

AC Insights

Insights for reviewing financial reports

Insights on financial reporting for audit committees

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Economic uncertainties: Reporting the impact

The International Monetary Fund reports¹, “Global economic activity is experiencing a broad-based and sharper-than-expected slowdown, with inflation higher than seen in several decades. The cost-of-living crisis, tightening financial conditions in most regions, Russia’s invasion of Ukraine, and the lingering COVID-19 pandemic all weigh heavily on the outlook. Global growth is forecast to slow from 6.0 percent in 2021 to 3.2 percent in 2022 and 2.7 percent in 2023. This is the weakest growth profile since 2001 except for the global financial crisis and the acute phase of the COVID-19 pandemic.”

The IMF’s *World Economic Outlook Report* paints a picture of uncertain economic times caused by several factors. Politicians and other economists have expressed similar sentiments in their year-end messages. Many Canadian companies have or will face economic challenges during the final quarter of 2022 and into 2023. Several factors continue to affect Canadian and global economies — the lingering impacts of COVID-19, supply chain constraints, tight labour markets, inflationary pressures, tightening monetary and fiscal policies, rising interest rates, collateral impacts of the conflict in Ukraine and other geopolitical tensions, and energy shortages and costs.

During the last quarter of 2022, securities regulators across the globe have commented on the potential effect of the current and evolving economic conditions on financial reporting. The regulators have reminded issuers to consider how these uncertainties affect various accounting estimates, such as the valuation of assets and liabilities, exposures to losses, and liquidity assessments. Companies may need to update their judgments about future prospects and assumptions when preparing estimates for upcoming year-ends. The regulators have also emphasized the importance of high-quality and transparent disclosures in financial statements, MD&A, and other reports to explain known risks, judgments, critical assumptions, and factors that may affect future trends.

Securities regulators' perspectives

Securities regulators expressed their perspectives on the impact of economic uncertainties on financial reporting in their year-end statements, reports, and remarks.

In November 2022, the International Organization of Securities Commissions (IOSCO) set out its views on the potential impact of current economic conditions in its [*Statement on Financial Reporting and Disclosure during Economic Uncertainty*](#). The IOSCO statement provides considerations for issuers, auditors, and audit committees.

In the last quarter of 2022, the CSA and the OSC highlighted the importance of disclosing how current economic conditions affect a reporting issuer's operations. These comments were provided in the [*CSA Staff Notice 51-364: Continuous Disclosure Review Program Activities for the fiscal years ended March 31, 2022 and March 31, 2021*](#), and the [*OSC Staff Notice 51-734: 2022 Annual Report*](#). (A summary of the key points from both the CSA and OSC reports is provided in this edition of *AC Insights*, "[Improving quality through reviews](#)".)

Finally, in remarks presented at the annual Conference on Current SEC and PCAOB

Developments, the SEC staff reminded companies to consider the impacts of current economic uncertainties when preparing financial statements and reports. Further, the SEC expects issuers to discuss known risks, impacts of the economic uncertainties on current operations, and any known trends. The SEC also reminded auditors to ensure their audits consider the risks associated with the current economic conditions (see further comments about the Conference in this edition of *AC Insights*, "[Transparency in financial reporting](#)").

In this article, we have collated the observations and points made by these regulators to provide a framework for preparers to consider when they are preparing their current financial reporting. Audit committees may find these observations beneficial in carrying out their oversight responsibilities.

Views on accounting and financial statements

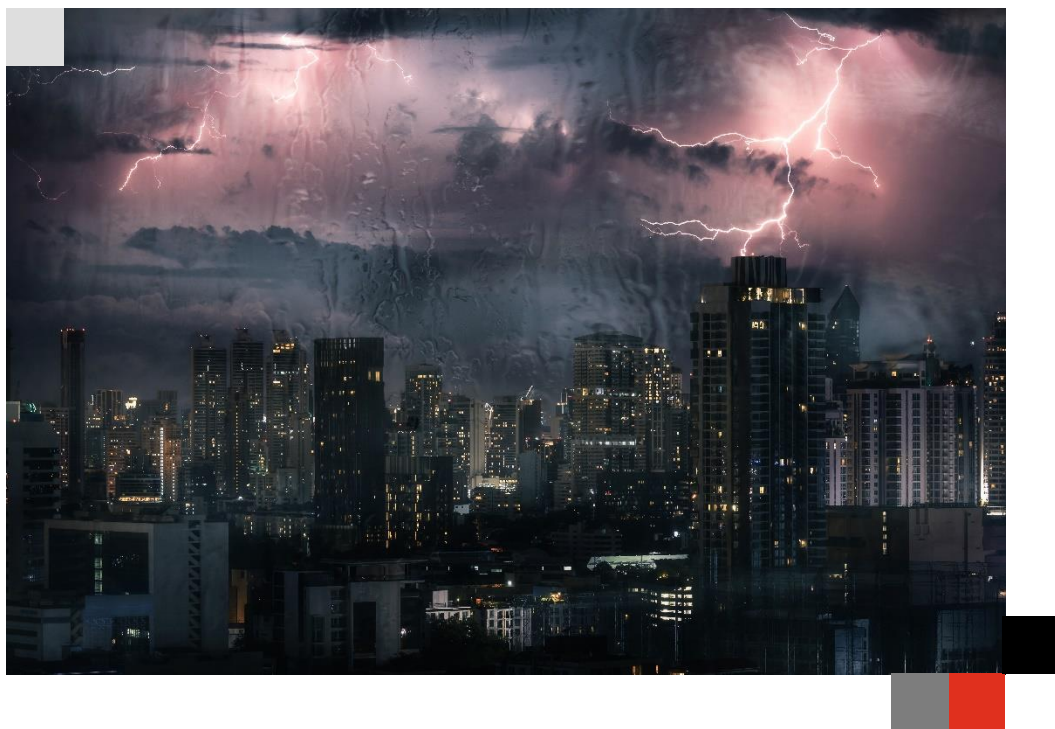
Judgments and estimates

Management makes many judgments and estimates when preparing financial statements, some of which significantly impact operating results and financial position.

Judgments

Judgments are often applied when there are different alternatives for applying an accounting policy to specific facts or circumstances. For example, assessing whether there are any indicators of impairment of non-financial assets is a judgment. This assessment determines whether certain nonfinancial assets need to be tested for impairment.

Changes in facts and circumstances can lead to or require a different application of an accounting policy than previously applied. Some of these conclusions may lead to materially different accounting treatments. Current economic conditions may require management to assess judgments in several areas. The following are some areas that management may need to consider.



- Are there any indicators of potential impairments of non-financial assets?
- Are the useful lives of non-financial assets consistent with their planned use?
- Should any assets held for disposal be classified as discontinued operations?

- Are deferred tax assets recoverable from future profits?
- Does the method for determining fair value measurement result in the best representation of fair value?
- Has a contract become onerous?
- Are forecasted transactions in a hedging relationship still highly probable?
- Are there factors that cast doubt on the entity's ability to continue as a going concern?

Accounting estimates

The measurement of some transactions, events, and balance sheet items depends on outcomes expected to occur in the future. These measurements are accounting estimates; they are not precise measurements and may be subject to change. For example, determining the recoverable amount of a group of assets and any related impairment charge involves an estimate. Initial and period-end estimates are based on estimation and valuation techniques using one or more assumptions. Accounting estimates must be based on the latest available, reliable information. Judgment is usually required to select an estimation or valuation technique and reasonable assumptions used as inputs in those techniques.

Many estimates involve assumptions about future amounts, such as expected selling prices, costs, expenditures, profits, and cash flows. Some estimates are measured at fair value, value in use, or a net present value using assumed discount rates. Current economic challenges can have wide-reaching effects on these estimates. Some effects will seem relatively obvious (for example, increases in discount rates used to reflect the time value of money and adjustments to cash flows to account for the effect of general inflation). However, many indirect effects will impact accounting estimates, such as:

- Increasing costs for energy and many other materials, supplies, services, and labour;
- More volatile foreign exchange rates;
- Limitations on the extent that cost increases can be passed on to customers through price increases;
- Changes in demand for products and services;
- Changes in the availability of materials, supplies, services, and labour; or
- Possible financial difficulties for the entity, its customers, suppliers, or other counterparties.

Historical trends, previous judgments, and prior assumptions may no longer be relevant or reliable for predicting future prospects. Management will need to update its judgments and assumptions to reflect current conditions and expectations. Depending on the level of uncertainty inherent in the business, issuers may need to consider different scenarios and outcomes.

Disclosures about judgments and estimates

IFRSs require disclosures about critical judgments and estimates in the notes to the financial statements. These disclosures aim to help investors understand the basis and impact of the accounting for specific items and the sensitivity of certain estimates to change in future periods. The disclosure about estimates focuses on assumptions and other factors that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. These disclosures may be required when:

- Reasonably possible different assumptions could have resulted in materially different measurements for an item's carrying amount;
- Changes to an uncertain factor could cause the carrying amount of an item to change materially in the next year; or
- A reasonably possible change in an assumption could occur, resulting in a material impact on the amounts recognized.

These disclosure requirements are found in general and specific topic standards under IFRSs. Securities regulators expect issuers to provide clear and transparent disclosures, indicating whether the carrying amounts of certain items are susceptible to material change and the range of reasonably possible outcomes in such cases.



Liquidity & going concern

Securities regulators reminded issuers of the need to consider whether the worsening economic conditions cast doubt on an entity's ability to continue as a going concern. An issuer must assess all available information about the future, looking out at least, but not limited to, twelve months from the end of its reporting period that may affect its ability to continue as a going concern. This assessment should continue until the date the financial statements are authorized for issue. Any significant judgments made, or uncertainties considered in the assessments should be clearly disclosed in the notes to the financial statements.

Subsequent events

In uncertain economic times, a material event can occur after the reporting period but before the financial statements are authorized for issue. Issuers need to determine whether these events require adjustments to amounts reported in the financial statements or non-adjusting events. Issuers will need to assess the nature of the events to determine how they should be treated; this assessment may involve significant judgment. The nature and financial effect of any material non-adjusting events should be disclosed in the financial statements; if the financial impact cannot be determined that fact should be disclosed. Securities regulators expect issuers to provide transparent disclosures to allow investors to understand how events after the reporting period may affect business operations and trends, including any changes to strategic plans.

Year-end considerations

Considering the current and evolving economic circumstances, issuers may need to:

- Reassess materiality judgments as previously established materiality thresholds may have changed.
- Update significant judgments and estimates about future cash flows considering a wide range of outcomes.
- Reassess the facts and circumstances considered in making judgments for applying accounting policies and determining assumptions used in estimates more frequently.
- Rely less on (or adjust) historical trend information in making predictions.
- Provide additional disclosures about the current and expected impact of the economic uncertainties on the entity's business.

Views on disclosures in management's discussion and analysis

Securities regulators have emphasized the importance of having transparent disclosures of the current impact on operations and any known possible trends or uncertainties that have had or are reasonably likely to have a material effect on their financial condition, results of operations, or liquidity. These disclosures are critical to investors in times of economic uncertainty.

Issuers may have described in prior disclosures that the potential impact of macroeconomic and geopolitical events were future or hypothetical risks. For example, inflation may have been described as a future risk. Disclosures should be updated if more recent events have had or are expected to have an impact. Existing conditions should not be described as future risks.

Also, issuers should review existing disclosures to ensure they reflect current conditions. For example, COVID-19 disclosures should be updated to reflect the pandemic's current and potential future effects.

Issuers are expected to discuss the impact of each relevant macroeconomic and geopolitical condition separately so investors can understand the potential impact of each material condition. However, issuers are cautioned that any adjustments to remove the effect of current macroeconomic conditions may not qualify as adjustments for non-recurring, infrequent, or unusual events. Such adjustments may result in the non-GAAP or other financial measures being misleading.

Views on internal control over financial reporting

Securities regulators are concerned that uncertain economic times may increase the risks of cybersecurity incidents and fraud for some issuers as their staff continue to work remotely or are reduced due to decreased demands for products and services. Heightened cybersecurity risks and material cybersecurity incidents should be disclosed to provide investors with insights into these risks and any impacts of any incidents on the issuer's financial position and the results of operations. Companies will need to consider how these heightened risks may impact the effectiveness of internal control over financial reporting.

Audit committee response

The securities regulators encourage audit committees to be actively engaged in the oversight of the financial reporting process. Audit committees need to consider the change in risks resulting from the macroeconomic and geopolitical uncertainties, including the potential for heightened fraud risk. Audit committees are encouraged to consult with others, when necessary, to navigate the challenges and uncertainties presented by the current and evolving economic and geopolitical climate.

In particular, the audit committee should:

- Engage in an open, timely, and meaningful dialogue with management and the external auditor to identify and address critical risks.
- Understand and evaluate the facts, economics and financial reporting requirements surrounding each critical accounting judgment and estimate.
- Consider the appropriateness of management's selection of accounting principles and critical accounting policies.

- Assess the method and the assumptions used in making critical accounting judgment and estimates.
- Question the degree of aggressiveness or conservatism surrounding judgments and estimates and assess the risk for management bias.
- Confirm with management and the external auditors that the judgments and estimates are reasonable in the circumstances.
- Assess whether the disclosures made in the financial statements, MD&A, and other disclosures are transparent and provide an adequate understanding of how the operations have been affected by current and evolving economic conditions.

References

1. International Monetary Fund. 2022. *World Economic Outlook Report: Countering the Cost-of-Living Crisis*. Accessed December 20, 2022.
<https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022#Overview>.





IFRS update

Standards update

During the final quarter of 2022, the IASB issued the amendments of IAS 1: *Presentation of Financial Statements* to clarify parameters for classifying liabilities as current or non-current. The IASB has been working to issue exposure drafts of three major projects—Financial instruments with characteristics of equity, Dynamic risk management, and Business combinations—disclosures, goodwill, and impairment. Work also continued on other projects: Rate-regulated activities, Disclosures for subsidiaries without public accountability, and Business combinations under common control. The Board also narrowed its approach for the project on review of disclosures and decided not to amend disclosures for IFRS 13: *Fair Value Measurement* and IAS 19: *Employee Benefits*. No new standards or amendments are expected to be issued in the first quarter of 2023. The status of projects is provided at the end of this section.

Classifying debt as noncurrent

Under IAS 1: *Presentation of Financial Statements*, a liability must be classified as current unless an entity has the right at the end of the reporting period to defer settlement of the liability for at least 12 months after the reporting period.

In January 2020, the IASB amended IAS 1 to clarify how an entity assesses whether it has the right to defer settlement of a liability for at least 12 months after the reporting period. The amendment, *Classification of Liabilities as Current or Noncurrent* (2020 amendments), changed one of the four criteria for the current classification of a liability—the right to defer settlement of a liability need not be unconditional. Under this amendment, a company would need to consider whether it complied with conditions or covenants at the end of the reporting period, even those conditions or covenants tested at a date after the reporting date. The 2020 amendments originally were applicable for reporting periods beginning on or after January 1, 2023.

Concerns were raised that the 2020 amendments would require companies to classify a liability as current when there was no contractual obligation to repay the debt within 12 months of the period-end. This classification could result if covenants to be tested at a future date after the reporting date were not met at the reporting date. For example, assume a company had a debt maturing in 2026 with an annual covenant test performed as of September 30, requiring a current ratio of 1.2. The company's current ratios on September 30 and December 31, 2022, were 1.3 and 1.1. Since the current ratio on December 31, 2022, was below the covenant requirement of 1.2, the company would have had to classify the debt as current. As a result of these concerns, the IASB undertook a project to reconsider the application guidance for the 2020 amendment. The effective date of the 2020 amendment was deferred to periods beginning on or after January 1, 2023.

What changed?

In October 2022, the IASB issued amendments to IAS 1, *Noncurrent liabilities with covenants*, to address the concerns. IAS 1 has now been amended only to require consideration of covenants and conditions on or before the reporting date. Covenants to be complied with in the next 12 months after the reporting date will not affect the classification of the liabilities as current or noncurrent at the reporting date. However, covenants assessed after the period end, based on the reporting period data, would affect the classification of the liability (for example, assume a December 31 reporting date. The outcome of covenants tests after the reporting date using December 31 financial data would affect the classification). This change will mean that for the situation in the example in the previous paragraph, the liability would be classified as noncurrent.

In addition, the 2022 amendments enhance the disclosures for loan arrangements classified as noncurrent if the arrangements have covenants to be complied with within 12 months of the reporting date. Entities will have to disclose information in the notes to the financial statements to allow readers to understand the risk that the liability may become repayable within 12 months of the reporting period date. The disclosures include:

- The carrying amount of the liability.
- Information about the covenants, including compliance dates.
- Facts and circumstances that indicate the entity may have difficulty complying with the covenants. Such facts and circumstances could also include the fact that the entity would not have complied with the covenants based on its circumstances at the end of the reporting period.

What's the impact?

The 2022 amendments are not expected to significantly change an entity's classification of liabilities as current or noncurrent based on existing guidance. If an entity had adopted the 2020 amendments, the 2022 amendments might significantly change classification. Most companies will be affected by the additional disclosure requirements.

When does it apply?

Both the 2020 and 2022 amendments are effective for annual reporting periods beginning on or after January 1, 2024, and should be applied retrospectively under IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application of the 2020 and 2022 amendments is permitted. If an entity early applies the 2020 amendments after the issue of the 2022 amendments, it is required to apply both the 2020 and 2022 amendments at the same time.

Comparison to US GAAP

While the principle of classifying liabilities currently repayable or due within 12 months of the reporting date as current is the same under IFRSs and US GAAP, there are some differences in how the principle is applied. Under US GAAP, entities can consider their intent and ability to refinance an obligation on a long-term basis and remedies to cure breached conditions when classifying a liability as current or noncurrent. These provisions are not contained in IFRSs.

Agenda decisions

In November 2022, the IFRS Interpretations Committee (IC) issued its latest collection of agenda decisions. The *Compilation of Agenda Decisions – Volume 7* covers the period from May 2022 to October 2022. The agenda decisions explain why certain issues or questions submitted to the IC have not been addressed through a maintenance project. The decisions also provide the committee's insights into how companies might apply existing IFRSs to address the matter.

When the IC receives an application question from an entity, the committee first decides whether to add a standard-setting project to the work plan. The item is considered for the work plan only if the matter is widespread and expected to have a material effect, a change is necessary to one or more IFRSs, and the issue can be efficiently resolved and is sufficiently narrow in scope. If these criteria are not met, the decision not to include the matter in the work plan is published, usually with explanatory comments.

Accounting for warrants on acquiring a special purpose acquisition company

Question: How should an entity account for warrants issued to acquire a special purpose acquisition company?

Relevant guidance: IFRS 2: *Share-based Payment* and IAS 32: *Financial Instruments: Presentation*

An entity may acquire a special purpose acquisition company (SPAC) to obtain the SPAC's cash and stock exchange listing. SPACs often have outstanding shares and warrants.

The IC concluded that a SPAC acquisition is the acquisition of an asset or group of assets that are not a business. The IC made several observations about these types of transactions.

- The entity often receives cash from the SPAC.
- When the entity assumes the SPAC warrants, it should consider whether it has assumed a financial liability or acquired an equity instrument using the guidance in IAS 32.
- When the entity replaces the SPAC warrants assumed with entity warrants, it will have to use its judgment to determine the accounting, as any IFRSs do not cover these transactions.
- The receipt of the SPAC exchange listing is not an acquisition of an intangible asset under IAS 38: *Intangible Assets*. In this situation, guidance in IFRS 2 should be considered. The fair value of equity instruments issued by the entity and the fair value of identifiable net assets acquired should be allocated to the stock exchange listing and accounted for as a service received.

Classification of public shares issued by a SPAC as financial liabilities or equity

Question: Is the shareholders' contractual right to extend the SPAC's life indefinitely when an acquisition target is not identified within the control of the SPAC? This assessment is needed to determine whether the SPAC has the unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation.

Relevant guidance: IAS 32: *Financial Instruments: Presentation*

The question relates to a SPAC, which issues two classes of shares: founder and public shares. The public shareholders individually have the contractual right to demand reimbursement of their shares if the SPAC shareholders do not approve an acquisition of a target; are reimbursed if the SPAC is liquidated when no target entity is acquired; and have the contractual right, along with the founder shareholders, to extend the life of the SPAC indefinitely if no target entity is acquired.

The IC noted that no guidance is available to assess the situation and suggested that the IASB consider the matter in their project on Financial Instruments with Characteristics of Equity.

Lessor forgiveness of lease payments

Question: How should a lessor account for operating lease receivables to be forgiven as part of a rent concession?

Relevant guidance: IFRS 9: *Financial Instruments* and IFRS 16: *Leases*

The IC considered a situation where a lessor grants a lessee a rent concession on an operating lease. The lessor releases the lessee from making specifically identified lease payments. Some of the lease payments forgiven were contractually due and unpaid. Others are not yet contractually due.

The IC observed:

- The operating lease receivable is subject to the impairment and derecognition requirements of IFRS 9. The lessor must recognize expected credit losses on the gross carrying amount of the receivables from the date the receivables are recognized. This guidance requires the lessor to recognize credit losses before granting the rent concession. The expected credit losses should include the lessor's expectations of forgiving the lease payments.
- Since the rent concession legally releases the lessee from its obligations, the lease receivable should be derecognized when the rent concession is granted.
- The rent concession is a change in the original terms and conditions of the lease; therefore, it is a lease modification. Under IFRS 16, the lease modification would be accounted for as a new lease from when the concession was granted.

Software reseller – principal or agent

Question: Is a software reseller a principal or agent of the manufacturer when:

1. The reseller has a distribution agreement with the software manufacturer.
2. The seller provides pre-sale advice to the customer to identify the number and type of software licenses required by the customer, negotiates the price for the software licenses with the customer, orders the licenses from the manufacturer, and invoices the customer.
3. The software manufacturer provides the customer with the license and an activation key through its portal. The software agreement is between the manufacturer and the customer.
4. Suppose the reseller's pre-sale advice results in the customer ordering an incorrect type or number of software licenses, and the customer does not accept the licenses. In that case, the reseller cannot return the licenses to the manufacturer or resell them to another customer.

The IC outlined the following two steps and other factors that the reseller should consider when analyzing the issue:

1. Identify the specified goods or services to be provided to the customer: The IC observed that (a) the contract with the customer specified the delivery of a specific number and type of standard software licenses; (b) the pre-sale advice was given before the contract was entered into and is not a service under the contract; and (c) the identified goods are the software licenses.
2. Assess whether the reseller controls the standard software licences before they are transferred to the customer. The IC observed that:
 - a. The manufacturer is responsible for several aspects of fulfilling the contract: The software licenses only exist after the reseller places the order with the manufacturer, the licenses are issued to the customer by the manufacturer, and the manufacturer is responsible for the functionality of the software, delivers it to the customer, and activates it.
 - b. The reseller is responsible for some aspects of fulfilling the contract: The reseller invoices the customer and is responsible for any unaccepted licenses.
 - c. The reseller has some inventory risk: While the reseller has no inventory risk before delivery of the software to the customer, the reseller bears the risk of unacceptable licenses.
 - d. The reseller has price discretion: The reseller negotiates the price with the customer; however, if the market for the software allows little pricing flexibility, this factor may be less relevant.

Ultimately, the reseller needs to assess whether they had control over the licenses before they were transferred to the customer. After analyzing the facts and circumstances, the reseller needs to apply its judgment in the assessment. The reseller would be required to disclose its accounting policy and judgments made in developing its accounting.

Negative low-emission vehicle credits

Question: Are obligations to reduce negative credits on the production or importation of certain vehicles with average fuel emissions higher than government targets on a liability under IAS 37?

Relevant guidance: IAS 37: *Provisions, Contingent Liabilities and Contingent Assets*

In certain jurisdictions, entities receive positive credits if they produce or import vehicles with average fuel emissions below the government target. The companies receive negative credits if the average fuel emissions exceed government targets. Usually, these credits are assessed over an annual period. Companies with negative credits must eliminate them by obtaining and surrendering positive credits. Positive credits can be purchased from other entities or generated over the next year. If negative credits are not eliminated, the government sanctions are limited to restricting the entity's access to the market. There are no financial fines or penalties.

The IC noted that the following factors should be considered in the analysis of the appropriate accounting:

1. Was there an outflow of resources embodying economic benefits? The elimination of negative credits by purchasing credits from another entity or generating positive credits is considered an outflow of resources embodying economic benefits.
2. Does the event create a present obligation from past events? The production or importation of vehicles with emissions higher than government targets is a past event that gives rise to a present obligation that could arise during the applicable calendar year.
3. Is there any realistic alternative to settling the obligation? A legal obligation could exist if accepting the sanctions for non-settlement is not a realistic alternative. This conclusion requires judgment considering the nature of the sanctions and the entity's specific circumstances.
4. Is there a possible constructive obligation? If there is no legal obligation, there may be a constructive obligation if the entity is generating negative credits and has taken action to create valid expectations that it will eliminate the negative credits through specific actions or statements.



Insurance contracts and IFRS 17: *Insurance Contracts*

Two agenda decisions focused on specific questions about insurance contracts. Companies with insurance contracts may wish to review the IC's observations outlined in the Compilation for:

- A group of annuity contracts and how an entity determines the amount of the contractual service margin to recognize in profit or loss in a period because of the transfer of insurance coverage for survival in that period.
- Multi-currency groups of insurance contracts and how an entity accounts for insurance contracts with cash flows in more than one currency.

New standards and amendments not effective

The following standard and amendments are effective for public entities for years beginning on or after January 1, 2023.

Type of change	Standard affected	Purpose of standard or amendment
New standard	IFRS 17: <i>Insurance Contracts</i>	Establishes principles for recognition, measurement, presentations and disclosure of insurance contracts.
Amendment	IFRS 17: <i>Insurance Contracts</i>	Simplifications made to IFRS 17 to assist with implementation and transition.
Amendment	IFRS 17: <i>Insurance Contracts</i> IFRS 9: <i>Financial Instruments</i>	Narrow scope amendment to transition requirements.
Amendment	IAS 12: <i>Income Taxes</i>	Specifies how to account for deferred income taxes on transactions such as leases and decommissioning obligations, which are transactions where an entity recognizes both an asset and a liability.
Amendment	IAS 1: <i>Presentation of Financial Statements</i>	Improves accounting policy disclosures to provide more useful information and distinguishes accounting policies from accounting estimates.
Amendment	IAS 1: <i>Presentation of Financial statements</i> IAS 8: <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	Defines accounting estimates.

IFRS news

IFRS 9 operating as intended

The IASB completed its Post-Implementation Review of IFRS 9: *Financial Instruments* in December 2022 by publishing its findings in its report, *Post-implementation Review - IFRS 9 Financial Instruments—Classification and Measurement*. The IASB found that the standard was operating as intended; however, clarifications are needed in some areas to improve the understandability of the requirements.

Two matters identified as requiring immediate action were:

- The assessment of the contractual cash flow characteristics of financial assets with interest rates linked to ESG targets. The interest rates for these instruments may be adjusted depending on whether the borrower achieves specific pre-determined ESG targets. Under IFRS 9, the amortized cost method of accounting may be used when the cash flows are characterized as solely payments of principal and interest. Otherwise, the financial instruments would need to be accounted for at fair value through profit and loss. A project was started in June 2022 to clarify how to account for these ESG-linked instruments.

- Electronic cash transfers as settlement of a financial asset or liability. The issue is when a company can consider an electronic transfer as settling an obligation – the date the company is notified or the date the counterparty receives the payment. The IASB plans to clarify that an entity applies settlement date accounting when derecognizing financial assets (except for ‘regular way’ transactions) and financial liabilities. The amendments will also allow an entity to derecognize a financial liability before it delivers cash on the settlement date when specified criteria are met.
- Clarification of the application of the contractual cash flow characteristics assessment to contractually linked instruments.
- Disclosures of fair value changes relating to equity instruments a company has presented in other comprehensive income rather than profit or loss.









The IASB also identified two other matters not considered to be a high priority but that may be considered at the same time as the matters noted above:






The IASB also plans to amend IFRS 7: *Financial Instruments: Disclosures* to provide useful information to users of financial statements about contractual terms that could change the timing or amount of contractual cash flows of financial assets and financial liabilities.

In addition, the IASB decided to research how it could clarify the requirements in IFRS 9 for modifying financial assets and liabilities and applying the effective interest method.



Status of standard setting projects

Project	Objective	Status
Business combinations under common control	Consider possible reporting requirements that would reduce the diversity in practice for accounting for business combinations under control.	
Disclosure initiative – Subsidiaries without public accountability	Reducing the disclosures required in financial statements of subsidiaries that are SMEs.	
Disclosure initiative: Targeted standards-level review of disclosures	Developing guidance for developing disclosure requirements in IFRSs.	
Dynamic risk management	Developing an approach to account for an entity's dynamic risk management activities.	
Financial instruments with characteristics of equity	Clarifying IAS 32: <i>Financial Instruments: Presentation</i> to address challenges in classifying specific complex financial instruments as financial liabilities or equity instruments.	
Management commentary	Revise and update the current IFRS Practice Statement 1: <i>Management Commentary</i> .	
Primary financial statements	Improving comparability and transparency of the presentation and disclosures in financial statements, focusing on the statement of financial performance.	
Rate-regulated activities	Developing a standard to address the effects of rate regulation on recognition of revenues and expenses.	

				
Added to agenda, planning, and research	Initial deliberations & tentative conclusions	Exposure Draft issued or to be issued	Feedback analysis and refinement	Final standard issued



US GAAP update

Standards update

The FASB met several times over the summer to discuss and develop tentative conclusions and redeliberate several maintenance projects. Some exposure drafts are expected in the next quarter on some of these projects, including a proposed ASU on joint venture formations.

Transitional amendments

ASU 2022-05: *Transition for Sold Contracts*

Topic 944: *Financial Services – Insurance*

The ASU amends the transition guidance in ASU 2018-12: *Targeted Improvements to the Accounting for Long-Duration Contracts* for a contract that has been derecognized because of a sale or disposal of an individual or a group of contracts or legal entities before the effective date of ASU 2018-12. The transition is amended to allow an insurance entity to make an accounting policy election to exclude specific contracts or legal entities from applying the ASU 2018-12 when, as of the effective date, (a) the insurance contracts have been derecognized because of a sale or disposal, and (b) the insurance entity has no significant continuing involvement with the derecognized contracts.

ASU 2022-06: *Deferral of the Sunset Date of Topic 848*

Topic 848: *Reference Rate Reform*

ASU 2022-06 extends the period preparers can utilize the reference rate reform relief guidance issued by ASU 2020-04: *Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, dealing with the accounting for (or recognizing the effects of) reference rate reform on financial reporting. ASU 2020-04 was designed to provide relief during a temporary transition period to match the expected date when the London Interbank Offered Rate (LIBOR) would cease to be published. In 2021, the UK Financial Conduct Authority (FCA) delayed the intended cessation date of certain tenors of USD LIBOR to June 30, 2023. ASU 2022-06 defers the sunset date of Topic 848 from December 31, 2022, to December 31, 2024.

New standards and amendments not effective

The following standard and amendments are effective for public entities for years beginning on or after January 1, 2023.

ASU	ASC Topic	Purpose
ASU 2022-06: <i>Deferral of the Sunset Date of Topic 848</i>	848: <i>Reference Rate Reform</i>	Defers the sunset date of the guidance on reference rate reform for one year.
ASU 2022-05: <i>Transition for Sold Contracts</i>	944: <i>Financial Services–Insurance</i>	Provide transitional option for insurance contracts sold as of the effective date.
ASU 2022-04: <i>Disclosure of Supplier Finance Program Obligations</i>	405: <i>Liabilities</i>	Enhances disclosures for supplier finance programs.

ASU	ASC Topic	Purpose
<i>ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures</i>	326: <i>Financial Instruments—Credit Losses</i>	Eliminates the special accounting for troubled debt restructurings and adds disclosures for gross write-offs by vintage year.
<i>ASU 2022-01: Fair Value Hedging—Portfolio Layer Method</i>	815: <i>Derivatives and Hedging</i>	Specifies when and how the portfolio layer method may be used.
<i>ASU-2021-08: Accounting for Contract Assets and Contract Liabilities from Contracts with Customers</i>	805: <i>Business Combinations</i>	Requires contract assets and contract liabilities acquired in a business combination to be accounted for as if the acquirer had originated the contracts with customers.
<i>ASU 2020-11: Effective Date and Early Application</i>	944: <i>Financial Services—Insurance</i>	Amended effective date to years beginning after December 15, 2022.
<i>ASU 2018-12: Targeted Improvements to the Accounting for Long-duration Contracts</i>	944: <i>Financial Services—Insurance</i>	Revises the accounting for long-duration insurance contracts.



ESG & corporate reporting update

Standards update

The International Sustainability Standards Board continues its redeliberation of its general sustainability-related and climate-related disclosures. The ISSB continues its work with a plan to complete these two initial standards in 2023.

Implementation update

More urgent progress needed on climate-related disclosures

Five years ago, the Task Force on Climate-Related Disclosures (TCFD) released its final recommendations for climate-related disclosures (the Recommendations). In December 2022, the TCFD issued its fifth annual status report, the [*2022 Status Report*](#), observing how the Recommendations have been endorsed around the globe by companies, investors, regulators, and standard setters. While the implementation of the Recommendations has been impressive, Michael Bloomberg, Chair of TCFD, stated, “this report makes clear that more urgent progress is needed. Supporting market efficiency and stability is paramount as we look to build a more sustainable and resilient future.”

The *Status Report* provides an in-depth study of what is being disclosed by public companies, asset managers, and asset owners for each of the Recommendations and the progress being made to implement the complete set of Recommendations. A detailed analysis is provided for each of the 11 Recommendations. The TCFD also sought the insights from seven companies on implementing the Governance Recommendations and their respective boards’ oversight of climate-related issues. These insights are summarized in case studies of how each board’s oversight activities evolved and the lessons they learned from the implementation of the Recommendations. The Report also outlines how regulators, standard setters, stock exchanges, and industry groups are integrating the Recommendations into their initiatives.

In this article, we provide a high-level summary of the TCFD findings to understand the progress and influence of the Recommendations. The *Status Report* has many statistics, in-depth analysis, and illustrative examples. Companies preparing disclosures using the Recommendations and other interested parties should read the complete *Status Report* to understand the current state of disclosures and how improvements can be made.

Climate-related disclosures by public companies

To understand the state of climate-related disclosure practices, the TFCF used artificial intelligence technology to review disclosures of over 1,400 companies worldwide over a three- to five-year period. The companies represented eight industries from five different regions. The eight sectors included are (a) agriculture, food, and forest products; (b) banking; (c) consumer goods; (d) energy; (e) insurance; (f) materials and building; (g) technology and media; and (h) transportation. Specific information on implementation has been provided for these eight industry groups in the Appendices to the Report.

The TFCF review observed that 80% of the companies in their sample provided information consistent with one of the Recommendations, while only four percent disclosed information against all 11 Recommendations. While disclosures against all Recommendations have been increasing since 2019, TFCF calls for more urgent progress in implementing its Recommendations. The top three disclosures made by companies were about identified climate-related risks and opportunities (under Strategy), the impact of climate-related risks and opportunities on the company's business, strategy, and financial planning (under Strategy), and climate-related metrics used by the company (under Metrics and Targets). The top three Recommendations with which companies struggle include the description of the resilience of the company's strategy, including different climate-related scenarios, including a 2°C or lower scenario (under Strategy), management's role in assessing and managing climate-related risks and opportunities (under Governance), and the board's oversight of climate-related risks and opportunities (under Governance).

The review indicated that the highest average percentage of disclosures against all Recommendations was provided by energy companies (43%), materials and building companies (42%), banks (41%), and insurance companies (41%). At the other end of the spectrum were technology and media companies, with an average percentage of disclosures of 15%.

The TFCF found Europe is the leading region for disclosures, with the average percentage of disclosure against the 11 Recommendations at 60%. Other areas are significantly behind Europe, with North America at 29%. However, the Report shows encouraging improvements by region.

The size of the company, based on market capitalization, also made a difference in the extent of reporting. Larger companies were more likely to provide TFCF-aligned information than smaller companies. Further, larger companies have increased the extent of disclosures since the Recommendations were approved. Overall, the average number of disclosures against the 11 Recommendations has risen from 1.4 in 2017 to 4.2 in 2022.

To help understand the disclosures and ways to improve their disclosures, the TFCF provided examples of climate-related disclosures made by some companies under each of the TFCF Recommendations.

Climate-related disclosures by asset managers and asset owners

In addition to reviewing disclosures by public companies, the TFCF surveyed asset managers and asset owners (pension funds, insurance companies, foundations, and so on) to understand how asset managers and asset owners reported climate-related information using the Recommendations to their clients and beneficiaries.

Sixty-seven percent of respondents in the survey indicated they currently provide climate-related information to their clients or beneficiaries, with 31% planning to provide climate-related disclosures. For those planning future disclosures, 14% expect to report by the end of 2022. Asset managers and owners stated they currently report climate-related disclosures for several reasons. Most believe climate-related risks are material, and reporting those risks is a senior management priority. Clients or beneficiaries request the information, and regulatory agencies require or are expected to require such information. Further, their peers report similar information.

The *2022 Status Report* also provided statistical analysis about the frequency of reporting, reporting against the 11 Recommendations, the use of scenario analysis, and challenges to reporting climate-related information. Examples in the Report illustrate the types of disclosures made by asset managers and asset owners for each of the 11 Recommendations.

Reflection on implementation of the Recommendations

While the Task Force is encouraged by the implementation of the Recommendations by companies and the support of regulators and standard setters, the Task Force is concerned that disclosures made by companies do not provide decision-useful climate-related financial information. Without useful information, investors and other users may lack the knowledge to assess and price climate-related risks appropriately. To understand the implementation progress, the TFCF surveyed preparers and users who are subscribers to the TFCF website. The key findings of the survey were:

- Ninety-one percent of preparers have implemented or are implementing the Recommendations.
- Ninety percent of users have incorporated climate-related financial disclosures in their financial decision-making processes, and 66% indicated such disclosures factor into their pricing decisions.

- Ninety-five percent of respondents not identified as preparers noted an increase in the availability of climate-related information. Eighty-eight percent indicated that the quality of the information had improved.
- Many users observed improvements in the use of standardized, industry-specific climate-related metrics in the disclosures.

Some challenges highlighted in the survey responses were the difficulties in preparing different climate-related scenarios to illustrate the resilience of the company's strategy and problems with collecting and reporting Scope 3 GHG Emissions data.

The Report identified the following principal reasons why companies implemented the Recommendations. The most significant reasons were that climate-related issues were material to the company, and investors requested the information. Other important factors were the corporate citizenship and reputation benefits of making such disclosures and the priority assigned by senior management to the issues.

The Report also reviews the progression and sequencing of disclosures made to meet the Recommendations. Respondents were asked to comment on the ease of implementation of the Recommendations. The top difficult (somewhat or very) areas of disclosure were the impact of climate-related risks and opportunities on the organization, resilience of the strategy (scenario analysis), Scope 3 GHG Emissions, and climate-related targets. Disclosures made using the Recommendations were primarily provided in the financial filings, annual or integrated reports, and separate sustainability reports.

The majority of users found the information provided by the Recommendations beneficial, except for the information related to the resilience of the company's strategy and Scope 3 GHG Emissions. However, these latter two categories were still considered somewhat useful.

Climate-related risks and pricing

The *Status Report* includes an analysis of the disclosure of climate-related risks and pricing of financial instruments. The TFCF reviewed over 100 peer-reviewed academic papers, other literature, and articles to understand the current views on these relationships. The studies are not determinative but provide some insights into current thinking on those relationships.



Case studies on board oversight of the implementation of Recommendations

The Report provides seven case studies illustrating the experiences of seven companies in implementing the Governance Recommendations. Companies in the energy, financial services, insurance, materials and building, pension, and telecommunications sectors supplied some practical insights and considerations for implementing Governance Recommendations.

The case studies highlight the need to involve many stakeholders across the company when implementing the Recommendations. Each function's key roles and responsibilities should be defined early in the process. Public disclosures made by peers and other companies are good resources when developing or enhancing a company's climate-related financial disclosures. If companies expect climate-related disclosures to be mandated by regulators, they should consider implementing a process as early as possible.

The Recommendations have been accepted as a universal framework for climate-related and ESG disclosures. The *Status Report* provides a picture of the depth of implementation, indicating that despite the universal acceptance of the Recommendations, implementation has been mixed, and improvements are needed to meet the spirit of the Recommendations. As disclosures following the Recommendations become mandated in certain regions, we expect the quality and depth of disclosures to improve.

ESG & corporate reporting news

CSA considering international developments on climate

In October 2021, the CSA proposed requirements for climate-related disclosures primarily based on the Recommendations of the Task Force on Climate-Related Disclosures. The comment period for these proposals ended in February 2022. The CSA announced in October 2022 that it is now actively considering international developments. The CSA is assessing various international climate-related rule proposals to develop a CSA rule that meets the needs of Canadian markets and the realities of Canadian issuers.

The announcement acknowledges two key developments: the SEC proposals for climate-related information and the proposed standards of the International Sustainability Standards Board (ISSB). The CSA noted that these two proposals are based on TFCF Recommendations but have substantive differences. The CSA is now reviewing the comments it received on its 2021 proposals and Canadian stakeholders' responses to the SEC and ISSB proposals. No timetable was provided for this review.



Global coordination

At COP 27, the United Nations Climate Conference held in Sharm El-Sheikh, Egypt, in December 2022, the Climate Disclosure Project announced it would incorporate the ISSB Climate-Related Disclosures Standard into the CDP's global environmental disclosure program. Eighteen thousand seven hundred companies around the globe disclose environmental information through the CDP. IFRS S2: *Climate-related Disclosures* will be incorporated in CDP's existing questionnaires.

This integration with the CDP is expected to mean an accelerated early adoption of the ISSB standard. The CDP will provide the ISSB with access to data on climate-related disclosures for monitoring the implementation of and improving the ISSB standards.

On 29 December 2022, the Trustees of the IFRS Foundation announced the ISSB will open an office in Beijing, China in mid-2023. The Beijing office will work with other offices with a focus on leading and executing the strategy of emerging and developing economies.

ESG & corporate reporting library

Getting to Net Zero: A Global Review of Corporate Disclosures

International Federation of Accountants, November 2022

This [Review](#) provides insights into climate-related disclosures, focusing on corporate emissions reduction reporting. The information is based on 2020 corporate reports of the 40 largest companies in 15 jurisdictions, including Canada. The Report indicates that 66% of large, exchange-traded companies include some type of emissions reduction targets in their disclosures, with substantially all including some transition plans. You should read this Report to understand how companies report reduction targets across jurisdictions and industries, the types of targets being disclosed, the time frames for targets, plans to meet targets, expected costs of transition, and disclosures about transition plans.



Canadian securities update

Canadian regulatory update

More investors eligible under prospectus exemptions

The OSC launched a new prospectus exemption under an 18-month pilot expanding the use of prospectus exemptions for businesses headquartered in Ontario. The blanket order allows companies to sell securities without a prospectus to additional investors meeting specific education or work experience criteria.

Under the blanket order, individuals, referred to as Self-Certifying Investors, meeting the following criteria may purchase securities under the prospectus exemption. Self-Certifying Investors include financial or investment professionals holding certain designations, individuals holding specific university degrees in business or finance, lawyers with practices involved in financings or mergers and acquisition transactions, and others with business experience in the same industry or sector as the issuer.

Self-Certifying Investors must complete a risk acknowledgment form confirming they understand the risks of investing. These Investors are limited to annual purchases of \$30,000, which may be allocated to one or more issuers. Issuers must report the use of the self-certified prospectus exemption by filing reports of exempt distributions.

More disclosures in prospectus-exempt offerings

The CSA has amended some requirements for prospectus exemptions to provide a framework for disclosures. The changes adapt the requirements for an Offering Memorandum (OM) to current conditions where prospectus exemptions are being used by larger and more complex issuers involved in real estate and collective investment vehicles. The amendments form part of NI 45-106: *Prospectus Exemptions* and will be effective March 8, 2023, with applicable provisions to allow a transition to the new requirements.

Amendments affecting real estate issuers

Real estate activities are activities that generate for security holders income or gains for the lease, sale, or disposition of real property (excluding mineral projects, oil and gas activities, and certain real estate investments in the province of Quebec).

Issuers engaged in real estate activities (real estate issuers) that raise funds through a prospectus exemption will be required to provide purchasers with an appraisal report if the issuer:

- Proposes to acquire an interest in real property from a related party and the likelihood of completing the acquisition is high,
- Discloses in the OM a value for an interest in real property (other than in the financial statements), or
- Both of the above.

The appraisal must be prepared and certified by an independent qualified appraiser and provide the appraised fair market value of the property as is (without any proposed improvements or development) as of a date within six months of when the appraisal is delivered to the purchaser. Alternative values for the property are not permitted unless the issuer has a reasonable basis for the alternative value. If an alternative value is disclosed in any communications related to the offering, the communications must also include the appraised fair market value with equal or greater prominence, material factors and assumptions used to determine the alternative value, and whether an independent qualified appraiser determined the alternative value. A copy of the appraisal for the alternative value must be filed concurrently with the OM.

Real estate issuers are also required to supplement the OM with specific information as required by Schedule 1 of Form 45-106F2: *Offering Memorandum for Non-Qualifying Issuers*. Alternatively, real estate issuers could use Form 45-106F3: *Offering Memorandum for Qualifying Issuers*. A qualifying issuer is essentially a reporting issuer.



Amendments for collective investment vehicles

A collective investment vehicle (CIV) is either an investment fund or another issuer that primarily invests funds received from its security holders in a portfolio of securities other than securities of the CIV.

A CIV is required to supplement its OM with specific information as required by Schedule 2 of Form 45-106F2: *Offering Memorandum for Non-Qualifying Issuers*. However, these disclosures are not required if the OM is prepared using Form 45-106F3: *Offering Memorandum for Qualifying Issuers*.

Amendments to OM

The NI clarifies that any OM used for an exempt offering must contain sufficient information to enable a purchaser to make an informed investment decision. The OM must not contain a misrepresentation and must be updated to reflect any material changes between the date the OM is certified, and the issuer accepts the purchaser's agreement to purchase securities. An amended OM must be certified.

Form 45-106F2 has been amended to enhance the level of disclosures to provide investors with sufficient disclosures to make an informed investment decision. Separate requirements are provided for real estate issuers and CIVs.

Implementation guidance

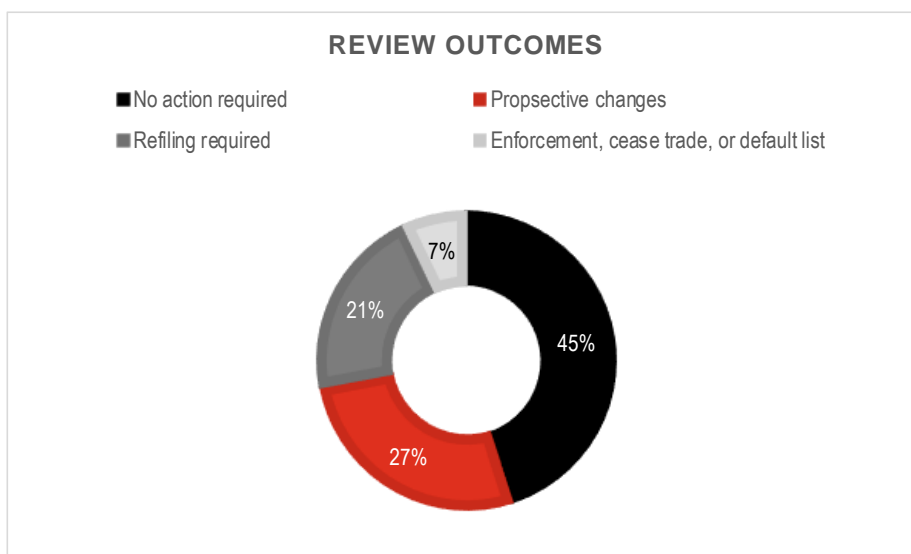
Improving quality through reviews

Each year, the staff of the CSA and provincial securities administrators review the disclosures made by reporting issuers. The purpose of the reviews is to improve the completeness, quality, and timeliness of disclosures. These disclosures include financial statements, disclosures required by securities requirements, and voluntary disclosures made by reporting issuers. The reviews may be a comprehensive assessment of a reporting issuer's disclosures over 12 to 15 months or an issue-oriented review on a specific accounting, legal, or regulatory issue.

In November 2022, the CSA released its findings and comments on reviews completed for the two years ended March 31, 2022, in [CSA Staff Notice 51-364: Continuous Disclosure Review Program Activities for the fiscal years ended March 31, 2022 and March 31, 2021](#). In addition, the Ontario Securities Commission Corporate Finance Branch published its *2022 Annual Report* in December 2022, which includes a summary of findings from its continuous disclosures review for the year ended March 31, 2022 (see [OSC Staff Notice 51-734](#)). Other provincial securities administrators may publish similar reports with the same observations and additional findings of importance to their respective regions. In this article, we provide a summary of the key points from both the CSA and OSC notices.

Over the two-year period, over 1,000 reviews were completed, with approximately 70% focussed on specific accounting, legal, or regulatory issues, emerging issues or industries, implementation of new financial reporting standards and securities requirements, and issues arising from public complaints. The issuer-oriented reviews primarily focused on mining, oil and gas disclosures, COVID-19 disclosures, news releases, and climate change disclosures.

The reviews had different outcomes. Many resulted in no action, while some required changes to be made in future disclosures or the disclosures reviewed, and others resulted in the issuer being placed on the default list, being cease traded, or being referred to enforcement. The chart below illustrates the results for the last two years.



Both Notices emphasized the need to consider current and evolving economic and geopolitical conditions. In this edition of *AC Insights*, we covered those observations in our article, [“Economic uncertainties: Reporting the impact”](#). The CSA and OSC staff also provided several insights into areas of concern, deficiencies identified in staff reviews, and areas for improvement in financial reporting made by reporting issuers. Reporting issuers should review the Notices to understand how they might improve their disclosures in their financial statements and other year-end disclosures. Audit committees will find the Notices helpful in reading the financial statements and disclosures prepared by management and raising questions for management and the auditors about current issues as part of their oversight role.

Financial statement issues

The two Notices covered a few common financial statement issues identified during the reviews. These issues relate to implementing new standards and other standards that have been in place for several years.

Revenue

A complex aspect of IFRS 15: *Revenue from Contracts with Customers* is determining the transaction price when the contract includes variable consideration. Variable consideration can consist of discounts, rebates, returns, price concessions, incentives, performance bonuses or penalties, and other similar adjustments to the price. The CSA found that some issuers failed to consider whether the consideration promised in a

revenue contract included variable consideration. IFRS 15 takes a prudent approach to the recognition of variable consideration. Some issuers did not consider whether or not it was highly probable that a reversal of the estimated variable consideration included in the transaction price could occur. The CSA staff urges reporting issuers to consider both the specific facts and circumstances of the arrangement and the factors outlined in IFRS 15 for assessing the extent of variable consideration to be included in the transaction price.

Issuers were reminded to update the estimated transaction price each period and disclose the nature of

variable consideration, the impact of payment terms on variable consideration, and the methods, assumptions, and inputs used to determine the transaction price. Issuers should use judgment in deciding what information should be disclosed.

Financial instruments

IFRS 7: *Financial Instruments – Disclosures* requires disclosures of the nature and extent of risks arising from financial instruments, including credit risks. Securities regulators are concerned that some issuers are not providing adequate disclosures to allow users to understand how credit risk affects the amount, timing, and uncertainty of cash flows. IFRS 7, paragraphs 35A to 35N provides significant guidance on disclosures issuers should consider for credit risks.

Operating segments

Some issuers failed to disclose how reportable segments were identified and the judgments made in aggregating operating segments into reportable ones. IFRS 8: *Operating Segments* allows operating segments with similar economic characteristics to be aggregated into reportable segments if certain criteria are met. Disclosures are required about the judgments made in aggregating operating segments. Issuers were reminded to provide disclosures about their reportable segments in MD&A and other information consistent with the segments reported in the financial statements' disclosures.

Business combinations

IFRS 3: *Business Combinations* requires disclosures of post-acquisition information about a business combination in the notes to the financial statements. Issuers must disclose (a) post-acquisition revenue and profit or loss for the acquired business, and (b) proforma revenue and profit or loss of the combined businesses for the year of the combination. Some issuers have not been providing this information.

MD&A issues

The topics raised in comments related to the MD&A were the same issues repeatedly mentioned in staff comments over the last several years.

Non-GAAP and other financial measures

Non-GAAP and other financial measures have been and continue to be a focus of reviews by securities regulators. In 2021, the CSA issued NI 52-112: *Non-GAAP and Other Financial Measures Disclosure* to update its guidance on non-GAAP measures. NI 52-112 applies to six types of measures—non-GAAP measures, forward-looking non-GAAP measures, non-GAAP financial ratios, capital management measures, a total of segments measure, and supplementary financial measures. The CSA believes it is important for issuers to be transparent about the nature of the measures used in disclosures so investors can understand the basis of the measures and the underlying source data.

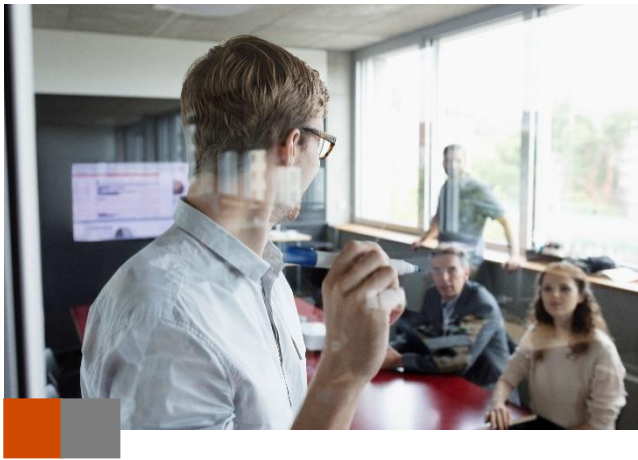
While the securities administrators have been pleased with the quality of disclosures made by issuers since NI 52-112 was issued, some areas for improvement were noted as follows:

- Quantitative reconciliations must be disclosed for all applicable financial measures presented for all comparative periods, including each non-GAAP financial measure component of the non-GAAP ratio.
- Earnings releases must include the required quantitative reconciliation to the most directly comparable GAAP measures in the financial statements. A cross-reference to a quantitative reconciliation disclosed in the MD&A is not permitted. Further, the non-GAAP financial measures cannot be presented with more prominence than GAAP measures in an earnings release.

- Significant differences between the forward-looking non-GAAP financial measure and its equivalent historical non-GAAP financial measure must be disclosed.
- A measure reported in the operating segments' note to the financial statements may not be a total of segments measure under IFRS 8: *Operating Segments*. The appropriate disclosures for a non-GAAP financial measure, including a quantitative reconciliation to the most comparable GAAP measure, must be included for these measures, even if they are extracted from the operating segments' note. In some cases, CSA staff may request that such measures be removed from the financial statements.
- Confusing labels are sometimes used to name supplementary financial measures. A supplementary financial measure must be labelled using a term that, given the measure's composition, describes the measure. Some measures may be well-established or industry based with defined methods of calculation. Using those terms when the composition is inconsistent with the definition would be considered confusing.
- Some investor presentations may refer to required information, such as reconciliations, included in other documents. When referring to information in other documents, the issuer should ensure the incorporated document has been filed before the presentation is made. There can be issues when the MD&A incorporated by reference has yet to be filed, the specific financial measure disclosed in the presentation is not included in the MD&A incorporated by reference, or the reference does not explicitly identify which MD&A and where in that MD&A the information can be found.

Projects with no revenue

The MD&A requires specific disclosures about projects that have not generated revenues to give investors an understanding of the project, including its timing and costs. This requirement applies to all issuers, not only early-stage and development-stage issuers. While issuers often disclose research and development expenses, the CSA staff found that issuers developing new products and technologies sometimes failed to disclose further information to understand the nature of the project. The Notices provide several tips for issuers to consider when they have projects planned or in progress for new products and technologies.



Venture issuers without significant revenue from operations must also include an analysis of costs by material component distinguishing between exploration and evaluation activities, research and development, intangible assets under development, and general and administrative expenses. Venture issuers often fail to make these disclosures. Non-venture issuers may also have to disclose their research and development activities in the Annual Information Form.

Variances in operations

The OSC staff observed that some issuers' discussions about their operating performance were limited to stating the amount of the variance and the percentage change. Variances alone are insufficient to provide investors with entity-specific information to understand how the business has been affected by economic circumstances, trends, events, and uncertainties. The OSC staff recommended that issuers clearly explain the factors, drivers and reasons contributing to variances affecting revenues and expenses by reference to the price, volume, and mix changes. Further, in discussions of changes in financial condition and results, issuers should include an analysis of the effect of any acquisition, disposition, write-off, abandonment, or other similar events.

Forward-looking information

As in past years, Forward-Looking Information (FLI) is an area of challenge for several reporting issuers. FLI may include information such as revenue projections, projected earnings, projected earnings per share and projected operating costs. Securities regulators have stated that FLI presented often failed to provide a balanced discussion of the critical factors and assumptions used in its preparation and the material risks that could cause actual results to vary materially from the FLI.

Some issuers have provided overly optimistic revenue projections that were not supported by reasonable assumptions. The CSA staff provided an example of inappropriate disclosure of revenue projections. Also, it was noted that the presentation of a multi-year FLI can be challenging as it may be difficult to obtain sufficient support for the assumptions used in the FLI. OSC staff have asked issuers to limit the number of years to one or two years when the assumptions were not clearly supported. The OSC provided some tips in its Notice to assist issuers in improving their FLI and avoiding OSC intervention.

Some issuers provide information on order backlog, order book, or order intake estimates based on data other than firm purchase orders. This information is considered FLI and requires the disclosure of the basis of the estimates, including any material factors and assumptions. The CSA Notice provides an example of disclosure of such FLI requiring improvement, how it could be improved, and the improved disclosures. Issuers are reminded that certain backlog measures may be supplementary financial measures subject to disclosures requirements under NI 52-112.

Reporting issuers must update previously issued FLI to allow investors to understand how the issuer is progressing toward its disclosed targets and objectives and how actual results differ from previously disclosed FLI. The securities regulators observed that, in some cases, it might be apparent during the year that the projections will likely not be achieved, but the FLI was not updated. Issuers should update the FLI by disclosing the relevant events and circumstances, the expected differences between actual results and the FLI, changes to factors and assumptions used to develop the FLI, and factors that led to the withdrawal of the FLI, if relevant. In some cases, it may be necessary to withdraw the FLI. These updates or withdrawals must be disclosed. The information may be provided in a press release, with the press release being referred to in the subsequent MD&A.

Other regulatory disclosures

Issuers are required to make disclosures on other documents required by securities requirements. In addition, issuers may also make voluntary disclosures to inform investors. Whether required or not, securities regulators may review these disclosures. Some observations from the securities regulators are noted below.

One issue observed is the lack of consistency in information in documents filed by issuers under securities legislation and voluntary disclosures on the issuers' websites and social media platforms. Further, some issuers fail to update information on a timely basis. Stale-dated information no longer relevant should be removed from the MD&A and AIF. News releases must be issued as soon as practicable when a material change occurs, with a material change report filed within ten days of the event or change in the circumstances. Issuers must have a consistent and comprehensive approach to disclosures to ensure that material information is released or updated promptly.

Promotional and greenwashing news

The OSC staff had observed an increase in press releases with overly promotional or 'good news' announcements, particularly by early-stage and development-stage businesses without revenues. Some issuers issue numerous releases that do not disclose material information or any new facts. Further, unfavourable information that may exist is not disclosed. The OSC staff have requested issuers to limit these releases or issue clarifying disclosures. Some issuers that report news of new partnerships, agreements, transactions, or research and development outcomes fail to provide updates about these events in the MD&A or subsequent news releases. Issuers should provide all relevant information affecting the business and operations in their MD&A or AIF.

The CSA staff raised concerns over issuers making potentially misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of their business operations, products, or services. These claims are commonly referred to as "greenwashing". These greenwashing disclosures have been found in both required and voluntary disclosures. The CSA staff stressed the importance of ensuring these disclosures are factual and balanced. The CSA included an example in the Notice to illustrate how unsubstantiated and promotional disclosures contribute to greenwashing.

The OSC Notice provides several best practices for issuers to consider when making announcements. Companies should establish written disclosure policies for the dissemination of information. The information to be disclosed should be assessed for materiality. The review of news releases should be sufficiently detailed to understand the substance of the matter and ensure the information is consistent with other disclosures. Companies should survey their advisors, the board of directors, or one of its committees for feedback on the disclosures. Finally, management should ensure that all material information is included in the MD&A.

Business acquisition reports

Some issuers did not file business acquisition reports (BAR) for significant business acquisitions. Determining when a BAR is required depends on various tests and the type of issuer. Exemptions may be requested but must be requested before the due date of the BAR.

Some transactions, such as reverse takeovers, are restructuring transactions. Determination of whether a transaction is a reverse takeover requires an analysis of the facts and circumstances and involves significant judgment. For such transactions, issuers are reminded to file a material change report to provide information about the transaction. The material change report can incorporate the relevant disclosures made in a management information circular, a prospectus, or an exchange takeover bid circular issued for the transaction. Prospectus-level information may be required by Form NI 51-102F5, *Information Circular*, Item 14.2.

Audit committee composition

The CSA Report noted that the composition of some audit committees was not in compliance with the requirements to have a minimum of three members with the relevant independence criteria. The independence requirements vary depending on whether the issuer is a venture or a non-venture issuer. Venture issuers that rely on the exemptions in NI 52-110: *Audit Committees* were reminded to review the requirements before relying on them.

Material contracts

Certain material contracts must be filed with the securities regulators on a timely basis. The OSC staff reminded issuers to review contracts to assess whether they must be filed.

Mineral Projects Disclosures

Mineral projects' disclosures are subject to ongoing review by CSA staff. This year's reviews followed up on how mining companies responded to the requirements for inspections by qualified persons during the pandemic.

During the pandemic, the CSA allowed issuers to obtain exemptive relief from the requirements for personal inspections of mineral projects by qualified persons. However, the CSA did not provide blanket exemptions. A follow-up review found that some issuers filed Technical Reports where the qualified persons exempted themselves from personal inspections or used virtual personal inspections (using drones and helmet cameras). These substitutes were not considered to comply with the requirements for Technical Reports. Some issuers may defer personal inspections for early-stage exploration properties, provided a Technical Report is filed once the inspection is done. Some issuers did not file a subsequent Technical Report as required.

A Qualified Person for a particular element of scientific or technical information must have sufficient relevant experience with the subject matter being disclosed. In some cases, the disclosure of scientific or technical information appeared to be approved by geoscientists or engineers lacking the relevant experience and who may have relied on the reports of consultants without interpreting the results for investors.

The CSA also observed that some issuers disclose exploration results or mineral resource estimates using equivalent grades, calculated entirely by price-weighting. This method does not consider the differential recovery of each potential element and may be potentially misleading. The CSA commented that grade equivalents could be calculated using the results of metallurgical tests or reasonable assumptions to recover the constituent elements. The CSA suggested that companies consider guidance developed by other bodies to calculate equivalent grades.

Prospectuses and transaction documents

The OSC Report also provides the staff's findings about disclosures required in prospectuses and information circulars requiring prospectus-level disclosures and other transactional and process matters, which may be important to certain interested parties.

Women on Boards and in Executive Positions

In 2022, the CSA completed its eighth review of women on boards and executive positions. The results were published in October 2022 in *CSA Multilateral Staff Notice 58-314, Review of Disclosure Regarding Women on Boards and in Executive Officer Positions*. The Report is based on a sample of 625 issuers with year-ends between December 31, 2021, and March 2022.

The Report shows marginal improvements in women's representation on boards and executive positions over the year but significant progress since 2014. Stan Magidson, CSA Chair and Chair and CEO of the Alberta Securities Commission, commented, "The increased representation of women in corporate board rooms and in senior leadership is encouraging, and we're considering our approach with respect to broader diversity."

Women now hold 24% (2021 – 22%) of the total board seats, with 7% (2021 – 6%) of issuers having a woman as the chair. A significant improvement has occurred in the board vacancies being filled by women – 45% in 2022, 35% in 2021, and 30% in 2020. Five hundred and eight board seats were vacated during the period, with 436 being filled. Eighty-seven percent (2021 – 82%) of issuers have at least one woman on their boards, with 30% (2021 – 24%) having three or more. The issuers with at least one woman on their boards vary by industry ranging from 80% for mining issuers to 98% for manufacturing companies.

Issuers with at least one woman in an executive officer position increased to 70% from 67% in 2021. This statistic varies widely by industry, from 55% for mining to 92% for utilities. The trend for issuers with a woman CEO has remained stagnant at 5% over the last three years, with women CFOs increasing to 19% from 17% in 2021.

The issuers that have adopted a policy relating to the representation of women on boards stands at 61%, slightly better than 60% in 2021. Companies that have set a target for women on boards did increase to 39% from 32% in 2021. However, targets for women in executive positions have declined from 6% in 2021 to 4% in 2022. The review found that boards that had policies and targets for the representation of women on boards had a more significant proportion of women on their boards.

The boards that have set term limits for directors have stalled at 21% (slightly down from 23% in 2021). The term limits were based on (a) age, (b) tenure, or (c) age and tenure.

The Report includes details on trends since the disclosure requirements were adopted and breakdowns by market capitalization and industry.



CSA news

Sanctions levied for fraudulent reporting and activities

During the last quarter of 2022, the securities regulators in Alberta, British Columbia, and Ontario resolved several enforcement cases with settlements with the reporting issuers or individuals involving accounting misconduct, misleading disclosures, and financial fraud. The SEC Enforcement Division participated in investigations of two cases with a presence in the US.

Improper accounting for revenues and goodwill

In October 2022, a cannabis company and its former CFO entered into settlement agreements with the OSC and SEC for improperly accounting for revenue and goodwill in multiple accounting periods, resulting in restatements of interim financial results.

The company improperly recognized revenue in three quarters of 2019. On two occasions, the company recognized revenues from selling cannabis raw materials to a counterparty while simultaneously purchasing processed products from the same counterparty. These transactions were recorded as revenue valued at \$7.6 million.

On another occasion, the company's CFO arranged to sell some raw materials to the counterparty, promising to purchase cannabis products in the next quarter after selling the raw materials. The counterparty agreed to the transaction as a favour to the company to meet its sales targets. A sale of raw materials was recognized at \$3 million. The purchase of the products back from the counterparty did not occur, and the company ultimately wrote off the receivable. These arrangements were deemed not to have commercial substance under IFRSs.

In addition, in 2021, the company failed to record impairment charges of about \$235 million on its goodwill and intangible assets for a reporting unit. After discovering the accounting errors, the company promptly reported the misconduct to the SEC and provided extensive cooperation that advanced the investigation.

In its settlements, the company admitted that it failed to file interim financial statements prepared following applicable generally accepted accounting principles. The company has paid penalties and costs of \$1.3 million to the OSC. The company will also retain an independent consultant to review, assess, and make recommendations on the company's financial reporting and accounting controls. The CFO agreed to a one-year ban from acting as a director or officer of any reporting issuer, a payment of \$70,000 to the OSC, a three-year officer and director ban for SEC registrants, and a three-year suspension from practicing as an accountant before the SEC.



Misleading disclosures

The BCSC sanctioned both the CEO and a geoscientist for misleading statements on mining estimates. The CEO was permanently prohibited from trading or purchasing securities and derivatives other than for his own account and from holding promotional, management, or advisory roles in the securities or derivatives markets. The geoscientist also received a ten-year trading ban and a permanent ban on holding positions in the capital markets. In aggregate, the two were fined \$242,000.

Fraudulent activities

Three individuals in BC participated in an elaborate fraud by soliciting BC investors to invest in two US-based LLCs. At events organized by the individuals, investors were promised extraordinarily high, no-risk returns from supposedly lucrative gold mining operations in Mali and Brazil. However, there were no such mining operations.

In a parallel case, the SEC found that the fraud involved over 1,400 investors who invested over US\$15 million in the US-based LLCs. A Brazilian national living in Florida organized the Ponzi and pyramid scheme. None of the funds raised were used for mining operations, and over US\$6 million was diverted to the Brazilian national's personal expenses and luxury cars. In 2019, a US federal court found that the Brazilian national and several others had committed fraud and sold securities without being registered. The Brazilian national was ordered to pay more than \$11 million.

Although there were several red flags about the investment, including the promise of unreasonably high returns, the three BC individuals continued to promote the investment. One of the individuals was an accountant. One claimed to be knowledgeable about gold mining in Africa. The other individual had previously been registered to sell insurance and mutual fund products. The BCSC will now consider what sanctions should be placed on the three BC individuals and the Brazilian national.

In another case, in November 2022, the ASC found that an individual and a reporting issuer had perpetrated a fraud on its investors. The company raised \$940,000 from investors to invest in a business in Mexico. Instead, the individual used the funds to purchase a house in British Columbia. The ASC will now determine what sanctions or cost recovery orders will be issued.

Three individuals from BC recently found to have committed fraud against investors who had invested in a project to build a battery plant were sanctioned during the quarter. Some of the funds were diverted for personal use by the individuals. The individuals were permanently banned from being directors or officers of any issuer or registrant and specific trading in securities. The three were required to repay amounts obtained through the fraud and pay penalties of \$1,140,000 in aggregate.



SEC regulatory update

SEC regulatory update

Implementing compensation clawbacks

The Dodd-Frank Wall Street Reform and Consumer Protection Act required the SEC to direct the national securities exchanges and associations that list securities to establish listing standards requiring issuers to develop and implement a compensation clawback policy.

Such policies would require an issuer to recover incentive-based compensation paid to current and former executive officers based on misstated financial reporting measures. The policy would apply to compensation received during the three years preceding the date an issuer is required to prepare the accounting restatement. The recoverable amount is the incentive-based compensation received over the amount that otherwise would have been received had it been determined based on the restated financial measure. An issuer that does not adopt and comply with a compensation recovery policy that meets the requirements of the listing standards would be delisted.

There are some limited exceptions available to enforcing the policy, which includes situations when:

- The direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be recovered, and the issuer has reasonably attempted to recover the compensation through other means.
- The recovery would violate the home country law that existed at the time of adoption of the rule, and the issuer provides a legal opinion to the exchange to support that conclusion; or
- The recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.

The SEC also amended Regulation S-K, Form 40-F, and Form 20-F to require new disclosure requirements related to the required policies. A listed issuer would be required to file its policy as an exhibit to its annual report and disclose how it has applied the policy if a restatement occurred. Suppose there is a restatement of prior period financial statements other than changes for retrospective application of accounting standards or disaggregation of information. In that case, the cover page of specific filing forms must identify the fact.

These requirements will begin in early 2023 after the exchanges have amended their listing requirements.

SEC implementation guidance

Transparency in financial reporting

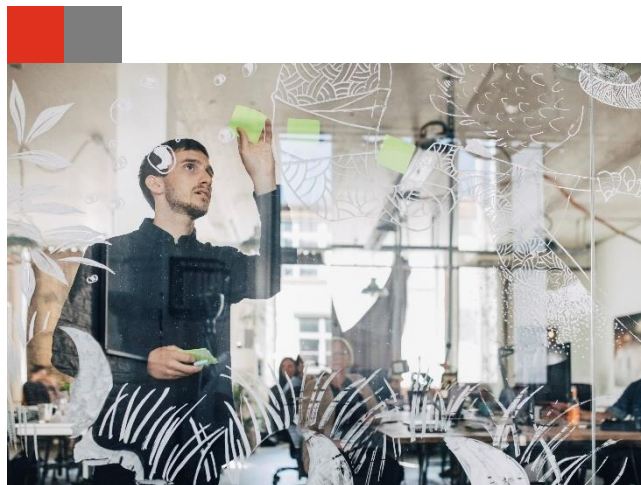
Annually in December, the American Institute of Certified Public Accountants (AICPA) and the Chartered Institute of Management Accountants (CIMA) host the Conference on Current SEC and PCAOB Developments in Washington, DC. Regulators, standards setters, and other professionals review the latest issues and developments in financial reporting for public companies registered with the SEC.

The central theme of the 2022 Conference was transparency in financial reporting. SEC staff emphasized that financial reporting is not just a compliance exercise but an essential tool for communicating with investors. These communications are critical in times of uncertainty and when dealing with unique transactions such as crypto-asset transactions. The SEC staff is looking for more insights in management's discussion and analysis. Issuers are expected to comply with the requirements, as evidenced by increased comments on disclosures. The SEC staff uses "Dear Issuer" letters to set out their expectations for disclosures on specific topics. Companies can use these letters as checklists to ensure they have covered the SEC staff's expectations.

The preparation of disclosures should not simply be a roll-over exercise. Registrants should step back and consider the current environment when preparing disclosures. What is the impact of macroeconomic conditions and risks such as climate change? Have they been adequately explained in the company's MD&A, risk profiles, and other disclosures? In "[Economic uncertainties: Reporting the impact](#)" in this edition of *AC Insights*, we have outlined the securities regulators' expectation for disclosures of the impact of current uncertainties on financial reporting.

Certain uncertainties are expected to be disclosed in discussions of critical accounting estimates; these disclosures are incremental to accounting policy notes. The SEC staff expect registrants will include quantitative and qualitative analysis to explain the impact of current conditions, such as rising interest rates, on estimates. Registrants should evaluate their disclosures to ensure they go beyond simply identifying the existence of an uncertainty or risk to explain the impact of these uncertainties and risks.

Throughout the three-day conference, the staff of the SEC, PCAOB, and standard setters and panels of professionals from preparers and auditing firms presented views on various financial reporting and auditing issues. A summary of the key highlights relevant to Canadian issuers is provided below.



Accounting and financial reporting

Crypto assets

Several participants discussed crypto asset transactions, emphasizing the unique nature of these transactions and the related risks and uncertainties. SEC Commissioner Hester Pierce urged businesses to use best practices learned from traditional finance transactions when engaging in crypto transactions. Investors and counterparties should perform appropriate due diligence, verify reserves held to back-up certain coins, be aware of conflicts of interest, and understand the investment risk. Commissioner Pierce noted that some form of regulation should be expected in the crypto space.

Crypto-based lending arrangements: The SEC staff discussed the accounting for one type of crypto asset transaction involving the lending of crypto assets. Currently, there are no specific FASB or IFRS standards for crypto transactions. In the example, a lender loans a fixed quantity of crypto assets for a fee to another party for a specified period. The borrower can use the assets at its sole discretion, including the ability to sell or pledge the crypto assets. The borrower must return the same quantity and type of crypto assets to the lender. The SEC staff expressed the view that the arrangement should be accounted for like a loan arrangement.

- The lender should derecognize the loaned crypto assets because the lender does not have the economic benefits of the crypto assets until the borrower returns them. The lender would recognize an asset that reflects its right to receive a crypto asset, like a loan receivable.

- The crypto asset loan receivable would be measured at inception and subsequently at fair value of the loaned crypto assets through the income statement, potentially resulting in a day one gain or loss. The gain or loss should not be presented as revenue but as an other gain or loss.
- Since the lender is exposed to the borrower's credit risk, the lender should recognize an allowance for expected credit losses.
- Disclosures should provide information about the key terms and risks associated with the arrangement, including terms of any collateral provided, rights in the event of borrower default, and how the lender monitors credit risk. Disclosures should also address the concentration of credit risk and related party transactions, if applicable.

SAB 121 and safeguarding crypto assets: In March 2022, the SEC staff published Staff Accounting Bulletin 121, providing interpretative guidance on the accounting for, presentation of, and disclosures about crypto assets custodial arrangements. The SAB requires parties holding crypto assets in a custodial arrangement to recognize a crypto asset safeguarding liability and a corresponding asset on the balance sheet at fair value. The SEC staff reminded registrants to review SAB 121 to understand when it applies.

“Dear Issuer” Letter for Digital Assets: In December 2022, the Division of Corporate Finance issued a [Sample Letter](#) with the types of comments it might give related to certain developments in the crypto assets markets, such as bankruptcies and financial distress in the crypto asset markets. The SEC expects companies to consider providing specific, tailored disclosures about the direct and indirect impact of market events and conditions. The Sample Letter includes 16 points that issuers may be asked. These disclosures may include discussions about:

- A company's exposure to specific counterparties and other parties such as customers, custodians, or other participants in the crypto space who are bankrupt or insolvent or have similar financial difficulties.
- Policies to safeguard customers' crypto assets.
- Excessive redemptions or withdrawals of crypto assets and the impact on financial condition and liquidity.
- Crypto assets are pledged as collateral against loans or other arrangements.
- Material risks in the crypto space related to the company's reputation, existing regulation, regulatory developments, safeguarding of assets, and disruptions in the crypto markets.
- Risk management policies.

Initial coin offerings: The SEC staff shared perspectives on the accounting for crypto assets in initial coin offerings. Companies should complete a comprehensive accounting analysis to determine the accounting treatment of these coins. The study should consider all the terms of the arrangement, including the rights of the holder and obligations of the issuer (which may be implied). Any accounting conclusions should be well-supported and communicated to the company's auditors and audit committee.

Consolidation of subsidiaries

The SEC staff noted an increased level of consultations on the consolidation of foreign subsidiaries and variable interests. Some consultations have focused on questions about a parent company's control of a financial interest in a foreign subsidiary. In addition, there may be challenges in assessing whether an entity is a primary beneficiary due to the foreign regulatory environment, as in some countries like China. The staff observed situations in which an investor acquires or retains a large economic interest in the investee and claims not to have power over that investee. The SEC staff stressed the need to apply skepticism in such scenarios.

Segment reporting

The SEC staff continues to focus on the identification and aggregation of operating segments. They observed that investors have requested additional information about segments and questioned whether companies have the right number of segments.

Many issuers identify segments based on information the chief operating decision maker (CODM) reviews. The SEC staff have stated that issuers should consider the mix of information presented to the CODM and align segments reported in the financial statements with management's internal evaluation and other publicly available information. The SEC staff will consider all publicly available information, including a company's websites, analyst reports, earnings call transcripts, public comments, and social media posts when evaluating whether the issuer has appropriately identified operating segments. SEC staff provided two examples of issuers disclosing a single operating segment in their financial statements. However, outside the financial statements, the companies provided more granular information. Through the comment letter process, the SEC staff discovered that the CODM regularly reviewed information at the lower level presented in other information outside the financial statements. Following the SEC comments, the issuers revised their disclosures to increase the number of segments reported.

Climate-related factors

The staff reminded issuers that climate-related risk is not simply a disclosure issue; they may also affect the registrant's financial statements. The development of green technologies, net-zero commitments, or plans for energy-efficient technology may impact the useful life of long-lived assets. Demand for products or services may affect future prospects. These and other climate-related factors may influence the going concern analysis, impairment analysis, and other estimates. The staff reminded registrants to review its educational paper for more insights into climate-related accounting considerations.

Financial reporting outside the financial statements

The SEC staff highlighted several areas of focus in reviews of MD&A and other disclosures outside the financial statements.

Non-GAAP measures

On December 13, 2022, the staff announced that they updated their Compliance & Disclosure Interpretations (C&DIs) relating to non-GAAP financial measures. The updates are intended to memorialize existing staff views provided through public statements or comment letters. The updates have an immediate effect.

A key focus of the updates is to provide further guidance on what is considered "misleading", including guidance on operating expenses that are "normal and recurring". A non-GAAP measure may be regarded as misleading if it excludes cash operating expenses that are normal or recurring in the business's operations. The SEC staff evaluates "normal" in the context of how a non-GAAP adjustment is related to the registrant's operations, revenue-generating activities, business strategy, industry, and regulatory environment. "Recurring" is assessed by considering whether an expense occurs repeatedly, occasionally, or at irregular intervals. As an example, SEC staff noted that the opening, closing, and relocation of retail outlets in the ordinary course of business should be considered recurring as it is part of the normal operations of a retail company.

The C&DI was also updated to clarify that non-GAAP adjustments that change the GAAP recognition or measurement principles are considered to be the application of individually tailored accounting principles and may be misleading. The concept of individually tailored accounting principles can affect the presentation of revenue and expenses. An example is using a cash basis rather than an accrual basis for revenues and expenses.

The SEC staff has provided guidance on the labelling of non-GAAP measures and related adjustments. The C&DI provides examples of misleading labels and descriptions for non-GAAP measures. Misleading non-GAAP measure descriptions are those that are the same or confusingly similar to titles or descriptions used for GAAP financial measures. Non-GAAP measures labelled as "pro forma" would be misleading if they are not calculated following the requirements of Regulation S-X, Article 11. Registrants are not required to use the term "non-GAAP" in the title of each non-GAAP measure; however, they must label the related disclosures as non-GAAP.

The C&DI stresses that disclosures cannot make a misleading measure compliant with non-GAAP rules. If a non-GAAP measure is determined to be misleading, it should be removed or amended in the subsequent filing or public disclosure for all periods presented.

Guidance on the prominence of non-GAAP measures to the corresponding GAAP measures was updated to explain what is considered undue prominence and refresh examples of situations in which non-GAAP measures would be disclosed more prominently than the comparable GAAP measures. Examples of more prominent disclosure of non-GAAP measures include disclosure of ratios based on a non-GAAP measure without disclosing the equivalent ratio using GAAP measures or presentation of charts, tables, or graphs of non-GAAP measures without disclosing the comparable GAAP measures. The C&DI clarifies that non-GAAP reconciliations should always begin with the most directly comparable GAAP measure and reconcile to the non-GAAP measure. Further, the C&DI defines what would constitute a non-GAAP income statement.

"Dear Issuer" Letters

The SEC staff reminded issuers that it had published several "Dear Issuer" sample comment letters to provide guidance on disclosures about a registrant's business, risk factors, and the discussion of operations, liquidity, and capital resources in upcoming filings. "Dear Issuer" letters were issued setting out the staff's expectations for disclosures about:

- **Crypto asset markets**—The issuer's evaluation of the issuer's exposure to recent bankruptcies and financial distress in the crypto asset markets and their exposure to other parties and regulatory impacts (see above).
- **Climate change**—Disclosures about the impact of climate change and the company's plans to address climate change.
- **Russia-Ukraine conflict**—Disclosures of the direct and indirect impact of Russia's invasion of Ukraine on the issuer's business and associated supply-chain issues, including potential or actual disruptions to suppliers, customers, or employees.

- China-based companies—Specific and prominent disclosure of the legal and operational risks associated with having the majority of a company's operations in China.

Critical accounting estimates

The purpose of disclosures of critical accounting estimates (CAE) is to inform investors by providing qualitative and quantitative information to understand estimation uncertainty and the impact the CAE has had or is reasonably likely to have on the financial condition or results of operations of a company. The SEC staff expects quantitative and qualitative disclosure to:

- Address why the estimate is critical;
- Provide a robust quantitative analysis to understand the estimation uncertainty;
- Include information incremental to the accounting policy;
- Explain the past variability in estimates and assumptions; and
- Discuss the sensitivity of the reported estimate to methods of calculation and assumptions.

The SEC staff encouraged registrants to avoid simply repeating information in the financial statements by providing a more robust analysis, especially when a potential impact is more likely or increases in magnitude. For example, with increased interest rates, disclosures about the effects of interest rate assumptions may be material. Companies may need to disclose the sensitivity of reported amounts to changes in the underlying assumptions when it is more likely that these changes would materially impact the estimate.

Cybersecurity disclosures

The SEC staff and cybersecurity specialists reminded issuers of the importance of providing investors with accurate and timely information about cybersecurity defences and any material cyber incidents. Disclosure about material cybersecurity breaches must include more than the potential risk of an incident or a hypothetical risk that data may be compromised when a company is aware that the data or systems have been compromised.



Auditing and assurance issues

The PCAOB outlined their inspection process, indicating that PCAOB Inspectors focused on industries with elevated risks resulting from the pandemic and financial statement areas most affected by current economic events. Financial statement items such as revenue, inventory, business combinations, long-lived assets, allowance for credit losses, and equity were common themes from the 2022 inspection cycle. Inspections for 2022 also focused on audit execution risk resulting from human resource constraints, remote working environments, diminished training for staff, and the use of shared service centres. Auditors were also encouraged to focus on risk assessments and fraud by identifying new risks that require new responses.

For the 2023 inspection cycle, the PCAOB expects to focus on (1) financial statement areas that are more complex, involve significant judgment, and are susceptible to change; (2) risk assessments; (3) auditor independence; and (4) audits of issuers with material crypto asset balances and transactions.

The PCAOB also provided a preview of their expected inspection findings for 2021, which are covered in this edition of *AC Insights*, "[PCAOB previews 2021 inspections' findings](#)".

The SEC continued to emphasize the importance of auditor independence and ethics. Auditors are critical gatekeepers in the financial reporting system. The SEC staff noted that auditors use the independence rules as a checklist of permissible services and relationships. However, the staff reminded auditors and audit committees to consider both the general standard of independence and the rules about permissible services and relationships to make decisions because the rule is not comprehensive. Auditors were reminded that firms need to be independent in both fact and appearance and have a tone at the top that promotes a culture of ethical behaviour and compliance with the SEC's auditor independence rules.

The SEC stressed the importance of auditors' professional skepticism, particularly in challenging economic times. Auditors need to be alert to follow up on red flags. The SEC illustrated the need for skepticism through an example in which an auditor believes a long-lived asset might be impaired. Management does not hold the same view. Near year-end, management provides the auditor with an unexecuted draft sales agreement with a sales price indicating that the asset is not impaired. In this scenario, more skepticism is required to evaluate whether the draft sales agreement is appropriate audit evidence, particularly given the timing of the agreement, the fact that the contract is not executed, and there had not been any previous communications about potentially selling the asset.

Heightened uncertainties often present opportunities for increased fraud risk and bias in estimates and judgments used in financial statements. The SEC staff urged auditors to use diligence in identifying fraud risks, designing procedures to address fraud risks, investigating red flags, and maintaining professional skepticism. The SEC staff advised auditors to consider the company's culture, interview various personnel across the company, and assess whether the entity-level controls are robust.

Separately, the SEC staff cautioned auditors to assess the audit risks of crypto transactions, including consideration of (1) skills needed by management and auditors to understand the markets, (2) risk of misappropriation or loss of assets, (3) possible override of controls, (4) the role of third-party service providers for custody and other accounting information, and (5) any related party transactions.

SEC news

Penalties to deter misconduct

The SEC continues with a robust enforcement program by imposing penalties to deter future violations, establishing accountability from major institutions, and tailoring undertakings for compliance by other firms. In November 2022, the SEC Enforcement Division announced that there were 760 enforcement actions launched for fiscal 2022 compared to 697 in 2021.

Enforcement activities

Representatives from the SEC's Division of Enforcement discussed themes arising from cases brought by the Commission over the past year. The Division highlighted working with a sense of urgency to protect investors, hold wrongdoers accountable, and deter future misconduct in the financial markets. In this edition of *AC Insights*, "[Penalties to deter misconduct](#)" summarizes the SEC enforcement actions.

Why is this important?

The Conference provided an opportunity for regulators and standard setters to highlight their activities and communicate areas of focus. Companies should consider these topics as they prepare their upcoming year-end or quarterly financial statements. The key takeaways are as follows:

- Take a fresh look at the company's disclosures and ensure the impact of uncertainties of the current environment are reflected in the financial statements and MD&A;
- Expand the discussion of critical estimates to explain more about the nature and sensitivity of those estimates;
- Go beyond the minimum to provide transparent communications beneficial to investors;
- Some items are compliance exercises, and the rules should be reviewed for completeness; and
- Make sure risk factors are up-to-date and relevant, and explain what the potential impacts are for elevated risks.

SEC actions resulted in civil penalties, disgorgement, and pre-judgment interest, totalling \$6.4 billion, up from \$3.9 billion in the fiscal year 2021. Civil penalties, representing 66% of the total, were also the highest on record. The fiscal year 2022 also saw the second-highest year in whistleblower awards. The SEC received over 12,300 whistleblower tips in the year and issued 103 awards in an aggregate amount of \$229 million. Harmed investors received about \$937 million in the year compared to \$621 million in the prior year.

Personal accountability

The SEC's actions often focus on personal accountability. Two-thirds of the stand-alone enforcement actions involved at least one individual. Some prominent cases involved a CEO making false statements about a product's safety, a CEO making negligent false and misleading statements about certain related party transactions, and a Chief Investment Officer allegedly overvaluing assets managed by a firm and preventing investors from redeeming their funds while personally receiving significant fees. During the 2022 year, the SEC charged several executives under the SOX rules and ordered executives to return bonuses and compensation following misconduct at their firms, even when those executives were not charged with wrongdoing. For example, three executives of a registrant were ordered to return \$2 million in bonuses after the registrant restated its financial statements following the misconduct of a former executive. The SEC also pursues criminal charges in cases where persons engaged in intentional misconduct.

Cooperation from individuals and entities involved in actions often helps to expedite investigations and provide critical evidence to investigators. This cooperation is considered when remedies are ordered, particularly financial penalties. The Whistleblower Program is an integral part of the Enforcement Program. The SEC vigorously safeguards the anonymity of whistleblowers and has acted against those who attempted to impede or retaliate against the whistleblowers.

Enforcing financial reporting and disclosure requirements

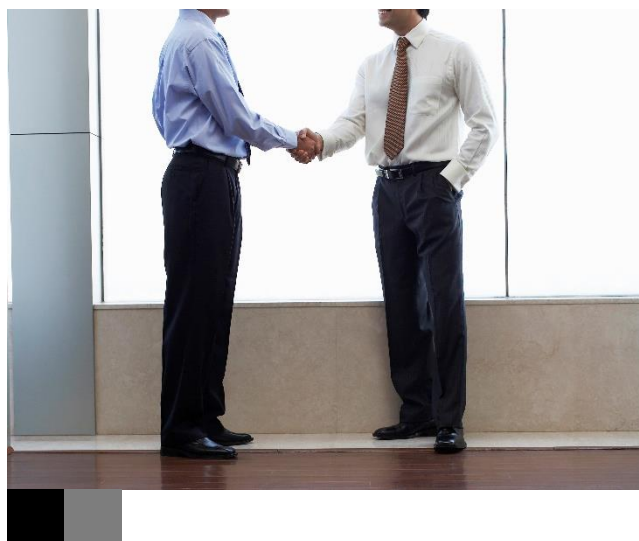
The SEC states that "public company disclosure is the bedrock of our securities markets". Ninety-two cases during the year involved financial reporting, accounting, or auditing matters. The SEC staff regularly investigates and recommends enforcement actions charging misconduct by issuers, auditors, lawyers, transfer agents and their employees. Issuers have been brought to task for misleading disclosures, failure to disclose financial risks, and the impact of new ventures on existing businesses. Auditors have been charged with failing to conduct audits or interim reviews properly. Lawyers have been charged for their roles in unregistered, fraudulent securities offerings and pump-and-dump schemes.

The SEC monitors the crypto asset securities sector closely and has doubled its staff focused on this area. The team has acted against entities and individuals for failing to register the offer and sales of crypto products, promoting a fraudulent crypto pyramid and Ponzi scheme, and insider trading activities.

The Enforcement Division has monitored environmental, social and governance disclosures by public companies, investment products, and strategies. Some actions taken by SEC enforcement over ESG disclosures include charges against an investment advisor for materially misleading statements and omissions about how it considered ESG principles in making investment decisions for certain mutual funds. A mining entity allegedly made false and misleading claims about the safety of its infrastructure before it failed, killing several people, and causing significant environmental and social harm and a material decline in its market capitalization. Charges were made against an investment advisor, which had marketed itself as providing advisory services compliant with Islamic or Shari'ah law but failed to adopt and implement written policies and procedures addressing how it would assure Shari'ah compliance on an ongoing basis.

Bribes and corrupt practices

There were several enforcement actions in 2022 under the Foreign Corrupt Practices Act (FCPA) against issuers of securities traded in the US that engaged in bribery and other prohibited corrupt practices abroad. An entity with subsidiaries in Turkey, the United Arab Emirates and India was charged with creating and using slush funds to bribe foreign officials in return for business. A global manufacturer was charged with FCPA violations related to a bribery scheme involving its Brazilian subsidiary.



Abusive trading practices

The SEC continues to pursue abusive trading practices such as insider trading by issuer executives and service providers, market manipulation, and cherry-picking (whereby advisors preferentially allocated profitable trade or failed to allocate unprofitable trades to the advisor's personal accounts).

The Enforcement Division uses various tools in its investigations, including technological and analytic tools, cooperation of individuals involved, and whistleblower programs. The SEC staff successfully uses data analytics to detect suspicious trading patterns. For example, nine individuals involved in three separate insider trading schemes yielding \$6.8 million in illicit gains were detected and subject to criminal charges. Over 38,500 tips, complaints, and referrals from the public were triaged during the year. Some cases involved international penny stock schemes and fraudulent market manipulation.

The annual report by the Enforcement Division shows the SEC's commitment to acting against wrongdoers across the market. Issuers, executives, auditors, and investment and legal professionals are held accountable.

Enforcement clamps down on bad and corrupt behaviours

During the most recent quarter, the SEC announced settlements of prominent cases involving several multinational registrants.

Misstated tax provisions

In October 2022, the SEC settled with a consumer goods manufacturer relating to misstatements in its Q3 and Q4 2017 financial statements. The company had understated the tax-related valuation allowance for the third quarter of 2017 by \$109 million and overstated the tax expense for the fourth quarter of 2017 by the same amount. Consequently, the company's net loss and net loss per share were understated by 15% in Q3 and overstated by 65% in Q4. The company concluded it did not have internal controls specifically related to tax valuations allowances. The company cooperated with the SEC's investigation and agreed to pay a \$3.5 million penalty.

In a separate order, the SEC alleged that the audit partner for the company's auditor failed to verify that the uncorrected error was documented, despite knowing about it and failed to communicate the error to the company's audit committee. The order further alleges that the audit partner did not maintain independence as the partner had provided human resource advice to the company, which is a prohibited activity. The matter with the audit partner is not yet resolved.

Misleading disclosures

A multinational bank in Scandinavia was charged with misleading investors about its anti-money laundering (AML) compliance program for a Baltic branch and failing to disclose the risks associated with its significant deficiencies. The SEC alleged that the Scandinavian bank knew or should have known when it acquired the Baltic unit in 2007 that a substantial portion of the branch's customers was engaging in transactions with a high risk of money laundering. Further, the bank knew or should have known that (a) its internal risk management procedures were inadequate to prevent such activities, (b) its AML and other procedures were not being followed, and (c) the branch did not comply with applicable laws and rules. The SEC alleged that between 2009 and 2016, foreign customers of the Baltic branch used the bank's services to transact billions of dollars of suspicious transactions through the US and other countries. The Baltic branch generated as much as 99% of its profits from these services. When the bank's AML failures became apparent, the bank's share price dropped. The US court ordered the bank to pay \$179 million in disgorgement, \$56 million in prejudgment interest, and a civil penalty of \$179 million. In addition, the bank has agreed to pay more than \$2 billion as part of an integrated, global resolution with the SEC and other US and Scandinavian agencies.

Selective disclosure of information to analysts

In December 2022, a telecommunications company agreed to pay a \$6.3 million penalty. Three executives also agreed to each pay \$25,000 to settle charges related to the company's selective disclosure of material non-public information to research analysts. Because of significant declines in 2016 Q1 smartphone sales, the company anticipated falling short of analysts' estimates for Q1 revenues. It is alleged that three executives privately called analysts at approximately 20 separate firms and disclosed the company's smartphone sales data and the impact on revenue metrics. This information was considered material and not disclosed publicly. The analysts, in turn, reduced their revenue projections, which allowed the company to beat the overall revenue consensus.

Bribes

A global manufacturing and technology company settled charges with the SEC for violations of the Foreign Corrupt Practices Act (FCPA) related to a bribery scheme in South Africa. On December 3, 2022, the company agreed to pay a \$75 million civil penalty to settle the SEC's charges. It is alleged that the company paid certain service providers \$37 million to bribe a government official and obtained a \$160 million contract to supply and install infrastructure at a facility in South Africa. In addition to the penalty, the company made restitution to the South African government. The company also agreed to regularly report to the SEC for three years on the ongoing remediation of its internal accounting controls and compliance program.

In another case, the SEC and an aerospace and technology company settled charges for violations of the FCPA. The company is alleged to have offered at least \$4 million in bribes in 2010 to a high-ranking government official in Brazil to obtain business from a state-owned entity. In another situation, employees and agents of the company's foreign subsidiary paid more than \$75,000 in bribes to an Algerian government official to obtain and retain business from a state-owned entity. The company agreed to pay more than \$81 million to settle the SEC's charges, which was offset by approximately \$39 million in payments made to Brazilian authorities. The company also entered into a deferred prosecution agreement with the US Department of Justice and agreed to pay more than \$78 million to settle criminal charges. The company also agreed to settle additional charges brought by the Brazilian government.



Auditing & assurance update

A&A News

CPAB to improve communications

In September 2022, CPAB announced that it would update its approach to communications about its oversight of auditing firms that audit Canadian reporting issuers. The update reflects feedback received from stakeholders. The approach is outlined in [CPAB's disclosure recommendations](#). CPAB plans to introduce some changes in the near term and others later after CPAB has received the agreement of regulators and obtained any necessary legislative changes.

Near-term changes

CPAB has begun a process to disclose significant enforcement actions imposed on auditing firms. CPAB rules currently provide CPAB with the discretion to publicly disclose enforcement actions imposed on a firm if doing so is in the public interest. CPAB plans to make these disclosures without identifying the related reporting issuer. The Recommendations include an illustration of how these actions would be disclosed. The information would consist of the firm's name, the nature of inspections completed, brief descriptions of the deficiencies culminating in the enforcement action, and the restrictions imposed on the firm.

In addition, CPAB plans to disclose recommendations made in a firm report but not addressed by that firm. Under existing rules, CPAB has the power to disclose weaknesses, deficiencies, or recommendations not addressed by a firm within 180 days of the date of the final inspection report. An example of such a communication is included in the Recommendations. CPAB indicates it will disclose the relevant inspection report, the date of the notice, and the specific recommendation(s) not implemented to CPAB's satisfaction. These disclosures will be made beginning in January 2023 for actions arising from 2022 inspections.

Phase 2 changes

Other changes outlined in the Recommendations will require approval by other government agencies and legislative bodies. CPAB has begun seeking the necessary approvals and regulatory or legislative changes. No expected completion date has been announced.

CPAB plans to require mandatory disclosure of a reporting issuer's specific significant inspection findings to its audit committee. Currently, 173 firms out of approximately 260 participating firms participate in a voluntary protocol to share inspection findings with the audit committee of reporting issuers. For 2021 inspections, 96% of the findings were shared, compared to 69% for 2020. An example of a significant inspection findings report for a specific issuer is included in the Recommendations.

The other planned disclosure is a condensed individual public inspection report for each audit firm inspected by CPAB. Audit committees and investors supported this type of disclosure. However, a concern has been raised that the information disclosed could be misinterpreted by some readers. CPAB plans to manage this and other risks by explaining their regulatory oversight process and approach in the individual reports and their website and ensuring inspection reports focus on the facts and provide appropriate context. A sample firm inspection report is included in the Recommendations. The report is expected to disclose the following:

- Information about the firm — the number of reporting issuers audited by the firm, the frequency of inspections, and the number of inspections in the last two years;
- The focus areas for inspections of reporting issuers' files, including the number of files within the specific focus area and the number of significant findings for each area; and
- Explanation of the CPAB process and approach to inspections.

These planned improvements to communications about CPAB's inspections and oversight over auditing firms respond to feedback received from stakeholders. Audit committees expect the information will assist them in their oversight of auditors. Others commented that increased disclosures support the CPAB mandate of public accountability and quality in audits.

CPAB inspection interim results

CPAB is currently in the process of completing its inspections for its 2022 cycle. In October 2022, CPAB released the [*CPAB Audit Quality Insights Report: 2022 Interim Inspections Results*](#), which summarizes some of its findings from those inspections.

In 2022, CPAB selected 67 files for inspections of the four largest firms compared to 75 in 2021. Significant findings were identified in seven files (2021 – seven). Three of the four had findings below CPAB's target of 10% of the files, while one firm had findings in greater than 20% of their files. Inspections were completed on 12 files for firms not inspected annually. Of those files, 11 had significant findings. Inspections of other annually inspected firms are in progress. Two restatements were required since the 2021 report, one at a large firm and one at an annually inspected firm.

CPAB conducted quality management systems (QMS) assessments at the four largest audit firms and one other annually inspected firm. As a result of recent investigations and enforcement actions related to sharing answers on tests required under mandatory training and backdating of working papers, CPAB has been assessing firm governance and culture as part of the quality management systems assessments. While these assessments are still in progress, indications are that firms have made progress in developing or refining controls to respond to deficiencies identified in 2021. However, one firm's assessment indicates that specific controls may not be designed appropriately or operating effectively.

Common deficiencies and other concerns

The common inspection findings related to:

- The sufficiency and appropriateness of audit evidence. Deficiencies include insufficient testing of data inputs and outputs of automated tools used to evaluate revenue, insufficient evidence to support the fair values of assets and liabilities acquired in a significant business combination, and inadequate evaluation of information obtained from third-party organizations. CPAB states these deficiencies should have been identified and remedied by effective supervision and review by senior engagement team members.

- Identifying and evaluating threats to the auditor's independence from non-audit services provided by the auditor to the reporting issuer. These situations usually occur for new reporting issuer engagements or when an issuer becomes a reporting issuer through an IPO or other transaction.

Other current areas of interest mentioned in the Report included the following points:

- In 2022, CPAB started reviewing how auditors evaluate climate-related risks in financial statement audits. CPAB observed that the responses from firms was mixed, with no noted changes to audit approaches to respond to climate-related risks. While climate-related guidance is evolving, the Interim Report provides some questions audit committees might consider asking about how climate-related risks are addressed in the audit approach.
- A review of fraud risk identification and assessment suggested auditors could do more to enhance the quality of their work in this area.

Questions for audit committees

The Interim Report provides questions related to the topic matters that members of the audit committee may consider asking the auditor.

- Some companies use third parties to provide information used in preparing financial statements. This information may include inputs used in various estimates or information from outsourced accounting functions. Audit committees may wish to ask the auditor how the auditor evaluated the nature and significance of services provided by third parties, how the auditor assessed internal controls at the service organization and management's oversight controls, and how any deficiencies in controls were addressed in the audit approach.



- Threats to independence may arise when the auditor provides non-audit services. Questions the audit committee may consider include whether the auditor has identified any threats, how the significance of threats was evaluated, and what safeguards reduce those threats to an acceptable level.
- More focus is being placed on the impact of climate-related risks on financial statements. Members of the audit committee might consider what climate-related risks the auditor considered and how they affected the audit plan. In addition, audit committees may want to know if any significant accounting estimates were affected by climate-related risks not identified by management.

The Interim Report provides some insights into areas where auditors can improve their quality of work. Audit committees oversight often includes asking informed questions about the auditor's audit approach and work. The Interim Report provides some background that may help fulfil that obligation for 2022.

PCAOB previews 2021 inspections' findings

The PCAOB staff released a preview of its findings from 2021 inspections in its report, *Staff Update and Preview of 2021 Inspection Observations*. PCAOB Chair, Erica Williams, called for the audit profession "to sharpen its focus on improving audit quality and protecting investors". The PCAOB staff expected that about 55% of the audits reviewed would have one or more deficiencies for failing to comply with PCAOB standards or rules, compared to 44% in 2020. PCAOB inspected 141 audit firms in 2021, of which 48 were non-US firms. Six hundred and ninety audits were reviewed.

While a significant portion of this increase related to deficiencies in the application of new standards for reporting critical audit matters (CAMs), the PCAOB also observed a trend of recurring shortcomings in certain areas over the last three years. Most of the CAMs-related deficiencies were instances in which auditor procedures to determine CAMs did not include every matter that should have been analyzed as a potential CAM.

The PCAOB Report highlights several common deficiencies found in the audits inspected.

- Recurring deficiencies were identified in audits of Internal Control over Financial Reporting (ICFR)—Auditors failed to (a) evaluate the review and follow-up procedures performed by control owners; and (b) identify and test controls relevant to the assessed risk of material misstatement, including controls over the accuracy and completeness of the information used in the operation of a control.

- Deficiencies in audits of financial statements included failures to design and perform procedures to address assertions related to revenue, expected credit losses, fair value of acquired assets, fair value of goodwill and intangible assets, recoverability of long-lived assets, and cost of inventories.
- Deficiencies identified in compliance with other PCAOB standards required improvements in (a) the application of standards for the reporting of CAMs, auditor tenure, and the involvement of participants in the audit, (b) application of the standard for communicating with audit committees, and (c) the review of journal entries as part of fraud considerations.
- Quality control concerns related to (a) the failures to obtain audit committee approvals for certain audit-related services, non-audit services, and tax services before the auditors were engaged for these services; (b) a high frequency of personal independence issues; (c) failures of engagement partners to address significant audit risks; and (d) lack of adequate documentation of procedures performed by the engagement quality reviewers.

PCAOB staff also observed practices used by some firms that were effective in enhancing audit firms' quality control systems and audit quality generally. The Report included examples to help other firms improve their quality control systems.

The PCAOB staff have identified some deficiencies affecting the quality of some audits. Audit committees may wish to focus on issues identified by the PCAOB that are relevant to their company when having discussions with the auditors about the audit of ICFR and financial statements.

PCAOB strengthens enforcement

One of the elements of the PCAOB strategic plan for 2022 is to strengthen enforcement activities to discourage unacceptable behaviours by audit firms. The Board is advancing this plan by increasing penalties, pursuing enforcement actions for certain types of violations, and proactively seeking out wrongdoing by expanding the use of sweeps against firms where there may be a violation of PCAOB standards or rules. Sweeps allow the PCAOB to obtain additional information from several firms at the same time in areas of concern to the PCAOB.

The PCAOB imposes sanctions against auditing firms or individual audit personnel through settlements or disciplinary proceedings. The PCAOB publishes the results of these actions after meeting the requirements for publication. During the last quarter of 2022, the PCAOB released information on several settled cases. Some of these evolved from sweeps. The firms involved often agreed to pay significant penalties and take remedial actions to improve quality control. Individuals participating in the misconduct were banned from being associated with a registered firm or participating in audits of public companies for one or more years, with some barred permanently.

The findings on cases resolved and published during Q3 2022 involved the following situations.

- An audit partner failed to adequately evaluate a significant estimated allowance for customer receivables, including not obtaining support for critical assumptions and testing the financial statement's completeness.
- Three individuals of an audit team failed to evaluate a company's identification of, accounting for, and disclosure of transactions and relationships between a company and its related parties when they knew there were risks of material misstatement of revenues and receivables.
- Audit personnel altered the audit documentation for audits selected for the PCAOB inspection. In some cases, audit personnel misrepresented the information given to PCAOB inspectors.
- A partner and other engagement team members signed blank placeholder working papers. The blank working papers were replaced with completed ones, but the sign-off dates were not updated.

- Audits were performed by staff without appropriate experience to audit the client. The audit approach failed to consider specific risks related to the client.
- Firm personnel shared answers for tests in internal training courses related to PCAOB rules and standards, undermining the purpose of the training.
- An unregistered audit firm participated in the audits of public companies of a registered firm. The unregistered firm incurred significant audit hours and was not properly supervised by the registered accounting firm.
- Registered firms did not report the use of unregistered firms used in audits under Form AP (several instances were reported, often involving affiliated firms).
- Registered firms failed to file Form AP to identify who led the audit and whether other firms were involved in the audit (several instances reported).
- Registered firms failed to report on a timely basis reportable events when the firms were subject to certain criminal or disciplinary proceedings involving other agencies or professional organizations.

The list of cases resolved by the PCAOB illustrates both the significance the PCAOB places on compliance and the effectiveness of their sweeps to ensure audit firms comply with all the PCAOB administrative standards and rules.

Auditing & assurance library

The auditing & assurance library is our curated list of publications, articles, podcasts, and webcasts that we provide to you on topics of interest in this area.

Lessons Learned from KAM Reporting on Audits of TSX-Listed Entities: Observations from the 2020 Canadian Experience

Canadian Auditing and Assurance Standards Board

The [CAASB resource](#) summarizes a study undertaken on key audit matters (KAMs) reporting in Canada. Researchers at the University of Guelph, Department of Management, and York University, School of Administrative Studies, prepared the study funded by the CAASB.

You should read this Report to understand the Canadian practice for reporting KAMs, the constraints on and recurring disclosure of KAMs, and investors' perspectives on the utility of KAMs reporting in their analysis of public companies. The CAASB summary provides a link to the full research report.

Audit Committee: The Kitchen Sink of the Board

Center for Audit Quality, November 2022

This [Report](#) compiles leading practices on audit committee responsibilities and disclosures about what audit committees do in corporate governance disclosures. The practices were based on interviews of audit committee chairs or members for a variety of public companies, members of the investor community, and individuals tasked with preparing the corporate governance disclosures. The interviews were conducted by a research team from the University of Tennessee Knoxville's Neel Corporate Governance Center and the Pamplin College of Business at Virginia Tech.

You should read this Report to understand how boards effectively allocate oversight responsibilities to audit committees, manage their workloads, and communicate the committee's role and responsibilities to stakeholders.

2022 Audit Committee Transparency Barometer

Center for Audit Quality and Audit Analytics, November 2022

This [Report](#) analyzes disclosures made about audit committee oversight in proxy circulars. The Report is based on research completed by Audit Analytics. The Barometer illustrates how audit committees of US companies report their oversight activities. The survey is based on US companies included in the S&P Composite 1500.

This Report may be of interest to audit committees to understand practices on disclosures about auditor tenure, audit partner selection, cybersecurity oversight, ESG oversight, and other potential disclosure matters.

Audit Committee Effectiveness – A Webinar Series

Center for Audit Quality and the National Association of Corporate Directors

The [webinar](#) series explores critical insights from leaders in financial reporting and resources developed to assist audit committees and board members in fulfilling their responsibilities. The first episode produced was the "Audit Committee: The Kitchen Sink of the Board," which covers the report by the same name (see above) and the 2022 Audit Committee Transparency Barometer (December 7, 2022).

Audit Partner Pulse Survey, Fall 2022

Center for Audit Quality, November 2022

This [Survey](#) summarizes the views of large US firms' audit partners about industry trends, economic health indicators, challenges and risks facing businesses, and how businesses are changing strategies in the current economic environment.

The Report covers the economic outlook, how inflation and other challenges make cost management a top priority, how businesses are shifting strategies to mitigate economic risks, how companies prioritize talent retention as labour shortages continue, and what emerging risks business leaders are focused on.

Jumpstart Your Digital Assets Journey: A Tool for Audit Committees

Center for Audit Quality, November 2022

This [CAQ publication](#) provides an overview of the digital assets landscape and questions audit committees can ask to understand company management's digital asset strategy better and oversee the related risks.

You may be interested in this publication to understand why companies use digital assets, the risks associated with them and how they might be managed, the use, accounting and auditing of crypto assets transactions, and the state of regulation over such assets.

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