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U.S. Securities and Exchange Commission, Paul Munter, Acting Chief Accountant, Office of the Chief Accountant, Public Statement, Statement on OCA's Continued Focus on High Quality Financial Reporting in a Complex Environment (December 6, 2021)

Statement

Statement on OCA's Continued Focus on High Quality Financial Reporting in a Complex Environment

Paul Munter
Acting Chief Accountant

Dec. 6, 2021

Introduction[1]

The events of the past year bring to mind the old saying that "change is the only constant in life." Our capital markets continue to evolve and adapt in response to changes in the economic environment, investors' needs for new types of information, and challenges related to the ongoing effects of the pandemic. Amidst these changes, the U.S. financial reporting system remains strong, largely due to the cumulative efforts of thousands of stakeholders who have exhibited resilience and adaptability, while remaining focused on the need for high quality financial reporting for the benefit of investors.

In this statement, we describe the Office of the Chief Accountant's ("OCA") role in the financial reporting system, sharing perspectives from our ongoing priorities and our work over the past year related to rulemaking activities, oversight of standard setting, implementation and application of standards, and application of auditor independence requirements. We then discuss the vital role of individual stakeholder groups, sharing observations regarding key areas of focus for each stakeholder group to promote a continued flow of high quality financial reporting to investors.

Upholding the Basic Bargain: OCA's Responsibilities and Priorities

SEC Chair Gary Gensler has often noted a basic bargain that was struck in our capital markets with the passing of federal securities laws in the 1930s—that investors get to decide what risks they wish to take, while companies raising money from the public have an obligation to share information with investors on a regular basis.[2] Fundamental to the functioning of this basic bargain is that the information companies provide to investors be of high quality, including financial statements that are (1) prepared in accordance with U.S. generally accepted accounting principles ("GAAP")[3] and (2) audited in accordance with Public Company Accounting Oversight Board ("PCAOB") standards by an independent public accounting firm registered with the PCAOB.

The Chief Accountant of the SEC is the principal advisor to the Commission on accounting and auditing matters arising in the administration of the federal securities laws.[4] As such, OCA supports the Commission's oversight of the Financial Accounting Standards Board ("FASB"), monitoring of the International Accounting Standards Board

("IASB"), enforcement of U.S. GAAP and International Financial Reporting Standards ("IFRS") requirements by issuers, oversight of the PCAOB, and application of the Commission's auditor independence requirements. Fulfilling these responsibilities requires us to regularly interact with investors, investor advocates, and each stakeholder group in the financial reporting system (management, audit committees, external auditors, standard setters, other regulators), domestically and internationally.[5] By engaging with each of these stakeholder groups, and facilitating communication and collaboration between stakeholder groups, we promote the flow of high quality financial information to investors, who depend on this information to make informed decisions.

OCA is committed to supporting the Commission in holding up that basic bargain agreed to nearly 90 years ago. By furthering each element of high quality financial reporting—high quality accounting standard setting, high quality implementation and application of those standards, and high quality audits—we seek to ensure that investors continue to have the information they need to make well-informed investment decisions. More specifically, OCA supports the Commission's (1) rulemaking activities, (2) oversight of accounting standard setting, (3) efforts to promote effective implementation and application of those accounting standards, and (4) oversight of the PCAOB, each of which we discuss in further detail.

Rulemaking Activities

Commission rulemaking is foundational to the overall soundness of the U.S. financial reporting system and investor protection. OCA plays an active role throughout the lifecycle of the Commission's rulemaking process, advising the Commission on the impact of proposed rules or rule amendments on accounting or auditing matters, and often playing a key role in developing rule proposals related to accounting or auditing matters for the Commission's consideration.

The SEC's rulemaking agenda[6] reflects the agency's current priorities in fulfilling its three-part mission.[7] While the agenda includes a number of potential rulemaking projects that relate to financial reporting and could have an impact on accounting or auditing matters, we would like to highlight the following rulemaking agenda items:

- Climate Risk Disclosures;
- Trading Prohibitions Under the Holding Foreign Companies Accountable Act ("HFCAA"); and
- Recovery of Erroneously Awarded Compensation.

Climate Risk Disclosures

Given the dynamic nature of our capital markets, the total mix of information requested by investors continues to evolve to include new types of information, such as climate risk disclosures. To this point, Chair Gensler has stated: "Occasionally, investors in our capital markets tell us that they…want something a little bit different. When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more."[8] Chair Gensler has since directed the staff to develop a climate risk disclosure rule proposal, taking into account feedback received earlier this year.[9]

In addition, we note that the FASB staff published an educational paper in March 2021 to provide investors, issuers, and others with an overview of the intersections between environmental matters, including climate change, and existing U.S. GAAP requirements.[10] The IASB staff issued similar educational materials in November 2020.[11] In September 2021, the staff in the Division of Corporation Finance published an illustrative letter containing sample comments that the Division may issue to companies regarding their climate-related disclosure or the absence of such disclosure.[12] As stated in the sample comment letter, depending on the particular facts and circumstances, these disclosures may be required as part of a company's description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations.

Given the global nature of our capital markets, OCA also actively monitors international developments on these topics. In September 2020, the IFRS Foundation issued a consultation paper on sustainability reporting[13] that presented the possible formation of a global sustainability standards board under the governance of the IFRS Foundation, which is also responsible for governance and oversight of the IASB and is accountable to the Monitoring

Board. Based on feedback received on that consultation paper and a related exposure draft published in April 2021,[14] the IFRS Foundation Trustees approved targeted amendments to the IFRS Foundation constitution and announced in November 2021 the formation of the International Sustainability Standards Board ("ISSB") to set IFRS sustainability disclosure standards.[15]

Trading Prohibitions under the HFCAA

On December 18, 2020, the HFCAA was signed into law and, as required by the statute, the Commission adopted final rules on December 2, 2021 to specify disclosure and submission requirements for affected issuers.[16] The Act also requires a trading prohibition for an issuer's securities if that issuer uses an audit firm that the PCAOB is unable to inspect or investigate completely for three consecutive years.

Under the HFCAA, the PCAOB is responsible for determining in which jurisdictions it is unable to inspect or investigate completely registered public accounting firms because of a position taken by an authority in that foreign jurisdiction. The PCAOB adopted a new rule on September 22, 2021, that provides the framework for the PCAOB to use in making this determination.[17] The new PCAOB rule was approved by the Commission on November 4, 2021 and is now effective.

In addition to rulemaking activities in this area, we continue to work diligently with other offices and divisions of the SEC to bring to the attention of investors other risks related to investments in emerging markets, including China. For example, we recently issued, along with the SEC's Office of Investor Education and Advocacy and Division of Corporation Finance, an investor bulletin describing some of the specific risks of investing in U.S.-listed companies with China-based operations.[18]

Recovery of Erroneously Awarded Compensation

On October 14, 2021, the Commission issued a release reopening the comment period for its 2015 proposed rules that would direct the national securities exchanges and national securities associations to establish listing standards that would require each issuer to develop and implement a policy providing for the recovery of incentive-based compensation received by current or former executive officers that was awarded based on financial information that required restatement, and require disclosure of the issuer's policy.[19] Under the proposed rules, incentive-based compensation received by an executive officer during the three fiscal years preceding the date on which the issuer is required to prepare an accounting restatement to correct a material error would be subject to recovery, or "clawback." The amount to be recovered is the incentive-based compensation that exceeds the amount the executive officer would have received had the incentive-based compensation been determined based on the restated financial statements.[20]

Accounting Standard Setting

High quality financial reporting cannot be achieved without high quality accounting standards. The objective of general purpose financial reporting is "to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity."[21] No matter how well standards are applied, investor trust in financial reporting cannot exist without confidence that the underlying accounting standards are designed to achieve that basic objective. Promoting the development of high quality accounting standards is one of OCA's core objectives, which we accomplish by assisting the Commission in its oversight of the FASB and engagement with the IASB in its development of IFRS standards.

Oversight of FASB Standard Setting

OCA leads the SEC's efforts to oversee the standard-setting activities of the FASB, in part, by:

- Providing feedback on FASB projects throughout the projects' life cycle, which is informed by our unique position in the financial reporting structure;
- Participating as an official observer of FASB-related meetings such as those of the Emerging Issues Task Force, Financial Accounting Standards Advisory Council, Small Business Advisory Committee, and Investor

Advisory Committee; and

- Working collaboratively with the FASB staff to share insights and perspectives on a variety of matters.

Most recently, we have been actively engaged with the FASB on its agenda consultation. We will continue to be actively engaged with the FASB as it evaluates feedback received and assesses which projects to add to its technical agenda.

The FASB received over 500 responses, including 100 original comment letters, to its Invitation to Comment—Agenda Consultation.[22] We recognize and appreciate the time and effort required to provide meaningful feedback on the FASB's agenda or individual projects, and we continue to believe that the standard-setting process benefits greatly from early, detailed engagement from all stakeholders.

In addition to our role in the oversight of the FASB's process leading to the issuance of a final standard, we also work closely with the FASB during the implementation of new accounting standards and the post-implementation review ("PIR") activities for those standards. We have spent a considerable amount of time in this area related to the implementation of revenue, leases, and current expected credit losses ("CECL") standards, and have shared observations on these standards with the FASB and FASB staff.

Promoting High-Quality International Financial Reporting Standards

Our activities related to accounting standard setting are not limited to U.S. GAAP. More than 500 foreign private issuers ("FPIs") report financial statement information to the Commission under IFRS as issued by the IASB, making the United States one of the largest markets in the world for the securities of IFRS-reporting issuers. Many U.S. companies also have an interest in IFRS standards due to statutory financial reporting requirements for their non-U.S. subsidiaries or when entering into transactions, including acquisitions and other investments, with entities that report under IFRS. Due to the importance of IFRS to both U.S. investors and issuers, we have a strong interest in monitoring the quality of IFRS standards.

We engage with the IASB in a number of different ways. Through our participation on the Monitoring Board, we monitor the governance of the IFRS Foundation and the IASB, the development of IFRS standards, and the application of IFRS. Through our involvement in the International Organization of Securities Commissions' ("IOSCO") Committee on Issuer Accounting, Audit and Disclosure ("Committee 1"), in which I serve as the vice-chair, we, along with other securities regulators, issue comment letters on IASB proposals. We also engage directly with the IASB and its staff, like we do with the FASB, on specific accounting matters, including sharing observations from our consultations on the application of IFRS or areas of U.S. GAAP that are substantially converged with IFRS. In addition, at the beginning of this year, I became an observer to the IFRS Interpretations Committee, which works with the IASB in supporting the application of IFRS standards. In this role, I attend IFRS Interpretations Committee meetings and participate in the discussion on behalf of IOSCO.

Similar to the FASB, the IASB is currently working on its own agenda consultation. The IASB's process was similar to the FASB's in that it conducted extensive outreach with stakeholders to receive input on additional standard-setting projects, and then used that feedback to prepare its Request for Information—Third Agenda Consultation, in which it requested feedback regarding the prioritization of topics for its agenda.

Implementation and Application of Accounting Standards

In addition to our oversight and monitoring of accounting standard setting, we are actively involved in the implementation and application of those accounting standards through our engagement with preparers, industry groups, auditors, audit committees, standard setters, other offices and divisions within the Commission, such as the Division of Corporation Finance, investors, and other regulators.

One of the most important ways in which we engage with stakeholders and support high quality implementation and application of accounting standards is through our accounting consultation process. Registrants, be they domestic registrants or foreign private issuers, and companies planning to enter our public capital markets can consult with OCA on complex, novel, or unique issues they face on accounting matters under both U.S. GAAP and IFRS. As part of the consultation process, we work collaboratively with management, auditors, audit committees, and others to understand unique fact patterns and the judgements made by management in applying accounting standards to those fact patterns. Through this process, we are able to provide the staff's view on the application of U.S. GAAP or IFRS to those fact patterns.

Observations from Recent Accounting Consultations

Our recent accounting consultations have addressed a wide range of issues including questions related to financial statement presentation, segment reporting, revenue recognition, distinguishing liabilities from equity, consolidation, business combinations, financial assets, compensation, and leases.

Consistent with the increased volume of capital raising transactions, we have received a large number of consultations on accounting issues identified as companies prepare to enter the public markets, including through IPOs and mergers with special purpose acquisition companies ("SPACs"). Earlier this year, we, along with the Division of Corporation Finance, issued two statements on SPACs and mergers of private companies with SPACs that were directly informed by our consultation activity: *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*[23] and *Financial Reporting and Auditing Considerations of Companies Merging with SPACs*.[24] Since then, we have continued to see a range of other accounting and reporting issues that entities have been working through related to SPAC transactions, including additional issues relating to warrant accounting, earnings per share, temporary versus permanent equity classification, compensation, business combinations, and derivatives.

As it relates to companies that are entering, or planning to enter, the public markets, we want to reiterate the importance of ensuring that appropriate personnel and processes are in place to produce financial statements in accordance with U.S. GAAP applicable to public business entities, which would include the reversal of any previously-elected Private Company Council accounting alternatives available to private companies and, depending on the issuer's status, earlier effective dates for most standards.

One of the most frequent topics of accounting consultation continues to be revenue recognition, with many of these consultations coming from companies entering the public markets and seeking our views on accounting for emerging or unique business models or transactions. Similar to observations we have shared in the past, these revenue consultations often relate to the identification of the company's performance obligations, including the principal versus agent analysis, identification of the company's customer(s), and accounting for consideration payable to a customer.

Similar to the trend of revenue questions arising in emerging business models and companies accessing the public markets, we have received a number of consultations related to digital asset-related transactions or business models. These questions include, among others, when digital assets represent an asset or liability of the registrant, determining the cost basis for digital assets, and revenue recognition considerations. While we welcome constructive dialogue on whether accounting standards could be revised to better reflect the underlying economics of digital asset transactions or business models—and again, the FASB's and IASB's work to consider feedback from their respective agenda consultation processes will be important in this area—we remind stakeholders there is an existing accounting framework that is robust and provides a basis to account for and report these assets and related transactions. Application of the existing accounting guidance often requires judgment and depends on the issuer's specific facts and circumstances.

Additionally, recent consultations and broader engagement with investors and other stakeholders informed our issuance, along with the Division of Corporation Finance, of Staff Accounting Bulletin ("SAB") No. 120 on November 29, 2021. SAB 120 updates our existing SAB series to conform to share-based payment accounting guidance issued by the FASB and provides interpretive guidance on the accounting for certain share-based compensation arrangements commonly referred to as "spring-loaded awards."[25]

We remain available for consultation and encourage stakeholders to contact our office with questions.[26] We value our interactions with engaged stakeholders regarding issues they are facing, and we will continue to be informed by such feedback as we focus on investors' need for high quality financial information, consistent with the SEC's mission.

Independent Audit Oversight

Assurance provided by independent public accountants improves the quality of financial disclosures and is a strong contributor to investor confidence in and the strength of our capital markets.[27] The U.S. capital markets' disclosure regime is designed to promote high quality audits through the adherence of accountants to rigorous independence, quality control, and auditing standards and rules.

Promoting Auditor Independence

Similar to our accounting consultation process, we regularly receive consultations related to auditor independence under the Commission's and the PCAOB's independence rules. These questions are often raised by audit firms, but we also receive consultations from audit committees and management on independence matters that impact their filings. In cases where a question is raised by the auditor, we often also discuss the issue with the audit committee to understand its position on the matter.

Since the Commission adopted targeted amendments to the independence requirements in Rule 2-01 of Regulation S-X in October 2020,[28] the total number of auditor independence consultations we have received has increased. As described in more detail in our recent statement, *The Importance of High-Quality Independent Audits and Effective Audit Committee Oversight to High Quality Financial Reporting to Investors*,[29] the Commission views the text of Rule 2-01(b) of Regulation S-X together with the four guiding principles laid out in the Introductory Text of Rule 2-01 as a framework to be applied when considering matters that are not directly addressed in other parts of Rule 2-01. The guiding principles refer to whether a relationship or a provision of a service:

- Creates a mutual or conflicting interest between the accountant and the audit client;
- Places the accountant in the position of auditing his or her own work;
- Results in the accountant acting as management or an employee of the audit client; or
- Places the accountant in a position of being an advocate for the audit client.

In applying this principles-based standard, OCA staff has consistently provided the view that it would be a high hurdle to reach a conclusion that the accountant could be viewed as objective and impartial under the general standard when an auditor has provided services in any of the periods included in the filing that are contrary to one of these guiding principles.

We in OCA remain available for consultation on all auditor independence matters,[30] and we encourage stakeholders to contact us in advance of transactions or the provision of services that could raise independence questions.

Oversight of the PCAOB

The PCAOB plays a significant role in the financial reporting system, overseeing the audits of public companies and SEC-registered brokers and dealers to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The Commission oversees the PCAOB in accordance with the Sarbanes-Oxley Act, including the appointment of its board members, approval of PCAOB rules and standards, and approval of the PCAOB's budget and accounting support fees. OCA advises the Commission on these important oversight responsibilities, including through direct engagement with the PCAOB.

On November 8, 2021, the Commission announced the appointments of Erica Y. Williams as Chairperson of the PCAOB and Christina Ho, Kara M. Stein, and Anthony (Tony) C. Thompson as Board members.[31] Duane DesParte will continue his service as a Board member and will serve as Acting Chairperson until Erica Williams begins her service on the Board. The incoming Board brings a broad depth and diversity of experience and the SEC staff look forward to collaborating with the Board to further the PCAOB's vital mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

Promoting Quality in International Audits

OCA is also heavily involved in promoting quality in international audits through our leadership role on the Monitoring Group,[32] which is a group of international financial institutions and regulatory bodies committed to advancing the public interest in international audit, ethics, and independence standard setting and audit quality. This role provides us the ability to help guide the governance of the international auditing and ethics standard-setting system.

In July 2020, the Monitoring Group published a set of recommendations to strengthen the international audit and ethics standard-setting system.[33] Since the Monitoring Group's publication of these recommendations, OCA staff has been actively working with key stakeholders, including, among others, the Public Interest Oversight Board ("PIOB"), the International Audit and Assurance Standards Board ("IAASB"), the International Ethics Standards Board for Accountants ("IESBA"), and the International Federation of Accountants ("IFAC") to achieve consensus on both transition and implementation of the recommendations. Important upcoming milestones include the transition to Gabriela Figueiredo Dias as the next IESBA Chair effective January 1, 2022,[34] identifying members to fill the two open vacancies on the PIOB, and launching of the new structure, which will result in enhanced oversight of the standard-setting system by the PIOB.

We highly value the opportunities provided to us through our participation and leadership role within the Monitoring Group to engage globally in support of promoting audit quality. We also acknowledge the significant contributions from others across the globe in this inclusive, multi-stakeholder effort.

Key Areas of Focus for Each Stakeholder to Produce High Quality Financial Information for Investors

To maintain the strength of our U.S. financial reporting system, each stakeholder should constantly reassess its areas of focus in light of changing priorities, evolving investor needs, and updates to standards, rules, and regulations. This process must be intentional and ongoing, such that it results in continuous improvement to maintain the flow of high quality financial information to investors. OCA's unique position in the financial reporting system allows us to support each stakeholder in identifying relevant areas of focus.

Accounting Standard Setters

As noted earlier, high quality accounting standards are ones that are designed to provide decision-useful financial information to investors. The development of high quality accounting standards by the FASB, in its important role as the independent accounting standard-setter for U.S. GAAP, and by the IASB, whose IFRS standards may be used by FPIs, requires broad engagement with financial statement users, preparers, auditors, regulators, and others. Diverse stakeholder input, along with other research, enables the standard setters to better evaluate proposed standards and identify potential areas for improvement in their accounting and reporting requirements.

To maintain quality over time, accounting standards must evolve in response to changing circumstances and stakeholder feedback, particularly investor feedback, regarding the usefulness of the resulting financial information. To this end, it is critical that the FASB and IASB solicit and transparently incorporate investor feedback into standard-setting decisions. For example, while we note the extensive engagement that currently takes place between the FASB and investors, we believe that enhanced transparency of this engagement and the use of that input to its standard-setting process will allow stakeholders to better understand investor perspectives and how investor feedback is considered in the FASB's standard-setting process and decisions.

While it is certainly important that accounting standards evolve in response to changes in the total mix of information that investors find material, issuing new standards simply for the sake of change does not promote high quality financial reporting. Instead, the need for standard setting must be well-supported, with consideration of whether a change will provide more decision-useful information to investors, and whether the expected benefits resulting from any such change will outweigh its cost, including costs to investors from the change. We will continue to urge both the FASB and IASB to clearly articulate the case for any proposed changes to their standards, particularly where stakeholder feedback is mixed or a long-standing, well-understood, decision-useful framework exists.

It is also imperative that the FASB and IASB maintain active dialogue and information sharing practices to promote high quality accounting standards around the world. We encourage the FASB and IASB to continue to work collaboratively on areas of mutual interest, and believe their respective agenda consultation projects present a great opportunity to identify potential intersections between the future standard-setting agendas of the FASB and IASB.

Preparers

Preparers are responsible for properly implementing and applying accounting standards to accurately reflect the economics of underlying transactions in their financial statements. Therefore, responsibility for high quality financial reporting, including high quality financial statements, rests in the first instance with management.

In their preparation of financial information for the benefit of investors, we cannot overstate the importance of preparers making well-reasoned and supported judgments that are grounded in their particular facts, relevant rules, and accounting principles and that consider the usefulness and transparency of the resulting information provided to investors. Preparers should also ensure that significant judgments and estimates are disclosed in the financial statements in a clear and transparent manner that is understandable and useful to investors.

The ability to make well-reasoned accounting judgments and estimates and provide clear and transparent disclosures of those judgments and estimates is inextricably linked to the effectiveness of a company's internal control over financial reporting ("ICFR") and disclosure controls and procedures. In particular, management review controls often play an important role in addressing a company's financial reporting risk in areas of judgment. While there is no universal definition of a management review control, they are often considered to be reviews of aggregated financial information or estimates by knowledgeable personnel to detect misstatements at an appropriate level of precision. It is important for registrants to continually assess their financial reporting risks and evaluate whether their ICFR environment is effective, including a particular focus on the design, implementation, and operating effectiveness of management review controls involving areas of significant judgment. Additionally, in light of significant changes to many companies' operations, for example, changes to their financial reporting processes in a remote work environment, we remind preparers that if any change materially affects, or is reasonably likely to materially affect, an entity's ICFR, such change must be disclosed in quarterly filings in the fiscal quarter in which it occurred (or fiscal year in the case of a foreign private issuer).[35]

Further, if an error is identified in the financial statements, management must determine whether the error is material, which is based on what is important to the user. If that analysis indicates that previously issued financial statements are materially misstated, those financial statements would need to be restated and reissued. By comparison, if the error is not material to previously issued financial statements, but correcting the error in the current period would be material to the current period, an entity is not precluded from correcting the error in the current period comparative financial statements by restating the prior period information and disclosing the error, which is commonly referred to as a "little r" restatement. While the total number of restatements by U.S.-based public companies has declined each year for the past six years, we note that "little r" restatements as a percentage of total restatements rose to nearly 76% last year, up from about 35% in 2005.[36] In this regard, we note that under existing accounting guidance assessing whether an error is material to prior periods is not a mechanical exercise, nor is it based solely on a quantitative analysis. Rather, management must judiciously evaluate the total mix of information, taking into consideration both quantitative and qualitative factors to determine whether an error is material to investors and other users.[37]

We also emphasize the importance of identifying and communicating material weaknesses in ICFR before they become evident in the form of a restatement and reissuance. We encourage ongoing attention, including audit committee participation, regarding the adequacy of and basis for a company's effectiveness assessment, particularly where there are "close calls" in the assessment of whether a deficiency is a significant deficiency (and reported to the audit committee) or a material weakness (and also reported to investors).

Auditors

The independent auditor plays an important role in promoting transparent, accurate financial information and in maintaining investor confidence in that information by providing reasonable assurance to investors that the financial statements are free from material misstatement. As further described in our recent statement on audit quality,[38] the independence of the auditor, in both fact and appearance, is foundational to the credibility of the audit, and therefore to the confidence of investors in the quality of the financial statements.

Just as preparers are responsible for assessing the effectiveness of ICFR, it is important for audit firms to continually assess the effectiveness of their risk management and quality control systems, which serve as frameworks to anticipate and mitigate the risk of audit deficiencies.

One area that auditors must carefully monitor as part of their risk management and quality control systems is the scope of services being provided by the audit firm, including network firms, to avoid potentially independence-impairing situations for the accounting firm that issues the auditor's report.[39] This includes evaluating the impact of business relationships and non-audit services on both existing and prospective audit relationships. Entering into significant, multi-year non-audit service contracts or business relationship arrangements with non-audit clients can impact the auditor's ability to remain independent in certain future circumstances. For example, this type of service contract or relationship arrangement can be independence-impairing for the audit firm if an existing audit client merges with or acquires the non-audit client. While sourcing an independent auditor is a key responsibility of the audit committee,[40] compliance with auditor independence rules is a shared responsibility of the issuer, its audit committee, and the auditor.[41]

Additionally, for auditors that are part of global networks of firms, the assessment of the effectiveness of risk management and quality control systems also means focusing on strong global network governance and management to promote audit quality across all jurisdictions, including emerging markets, such as China, by considering both domestic and international audit-related standards. This involves having strong client acceptance and continuance policies, a robust internal inspection function, including cross-network reviews, continuous and consistent training, and audit quality benchmarking. We will continue to promote audit quality in emerging markets, including China, through ongoing discussions with global audit firm networks and other means as necessary.

Audit Committees

Audit committees make significant contributions to the financial reporting system through their oversight of a company's ICFR and related culture, the quality of financial reporting, and the quality of the independent, external audit process. As we have said time and time again, the measures related to audit committees have proven to be some of the most effective financial reporting enhancements included in the Sarbanes-Oxley Act.[42]

Without a doubt, today's audit committees have a lot on their plates. Increasingly, audit committees are being tasked with overseeing a company's cybersecurity policies; environment, social, and governance practices; legal and regulatory compliance; and tax risks. While these are most assuredly important issues, and audit committees may be adept at monitoring these risks, we believe it is important that audit committees assess whether the scope of their responsibilities is appropriate, achievable, and aligned with the experience of its members, and importantly, not lose sight of their core responsibility—oversight of financial reporting, including ICFR, engagement of the independent auditor, and oversight of the external audit process. We cannot overstate the importance of independent and diverse thinking brought by independent directors in fulfilling this responsibility.

We also continue to encourage audit committees to consider the sufficiency of the auditor's and the issuer's monitoring processes, including those that address corporate changes or other events that could affect auditor independence.[43] In addition to evaluating independence of the auditor, we believe it is foundational to high quality audits that audit committees give careful consideration to audit quality, and not merely focus on price, when appointing and retaining auditors.

Conclusion

The strength of our capital markets is built, in large part, on a foundation of trust. Each stakeholder must, therefore, remain keenly focused on quality in every aspect of the financial reporting process, with a central focus on providing high quality information to investors. We in OCA are committed to doing our part to support stakeholders in these efforts to produce high quality financial reporting and maintain the confidence of investors in our financial reporting system, and we express our sincere gratitude to all stakeholders who continue to fulfill their respective roles and responsibilities with the utmost integrity and professionalism in these challenging times.

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[1] This statement represents the views of the staff of the Office of the Chief Accountant ("OCA"). It is not a rule, regulation, or statement of the Securities and Exchange Commission ("SEC" or the "Commission"). The Commission has neither approved nor disapproved its content. This statement, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. "Our" and "we" are used throughout this statement to refer to OCA staff.

[2] *See, e.g.,* Chair Gary Gensler, *Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs* (Sept. 14, 2021), *available at* https://www.sec.gov/news/testimony/gensler-2021-09-14.

[3] Foreign private issuers may prepare their financial statements under International Financial Reporting Standards as issued by the International Accounting Standards Board without reconciliation to U.S. GAAP. *See Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP*, SEC Release No. 33-8879 (Dec. 21, 2007), *available at* https://www.sec.gov/rules/final/2007/33-8879.pdf.

[4] 17 CFR 200.22.

[5] U.S. investors routinely invest in foreign companies to diversify their portfolios, whether through direct investments or through investments in funds with international exposure. As of December 31, 2020, U.S. holdings of foreign equities and debt was approximately $14.4 trillion. *See* Report on U.S. Holdings of Foreign Securities at End-Year 2020, *available at* https://home.treasury.gov/news/press-releases/jy0445.

[6] *See Agency Rule List – Spring 2021*, *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235.

[7] The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

[8] *See* Chair Gary Gensler, *Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar* (Jul. 28, 2021), *available at* https://www.sec.gov/news/speech/gensler-pri-2021-07-28.

[9] *See* SEC's "Comments on Climate Change Disclosures" webpage, *available at* https://www.sec.gov/comments/climate-disclosure/cll12.htm.

[10] *See* FASB Staff Educational Paper, *Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards* (Mar. 19, 2021), *available at* https://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176176379917.

[11] *See* IASB Staff Educational Paper, *Effects of Climate-related Matters on Financial Statements* (Nov. 2020), *available at* https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf.

[12] *See* Division of Corporation Finance, "Sample Letter to Companies Regarding Climate Change Disclosures" (Sept 22, 2021) *available at* https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

[13] *See* IFRS Foundation, *Consultation Paper on Sustainability Reporting* (Sept. 30, 2020), *available at* https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf.

[14] *See* IFRS Foundation, Exposure Draft: *Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards* (Apr. 30, 2021), *available at* https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/ed-2021-5-proposed-constitution-amendments-to-accommodate-sustainability-board.pdf.

[15] *See* IFRS Foundation, *IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements* (Nov. 3, 2021), *available at* https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/.

[16] *See Holding Foreign Companies Accountable Act Disclosure*, SEC Release No. 34-93701 (Dec. 2, 2021), *available at* https://www.sec.gov/rules/final/2021/34-93701.pdf.

[17] *See Rule Governing Board Determinations Under the Holding Foreign Companies Accountable Act*, PCAOB Release No. 2021-004 (Sept. 22, 2021), *available at* https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-048-proposed-rule-governing-board-determinations-under-holding-foreign-companies-accountable-act.

[18] *See* Office of Investor Education and Advocacy, Office of the Chief Accountant, and the Division of Corporation Finance, *Investor Bulletin: U.S.-Listed Companies Operating Chinese Businesses Through a VIE Structure* (Sept. 20, 2021), *available at* https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-95.

[19] *See Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation,* SEC Release No. 33-10998 (October 14, 2021), *available at* https://www.sec.gov/rules/proposed/2021/33-10998.pdf.

[20] *See* FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.

[21] FASB Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, paragraph OB2 and International Accounting Standards Board ("IASB") *Conceptual Framework for Financial Reporting*, paragraph 1.2.

[22] *See* FASB's "Online Comment Letters – Project: 2021-004 Agenda Consultation" webpage, *available at* https://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=2021-004.

[23] *See* John Coates, Acting Director, Division of Corporation Finance, and Paul Munter, Acting Chief Accountant, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")* (Apr. 12, 2021), *available at* https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

[24] *See* Paul Munter, Acting Chief Accountant, *Financial Reporting and Auditing Considerations of Companies Merging with SPACs* (Mar. 31, 2021), *available at* https://www.sec.gov/news/public-statement/munter-spac-20200331.

[25] *See* Staff Accounting Bulletin No. 120, which is codified in SAB Topic 14: *Share-Based Payment* and SAB Subtopic 5.T: *Accounting for Expenses or Liabilities Paid by Principal Stockholder(s)*. A share-based payment award granted when a company is in possession of material nonpublic information to which the market is likely to react positively when the information is announced is sometimes referred to as being "spring-loaded."

[26] More information about how to initiate a dialogue with OCA, what to expect from the consultation process, and what information should be included in a consultation submission in order for OCA to most quickly address a company or auditor's question is available on OCA's webpage, *available at* https://www.sec.gov/page/communicating-oca.

[27] The terms "accountants" and "auditors" are used interchangeably throughout this statement.

[28] *See Qualifications of Accountants,* SEC Release No. 33-10876 (October 16, 2020), *available at* https://www.sec.gov/rules/final/2020/33-10876.pdf.

[29] *See* Paul Munter, Acting Chief Accountant, *The Importance of High-Quality Independent Audits and Effective Audit Committee Oversight to High Quality Financial Reporting to Investors* (October 26, 2021), *available at* https://www.sec.gov/news/speech/munter-audit-2021-10-26.

[30] *See supra,* at n. 26.

[31] *See* SEC Press Release: *SEC Appoints New Chairperson and Board Members to the Public Company Accounting Oversight Board* (Nov. 8, 2021), *available at* https://www.sec.gov/news/press-release/2021-228.

[32] I have the honor of serving as the co-chair of the Monitoring Group, along with Mr. Jean-Paul Servais, Chairman of the Financial Services and Market Authority (FSMA), Belgium. Members of the Monitoring Group are the Basel Committee on Banking Supervision, European Commission, Financial Stability Board, International Association of Insurance Supervisors, International Forum of Independent Audit Regulators, International Organization of Securities Commissions, and the World Bank Group. *See* IOSCO's "The Monitoring Group" webpage, *available at* https://www.iosco.org/about/?subsection=monitoring_group.

[33] *See* The Monitoring Group, *Monitoring Group publishes its Recommendations to Strengthen the International Audit and Ethics Standard-Setting System* (July 14, 2020), *available at* https://www.iosco.org/about/monitoring_group/pdf/2020-07-Monitoring-Group-Recommendations-to-Strengthen-the-International-Audit-and-Ethics-Standard-Setting-System.pdf.

[34] *See* The Monitoring Group, *Monitoring Group Welcomes the Appointment of Ms. Gabriela Figueiredo Dias as Next IESBA Chair* (Oct. 6, 2021), *available at* https://www.iosco.org/news/pdf/IOSCONEWS619.pdf.

[35] *See* Securities Exchange Act of 1934, Rules 13a-15(d) and 15d-15(d); *see also* Regulation S-K, Item 308(c).

[36] *See* Audit Analytics, *2020 Financial Restatements: A Twenty-Year Review* (November 2021), *available at* https://go.auditanalytics.com/2020-Restatements-Report.

[37] *See* Codification of Staff Accounting Bulletins, Topic 1.M and Topic 1.N, *available at* https://www.sec.gov/interps/account/sabcodet1.htm.

[38] *See supra,* at n. 29.

[39] *See* 17 CFR 210.2-01(e)(3); s*ee also* paragraphs .09-.10 of PCAOB Quality Control Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, *available at* https://pcaobus.org/oversight/standards/qc-standards/details/QC20.

[40] The Sarbanes-Oxley Act mandates that audit committees be directly responsible for the oversight of the engagement of the company's independent auditor. *See* Section 10A(m) of the Securities Exchange Act of 1934 [15 USC 78j-1(m)].

[41] *See supra,* at n.28.

[42] *See supra,* at n. 29.

[43] *Id.*

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