

# 2020 AICPA Conference on Current SEC and PCAOB Developments

## Compendium of significant accounting and reporting issues

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### Summary

Regulators and standard setters discussed a broad range of financial reporting, auditing and regulatory topics last week at the annual AICPA Conference on Current SEC and PCAOB Developments (Conference), which was held virtually for the first time.

The speakers and panelists included representatives of the Securities and Exchange Commission (SEC or Commission), the Financial Accounting Standards Board (FASB or Board), the International Accounting Standards Board (IASB) and the Public Company Accounting Oversight Board (PCAOB).

A number of the topics addressed at the Conference this year related to the COVID-19 pandemic, including how companies, auditors, regulators and standard setters have been responding to its many challenges.

Highlights included:

**Accounting standard setting** – The FASB paused its ongoing standard-setting activities at the beginning of the pandemic to prioritize emerging issues related to COVID-19. However, the FASB continued its post-implementation review (PIR) activities related to the new standards on credit losses, leases and revenue recognition, including outreach to stakeholders to obtain feedback on how to improve the standards. FASB staff members highlighted a recent proposal to amend the new leases standard to address issues identified in feedback from stakeholders.

**Reference rate reform** – The FASB continues to monitor global developments associated with the transition away from the London Interbank Offered Rate (LIBOR) and other rates that are due to be phased out as a result of reference rate reform. FASB staff members discussed the FASB's recent proposal to expand the scope of its guidance on reference rate reform and

allow entities to apply certain optional practical expedients to all derivative instruments that are affected by changes in the interest rate used for discounting, margining or contract price alignment but do not reference LIBOR or another rate that is expected to be discontinued. SEC staff members also stated their expectations for clear and transparent disclosures about registrants' plans for the transition and discussed the accounting implications of reference rate reform for affected financial instruments.

**SEC rulemaking** – SEC staff discussed new rules the SEC has adopted related to capital formation and disclosure effectiveness, including amendments to disclosure requirements for significant business acquisitions, subsidiary guarantors and issuers of registered debt, as well as management's discussion and analysis (MD&A) and other areas outside the financial statements. This included the new requirements for human capital disclosures, which are the first disclosures the SEC has mandated related to environment, social and corporate governance (ESG) topics that have generated increasing attention in recent years.

**Non-GAAP measures** – SEC staff members provided guidance on the use of non-GAAP measures by companies to discuss the effects of the pandemic. They also said that presenting certain types of other non-GAAP financial measures may be inappropriate, including non-GAAP revenue measures.

**Audit matters** – Members of the PCAOB discussed its response to COVID-19 and emphasized that auditors may need to perform additional procedures or perform procedures differently to respond to changes in a company's business and internal controls. The SEC staff commended the PCAOB for performing outreach and implementing inspection strategies to understand changes to audit firms' policies, procedures and methodologies in response to COVID-19. They also discussed the post-implementation efforts related to critical audit matters (CAMs) and highlighted the recent amendments to Rule 2-01 of Regulation S-X that are intended modernize the SEC's auditor independence rules.

#### **A conversation with SEC Chief Accountant Teotia**

SEC Chief Accountant Sagar Teotia shared his views on the priorities and accomplishments of the SEC's Office of the Chief Accountant (OCA) in 2020, including its response to the COVID-19 pandemic.

Mr. Teotia commended the work of companies, auditors, audit committees and others in the financial reporting ecosystem for continuing to provide high-quality information to investors during the pandemic and demonstrated the resilience of the US financial reporting system. He also noted the relative calmness of the markets throughout most of the pandemic and credited stakeholders' hard work.

Mr. Teotia noted that, during the pandemic, OCA has engaged with companies, investors and other stakeholders and has focused on clearly communicating the pandemic-related accounting and auditing issues the staff has observed and how to address them. The staff has sought to communicate its views on topics that have arisen in its collaboration with the FASB and the PCAOB such as accounting judgments, internal control over financial reporting and going concern considerations.

Mr. Teotia issued a [public statement](#) summarizing OCA's response to the pandemic, including many of the topics discussed at the Conference. It supplements several statements Mr. Teotia issued earlier this year.

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The resilience of  
our financial  
reporting system  
following the  
emergence of the  
pandemic is an  
incredible testament  
to the efforts of all  
stakeholders  
involved.

— Sagar Teotia,  
Chief Accountant

## How we see it

Mr. Teotia's statements on the importance of high-quality financial reporting during the pandemic have addressed areas of focus for companies. While companies may have considered these statements in preparing their interim filings, we encourage them to review the statements collectively to identify any relevant considerations as they prepare for year end.

Mr. Teotia also discussed OCA's other activities and priorities, including its collaboration with the FASB on the implementation of accounting standards and the SEC's modernization of the auditor independence rules, both of which continued this year despite the pandemic. He also discussed OCA's oversight of the PCAOB's standard-setting efforts and its engagement with stakeholders.

Mr. Teotia noted that international matters remain a critical priority for OCA. He highlighted the work done by the Monitoring Group of the International Organization of Securities Commissions, which published its recommendations to strengthen international audit and ethics standard setting earlier this year. Mr. Teotia co-chairs the group.

In light of this year's challenges, Mr. Teotia emphasized OCA's continued focus on fulfilling its mission of investor protection and working collaboratively with relevant stakeholders in pursuit of high-quality financial reporting.

### Remarks by Richard Jones, Chairman of the FASB

FASB Chairman Richard R. Jones discussed the importance of an independent standard-setting process, calling it a key underpinning of our capital markets and something requiring "active listening and making a strong case for change." Mr. Jones also said that addressing challenges related to the pandemic is a top priority for the Board and provided an overview of certain projects on the FASB's technical agenda and its agenda consultation outreach plan.

#### *Active listening*

Mr. Jones said that his first priority as FASB Chairman is to embark on a listening tour to better understand the perspectives of the Board's diverse stakeholder groups. Mr. Jones said that incorporating diverse views into the FASB's standard-setting process results in standards that provide investors with relevant, unbiased information in the most cost-effective way possible.

While the FASB performed outreach when it developed its standards on leases, revenue recognition and credit losses, Mr. Jones cautioned that "the biggest standards are rarely one and done." He said that the FASB continues to improve all three standards as part of its PIR activities, which he called the "quality control" phase of standard setting. During this phase, the Board and its staff perform additional stakeholder outreach and research to determine whether a standard is performing in line with its objectives and whether the information it provides the markets is worth the resources needed to deliver it.

#### *Making a case for change*

Mr. Jones said that changes to accounting standards should only be made when there is a strong case for change. He believes there are three primary reasons for changing a standard:

- ▶ ***Provide investors with decision-useful information*** – While Mr. Jones said the FASB obtains investor input at every stage of the standard-setting process, he said the FASB must balance some investors' desire for more granular information with the cost to provide that information, and he intends to put added emphasis on cost-benefit analysis throughout the Board's standard-setting activities.

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I intend to put added emphasis on cost-benefit analysis throughout our standard-setting activities. It will challenge us to carefully evaluate the case for change.

— Richard Jones,  
Chairman of the FASB

- ▶ **Remove unnecessary cost and complexity from the system** – Mr. Jones said the Board has been proactive in addressing unnecessary cost and complexity in financial reporting and stressed that the Board’s simplification projects are not intended to benefit only companies. For example, he noted that investors told the Board during its project on convertible debt instruments that they wanted a less complex model and found the information provided by the less complex model more useful.
- ▶ **Maintain and improve the Codification** – Mr. Jones said that maintaining and improving the Accounting Standards Codification (ASC or Codification) remains a significant and important part of the FASB’s work. These types of changes are necessary for the Codification to remain relevant to current transactions, to address practice issues and to narrow unacceptable diversity in practice.

#### **Technical agenda**

Mr. Jones said the pandemic continues to be a top priority for the Board. He noted that the Board has delayed certain effective dates and provided educational materials to help entities address emerging issues in the current environment. He said the Board also made comment periods for exposure drafts longer to give stakeholders enough time to provide meaningful feedback.

Mr. Jones also said the FASB has put together an agenda consultation outreach plan to gather input from its advisory groups and other stakeholder groups about the FASB’s priorities. The Board also will hold meetings and request written comments to evaluate stakeholders’ views. Mr. Jones said, based on the feedback received, the FASB will issue an Invitation to Comment by the middle of next year and then decide which topics to prioritize.

Finally, Mr. Jones encouraged stakeholders to share their views to help the FASB set standards that will provide users with better information and “fuel trust in our capital markets.”

#### **A discussion with the PCAOB**

Several PCAOB members shared their views about the PCAOB’s priorities. Chairman William Duhnke outlined actions that the PCAOB has taken to focus on its mission of promoting audit quality through inspections, enforcement and standard setting during this unprecedented year. Mr. Duhnke also discussed priorities for 2021, which include improving the timeliness of PCAOB inspection reports and observations, enhancing internal and external stakeholder engagement and supporting the implementation of recently issued auditing standards, including those related to auditing estimates, using the work of specialists and reporting on CAMs.

#### **PCAOB response to the COVID-19 pandemic**

Mr. Duhnke discussed the PCAOB’s move to remote inspections as a result of COVID-19 and other changes it made to its inspection approach this year. Specifically, the PCAOB conducted inspections of audits of issuers with year ends through 30 June 2020 and interim reviews to better understand how the pandemic is affecting audits and audit quality. Staff members of the PCAOB’s Division of Registration and Inspections (DRI) said that while they learned a lot from inspections of interim reviews, they have not yet determined whether the PCAOB will continue to conduct them in 2021 and beyond.

Board member Megan Zietsman discussed the need for auditors to understand how a company’s business and its controls may have changed due to the COVID-19 environment. Specifically, she emphasized that auditors may need to perform additional procedures or perform procedures differently to gain this knowledge. She also reminded auditors that conditions may change from one quarter to the next, which may require changes to planned procedures.

The effects of the pandemic may result in new or different risks of material misstatement.

Under the PCAOB's risk assessment standards, auditors are required to identify and assess risks of material misstatement throughout the audit, including fraud risks. Ms. Zietsman noted that the effects of the pandemic may result in new or different risks of material misstatement. Staff members from the Office of the Chief Auditor and DRI also emphasized the need for auditors to continually reassess risks and planned audit procedures in light of the current environment.

#### ***Audit quality and inspection transformation***

PCAOB member Rebekah Goshorn Jurata noted a decline in Part I deficiencies in 2020 inspections, which she said indicates that audit quality has improved across the profession and expressed hope that this trend continues. She noted that the PCAOB has started to highlight practices that promote audit quality, such as the early involvement of the engagement quality reviewer and increased partner involvement.

In June 2020, the PCAOB released the 2018 inspection reports for the six largest US audit firms in a new format. Mr. Duhnke said the new inspection report format reduces boilerplate language and increases the use of charts and graphs to convey information. He also noted that the PCAOB has implemented a new framework that inspectors have begun using to evaluate whether deficiencies identified in inspections may indicate potential deficiencies in a firm's system of quality control.

Mr. Duhnke also discussed the PCAOB's use of targeted inspection teams to focus on emerging or significant audit risks across the profession. PCAOB staff focused on multi-location audits in audits of 2019 financial statements and will consider targeting audit risks arising from the COVID-19 pandemic in audits of 2020 financial statements. Ms. Zeitsman said upcoming inspections will focus on industries that experienced the most significant disruption due to COVID-19, such as transportation, entertainment, hospitality, manufacturing and retail.

Ms. Zeitsman stated that for the upcoming year, the PCAOB plans to select roughly the same number of audits for inspection but will "significantly increase" the percentage of audits selected for inspection at random. She noted that the PCAOB plans to select nontraditional focus areas (i.e., those not commonly selected in inspections) to further reduce the predictability of inspections.

The PCAOB believes that increasing the number of random selections of audits for inspection will prompt audit firms to focus on consistently performing high-quality audits across the practice rather than focusing on audits deemed to have a higher risk of selection for PCAOB inspection. PCAOB member Jay Brown also observed that the PCAOB is taking into account the importance of the remediation of inspection deficiencies when considering possible revisions to its quality control standards and the PCAOB transformation process as a whole.

Ms. Goshorn Jurata also highlighted the Holding Foreign Companies Accountable Act, which would prevent foreign companies from listing or trading securities on US markets where the PCAOB has not been able to inspect their auditors for three years in a row. The legislation passed the Senate and the House unanimously and is expected to be signed into law by President Trump later this month. She said the current limitation on PCAOB inspection activities in mainland China and Hong Kong is an ongoing and dynamic situation.

Mr. Duhnke noted that the Interim Inspection Program for Auditors of Brokers and Dealers continues to function as designed, and the PCAOB is discussing a permanent version of the program.

### *External engagement*

PCAOB members highlighted the continued focus on external engagement with stakeholders. Mr. Duhnke said that between 2019 and 2020 the PCAOB reached out to nearly 700 audit committee chairs whose audits were selected for inspection. He emphasized that the PCAOB's goal was to increase the exchange of information between the PCAOB and all relevant stakeholders.

## **Accounting and disclosure matters**

### **Standard setting and implementation**

Hillary Salo, FASB Technical Director, said the FASB is currently focusing on responding to pandemic-related matters, engaging with stakeholders and performing PIR activities for new accounting standards on topics such as credit losses, leases and revenue recognition. She also highlighted recent Accounting Standards Updates issued by the FASB and provided an update on several projects on the FASB's technical agenda.

### *Reference rate reform*

Ms. Salo said the FASB continues to monitor global developments associated with the transition away from LIBOR and other rates that are due to be phased out as a result of reference rate reform. She said that, as part of its effort to address issues related to reference rate reform in a timely manner, the FASB recently proposed expanding the scope of its reference rate reform guidance in ASC 848. The proposal would allow entities to apply certain optional expedients and exceptions to all derivatives affected by the market-wide change in the interest rates used for discounting, margining or contract price alignment (i.e., the discounting transition), even if they do not refer to LIBOR or another rate that is expected to be discontinued. The Board recently approved issuance of a final standard, which is expected in January 2021.

### *Credit losses*

Ms. Salo shared some feedback from the PIR of the current expected credit losses (CECL) model, which is in its early stages. Investors and other users who provided feedback generally indicated that the CECL model provides more useful information than the legacy incurred loss model, but they expressed frustration over the lack of consistency in disclosures across entities.

Ms. Salo said some stakeholders have questioned (1) the accounting for acquired financial assets that did not qualify as purchased assets with credit deterioration (or PCD assets), (2) whether troubled debt restructuring (TDR) accounting is relevant for entities that have adopted the CECL model and (3) whether the CECL model should be applied to trade receivables. The staff plans to perform more research and outreach on the accounting for non-PCD assets and TDR and will discuss those topics with the Board.

### *Goodwill*

Mr. Jones said that in its project on accounting for goodwill, the FASB is leaning toward a model that would require the amortization of goodwill with impairment testing. Ms. Salo said the FASB staff is currently exploring different goodwill amortization methods and amortization periods and plans to present them to the Board later this month.

Ms. Salo also discussed a project that was recently added to the FASB's technical agenda that would provide certain private companies and not-for-profit entities with an option to perform the identification and evaluation of a triggering event for goodwill impairment testing only as of their annual reporting date. She said the FASB plans to issue an exposure draft by the end of the year.

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### **Ernst & Young LLP resources**

- ▶ To the Point, [FASB proposes expanding the scope of guidance on reference rate reform](#)

## **Ernst & Young LLP resources**

- ▶ To the Point, [FASB proposes targeted changes to the new leases standard](#)
- ▶ To the Point, [FASB defers effective dates of the new revenue and leases standards for certain entities](#)

### **Leases**

Ms. Salo said that, as part of the PIR of the new leases standard, the FASB held a public roundtable to obtain stakeholder feedback on several issues, including lessee application of the rate implicit in the lease, lessee application of the incremental borrowing rate (IBR), embedded leases, lease modification accounting and lessee allocation of payments. The FASB staff also performed outreach with users of financial statements to better understand whether reporting under the new leases standard provides useful information and how analysts and investors use that information.

Ms. Salo said the feedback received from stakeholders has been mixed, but that it highlighted several areas where the standard could potentially be improved. For example, some stakeholders suggested that nonpublic lessees that apply the practical expedient to use the risk-free rate, rather than the IBR, to discount their lease liabilities should be able to apply the expedient by class of underlying asset instead of on an entity-wide level.

Ms. Salo noted that the FASB recently proposed targeted improvements to the new leases standard that address several issues identified through previous outreach with stakeholders. The comment period on that proposal recently closed, and Ms. Salo said the feedback appears to be largely supportive. Ms. Salo also noted that the FASB has deferred the effective date of the new leases standard for certain entities.

John Vanosdall, Deputy Chief Accountant in OCA, said the SEC staff continues to address questions related to the new leases standard in consultations, including questions about the scope of the standard, transition, and certain lessee and lessor costs.

### **Other accounting matters**

#### ***Evaluation of SOFR interest rate reset features***

Jillian Pearce, professional accounting fellow in OCA, discussed a recent inquiry with SEC staff about whether certain interest rate reset features in instruments that reference the Secured Overnight Financing Rate (SOFR) would meet the definition of an embedded derivative that requires bifurcation and separate accounting. The inquiry focused on interest rate reset conventions based on:

- ▶ Term SOFR (i.e., SOFR for a specified period of time greater than overnight)
- ▶ Compounded SOFR “in arrears”
- ▶ Compounded SOFR “in advance”
- ▶ Average SOFR “in advance”

The inquiry highlighted certain unique factors associated with these SOFR-based reset features, including that (1) their purpose is to provide a market-based solution to the discontinuation of LIBOR, (2) they are not meant to provide leveraged returns to investors and (3) certain of the features will be required for specific products due to consumer protection laws that require advance notice of interest rate changes to be provided to borrowers.

The SEC staff did not object to a view that these reset features are normal market conventions that could be viewed as terms of the host contract and, therefore, are not embedded derivatives requiring further assessment of bifurcation. The SEC staff based its conclusion on current expectations of how markets for certain SOFR-based products will develop and noted that entities would need to evaluate any new interest rate features as markets continue to develop and changes in facts or circumstances occur.



### *Revenue recognition*

Mr. Vanosdall said that revenue recognition under ASC 606, *Revenue from Contracts with Customers*, continues to be a frequent topic of consultations, and professional accounting fellows in OCA discussed recent consultations related to revenue recognition.

### *Principal versus agent considerations*

Geoff Griffin, a professional accounting fellow in OCA, noted that determining whether an entity is a principal or an agent in a revenue transaction continues to be an area of frequent consultation due to the significant judgments that may be required to apply this guidance in ASC 606. Mr. Griffin stated that this determination can be particularly challenging in certain industries, such as the technology industry, where multiple parties may be involved in providing a specified good or service to a customer.

Mr. Griffin shared observations from a recent consultation involving a registrant that operated a platform that facilitated an advertiser's purchase of digital advertising space from a publisher. The registrant concluded that it was an agent in the transaction, despite the fact that it obtained momentary title of the digital advertising space, because the registrant was unable to direct the use of the potential advertising space to an ad other than the advertiser's predetermined ad. The registrant further evaluated the indicators of control and determined that it was not primarily responsible for fulfillment and did not have inventory risk. The staff did not object to the registrant's conclusion that it was an agent in the transaction.

Ms. Pearce discussed a consultation involving a registrant that produces and sells a commodity, which it may source from its own production, a related party's production or from a third party. For sales sourced from the related party, the registrant took possession and legal title of the product and had the right to redirect the product to other customers during shipment. The price of the commodity generally was determined based on the market price at delivery, and payment was made by the end customer to the registrant. The registrant then remitted the payment, less a fixed percentage fee, to the related-party producer. The registrant evaluated the indicators of control and concluded it was an agent because it did not receive substantially all the benefits of the sale due to the fixed percentage commission. The staff objected to this conclusion based on the facts presented.

### **How we see it**

The principal versus agent determination remains a frequent consultation topic for the SEC staff as a result of the significant judgments that may be required to apply the guidance in ASC 606. These accounting conclusions require a robust analysis of all relevant facts and circumstances, and companies should contemporaneously perform and document their analyses of the requirements in ASC 606.

### *Identifying performance obligations*

Kevin Cherrstrom, another professional accounting fellow in OCA, discussed a consultation in which the staff did not object to the registrant's conclusion that a software license and periodic updates to the software represent a single performance obligation. The registrant performed a detailed assessment of the nature and frequency of the software updates and concluded that the updates were essential to maintaining the utility of the software license. As a consequence, the registrant concluded that the software license and related updates were highly interdependent or interrelated.



### ***Impairment of abandoned lease ROU assets***

Mr. Griffin discussed a recent consultation involving a registrant that identified leases for abandonment but expected there to be an extended period of time between the identification of the leases and the abandonment date. After identifying the specific leases that would be abandoned, the registrant did not change the asset group for which it assessed impairment, and it didn't recognize an impairment. In this case, the SEC staff did not object to the registrant's conclusion to re-evaluate the economic life of the right-of-use (ROU) assets subject to abandonment and amortize those assets ratably over the period between its identification of leases for abandonment and the actual abandonment date.

As a reminder, lessees that have adopted ASC 842, *Leases*, must evaluate ROU assets for impairment in accordance with ASC 360-10, *Property, Plant, and Equipment – Overall*. Lessees also must apply the guidance in ASC 360-10 to determine whether an ROU asset has been abandoned, which could affect the asset groupings and the estimated useful life of ROU asset.

### ***Equity method accounting***

Jeffrey Nick, a professional accounting fellow in OCA, discussed a consultation involving the equity method of accounting, which generally applies when an investor has the ability to exercise significant influence over the operating and financial policies of an investee. ASC 323, *Investments – Equity Method and Joint Ventures*, lists indicators entities should consider when determining whether an investor has the ability to exercise significant influence, including representation on the board of directors of the investee and interchange of managerial personnel.

The registrant in the consultation held less than 20% of the outstanding voting stock of the investee but was party to a contractual arrangement with other investors to vote their shares in concert with respect to electing members to the board of directors of the investee. The voting arrangement provided the group of investors with an ability to appoint a majority of the board. In addition, the composition of the board included representatives from the registrant. The registrant also shared managerial personnel with the investee and had access to confidential information of the investee. The SEC staff objected to the registrant's conclusion that it did not have significant influence over the investee. Accordingly, the registrant was required to apply the equity method of accounting in this fact pattern.

### ***Consolidation***

Mr. Nick also discussed a consultation involving a registrant's determination that it should consolidate a voting interest entity that is not a limited partnership under ASC 810, *Consolidation*. ASC 810 states that a reporting entity that holds a majority of the voting rights should evaluate whether another party has a substantive right to participate in certain significant financial and operating decisions that are made in the ordinary course of business of the voting interest entity.

The registrant had concluded that a right held by another party to participate in such decisions was not substantive because, in the event of disagreement, the registrant could purchase the other party's interest at fair value. The SEC staff objected to the registrant's conclusion that it should consolidate the entity.

Damon Romano, a professional accounting fellow in OCA, discussed a consultation involving determining the primary beneficiary of a variable interest entity (VIE) under ASC 810. When determining the primary beneficiary of a VIE, a reporting entity must identify which party, if any, has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance. If the power to direct such activities is shared, the reporting entity must determine whether the parties that share that power are related parties or de facto agents to determine which party, if any, should consolidate the VIE.

The SEC staff did not object to a registrant's conclusion that power over the VIE was not shared among related parties or de facto agents. To reach this conclusion, the registrant evaluated whether the existence of a fixed price buyout agreement between the registrant and the other investor was the equivalent of a loan to fund the other investor's interest in the VIE. The registrant concluded that the fixed price buyout agreement did not create a de facto agency relationship because (1) the registrant did not directly finance the other party's equity interest, (2) the other party had an equity interest in the VIE since it was founded and before the registrant had an equity interest, (3) the other party did not need a loan to continue participating in the VIE, and (4) the purpose of the buyout agreement was to facilitate dissolution of the VIE.

#### **Statement of cash flows**

Mr. Cherrstrom described a recent consultation in which the SEC staff objected to a registrant's conclusion to present cash outflows to a vendor for the purchase of fixed assets net of cash inflows arising from payments from the same vendor.

ASC 230, *Statement of Cash Flows*, states that presentation of gross amounts of cash receipts and cash payments is more useful to users of financial statements than net reporting of the amounts. However, ASC 230 provides that net presentation is acceptable for certain items for which the turnover is quick, the amounts are large, and the maturities are short.

The registrant asserted that certain aspects of the cash inflows and outflows were similar to the situations in which net reporting would be acceptable under US GAAP. Specifically, the registrant asserted that the amounts were large, and the turnover was quick because the registrant had contracts to purchase additional goods from the vendor in the near future for amounts in excess of the cash inflows. The registrant further asserted that the criterion stipulating that maturities be short was not relevant to the evaluation since the contractual cash outflows and inflows did not have stated maturities.

### **SEC regulatory update**

#### **Division of Corporation Finance practice matters**

Lindsay McCord, Chief Accountant in the Division of Corporation Finance (DCF), highlighted reference rate reform as a focus area for DCF moving into 2021. She emphasized that companies should provide disclosures in MD&A about their plans for the transition away from LIBOR if the effects are expected to be material.

She also said that DCF would focus on companies' compliance with recent amendments to SEC rules, which include changes to Regulation S-K and the disclosure requirements for acquired businesses and subsidiary issuers and guarantors of registered debt securities, among others.

Ms. McCord was joined by Patrick Gilmore, Deputy Chief Accountant in DCF, and Craig Olinger, her Senior Advisor, who provided their observations on registrant disclosures in 2020 and their expectations for 2021.

#### **COVID-19-related disclosures and non-GAAP measures**

Mr. Gilmore observed that companies were generally responsive to the pandemic-related disclosure guidance provided by DCF during the year and that the disclosures were "pretty good."

However, he suggested that companies provide more disclosure in MD&A about their expectations of the long-term effects of the pandemic, particularly in their discussions of liquidity and capital resources. While registrants generally provided timely and detailed disclosures during 2020 about the short-term effects of the pandemic on liquidity and capital resources (e.g., disruptions to cash flows, additional financing), disclosures about the long-term effects were less common. Mr. Gilmore said he expects more disclosures about companies' plans to repay or refinance debt incurred during the pandemic.

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Where LIBOR  
transition is  
material, the  
division expects  
clear and  
transparent  
disclosure around  
transition and  
registrants' plans.”

— Lindsay McCord,  
Chief Accountant of the  
SEC Division of  
Corporation Finance

## Ernst & Young LLP resources

- ▶ To the Point, [SEC eliminates certain MD&A requirements and revises others to make disclosures more useful](#)
- ▶ To the Point, [SEC issues guidance on disclosures about key performance indicators and other metrics in MD&A](#)
- ▶ Technical Line, [How to appropriately use non-GAAP measures to discuss the effects of COVID-19](#)

## How we see it

The SEC recently amended the MD&A requirements to explicitly require an analysis of a registrant's ability to generate and obtain adequate amounts of cash to meet its requirements and its plans for cash in the long term in addition to the short term. The amended MD&A rules can be applied 30 days after they are published in the Federal Register and must be applied 210 days after being published. We expect them to be published in the Federal Register soon.

As a reminder, the legacy MD&A rules are more general and require registrants to discuss any known trends or any known demands, commitments, events or uncertainties that are reasonably likely to result in liquidity increasing or decreasing in any material way. Registrants must also discuss any expected material changes in the mix and relative cost of their capital resources (e.g., equity, debt). However, related Commission guidance states that registrants should discuss their ability to meet their cash requirements over both the short and long term.

Ms. McCord also noted that companies increased their use of metrics such as the cash burn rate in MD&A discussions of their results during the pandemic. She recommended that companies make sure that their metrics are accompanied by the disclosures required by the Commission's recent guidance on key performance indicators and other metrics in MD&A.

Mr. Gilmore provided guidance on the use of non-GAAP measures by companies to discuss the effects of the pandemic. He noted that the requirements in Item 10(e) of Regulation S-K and Regulation G as well as the SEC staff's related guidance continue to apply to all non-GAAP measures.

He also provided a framework to help companies determine whether pandemic-related adjustments to arrive at non-GAAP measures are appropriate. Adjustments that meet the following criteria may be appropriate:

- ▶ Directly attributable to the pandemic
- ▶ Incremental to normal operations
- ▶ Based on actual (not hypothetical) amounts

He noted that items such as hazard pay to employees and incremental expenses incurred to deep clean facilities are examples of adjustments that fit into this framework. However, he said that companies that make such adjustments should continue to monitor whether they are incremental to normal operations. For example, if higher cleaning expenses become part of a company's normal operations and are expected to continue after the pandemic, making that adjustment would no longer be appropriate.

Mr. Gilmore also provided the following examples of adjustments that would not be appropriate:

- ▶ Estimated lost revenue
- ▶ Paying idled employees
- ▶ Expenses related to temporarily idled facilities, including rent

Registrants that exclude charges related to the pandemic in calculating a non-GAAP measure should not include related gains in the same non-GAAP measure (i.e., cherry picking).

## How we see it

While some companies used new non-GAAP measures to discuss the effects of the pandemic, we did not observe widespread use among registrants. Most registrants discussed and quantified (where possible) the impacts of the pandemic separately.

### *Other non-GAAP measures*

Mr. Gilmore emphasized the importance to investors of revenue determined in accordance with US GAAP and said more companies are inappropriately presenting non-GAAP measures with the term “revenue” in the title. For example, he said presenting a measure entitled “gross revenue” before discounts or other incentives that reduce revenue under US GAAP would not be appropriate.

However, Mr. Gilmore said a registrant could present such a measure and call it “billings” if it is consistent with amounts invoiced to customers. In that case, he said the non-GAAP rules wouldn’t apply, as such a metric would be considered a key performance indicator.

Mr. Gilmore also said some companies have presented a “net revenue” measure calculated by subtracting a portion of cost of revenue to arrive at a tailored measure of gross margin. He said a registrant that presents such a measure should make it clear that it is a margin calculation and should not use the term “revenue” in the title. The registrant should also reconcile the measure to gross margin as defined in US GAAP. If a registrant does not present gross margin in its financial statements, it must calculate and disclose it to meet the requirement to reconcile non-GAAP measures with GAAP measures.

Mr. Gilmore also said that DCF has observed an increase in the number of companies disclosing multiple measures of segment profit or loss in the notes to their financial statements. He said that DCF only considers the measure of segment profit or loss disclosed in accordance with ASC 280, *Segment Reporting*, to be required by US GAAP. That is, measures of segment profit or loss other than the one used by the chief operating decision maker to allocate resources and assess performance are be considered non-GAAP measures unless calculated in accordance with US GAAP. Mr. Gilmore noted that non-GAAP measures can never be presented in the financial statements, and DCF will object if they are. He also said that the entity-wide revenue disclosures required by ASC 280 must be presented in accordance with US GAAP.

### *Discussion of incentives in MD&A*

Mr. Gilmore said the staff has observed that more registrants are operating technology platforms to connect suppliers to end users that offer incentive programs to gain more users. When these incentives are material and are classified as sales and marketing expense or cost of sales (rather than as a reduction of revenue), registrants should quantify and discuss the incentives in MD&A, he said.

Mr. Gilmore also said that companies that have material negative revenue (i.e., payments made to customers that exceed the consideration received) classified as sales and marketing expense or cost of sales should also quantify and discuss those amounts in MD&A.

## How we see it

The SEC staff has focused on incentives because of the level of judgment involved in determining how to classify them. The staff said that registrants should quantify and discuss in MD&A the incentive amounts they classify as sales and marketing expense and cost of sales. We believe registrants should also consider providing these disclosures when incentives are classified as reductions of revenue.

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**Ernst & Young LLP  
resources**

- ▶ Technical Line, [Navigating the requirements for merging with a special purpose acquisition company](#)

**Special purpose acquisition company transactions**

Mr. Olinger said the amount of capital raised by special purpose acquisition companies (SPACs) in recent months has increased significantly. He reiterated the DCF's view that a private operating company becoming a publicly traded company through a merger with a SPAC is similar to an initial public offering (IPO) for the operating company. As a result, DCF reviews SPAC merger proxy filings with the same rigor as traditional IPO registration statements.

Mr. Olinger highlighted the SEC staff's recent compliance and disclosure interpretation that clarifies that a company needs at least 12 months of Exchange Act reporting after the SPAC transaction before it may use Form S-3. He also noted that the DCF Financial Reporting Manual has recently been updated to state that the financial statements of the target company included in a SPAC merger proxy statement must be audited in accordance with PCAOB standards.

**SEC rulemaking update**

Ms. McCord and Mr. Olinger discussed significant rulemaking projects that the SEC finalized in 2020.

**Amendments to disclosures about significant business acquisitions and disposals**

Mr. Olinger discussed the amendments to Regulation S-X Rules 3-05, 3-14 and Article 11 that reduce the cost of providing information about significant acquisitions and disposals of businesses and real estate operations. The amendments change the significance tests used to determine whether registrants need to file separate audited financial statements of acquired businesses and related pro forma financial information, the periods those financial statements must cover, and the form and content of the pro forma financial information.

The amendments are effective 1 January 2021 for calendar year-end companies and the first day of a fiscal year that begins after 31 December 2020 for other companies. Earlier compliance is permitted.

DCF Associate Chief Accountants Jessica Barberich and Todd Hardiman discussed a variety of practice issues related to these amendments. They clarified several points on how to calculate significance, including:

- ▶ The average aggregate worldwide market value of a registrant's voting and non-voting common equity used in the investment test should not include preferred stock (even if it is convertible into common stock) or non-traded common shares that are exchangeable into traded common shares.
- ▶ When evaluating whether the revenue component can be used as part of the income test (i.e., whether the registrant and tested entity both had material revenue during the two most recently completed fiscal years), the registrant should consider whether its revenue or the revenue of the target is so small that a revenue comparison is not a meaningful assessment of significance.
- ▶ When a registrant considers whether to apply the revenue component of the income test to calculate the significance of individually insignificant acquisitions, it must treat the businesses as if they were a single acquisition and determine whether their aggregate revenue recognized during the two most recent years was material. If the acquisitions must be aggregated into two groups (i.e., those that reported income and those that reported losses), each group should be treated as if it is a single acquisition.
- ▶ The investment test for a disposal in a pro rata spin-off transaction should compare the carrying value of the business or real estate operation that is spun off to the registrant's total assets for the most recently completed fiscal year rather than the aggregate worldwide market value.

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**Ernst & Young LLP  
resources**

- ▶ Technical Line, [Applying the SEC's new requirements for significant acquired businesses](#)

Ms. Barberich and Mr. Hardiman also discussed the financial statement requirements in amended Regulation S-X Rule 3-05. Specifically, Ms. Barberich clarified that registrants can no longer use their post-acquisition audited financial statements to reduce the number of audited periods required in separate pre-acquisition financial statements of the acquired business.

Mr. Hardiman also addressed how to report transactions in pro forma financial information that are directly attributable to an acquisition. He said such transactions should be evaluated under Regulation S-X Rule 11-01(a)(8) and included in the presentation, if material. Examples include financing obtained to fund an acquisition and any regulatory effects of a transaction (e.g., deposit fee caps, additional regulatory costs following the merger of two banks).

### How we see it

We believe companies should focus primarily on making sure all material aspects of the business combination are reflected in the pro forma combined amounts and that the pro forma financial information is understandable. Accordingly, we believe that a registrant could present the separate material transactions in a single column unless combining the transactions would mislead investors.

Mr. Hardiman and Ms. Barberich discussed the following transition matters:

- ▶ A company conducting an IPO may continue to use the legacy rules through the completion of its offering only if it files publicly for the first time before the compliance date.
- ▶ An existing registrant that files a registration statement after the compliance date should comply with the amended rules. However, the staff will not object if the pro forma financial information is prepared under the legacy rules if the only transaction reflected was consummated before the compliance date and pro forma information under the legacy rules had been previously filed.
- ▶ In a Form 10-K filed after the compliance date, a registrant is required to recompute the prior-year significance of its equity method investees for purposes of Regulation S-X Rules 3-09 and 4-08(g) using the amended income test.

### Amendments to Regulation S-K

Ms. McCord discussed the amendments to Regulation S-K that streamlined the disclosures registrants are required to make to describe their business, legal proceedings and risk factors. The SEC also added a requirement to disclose information about human capital resources.

The amended rules, which are more principles-based than the legacy rules, are intended to reduce the burden of preparing the disclosures and provide investors with more meaningful information. In addition, registrants other than smaller reporting companies are now required to disclose their human capital objectives or measures that management uses to run the business and that are material to an understanding of the business.

Among other changes, the amendments also eliminated the requirement to disclose the development of a registrant's business over a five-year period and require registrants to provide a summary of risk factors if their disclosure exceeds 15 pages.

The amendments are now effective for all companies.

### How we see it

We believe further rulemaking in the area of ESG disclosure will be a priority for the SEC in the future.

### Ernst & Young LLP resources

- ▶ To the Point, [SEC streamlines some Regulation S-K disclosures and requires human capital disclosures](#)
- ▶ [How to approach the SEC's new human capital disclosures](#)
- ▶ To the Point, [SEC eliminates certain MD&A requirements and revises others to make disclosures more useful](#)



Ms. McCord also discussed other amendments to Regulation S-K that involve financial disclosure. These amendments eliminate the requirements for registrants to provide the selected financial data and contractual obligations tables and scale back the requirement to provide selected quarterly financial data so that registrants can omit it in most cases. The SEC also codified its interpretative guidance requiring disclosure of critical accounting estimates and modernized the rules that require registrants to discuss their financial condition, results of operations and cash flows, among other changes.

Ms. McCord emphasized that registrants may only voluntarily comply with the rules 30 days after publication in the Federal Register, and compliance is mandatory 210 days after publication. Registrants can determine whether to comply before the mandatory date for each item separately.

#### ***Disclosures for subsidiary guarantors of registered debt***

Mr. Olinger discussed the amendments to Regulation S-X Rule 3-10 that simplified and streamlined the SEC's disclosure requirements for registrants that conduct registered debt offerings. Among other changes, the SEC narrowed the circumstances in which separate audited financial statements of subsidiary issuers and guarantors of registered debt are required and streamlined the requirements for alternative disclosures made in lieu of those financial statements. The new rules are effective 4 January 2020, but earlier compliance is permitted. Mr. Olinger noted many registrants are now providing the alternative disclosures outside of the registrant's financial statements in MD&A.

#### **Remarks from the SEC Division of Enforcement staff**

Matthew Jacques, Chief Accountant in the SEC's Division of Enforcement, and members of the Division of Enforcement staff discussed the division's activities and highlighted recent enforcement actions involving accounting issues and disclosures.

Mr. Jacques said the Coronavirus Steering Committee (Steering Committee) was formed in response to coronavirus-related enforcement issues and comprises leaders from across the Division of Enforcement. Its mandate includes proactively identifying and monitoring areas of potential misconduct and making sure the division's staff consistently addresses coronavirus-related matters, among other things.

The Steering Committee has developed a process for reviewing filings from issuers in industries deemed to be at a higher risk for pandemic-related accounting and disclosure issues, which focuses on identifying disclosures that appear to be significantly out of step with others in the same industry. Mr. Jacques noted that the division is closely monitoring filings to identify attempts by companies to disguise previously undisclosed problems or weaknesses as pandemic-related losses. He also noted that the Commission has suspended trading in companies that have made false or misleading disclosures related to the coronavirus.

Mr. Jacques also discussed the division's EPS Initiative, which uses risk-based data analytics to uncover potential accounting and disclosure violations caused by, among other things, earnings management practices. Specifically, the initiative analyzes companies' filings to identify anomalous patterns and reporting, and quarterly earnings-per-share (EPS) metrics that suggest potential earnings management. The division settled the first actions arising from investigations generated by the initiative in September 2020.<sup>1</sup>

Members of the SEC enforcement staff highlighted recent enforcement actions, including those involving allegations of financial fraud and disclosure, improperly manipulated non-GAAP measures and key performance indicators, and failure to comply with executive compensation disclosure rules. The staff also discussed auditor-related enforcement matters involving allegations of an auditor's failure to meet auditing standards and noncompliance with audit documentation standards.

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#### **Ernst & Young LLP resources**

- Technical Line, [How to apply the SEC's new requirements for registered debt issued or guaranteed by subsidiaries](#)



## **Ernst & Young LLP** **resources**

- ▶ Applying IFRS, [Accounting for COVID-19 related rent concessions](#)
- ▶ Applying IFRS, [IBOR reform](#)

## **International matters**

Sue Lloyd, Vice-Chair of the IASB, discussed the IASB's response to COVID-19, its priorities in 2020 and its priorities for 2021.

Ms. Lloyd said that, like the FASB, the IASB engaged with companies during the pandemic and focused on supporting the application of new standards by (1) publishing educational materials on how to apply the standards on credit impairment and leases and how to address estimation uncertainty during this economic environment and (2) issuing targeted amendments to IFRS 16, *Leases*, on the accounting for rent concessions. Like the FASB, the IASB also delayed the effective dates of some standards and extended comment letter deadlines on some projects in response to COVID-19.

Ms. Lloyd also reflected on the IASB's standard-setting priorities in 2020, which included amending standards to address the accounting for insurance contracts and for interbank offered rates (IBOR) reform. To make the financial statements more useful to investors, the IASB also proposed requiring certain subtotals in the income statement and disclosures about some management performance measures (more commonly known as non-GAAP measures).

Like the FASB, the IASB also has a project on the accounting for goodwill, and its discussion paper highlights the pros and cons of keeping the current impairment-only model and changing to an amortization model.<sup>2</sup> The comment period ends 31 December 2020. Ms. Lloyd also emphasized that the IASB's Interpretations Committee continues to support consistent application of its standards.

Moving forward, Ms. Lloyd highlighted that, similar to the FASB, the IASB will seek feedback on its agenda in 2021. The IASB also will examine how it can use technology more effectively and will issue an exposure draft that will describe how the management commentary can be used to report on ESG issues. The Trustees of the IFRS Foundation are assessing demand for global sustainability standards and how the IFRS Foundation might contribute to the development of such standards.<sup>3</sup>

## **Audit matters**

### **Amendments to auditor independence rules**

OCA Deputy Chief Accountant Diana Stoltzfus highlighted the recent amendments to Rule 2-01 of Regulation S-X that were intended to modernize the SEC's independence requirements.<sup>4</sup> She emphasized that auditor independence is foundational to the audit and is a shared responsibility among auditors, management and audit committees. She also noted that the amendments were informed by SEC staff consultations and by a focus on auditor independence considerations related to relationships and services that are most likely to pose a threat to an auditor's objectivity or impartiality.

### **CAMs**

Jeffrey Joseph, a professional accounting fellow in OCA, discussed the important role of stakeholders across the financial reporting system in implementing the new guidance on reporting CAMs. Mr. Joseph noted that stakeholders should remain engaged during the post-implementation period. Mr. Joseph also noted that CAMs are more useful when they contain entity-specific information (e.g., specific inputs or assumptions) rather than boilerplate language. In addition, Mr. Joseph highlighted the PCAOB's post-implementation efforts regarding CAMs for large accelerated filers and encouraged stakeholders to read the PCAOB's interim analysis and white papers.<sup>5</sup>

## PCAOB auditing standard setting update

Barbara Vanich, PCAOB Acting Chief Auditor, provided an update on the PCAOB's standard-setting projects, research projects, and monitoring and implementation activities and noted that the PCAOB recently refreshed its agendas to focus on projects it expects to make progress on in the next 12 to 18 months. These include projects related to the PCAOB's standards related to a firm's system of quality control, the lead auditor's supervision of other auditors, audit evidence, and the impact of the use of data and technology in the performance of audits.

### *Response to COVID-19*

Ms. Vanich discussed some recent PCAOB activities in response to COVID-19 and highlighted certain year-end audit reminders that are consistent with the Spotlight publications the PCAOB has issued during the pandemic. Ms. Vanich reiterated the need for auditors to identify and assess risks of material misstatement, including fraud risks, throughout the audit. She also said that in the current environment auditors may need to reassess materiality and tolerable misstatement, revise the nature, timing, and extent of planned audit procedures, and further evaluate accumulated uncorrected misstatements.

### **How we see it**

The COVID-19 pandemic may create additional pressure or opportunities for people to commit fraud. Companies and their auditors should consider whether their risk assessment processes are sufficient in light of this potentially heightened fraud risk. Management should consider whether it needs to make changes to its controls related to the detection and prevention of fraud to respond to the additional risks. Auditors will need to continually reassess risks throughout the year and adjust audit procedures to address risks of material misstatement, including fraud risks, as necessary.

### *New standards implementation*

Ms. Vanich also commented on the PCAOB's monitoring of audit firms' implementation of the new auditing standards on estimates and the use of specialists that are effective for calendar-year end 2020 audits, and the requirements to report on CAMs in many audits for the first time and provided some insights into how the pandemic may affect the implementation of these standards.

Specifically, she discussed the requirement for auditors to identify significant assumptions used within accounting estimates and evaluate the reasonableness of those assumptions individually and in combination with other significant assumptions. This includes evaluating whether there are external factors, including recent economic conditions, that could impact the auditor's evaluation of whether the company has a reasonable basis for those assumptions. She observed that auditors may need to adjust the extent of supervision, particularly in audit areas that may have become more complex in the current environment, and shift work from less-experienced engagement team personnel to more-experienced personnel to respond to changing risks.

### *System of quality control and supervision of other auditors*

Ms. Vanich said the PCAOB plans to propose a new standard on audit firms' systems of quality control in 2021. She noted that most commenters on the PCAOB's 2019 concept release<sup>6</sup> supported basing a new standard on the International Standard on Quality Management 1, which was approved earlier this year by the International Auditing and Assurance Standards Board and sets forth a risk-based approach and framework for audit firms' systems of quality control. However, she said a PCAOB quality control standard would need to align with US federal securities law, SEC rules and PCAOB rules and address risks or problems the PCAOB has observed through its oversight activities.

Ms. Vanich also discussed the PCAOB's standard-setting project on supervision of other auditors. She stated the PCAOB is currently evaluating comments received on the 2016 proposal and 2017 supplemental request for comment, and the PCAOB staff is developing a recommendation it hopes to bring to the PCAOB for consideration in 2021.

#### **Research projects**

Ms. Vanich also provided an update on the PCAOB's research agenda, which includes projects on audit evidence and firms' use of data and technology in the audit. Ms. Vanich said there may be questions in practice about the extent to which the auditor needs to evaluate the relevance and reliability of external data. She stated the PCAOB has and will continue to monitor other standard setters' recent work on audit evidence standards.

Ms. Vanich discussed the PCAOB's data and technology research project, stating this project will remain on the research agenda as firms continue to expand their use of technology in audits. She said the PCAOB has recently focused on firms' use of technology tools to respond to risk, perform confirmations and test inventory. She noted that other areas of interest include the use of technology in the auditor's response to fraud and in performing substantive analytical procedures. She said the PCAOB may issue another Spotlight publication in early 2021 to highlight its activities relating to technology in the audit.

#### **PCAOB inspections and enforcement matters**

George Botic, Director of the DRI at the PCAOB, discussed the impact of the COVID-19 pandemic on the inspection process, observations from 2020 inspection activities and the focus areas for inspections in 2021.

Mr. Botic stated that while the audit environment has changed as a result of the pandemic, "the fundamentals of auditing have not changed" and that "the auditor's continued focus on the fundamental audit skills and procedures will be paramount during the upcoming year-end 2020 audit season."

#### **2020 inspections highlights**

Mr. Botic discussed the PCAOB's 2020 inspection activities, which included a selection of audits of periods ending through June 2020.

Mr. Botic summarized some of the recurring deficiencies, including those that relate to the design and performance of audit procedures to address the risk of material misstatement related to revenue, the accounting and auditing of estimates (particularly the allowance for loan losses and estimates made in conjunction with business combinations), and the sufficiency of testing of the precision of controls with a review element. He also noted the continued importance of audit firms' compliance with the relevant PCAOB and SEC independence standards.

To promote audit quality, Mr. Botic also highlighted good practices that PCAOB inspectors observed at audit firms, including:

- ▶ Using interactive engagement team meetings tied to milestones or phases of the audit
- ▶ Increasing partner involvement in tests of controls
- ▶ Preparing narratives and process flow maps of the firms' quality control systems

“  
The auditor's continued focus on the fundamental audit skills and procedures will be paramount during the upcoming year-end 2020 audit season.

— George Botic,  
Director of the  
PCAOB Division of  
Registration and Inspections

## How we see it

The challenges associated with the current environment reinforce the importance of companies to reassess the risks of material misstatement throughout the year. This should include the need for new and/or different information to assess the effect of the COVID-19 pandemic on assumptions used in the development of estimates. Companies will need to consider how this is reflected within their system of internal control, including the evidence they use to assess the design and operating effectiveness of their controls. Auditors will need to perform similar assessments and adjust audit procedures to address the relevant risks.

Mr. Botic also noted that the PCAOB issued a recent Spotlight publication<sup>7</sup> that summarized recent observations from its inspections of reviews of interim financial information and audits considering the impact of COVID-19.

### *Inspections outlook for 2021*

Mr. Botic reiterated that while the overall number of audits to be inspected will remain the same in 2021, the PCAOB intends to increase the number of audits subject to random selection and the selection of nontraditional focus areas. Mr. Botic also noted that the PCAOB will continue to emphasize inspections of audits of larger and more complex public companies as well as those in industries that have experienced an elevated risk during the COVID-19 pandemic.

Mr. Botic highlighted the following areas as potential focus areas in 2021 inspections:

- ▶ Goodwill and intangible asset impairment
- ▶ Going concern considerations
- ▶ Inventory procedures
- ▶ Fraud procedures

He also noted that the broker-dealer inspection program will likely emphasize audits of those responsible for the custody and control of customer funds and securities.

Mr. Botic stressed the importance of robust fraud procedures throughout the audit. He noted that auditors may need to reassess their initial assessments of risk, identify new or amend existing risks, and modify planned procedures as circumstances evolve. He said examples of situations that may indicate a heightened fraud risk include estimates that are largely based on future forecasts with high estimation uncertainty and the risk of management override when there have been staff changes, downsizing and reporting and structure changes as a result of the pandemic that may affect the segregation of duties. He also said he is interested in understanding how auditors have incorporated unpredictability into the audit and evaluated judgments in areas of estimation (e.g., impairment), given the current environment.

Mr. Botic said inspectors will continue to assess compliance with reporting requirements related to CAM determinations and communications. Inspectors observed instances where the auditor's evidence of CAM determinations did not include an assessment of certain items that were both communicated to the audit committee and related to a material account or disclosure. Inconsistencies were also identified between what was communicated in the auditor's report and the work performed and documented in the audit workpapers.

During 2021, inspectors will assess training and tools provided by audit firms to assist with the determination and communication of CAMs, as well as how audit teams determine and communicate CAMs. He also said the PCAOB will continue to focus on audit firms' systems of quality control to prevent and detect audit deficiencies.

### Enforcement matters

Patrick Bryan, Director of the Division of Enforcement and Investigations at the PCAOB, discussed recent enforcement trends, notable enforcement matters and priorities for the PCAOB enforcement division. He said the division continues to prioritize audit violations that present risks to investors or threaten the PCAOB's regulatory process, as well as matters related to significant independence violations. Mr. Bryan noted that the PCAOB expects to focus on impacts from the COVID-19 pandemic, including firms' potential failure to adapt to risks in the current environment, such as auditing intangibles assets. Mr. Bryan also highlighted recent enforcement matters brought against audit firms with operations in foreign countries, including China, relating to topics such as client acceptance, supervision and required firm disclosures.

### Endnotes:

- <sup>1</sup> "SEC Charges Companies, Former Executives as Part of Risk-Based Initiative." 28 September 2020, <https://www.sec.gov/news/press-release/2020-226>.
- <sup>2</sup> See *IFRS Standards Discussion Paper on Business Combinations – Disclosures, Goodwill and Impairment*, for more information.
- <sup>3</sup> IFRS Foundation, September 2020, *Consultation Paper on Sustainability Reporting*.
- <sup>4</sup> "SEC Updates Auditor Independence Rules," 16 October 2020, <https://www.sec.gov/news/press-release/2020-261>.
- <sup>5</sup> "Post-Implementation Review of AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion," <https://pcaobus.org/oversight/standards/economic-analysis/pir/post-implementation-review-as-3101-auditors-report-audit-financial-statements-when-auditor-expresses-unqualified-opinion>.
- <sup>6</sup> Concept Release, *Potential Approach to Revisions to PCAOB Quality Control Standards*: [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/2019-003-quality-control-concept-release.pdf?sfvrsn=5856398d\\_0](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/2019-003-quality-control-concept-release.pdf?sfvrsn=5856398d_0).
- <sup>7</sup> *Staff Observations and Reminders during the COVID-19 Pandemic*, December 2020. [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/documents/staff-observations-reminders-covid-19-spotlight.pdf?sfvrsn=b14c0d8\\_6](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/documents/staff-observations-reminders-covid-19-spotlight.pdf?sfvrsn=b14c0d8_6).

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## Appendix – Conference speeches

	Speech and link to source
SEC Chief Accountant Sagar Teotia	▶ <a href="#"><u>Statement on OCA's Focus on High-Quality Financial Reporting During an Unusual Year and a Discussion of our Upcoming Priorities</u></a>
SEC Professional Accounting Fellow Kevin Cherrstrom	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Geoff Griffin	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Jeffrey Joseph	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Sheena Lam	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Jeffrey Nick	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Jillian Pearce	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
SEC Professional Accounting Fellow Damon Romano	▶ <a href="#"><u>Speech by SEC Professional Accounting Fellow: Remarks before the 2020 AICPA Conference on Current SEC and PCAOB Developments</u></a>
FASB Chairman Richard Jones	▶ <a href="#"><u>Remarks of FASB Chair Richard R. Jones, AICPA Conference on SEC and PCAOB Developments</u></a>
IASB Vice-Chair Sue Lloyd	▶ <a href="#"><u>IASB Vice-Chair on challenges and developments in 2020 and plans for the year ahead</u></a>
PCAOB Board Member J. Robert Brown Jr.	▶ <a href="#"><u>The Need for Increased Transparency and Accountability in the PCAOB's Remediation Process</u></a>
CAQ Executive Director Julie Bell Lindsay	▶ <a href="#"><u>Prepared Remarks by CAQ Executive Director Julie Bell Lindsay for the AICPA Conference on Current SEC and PCAOB Developments</u></a>