior fiscal year after the year of filing has occurred. For example, generally the SEC staff will not issue an initial comment letter on a fiscal year-end company's 2021 10-K after December 2022.

Best practices in responding to SEC comment letters include:

- If making new disclosures to respond to a comment in future filings, include that language in the comment letter response
- Respond to each SEC comment specifically and order the response in a similar way so the SEC staff can follow clearly

- Ensure a company's contact information is updated in EDGAR to ensure comment letters are accurately mailed to the right individuals

SEC reviews are not limited to SEC filings—all publicly available data about the company is considered social media. The SEC wants to ensure disclosures and information are consistent across all publicly available information and in filings with the SEC.

Top areas of current comments from the SEC staff include:

- MD&A (results of operations, liquidity, critical accounting estimates). The SEC staff continues to issue comments on company quantification disclosures that note the **overall** changes in the financial statement line items. In many cases, companies do not provide **detailed** disclosures about the specific drivers behind these movements or do not identify what caused the changes to occur. In addition, if applicable, these disclosures should identify any offsetting changes that may counter the overall impact on the financial statement line item
- Non-GAAP measures
- Macroeconomic issues
- Climate change
- Internal controls over financial reporting
- Segment reporting. The SEC staff wants to make sure identification of the operating segments is truly consistent with:
 - How the company manages itself internally
 - Who is the chief operating decision maker and their direct reports
 - How the company budgets are done and managed

The panel also cautioned that when using key performance indicators in SEC filings and publicly available materials, these measures should be clearly defined, explained in detail, and consistently used by the company.

The panel believes the SEC staff will focus on the following areas in future comment letters:

- Crypto assets
- Disclosures regarding the impact of the passage of the *Inflation Reduction Act of 2022*
- Impairment and early warning MD&A disclosures, including discussion of material risks and uncertainties
- Impairment testing timing and whether significant adverse changes have arisen that require interim testing
- Risk management disclosures

6. Upcoming Effective Dates & SEC Insights

1. Executive Pay Clawbacks

This [final rule](#) completes a mandate from the 2010 Dodd-Frank Act. New Rule 10D-1 addresses standards for exchange-listed companies for the recovery of erroneously awarded compensation to executive officers, known as a clawback policy. The executives covered are broad and include the issuer's president; principal financial officer; principal accounting officer; any vice president in charge of a principal business unit, division, or function; and any other officer who performs policymaking functions.

Resource from FORVIS: SEC Finalizes Executive Pay Clawback Rules

Craig Olinger, senior advisor to Corp Fin’s chief accountant, clarified that a clawback analysis would not be required when a registrant corrects a clearly immaterial error, including out-of-period adjustments, or chooses to voluntarily revise prior-period financial statements to correct such an error.

2. Pay Versus Performance

This [final rule](#) requires new narrative and quantitative disclosures detailing how executive compensation for the principal executive officer and other named executive officers relates to a registrant’s financial performance. New Regulation S-K Item 402(v) requires a five-year table that includes “actual” compensation paid and several performance measures:

- Registrant’s total shareholder return (TSR)
- TSR for the registrant’s peer group
- Registrant net income
- Registrant’s selected performance measure that represents the most important metric to link pay to performance

A registrant also will be required to list at least three and up to seven of its most important performance measures used to link compensation actually paid to performance for the most recently completed fiscal year. Several accommodations are available for smaller reporting companies.

Registrants must include these new disclosures in proxy and information statements for fiscal years ending on or after December 16, 2022.

Resource from FORVIS: [SEC’s New Pay Versus Performance Disclosures](#)

Lindsay McCord, chief accountant for Corp Fin, provided the following implementation suggestions:

- 1. When disclosing compensation actually paid (CAP) to executives, a registrant needs to measure equity awards at fair value (generally determined in a manner consistent with fair value applicable to share-based payments reflected in the registrant's financial statements) on a recurring basis until the award vests. Registrants will need to update their assumptions, including the expected term. It would not be appropriate to simply deduct time elapsed from the expected term as of the grant date.*
- 2. While a market condition is not a vesting condition in accordance with ASC 718, when developing disclosures about pay versus performance, a registrant should consider market conditions in the evaluation of whether an award is vested or unvested.*
- 3. Dividends that are already reflected in the fair value of an equity award should not also be included in the CAP. However, since the award is remeasured until it vests, some dividends may actually be paid and should be captured in the CAP since they would no longer be reflected in the fair value of the equity award.*
- 4. Registrants should disclose any assumptions used to calculate the equity award's fair value if these assumptions materially differ from those used to measure the award's grant-date fair value. In evaluating this disclosure, registrants should consider whether the updated assumptions would have resulted in a material change to the grant-date fair value.*

Conclusion

The Assurance Team at **FORVIS** delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. FORVIS works with hundreds of publicly traded companies in the delivery of assurance, tax, or advisory services, within the U.S. and globally. For more information, visit forvis.com.

Appendix

Updates to Compliance & Disclosure Interpretations

December 13, 2022, updates are italicized

101.1. **Updated.** Can certain adjustments, although not explicitly prohibited, result in a non-GAAP measure that is misleading? Yes. *Whether or not an adjustment results in a misleading non-GAAP measure depends on a company's individual facts and circumstances. Presenting a non-GAAP performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business is one example of a measure that could be misleading.*

When evaluating what is a normal operating expense, the staff considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue-generating activities, business strategy, industry, and regulatory environment. The staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring.

101.4. **Updated.** Can a non-GAAP measure violate Rule 100(b) of Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP? Yes. *By definition, a non-GAAP measure excludes or includes amounts from the most directly comparable GAAP measure. However, non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading. Examples the staff may consider to be misleading include, but are not limited to:*

- *Changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed*
- *Presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse, presenting a measure of revenue on a gross basis when net presentation is required by GAAP*
- *Changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis*

101.5. **New.** Can a non-GAAP measure be misleading if it, and/or any adjustment made to the GAAP measure, is not appropriately labeled and clearly described? Yes. *Non-GAAP measures are not always consistent across, or comparable with, non-GAAP measures disclosed by other companies. Without an appropriate label and clear description, a non-GAAP measure and/or any adjustment made to arrive at that measure could be misleading to investors. The following examples would violate Rule 100(b) of Regulation G:*

- *Failure to identify and describe a measure as non-GAAP*
- *Presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure, such as:*
 - *A contribution margin that is calculated as GAAP revenue less certain expenses, labeled "net revenue"*
 - *Non-GAAP measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as "Gross Profit" or "Sales"*
 - *A non-GAAP measure labeled "pro forma" that is not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X*

101.6. **New.** *Can a non-GAAP measure be misleading, and violate Rule 100(b) of Regulation G, even if it is accompanied by disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure? Yes. It is the staff's view that a non-GAAP measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each adjustment would not prevent the non-GAAP measure from being materially misleading.*

102.10(a). **Updated.** *Are there examples of disclosures that would cause a non-GAAP measure to be more prominent? Yes. This requirement applies to the presentation of, and any related discussion and analysis of, a non-GAAP measure. The staff would consider the following to be examples of non-GAAP measures that are more prominent than the comparable GAAP measures:*

- Presenting an income statement of non-GAAP measures
- Presenting a non-GAAP measure before the most directly comparable GAAP measure or omitting the comparable GAAP measure altogether, including in an earnings release headline or caption that includes a non-GAAP measure
- Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence
- Presenting a non-GAAP measure using a style of presentation, e.g., bold, larger font, etc., that emphasizes the non-GAAP measure over the comparable GAAP measure
- Describing a non-GAAP measure as, for example, "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable GAAP measure
- Presenting charts, tables, or graphs of non-GAAP financial measures without presenting charts, tables, or graphs of the comparable GAAP measures with equal or greater prominence, or omitting the comparable GAAP measures altogether
- Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence

102.10(b). **New.** *Are there examples of disclosures that would cause the non-GAAP reconciliation required by Item 10(e)(1)(i)(B) of Regulation S-K to give undue prominence to a non-GAAP measure? Answer: Yes. The staff would consider the following examples of disclosure of non-GAAP measures as more prominent than the comparable GAAP measures:*

- Starting the reconciliation with a non-GAAP measure
- Presenting a non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures. See Question 102.10(c)
- When presenting a forward-looking non-GAAP measure, a registrant may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence

102.10(c). **New.** *The staff considers the presentation of a non-GAAP income statement, alone or as part of the required non-GAAP reconciliation, as giving undue prominence to non-GAAP measures. What is considered to be a non-GAAP income statement? Answer: The staff considers a non-GAAP income statement to be one that is comprised of non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement.*