



# THE POWER OF BEING UNDERSTOOD

# Embracing change: A strategic briefing for board members

Strategizing, planning and understanding what is ahead

Sept. 2023



# Agenda

Topic	Duration
Introductions	5 minutes
Regulatory update	15 minutes
SEC Cyber final rules update	15 minutes
Economic update	25 minutes

## With you today

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## Timing of proposals from SEC

Cyber

Crypto

ESG/Climate

# PCAOB proposed rules

Trickle-down effect

Following lead of SEC 15 months ago (Spring 2022)

Dropped 2 proposed rules/amendments last few months (from June to date)

- 1) Evaluation, identification and communication with respect to noncompliance with laws and regulations (“NOCLAR”)
- 2) Designing and performing audit procedures that involve Technology-Assisted Analysis of information in electronic form

Crypto



# Crypto

- **Staff Accounting Bulletin No. 121 (SAB 121)**
  - Expresses the views regarding accounting obligations to safeguard crypto-assets an entity holds for platform users.
  - Associated risk:
    - Technological risks
    - Legal risks
    - Regulatory risks
- **Investor Advisory Committee (IAS) view points:**
  - Virtually all, if not all, crypto tokens are securities and should be subject to federal securities laws.
- **Crypto Assets and Cyber Unit:**
  - To ensure investors are protected in the crypto markets
  - Investigate securities law violations related to:
    - Crypto asset offerings
    - Crypto asset exchanges
    - Crypto asset lending and staking products
    - Decentralized finance (DeFi) platforms
    - Non-fungible tokens (“NFTs”)
    - Stablecoins



# ESG round up

# Regulatory round up

## **ESG regulatory round up**

In addition to the growing bottom-up demand for responsible business practices, several top-down ESG mandates are coming into focus.

**1**

### **SEC's Climate Change Disclosures**

The SEC has proposed rule amendments that would require a registrant to include certain climate-related information in its registration statements and periodic reports. Disclosure topics could include climate-related risks (i.e., Scope 1 and 2 GHG emissions) and their actual or likely material impacts on the registrant's business, among others.

**2**

### **Financial Reporting Convergence Projects with AICPA and Center For Audit Quality**

Development of ESG roadmap provides blueprint for independent auditors and public and private companies to achieve their ESG reporting goals in response to growing demand from investors and consumers.

**3**

### **The Division on Examinations' Review of ESG Investing and Greenwashing**

The Division noted that the Portfolio management practices have inconsistent disclosures, controls to monitor ESG related guidelines are inadequate, inconsistencies exist between stated approaches and actual approaches, compliance programs lack ESG content, and at times, the compliance personnel themselves had limited ESG knowledge.

**4**

### **Creation of the International Sustainability Standards Board (ISSB)**

The IFRS foundation, has recently consolidated with the Climate Disclosure Standards Board and Value Reporting Foundation, and collaborated with the Task Force Climate-Related Financial Disclosures and the WEF, to create a global baselines for sustainability reporting that are expected to be released in the second half of 2022.

## SEC climate risk disclosure proposal – Key requirements

Climate related line item and footnote disclosure in the financial statements

Governance of climate-related risks

Processes for identifying, assessing and managing climate-related risks

Climate-related targets and goals, and related progress towards those

Scope 1, 2, 3 greenhouse gas (GHG) metrics (and assurance requirements)

GHG emissions targets/goals, including scenario analysis

# What should boards and management be thinking about

Boards will be heavily influenced by rules but many middle market companies are taking a wait and see approach there will be time to get in compliance. Key preliminary activities include getting the organization up to speed on the issues and forming groups within the organization to tackle nuanced/glaring issues



Climate change: evaluate what is our footprint, how should it be measured, and how should the initiative be managed. Waiting for “speed limit” and collect data accordingly. Middle market companies tend to not want to be first but rather a quick second



Early filers (e.g. Microsoft) will give direction/perspective



Size, scale and complexity of the Issuer company will influence the level of effort required by the company and the oversight required to be provided by the board



Before thinking about compliance, get it be top of mind

# Cyber update



# Finalized SEC rule and changes from proposed versions

## Oversight of Cyber Risks



- ❖ Registrants (Form 10-K) and foreign private issuers ("FPIs")(Form 20-F) must describe the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threats.

## Cyber Risk Management



- ❖ Within 10-K and 20-F reports, organizations must detail processes for assessing, identifying, and managing cybersecurity risks.
- ❖ They must also disclose how these risks materially affect business strategy, operations, and financial condition.
- ❖ These requirements start with reports for fiscal years ending on or after December 15, 2023.

## Disclose Material Incidents



- ❖ Report material incidents on Form 8-K within four business days of determining their materiality; exceptions for national security or public safety.
- ❖ Materiality isn't quantifiable; consider impact from quantitative and qualitative angles, like a reasonable investor would.
- ❖ Compliance with this rule requires an incident response program and cybersecurity risk management capabilities
- ❖ This rule is effective 90 days after Federal Register publication or by December 18, 2023, with a 180-day extension for smaller reporting companies.



**Narrowing of Information in Material Cybersecurity Incident Disclosure.**



**Permitted Delays in Reporting.**



**Narrowed Timing of Materiality Determinations.**



**Less Granular Required Disclosures Concerning Risk Management Strategy.**

# Key actions and considerations for organizations



**Cybersecurity Risk Assessment and Management**



**Board and Executive Oversight**



**Enhanced Incident Response and Reporting**



**Compliance and Disclosure Timelines**



**Transparency and Documentation**

# Some key questions to ask the business



## Cybersecurity Leadership and Governance

- ❖ Who oversees cybersecurity within the organization, and do they have direct board access?
- ❖ Is our cyber risk management program well-documented for public disclosure?



## Cyber Threat Management and Risk Assessment

- ❖ How do we classify and determine the materiality of cybersecurity risks?
- ❖ Have we implemented a specific risk assessment framework or methodology, and if so, what is it?



## Incident Response and Recovery

- ❖ Are formal procedures in place for identifying, responding to, and recovering from cybersecurity incidents?
- ❖ Are our incident response procedures designed to ensure compliance with legal and regulatory requirements, including reporting obligations?



# Economic Outlook: Resilient economy amid stubborn inflation, rising rates

Outlook 2023



# Regime change: What comes next

## Big-picture changes in the U.S. economy

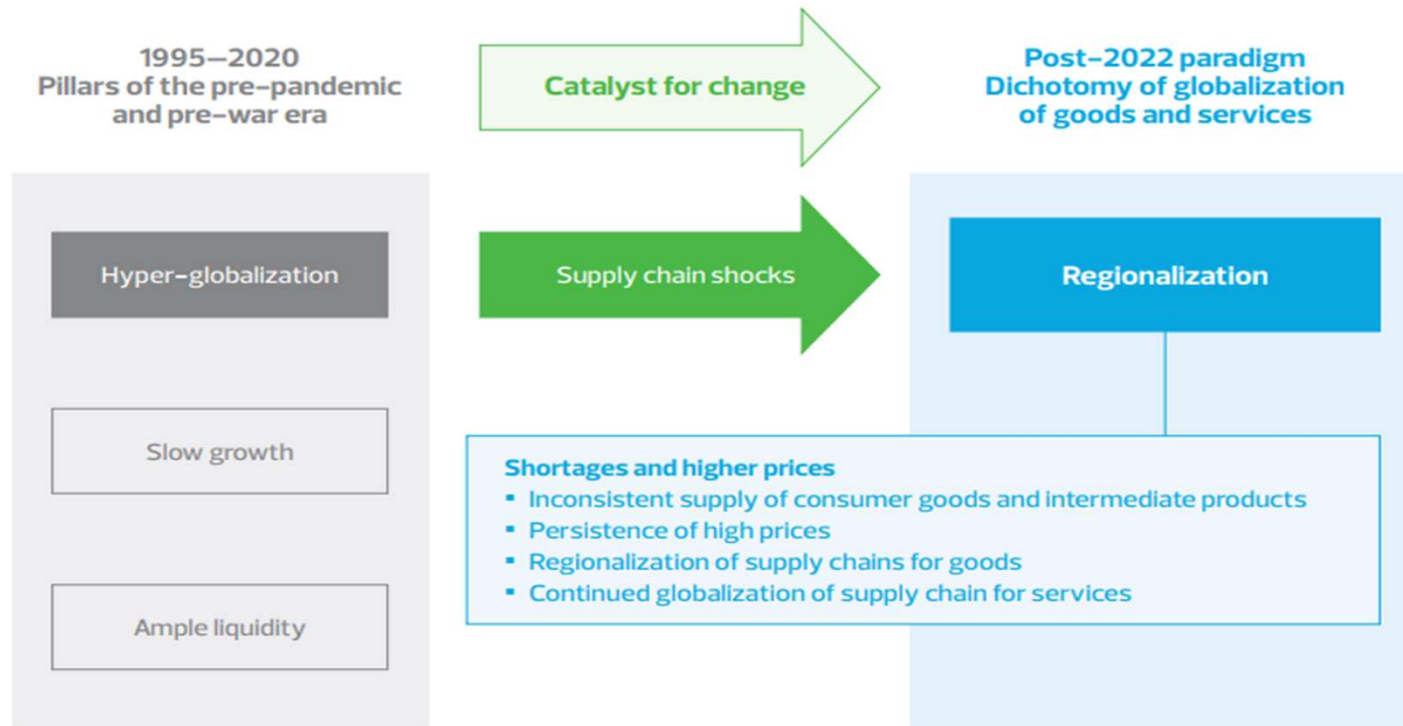
Moving from pre-pandemic financial and real economy conditions to "what comes next"

1995–2020 pre-pandemic and pre-war era	Post-pandemic economy
Insufficient aggregate demand	Insufficient aggregate supply
Excess savings	Liquidity constraint
Hyper-globalization	Dichotomy of globalization Re-globalization/regionalization Industrial policy: Infrastructure buildout and energy transformation Digital globalization intensifies
Low inflation	High inflation
Low interest rates	Higher interest rates
Plentiful labor	Demographic constraints: Less labor

# Regime change: Re-globalization

## From hyper-globalization to regionalization

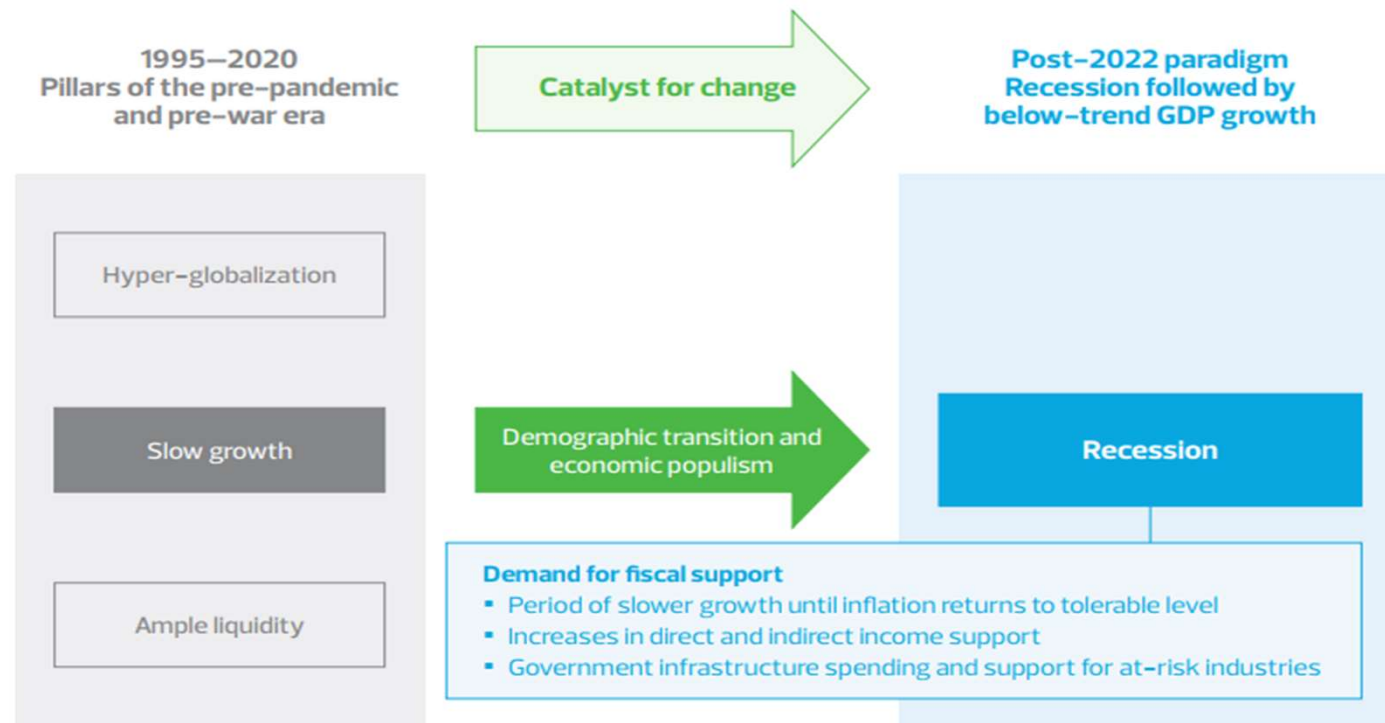
Adapting to the increased risk of breakdowns of supply chains for goods



# Regime change: Picking winners and losers

## From slow growth to picking winners and losers

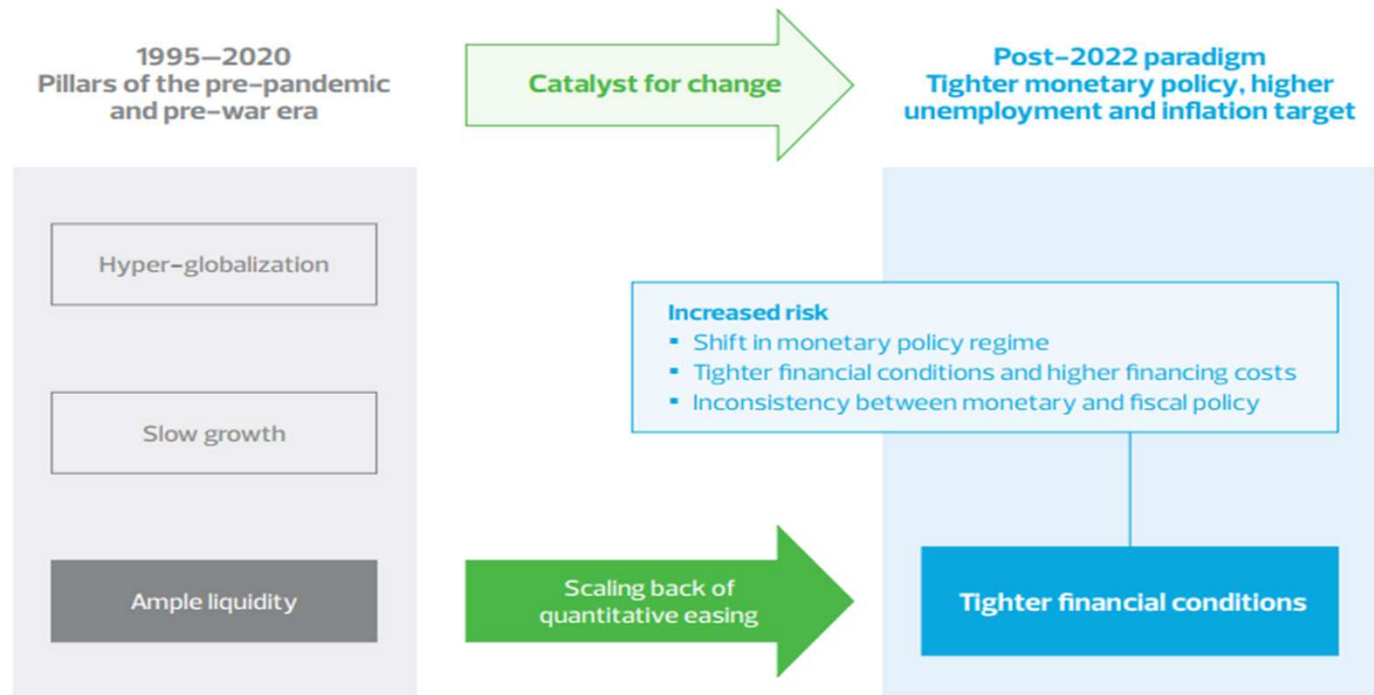
Adapting to the increased risk of just getting by



# Regime change: Liquidity constraints

## From monetary accommodation to increased financial risk

Adapting to growing unwillingness to borrow or to lend



# U.S. economy: Growth, inflation, and geopolitical tensions



## Economic themes

- Economy resilient with upside
- Labor market remains tight; capital expenditure boom possible once price stability reached
- Acute inflation peaked at 9.1% June '22); wage growth 5%
- Fed right at terminal rate, balance sheet runoff continues
- Recession probability 60%



## Core economic fundamentals

- 50-plus year low unemployment, strong household balance sheets
- Still adding >150k jobs per month; prime-aged employment record high
- Steady corporate profits, low leverage
- Tighter lending conditions for middle market to persist



## Consumption outlook

- There is no “The Consumer”; highly segmented, bolstered by data and artificial intelligence
- US core inflation remains sticky in services 5.1%, top line all-items inflation falling markedly
- Easing inflation bolstering real wages
- Average interest rate charged on credit card near 20%.
- Inventories an issue for manufacturing, retail

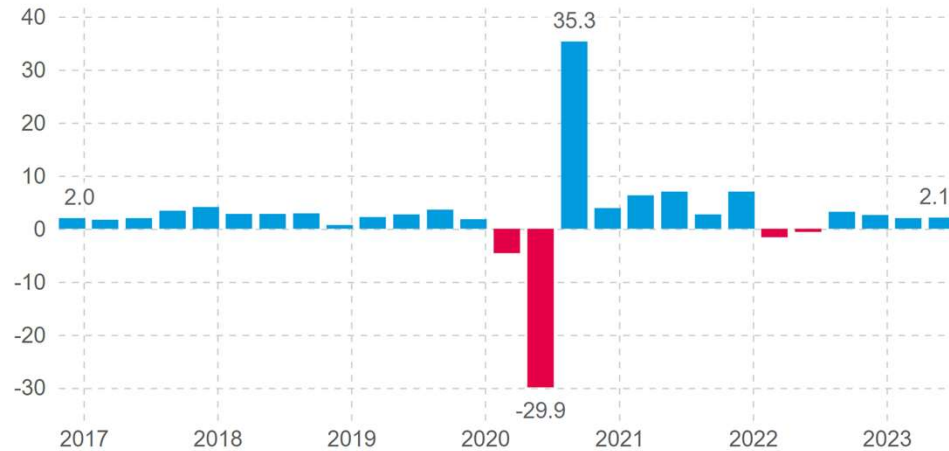
## What is a recession anyway?

- Common: ~~Two consecutive quarters of negative GDP~~
- More accurate: A period of significant decline in economic activity
  - Decline in GDP, employment, income, consumer spending, investment

# US GDP: Resilient with risk of recession

## U.S. real GDP growth

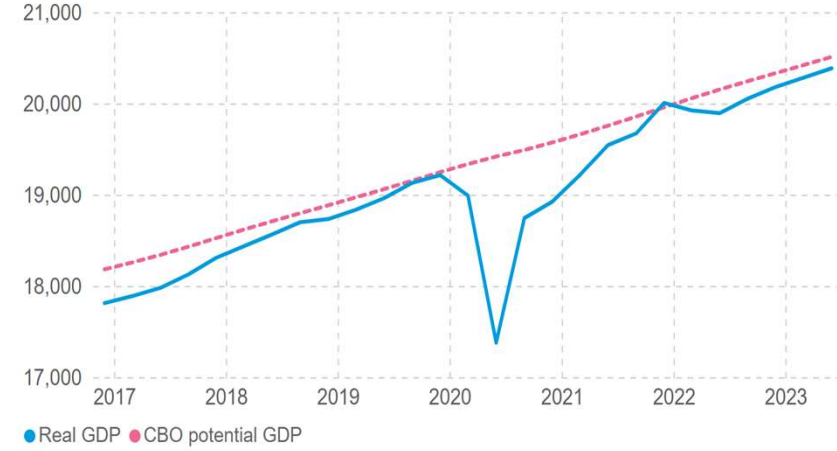
Quarterly %; annualized and seasonally adjusted



Source: BEA, RSM US

## Real gross domestic product vs. potential

\$ billion

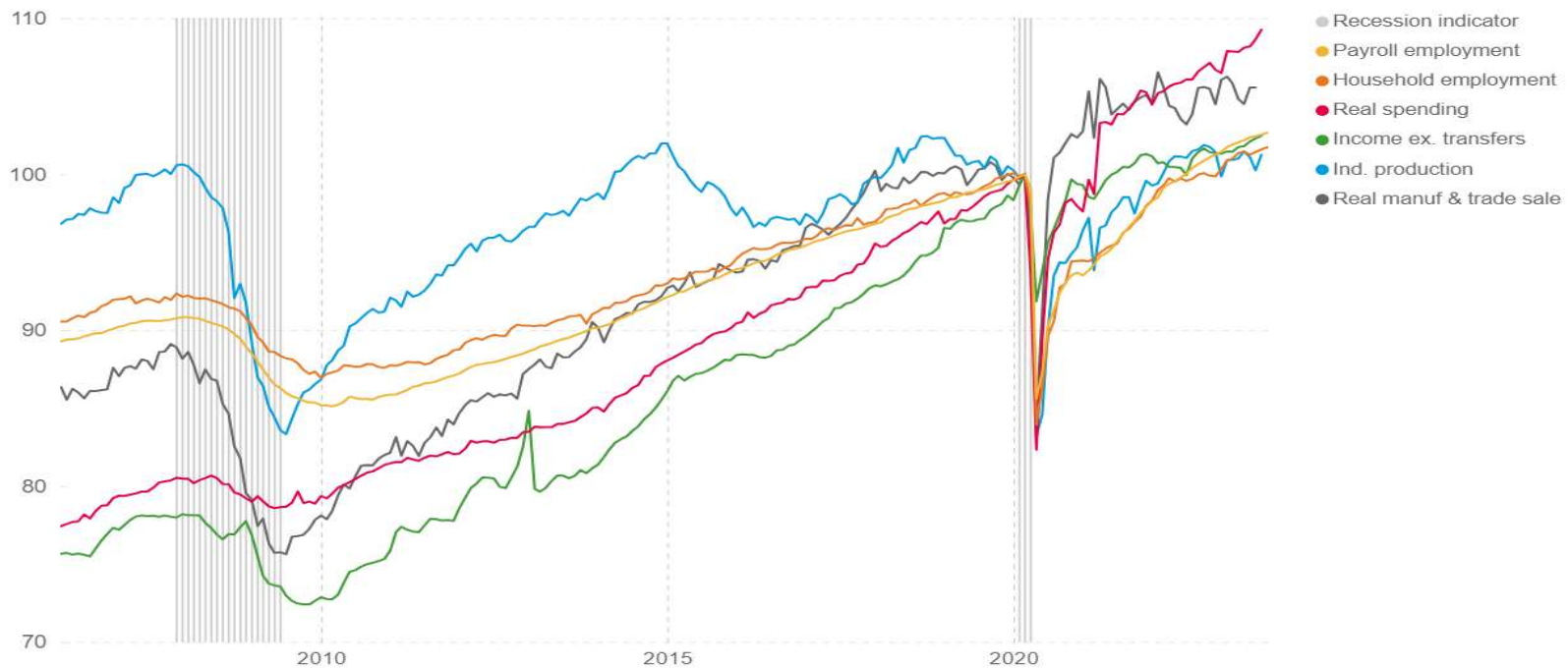


Source: BEA, RSM US



# We are not in recession... yet

**NBER recession key indicators**  
Normalized with Feb 2020 = 100



Source: BEA, RSM US

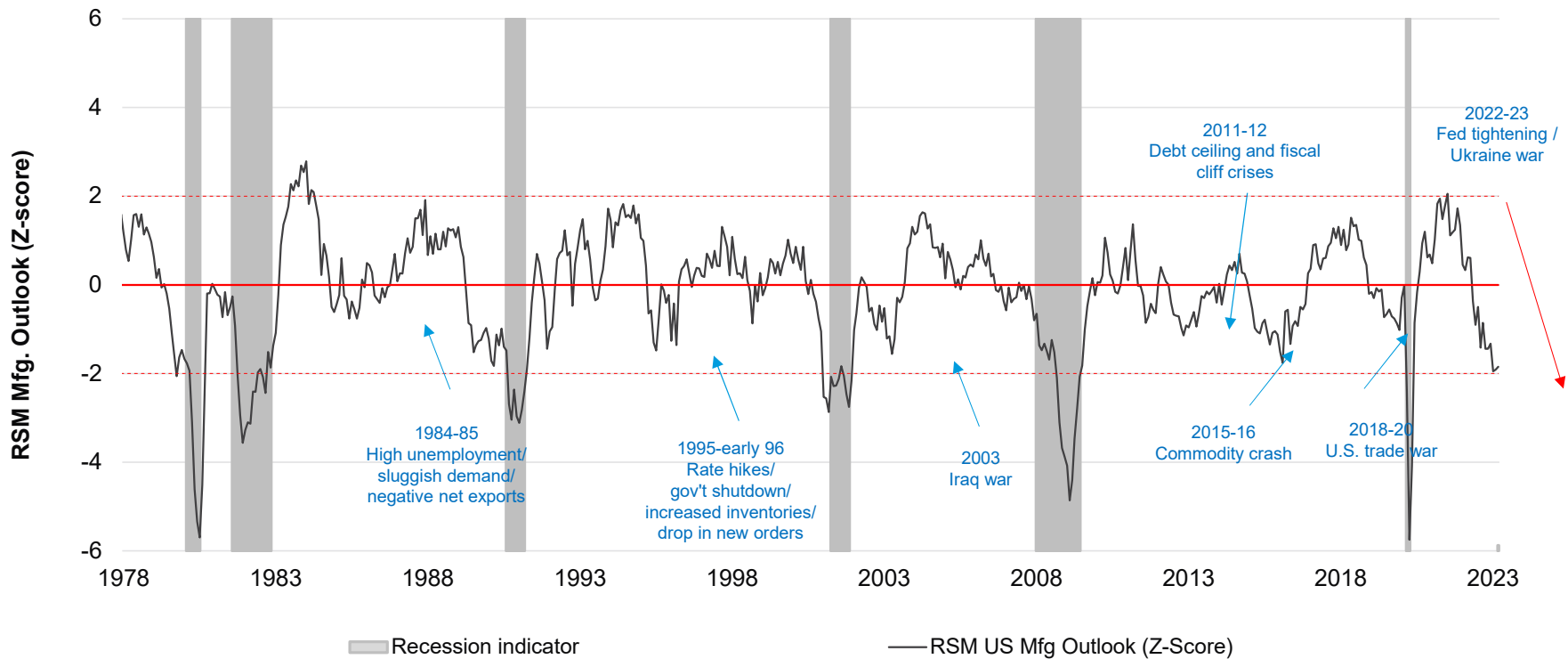
## Recession causes: 1972-2009

Recessions	Peak to trough (months)	Proximate cause
Nov. 1973-March 1975	16	External: Oil shock (rising prices)
Jan. 1980-July 1980	6	Internal and external: Rates and Oil shock
July 1981-Nov. 1982	16	External: Oil shock (rising prices)
July 1990-March 1991	8	External: Oil shock (rising prices)
March 2001-Nov. 2001	8	Internal: Corporate debt bubble, dotcom, inventories
Dec. 2007-June 2009	18	Internal: Housing and banking collapse, debt bubble

Average duration: 12 months  
Ex-GFC: 10.8 months

# Outlook: Manufacturing experiencing slowdown

RSM US Manufacturing Outlook Index and mid-cycle downturns



Source: NBER; Bloomberg; RSM US Calculations

# U.S. employment: Labor market tightness

## Measures of labor market tightness

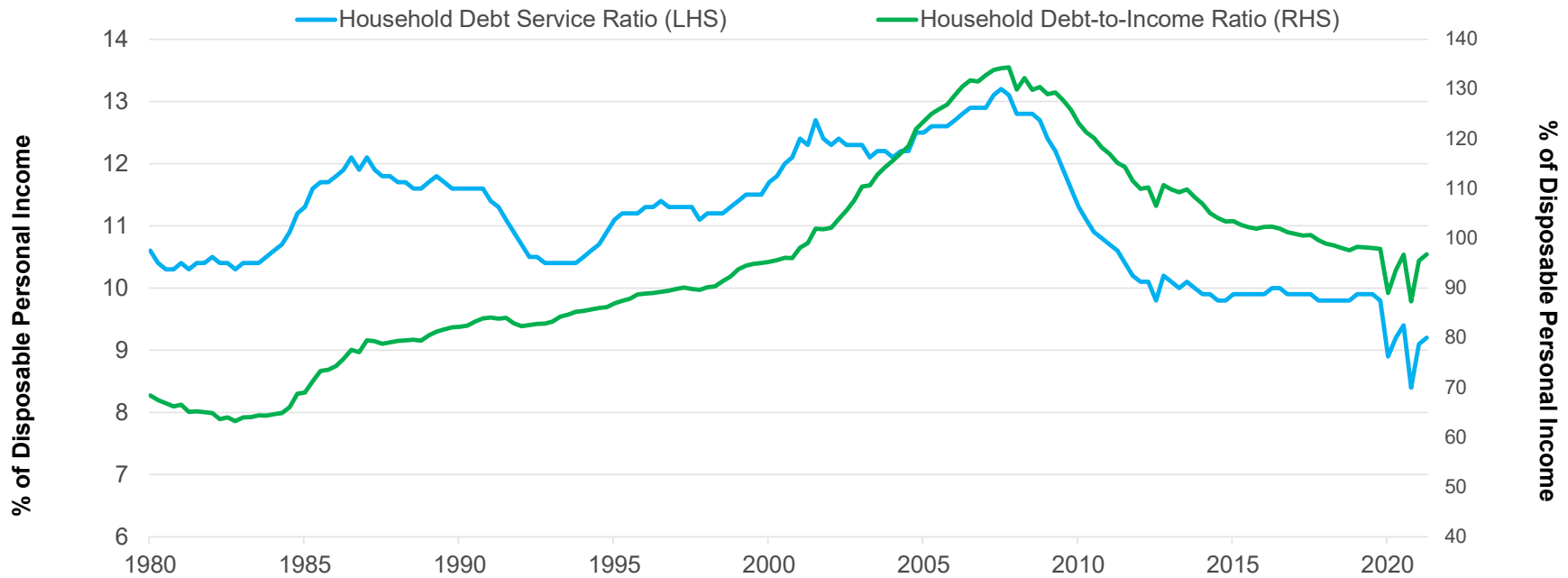
Calculated using z-score based on mean and standard deviation from 2001 to 2019

■ Unemployment rate (prime-age)   ■ Unemployed per job opening  
■ Unemployment rate (U-3)   ■ Reverse quit rate



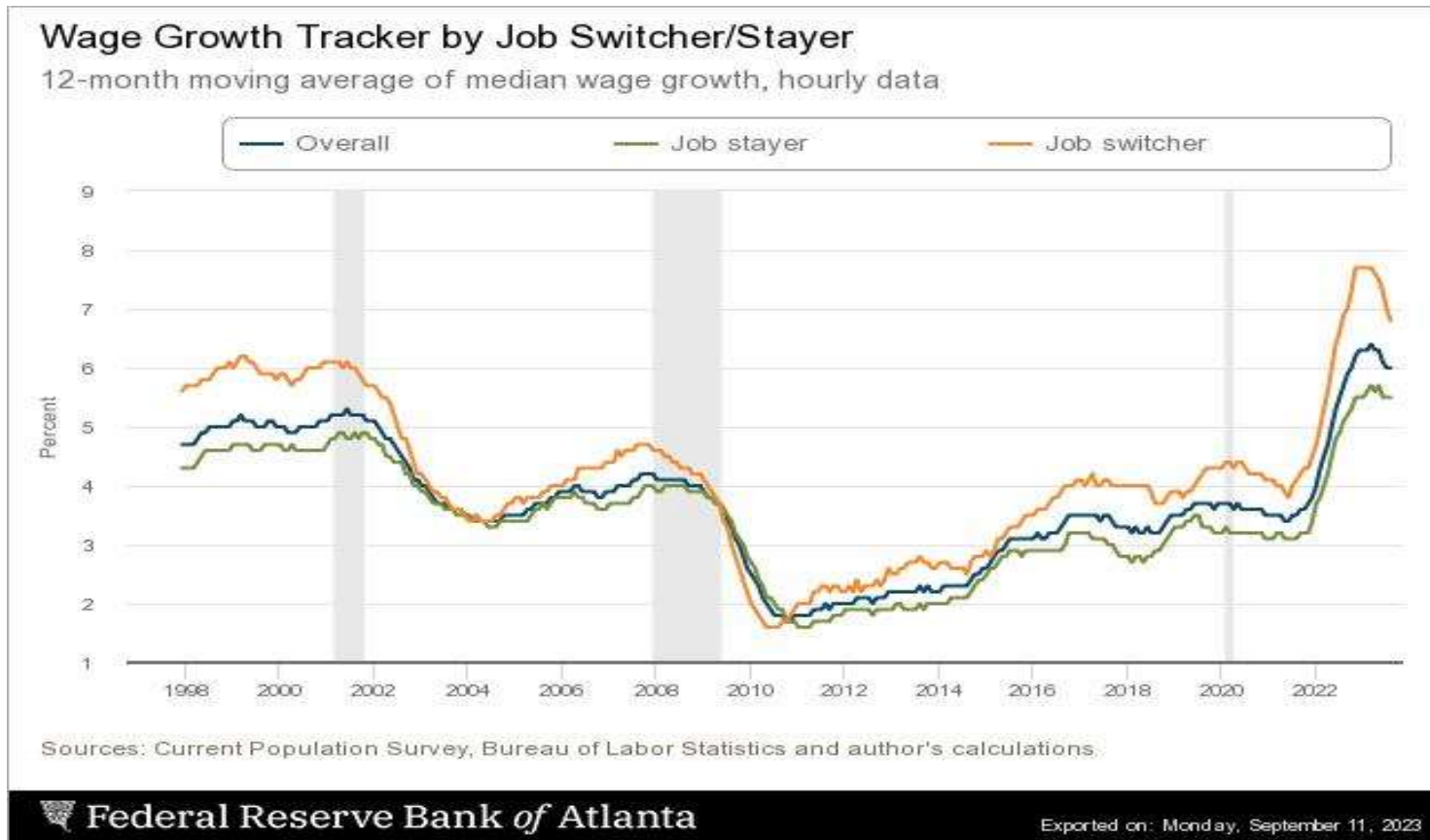
Note: Values below 0 indicate more tightness than neutral. The reverse quit rate is calculated as 1 minus the quit rate.  
Source: BLS, RSM US

# Household balance sheets strong



Source: Federal Reserve; RSM US LLP

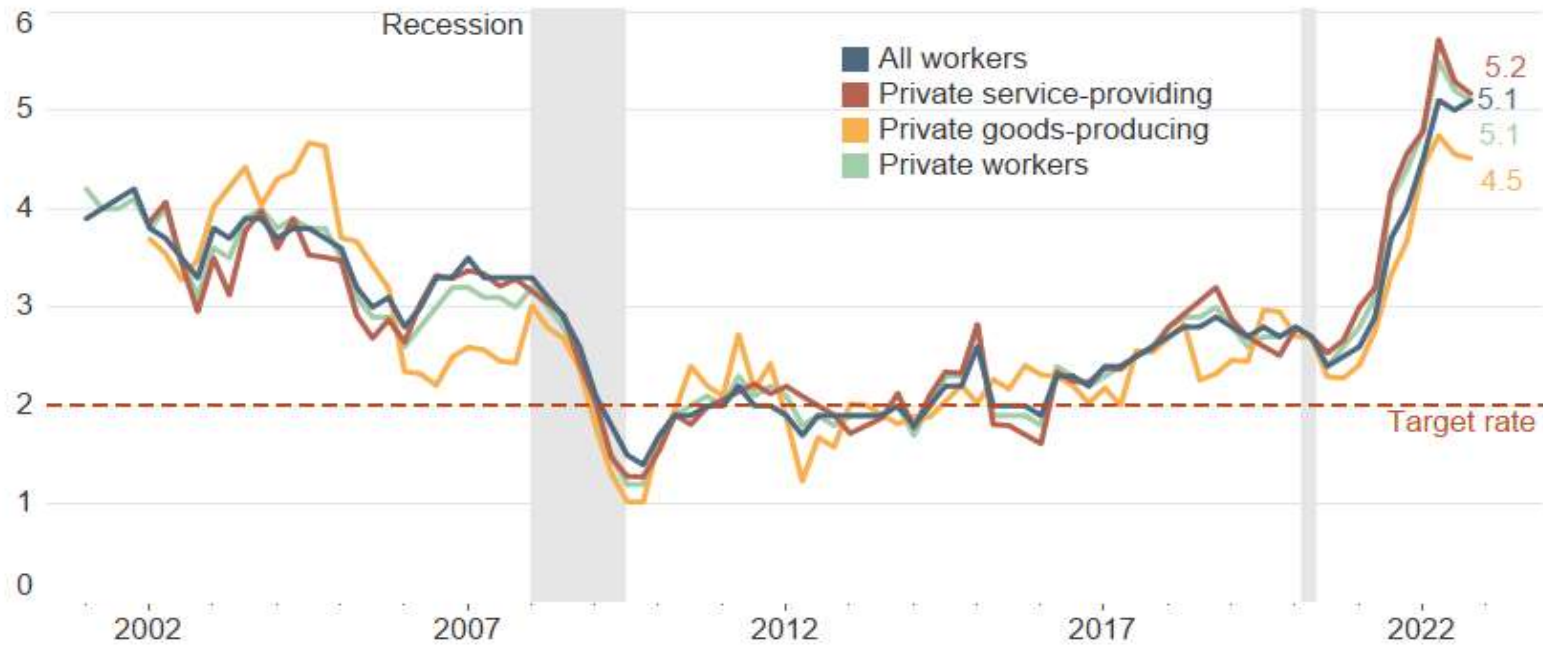
# U.S. outlook: Wage growth for switchers has peaked; reset higher



# U.S. outlook: Fed's preferred wage measure

## Employment Cost Index

Seasonally adjusted year-over-year % change



Source: Bureau of Labor Statistics, RSM US

# Primary long-run economic themes

## Higher inflation and higher rates

- Era of easy money has ended
- Decoupling from China (goods and labor) will raise floor for inflation
- Structural changes in domestic labor force; premiums for both skilled and non-skilled labor to increase
- Higher inflation will require higher policy rates, higher long-term rates
- Massive industrial policy spend

## Technological acceleration: Secular economic change

- Third secular change in the past 30 years
- 1990: Microsoft Suite
- 2008: iPhone
- Integration of technology into production of goods, provision of services
- Key to bolstering productivity and overcoming tight labor market
- Generative AI and processing power future deployment across 7 billion smartphones



# Stumbling blocks for the global economy

## **Inflation could remain stubbornly high**

- There is the possibility of continued labor market tightness and growing wage pressures, requiring tighter monetary policies. There is also the possibility of continued shortages of energy and food; sticky prices.

## **China's debt and deleveraging crisis**

- There could be a further slowdown in China's property sector, a domestic debt overload or the inability of emerging economies to repay Chinese loans. Typically takes 7-10 years to work through.

## **Geopolitical uncertainty**

- An escalation of the war in Ukraine remains a major threat, further destabilizing energy and food markets and further fragmenting the global economy. Friend-shoring is unlikely to happen overnight.

## **Repercussions for emerging markets**

- Unchecked inflation, particularly in Europe, could disrupt the financial markets, with increased financial risk affecting the ability of emerging economies to maintain debt requirements.

THANK YOU FOR  
YOUR TIME AND  
ATTENTION

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