

SEC ACCOUNTING STANDARDS AND REPORTING TECHNICAL UPDATE

September 15, 2023



The Institute of
Internal Auditors



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Discussion Outline



SEC Rulemaking



SEC Staff Guidance



SEC Enforcement Trends



Comment Letter Trends



| SEC Rulemaking

SEC's Rulemaking Agenda

The SEC's [Spring 2023 rulemaking agenda](#) included 18 regulations in the proposed rule stage and 37 in the final rule stage

- ▶ Final Rule Stage
 - ▶ Climate change disclosures
 - ▶ Cybersecurity risk governance
 - ▶ Special purpose acquisition companies
- ▶ Proposed Rule Stage
 - Corporate board diversity
 - Human capital management disclosure
 - Incentive based compensation at certain financial institutions

SEC Rulemaking

Final Rules:

- ▶ [Cybersecurity risk management](#), strategy, governance, and incident disclosure - July 2023
- ▶ [Share Repurchase Modernization](#) - May 2023
- ▶ [Amendments to Rule 10b5-1 Insider Trading Plans](#) - December 2022
- ▶ [Recovery of Erroneously Awarded Compensation](#) - October 2022
- ▶ [Pay vs. performance](#) - August 2022
- ▶ [JOBS Act Inflation Adjustments](#) - required at least once every five years
 - EGC revenue threshold increased to \$1.235 billion (from \$1.070 billion)

Proposed Rules:

- ▶ [Climate-related disclosures](#) for investors - March 2022
- ▶ Enhancing disclosure and investor protection relating to [special purpose acquisition companies, shell companies, and projections](#) - March 2022
- ▶ Proposed rule changes [applicable to funds and certain investment companies](#) - May 2022
 - Rule changes to prevent misleading or deceptive fund names
 - Enhanced disclosures by certain investment advisers and investment companies about ESG investment practices

SEC Proposed Rules to Enhance and Standardize Climate-Related Disclosures

Summary:

- ▶ Applies to nearly all SEC registrants
 - No relief for EGCs
 - Limited relief for SRCs
- ▶ Disclosures required in registration statements (IPOs, de-SPACs, mergers)
- ▶ As proposed, registrants may need to obtain information from equity method investees, vendors, suppliers, etc. in order to meet the requirements
- ▶ Certain disclosures subject to audit and management ICFR - consideration of policies, procedures and controls in place
 - Footnote disclosures - 1% based on absolute value
 - Disaggregated by negative and positive for physical and transition activities
 - Financial metrics
 - Expenses and capitalized costs
 - Attestation requirement for certain disclosures outside the footnotes (phased-in)
 - Assets and risk disclosed at the zip-code level

Staff Guidance - Climate-Related Disclosure Sample Comment Letter

- ▶ [Sample Letter](#) sent to companies regarding climate change disclosures is still an excellent resource prior to final rules
 - Emphasizes the Commission-level [interpretive guidance](#) from 2010 on climate change disclosures and duty to disclose material information even if not expressly required by rules
 - Key areas of consideration
 - Climate-related disclosures in other reports, but not SEC filings
 - Impact of climate-related legislation, regulations, and international accords
 - Indirect consequences of regulation or business trends - e.g.
 - Decreased demand for goods w/significant greenhouse emissions
 - Increased competition to develop new/innovative products
 - Decreased demand for services related to carbon based energy sources
 - Physical impacts of climate change
 - Severity of weather and financial/operational impacts
 - Disclosures may appear in Business, Legal Proceedings, Risk Factors, and MD&A

Climate-Related Disclosures – Internal Audit Considerations

- Perform an ESG Maturity Assessment to evaluate current status, identify gaps, and propose a roadmap
- Evaluate the Data Used in Current Sustainability Reporting
 - Consider using Sarbanes-Oxley guidance regarding documentation, IPE (key reports/spreadsheets), and MRCs (management review controls) to assess the quality of the data used for key metrics, assumptions, and models
- Evaluate the incorporation of ESG in the Organization's ERM Program
- Perform a Third-Party Risk Assessment to evaluate your current supplier's ESG performance to identify any gaps, risks, or opportunities
- Evaluate whether the organization has the internal capabilities to manage an enterprise-wide ESG compliance project to implement the SEC Climate-Related Disclosures
- Improve Vendor Risk Management practices for on-boarding new vendors by incorporating ESG factors

SEC Final Rules: Cybersecurity Risk Management, Strategy, Governance & Incident Disclosure

- Requires registrants to disclose material cybersecurity incidents in Form 8-K and make annual disclosures regarding their policies and procedures to identify and manage cybersecurity risk, the board's oversight of risks from cybersecurity threats, and management's role in assessing and managing material risks from cybersecurity threats.

Effectiveness:

- **Annual disclosures (Regulation S-K Item 106):** All registrants must provide such disclosures beginning with annual reports for FY ending on or after 12/15/2023.
- **Form 8-K incident disclosures (Item 1.05):** All registrants other than smaller reporting companies (SRCs) must begin complying on the later of 90 days after publication in the Federal Register or December 18, 2023. SRCs will have an additional 180 days and must begin complying on the later of 270 days from the effective date of the rules or June 15, 2024.
- **Compliance with the structured data requirements:** All registrants must tag disclosures in Inline XBRL beginning one year after initial compliance with the related disclosure requirement.



Click [here](#) for Final SEC Rule

Click [here](#) for SEC Fact Sheet

Click [here](#) for BDO Bulletin

SEC Cybersecurity Risk Management, Strategy & Governance Final Rules

Item	Disclosure Requirement
New Regulation S-K Item 106(1) - Definitions	<ul style="list-style-type: none">• Cybersecurity incident: An unauthorized occurrence, or a series of related unauthorized occurrences, on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein.• Cybersecurity threat: Any potential unauthorized occurrence on or conducted through a registrant's information systems that may result in adverse effects on the confidentiality, integrity or availability of a registrant's information systems or any information residing therein.• Information systems: Electronic information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of the registrant's information to maintain or support the registrant's operations.
New Regulation S-K Item 106(b) - Risk Management and Strategy	Describe processes, if any, for the assessment, identification, and management of material risks from cybersecurity threats, and describe whether any risks from cybersecurity threats have materially affected or are reasonably likely to materially affect their business strategy, results of operations, or financial condition.
New Regulation S-K Item 106(c) - Governance	Describe board's oversight of risks from cybersecurity threats: <ul style="list-style-type: none">• Identity any board committee or subcommittee responsible for the oversight of risks from cybersecurity threats.• Processes by which the board or such committee is informed about such risks.
New Regulation S-K Item 106(c) - Governance	Describe management's role in assessing and managing material risks from cybersecurity threats, including (non-exclusive list): <ul style="list-style-type: none">• Whether and which management committees or positions are responsible for assessing and managing such risks, and the relevant expertise of such persons or members.• Processes by which such persons or committees are informed about and monitor the prevention, detection, mitigation, and remediation of cybersecurity incidents.• Whether such persons or committees report information about such risks to the board of directors or a committee or subcommittee of the board of directors.

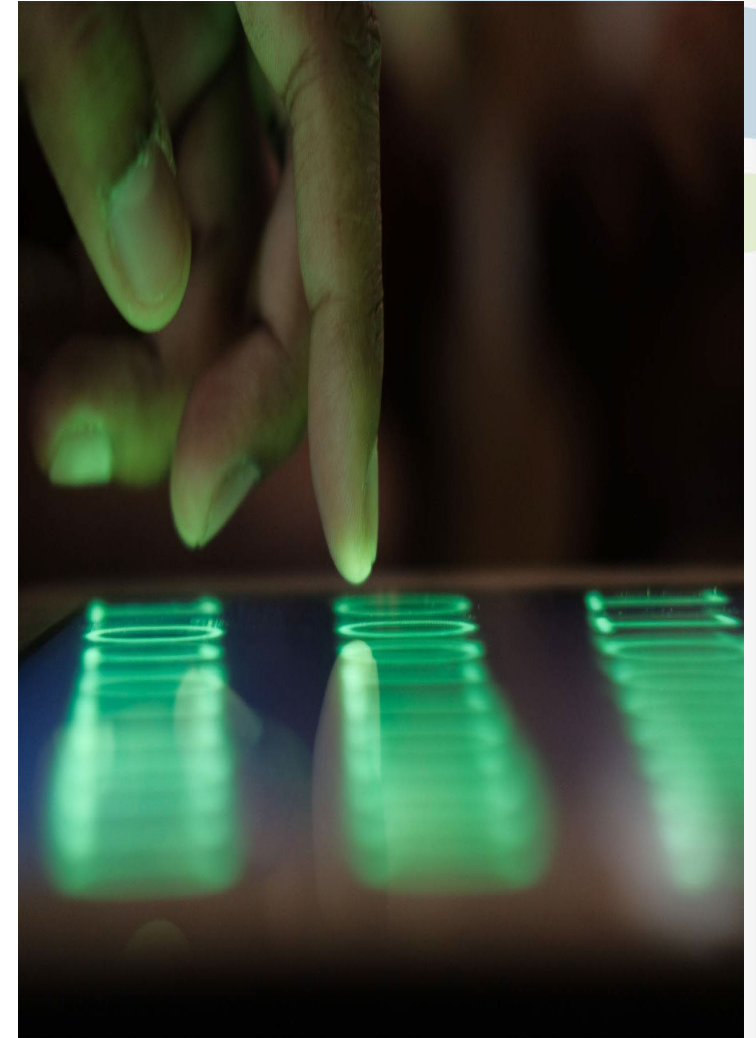
SEC Cybersecurity Incident Disclosure Final Rules

Item	Disclosure Requirement
New Form 8-K Item 1.05 - Material Cybersecurity Incidents	<ul style="list-style-type: none">• Disclose any cybersecurity incident they experience that is determined to be material and describe the material aspects of its:<ul style="list-style-type: none">◦ Nature, scope, and timing and impact or reasonably likely impact.• An Item 1.05 Form 8-K must be filed within four business days of determining an incident was material. A registrant may delay filing if the US Attorney General determines immediate disclosure would pose a substantial risk to national security or public safety.• Registrants must amend a prior Item 1.05 Form 8-K to disclose any information called for in Item 1.05(a) that was not determined or was unavailable at the time of the initial Form 8-K filing.
Amended Form 20-F - Foreign Private Issuers	<ul style="list-style-type: none">• Describe the board's oversight of risks from cybersecurity threats.• Describe management's role in assessing and managing material risks from cybersecurity threats.
Amended Form 6-K - Foreign Private Issuers	<ul style="list-style-type: none">• Furnish on Form 6-K information on material cybersecurity incidents that they disclose or otherwise publicize in a foreign jurisdiction, to any stock exchange, or to security holders.



Cybersecurity Disclosure Guidance

- ▶ Commission-level [interpretive release](#) on cybersecurity disclosures from 2018 - an excellent resource prior to final rules
 - ▶ Reinforced [staff's 2011 guidance](#) that addressed disclosure expectations
 - The Description of Business - do cyber incidents affect products, services, relationships with suppliers/customers, etc.
 - Risk Factors - consider past incidents and probability of new incidents, including whether incidents should be disclosed to provide context
 - Legal Proceedings - material pending proceedings related to cyber incidents
 - MD&A - are costs or consequences of cyber incident(s) known trends or uncertainties that are likely material to the business
 - Financial statements - impact of incidents on estimates or assumptions or known losses from incidents
 - Disclosure controls and procedures - do cyber incidents pose risk that DCP may not be effective



Cybersecurity Disclosures – Internal Audit Considerations

- ▶ **Perform a Cybersecurity Maturity Assessment, updated for the SEC Disclosure Guidance, to identify gaps**
- ▶ **Evaluate the Incident Response Plan**
 - Consider improving existing processes and procedures around the “identification and escalation” of incidents
 - Consider performing a tabletop exercise
 - Consider the timing of board communication in the Response Plan
 - Consider having a third-party legal counsel review the updated plan
 - Consider using the Crisis Management procedures from the Business Continuity plan to apply to an incident
- ▶ **Evaluate the Incident Reporting Process (Disclosure)**
 - Consider using the Disclosure Committee to assess materiality based on quantitative & qualitative factors collectively
 - Define the level of documentation required for materiality judgment by developing or updating Sarbanes-Oxley policies
 - Consider developing a standard disclosure template for material breaches before a breach occurs, which can be updated
 - Consider evaluating the scope of similar related breaches in materiality calculation
 - Consider using similar SOX deficiency evaluation procedures for ICFR as a baseline or key input for Cybersecurity breach disclosures (e.g., approval for SEC Disclosures by CEO or CFO)



| SEC Staff Guidance

Staff Guidance - Materiality

- ▶ Staff [statement](#) on materiality
 - Focus on the views of reasonable investors
 - Emphasizes the importance of objectivity in the overall evaluation of materiality of errors, particularly the evaluation of qualitative factors
 - *“We believe, however, that as the quantitative magnitude of the error increases, it becomes increasingly difficult for qualitative factors to overcome the quantitative significance of the error.”*
- ▶ Provides reminders about ICFR assessments when errors are identified
 - *“...while the existence of a material accounting error is an indicator of the existence of a material weakness, a material weakness may also exist without the existence of a material error.”*

Staff Guidance - Materiality

- ▶ Arguments the OCA staff has NOT found persuasive when considering a registrant's assessment of the materiality of errors:
 - Certain elements of GAAP or IFRS do not provide useful information to investors
 - Historical financial statements or specific line items in the financial statements are not relevant to investors' current investment decisions
 - A similar error was made by other registrants, and therefore reflects a widely-held view rather than an intention to misstate
 - An individual error isn't material because the effect is offset by other errors



Staff Guidance – Materiality

Internal Audit Considerations

- ▶ Develop a Sarbanes-Oxley Policy, which includes approach for evaluating deficiencies and materiality
- ▶ Coordinate with your External Auditor to consider enhancements to the existing Sarbanes-Oxley policy, based on the recent Staff Guidance



| SEC ENFORCEMENT

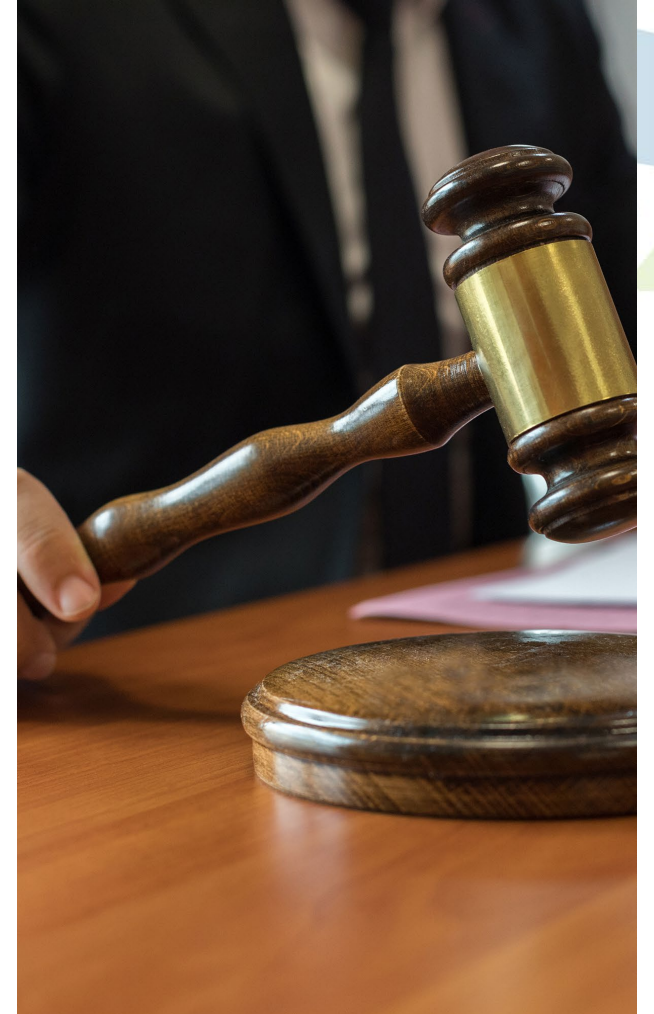
Recent SEC Enforcement Trends – Disclosure Related Matters

Key themes in the realm of SEC reporting

- ▶ Holding individuals and gatekeepers accountable
- ▶ Financial fraud and misleading disclosures
- ▶ Recent cases highlight the importance of having comprehensive, effective disclosure controls and procedures

Select 2023 Enforcement Actions

- ▶ Misleading non-GAAP measures
- ▶ Misleading disclosures about ransomware attack
- ▶ Failure to maintain disclosure controls and procedures related to complaints of workforce misconduct and violating whistleblower protection rule





| SEC Comment Letter Trends

SEC Comment Letter Trends

Comment Area
Non-GAAP financial measures
Management's discussion and analysis ("MD&A")
Segment reporting
Revenue recognition
Fair value measurements
Climate-related disclosures
Inventory and cost of sales
Signatures/exhibits/agreements
Goodwill and intangible assets
Acquisitions and business combinations

Table is based on data provided by Audit Analytics. This analysis compares the period 7/1/21 through 6/30/22 to the period 7/1/20 through 6/30/21 for public company filings on Form 10-K and Form 10-Q.

MD&A Disclosures

Results of Operations

S-K Item 303(a) Objective - *“The discussion and analysis must focus specifically on material events and uncertainties known to management that are **reasonably likely** to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are **reasonably likely** based on management’s assessment to have a material impact on future operations.”*

Observations from the SEC staff:

- ▶ Increasing specificity in describing “why” changes have occurred period over period
 - Seeking more information about the underlying causes and effects of known trends, events, and uncertainties
 - Understanding components of revenues or expenses
 - Known trends or uncertainties, unusual items, significant transactions
- ▶ Performance metrics
 - Definition of the metric, how it is calculated, how management uses the metric
 - Any changes in calculation of metric compared to prior periods, if so the reason and effect of the change

MD&A

Critical Accounting Estimates

Critical accounting estimates are those that involve significant estimation uncertainty and have, or are reasonably likely to have, a material impact on the registrant's results of operations or financial condition.

Observations from the SEC staff:

- ▶ Disclosures are too general
 - Do not duplicate significant accounting policies
- ▶ Consistency of information in critical accounting estimates as compared to footnote disclosures and other filings, including press releases
- ▶ Discussion of sensitivity on key inputs

MD&A

Liquidity and Capital Resources

Observations from the SEC staff:

- ▶ Enhanced disclosure regarding sources/uses of cash
 - Availability of cash to fund liquidity needs
 - Underlying drivers of changes in operating, investing and financing activity cash flows
 - Known trends and uncertainties expect to have material effect on future cash flow
- ▶ Enhanced discussion of material trends, commitments, events and uncertainties
- ▶ Contractual obligations table - no longer required
 - Registrants do need to disclose known contractual and other obligations (ST and LT)

Macroeconomics and Geopolitical Conditions

- ▶ Have supply chain disruptions, labor shortages, or inflation materially affected results of operations, cash flows, outlook or business goals
- ▶ Impacts on margins, reserves, ability to pass costs to customers, contracts
- ▶ Known trends and uncertainties related to any mitigation efforts - do such efforts introduce new material risks related to product quality, reliability or regulatory approval of products
- ▶ Consider if prior disclosures described the potential impact of macroeconomic or geopolitical events (e.g., war in the Ukraine) as hypothetical risks vs. events that have had an impact
 - Registrants indirectly or directly impacted by war in the Ukraine are encouraged to revisit the staff's [Sample Comment Letter](#) from May 2022
- ▶ Update and refresh disclosures related to COVID-19

Revenue Recognition

Comment letters seek clarity on Topic 606 accounting and disclosures, including:

- ▶ The identification of performance obligations
- ▶ The type and nature of variable consideration, including whether any variable consideration is constrained
- ▶ Information regarding the method used to recognize revenue for performance obligations and why the method is appropriate
- ▶ The analysis for presenting revenue on a gross vs. net basis (i.e., principal vs. agent considerations)
- ▶ Disaggregation of revenue that reflect how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows



Revenue Recognition

Other disclosure reminders:

- ▶ The opening and closing balances of contract assets and liabilities, if not separately presented or disclosed
- ▶ Revenue recognized during the period that was included in the opening contract liability balance
- ▶ An explanation of the significant changes in the contract asset and contract liability balances



Goodwill and Intangible Assets

- ▶ MD&A - early warning disclosures
 - Possibility of future impairment of goodwill for certain reporting units
- ▶ If critical accounting estimate, disclose when no reporting units are at risk of impairment
- ▶ Disclosure when impairment is recorded but not previously disclosed as a risk
- ▶ Disclosures when impairment triggers exist
 - Market capitalization
- ▶ If there was a change in segments, disclosure about changes in the composition of reporting units and the basis for reassignment of goodwill to each reporting unit

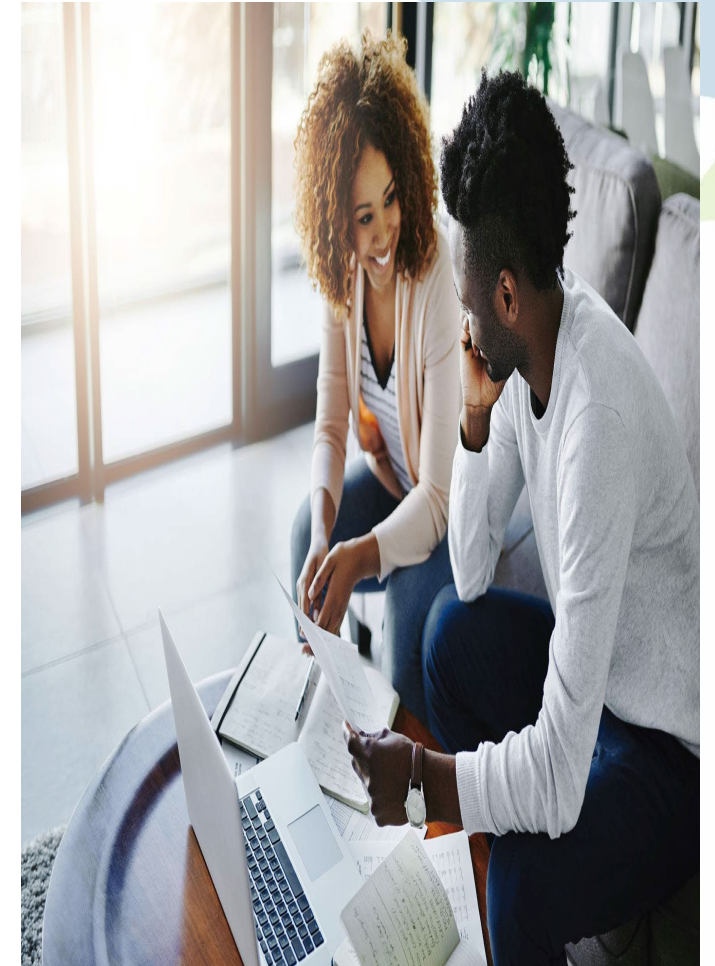
Goodwill and Intangible Assets

Goodwill Impairment Testing

The SEC may inquire on the registrant's goodwill impairment analysis on certain matters including:

- ▶ Details of the analysis
 - Identification of reporting units
 - How assts, liabilities and goodwill are assigned to each reporting unit
- ▶ Sensitivity of material assumptions underlying the analysis
- ▶ Reconciliation of fair value to market capitalization
 - Support for market premium
- ▶ Reason and rationale for impairment test, even if no impairment is recorded
- ▶ Events that could lead to future impairment

Reminder: Entities that have one or more reporting units with zero or negative carrying amounts of net assets shall disclose those reporting units with allocated goodwill and the amount of goodwill allocated to each and in which reportable segment the reporting unit is included. (ASC 350-20-50-1A)



Goodwill and Intangible Assets

Other Intangible Assets

ASC 350 requires indefinite-lived intangibles to be tested at least annual for impairment, or more frequently if events or circumstances indicate it is more likely than not the asset is impaired.

ASC 360 requires long-lived assets held and used, including finite-lived intangibles, to be tested for impairment when factors exist that indicate the carrying amount may not be recoverable.

- ▶ Disclosure of how such assets are tested for impairment
 - Valuation method
 - Key assumptions
- ▶ Challenged whether impairment should be recognized when indicators of impairment are present
- ▶ If goodwill is impaired, consideration of testing other assets for impairment
- ▶ Useful lives and amortization methods

Internal Control over Financial Reporting (ICFR)

The focus of the SEC staff's comments on Internal Control over Financial Reporting (ICFR) has not changed significantly from prior years. They continue to focus on the following areas:

- ▶ The identification and disclosure of material weaknesses.
- ▶ Management's disclosure about the effectiveness of ICFR and disclosure controls and procedures (DC&P)
- ▶ Management's documentation of the changes in ICFR that have materially affected, or are reasonably likely to materially affect, the registrant's ICFR as required by Item 308 of Regulation S-K
- ▶ Management's inappropriate exclusion of their assessment over internal control while filing their second Form 10-K

Other Comment Topics

► Income Taxes:

- Realizability of deferred tax assets
- Change in valuation allowance
- Forecasts used in evaluation the realizability of a deferred tax asset

► Exhibits and Certifications

SEC Comment Letter – Internal Audit Considerations

Annual Memos

- Segment Reporting, Fair Value Measurements, Goodwill and Intangible Assets, and Acquisitions and Business Combinations
- Development and review of an annual memo, including assumptions, evidence of review

Revenue Recognition

- Reevaluate adequacy of initial ASC 606 controls since implementation

Income Tax

- Reevaluate any tax controls, which contain assumptions (e.g., realizability of deferred tax assets, valuation allowance)

Questions

