

2024 AICPA & CIMA Conference on Current SEC & PCAOB Developments: Highlights

December 2024

OVERVIEW

Representatives from the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB), and the Public Company Accounting Oversight Board (PCAOB) shared their views on various accounting, reporting, and auditing issues at the annual AICPA & CIMA Conference on Current SEC and PCAOB Developments (“Conference”) held in Washington, D.C. on December 9-12, 2024.

This year’s Conference focused on recent rulemaking, new accounting standards, as well as other accounting and reporting reminders in areas related to:

- ▶ **SEC reporting matters** - the SEC staff shared 1) observations on disclosures related to recent rulemaking, including clawback, cybersecurity, pay versus performance, and special purpose acquisition companies (“SPACs”); 2) its views on the interaction of the new segment reporting disclosures and SEC rules and regulations; 3) disclosure reminders related to non-GAAP measures, management’s discussion and analysis (“MD&A”), and artificial intelligence; 4) guidance and best practices when submitting waiver requests.
- ▶ **Accounting matters** - the SEC staff provided guidance and reminders on upcoming accounting standards, including Accounting Standards Update (ASU) No. 2024-03 related to the disaggregation of income statement expenses, and International Financial Reporting Standards (IFRS) 18, *Presentation and Disclosure in Financial Statements*. The SEC staff also discussed disclosures related to the statement of cash flows and supplier finance arrangements, certain accounting matters, and tips when consulting with the Office of the Chief Accountant (“OCA”).
- ▶ **Audit matters** - the SEC staff discussed error assessments and independence, and the PCAOB staff discussed inspection results, priorities, and year-end reminders.

This publication shares insight into these matters and other accounting and reporting issues addressed at the Conference. Reference our companion publication, [2024 SEC Reporting Insights](#), for a more comprehensive discussion of key disclosure and reporting reminders for upcoming filings, the SEC’s rulemaking, and other activities that affect financial reporting, many of which were highlighted at the Conference.

CONTENTS

OVERVIEW	1
SEC REPORTING MATTERS	2
SEC Staff Guidance and Observations on Final Rules	2
Non-GAAP Measures	4
Segment Disclosures.....	5
Management’s Discussion & Analysis	7
Artificial Intelligence Emerging Risks	8
Waiver Requests and Best Practices	8
Other	8
ACCOUNTING MATTERS	10
Upcoming Accounting Standards	10
Financial Statement Disclosures	10
Accounting Issues	11
Consulting with the Office of the Chief Accountant	11
AUDIT MATTERS	12
Assessing Error Corrections....	12
Auditor Independence	12
PCAOB	12
CONTACTS	13

SEC REPORTING MATTERS

SEC Staff Guidance and Observations on Final Rules

Clawback

The SEC staff addressed the application of the clawback checkboxes and the disclosures required when a restatement requires the recovery of erroneously awarded compensation. The SEC staff emphasized that the disclosures required by Item 402(w) of Regulation S-K (“S-K”) are not solely dependent on the checkboxes.

As a reminder, the clawback checkboxes appear on the cover page of annual reports on Forms 10-K, 20-F, and 40-F and require listed registrants (“issuers”) to indicate whether:

- ▶ The financial statements included in the filing reflect the correction of an error to previously issued financial statements (“first checkbox”).
- ▶ Any of the error corrections identified in 1) required an analysis for the recovery of incentive-based compensation from its executive officers (“second checkbox”).

The clawback checkboxes apply to annual reports, not quarterly reports (such as Form 10-Q). In contrast, the S-K Item 402(w) disclosures apply to restatements during or after the last completed fiscal year that require the recovery of erroneously awarded compensation. Accordingly, the application of the clawback checkboxes depends on when a restatement is reflected, whereas the application of the S-K Item 402(w) disclosures depends on when a restatement is determined. As such, the S-K Item 402(w) disclosures may apply to an issuer even when the clawback checkboxes do not. To illustrate this, the SEC staff provided the following example:

Before filing its 2024 Form 10-K, an issuer restates its first, second, and third quarter 2024 Form 10-Qs to correct an error. After filing the amended Form 10-Qs, the issuer files its 2024 Form 10-K and presents restated 2024 interim financial information in an unaudited footnote to comply with S-K Item 302. In this instance, the SEC staff indicated it would not object if the issuer does not check the first checkbox on the cover page of its 2024 Form 10-K because the previously issued financial statements included in the annual report do not reflect the correction of an error.¹ However, the issuer must include the S-K Item 402(w) disclosures in its 2024 Form 10-K² because the restatement occurred during or after its last completed fiscal year.

The SEC staff reminded issuers that the first checkbox applies to any correction of an error, as defined by U.S. GAAP (or IFRS), including “Big R,” “little r,” and voluntary restatements. The first checkbox does not apply to out-of-period adjustments. The SEC staff addressed the application of the first checkbox in annual reports following a restatement. For example, assume an issuer identifies a material error to the financial statements included in its 2023 Form 10-K. The issuer amends its 2023 Form 10-K to correct the error and checks the first checkbox. In its 2024 Form 10-K, the issuer is not required to check the first checkbox for the same restatement because investors were made aware of the error when the issuer checked the first checkbox in its amended 2023 Form 10-K. However, if an issuer restates its previously issued financial statements in a filing other than an annual report (such as a registration statement or Form 8-K), the SEC staff believes the issuer must check the first checkbox in its annual report that reflects the correction of the error to the previously issued financial statements to inform investors of the error. For example, assume an issuer identifies an immaterial error to the financial statements included in its 2023 Form 10-K. Prior to filing its 2024 Form 10-K, the issuer corrects the error in its financial statements by filing an Item 8.01 Form 8-K. In this circumstance, the SEC staff believes the issuer should check the first checkbox when it files its 2024 Form 10-K as the issuer has not previously checked the first checkbox to inform investors of the error.

The second checkbox applies to Big R or little r restatements (it does not apply to voluntary restatements). When the first checkbox is checked due to a Big R or little r restatement, the second checkbox applies. This is true even if the executive officers did not receive incentive compensation during the relevant periods of the recovery analysis, and when the restatement has no impact on incentive compensation received, as an analysis for the recovery is required.

Lastly, the SEC staff shared observations from its review of the disclosures required by S-K Item 402(w). First, issuers must comply with the disclosure requirements when a restatement requires a clawback analysis, even when recovery is

¹ This is consistent with the SEC staff’s view detailed in [June 2024 CAQ SEC Regulations Committee Highlights](#), Topic III.A.

² Or its definitive proxy statement if the issuer forward incorporates Part III information into its Form 10-K.

not required. In these instances, the issuer must briefly explain why the application of its recovery policy did not require recovery. The SEC staff also reminded issuers that the clawback disclosures must be tagged using Inline XBRL.

Cybersecurity

During the Conference, the SEC staff reminded registrants that Item 1.05 of Form 8-K should only be used to disclose **material** cybersecurity incidents. A registrant may voluntarily disclose other cybersecurity incidents, such as those that are determined to be immaterial, or for which a materiality assessment is not yet complete, under Item 8.01 of Form 8-K.³ The SEC staff observed that disclosures about cybersecurity incidents often emphasize quantitative factors, indicating that the incident did not materially affect the registrant's operations or financial condition. However, the SEC staff reminded registrants that the assessment of materiality should also include qualitative factors, such as reputational damage and the impact on customer relationships.

Additionally, the SEC staff addressed its observations on the annual risk management, strategy, and governance disclosures required by S-K Item 106, noting that:

- ▶ If a registrant has a process for identifying, assessing, and managing significant cybersecurity risks, the disclosure should clearly describe this process to inform investors. Merely stating that a process exists is not enough. The disclosure should also cover any processes associated with third-party service providers used by the registrant.
- ▶ If a group is responsible for assessing and managing cybersecurity risks, the expertise of each individual should be described, rather than focusing on a single individual or the group in total. This ensures that investors have a clear understanding of the collective expertise within the organization, and the impact to the registrant if the composition of the group changes.

The SEC staff also reminded registrants that cybersecurity disclosures must be tagged using Inline XBRL beginning with annual reports for fiscal years ending on or after December 15, 2024, and in Item 1.05 of Form 8-K (or in Form 6-K) beginning December 18, 2024.

Pay versus Performance

The SEC staff shared the following areas for improvement in pay versus performance disclosures:

- ▶ Net income - the SEC staff reminded registrants that they must disclose consolidated net income. The SEC staff observed instances where figures other than consolidated net income were reported, such as consolidated net income excluding noncontrolling interests.
- ▶ Company-selected measure - if the company-selected measure is non-GAAP, registrants must disclose how it is different than the audited financial statements. Although a reconciliation to the most direction comparable GAAP measure is not required,⁴ the disclosure should clearly describe the measure, define any terms used, and avoid vague terminology.
- ▶ Compensation actually paid - registrants should use the terminology specified in the rule to describe each adjustment in the calculation of compensation actually paid. The SEC staff noted that using other descriptions for adjustments made it challenging to assess the registrant's compliance with the rule.
 - Additionally, the SEC staff reminded registrants to use the legal vesting terms of equity awards with retirement eligibility vesting provisions when calculating compensation actually paid. If retirement eligibility accelerates the vesting of an award and is the sole vesting condition, it is satisfied when the holder reaches retirement age. However, if an equity award includes other substantive vesting conditions in addition to retirement eligibility, these other conditions must also be considered.⁵

Lastly, the SEC staff reminded registrants that the disclosures must be tagged using Inline XBRL.

Refer to our Snapshot, [Pay versus Performance Disclosures](#) for more information on the disclosure requirements and related SEC staff guidance.

³ This approach is consistent with the SEC staff's [statement](#) issued in May 2024.

⁴ [CDI](#) 118.08 clarifies when non-GAAP measures included in Compensation Discussion & Analysis or other parts of the proxy statement are subject to the SEC's non-GAAP rules.

⁵ [CDI](#) 128D.18.

Special Purpose Acquisition Companies (“SPACs”)

In some de-SPAC transactions, a new entity known as “PubCo” becomes the parent company of both the SPAC and the private operating company target. In these cases, the SEC staff has clarified that PubCo is a registrant and does not qualify as a business combination related shell company. Consequently, PubCo’s financial statements are required in the Form S-4 or F-4 registration statement. The SEC staff has noted instances where these financial statements were omitted from the registration statement and has commented on such omissions.

Additionally, the SEC staff reminded registrants that once the registration statement becomes effective, PubCo has a reporting obligation under Section 15(d) of the Securities Exchange Act of 1934. As such, PubCo must timely file all periodic and annual reports after the registration statement’s effective date, even if the de-SPAC has not been completed. Furthermore, the SEC staff emphasized that the SPAC’s financial statements must be included in PubCo’s registration statements filed after the de-SPAC transaction until PubCo files financial statements reflecting the de-SPAC transaction. There have been questions about whether the SPAC’s financial statements in PubCo’s subsequent registration statements need to be audited or reviewed, as applicable, under PCAOB standards, even if the SPAC has suspended its reporting obligations. The SEC staff believes that these financial statements must be audited or reviewed, as applicable, under PCAOB standards because the SPAC is treated as if it were the registrant until PubCo’s financial statements reflect the de-SPAC transaction.⁶

Additionally, to illustrate the net assets the SPAC contributes to the post-combination entity, the SEC staff reminded registrants of the requirement to disclose both the net tangible book value (“NTBV”) per share, as adjusted, as well as the difference between the offering price and the NTBV per share, as adjusted.⁷

Refer to our Bulletin [SEC Adopts Rules on SPACs, Shell Companies, and Projections](#) for a summary of the SPAC rules.

Non-GAAP Measures

The SEC staff continues to focus and comment on non-GAAP measures and provided the following guidance for registrants to consider in their upcoming filings:

Misleading Measures

- ▶ Normal, recurring, cash operating expenses⁸ - presenting a non-GAAP measure that excludes normal, recurring, cash operating expenses is misleading, and the SEC staff will object to such presentation. The SEC staff reminded registrants to consider whether costs are normal, recurring, cash operating expenses relative to their operations. Additionally, the SEC staff clarified that an operating expense that is normal, recurring, or cash, may be considered a normal, recurring, cash operating expense (in other words, the operating expense does not need to be all three). For example, write-downs for excess or obsolete inventory are not cash operating expenses, but are considered to be normal, recurring, cash operating expenses. The SEC staff provided additional examples of normal, recurring, cash operating expenses, including losses on purchase commitments, lease expense when the leased assets are integral to the registrant’s operations, and cash compensation (including bonuses).
- ▶ Individually tailored accounting principles⁹ - presenting a non-GAAP measure that adjusts the measurement or recognition principles of U.S. GAAP or IFRS (“individually tailored accounting principles”) is misleading, and the SEC staff will object to such presentation. The SEC staff reminded registrants that individually tailored accounting principles encompass all adjustments, not only those specific to revenue recognition principles. The SEC staff provided other examples of individually tailored accounting principles including adjustments to change the accounting for a lease from a sales-type lease to an operating lease, adjustments to remove accelerated depreciation from measures other than EBITDA, and reversing the effects of purchase accounting after the acquisition date.

⁶ Article 15 of Regulation S-X.

⁷ S-K Item 1602.

⁸ [C&D](#) 100.01.

⁹ [C&D](#) 100.04.

Debt Covenant Measures

The SEC staff addressed the presentation of non-GAAP measures that are calculated in accordance with a debt covenant. If a registrant includes such a measure in its discussion of liquidity and capital resources to comply with S-K Item 303, the measure is excluded from the definition of a non-GAAP measure under S-K Item 10(e), and the SEC staff will not object to its presentation. Furthermore, the SEC staff clarified that disclosing this measure in an earnings release is not objectionable when it is material to understanding the registrant's financial condition and liquidity, provided it is presented similarly to the liquidity and capital resources disclosures in MD&A.

However, the SEC staff will likely object if a non-GAAP covenant measure is presented in an earnings release as an indicator of performance rather than liquidity, especially if it includes adjustments that result in a misleading non-GAAP measure, such as altering the pattern of revenue recognition in a way that is inconsistent with U.S. GAAP or IFRS.

Other Reminders

The SEC staff also reminded registrants of the following:

- ▶ Prominence - non-GAAP measures must not be presented with greater prominence than the most directly comparable GAAP measure. This includes the presentation of tables, charts, and graphs, and any discussion of a non-GAAP measure.¹⁰
- ▶ Labeling¹¹ - registrants should ensure that their disclosures allow investors to clearly understand the nature of each adjustment to non-GAAP measures. For example, if an adjustment in a non-GAAP reconciliation includes multiple, seemingly unrelated adjustments grouped together, the SEC staff will likely issue a comment asking the registrant to clarify the adjustment. The SEC staff is also likely to comment if the adjustments or accompanying disclosures are vague, generic, or unclear. However, merely relabeling or adding clarity may not always be sufficient, as detailed disclosures cannot cure a misleading non-GAAP measure.¹²

Segment Disclosures

Accounting Standards Update 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures* (the ASU or ASC 280), introduces new disclosure requirements for all public entities and must be adopted by calendar year-end companies in their upcoming Form 10-K filings. The expanded disclosure requirements must be applied retrospectively (unless impracticable) by **single and multiple** reportable segment entities. At the Conference, the SEC staff provided its views on multiple aspects of the new disclosure requirements.

Disclosure of Additional Measures of Segment Performance

The ASU permits (but does not require) additional measures of segment profit or loss within the financial statements if the CODM uses multiple measures of profit or loss to manage a segment. Because ASC 280 uses a management approach, the additional measures are not required to be consistent with the recognition and measurement principles of U.S. GAAP.

At the Conference, the SEC staff reiterated its view that additional measures of segment performance not calculated in accordance with U.S. GAAP are considered non-GAAP financial measures subject to the SEC's non-GAAP rules and guidance. The SEC staff offered the following guidance for entities that elect to disclose such non-GAAP segment performance measures:

- ▶ The entity must continue to disclose the measure of segment profit or loss that is most consistent with U.S. GAAP.
- ▶ Any measure of segment profit or loss disclosed should be regularly reviewed by the CODM and used by the CODM to allocate resources and assess performance.
- ▶ The measure must not be misleading and must comply with Regulation G, S-K Item 10(e), and the SEC staff's Compliance & Disclosure Interpretations, which include requirements to disclose:
 - A statement about why the non-GAAP measure is useful to investors, and
 - A reconciliation to the nearest U.S. GAAP measure (collectively, the "incremental disclosures").

¹⁰ [C&DI](#) 102.10.

¹¹ [C&DI](#) 100.05.

¹² [C&DI](#) 100.06.

The incremental disclosures are not required in the financial statements but must be included in the filing (for example, within MD&A). If entities elect to make the incremental disclosures in:

▶ MD&A

- Entities may not include a cross-reference to MD&A in their financial statements. However, entities may need to consider whether additional disclosures may be required by Regulation S-X (“S-X”) 4-01(a) that states, “*The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further **material** information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.*”

▶ Financial Statements

- The SEC staff has stated that they may be labeled “unaudited” because the audit opinion does not cover compliance with the SEC’s non-GAAP rules (note that the unaudited labeling does not extend to the additional measure(s) of segment profit or loss because each measure must be disclosed and audited in accordance with ASC 280). However, auditors need to consider their responsibilities under PCAOB Auditing Standard 2710, *Other Information in Documents Containing Audited Financial Statements*, when evaluating these disclosures.

Further, the staff expressed its views on whether an entity’s removal of an additional measure of segment profit or loss from its segment footnote constitutes an error correction in accordance with Accounting Standards Codification (ASC) Topic 250, *Accounting Changes and Error Corrections* (ASC 250). If the removal relates to a compliance matter with the SEC’s non-GAAP rules, it is not considered an ASC 250 error correction. The staff provided two examples:

- ▶ A registrant that removes an additional measure because the measure is not used by the CODM would be considered an error correction (as ASC 280 requires any disclosed measure of segment profit or loss must be used by the CODM to allocate resources and assess performance).
- ▶ A registrant that removes an additional measure because the measure is considered misleading in accordance with the SEC’s non-GAAP rules would not be considered an error correction. However, the registrant must consider the impact of such removal on its assessment of disclosure controls and procedures.

When an entity elects to disclose additional measures of segment profit or loss (whether GAAP or non-GAAP) that are regularly reviewed by the CODM and used to allocate resources and assess performance, the staff reminded registrants that ASC 280-10-50-28C requires the following disclosures for **each** reported measure of a segment’s profit or loss:

- ▶ Significant segment expenses and other segment items included in the measure of profit or loss provided to the CODM
- ▶ How the CODM uses the measure to assess performance and allocate resources
- ▶ A reconciliation of the total of the reportable segments’ measures of profit or loss to the entity’s pre-tax income from continuing operations

Significant Segment Expenses

The ASU does not require significant segment expenses to be calculated in accordance with U.S. GAAP. In some instances, corporate overhead departments may not be part of a reportable segment. At the Conference, the SEC staff stated that segment expenses are not considered non-GAAP items even if corporate overhead costs (for example, costs associated with a corporate headquarters or certain functional departments) are not allocated to a segment because ASC 280-10-50-4 acknowledges that not every part of a public entity is necessarily part of a segment.

However, the SEC staff encourages registrants to consider whether additional SEC disclosure requirements, including S-X Rule 4-01(a), apply if significant segment expenses are not calculated in accordance with U.S. GAAP. Therefore, we believe entities that report a significant segment expense that is not calculated in accordance with U.S. GAAP should disclose that, as well as the nature of any adjustments. Depending on the facts and circumstances, additional disclosures may be appropriate.

For more guidance on segment disclosures, see our publication, [New Segment Reporting Disclosures](#).

Management's Discussion & Analysis

Disclosures in MD&A remain at or near the top of the SEC staff's most frequent comment letter areas. SEC staff comments often focus on how the registrant's disclosures meet the objective of MD&A, which is to provide investors with material information relevant to assessing the registrant's financial condition and results of operations.

The SEC staff highlighted that registrants need to keep macroeconomic conditions (e.g., inflation, supply chain shortages, and wars) and the impacts of emerging technologies, like artificial intelligence (AI), at the top of their minds when drafting MD&A disclosures in upcoming filings. These evolving and emerging risks and conditions may have had a material impact on the registrant's financial condition and results of operations or create material known trends and uncertainties that should be addressed in MD&A. Consistent with past years, the SEC staff emphasized the need to avoid boilerplate language when addressing these risks, trends, and uncertainties.

Liquidity and Going Concern

The SEC staff noted that the analysis of changes in cash flows often recites information that is readily apparent from the statement of cash flows and does not describe the underlying reason(s) for material changes. The cash flow discussion should include quantitative **and** qualitative descriptions of the changes period over period. The SEC staff asked that registrants continue to answer the "why" until the key qualitative drivers of the change are disclosed.

Some registrants with negative cash flows from operations have little discussion of their ability to generate or obtain adequate cash to support their operations. The SEC staff reminded such registrants to specifically address how they will fund their operations when they do not generate cash from operations and plan to remedy material cash deficiencies. Robust MD&A disclosure may be required in such circumstances to better allow an investor to understand management's perspective with respect to the registrant's liquidity position.

Moreover, some registrants disclose that there is substantial doubt about their ability to continue as a going concern within one year after the financial statements are issued. The SEC staff reminded such registrants that S-K Item 303 requires a discussion of the registrant's ability to generate and obtain adequate amounts of cash over the short-term (within twelve months) and long-term (beyond the next twelve months). The SEC staff encouraged these registrants to revisit their liquidity and cash flow disclosures to ensure they meet the S-K Item 303 requirements and consider whether a related risk factor disclosure is also warranted.

Pillar Two

Pillar Two of the Organization for Economic Co-operation and Development's Global Tax Deal requires large multinational enterprises with global revenue in excess of EUR 750 million to pay a minimum level of tax of 15% in each jurisdiction in which they operate. The SEC staff briefly discussed the income inclusion and undertaxed profit rules:

- ▶ Income inclusion rule - the top tax that is paid in the country of a parent entity to meet the minimum 15% threshold
- ▶ Undertaxed profit rule - when the income inclusion rule has not yet been implemented and the entity has a taxable presence, the country can collect up to the minimum 15% threshold (which is effective for the 2025 tax year)

The SEC staff has observed MD&A disclosures that indicate changes in tax laws such as Pillar Two are not expected to have a material impact or, if such changes could have a material impact, registrants often omit quantification of the impact on income from continuing operations. As S-K Item 303 requires registrants to quantify the reasonably likely impact of changes (including tax law changes) that will (or are reasonable likely to) have a material impact on their results of operations and financial condition, the SEC staff stated that quantitative disclosures related to Pillar Two in MD&A should evolve over time. If there are complexities or uncertainties over the impact of the change, registrants may consider disclosing a range of likely outcomes. The SEC staff may question registrants that report a material impact related to the Pillar Two tax law changes but did not provide appropriate forewarning disclosures about the potential impact in MD&A.

BDO INSIGHTS – PILLAR TWO

In addition to the complex calculations and tax compliance challenges, Pillar Two introduces new considerations for tax accounting and financial statement disclosures. More information about these considerations as well as the top ten Pillar Two considerations for year-end can be found in BDO's publications, [What Pillar Two Means for Income Tax Accounting](#) and [Top 10 Pillar Two Year-End Considerations for Large Multinational Companies](#).

Artificial Intelligence Emerging Risks

The SEC staff noted that the rise of artificial intelligence (AI) has significantly increased AI-related disclosures, with references in Form 10-K filings doubling from 2023 to 2024. The SEC staff has observed that these disclosures often lack specificity and reminded registrants to provide information tailored to their unique circumstances and challenges with material AI risks. Considerations should include operational and market dynamics, cybersecurity and data privacy, discrimination and bias, intellectual property issues, litigation, compliance costs with federal and state AI regulations, consumer protection concerns, and potential labor market effects. Registrants should also consider disclosures related to AI risk management and corporate governance policies. The SEC staff urged registrants to avoid boilerplate disclosures, as the impact of AI may vary depending on the size, needs, or stage of AI integration within the business. Lastly, the SEC staff encouraged registrants to disclose the basis for any claims about the AI's impact on the results of operations or financial condition.

Waiver Requests and Best Practices

In accordance with S-X Rule 3-13, the SEC staff may waive or modify certain financial statement requirements when such requests are consistent with investor protection. Registrants may submit such requests for relief using an [online submission form](#) available on the SEC's website.

The SEC staff shared some recent waiver trends and best practices to follow during the waiver process. While the SEC staff observed a decrease in the volume of waiver requests following the amendments to Rule 3-05 of Regulation S-X, requests related to financial statements of acquired businesses remain the source of many waivers and interpretive questions, including those that relate to:

- ▶ Anomalous results from the significance tests when a business is acquired
- ▶ The use of abbreviated financial statements in certain transactions that do not otherwise meet the criteria for their use in S-X Rule 3-05(e)
- ▶ The conclusion under S-X Rule 11-01(d) about whether the acquired entity meets the definition of a business. The SEC staff reminded registrants that:
 - The definitions of a business under U.S. GAAP (or IFRS) and the SEC's rules are different.
 - There is a presumption that a legal entity constitutes the acquisition of a business under S-X 11-01(d).
 - Revenue is not required to meet the definition of a business (for example, the acquisition of a pre-revenue life science or technology entity may also meet the definition of a business)

To expedite the waiver process, the SEC staff highlighted the following best practices:

- ▶ Provide all relevant details of the significance tests and consider providing their actual calculations.
- ▶ Consider including an alternative request if the SEC staff does not agree with the registrant's initial position. For example, registrants may consider including a waiver request for the historical financial statement requirements of an acquired entity if the SEC staff disagrees with a registrant's conclusion that the acquired entity does not meet the SEC's definition of a business.
- ▶ Involve all relevant stakeholders when drafting the letter, including the external auditor and its National Office, who possess technical experience and can assist with navigating interactions with the SEC staff.
- ▶ Carefully consider who the primary point of contact will be if the SEC staff reaches out to the registrant for clarification. The SEC staff encourages registrants to select an individual who can speak to the facts of the transaction as well as someone who understands the relevant rules and accounting guidance.

Other

Reverse Merger Involving Two Operating Companies

When merging with a non-public operating company, a public operating company determines the acquirer for accounting purposes. In a reverse merger, the non-public operating company is the accounting acquirer. Prior to the merger, the registrant may present the pre-acquisition financial statements of the non-public operating company in a proxy statement or in Form 8-K related to the merger. The SEC staff noted that these pre-acquisition financial statements of the non-public company may be audited under AICPA auditing standards and the auditor does not have to be registered with the PCAOB or independent under PCAOB or SEC rules.

Once the registrant reflects the reverse merger in a periodic report, the financial statements of the non-public accounting acquirer become the historical financial statements of the registrant. Therefore, the reissuance of these historical financial statements subsequent to the reverse merger (e.g., in a registration statement or in Form 10-K), triggers different audit requirements compared to the original presentation of the pre-acquisition financial statements. The SEC staff indicated that the audit of these re-issued financial statements must be performed under PCAOB auditing standards and the auditor must be registered with the PCAOB and comply with PCAOB and SEC independence rules for all periods presented.¹³

The SEC staff provided an example of a public operating company that completed a reverse merger with a non-public operating company ("PrivateCo") during August 2024. The 2024 10-K for the calendar year-end registrant will present financial statements for the years ended December 31, 2024, 2023 and 2022. The 2023 and 2022 annual periods will reflect the financial statements of PrivateCo, the accounting acquirer. Financial statements for all years presented in the 2024 10-K (i.e., 2022, 2023 and 2024) must be audited in accordance with PCAOB standards by an audit firm that is PCAOB-registered and independent in accordance with PCAOB and SEC rules.

Foreign Private Issuers

The SEC staff has received questions about the applicability of Staff Accounting Bulletin (SAB) Topic 4C, *Change in Capital Structure*, to financial statements prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB) of foreign private issuers (FPIs). SAB Topic 4C requires a change in capital structure, such as a stock dividend or stock split, after the date of the latest reported balance sheet but before release of the financial statements or effective date of a registration statement (whichever is later) to be retroactively applied in the balance sheet.

The SEC staff observed that the subsequent events guidance under IFRS-IASB and U.S. GAAP is similar in nature in that neither require recognition of a subsequent change in capital structure. Therefore, the SEC staff believes that an FPI reporting under IFRS-IASB is required to comply with SAB Topic 4C to provide relevant and transparent financial information to users of the financial statements regarding changes in capital structure.

This guidance requires financial statements included in an IPO registration statement to be recast for subsequent changes in capital structure and filed in a pre-effective amendment. Consistent with the guidance in the Division of Corporation Finance's Financial Reporting Manual (FRM) section 13500, previously filed financial statements that are incorporated by reference into a registration statement or proxy are not required to be recast to reflect a stock split. Instead, the registration statement or proxy statement may disclose the stock split or other change and include selected financial data that includes per share information (adjusted for the impact of the stock split) for all periods presented.

Requesting Extensions for Comment Letter Responses

When the SEC staff issues a comment letter, there may be circumstances when the registrant is unable to respond in the suggested timeframe. The SEC staff is generally amenable to extension requests in order for the registrant to provide a more fulsome response and encourages registrants to request an extension in these circumstances. Registrants should reach out to the SEC staff personnel responsible for reviewing the comment letter response, the contact information for which is included in the comment letter.

The SEC staff encouraged registrants to keep their contact information updated when submitting their SEC filings. Occasionally, the SEC staff may reach out in advance of sending a comment letter to let a registrant know that it is considering sending a letter. When a registrant's contact information is inaccurate, it may delay the process and put unnecessary pressure on the timeline for a registrant to respond.

¹³ The SEC staff noted that its current view is not consistent with the guidance in FRM 12250.2.

ACCOUNTING MATTERS

Upcoming Accounting Standards

Scope

Certain industry groups have questioned the applicability of certain ASUs, including segments and disaggregation of income statement expenses, especially when industry-specific GAAP exists. The SEC staff noted that the ASUs apply to all companies unless there is a specific scope exemption in the standards (i.e., the staff has not identified any incremental scope exceptions).

IFRS 18, Presentation and Disclosure in Financial Statements

Given the potential IFRS 18 implementation challenges, the SEC staff reminded FPIs that apply IFRS to engage with the SEC staff should implementation questions or challenges arise. In that regard, the SEC staff discussed a recent IFRS 18 inquiry. Under IFRS 18, when a registrant presents a management-defined performance measure (“MPM”) outside the financial statements, the registrant must also disclose the MPM and other information, such as a reconciliation to the most similar IFRS amount, in the notes to the financial statements. As the MPM is first disclosed outside the financial statements, the SEC staff clarified that in all instances, the presentation of the measure outside the financial statements is subject to the SEC’s non-GAAP rules.

See our publication, [IFRS Accounting Standards In Practice - IFRS 18 Presentation and Disclosure in Financial Statements](#), for more information

Disaggregation of Income Statement Expenses (DISE)

The FASB staff noted that the DISE standard¹⁴ was drafted based on stakeholder feedback, which included requests for more information related to inventory costs. As such, the DISE standard required disclosure of expenditures related to inventory. The staff explained that such disclosures are limited the purchase of inventory items within the scope of ASC 330, *Inventory*.

See our Bulletin, [FASB Finalizes ASU to Disaggregate Income Statement Expenses](#), for more information.

Financial Statement Disclosures

Statement of Cash Flows

Determining the appropriate classification of cash flows as operating, investing, or financing activities may require significant judgment. The SEC staff encouraged registrants to carefully consider their facts and circumstances to determine the predominate source of cash flows for an item in accordance with ASC 230, *Statement of Cash Flows*. When significant judgment is used to classify material cash flows, the SEC staff suggested that registrants consider explaining the reason for these classifications in their significant accounting policies.

Supplier Finance Arrangements

The SEC staff emphasized that it remains focused on the disclosures related to supplier finance programs and encouraged registrants to ensure such disclosures align with the objectives of ASC 405-50, *Liabilities—Supplier Finance Programs*. This means that registrants should avoid boilerplate language and provide a detailed description of key terms to enable investors to understand the impact, or potential impact, on their operations and financial condition.

See our Bulletin [Disclosure of Supplier Finance Program Obligations](#), for more information.

¹⁴ ASU No. 2024-03: *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*.

Accounting Issues

Sale of a Subsidiary that is not a Business

The SEC staff described a fact pattern in which a registrant sold a subsidiary consisting of a group of assets and liabilities (the set) that did not meet the definition of a business in ASC 805, *Business Combinations*. In addition to operating assets and liabilities, the set included assets that, if sold individually, would constitute an output of the registrant's ordinary activities. Given the inclusion of these assets, the registrant evaluated whether it should apply the guidance in ASC 606, *Revenue from Contracts with Customers*, to the transaction. The registrant also considered whether it should account for the sale in accordance with the deconsolidation and derecognition guidance in ASC 810, *Consolidation*, which applies to the sale of a subsidiary that is a business, and to a subsidiary that is not a business if the substance of the transaction is not addressed directly by other guidance, including ASC 606 and ASC 610-20, *Other Income – Gains and Losses From the Derecognition of Nonfinancial Assets*. The SEC staff observed that it was most appropriate for the registrant to consider the total mix of assets and liabilities in the set and that no one item in the set should be viewed as determinative. The SEC staff noted that given the inclusion of the other assets and liabilities, the guidance in ASC 606 does not directly address the substance of such a transaction, and therefore the SEC staff did not object to the registrant applying the deconsolidation guidance in ASC 810 to the transaction.

For more information on the definition of a business, see our Blueprint, [Business Combinations Under ASC 805](#). For more guidance on the scope of ASC 606 and ASC 610-20, see our Blueprint, [Revenue Recognition Under ASC 606](#).

Eliminating a Lag in Reporting

The SEC staff described another fact pattern in which a registrant had been consolidating a subsidiary on a lag, which is acceptable based on the guidance in ASC 810-10-45-12 if the lag does not exceed three months. The registrant eliminated the lag period and recognized the three months of income statement activity through an adjustment to shareholders' equity and adjusted the subsidiary's assets and liabilities to their carrying amounts as of the date of the sale. The staff objected to this accounting, including eliminating the lag period through an adjustment to shareholders' equity.

Accounting for Financial Instruments

The SEC staff has observed widespread diversity in the application of the indexation guidance in ASC 815-40, *Contracts in Entity's Own Equity*, when classifying financial instruments like warrants as debt or equity. Specifically, the SEC staff highlighted two clauses in warrant instruments where diversity exists in evaluating the settlement provisions (commonly referred to as the "fixed-for-fixed" guidance):

- ▶ Participating dividend rights in which the warrant holder is treated the same as a shareholder, i.e., without considering the intrinsic value of the instrument.
- ▶ Pre-specified volatility inputs upon settlement in fundamental transactions, including scenarios where a greater of volatility (such as a 100% floor and historical volatility) is an input to a Black-Scholes valuation model.

The SEC staff noted that the examples in the current guidance differ from many instruments issued in the market and acknowledged that, from a standard-setting perspective, there is room for greater clarity on when adjustments are considered commercially reasonable and when, or to what extent, these adjustments might conflict with the indexation principle. The FASB is expected to issue an invitation to comment to gather feedback on its standard-setting agenda, and the SEC staff encourages stakeholders to participate in this process.

For more information on the accounting for warrants, refer to our upcoming Blueprint, *Issuer's Accounting for Complex Financial Instruments*, which will be available [here](#) in January 2025.

Consulting with the Office of the Chief Accountant

The SEC staff encouraged registrants to consult with them on challenging accounting or auditor independence issues when there is not clear authoritative guidance or when there are complex or novel fact patterns. The SEC staff shared the following best practices to facilitate the consultation process:

- ▶ Allow sufficient time to complete the consultation process in advance of any reporting deadlines.
- ▶ Clearly define the specific issue or question for consultation rather than presenting a broad analysis.
- ▶ Highlight key tension points and provide a robust analysis of alternatives considered including why the alternatives were ultimately rejected.

Refer to the SEC's website, [Consulting with OCA: What to Expect](#), for additional information.

AUDIT MATTERS

Assessing Error Corrections

An error in previously issued financial statements requires registrants to assess both the materiality of the errors and their impact on internal controls over financial reporting (ICFR). The SEC staff emphasized that this assessment must be objective, incorporating both quantitative and qualitative factors to determine whether there is a substantial likelihood that a reasonable investor would view the error as significantly altering the 'total mix' of information available to them.

The SEC staff noted its ongoing scrutiny of arguments supporting immaterial conclusions and, in certain cases, has objected to these conclusions. Common justifications questioned by the SEC staff include errors that:

- ▶ Originated from historical financial reporting decisions;
- ▶ Impacted financial statement line items deemed irrelevant to investors; and
- ▶ Pertained solely to disclosures, such as those involving cash or non-cash disclosures in ASC 230 or segment reporting disclosures in ASC 280.

See our publication [Accounting Changes and Error Corrections](#) for more information on error corrections.

Auditor Independence

The SEC staff discussed auditor independence, emphasizing that while the independence rules fall under the qualifications of accountants, both the audit committee and management share responsibility in maintaining auditor independence. The SEC staff highlighted recent observations related to auditor independence, including:

- ▶ Network firms - recent independence violations suggest that non-U.S. network firms may lack adequate controls to monitor non-audit services, leading to non-compliance with SEC or PCAOB auditor independence requirements. For example, inconsistencies in the timing of implementing restrictions on non-audit services for pre-IPO entities have resulted in violations under SEC independence rules.
- ▶ Change in lead auditor - instances have arisen where it is incorrectly assumed that independence automatically transfers between offices or network firms when there is a change in the lead auditor. A full independence assessment is necessary in such cases, as independence determinations do not automatically transfer.
- ▶ Rule 15Fi-5 and internal auditors - Rule 15Fi-5 requires independent audits of risk mitigation techniques for portfolios of uncleared security-based swaps. While internal auditors could theoretically satisfy this requirement, practical challenges arise due to their employment relationship with the company. Bonuses, salaries, and other employee benefits suggest internal auditors do not meet the independence requirements.

The SEC staff reiterated its availability to assist and answer questions regarding the application of auditor independence rules.

PCAOB

The PCAOB staff discussed recent standard setting activities including:

- ▶ [AS 1000](#), *General Responsibilities of the Auditor in Conducting an Audit*
- ▶ [QC 1000](#), *A Firm's System of Quality Control*
- ▶ [Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form](#)
- ▶ [Firm and Engagement Metrics](#) (subject to SEC approval)

Inspections

The PCAOB staff highlighted the primary areas of audit deficiencies identified in its recently issued [Spotlight](#), which summarizes the 2023 inspection activities. These deficiencies include ICFR testing, particularly those controls involving a review element, as well as the following financial statement deficiency areas:

- ▶ Leases
- ▶ Loans and related accounts
- ▶ Other investments

Year-End Reminders

The PCAOB staff also highlighted certain year-end reminders for auditors including:

- ▶ The new confirmation standard
- ▶ The need to re-evaluate critical audit matters
- ▶ The implementation of new accounting standards

2025 Inspection Priorities

For the 2025 inspection cycle, the PCAOB staff communicated the following priorities:

- ▶ Industries negatively impacted by economic and geopolitical volatility, such as banking, real estate, and information technology
- ▶ Audit execution challenges, including remote work
- ▶ The increased use of technology, such as generative artificial intelligence
- ▶ Compliance with specific rules and standards including audit committee communications, audit reports, Form AP, and independence

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