

SEC in Focus

Quarterly summary of current SEC activities

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SEC enhances focus on climate change and ESG

The Securities and Exchange Commission (SEC or Commission) increased its focus on disclosures related to environmental, social and governance (ESG) issues.

Acting SEC Chair Allison Herren Lee, who was appointed to that role by President Joseph Biden in January 2021, **directed** the Division of Corporation Finance (DCF) to enhance its focus on climate-related disclosure in public company filings by reviewing the extent to which public companies are addressing the topics identified in the Commission's **2010 climate change guidance** and considering updating that guidance to take into account developments over the last decade. As part of the process, the Division will engage with public companies and study how the market manages climate-related risks. "Now more than ever, investors are considering climate-related issues when making their investment decisions," Ms. Lee said in a statement.

The 2010 guidance provided the Commission's views on how the existing disclosure requirements (e.g., description of the business, risk factors, management's discussion and analysis) applied to climate change matters. The guidance states that disclosure obligations could be triggered by the impact of enacted or pending legislation and regulation, international accords, physical effects such as weather, and any actual or expected consequences to the business related to climate change.

Ms. Lee also issued a **statement** requesting public comment on how the SEC can best regulate climate change disclosures. The statement provides a list of questions that focus on what information can be quantified and measured for disclosure purposes, whether any new rules should incorporate or draw on existing frameworks developed by other organizations (e.g., Task Force on Climate-Related Financial Disclosures, the Sustainability Accounting Standards Board, the Climate Disclosure Standards Board), and how disclosures under any standards should be enforced or assessed, among other topics. Ms. Lee asked for input by 13 June 2021.



EY resources

- ▶ [Technical Line, Revisiting the SEC's guidance on climate change disclosures in today's environment](#)

In addition, Ms. Lee named Satyam Khanna to the new role of Senior Policy Advisor for Climate and ESG. She stated that “having a dedicated advisor on these issues will allow us to look broadly at how they intersect with our regulatory framework across our offices and divisions.”

The SEC also announced the creation of a **Climate and ESG Task Force** in the Division of Enforcement that will develop initiatives to identify misconduct related to ESG disclosures. The Task Force will initially focus on material gaps or misstatements in issuers' disclosures on climate risks and ESG issues under existing rules. The Task Force will be staffed by personnel drawn from SEC headquarters, regional offices and Enforcement specialized units and will work with other divisions and offices of the SEC.

Genler expected to be confirmed as SEC Chair

Gary Genler, President Biden's nominee to serve as chairman of the SEC, was approved by the Senate Banking Committee in March 2021 and is expected to be confirmed by the full Senate.

Mr. Genler has been a professor at Massachusetts Institute of Technology's Sloan School of Management. He previously was chairman of the Commodity Futures Trading Commission and held other government posts after working at Goldman Sachs.

During his confirmation hearing, Mr. Genler indicated that his goal as SEC Chair will be to strengthen accountability, transparency and efficiency of the markets as well as to make sure that both less-established and mature companies are able to effectively raise capital.

In response to questions about whether he would support potential SEC rules on disclosures about climate risk, Mr. Genler indicated that the SEC should play a role in bringing consistency and comparability to climate-related disclosures. He said he would conduct economic analysis, work with staff and seek public comment on potential disclosure requirements.

Other SEC rulemaking and current practice matters

SEC staff issues statements on risks related to SPACs

The staffs of the **DCF** and the **Office of the Chief Accountant** issued separate statements on the risks related to the increase in transactions that allow a private company to go public by merging with a special purpose acquisition company (SPAC) rather than through a traditional initial public offering.

Mergers between the SPAC (i.e., the existing public company) and the private companies they are acquiring (i.e., SPAC targets) are often completed in as little as a few months. This timing can create challenges for entities and their advisers in making sure the newly merged public company complies with all of the accounting, auditing and regulatory requirements. The SEC staff identified several accounting areas that SPACs and SPAC targets should focus on including:

- ▶ Transition to public company disclosure requirements and US GAAP for public business entities, including reporting on segments and earnings per share
- ▶ Determination of the acquirer for accounting purposes
- ▶ Accounting for earn-out or compensation arrangements
- ▶ Accounting for complex financial instruments, including warrants

The SEC staff emphasized the need for management of the new merged public company to understand and have a plan in place to comply with both the general requirements in the Exchange Act to maintain adequate books and records and internal controls, and the specific requirements related to internal control over financial reporting and disclosure controls and procedures. The SEC

staff also emphasized the importance of board oversight before, during and after the de-SPAC merger and noted that companies listed on a national stock exchange are required to have a majority of independent members and an independent audit committee with members who possess specialized experience, among other requirements. Effective communication between the audit committee, auditor and management is important to address reporting, control or audit issues that may arise during and after the merger process, the staff said.

In addition, the SEC staff said auditors need to apply appropriate acceptance and continuance procedures when a formerly private audit client prepares to go public through a SPAC merger to make sure they are staffing the audit team with people who have enough time and the appropriate level of experience to perform the audit. The staff also noted that the company and the auditor need to comply with SEC and PCAOB independence standards.

Finally, the SEC staff identified a number of regulatory restrictions that apply after a de-SPAC merger.

SEC adopts interim final rules for foreign companies in jurisdictions that don't allow PCAOB inspections

The SEC adopted interim rule amendments to implement submission and disclosure requirements for companies whose financial statements are audited by registered public accounting firms in foreign jurisdictions that don't allow inspections by the Public Company Accounting Oversight Board (PCAOB), as mandated by the Holding Foreign Companies Accountable Act.

The amendments ultimately will require registrants identified by the SEC to submit documentation establishing that they are not owned or controlled by a governmental entity in the foreign jurisdiction, among other things. However, the SEC is still seeking public comment on how it should identify registrants that will be subject to the requirements and other aspects of the rule amendments. No issuers will be required to comply with the new provisions until after the SEC establishes an identification process.

Public comments are due 30 days after publication in the Federal Register.

SEC provides sample comments for securities offerings amid extreme volatility

DCF provided a sample of a comment letter that it may issue to companies seeking to raise capital in securities offerings during times of extreme market and price volatility. The SEC staff urged companies to consider the sample comments as they prepare disclosure documents that may not typically be subject to review by the staff before their use, such as automatically effective registration statements and prospectus supplements for takedowns from existing shelf registration statements.

The sample comments are intended to prompt companies raising capital under these conditions to describe them and any related risks to investors. The sample letter includes comments the SEC staff may issue related to disclosures on the prospectus cover page and in the risk factors and use of proceeds sections of an offering document.

SEC staff provides guidance on the rescission of the auditing guidance in ASR 118

The staff of the SEC's Division of Investment Management issued a frequently asked question document (FAQ) related to the timing of the rescission of the auditing guidance in Accounting Series Release (ASR) 118 resulting from the adoption of rule 2a-5 under the Investment Company Act of 1940. The SEC staff said it would not object if an independent public accountant chooses to stop looking to the auditing guidance in ASR 118 and determines the appropriate audit approach by following only the relevant PCAOB auditing standards any time after 8 March 2021, which is the effective date of the adopting release withdrawing the prior auditing guidance. This would apply to audits for fiscal periods ending on or after 31 March 2021.

The SEC staff emphasized the importance of board oversight before, during and after the de-SPAC merger.

SEC staff addresses rule 2a-5 compliance date and effect on cross-trading

The staff of the SEC's Division of Investment Management issued an [FAQ](#) that addresses when cross-trading practices under rule 17a-7 have to conform with the new definition of "readily available market quotations" in rule 2a-5 under the Investment Company Act of 1940. In its response, the SEC staff said it would not object if a fund elects to comply with rule 2a-5 before the 8 September 2022 compliance date but does not apply the new definition to its cross-trading practices until the compliance date.

Nasdaq amends proposal on board diversity requirements for listed companies

Nasdaq filed an [amendment](#) with the SEC to a previous [proposal](#) that would require the boards of all companies listed on the exchange to meet certain minimum diversity requirements or publicly disclose why they aren't doing so.

The amendment proposes modifications and clarifications based on comments submitted to the SEC by Nasdaq-listed companies and other stakeholders. Among other things, the amendment would allow companies with small boards (i.e., five or fewer directors) to satisfy the requirement with one director with a diverse background rather than two and would give companies a one-year grace period if they no longer meet the requirement as a result of a vacancy on the board. Under the proposal, many Nasdaq-listed companies would still be expected to have, or explain why they do not have, at least one director who self-identifies as female and one director who self-identifies as either an underrepresented minority or as lesbian, gay, bisexual, transgender, queer or other (LGBTQ+). Companies that do not meet the board composition objectives within the required timeframe would not be subject to delisting if they provide a public explanation of their reasons for not meeting the objectives.

The SEC filed an [order](#) seeking comments on the proposed rule changes. Rebuttal comments are due by 20 April 2021.

SEC Division of Investment Management staff issues Dear CFO Letter

The staff of the Chief Accountant's Office of the SEC's Division of Investment Management issued a [Dear CFO Letter](#) to provide new guidance and modify or withdraw certain existing guidance in the [Accounting Matters Bibliography](#) applicable to registered investment companies, business development companies, issuers of insurance product securities, registered investment advisers and their auditors. The Dear CFO Letter, among other things, modifies the guidance related to the use of combined financial statements to comply with Rule 206(4)-2 of the Investment Advisers Act of 1940 and withdraws the guidance related to the application of the SEC's ASRs 113 and 118 when auditing the valuation of certain portfolio investments.

Personnel changes

New Acting Directors at SEC's Corporation Finance, Enforcement divisions

John Coates was named Acting Director of the SEC's DCF. Mr. Coates, who had been a professor of law and economics at Harvard Law School, served on the SEC's Investor Advisory Committee and chaired the Investor-as-Owner Subcommittee. He was previously a partner at Wachtell, Lipton, Rosen & Katz and consulted for the Department of Justice, Department of the Treasury and the New York Stock Exchange.

Paul Munter was appointed Acting Chief Accountant, following the departure of Sagar Teotia in February. Since 2019, Mr. Munter served as Deputy Chief Accountant, leading the international work in the agency's Office of the Chief Accountant. He will serve as the principal adviser to the Commission on accounting and auditing matters and will be responsible for assisting the Commission in overseeing the Financial Accounting Standards Board and the PCAOB.

Melissa R. Hodgman, Associate Director of the SEC’s Division of Enforcement, was named Acting Director of the division. Ms. Hodgman joined the division in 2008 and has led teams pursuing and litigating numerous enforcement actions covering various securities law violations, including matters related to financial fraud and disclosure.

Brown concludes service at PCAOB

J. Robert Brown Jr. left the PCAOB after three years as a member of the board. During his tenure, he called for increased transparency and public accountability at the PCAOB to enhance investor trust and confidence in the capital markets.

Enforcement activities

Former executives of San Francisco company charged with accounting violations

The SEC said the former chief executive officer (CEO) and chief financial officer (CFO) of a San Francisco Bay Area company settled charges that they allegedly made false and misleading statements and omitted material information that resulted in the company improperly recognizing revenue related to a contract with a large public-sector client.

According to the order, the company charged its client \$3.6 million for certain development and transition work associated with the contract in 2016. However, the order alleges that the client had repeatedly disputed those charges and indicated that it did not intend to pay the balance. The former CEO and CFO nevertheless included the disputed amounts in revenue and receivables and failed to disclose the dispute. In 2019, the company restated its financial statements for the second and third quarters of fiscal 2016 and the full fiscal year, reversing the entire amount of revenue the company had previously recognized in connection with the disputed charges. In addition, the former CEO and CFO failed to reimburse the company for certain incentive compensation and stock profits they received during the period when the company allegedly committed the accounting violations.

Without admitting or denying the allegations, the company’s former CEO and CFO agreed to cease and desist from further violations of the charged provisions. The former CEO and CFO agreed to pay penalties and reimburse the company for amounts representing incentive-based compensation and profits from the sale of the company’s stock.

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Public companies and their executives must consider all material facts — not just the ones that are favorable to their position — when making financial reporting decisions.

— SEC San Francisco Regional Office Director Erin Schneider

What’s next at the SEC?

Mr. Gensler’s confirmation as SEC Chairman would allow him to direct the Commission and its staff to consider rulemaking regarding disclosures related to climate change and ESG issues.

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