Snapshot

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Highlights of the 2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments

Maintaining trust in the capital markets

Contents

The AICPA & CIMA held the 2024 Conference on Current SEC and PCAOB Developments on December 9-11, featuring representatives from the AICPA, SEC, PCAOB, FASB, and Center for Audit Quality (CAQ), along with others from the accounting profession and business community.

The overarching theme of the conference was navigating tomorrow's challenges with confidence in the evolving political and regulatory landscape. Conference speakers and panelists also consistently highlighted the importance of elevating high-quality reporting and embracing technology in order to maintain trust in the capital markets.

This publication provides a summary of these themes and other topics highlighted at the conference, including rulemaking activity; recent SEC consultations; segment reporting; non-GAAP financial measures; and auditor independence.

A. Conference overview

The AICPA & CIMA held the 2024 Conference on Current SEC and PCAOB Developments in Washington, D.C. on December 9-11, featuring representatives from regulatory and standard-setting bodies as well as industry professionals, financial statement preparers, auditors, legal practitioners, decision-makers, thought leaders, and analysts. Speakers and panelists shared their views on current accounting, financial reporting, and auditing topics, as well as other emerging issues.

Change in U.S. administration

Many of the conference speakers and panelists focused their remarks on the anticipated changes due to the forthcoming change in administration. As generally occurs with a presidential and congressional leadership change, they believe the new administration will take a fresh look at the priorities and agendas of regulators and standard-setters, with a particular focus on the regulation of crypto markets and reporting requirements related to environmental, social, and governance matters. The conference also featured a conversation with SEC Commissioner Mark Uyeda, who provided his thoughts on priorities for the SEC given the transition to the new administration. He advocated for a less burdensome regulatory environment for public companies by promoting rules and regulations that are efficient, effective, and tailored to promote capital formation.

Elevating high-quality reporting

Speakers and panelists believe that elevating high-quality reporting remains vital in maintaining trust in the capital markets and contributes to investors timely receiving all material decision-useful information. All stakeholders play a role in maintaining and enhancing that trust, which PCAOB Chair Erica Williams in her remarks said is premised upon quality audits conducted by firms with a culture that promotes and prioritizes professional skepticism. She highlighted that PCAOB inspectors are currently seeing improvements in audit quality at the largest firms, evidenced by fewer Part I.A deficiencies in aggregate. The PCAOB also expects improvements in audit quality once its new Quality Control (QC) 1000 standard is fully implemented.

In his remarks, SEC Chief Accountant Paul Munter agreed that audit quality is critical in promoting trust in the capital markets. He stressed the importance of a positive and ethical culture that prioritizes quality reporting over financial performance at both audit firms and issuers. Mr. Munter also emphasized that a culture of quality is essential to avoid undermining investor trust and to ensure that audits meet the highest standards. He noted that creating a culture of quality is achieved not only by setting the proper tone at the top, but also by ensuring that a positive culture flows through the organization to create the right “mood in the middle” and “buzz at the bottom.”

Mr. Munter further asserted that auditor independence is also foundational to trust in the capital markets and emphasized that every member of an audit firm, regardless of their service line, has a responsibility to uphold this requirement. He further stated that audit firm leadership must actively champion the principles of auditor independence, emphasizing that it is not just a technical compliance exercise but about doing the right thing, a crucial step to maintain trust. Management and audit committees are also responsible for maintaining auditor independence, which Mr. Munter remarked is performed through the independent auditor reporting directly to the audit committee and viewing investors as the auditor’s client.

The staff of the SEC’s Division of Enforcement reiterated the importance of high-quality financial reporting and effective internal control over financial reporting (ICFR). The staff reminded registrants that audit quality does not stop with the organization but that it extends to the use of third-party consultants, further noting that registrants who outsource financial reporting activities should maintain ownership and control over the process, as well as have effective ICFR and disclosure controls and procedures (DCP) around the process, consistent with the controls in place at the organization level.

Further, the staff of the SEC's Office of the Chief Accountant (OCA) expressed its commitment to helping stakeholders understand and apply auditor independence rules, especially in complex situations such as IPOs, reverse mergers, and private equity transactions.

Additionally, conference speakers and panelists remarked that input from stakeholders in the standard-setting process contributes to high-quality reporting. Mr. Munter, for instance, encouraged stakeholders to constructively engage in the standard-setting process by providing suggestions on how to improve a standard rather than criticizing the proposal. He reminded financial statement preparers to view financial reporting as a communication activity and not simply a compliance exercise.

Embracing technology

During the welcome address, AICPA board member Wesley Bricker discussed the CPA talent pipeline, stating that the marketplace is demanding that accountants have certain skills, such as skills in technology, data analytics, and cybersecurity. Mr. Bricker noted that universities are responding to this demand by making key accounting courses more tech forward. The importance of embracing new technologies, specifically artificial intelligence (AI) given its rapid evolution and increased use, was echoed by multiple conference speakers. One panelist stated that generative artificial intelligence (GenAI) is fast emerging and allows a user to either obtain a lot of information based on a short prompt or to summarize a lot of information quickly. Various speakers also discussed several types of AI and use cases, reiterating that the next generation of accountants is demanding the use of technology and AI. The need to embrace technology to keep pace today and succeed in the future was a common refrain amongst speakers.

Lastly, the CAQ staff reminded the audience of their available resources and thought leadership on a variety of pertinent topics, including AI and a more diverse CPA pipeline.

B. Accounting matters

FASB standard-setting initiatives

FASB Chair Richard Jones told the audience that the Board will soon be seeking stakeholder input on its accounting standard-setting agenda. Similar to its approach to its last agenda consultation in 2021, Mr. Jones noted that the Board is starting its current consultation with a "blank sheet of paper," and is performing extensive outreach with stakeholders to understand their priorities. Mr. Jones explained that the FASB particularly wants to understand which topics stakeholders believe the Board should focus on to improve information provided to investors and to eliminate costs and complexity from the financial reporting system.

Mr. Munter believes the Board should consider improving the guidance on the statement of cash flows and accounting for intangibles, both of which are subjects of current FASB research projects. OCA Senior Associate Chief Accountant Gaurav Hiranandani indicated that the indexation guidance in ASC 815-40 is a good candidate for standard-setting improvements, a sentiment echoed by the participants on a current practice issues panel.

Mr. Jones encouraged respondents to the Board's agenda consultation to differentiate between (1) areas of accounting guidance where the financial reporting outcome seems appropriate, but the guidance is difficult to apply, and (2) areas where the financial reporting outcome seems inappropriate. In areas where the guidance is difficult to apply but practitioners generally reach reasonable accounting outcomes, Mr. Jones asked practitioners to consider their tolerance for potential changes to accounting outcomes when suggesting simplifications to the guidance.

FASB Deputy Technical Director Helen Debbeler summarized several proposed standards and ongoing projects on the FASB's technical agenda. Ms. Debbeler discussed the recently issued ASU 2024-03, *Disaggregation of Income Statement Expenses*, which requires entities to disclose disaggregated information about relevant expense captions, such as the cost of goods sold, in a table in the notes to the financial statements. Under the amendments, each relevant expense caption should be disaggregated into required expense categories, including employee compensation, depreciation, and amortization. The amendments in the ASU are effective for annual reporting periods beginning after December 15, 2026 and for interim periods beginning after December 15, 2027, with early adoption permitted.

OCA remarks

Consultations with OCA

Mr. Hiranandani stated that OCA is available for consultation with registrants' management and independent auditors on accounting, financial reporting, and auditing questions, especially those involving unusual, complex, or innovative transactions, as well as questions about implementing new accounting standards. OCA Deputy Chief Accountant Jonathan Wiggins noted that before consulting with OCA, registrants should clarify the reason for the consultation and the specific question(s) for the staff. For example, for a consolidation issue, Mr. Wiggins stated that the staff would expect a registrant to ask a particular question(s) about the consolidation analysis, as opposed to requesting that OCA evaluate the consolidation analysis in its entirety. He also noted that an accounting consultation typically involves at least one point of tension, and that it is helpful for the staff if the registrant identifies the point or points of tension in the request.

Stakeholder engagement in standard-setting

Mr. Hiranandani emphasized the importance of stakeholder engagement with accounting standard-setters, including the FASB and IASB, regarding their standard-setting agendas. He cited a recent example where a registrant consulted with OCA about applying the guidance in ASC 815-40 on whether an equity-linked contract was indexed to the issuer's stock price (the "indexation guidance") to certain provisions in an issued stock warrant. He said that the warrant included a provision that required the warrant to be net-share-settled upon the occurrence of certain fundamental transactions, such as the issuer's announcement of its acquisition in a cash transaction, with the number of shares calculated based on the Black Scholes option pricing model. The warrant specified certain inputs to the Black Scholes calculation on a "greater of" basis—for example, the volatility input might be the greater of 100 percent or the average volatility over the 100-day period immediately preceding the settlement date. In addition, Mr. Hiranandani stated that the warrant included a participation feature that permitted the warrant holder to participate in dividends declared on the issuer's common shares based on the number of shares into which the warrant could be exercised, without regard to the warrant's strike price. In other words, regardless of whether the warrant is in or out of the money, the warrant holder would be entitled to the same dividend based on the number of underlying shares.

According to Mr. Hiranandani, these types of warrant provisions are common in practice, and diversity in practice exists over whether the indexation guidance requires classifying these warrants as liabilities or equity. Additionally, as warrant provisions continue to evolve, he observed that new questions about applying the indexation guidance have surfaced accompanied by further diversity in practice.

Accordingly, Mr. Hiranandani believes that stakeholders, including investors, would benefit from engaging in standard-setting activity related to the indexation guidance to promote consistent application. He emphasized that stakeholders will have an opportunity to express their views about whether and how the indexation guidance, as well as other areas of U.S. GAAP, should be amended when the FASB solicits feedback on its technical agenda in the near future.

Derecognition guidance to apply when nonbusiness subsidiaries are sold to third parties and significant assets are sold in ordinary course

OCA Professional Accounting Fellow Jonathan Perdue summarized a recent consultation whereby a registrant sold a subsidiary that did not meet the definition of a “business” in ASC 805. The subsidiary included significant assets that were typically sold by the entity as part of its ordinary business activities along with other significant assets and liabilities that were not the output of the selling entity’s ordinary activities.

Mr. Perdue indicated that the registrant asked whether the sale of this subsidiary was within the scope of ASC 606 because the sale of the subsidiary, and significant assets held by the subsidiary, were part of the reporting entity’s ordinary business activities. Under ASC 606, the proceeds received from the sale would be recognized as revenue from contracts with customers in the income statement.

Because the assets and liabilities of the subsidiary were housed in a separate legal entity that did not constitute a business or nonprofit activity, the starting point for the accounting analysis was ASC 810-10-40-3A(c), which states that the derecognition guidance in ASC 810 applies unless the substance of the transaction is covered by any other Codification Topics, such as ASC 606.

Mr. Perdue noted that the key consideration and judgment that OCA focused on was determining if the substance of the sale of the subsidiary was addressed in ASC 606, since significant assets in the subsidiary were typically sold to the subsidiary’s customers in the ordinary course of doing business. However, he noted that the transaction also included the sale of multiple items that are not typically accounted for under ASC 606, including lease contracts, receivables, trade payables, derivative contracts, and other liabilities. While the staff would not find any one of these individual underlying assets or liabilities to be determinative when evaluating the substance of the transaction, he said that the staff would generally conclude that the substance of the transaction is not directly in the scope of ASC 606, given the total mix of assets and liabilities held by the subsidiary. In this case, Mr. Perdue reported, the staff would not object to the sale of the subsidiary being accounted for in accordance with ASC 810 rather than ASC 606.

Removing a subsidiary reporting lag

Mr. Hiranandani shared a fact pattern whereby a registrant was winding down its subsidiary by selling some of the subsidiary’s assets and liabilities to a third party. He noted that the registrant was reporting the results of its subsidiary on a three months’ lag, which is permissible under ASC 810-10-45-12.

In the process of winding down its subsidiary, Mr. Hiranandani indicated that the registrant had to cease reporting the subsidiary’s results on a three-month lag and align the fiscal periods of the consolidated reporting entity and the subsidiary. He stated that the staff objected to the registrant’s view that it should accomplish this by recording three months of the subsidiary’s income statement activity directly to consolidated stockholder’s equity, with a corresponding adjustment to the carrying amounts of the subsidiary’s assets and liabilities, to reflect their carrying amounts as of date of sale without the lag.

Scope of recently issued FASB guidance

Mr. Hiranandani explained that some specific industry groups have raised questions about applying the FASB's recent ASUs on segment reporting and income tax disclosures, particularly for entities required to follow industry-specific GAAP. OCA staff's consistent message to these industry groups has been that the broad requirements of the Codification apply to all entities, unless an entity is explicitly scoped out of an ASU or existing standard, or if industry-specific guidance precludes certain accounting treatments.

For example, Mr. Hiranandani clarified that ASC 280 applies to all entities that meet the definition of a "public entity," as defined in the ASC Master Glossary, including investment companies that are required to file financial statements with the SEC under both the Investment Company Act of 1940 and the Securities Exchange Act of 1934 (Exchange Act).

Refer to Grant Thornton's Snapshot on segment reporting and Snapshot on improvements to income tax disclosures for additional information on these topics.

IASB activity

Mr. Perdue noted that in the past year, the IASB has issued several final standards and proposed amendments covering various areas of financial reporting. He explained that the proposed amendments, among other things, would (1) address challenges related to accounting for financial instruments with characteristics of equity, (2) expand disclosures about the performance of business combinations, (3) improve the guidance on testing cash-generating units containing goodwill for impairment, (4) address application questions about the equity method of accounting, and (5) improve the related disclosures and make targeted improvements to the guidance on provisions in IAS 37.

Mr. Perdue further reminded participants that the comment periods for the equity method and provisions projects are currently open and encouraged stakeholders to provide feedback to the IASB. See the IASB's website for further information on these standards and projects.

Presentation and disclosure in financial statements

In April, the IASB issued IFRS 18, *Presentation and Disclosure in Financial Statements*, which represents a significant change in how entities communicate via the financial statements and, once effective, will replace the existing requirements in IAS 1. IFRS 18 introduces requirements for aggregating and disaggregating information in the primary financial statements, and requires the presentation of defined subtotals, including profit or loss before financing and income taxes. Mr. Perdue reminded participants that under IFRS 18, entities must disclose information about management-defined performance measures (MPMs) in the notes to the financial statements when the entity discloses those measures outside the financial statements.

Although IFRS 18 is not effective until 2027, Mr. Perdue noted that implementation efforts should already be underway since comparative periods must be retrospectively adjusted once the standard is effective. He emphasized that OCA is available to discuss implementation questions or challenges with registrants.

Mr. Wiggins reminded registrants that MPMs disclosed in the notes to the financial statements under IFRS 18 will not be considered non-GAAP financial measures under the SEC non-GAAP rules. However, he clarified that when such measures are used in public communications outside of the financial statements, they are subject to the SEC's non-GAAP rules.

This topic was discussed at the May 2024 meeting between the CAQ's International Practices Task Force (IPTF) and the SEC staff.

Classification in the statement of cash flows

Sarah Lowe, Deputy Chief Accountant of the SEC's Division of Corporation Finance (CorpFin), noted that classifying cash flows as operating, investing, or financing in the statement of cash flows often requires significant judgment. When determining how to classify cash flows, entities should consider their own unique facts and circumstances, and determine the predominant activity that is the source of the cash flows in accordance with ASC 230, *Statement of Cash Flows*, she explained. Ms. Lowe reminded registrants to consider accounting policy disclosure in the notes to the financial statements explaining the rationale for the classification decision.

Changes in capital structure for FPIs

According to CorpFin Deputy Chief Accountant Melissa Rocha, SEC Staff Accounting Bulletin (SAB) Topic 4.C, *Change in Capital Structure,* requires registrants that experience a change in capital structure after the date of the latest statement of financial position, but before the subsequent release of the financial statements or the effective date of a registration statement, to reflect the change on a retroactive basis in the statement of financial position. Neither U.S. GAAP nor IFRS requires retroactive application of a change in capital structure that occurs after the financial statements are authorized for issuance or deemed available for issuance. Accordingly, Ms. Rocha clarified that a foreign private issuer (FPI) that prepares its financial statements under IFRS as issued by the IASB should comply with SAB Topic 4.C in the same manner as a registrant that prepares its financial statements under U.S. GAAP. This topic was also discussed at the May 2024 meeting between the IPTF and the SEC staff.

Ms. Rocha also reminded registrants that Section 13500 of the CorpFin *Financial Reporting Manual* explains that the staff would not ordinarily require the retrospective revision of previously filed financial statements that are incorporated by reference into a registration or proxy statement solely due to a stock split. Instead, the staff would permit the registrant to include selected financial data, including relevant per share information for all periods, with the stock split prominently disclosed.

Segments

In November 2023, the FASB issued ASU 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*, to expand the disclosure requirements of reportable segments made by public entities. The amendments permit, but do not require, entities to disclose more than one measure of segment profit or loss. Ms. Rocha emphasized that additional measures of segment profit or loss may be disclosed in the financial statements only if the measure is regularly provided and reviewed by the chief operating decision maker (CODM) to assess the performance and allocate the resources of the related segment.

Non-GAAP considerations

According to the SEC staff, entities are permitted, but are not required, to disclose additional measures of segment profit or loss; therefore, any additional measures that are voluntarily disclosed and are not computed in accordance with U.S. GAAP are considered to be non-GAAP financial measures pursuant to S-K Item 10(e)(5).

Ms. Rocha emphasized that when such additional measures of segment profit or loss are included in the financial statements, incremental disclosures required by the SEC's non-GAAP rules may be presented outside the financial statements, such as in Management's Discussion and Analysis (MD&A). If such disclosures are presented outside the financial statements, registrants are not required to duplicate them within the financial statements. Ms. Rocha reminded registrants not to cross-reference within the financial statements any information that is presented outside of the financial statements, as this is expressly prohibited under SEC regulations.

Accordingly, CorpFin Chief Accountant Heather Rosenberger indicated that the auditor's responsibility is to express an opinion on whether financial statements are presented in accordance with the applicable financial reporting framework in all material respects. She indicated that the auditor's responsibility does not extend to assessing whether the additional measure of segment profit or loss complies with the SEC's non-GAAP rules. Therefore, Ms. Rosenberger noted that the auditor may choose to include an emphasis of matter paragraph in its audit report to indicate which information was not subject to the audit. Further, if the incremental disclosures required by the SEC's non-GAAP rules are included in the financial statements, such disclosures should be labeled "unaudited," she said. Ms. Rosenberger also reminded auditors of their responsibilities to consider the requirements under S-X Rule 4-01(a) and PCAOB AS 2710, *Other Information in Documents Containing Audited Financial Statements*.

Ms. Lowe reminded registrants that ASC 280-10-50-4 stipulates that not every component of a public entity is necessarily considered an operating segment or a part of an operating segment. For example, she noted that corporate headquarters or certain functional departments may not be considered part of an operating segment. Consequently, expenses related to these components would not be allocated to an operating segment and, therefore, would not be included in the measure of segment profit or loss. Ms. Lowe clarified that, for purposes of segment reporting, the staff does not regard a measure of segment profit or loss as a non-GAAP financial measure if such costs are included in the registrant's consolidated financial statements but are not fully allocated to the registrant's operating segments. She provided an example where certain corporate overhead costs included in the operating income line item on the registrant's consolidated financial statements were not allocated to the registrant's operating segments and indicated that the staff would not consider the segment operating income to be a non-GAAP financial measure in this scenario solely because those costs were not fully allocated to the operating segments.

Error correction assessment

In situations where the SEC staff objects to the inclusion of a measure of segment profit or loss in the financial statements, Ms. Lowe explained that

- It would be an error correction under ASC 250, *Accounting Changes and Error Corrections,* if the additional measure is removed because it did not comply with ASC 280 (if, for example, it is not regularly provided to the CODM and used to assess segment performance and allocate resources); or
- It would not be an error correction under ASC 250 if the additional measure is removed solely due to noncompliance with the SEC's non-GAAP rules; however, registrants should evaluate the implications on the conclusions related to the effectiveness of DCP.

Pillar 2 implementation

A practitioner panel discussed several accounting issues related to implementing corporate tax rates under the Organisation for Economic Co-operation and Development's (OECD's) Pillar 2 framework, which calls for implementing a minimum 15 percent effective corporate tax rate for multinational companies with global consolidated revenues of €750 million or more, regardless of the local tax rate or tax base. The Pillar 2 corporate tax became effective for tax years beginning January 1, 2024 in many jurisdictions worldwide.

A panelist explained that there are several safe harbors available to entities subject to Pillar 2 taxes that may reduce an entity's exposure. One example that has received a lot of attention is a transitional safe harbor provision based on so-called Country by Country Reports (CbCRs). A CbCR is a report provided by a taxpayer to a taxing authority containing various taxpayer information such as revenue and number of employees. This transitional CbCR safe harbor identifies lower-risk jurisdictions through the application of three quantitative tests taking information primarily from an entity's CbCR.

A panelist cautioned that an entity's CbCR must be "qualified" to apply this transitional safe harbor, adding that entities may inadvertently cause their CbCR to fail to meet this standard. To be a qualified CbCR, all figures used for the safe harbor calculations must stem from "Qualified Financial Statements," since any discrepancies between the CbCR and the Qualified Financial Statements may disqualify an entity from the benefits of the transitional CbCR safe harbor. For example, the OECD's administrative guidance provides that adjustments made for transfer pricing after the fiscal year-end may disqualify the CbCR (or at least aspects of the report). Taxpayers typically aim to reflect "actual" numbers in their CbCR, incorporating transfer-pricing adjustments to enhance data quality. If these adjustments are not mirrored in the Qualified Financial Statements, however, the data for that specific jurisdiction may be immediately disqualified. Accordingly, the panelist emphasized the importance of clear communication between an entity's tax and financial reporting departments to avoid such disqualification.

From an accounting standpoint, a panelist also noted that the FASB staff determined that the Pillar 2 framework is an alternative minimum tax framework under ASC 740 that does not require the recognition or the remeasurement of deferred tax assets and liabilities. Accordingly, entities should recognize Pillar 2 taxes as incurred.

A panelist explained that there are no specific disclosure requirements in U.S. GAAP related to Pillar 2 taxes, but added that the SEC may still expect disclosure depending on the significance of an entity's exposure to Pillar 2 taxes. A panelist noted that disclosure about Pillar 2 exposure to date is "very light," perhaps due in part to safe harbor considerations.

CorpFin remarks on Pillar 2

Ms. Lowe discussed disclosure considerations related to the minimum tax rules under Pillar 2 and reminded registrants that if the tax law changes materially impact the reported amounts of income tax, a description of the change and its effects are required to be disclosed under SEC regulations.

Further, Ms. Lowe noted that S-K Item 303 requires disclosure of matters that are reasonably likely to have a material effect on a registrant's results of operations or financial condition. She acknowledged that due to inherent complexity and uncertainty, certain registrants who expect these changes to have a material impact on their results of operations may not be able to quantify the expected impact. However, as registrants continue to evaluate the changes, she said, the staff expects them to include quantitative disclosures, which may involve a range of reasonably likely outcomes.

Lastly, she indicated that when a registrant reports a material impact on its historical financial statements for a regulatory change but has not previously provided a forewarning disclosure in MD&A about reasonably likely impacts, the staff may comment on the absence of such disclosures required by S-K Item 303.

For more information on the Pillar 2 tax regime, refer to Grant Thornton's resource center for Navigating Pillar 2.

C. SEC reporting matters

SEC rulemaking and initiatives

During the CorpFin panel, the staff provided observations on recent rulemaking, comment letter trends, and other important matters. In particular, Cicely LaMothe, CorpFin Deputy Director of Disclosure Operations, noted that one of the division's ongoing initiatives is implementing rulemaking into the disclosure review program to ensure that the reviewers are well trained in the new rules. She stated that the reviewers generally take a pragmatic approach to reviewing disclosures in the first year of a rule's implementation, while the staff is focused on gaining early insights about how registrants comply with the new rules to determine if additional interpretive guidance is needed. The staff also reminded registrants about the various XBRL tagging requirements related to new rules.

Observations regarding rulemaking

Cybersecurity

Sebastian Gomez, Associate Director in CorpFin's Disclosure Review Program, and a panel of attorneys provided observations on cybersecurity disclosures and reminded registrants of the statement from CorpFin Director Erik Gerding encouraging them to use Item 8.01 of Form 8-K when *voluntarily* disclosing a cybersecurity incident, rather than using new Item 1.05, which is intended for disclosing *material* cybersecurity incidents. Mr. Gomez clarified that if a registrant has not finalized its materiality determination but would like to voluntarily disclose the cybersecurity event in the interim, it may use Item 8.01 and transition to Item 1.05 if the incident is subsequently deemed material. He further reminded registrants that the four business-day window for incident reporting on Form 8-K begins on the date when the registrant *determines the cybersecurity incident is material*, and not from the date when either the breach occurred or was discovered.

In reviewing registrants' filings, the staff has observed that disclosure of materiality assessments are largely limited to quantitative factors, such as the impact on the results of operations or financial condition. Mr. Gomez and other panelists highlighted that registrants should also consider qualitative factors, such as whether the breach impacts the registrants' reputation and customer relations when determining materiality. Panelists also emphasized the importance of effective DCP around the identification, assessment, and reporting of cybersecurity incidents.

Risk factor disclosures

Mr. Gomez and other panelists reiterated the importance of updating risk factors that formerly referred to "hypothetical" cybersecurity incidents when a registrant has experienced such an event. While the comments were made in the context of cybersecurity disclosures, the same principle applies to other risk factor disclosures as well.

Special purpose acquisition companies

Effective July 1, the SEC's special purpose acquisition company (SPAC) final rule enhances the comparability and completeness of disclosures provided by SPACs in their IPOs, as well as disclosures provided by SPACs and their target companies in de-SPAC transactions, while affording investors similar protections that are available under a traditional IPO. Refer to Grant Thornton's Snapshot for further information.

Ms. Rocha stated that the financial statements of a private operating company in a de-SPAC transaction should be the same as those presented as if the private operating company were conducting an IPO. She offered the following staff observations on this topic:

1. A private operating company qualifying as an emerging growth company (EGC) that combines with a shell company as part of a de-SPAC transaction may report as an EGC in the registration statement for the de-SPAC transaction. The private operating company does not need to consider whether a SPAC or post-combination entity qualifies as an EGC.
2. In a transaction where a newly formed entity will be the parent of both the SPAC and the private operating company (PubCo), the PubCo does not meet the definition of a "business combination related shell company." Therefore, the de-SPAC registration statement requires separate PubCo financial statements. Ms. Rocha also emphasized that after the effectiveness of the registration statement, PubCo has a reporting obligation under Section 15(d) of the Exchange Act regardless of whether the de-SPAC transaction is consummated.
3. Registration statements filed by PubCo after consummation of the de-SPAC transaction should include the financial statements of the SPAC, as if the SPAC were the registrant, until such time when the PubCo financial statements reflect the de-SPAC transaction. Accordingly, the SPAC's annual and interim financial statements included in PubCo's filing are required to be audited and reviewed, respectively, under PCAOB standards, regardless of whether the SPAC itself has terminated its Exchange Act reporting obligations.

Finally, Ms. Rocha reminded registrants of the requirement to report in the registration statement for the de-SPAC transaction net tangible book value per share, as adjusted, and to demonstrate the difference against the offering price—for example, for each redemption scenario—in order to show the net assets the SPAC would be contributing to the post-combination registrant.

Clawback of erroneously awarded compensation

Ms. Rosenberger shared reminders on the SEC's clawback final rule, noting when (1) each box on the cover page of the annual report on Form 10-K should be checked, and (2) the recovery analysis disclosures under S-K Item 402(w) are required.

Ms. Rosenberger clarified that the first box on the cover page on Form 10-K should be checked when previously issued annual financial statements are restated for any "error correction," as defined by ASC 250, and such restatement is reflected in the financial statements included in the annual report. She also stated that the second box should be checked whenever an error correction triggers a recovery analysis, regardless of whether (1) the clawback of any incentive-based compensation is required, or (2) such compensation was received by executive officers during the impacted period. If an analysis results in no recovery of compensation, she noted, the disclosure should include additional insights of the analysis performed and indicate why the analysis resulted in no recovery of compensation.

Additionally, when a registrant restates its interim financial statements by amending any Form 10-Q during the year prior to filing its subsequent Form 10-K, Ms. Rosenberger stated that the staff would not object if an issuer leaves both boxes unchecked since the boxes relate to restatements of annual financial statements. However, she clarified that the recovery analysis disclosures in S-K Item 402(w) remain required in this instance, since the rule requires disclosure whenever an error is identified during the year, regardless of the period impacted.

Lastly, Ms. Rosenberger clarified that when an issuer restates its financial statements by amending the annual report on Form 10-K, the staff expects the first box to be checked on the cover page of Form 10-K/A. In this fact pattern, the issuer is not required to recheck the first box in Form 10-K for the subsequent year, assuming no other restatements were identified. When the restated financial statements for an annual period are included in an SEC filing other than Form 10-K/A, such as a registration statement or Form 8-K, the staff expects the first box to be checked in the issuer's next Form 10-K since the registrant did not previously inform investors of the restatement via checkbox in an annual report.

The table below summarizes fact patterns discussed by CorpFin staff and the corresponding applicable checkbox in each instance.

Clawback checkbox decision matrix

Fact pattern	Checkbox 1 (restatement)	Checkbox 2 (recovery analysis)
"Big R" restatement – previously issued annual financial statements are corrected for a material misstatement	Yes	Yes*
"Little r" restatement – previously issued annual financial statements are corrected for an immaterial misstatement. Correcting the error by way of an out-of-period adjustment will materially misstate the subsequent year's financial statements	Yes	Yes*
Voluntary restatement – previously issued annual financial statements are corrected for an immaterial misstatement. However, the registrant may have corrected the error as an out-of-period adjustment in the subsequent year's financial statements.	Yes	No
Restatement of interim periods only	No	No
Correction of error as an out-of-period adjustment – no change to the previously issued financial statements	No	No
Retrospective change that does not constitute an error correction, such as adoption of an accounting principle with retrospective	No	No

Fact pattern	Checkbox 1 (restatement)	Checkbox 2 (recovery analysis)
effect or reclassification of prior-period comparative financial information to conform to the current-year presentation		

**This box should be checked even if incentive-based compensation was not received by executive officers during the relevant period or if no recovery was required based on the analysis.*

Pay versus performance

Ms. LaMothe stated that in the second year of reviewing pay versus performance disclosures, the staff engaged more with registrants as well as requested additional analysis and information. She identified one disclosure improvement: The majority of filings reviewed included all, or substantially all, of the relationship disclosures required by the SEC's pay versus performance final rule. As for additional improvement areas, registrants were reminded (1) to use GAAP net income, as disclosed in their income statement, which includes net income attributable to a noncontrolling interest, in their pay versus performance tables, (2) to clearly describe and disclose how a "Company-Selected Measure" is calculated from the audited financial statements when the measure is a non-GAAP measure, and (3) to follow the legal vesting terms for awards that include retirement eligibility conditions when calculating "compensation actually paid" and to include such awards in the pay versus performance disclosures until the *earlier* of the executive's retirement or completion of the service period.

See Grant Thornton's Snapshot for further details on the SEC's Final Rule, *Pay Versus Performance*.

Filing review observations

Management's Discussion and Analysis

Ms. Rocha shared observations on disclosures related to changes in a registrant's financial condition and liquidity. She reminded registrants that the objective of MD&A is to provide relevant material information to investors so that they can assess the company's financial condition and results of operations, including the evaluation of amounts and certainty of cash flows from internal and external sources.

She noted that registrants are required to describe the underlying reasons for material changes in their financial condition and that merely repeating information readily available in the statement of cash flows is not sufficient. She encouraged management to consider whether an analysis of liquidity-related metrics, such as day sales outstanding or days payable outstanding, could be effective in providing an understanding of the registrant's financial condition and cash flows.

Ms. Rocha also reminded registrants with negative operating cash flows to describe how they expect to fund their operations and meet cash requirements in the short-term. Further, when a registrant is experiencing a prolonged or significant decline in liquidity, the staff noted that it expects more robust liquidity disclosures.

In situations where a registrant identifies a material cash deficiency, including when the audit report is modified for a going concern uncertainty, Ms. Rocha explained that the registrant is required to disclose either its existing or proposed course of action to remedy the deficiency. She encouraged registrants in this situation to (1) revisit their MD&A disclosures, (2) consider the need for additional risk factor disclosure, and (3) ensure that their disclosures under ASC 205, *Presentation of Financial Statements*, are complete and adequate.

Emerging risks

Ms. LaMothe noted that disclosures related to emerging risks faced by registrants continue to be a focus area in filing reviews and pointed to an increase in references to AI in Form 10-Ks. She reminded registrants that when disclosing how a certain technology may improve their results of operations, financial condition, prospects, or opportunities, they need to have a basis for such claims.

Ms. LaMothe also observed that based on recent reviews of AI-related disclosures, most AI risk factor disclosures use boilerplate language. She noted that the staff expects tailored, company-specific, AI-related risk disclosures that include, among other things, cybersecurity and data privacy concerns, intellectual property issues, litigation risks, and the costs and burdens of complying with federal and state AI regulations. Further, she stated that if a registrant believes AI risks are material, it should consider including specific disclosure about AI-related risk management and corporate governance policies.

Non-GAAP financial measures

Ms. Rosenberger and Ms. Lowe noted that the comments in filing reviews range from basic compliance issues, such as prominence and labeling, to issues that require significant judgment. They focused their remarks on the 2022 updates to CorpFin's Compliance and Disclosure Interpretation (C&DI), *Non-GAAP Financial Measures,* and highlighted the following:

- *Exclusion of normal, recurring, cash operating expenses [Question 100.01]:* Ms. Rosenberger clarified that an adjustment that does not meet all of the three parameters, such as a non-cash expense, may still render the measure misleading. Ms. Lowe clarified that in determining the appropriateness of an adjustment, the staff assesses how the expense relates to the normal business operations or strategy, or how it contributes to revenue generation. She also shared that the staff may object to the presentation of a non-GAAP financial measure that excludes (1) markdowns on obsolete or excess inventory, (2) losses incurred on purchase commitments, (3) cash compensation, or (4) rent expense when leased assets are integral to a registrant's operations and revenue generation.
- *Individually tailored accounting principles [Question 100.04]:* Ms. Lowe reminded registrants that the individually tailored accounting concept is not limited to revenue and provided the following examples of when an adjustment may render the measure misleading: (1) changing a sales type lease to an operating lease, (2) removing accelerated depreciation from a measure other than EBITDA, or (3) reversing the effects of purchase accounting in the results of operations subsequent to an acquisition.
- *Debt covenant measures [Question 102.09]:* Ms. Lowe stated that the staff would not object to the disclosure of a non-GAAP financial measure that is calculated in accordance with a debt covenant disclosed in the earnings release, as long as it is clear that the covenant is material to an investor's understanding of the registrant's financial condition or liquidity. However, the staff would object if a non-GAAP financial measure calculated in accordance with a debt covenant is disclosed as a measure of performance and that measure includes an adjustment that results in a potentially misleading measure, such as a change in revenue recognition under GAAP.
- *Prominence [Question 102.10]:* Ms. Rosenberger stated that this question was updated to explain that the *prominence* concept applies to any discussion and analysis of a non-GAAP financial measure, including ratios, tables, and charts that include non-GAAP financial measures.

Refer to Grant Thornton's Snapshot for further information on the 2022 C&DIs updates.

Reverse merger between two operating companies

Ms. Rosenberger discussed the audit and reporting requirements for a reverse merger transaction between a nonpublic operating company that is the accounting acquirer and an operating public company registrant. She noted that the nonpublic operating company is not considered an issuer for the purposes of its preacquisition financial statements when those financial statements are included in Form S-4, a proxy statement, or Form 8-K that is filed upon consummation of the reverse merger transaction. Therefore, she clarified that such preacquisition financial statements of the nonpublic operating company may be audited under AICPA standards by a non-PCAOB-registered audit firm.

However, she explained that once the reverse merger is reflected in a periodic report that includes the period in which the transaction was consummated, the preacquisition financial statements of the nonpublic operating company become the registrant's historical financial statements. Accordingly, when such preacquisition financial statements of the nonpublic operating company are included in a registration statement or Form 10-K, those financial statements are required to be audited under PCAOB standards by a PCAOB-registered audit firm that is independent under both PCAOB and SEC rules.

Waiver requests

Ms. Rosenberger provided an overview of waiver requests related to the acquisition of a business and the related rules under S-X Rule 3-05 and Article 11. Best practices for registrants considering a waiver request, she noted, include providing (1) all relevant details and background information in the letter for transparency, (2) the reasons for the request, and (3) significance calculations, if applicable. She further stressed the importance of involving the right people in the process, including registrants' external auditors and internal individuals with the appropriate skills and expertise on the matter. For preclearance requests relating to the determination that a transaction is an asset acquisition, she reminded registrants to add an alternative waiver request in the same letter in case the staff disagrees with the registrants' position. Lastly, she clarified that a pre-revenue company may be considered a business under S-X Article 11-01(d).

Sustainability reporting update

The conference featured a panel discussion comprising industry participants and professionals who provided updates and reminders on upcoming sustainability rules affecting financial reporting. While the SEC's climate-related disclosure final rule is stayed and in litigation, panelists advised registrants to continue with their efforts to comply with the requirements of the European Union's Corporate Sustainability Reporting Directive and California climate reporting bills.

See Grant Thornton's Snapshots 2022-19 (updated November 2023) and 2023-11 (updated October 2024) for additional details.

D. Auditing matters

PCAOB standard-setting update

PCAOB Chief Auditor and Director of Professional Standards Barbara Vanich provided a standard-setting update for the PCAOB, focusing on recently finalized standards, including the general responsibilities of the auditor when conducting an audit, the new quality control standard, and the auditor's use of technology-assisted analysis in performing audit procedures. Ms. Vanich also discussed the firm and engagement metrics final rule, which are currently subject to SEC approval, and the upcoming effective date of the PCAOB's confirmation standard. Looking ahead to year-end, Ms. Vanich reminded attendants about the supervision of other auditor standards and encouraged auditors to revisit the participation and designation of the lead auditor. Ms. Vanich also urged auditors to reassess the critical audit matters (CAMs) in the auditor's report and to consider whether the identified CAMs are appropriate and informative to investors.

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