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To our clients, our colleagues, and our other friends, we wish each of you a joyous and peaceful holiday season and a happy new year.

Hashtags Roasting on an Open Fire
Highlights of the 2016 AICPA Conference on Current SEC and PCAOB Developments

by Deloitte & Touche LLP's National Office

In This Issue

Executive Summary

On the heels of the U.S. presidential election, participants at the 2016 AICPA Conference on Current SEC and PCAOB Developments in Washington, D.C., were eager to talk about the changing financial reporting and audit landscape. While there was much speculation about the impact of the new administration on financial reporting regulations, there was little uncertainty regarding the effect that new accounting standards will have when they are adopted in the coming years. Specifically, the new standards on revenue recognition, leases, financial instruments, and credit losses — or the "new GAAP standards" as SEC Chief Accountant Wesley Bricker[1] referred to them — were a central theme throughout the conference.

[1] For a list of speeches that were publicly available as of the date of this publication, see Appendix B.

Despite all the talk of change, the conference proceeded in its usual fashion, with speakers and panelists offering their insights into current accounting, reporting, and auditing practice issues. Picking up where they left off at last year's conference, SEC staff members discussed their efforts over the past year to rein in certain practices related to the presentation of non-GAAP measures. Also revisited at this year's conference was internal control over financial reporting (ICFR) — from the significance of the control environment in a time of immense accounting change to the importance of ongoing dialogue between management, audit committees, and auditors.

One thing that clearly has not changed is the mission of the SEC and the PCAOB. Mr. Bricker discussed the important role that preparers, auditors, audit committee members, regulators, and others play in meeting investors' needs for high-quality financial information. PCAOB Chairman James Doty reiterated that the PCAOB's critical mission, investor protection, is as relevant today as it was at the PCAOB's inception. And Cynthia Fornelli, executive director of the CAQ, reminded attendees that there were many reasons to be "#AuditorProud."

Internal Control Over Financial Reporting

Mr. Bricker emphasized the importance of ICFR and stated that the staff of the Office of the Chief Accountant (OCA) continues to encourage management, audit committees, and auditors to "engage in dialogue" on ICFR assessments. Whether related to new GAAP standards, non-GAAP measures, disclosure effectiveness, or any of the other issues addressed at the conference, it is clear that ICFR and disclosure controls and procedures are, and will continue to be, a key focus for regulators, preparers, auditors, and audit committees.

New GAAP Standards

While the effective dates of the new GAAP standards vary, the message from the SEC, FASB, preparers, and auditors was clear: if you haven't started preparing for the adoption of these standards, it's time to do so. The SEC staff also reiterated its focus on disclosures that registrants provide about implementation of accounting standards in the years leading up to adoption, or what the veteran attendees fondly referred to as "SAB 74 disclosures." On this note, the staff particularly emphasized revenue recognition, noting that it expects to see more robust qualitative and quantitative disclosures about the anticipated impact of the new revenue standard, as well as about management's status in achieving implementation, in registrants' upcoming Form 10-K filings.

Non-GAAP Measures

Also top of mind was the ongoing dialogue related to disclosures about non-GAAP measures. Staff members from the SEC's Division of Corporation Finance (the "Division") indicated that they had seen notable improvement in the disclosures since the release of the SEC's updated compliance and disclosure interpretations (C&DIs) in May. However, Mr. Bricker noted there is still "more progress for companies to make, for example, in the evaluation of the appropriateness of the measure and its prominence, as well as the effectiveness of disclosure controls and procedures."

Auditor, Management, and Audit Committee Shared Responsibilities

Internal Control Over Financial Reporting

ICFR continues to be a key focus for regulators, preparers, auditors, and audit committees. Mr. Bricker stated that “it is hard to think of an area more important than ICFR to our mission of providing high-quality financial information that investors can rely on. If left unidentified or unaddressed, ICFR deficiencies can lead to lower-quality financial reporting and ultimately higher financial reporting restatement rates and higher cost of capital.” Several other speakers commented on the importance of ICFR to the quality of an audit and how it continues to be one of the hottest topics in the field.

Risk Assessment and the Audit Plan

During the panel discussion on ICFR, a common theme was effective communication between preparers, auditors, and audit committees on both risk assessment and the audit plan for ICFR. All panelists discussed the benefits associated with effective communication of (1) the audit plan and (2) changes in the audit from the prior year and during the current year. PCAOB Board Member Jay Hanson and OCA Senior Associate Chief Accountant Kevin Stout also discussed the feedback received from outreach activities in 2015 and 2016. These activities included dialogue with preparers and audit firms on various ICFR matters. Mr. Hanson and Mr. Stout noted that progress has been made given that issues with management review controls appear to be improved and were not raised as often in 2016.

The issue raised most frequently in 2016 is differences between preparers’ risk assessments and those of their auditors. Panelists noted that auditors and management need to be close to full agreement on which controls are appropriate to test and to what extent to test them. Management and auditors should talk on a recurring and timely basis throughout the audit to understand each other’s risk assessment and the impact on the audit of ICFR. Specifically, auditors should understand management’s reasoning when there are differences in risk assessment or in the selection of controls to test.

Later in the conference at a separate session, Helen Munter, director of the PCAOB’s Division of Registration and Inspections, noted that in the inspections that occurred in 2016, ICFR drew the most inspection findings (which may be partly because it was the area most focused on by inspectors), with the top theme once again being the testing of management review controls. However, she further stated that the PCAOB staff also saw improvement in such testing. She said that the staff reviews many audits in which engagement teams do a good job of testing management review controls, indicating that this testing can be done well.

During the panel discussion on ICFR, the panelists emphasized the importance of risk assessment of controls. They specifically noted that auditors should be spending more time on the higher-risk controls and less time on the lower-risk controls. The higher-risk controls would typically consist of management review controls related to management estimates, complex transactions, or nonrecurring transactions.

The panelists also discussed the challenges faced by preparers and auditors when there are changes to the audit plan late in the execution of the audit. Some of these changes are the result of audit firms’ issuing new guidance and tools in response to PCAOB inspection findings. Panelists recommended that firms (1) thoughtfully assess whether inspection findings are specific to the issuer or apply more broadly to the practice and (2) plan for remediation actions to be taken at an appropriate time in the audit cycle. They further noted, in a manner consistent with comments at last year’s conference, that PCAOB inspection findings may also indicate deficiencies in management’s controls and processes, such as overreliance on a higher-level control that is not precise enough to adequately address the related risk, failure to consider lower level controls on which a review control depends, or insufficient support for the operating effectiveness of a control. Management is encouraged to take a broader view of PCAOB findings and consider how those findings may be related to weaknesses in management's own system of internal control.

Evaluating the Severity of Control Deficiencies

Mr. Stout noted that there are signs that companies are identifying material weaknesses in a timelier manner. The SEC believes that material weaknesses should be identified before a restatement. In 2011, only 11 percent of companies that restated their financial statements had reported a material weakness in ICFR the previous year. However, as Mr. Stout further noted, that percentage increased to 37 percent in 2015, suggesting that management and auditors are performing a more thorough assessment of the severity of deficiencies. Nevertheless, he stated that improvement is still needed with respect to the timing of identifying deficiencies and the evaluation of their severity, and that this continues to be a focus of the SEC.

New GAAP Standards

Mr. Bricker noted that over the next several years, updating and maintaining internal controls will be particularly important as companies implement the new accounting standards. Panelists noted that it is important for auditors to understand how management's ICFR has changed as a result of the implementation of the standards, including what controls management has put in place, what judgments are involved in those controls, and what changes, if any, were made to IT systems. One panelist noted that whitepapers and other documentation of the accounting assessments that management has prepared may serve as evidence of ICFR and would be helpful to auditors in understanding and testing ICFR related to the new standards.

Cybersecurity

Throughout the conference, speakers and panelists also provided perspectives on cybersecurity. As noted in the CAQ's recent publication *Cybersecurity: How CPAs and Their Firms Are Addressing a Dynamic and Complex Risk* and addressed by Ms. Fornelli in her remarks, reliable and comparable information on companies' activities to identify and respond to cybersecurity risks is needed now more than ever, and the CPA profession is in a unique position to respond to this need. The CAQ is working closely with the AICPA as it develops a potential framework for use by management and its auditors to communicate information regarding cybersecurity programs to stakeholders. The potential framework would include three key components: (1) management's description of the cybersecurity risk management program, (2) management's assertions about the presentation of its description of the program and the effectiveness of the related internal controls to achieve the entity's stated objectives, and (3) the CPA's opinion on these assertions.

In addition, in a panel discussion, speakers described the impact of cybersecurity on the accounting world, focusing on the responsibility of the board of directors, management, the government, and auditors with regard to cybersecurity. Among other points, the panel noted that an integral part of any cybersecurity risk assessment is the identification of controls to address the risks, which need to be evaluated regularly in response to the changing risk landscape.

Auditor Independence

In a manner consistent with remarks from prior conferences, Mr. Bricker and members of the OCA staff highlighted the importance of auditor independence. They focused on potential impairment not only as a result of prohibited relationships and the provision of prohibited nonaudit services but also because of violations of the general standard of independence.

OCA Deputy Chief Accountant Marc Panucci noted that the staff continues to receive requests for consultation on a broad range of independence topics and that consultations have increased on questions about relationships or services that are not specifically prohibited by Regulation S-X, Rule 2-01, but require consideration under the four principles described in that rule's preliminary note.[2] In Mr. Bricker's keynote address, he reminded auditors and clients to consider whether services or relationships not specifically addressed in the independence rule may nevertheless impair independence.

Mr. Bricker also noted that since many companies are currently undergoing a period of significant accounting changes, auditors may be asked to give management input or feedback on revisions to accounting policies, processes, and controls. While there is benefit to robust discussion between auditors and management about implementing new accounting standards, there are boundaries to the extent of accounting advice that an auditor can give its audit client, and determining those boundaries requires professional judgment and common sense.

Audit Committees

Mr. Bricker emphasized the vital role that audit committees play in the capital markets. He indicated that, like auditors, audit committees are gatekeepers "in the chain responsible for credible, reliable financial reporting." Mr. Bricker offered the following advice to audit committee members regarding fulfilling their duties:

- *Stay current on emerging issues related to financial statements, internal controls, and disclosures* — Identify continuing education opportunities and seek expert advice when necessary.
- *Set the tone for the relationship with external auditors* — The audit committee's oversight of external auditors promotes auditor independence and alignment of auditor interests with those of the investors. External auditors are in a unique position to provide feedback to the audit committee about management, the company's processes, accounting policies, and ICFR. It is crucial for audit committees to establish and maintain a direct relationship with the external auditors. Asking the following types of questions might help initiate a dialogue with auditors:
    - If you were in management's position, would the financial statements have been prepared differently?
    - If you were in an investor's position, "would you believe that you have received the information that is essential to understanding the company's financial position and performance?"
    - Are the company's procedures for ICFR and internal audit the same as those you would apply if you were in the CEO's shoes?
    - Are there recommendations that you made as an auditor that management has not carried out?
- *Work with other board committees to monitor corporate activities* — For example, monitor cost-reduction plans to ensure that corporate activities do not unintentionally hinder management's ability to meet its financial reporting responsibilities. Similarly, exercise care in determining the terms of engagement with external auditors, including auditor compensation. The design and implementation of certain company procurement policies may be inappropriate when applied to auditor selection, retention, and compensation decisions.

[2] The preliminary note states, in part, "The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in § 210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the 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."

Accounting and Financial Reporting Topics

Adoption of the New GAAP Standards

Adoption of the new accounting standards on revenue recognition, leases, financial instruments, and credit losses continues to be a key priority for preparers, auditors, and regulators. Mr. Bricker noted that implementation of the standards "is a financial reporting topic that deserves close attention, both to make sure that [it] is done timely and with useful transition disclosures and to ensure the application of the standards, once implemented, is appropriate."

The SEC staff discussed transition disclosures, effective dates, and changes in accounting policies related to the new accounting standards as well as specific observations about each new standard (see discussions below).

Transition Disclosures

OCA Professional Accounting Fellow Sylvia Alicea and other OCA staff members emphasized the importance of providing the transition disclosures related to the new revenue standard in a manner consistent with the SEC staff's September 2016 announcement regarding additional qualitative disclosures that registrants are expected to provide about the impact of certain recently issued accounting standards. Such disclosures are important to financial statement users because they contain information about the status of the implementation and possible challenges ahead as well as the potential impact on the financial statements and the business in general.

In Ms. Alicea's view, registrants should not avoid disclosures about reasonably estimable quantitative information when there is a lack of certainty related to the ultimate impact of adoption. Further, it would be appropriate to disclose the expected impact of adopting the new revenue standard even when the impact is only known for a subset of revenue (e.g., a single product category or revenue stream). Ms. Alicea noted that a registrant should generally provide more qualitative disclosures when there is a lack of quantitative disclosures. Such qualitative disclosures could include information about potential changes in the timing of revenue recognition under the new revenue standard. She also noted that these disclosures should be (1) consistent with the information the registrant is providing to the audit committee and investors and (2) subject to the registrant's ICFR.

Editor's Note

In a Q&A session, the OCA staff reiterated that it would generally not be appropriate to avoid quantitative disclosures when positions are pending industry clarification. Further, if a registrant discloses a quantitative impact on the basis of its best estimate but the ultimate amounts recognized differ, the difference does not necessarily indicate a control weakness if the cause of the change was information that was not available when the registrant's best estimate was developed. The Division staff also reminded registrants that the transition disclosures in SAB 74 apply to foreign private issuers (FPIs).

Adoption Dates for Equity Method Investees of Public Business Entities

OCA Associate Chief Accountant Jonathan Wiggins discussed when an equity method investee should adopt new accounting standards (e.g., the new revenue standard) if the equity method of accounting is applied to an investor registrant's financial statements. Specifically, he observed that when an equity method investee does not meet the definition of a public business entity (PBE) in U.S. GAAP, the investee would not need to use a new standard's effective dates that apply to PBEs. Accordingly, if a standard's differing effective date for PBEs results in differences between the equity method investee's and the registrant's accounting, the registrant would not need to adjust its (non-PBE) equity method investee's adoption dates of the standards to conform with the registrant's adoption dates. However, Mr. Wiggins reiterated that when an equity method investee meets the definition of a PBE, the registrant's equity method accounting would be expected "to be based on the [investee's] financial statements prepared using the public business entity effective dates."

Editor's Note

Paragraph BC12 of ASU 2013-12 states that an entity meets the definition of a PBE when it "is required by the SEC to file or furnish financial statements or does file or furnish financial statements with the SEC" (e.g., its "financial statements or financial information that is required to be or is included in a filing with the SEC, [such as the information required under Regulation S-X, Rules 3-09, 3-05, and 4-08(g)]"). Equity method investees whose financial statements are included in a registrant's filing under Rule 3-09 because the equity method investee is significant to the registrant are considered PBEs under U.S. GAAP. Therefore, such an equity method investee should use PBE adoption dates when preparing its financial statements. Subject to materiality requirements, a registrant should also consider whether to use PBE adoption dates when it is preparing the summarized financial information of equity method investees that is required by Rule 4-08(g). This could be a difficult process if the registrant has numerous insignificant investees that meet the Rule 4-08(g) disclosure requirement only as a result of the registrant's aggregation of all of its equity method investees in the summarized financial information. In such circumstances, an investee that does not otherwise meet the definition of a PBE could then be required to adopt a new standard one year early. Registrants should stay alert to potential developments or clarifications regarding these matters.

Accounting Policy Changes

OCA Professional Accounting Fellow Sean May provided his observations about determining whether a registrant is required to perform a preferability assessment upon adopting a new accounting principle.

Under ASC 250, a change in accounting principle is permitted only if either (1) the change is required by new accounting guidance or (2) it can be established that an alternative approach is allowable and preferable. ASC 250 also indicates that the initial adoption of an accounting principle as a result of new events (or transactions), or that a change in an accounting principle to address events that are "clearly different in substance" from previous events, would not be viewed as a change in accounting principle.

Mr. May observed that a registrant must use judgment in determining whether events are "clearly different in substance" from previous events. Further, he stated that "identifiable differences between certain transactions or events does not necessarily equate to a clear difference in substance that necessitates a new or revised accounting principle." Accordingly, registrants should consider the facts and circumstances of each case. Mr. May noted that in the assessment of specific accounting conclusions, the starting point is often to review the existing documented accounting policies.

Revenue Recognition

Observations on the New Revenue Standard

Mr. Bricker reiterated the importance of the revenue metric to investors and highlighted that the new revenue standard, including its guidance on disclosures, is a step forward in financial reporting. While the quantitative impact of adoption may be less significant for certain issuers, the disclosures necessary to explain the changes to investors may not be. He also shared some recent survey results suggesting that progress has been made since his remarks at last year's conference given that only 8 percent of participants in this year's survey had not started their initial assessment, compared with a third of the participants in last year's survey. However, issuers that continue to lag behind should discuss the reasons for their delay with their audit committees and auditors.

During a Q&A session with panelists, Mr. Bricker noted that the SEC is actively monitoring activities related to the implementation of the new revenue standard, including those of the transition resource group (TRG). He also stated that from the OCA's perspective, the implementation can proceed as scheduled and that the SEC does not currently plan to issue guidance supplementing ASC 606. However, Ms. Alicea observed that until a registrant adopts ASC 606, SAB Topic 13 will continue to apply.

The SEC staff also highlighted that the disclosure guidance in ASC 606 on disaggregation of revenue is similar to the segment reporting guidance, but it noted that ASC 606 does not provide an impracticability exception. Further, the SEC staff stated that its reviews of filings will include reviews of other materials, such as investor presentations and earnings releases, to determine whether the appropriate amount of disaggregation is disclosed.

Further, Mr. Bricker and other members of the OCA staff emphasized throughout the conference that the OCA continues to be available to companies finalizing their implementation efforts. In terms of ongoing consultations, the OCA staff first considers the economic substance of the transaction, the determination of which involves understanding the terms in the contract. Once the OCA staff understands the substance of the transaction, it considers:

- The language in the new revenue standard, including the standard's Basis for Conclusions.
- Implementation discussions.
- "[O]bjectives expressed in the standard for consistency and comparability."

The OCA staff also discussed a few of the issues it has addressed to date, as detailed below.

Definition of a Contract

Ms. Alicea noted that certain companies engage in "loss leader" pricing strategies to generate greater future volumes or profits. Questions have arisen about whether, in such circumstances, it would be appropriate to consider anticipated future contracts as part of the existing arrangement. In Ms. Alicea's view, the definition of a contract under ASC 606 would preclude a company from including anticipated future contracts as part of the existing arrangement because enforceable rights (i.e., payment) and obligations would not yet exist despite the underlying economics of the transaction.

Contract Combination

Ms. Alicea noted that some companies' contracts are negotiated concurrently with multiple parties unrelated to a single customer and have interdependent pricing (i.e., the consideration under one contract is dependent on the consideration under another) and a single commercial objective. Questions have arisen about whether the contract combination guidance would apply in these circumstances. Ms. Alicea noted that the OCA staff would object to applying the contract combination guidance to such arrangements since the arrangements would not meet the requirement under ASC 606 to be with either the same customer or related parties of the customer.

Payments to Customers

OCA Professional Accounting Fellow Ruth Uejio discussed the accounting for payments to customers, noting that the accounting for such payments can be challenging in practice. Registrants should carefully consider their facts and circumstances and understand the underlying economic reasons for a transaction in applying the new revenue standard. As part of analyzing such transactions, the OCA staff may focus on why the payment is being made and how the payment was communicated to investors as well as on assessing the relevant contractual terms and determining the accounting basis for capitalization or recognition through earnings.

In addition, Ms. Uejio stated that in addressing payments to customers, entities should look to the guidance in the new revenue standard (including its Basis for Conclusions), the definition of an asset as contemplated in the FASB's concepts statements, and relevant TRG materials. Ultimately, the accounting model applied should be consistent with the substance of the transaction and the relevant accounting literature. Ms. Uejio emphasized that "'matching' is not a determinative factor."

Editor's Note

In a subsequent session, the SEC staff observed that there is diversity in practice related to the classification of incentives to customers under current U.S. GAAP for more complicated transactions. It was noted that the SEC staff would expect disclosure in MD&A to the extent that material amounts related to such transactions are classified outside of revenue under current U.S. GAAP or the new revenue standard.

Gross Versus Net

Ms. Uejio highlighted the importance of a registrant's conclusion related to gross-versus-net presentation and that the conclusion should be a focus of management. The accounting determination under the new revenue standard may differ from that under current U.S. GAAP, and entities will need to revisit previous conclusions. Ms. Uejio also emphasized that neither gross nor net reporting is a default or safe harbor under the new revenue standard. Further, as companies and business models continue to evolve, the nature of the promise to the customer and method of delivery may create unique challenges in the determination of whether the entity is a principal or an agent under the standard.

Editor's Note

In a Q&A session, the OCA staff noted that the gross-versus-net conclusion under ASC 606 requires judgment based on specific facts and circumstances. The staff added that it would be inappropriate to make any blanket statements related to the significance of any indicators in a control model as compared with their significance in the previous risks-and-rewards model.

For more information, see Deloitte's *A Roadmap to Applying the New Revenue Recognition Standard*.

Lease Accounting

Significant changes as a result of the FASB's and IASB's new standards on leases were addressed in a panel discussion. Panelists, which included several preparers, discussed key issues associated with implementing the standards and acknowledged that entities will often be required to use judgment, particularly related to the assessment of a lease term and the identification of leases. The distinction between leases and services, which becomes more critical under the new guidance, was also emphasized. Panelists noted the importance of education and communication of such technical accounting issues, especially in conjunction with interpretive efforts of preparers' auditors and other stakeholders, highlighting that more accounting issues may arise as companies complete their adoptions of the new revenue standard and turn to the new leases standard.

Panelists further discussed implementation, operational, and internal control issues that preparers and auditors should consider as companies adopt the new standard. Preparer accounting personnel may need to include other business functions in such implementation efforts, particularly with respect to data gathering and new systems solutions that may be needed to comply with the new standard's requirements. The importance of carefully considering materiality conventions in the context of lease assets and liabilities, as well as the effect of those assets and liabilities on debt covenants, was also highlighted.

The topic of lease accounting under the FASB's new standard was also noted in remarks by FASB Chairman Russell Golden and FASB Technical Director Susan Cosper. Both Mr. Golden and Ms. Cosper emphasized that the Board is not planning to establish a TRG for the leases standard because the new lease accounting standard does not change current guidance to the same degree as the new revenue and credit losses standards. However, Mr. Golden noted that the Board has carefully monitored implementation issues identified by stakeholders since the standard's issuance and will continue to do so. Specifically, Ms. Cosper indicated that the FASB staff has received a number of technical inquiries to date regarding implementation questions related to the application of the new lease accounting standard. Ms. Cosper identified lessee accounting and transition as the two most prevalent topics of inquiry.

Separately, Ms. Uejio stated that the OCA has been, and will continue, consulting with registrants on questions related to the new lease accounting standard and that the staff is monitoring implementation efforts with both registrants and auditors. She also acknowledged that the new lease accounting standard includes a number of topics that require judgment and estimation, and that accordingly, ICFR will remain important to implementation efforts.

See Deloitte's March 1, 2016, *Heads Up* (updated July 12, 2016) for additional information about the FASB's new lease accounting standard.

Financial Instruments

New Guidance on Recognition and Measurement of Financial Liabilities

OCA Professional Accounting Fellow Brian Staniszewski discussed observations related to the implementation and interpretation of ASU 2016-01 (codified in ASC 825).[3] Specifically, for financial liabilities for which the fair value option (FVO) has been elected, he addressed (1) whether certain hybrid financial liability instruments are within the scope of the ASU and (2) the measurement of instrument-specific credit risk.

See Deloitte's January 12, 2016, *Heads Up* for more information about ASU 2016-01's amendments to the guidance on classification and measurement of financial instruments.

[3] For PBEs, the guidance in ASU 2016-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. For all other entities, the guidance is effective for fiscal years beginning after December 15, 2018, and interim reporting periods within fiscal years beginning after December 15, 2019. Entities may early adopt only the following guidance in ASC 825 as amended by the ASU: (1) for financial liabilities measured under the FVO, fair value changes resulting from a change in instrument-specific credit risk would be presented in OCI, and (2) the fair value disclosure requirements in ASC 825 for financial instruments not recognized at fair value would be eliminated for non-PBEs.

Scope of Hybrid Instruments

ASU 2016-01 amended the presentation guidance in ASC 825 on financial liabilities for which the FVO has been elected. Under those amendments, entities are required to present changes in fair value associated with instrument-specific credit risk separately in other comprehensive income (OCI). Mr. Staniszewski noted that a question had arisen regarding whether this accounting treatment would only apply to financial liabilities for which the FVO was elected under ASC 825 or whether it would also apply to hybrid financial liabilities for which an entity had qualified for and elected the FVO under ASC 815-15.

In considering this question, Mr. Staniszewski indicated that he saw no conceptual basis for accounting for the financial liability differently just because the FVO was elected under different standards. Therefore, he believes that "an entity that elects a fair value option under either guidance for an eligible hybrid financial liability should present separately in OCI the portion of the total change in fair value that results from a change in instrument-specific credit risk."

Instrument-Specific Credit Risk

As noted above, changes in fair value related to instrument-specific credit risk must be recognized in OCI for financial liabilities for which the FVO has been elected. Mr. Staniszewski noted that it may sometimes be appropriate to use the "base rate method," as indicated by the ASU, in measuring instrument-specific credit risk. Under this method, a change in instrument-specific credit risk is considered to be the change in fair value that excludes the base market risk (e.g., the risk-free rate or benchmark interest rate).

However, Mr. Staniszewski indicated that, in certain circumstances, the base rate method may not be appropriate and an alternative method may need to be developed and applied. To illustrate this point, he discussed the following scenarios:

- *Scenario 1* — A nonrecourse financial liability for which the FVO has been elected under ASC 825 and the payment is solely tied to the cash flows or value of the collateral.
- *Scenario 2* — A hybrid financial liability for which the FVO has been elected under ASC 815-15 and the debt obligation is indexed to the price of gold.

In Scenario 1, the change in fair value would be solely tied to the underlying financial assets; accordingly, the full change in fair value of the financial liability would be recognized in earnings because there would be no instrument-specific credit risk. In Scenario 2, the change in fair value would partly be based on the index of gold; accordingly, the base rate method would not result in a true representation of the change in fair value associated with the instrument-specific credit risk and an alternate approach would need to be used.

In considering the above scenarios, Mr. Staniszewski noted that as the complexity of financial liabilities increases, an entity will need to use greater judgment to determine permissible methods for measuring instrument-specific credit risk.

Implementation of New Guidance on Measurement of Credit Losses

Mr. May noted that the OCA is actively monitoring the implementation of ASU 2016-13 (codified in ASC 326)[4] and is continuing to meet with stakeholders (i.e., accounting firms, FASB representatives, regulators, registrants, and industry groups) to identify implementation questions.

[4] For PBEs that meet the U.S. GAAP definition of an SEC filer, ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For PBEs that do not meet the U.S. GAAP definition of an SEC filer, the ASU is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. In addition, entities are permitted to early adopt the new guidance for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

Mr. May indicated that, under the new standard, there is no single correct method for estimating expected credit losses. Thus, entities' approaches for such estimation may differ and may involve unique implementation challenges. Mr. May stressed that, like other accounting policies, the method the entity chooses would need to be applied consistently from period to period. He further noted that the ASU does not alter the requirement for management to document its "policies, procedures, methodologies and decisions."

In addition, Mr. May explained that the guidance in FRR 28 and SAB 102 will remain relevant to entities that are preparing to implement the ASU. Specifically, he noted:

> [I]n planning for implementation of the new standard, registrants engaged in lending activities should be preparing to support their expected credit loss estimates through documentation of a systematic methodology to be employed each period, with rationale supporting each period's determination that the amounts reported are consistent with the principles of the new standard. The systematic methodology employed should ensure that matters affecting loan collectibility are consistently and appropriately identified, and that the findings are considered in an appropriately disciplined manner by persons exercising judgment in determining the amounts to be reported.

Mr. May also encouraged registrants to "allocate appropriate time and resources to make the most of the implementation time provided."

See Deloitte's June 17, 2016, *Heads Up* for more information about the guidance in ASU 2016-13 on the measurement of credit losses.

Classification as Liabilities or Equity

Mr. Staniszewski observed that entities continue to encounter difficulties in navigating and applying the debt-equity guidance. Specifically, he noted that the OCA staff had objected to the equity classification of warrants that include a feature allowing the warrants to be put back to the issuer for cash equal to the fair value of the warrants. In such circumstances, the warrants would be a liability under ASC 480 because the issuer may be required to transfer cash to settle them. Because of the complexity of the debt-equity guidance, Mr. May reminded registrants to continually monitor their resources and ensure that their personnel have sufficient training. He believes that such activities are essential to maintaining an effective control environment.

For more information, see Deloitte's December 8, 2016, *Heads Up* and *A Roadmap to Accounting for Contracts on an Entity's Own Equity*.

Insurance — Disclosures About Short-Duration Contracts

In his remarks about insurers' upcoming implementation of the requirement in ASU 2015-09[5] to provide disclosures related to the incurred and paid claims development table, Division Deputy Chief Accountant Craig Olinger noted that although the ASU does not prescribe how an insurer should present acquisitions, dispositions, and foreign exchange effects in the development tables, the following approaches, which an insurer applies in providing such disclosures, must be consistent with the ASU's objectives:

- *Acquisition* — Retrospective presentation; alternatively, if a prospective approach is used, the acquired liabilities would need to be presented separately from the acquirer's existing business.

[5] In May 2015, the FASB issued ASU 2015-09 (codified in ASC 944), which revises the disclosure requirements related to insurers' short-duration contracts. The new disclosure requirements apply to the financial statements of PBEs for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016.

- *Disposition* — Retrospective presentation, with amounts related to the disposed-of business removed from the development table.

Editor's Note

The highlights from the November 1 and November 17, 2016, meetings between the AICPA's Insurance Entities Expert Panel and SEC staff further clarify that the development information for acquisitions and dispositions that is either added to or removed from the incurred and paid development tables should be shown for (or removed from) each accident year presented in those tables.

- *Foreign exchange effects* — Application of a constant exchange rate to all data in the development table disclosures to avoid the distortion of trends. Accordingly, an insurer could (1) recast all data in the development tables by using the current period-end exchange rate or (2) present separate development tables for each functional currency.

Further, Mr. Olinger acknowledged that SEC Industry Guide 6 also requires insurers to present a loss reserve table in either the business or MD&A section of the filing. He clarified that to avoid requiring insurers to disclose two different types of development tables, the SEC staff would permit, but would not require, an insurer that discloses the ASU 2015-09 development table to also disclose the Guide 6 development table. This view was reflected in Section 11300 of the SEC's *Financial Reporting Manual*, as updated on November 9, 2016.

For more information see Deloitte's December 9, 2016, *Financial Reporting Alert*.

Income Taxes

Indefinitely Reinvested Earnings

In a manner consistent with the SEC staff's comments at last year's conference, Mr. Staniszewski reiterated the importance of coordination among an entity's global business functions (e.g., treasury, accounting, and business functions) with respect to the accounting for deferred taxes on undistributed earnings of a foreign subsidiary under ASC 740. He indicated that the staff has questioned registrants when information communicated outside the audited financial statements is inconsistent with assumptions used and conclusions reached in the accounting for income taxes on undistributed earnings in the financial statements.

MD&A Disclosures

Division Deputy Chief Accountant Nili Shah discussed income tax disclosures in MD&A and indicated that the SEC staff expects to issue more comments in the coming year if such disclosures are not an improvement over what the staff has seen in prior years. She reminded registrants that the staff is looking for disclosures that help the reader understand the company's big-picture tax situation. That includes helping the reader understand the trends and uncertainties associated with:

- The historical effective tax rate (ETR) and the extent to which it is expected to be indicative of the future ETR.
- Income tax expense.
- Cash tax obligations and how they affect liquidity.

- Unrecognized tax benefits and changes related to those benefits.
- Cash held in foreign jurisdictions that the company has asserted will be indefinitely reinvested.

At previous conferences, the staff has highlighted situations in which improved disclosure would help accomplish the above objectives (see Deloitte's December 15, 2015, *Heads Up* on last year's conference). For example, the staff has previously highlighted the use of boilerplate or unclear descriptions of the components of the rate reconciliation, noting that an explanation in MD&A of why certain events that affected the ETR occurred and how those events will affect the tax rate going forward would provide meaningful information to investors. The staff has also previously noted that in situations in which a registrant asserts that its foreign earnings are indefinitely reinvested, but also has significant amounts of cash located in foreign jurisdictions that would be subject to tax if such amounts were repatriated, the staff has requested disclosure of the amount of cash held in those foreign jurisdictions.

At this year's conference, Ms. Shah added that the SEC staff sometimes sees boilerplate language that is effectively a restatement of U.S. GAAP to describe the reason for reversal of a valuation allowance. The staff would consider a discussion of the sources of future taxable income and the associated uncertainties to be more useful for investors than a statement such as "It is no longer more likely than not that a deferred tax asset will not be realized, so we have reversed our valuation allowance."

For more information, see Deloitte's *A Roadmap to Accounting for Income Taxes*.

Consolidation

Joint Ventures, Strategic Alliances, and Collaborative-Type Arrangements

Mr. Wiggins discussed considerations associated with the accounting for joint ventures, strategic alliances, and other collaborative-type arrangements. He noted that in determining the appropriate accounting model, a registrant should first identify whether the activities of these highly structured arrangements are conducted wholly or partially within a legal entity. If they are, the registrant should then consider whether it should consolidate the legal entity. Mr. Wiggins indicated that a registrant involved in these types of arrangements should carefully identify and assess the legal entity's significant activities in the context of the underlying economics of the arrangement.

If an arrangement is not housed in a separate legal entity, or if a legal entity is not consolidated, the registrant should carefully consider the appropriate accounting model. Particularly, a registrant should consider whether a legal entity that is not consolidated is a joint venture or whether an arrangement is a contract with a customer and thus within the scope of the new revenue standard. In the latter case, it is important to distinguish between an arrangement in which the registrant is providing outputs of its ordinary activities to another party and one in which the registrant and another party are sharing in the risks and rewards of an activity (e.g., a collaborative arrangement).

Mr. Wiggins noted that a significant amount of judgment is often involved in the assessment of these arrangements and that consultation with the OCA staff is available.

Simplifying the Consolidation Guidance

In her remarks about the FASB's standard-setting activities, Ms. Cosper discussed recent activities being considered by the Board to simplify its consolidation guidance. She indicated that the Board will hold a public roundtable in December to discuss the following efforts, and she urged stakeholders to notify the FASB if they want to participate:

- *Reorganization project* — On the basis of feedback received from stakeholders, the Board agreed to add to its agenda a project to reorganize its consolidation guidance. The project would include adding to the Codification a new topic, ASC 812, which would supersede ASC 810 in its entirety and contain separate subtopics for each of the consolidation models as well as guidance on determining which model is appropriate.

  Ms. Cosper also indicated that the Board will consider clarifying some of the terms and concepts in the variable interest entity (VIE) guidance as a result of stakeholder feedback indicating they are overly complex.

- *Potential amendments to the VIE guidance on common-control for private companies* — Ms. Cosper noted that the Board was considering a private-company scope exception to the VIE guidance for entities under common control that are involved with a potential VIE. She noted that there is diversity in practice related to how the relevant guidance is applied to private companies.

- *Potential related-party amendments to the VIE model* — Ms. Cosper stated that the Board was considering targeted changes that would (1) eliminate the related-party tiebreaker test and (2) improve the guidance for entities under common control in the consideration of the effect of related parties on determining the primary beneficiary.

For more information, see Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest*.

Employee Benefits

Measurement of the Interest Cost Component of Net Periodic Benefit Cost

Ms. Uejio discussed recent observations related to the approaches preparers use in performing certain defined benefit accounting computations under ASC 715. As discussed at last year's conference, there are two common approaches preparers use to apply discount rates to measure the components of net periodic benefit cost when entities use a yield curve approach to determine discount rates: (1) the single-weighted-average discount rate approach and (2) the disaggregated approach (also referred to as the "spot rate" approach), which is an alternative method developed recently by actuaries.

In light of the SEC staff's acceptance of the use of a spot rate approach for measuring interest cost by entities that develop their discount rate assumption by using a yield curve approach, the OCA was consulted on the use of a derived spot rate approach to measure components of net periodic benefit cost for registrants that use a bond-matching approach to support the discount rate. The OCA objected to this proposed approach since using such derived spot rates to measure interest cost on the defined benefit obligation could not be demonstrated, at each maturity, to be based on the same rates inherent in the measurement of the defined benefit obligation under the bond-matching approach (i.e., the spot rates inherent in the bond portfolio are not observable). Ms. Uejio reiterated that use of discount rates to measure the present value of the benefit obligation and the determination of interest cost are *integrated* concepts under ASC 715 and that the measurement of the benefit obligation is the starting point.

See Deloitte's November 16, 2016, *Financial Reporting Alert* for more information about this topic.

Grant Date and Clawback Provisions

Mr. May discussed observations related to clawback provisions in share-based payment awards and the judgment an entity must use in determining the grant date of such awards. He pointed out that determining the grant date under ASC 718 is important because compensation cost for equity-classified share-based payment awards is generally measured on the basis of the awards' grant-date fair value. In addition, if the service inception date precedes the grant date, compensation cost is based on the fair value of the equity-classified awards on each reporting date, with a final measurement on the grant date. Moreover, Mr. May reminded participants that ASC 718 defines the grant date as "the date at which an employer and an employee reach a mutual understanding of the key terms and conditions of a share-based payment award" and that such key terms and conditions may be based on "a written agreement, an oral agreement, or the entity's past practice."

Specifically, Mr. May observed that clawback provisions may either be objective or may provide those with authority over share-based payments with discretion. He noted that if the key terms or conditions of share-based payment awards are subject to discretion, "a registrant should carefully consider whether a mutual understanding has been reached and a grant date has been established." Such consideration should include an assessment of "past practices exercised by those with authority" over share-based payments and how such practices may have evolved. Further, Mr. May noted that "registrants should consider whether they have the appropriate internal control over financial reporting . . . to support the judgment needed" to establish a grant date.

Other Accounting and Disclosure Topics

Measurement-Period Adjustments

Mr. Wiggins discussed observations related to measurement-period adjustments in a business combination.

Under ASC 805, if the initial accounting for the business combination is incomplete by the end of the reporting period covering the business combination, the acquirer is required to report provisional amounts. Mr. Wiggins reminded registrants about the guidance in ASC 805-10-25-14, which indicates that the measurement period during which an acquirer measures provisional amounts would end if the "acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable." In addition, this measurement period is not permitted to exceed one year.

Mr. Wiggins pointed out that although ASU 2015-16 eliminated the requirement to retrospectively account for measurement-period adjustments, it "does not change the measurement period or apply when an adjustment represents the correction of an accounting error." He indicated his belief that "registrants should ensure they have sufficient internal control over financial reporting to identify and account for measurement period adjustments appropriately and separately identify accounting errors."

Mr. Wiggins further reminded registrants that "if the initial accounting for a business combination is incomplete at the reporting date, the disclosures regarding provisionally recorded amounts are required."

See Deloitte's September 30, 2015, *Heads Up* for more information about ASU 2015-16.

Loss Contingencies

The Division staff indicated that while loss contingencies have not been discussed at the conference for a number of years, the topic has remained a source of SEC comments. In particular, recent comments have focused on "surprise situations," suggesting that registrants are not always disclosing accruals of loss contingencies in a timely manner or that there are circumstances in which registrants have not disclosed the reasonably possible range of loss. The staff therefore reminded registrants to ensure that they have applied the requirements of ASC 450.

Cash Flows

As an update to current practice issues, it was noted that errors in the statement of cash flows continue to be one of the leading causes of restatement. It was further noted that as a result of recent EITF activities, the FASB has now issued ASU 2016-15 and ASU 2016-18. The ASUs are intended to add to or clarify the guidance on classifying certain cash receipts and payments, including the classification of restricted cash.

The panel highlighted the importance of several of these changes, including repayment of zero coupon bonds, distributions from equity method investees, separately identifiable cash flows and application of the predominance principle, and restricted cash.

See Deloitte's November 17, 2016, *Heads Up* for more information about ASU 2016-18 on restricted cash and Deloitte's August 30, 2016, *Heads Up* for more information about ASU 2016-15 on cash flow classification.

Further, see Deloitte's *A Roadmap to the Preparation of the Statement of Cash Flows* for more information and interpretive guidance on ASC 230.

Segment Reporting

Ms. Shah observed that the SEC continues to comment on presentation and disclosures related to operating segments and that the Division staff has at times objected to a company's segment presentation.

Her discussion focused on the following aspects of segment reporting:

- *Identification of an operating segment* — Ms. Shah observed that in a scenario in which a company had gross margin information but did not allocate a number of its shared costs, the staff has not been persuaded by the company's argument that there is no discrete financial information.
- *Aggregation of operating segments* — Ms. Shah reminded registrants that there are three main criteria on which registrants should base their determination of whether operating segments may be aggregated: (1) the quantitative characteristics of the operating segments, (2) the qualitative characteristics of the operating segments, and (3) the principles of the standard. Ms. Shah observed that the staff has seen some companies that, upon determining that the operating segments were quantitatively similar, did not spend as much time evaluating whether they were qualitatively similar.

She cautioned that since quantitative similarity may be coincidental, registrants need to carefully analyze any qualitative similarities. Further, Ms. Shah described a number of situations in which registrants needed to consider the definition of "similar," particularly with respect to qualitative characteristics and the scope of the company's activities.

- *Enterprise-wide disclosures* — Ms. Shah observed that although enterprise-wide disclosures are required, registrants do not always include them in their segment reporting. She noted that when preparing enterprise-wide disclosures, registrants should consider whether the objectives in ASC 280 related to disclosures about segments have been achieved.
- *General information* — Ms. Shah reminded registrants of ASC 280's requirement to disclose the factors they used in their identification of the public entity's reportable segments, including the basis of organization (e.g., whether management has chosen to organize the public entity on the basis of differences in products and services, geographic areas, regulatory environments, or a combination of factors) and whether operating segments have been aggregated.

During a Q&A session, Ms. Shah referred to a speech by former OCA Professional Accounting Fellow Courtney Sachtleben at last year's conference. See Deloitte's December 15, 2015, *Heads Up* for more information about Ms. Sachtleben's remarks.

For additional discussion of trends related to segment reporting identified in the SEC staff's comment letters, see Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* and the 2016 supplement.

Disclosure Framework

Ms. Cosper provided an update on the FASB's disclosure framework project, which is intended to improve the effectiveness of the financial statement notes. The FASB has been reviewing responses to its proposed concepts statement and proposed amendments to the disclosure requirements related to income taxes, fair value measurement, and pensions. The Board also plans to issue an exposure draft on inventory disclosures in the first quarter of 2017. In the coming months, the FASB plans to hold a roundtable session to review the feedback received on the proposed guidance as well as on the application of materiality to disclosures.

SEC Reporting Topics

Non-GAAP Measures

The role of non-GAAP measures in high-quality financial reporting was discussed by many speakers at this year's conference. These measures have become one of the topics on which the SEC comments most frequently. During a panel discussion, Division Chief Accountant Mark Kronforst discussed the staff's continuing dialogue with registrants on presentation of such measures and shared some observations related to non-GAAP disclosures since the Division's C&DIs were updated in May 2016.

Mr. Kronforst observed that in issuing the C&DIs, the Division's intent was not to prohibit the presentation of non-GAAP measures or eradicate them from filings. Rather, they were intended to address broad-based concerns about excessive prominence of non-GAAP measures and other less broad-based abuses. For example, the C&DIs provide prescriptive examples illustrating circumstances in which a non-GAAP measure would be more prominent than the comparable GAAP measure, such as (1) the omission of a comparable GAAP measure from an earnings release headline or caption that emphasizes non-GAAP measures, (2) the presentation of a non-GAAP measure before a comparable GAAP measure, or (3) the presentation of a full non-GAAP income statement. Mr. Kronforst was also clear that when reconciling non-GAAP measures to the most comparable GAAP measures, registrants should start with the GAAP measure.

Mr. Bricker's keynote remarks acknowledging the progress registrants have made "in addressing the problematic practices," especially related to prominence, were also reiterated by Mr. Kronforst. However, Mr. Kronforst indicated that there are certain aspects of non-GAAP disclosures that the Division staff continues to address in the comment letter process because they may be misleading or prohibited. These disclosures are discussed below.

See Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* and the 2016 supplement for detailed information on recent trends in staff comments, including non-GAAP measures.

Individually Tailored Accounting Principles

Mr. Kronforst discussed the following examples:

- *Accelerating unearned revenue* — He described a non-GAAP performance measure that reflects revenue (that is recognized over the service period under GAAP) on an accelerated basis as if the registrant earned the revenue when it billed its customers. Such a measure is prohibited because it is an individually tailored accounting principle and does not reflect the registrant's required GAAP measurement method.

  Mr. Kronforst stated that he did not "want to suggest that there is no circumstance under which revenue can be adjusted" and noted that it may be acceptable for a registrant to present measures that adjust revenue and expense if there are some very unique or unusual factors, such as a change in revenue model coupled with the anticipated impact of adopting the new revenue recognition guidance in ASC 606.

- *Pro rata consolidation* — He also discussed a scenario in which a non-GAAP performance measure presents the earnings of unconsolidated affiliates on a pro rata consolidated basis (i.e., on the basis of proportional ownership in an unconsolidated affiliate). Such presentation has been common in the real estate, health care, and energy industries but is prohibited as an individually tailored accounting principle because the criteria to consolidate the affiliates under GAAP have not been met. The presentation also fails to comply with the "prominence" guidance since a full non-GAAP income statement is presented on a pro rata consolidated basis. Mr. Kronforst acknowledged that in such scenarios, certain investors may want to understand the proportional impact of the investees. He explained that while a registrant could still provide the relevant pieces of detailed financial information used in the calculation of this presentation (which, by itself, would not be considered a non-GAAP measure), the registrant should not "do the math."

Normal Recurring Cash Operating Expenses

Since the release of the C&DIs, the Division has issued a number of comments related to restructuring costs and litigation expense adjustments. Mr. Kronforst indicated that the Division may gather additional information about the nature and circumstances specific to an adjustment in the comment letter process so that a conclusion about the adjustment's appropriateness can be reached. For example, in situations in which the Division identified companies that appeared to be "serial restructurers," the staff has asked for further details about the facts and circumstances supporting an adjustment for what appeared to be a recurring cost. In most cases, the Division staff did not ultimately object to the use of the adjustment; however, in response to the SEC comment, the registrant may have revised its disclosures about the nature and purpose of the adjustment or the resulting non-GAAP measure.

Segment Measures of Profit or Loss

The non-GAAP rules[6] prohibit the disclosure of non-GAAP measures on the face or in the footnotes to the financial statements. However, financial measures that a registrant is required to disclose under GAAP are not considered non-GAAP measures. The most common examples of such measures are related to segment financial information such as revenue or the measure of profit or loss for each reportable segment. Panel members discussed two elective forms of segment disclosures that are examples of financial statement presentation that would be subject to the non-GAAP rules.

Mr. Kronforst mentioned that registrants should not voluntarily expand their ASC 280 segment footnote in the financial statements to provide a secondary non-GAAP measure of profit or loss that is evaluated by the chief operating decision maker. Any such additional measure would not be required by GAAP and therefore would be within the scope of the non-GAAP rules. In addition, if a registrant with only one reportable segment elects to disclose a measure of profit or loss that is evaluated by the chief operating decision maker, such measure also would need to comply with the non-GAAP rules because it is not required by GAAP.

See Section 2.5 in Deloitte's *A Roadmap to Non-GAAP Financial Measures* for more information about segment reporting measures and the non-GAAP measure rules.

Other Adjustments

Certain other adjustments were also mentioned during the non-GAAP panel discussion:

- *Pensions and derivatives* — The Division staff is continuing to think more about the appropriateness of adjustments related to pensions and derivatives.
- *Stock-based compensation* — Stock-based compensation has not been a focus of the Division staff to date. Mr. Kronforst clarified that there would typically not be an objection to a registrant's exclusion of any shortfall or windfall (tax impacts) as a result of the new stock compensation guidance in ASU 2016-09 in its non-GAAP measures.
- *Purchase accounting* — The Division staff does not plan to object to short-term adjustments related to purchase accounting, such as a revenue impact that amortizes over a period of several months, or the cost impact associated with a change in inventory valuation. However, the Division staff may request a dialogue with a registrant to better understand any particularly large or unusual adjustments.

[6] As mandated by the Sarbanes-Oxley Act of 2002 and including the rules outlined in SEC Release 33-8176 on conditions for the use of non-GAAP financial measures.

Editor's Note

The SEC's emphasis on management's responsibility for effective internal controls and the oversight role of the audit committee was also reflected in speakers' comments on non-GAAP measures. In his keynote address, Mr. Bricker advised audit committee members to "seek to understand management's judgments in the design, preparation, and presentation of non-GAAP measures and how those measures might differ from approaches followed by other companies." Deloitte's *A Roadmap to Non-GAAP Financial Measures* contains a chapter devoted to disclosure controls and procedures related to non-GAAP measures and an appendix that provides questions management can consider related to its use of non-GAAP measures.

Foreign Private Issuers

In a separate panel discussion on international reporting matters, Mr. Olinger reminded registrants that the non-GAAP measure rules also apply to FPIs.

For more information about the rules' application, and considerations particular to FPIs, see sections 1.4.3 and 2.1.2 of Deloitte's *A Roadmap to Non-GAAP Financial Measures*.

Transition-Period Activities Related to New Accounting Standards

The Division staff discussed transition-period activities related to several of the FASB's recently issued accounting standards and referred participants to Topic 11 of the SEC's *Financial Reporting Manual*, in which the staff addresses various reporting issues related to adoption of new accounting standards.

New Revenue Standard — Full Retrospective Method of Adoption

Requirement for Revised Financial Statements — New or Amended Registration Statements

The Division staff discussed the requirement in Form S-3, Item 11(b), for registrants to provide revised financial statements in a new registration statement. If a registrant elects to adopt the new revenue standard by using the full retrospective method and subsequently files a registration statement on Form S-3 that incorporates by reference interim financial statements reflecting the impact of the adoption of the new revenue standard, it would be required to retrospectively revise its annual financial statements that are incorporated by reference in that Form S-3 (i.e., the annual financial statements in its Form 10-K). Those annual financial statements would include one more year of retrospectively revised financial statements (the "fourth year") than what would otherwise be required if the registrant did not file a registration statement. Filing the registration statement would also accelerate the timing related to when a registrant would be required to provide revised information for previously completed years.

Editor's Note

The following example illustrates concepts Ms. Shah discussed in her remarks:

Example

A calendar-year-end registrant adopts the new revenue standard on January 1, 2018, by using the full retrospective method and files its first-quarter Form 10-Q on May 1, 2018. If the registrant files a Form S-3 in the second quarter of 2018, it is required by Form S-3, Item 11(b), to retrospectively revise — in the second quarter 2018 — its previously filed annual financial statements for the years ending 2017, 2016, and 2015, since financial statements for these years must be provided in the registration statement. If the registrant did not file a Form S-3, it would only be required to revise the two most recent prior comparative periods, 2017 and 2016, when it files its 2018 Form 10-K in early 2019.

Although the Division staff recognized preparers' concerns, the staff reiterated that there are no plans to modify the requirements of Form S-3. Therefore, when adopting the new revenue standard, an entity may look to the guidance in current U.S. GAAP or IFRSs on the adoption of new accounting standards and contemplate the impracticability exception to retrospective application. The staff observed that the impracticability exception is a high hurdle and that companies may opt to consult the OCA regarding this topic.

Editor's Note

The above guidance also applies to any new or amended registration statement (other than Form S-8) that is filed after a registrant files a Form 10-Q that reports the material retrospective change.

Requirement for Revised Financial Statements — Prospectus Supplements to Registration Statements That Are Currently Effective

For currently effective registration statements (e.g., an existing Form S-3), a registrant may use a prospectus supplement to draw down or issue securities. Paragraph 13110.2 of the SEC's *Financial Reporting Manual* indicates that "a prospectus supplement used to update a delayed or continuous offering registered on Form S-3 (e.g., a shelf takedown) is not subject to Item 11(b)(ii) updating requirements" (as discussed above). Paragraph 13110.2 states that instead, under Regulation S-K, Item 512(a), "registrants must update the prospectus . . . with respect to any fundamental change."

The Division staff clarified that it is the responsibility of management, in consultation with legal counsel, to determine whether the adoption of the new standard constitutes a fundamental change. In this regard, the staff stated that it would be "surprised" if management concluded that the adoption of the new revenue standard resulted in a fundamental change and could not see "circumstances under which the staff would challenge management's assessment of a non-fundamental change on that point."

New Revenue Standard — Modified Retrospective Method of Adoption

The Division staff pointed out that if registrants choose to adopt the new revenue standard by using the modified retrospective method, only the most recent fiscal year would be presented under the new standard. Therefore, the requirements discussed above are not applicable under the modified retrospective method. However, an entity using the modified retrospective method may wish to provide supplemental voluntary disclosures in its MD&A that discuss the effects of the adoption of the new revenue standard on prior years under the full retrospective method. The staff further indicated that such supplemental MD&A disclosures would be acceptable but noted that the entity should (1) disclose the impact on each financial statement line item affected by such retrospective treatment (i.e., revenue and expense line items), (2) disclose the assumptions used in estimating the impact on the prior-year information presented (e.g., any practical expedients applied, date of adoption), and (3) not present a full income statement under the full retrospective method but only focus on disclosing the financial statement line items affected.

New Leases Standard — Transition-Period Activities

The Division staff also commented on the relationship between the new leases standard and the retrospective reporting requirements applicable to filing a new or amended registration statement. The staff noted that the requirement to provide revised financial information for the fourth year (see Requirement for Revised Financial Statements — New or Amended Registration Statement above) is not applicable in connection with a new or amended registration statement after the initial adoption of the new leases standard because of its different transition guidance.

Editor's Note

While the requirement to provide revised financial information for the fourth year is not applicable in connection with a new or amended registration statement after the initial adoption of the new leases standard, the filing of the new or amended registration statement will accelerate the timing related to the requirement for a registrant to provide revised information for periods after the date of initial application. See Section 11210 of the SEC's *Financial Reporting Manual* for further guidance.

In addition, the Division staff clarified that because of the requirement in the new leases guidance to apply the standard as of the beginning of the earliest period presented in the financial statements by using a modified retrospective approach, a registrant would not be required to revise the latest two years ("years 4 and 5") in the five-year selected financial data disclosures under Regulation S-K, Item 301.

SEC Continues Its Focus on Disclosure Effectiveness

The Division staff discussed its continued commitment to advancing its disclosure effectiveness initiative — a broad-based review of the disclosure, presentation, and delivery requirements in the SEC rules. The staff indicated that significant progress was made over the past year on projects related directly and indirectly to its disclosure effectiveness initiative. See Appendix A for summaries of the projects as well as Deloitte resources that provide additional information about each project.

As part of the discussion, the staff commented on the SEC's *Report on Modernization and Simplification of Regulation S-K*, which was issued in November 2016 pursuant to a mandate in the FAST Act.[7] The report contains certain specific recommendations on ways to streamline and improve disclosures. Some of the most significant recommendations, which focus primarily on reduced burdens for preparers and enhanced readability, include revisions that would:

- Allow registrants to limit MD&A period-to-period comparisons to the two most recent fiscal years presented in the financial statements and to hyperlink to a prior year's annual report for the additional period-to-period comparison.
- Replace the table of contractual obligations with hyperlinks to relevant notes in the financial statements and provide additional narrative discussions in the liquidity section of the MD&A.

[7] Fixing America's Surface Transportation Act.

Many of the recommendations in the report are preliminary, and further outreach and study will be needed before the SEC initiates rulemaking related to them. The Division staff also clarified that the report, which complements its disclosure effectiveness initiative, was tailored to address the specific statutory mandates of the FAST Act.

In addition to evaluating the comments received in response to the concept releases, requests for comment, and rule proposals issued as part of the initiative, the Division staff intends to continue to make recommendations related to disclosure effectiveness for consideration.

Sustainability Accounting

As part of its concept release on Regulation S-K, the SEC sought public comment on disclosure of sustainability and public policy matters, characterized broadly as environmental, social, and governance concerns. This subject was also addressed in a separate panel consisting of practitioners as well as members of the Sustainability Accounting Standards Board. Panel members shared their views on the objectives and challenges of sustainability reporting and the status of the current standard-setting process in this area. See Deloitte's *Sustainability Disclosure — Getting Ahead of the Curve* for more information about market drivers and the reporting landscape.

Communications With the SEC — Reminders for Registrants

SEC Comment Letter Process

The SEC staff discussed its broad views on the SEC comment letter process. The staff stated that it continues to view this process as a dialogue between a registrant and the SEC and indicated that just because the staff asks a question does not mean that it has reached a conclusion or that a change is required. Thus, a registrant should not agree to include a disclosure in future filings solely to expedite the completion of a review. Further, the staff requested that if a registrant believes that a comment concerns an immaterial matter, the registrant should communicate this belief at the beginning of the process; the staff noted that such communication could save a lot of time during the review. In addition, the staff cautioned registrants about analogizing to other registrants' fact patterns, emphasizing that each comment letter review will depend on a company's specific facts and circumstances. The staff stated that while disclosures provided by other registrants and their responses to comment letters may be considered, they are typically not determinative.

Regarding transactional filings, the staff urged registrants to give the SEC time to appropriately evaluate substantive new information during the review process and pointed out that significant changes to a registration statement amendment shortly before a planned "roadshow" or registration statement effectiveness could result in delays. Registrants that anticipate such changes may consider giving their reviewers a "heads up" so that the staff has appropriate time to evaluate the new disclosures.

The staff also reminded registrants that while they are no longer required to provide "Tandy" language[8] in comment letter correspondence, the assertions covered by the Tandy language are still applicable.

> See Appendix B and Appendix C of Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* for more information regarding the SEC staff's review process and best practices for managing this process.

[8] On October 5, 2016, the SEC announced that registrants are no longer required to provide "Tandy" representations in comment letter correspondence. In the announcement, the Commission defines Tandy language as follows: a "name derived from the Tandy Corporation, the first company to receive a letter containing this language. Tandy letters required a company to acknowledge in writing that the disclosure in the document was its responsibility and to affirmatively state that it would not raise the SEC review process and acceleration of effectiveness as a defense in any legal proceeding."

Prefiling Letter Process

In addition to writing comment letters on a registrant's filings, the Division will consider registrants' requests for waivers and interpretations of SEC reporting requirements (prefiling letters).

Editor's Note

Requests for interpretations, accommodations, or waivers of financial reporting and disclosure requirements are generally directed to the Division's Office of Chief Accountant (CF-OCA). However, requests for accounting, financial reporting, and auditing interpretations, especially those involving (1) unusual or complex transactions for which there is no clear authoritative guidance and (2) auditor independence matters, would generally be directed to the SEC's OCA.

The staff discussed the prefiling letter process for topics addressed by the Division, hoping to find ways of making the process more efficient. The staff noted that these letters are often submitted by the registrant's attorney and may contain extraneous information or may refer to positions expressed in outdated speeches that the staff is no longer considering. Thus, the staff recommended that a registrant submitting a prefiling letter (1) focus on relevant facts, (2) propose solutions and provide adequate support for such proposals, and (3) show the letter to its auditors and consider their input before submitting the letter.

Editor's Note

During a different panel discussion, Mr. Olinger reminded registrants that the financial statement requirements for foreign investees or foreign acquirees differ depending on whether the entity meets the definition of a foreign business. He further noted that if the financial statement requirements do not make sense in the circumstances, registrants should consider preclearance with the SEC.

Accounting Standard Setting

Remarks of Russell Golden, FASB Chairman

Mr. Golden addressed the conference with a mix of fond reflection on the vast changes to the accounting standards during his tenure and eager forward thinking as the Board looks to continued cooperation with the IASB and other national standard setters.

Looking back, Mr. Golden stated his belief that the revenue, leases, and credit losses standards have been and will be viewed favorably by investors. In particular, he remarked on how ASC 606 will replace the often inconsistently applied existing revenue guidance and how, with the adoption of ASC 842, users will have a more faithful representation of an entity's leasing activities. He also lauded the efforts to collaborate among stakeholders — community banks and credit unions, auditors, users, and regulators — in a credit losses TRG before the final standard on that topic was issued in June 2016. He indicated that the FASB has been more responsive to a broader mix of constituencies, such as private companies and their financial statement users with the Private Company Council's ongoing counsel.

Looking forward, Mr. Golden sees continued opportunities for narrowly focused simplification projects. Specifically, the Board is making progress toward issuing a hedge accounting standard and an insurance accounting standard. The Board intends to permit hedge accounting for a broader range of risk management strategies. The insurance accounting standard is targeted to improve the accounting for long-duration contracts. Both of these projects are expected to be completed in 2017.

Technology remains front of mind for the FASB as investors continue to demand more timely financial information. Mr. Golden said that the Board will consider how to keep pace with technological developments to ensure that financial statement users are provided with "more relevant information, more quickly."

Regarding the international environment, Mr. Golden spoke on the importance of continuing to develop relationships with "the IASB and other national standard setters" since those relationships are critical to improving financial reporting and reaching "common solutions around the globe." He indicated that the FASB and IASB intend to hold joint meetings in 2017 to discuss their priorities and initiatives, as well as to continue collaborating on topics of mutual interest.

Editor's Note

In his keynote address, Mr. Bricker noted that the FASB and IASB should continue to regularly identify the needs of users and respond to those needs in a timely manner. He also provided an update on the possible use of IFRSs for domestic issuers, noting that "for at least the foreseeable future, the FASB's independent standard setting process and U.S. GAAP will continue to best serve the needs of investors and other users who rely on financial reporting by U.S. issuers." However, the SEC staff is continuing to consider the proposal outlined last year by former SEC Chief Accountant James Schnurr to allow domestic users to provide IFRS-based information as a supplement to GAAP financial statements.

FASB Standard-Setting Update

Ms. Cosper discussed the status of certain FASB projects, including the disclosure framework, inventory, income taxes, fair value measurement, pensions, hedging, long-duration insurance contracts, goodwill, and the definition of a PBE. For more information regarding the FASB's current projects, refer to the FASB's technical agenda and the respective sections elsewhere in this *Heads Up*.

Ms. Cosper also discussed feedback received to date on the FASB's Invitation to Comment on its future agenda. The Board intends to hold a public roundtable session in December 2016 to discuss the feedback before adding any of the potential projects to its agenda.

Remarks of Hans Hoogervorst, IASB Chairman

Mr. Hoogervorst cited the IASB's continued interest in finding common ground with the FASB, highlighting that U.S. investors, who have $7 trillion invested in IFRS reporters, have reason to advocate for increased convergence. He stated that the IASB intends to focus on improving existing standards after it issues its new standard on insurance contracts.

In addition, Mr. Hoogervorst noted that he shares the SEC's concern regarding the pervasive use of non-GAAP measures, expressing concern that non-GAAP measures are frequently used to depict a more favorable view of performance. He stated that the IASB intends to identify ways to provide guidance on the structure of the income and cash flow statements as well as on disclosures.

Auditing Developments

PCAOB Developments

In his keynote address, Mr. Doty reflected on the critical role that auditors play in the capital markets and how the PCAOB supports the accounting profession in meeting investor needs. Mr. Doty noted that the PCAOB's oversight of auditors (1) protects investors by promoting the integrity of audits; (2) raises awareness of the audit process, thus "helping companies maintain investor trust [and] avoid financial reporting failures"; (3) promotes high-quality audits and reduces the risk of audit failures; and (4) drives innovation and improvements in the audit. He also discussed the projects on the PCAOB's standard-setting agenda (summarized below), which he believes will ultimately benefit the capital markets and increase investor protection.

In addition, Mr. Doty highlighted recent PCAOB activities, including the Board's focus on:

- Enhancing its outreach to audit committees.
- Modifying its process of developing a standard-setting agenda, which will now include a research phase before a topic is added to the standard-setting agenda.
- Improving its research and economic analysis with respect to standard setting (including costs, benefits, and unintended consequences) and other activities.
- Initiating a post-implementation review (PIR) program with respect to its standards (initial PIR is currently being performed on its standard related to engagement quality reviews).
- Developing a proposal for a permanent inspection program for audits of broker-dealers.
- Strengthening its inspections abroad (e.g., by recently securing the renewal of the European Commission's adequacy determination with respect to the PCAOB, which allows the PCAOB to continue to conduct joint inspections of PCAOB-registered firms with European audit regulators) and enhancing the transparency of its inspections.

Standard Setting and Other Activities

Throughout the conference, the PCAOB and SEC staffs discussed developments in PCAOB standard setting and the projects on the PCAOB's planned research agenda. PCAOB Chief Auditor and Director of Professional Standards Martin Baumann focused his remarks on the topics discussed below.

Status of Proposed PCAOB Auditing Standards

Key proposed PCAOB standards of interest to investors, audit committees, and auditors are:

- *Auditor's reporting model* — In May 2016, the PCAOB reproposed changes[9] to the auditor's reporting model. While retaining the current "pass/fail" approach, the reproposal would require several significant modifications to the auditor's report, including the addition of a new section that describes "critical audit matters" (CAMs).[10] Mr. Baumann believes that reporting CAMs, and thereby sharing the most challenging and subjective aspects of the audit and how those matters were addressed, will enhance the value of the auditor's report and make the information in the financial statements more useful to investors.

  Both Mr. Doty and Mr. Baumann noted that similar expanded auditor reporting standards have been recently adopted in the United Kingdom[11] and by the IAASB,[12] and that the response from investors, issuers, and auditors has been positive. Mr. Doty also noted that while the changes proposed by the PCAOB differ from those in other jurisdictions, they would still allow auditors in the United States to provide reports that are more relevant, informative, and meaningful. The PCAOB received

[9] PCAOB Release 2016-003.

[10] See Deloitte's June 28, 2011, and November 2, 2011, *Heads Up* newsletters for summaries of the concept release and constituent responses, respectively, and Deloitte's September 5, 2013, *Heads Up* for a summary of the 2013 proposal. In addition, in April 2014, the PCAOB hosted a public meeting to obtain additional insights from a diverse group, including investor advocates, public companies, audit committees, audit firms, academics, and representatives from international standard-setting organizations; see Deloitte's April 30, 2014, *Heads Up* for an overview of the discussion.

[11] ISA (UK and Ireland) 700 (Revised June 2013), *The Independent Auditor's Report on Financial Statements*.

[12] ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, and a number of revised ISAs, including ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, and ISA 570 (Revised), *Going Concern*, issued in January 2015 by the IAASB, effective for audits of financial statements for periods ending on or after December 15, 2016.

extensive feedback through comment letters, public meetings, and discussions with its Standing Advisory Group (SAG) and Investor Advisory Group (IAG). The PCAOB staff has evaluated comments received and is drafting a final standard and adopting release for Board action.

See Deloitte's May 27, 2016, and October 14, 2016, *Audit & Assurance Update* newsletters for more information.

- *Auditing accounting estimates, including fair value measurements* — The PCAOB continues to analyze comments received on the staff consultation paper it issued in 2014, as well as feedback received from the SAG, CAQ, and the PCAOB pricing sources task force. The PCAOB sought input on (1) the potential need for changes to the Board's existing auditing standards to better address changes in the financial reporting frameworks related to accounting estimates and fair value measurements and (2) current audit practices that have evolved to address issues related to auditing accounting estimates and fair value measurements. In light of comments received, the PCAOB staff intends to closely coordinate the development and timing of this project on estimates with its project on the auditor's use of the work of specialists. In addition, the PCAOB staff is monitoring developments related to a similar project at the IAASB.

  The key issues the staff is considering in the development of the new standard are (1) the need for auditors to devote more attention to the wide range of measurement uncertainty inherent in the estimates and fair value measures, (2) consistent application of professional skepticism by auditors to address management's bias (which may include a potential new requirement to conduct a fraud brainstorming session, which would include a discussion on how financial statements could be manipulated through management bias), and (3) the use of pricing services by both management and auditors. The staff is developing a proposal, which it anticipates will be approved for public comment in the first quarter of 2017.

- *The auditor's use of the work of specialists* — The PCAOB's May 2015 staff consultation paper sought information to help address the potential need for improvement of PCAOB standards governing the auditor's use of the work of specialists (both management's specialists and the auditor's specialists). The key issues being considered on the basis of the comments received are (1) better alignment of the specialists' standard with the risk assessment standards and (2) strengthening the requirements related to the auditor's use of the work of the company's specialists. In addition, the staff is considering how the standards differentiate between specialists employed by the audit firm and specialists engaged by the auditors (and the appropriate oversight in both situations). The staff is developing a proposal for public comment in the first quarter of 2017.

- *Supervision of audits involving other auditors* — In April 2016, the PCAOB proposed amendments to its auditing standards to strengthen requirements that apply to auditors that are not part of the accounting firm that issues the audit report (i.e., "other auditors"). The proposal also includes a new standard for when the lead auditor divides responsibility with another firm (e.g., when the lead auditor needs to rely on the work of the equity investee's auditor). The amendments are designed to improve the quality of audits involving other auditors and to align with the PCAOB's risk-based standards. Mr. Baumann noted that the staff has been reviewing the comments received and is currently determining next steps. He added that the staff is considering the work undertaken on a related project at the IAASB.

See Deloitte's December 9, 2016, *Audit & Assurance Update* for a summary of the comments the PCAOB received.

- *Going concern* — The purpose of this project is to evaluate potential revisions to the existing PCAOB standard on the auditor's going-concern evaluation in light of changes in the relevant accounting requirements,[13] input from the SAG and IAG, observations from the Board's oversight activities, and relevant research. Mr. Baumann cited the PCAOB's Staff Audit Practice Alert 13, which reminds auditors to look at the existing PCAOB standards when evaluating whether there is substantial doubt about the company's ability to continue as a going concern and whether the auditor's report should be modified to include an explanatory paragraph. In addition, he emphasized that a determination that no disclosure is required under U.S. GAAP or IFRSs is not conclusive that no explanatory paragraph is required under the PCAOB auditing standards. The staff plans to closely monitor the effects of the accounting change and to continue its research and outreach activities to seek input on potential approaches to improving the performance and reporting requirements in the existing auditing standard on going-concern evaluations.

Recently Adopted Auditing Standards and Amendments

Mr. Baumann discussed the following recently adopted standards and amendments:

- *Reorganization of PCAOB auditing standards* — On March 31, 2015, the PCAOB adopted (1) amendments to reorganize its interim and final auditing standards in a topical structure with a single, integrated numbering system and (2) certain technical amendments to its rules and standards. The new organizational structure is intended to improve the usability of the Board's standards and help users navigate the standards more easily. The amendments do not impose new requirements on auditors or change the substance of the requirements for performing and reporting on audits under PCAOB standards. The reorganization and related amendments will be effective as of December 31, 2016.
- *Improving the transparency of audits* — On December 15, 2015, the PCAOB adopted new rules and amendments to require audit firms to (1) name the engagement partner who led the audit for the most recent period and (2) provide the names, locations, and extent of participation (as a percentage of the total audit hours) of other public accounting firms that took part in the audit (above a 5 percent threshold based on total audit hours). This information will be disclosed in a new form, Form AP, to be filed with the PCAOB by registered public accounting firms, and the information will be available in a searchable database on the PCAOB's Web site. The engagement partner name disclosure requirement will be effective for auditors' reports issued on or after January 31, 2017, and the requirements related to other accounting firms will be effective for auditors' reports issued on or after June 30, 2017.

Planned Research Agenda

Mr. Baumann explained the PCAOB's new planned research agenda and its planned approach to conducting the research. He identified the following current projects on the PCAOB's research agenda:

- *Improvements to quality control (QC) standards, including assignment and documentation of audit firm supervisory responsibilities* — The PCAOB staff is gathering and analyzing information from various sources (including from the work of a related IAASB task force) to identify the potential need for standard setting related to QC. The QC topics the PCAOB is exploring include (1) audit firm governance, leadership, and organization; (2) promoting uniformly effective practices related to root cause analysis and remediation of QC deficiencies; (3) using firm risk assessment to anticipate risks to the audit firm's QC and proactively address them; and (4) establishing appropriate QC with respect to other participants in the audit, including network firms.

[13] In accordance with ASU 2014-15, which is effective for annual periods ending after December 15, 2016, management is required to (1) evaluate the company's ability to continue as a going concern and (2) provide certain related disclosures.

- *Changes in the use of data and technology in the conduct of audits* — Large accounting firms are beginning to use technology-based audit tools that could fundamentally change how an audit is performed. However, these tools present their own set of challenges, which raise questions about whether PCAOB standards should be modified. The PCAOB staff will seek to understand how new technologies might affect the audit process, the technologies' potential benefits and their risks to audit quality, and implications for PCAOB standards.
- *Auditor's role with respect to other information and company performance measures* — Performance measures included in a company's annual report are considered "other information" and are subject to PCAOB standards that require auditors to read and consider the other information in documents containing audited financial statements. However, under current PCAOB standards, auditors do not have a responsibility to perform further audit procedures related to information presented outside the documents that contain audited financial statements. The PCAOB is considering the auditor's current role and whether it should be changed.
- *Auditors' consideration of noncompliance with laws and regulations* — The PCAOB staff will explore whether there is a need to provide better guidance to auditors on their responsibility when companies act illegally.

Implementation and Monitoring of New Auditing Standards

OCA Professional Accounting Fellow Jennifer Todling discussed the importance of having a strategy to implement and monitor new auditing standards. Ms. Todling pointed out that while initial auditing standard implementation starts with attention by auditors (and firm methodologies developed), various other stakeholders, including investors, audit committees, management, regulators, and academics, can contribute to the efforts of implementation and monitoring in the following ways:

- Investors can provide feedback to regulators and engage with the audit profession to share insights into how they are using information communicated by management and the auditor.
- Audit committees and management should consider engaging with auditors early on in the implementation of auditing standards. In addition, audit committees and management can monitor and identify best practices or challenges and share observations with auditors and regulators.
- Regulators should provide adequate guidance to facilitate successful implementation of new auditing standards and stay engaged with stakeholders to remain responsive in the post-adoption period.
- Academics can help evaluate and study the impact of changes to auditing standards, including changes to audit quality, and how the market and investors react to information provided by the auditor.

Inspection Staff Update and Common Findings

Ms. Munter provided an update on PCAOB inspections of registered audit firms. While the firms have made significant changes in the past few years, the recurring audit findings indicate that further changes are needed. Although Ms. Munter noted that she would expect some level of findings to continue, she warned that without elimination or significant reduction of the most troubling recurring findings, the firms should not expect that they should be able to satisfy the remediation requirements easily.

Ms. Munter discussed how the inspection process has evolved into a risk-based approach to identify emerging audit risks and firm-specific risks. She noted that the PCAOB has also refined its review of (1) firms' systems of quality controls; (2) their remediation efforts; and (3) their root cause analysis processes, which involve identification of both positive and negative quality events. In addition, she discussed the PCAOB staff's efforts to incorporate randomization into its risk-based selection process, which she believes would enable the staff to conclude on the state of audit quality, determine audit quality trends, and inform standard-setting activities.

Observations From 2016 Inspection Cycle

Ms. Munter provided an update on recent inspections results, noting that some improvements were observed in 2016 inspections as compared with 2015 inspections. She observed that positive results were achieved in the following three areas:

- Understanding the issuer and business processes, transactions, and controls to provide a better basis for planning the audit.
- Coaching and support of teams by the engagement team itself as well as by national office.
- Firm monitoring at both the engagement level and the firm level to proactively identify potential problems before it is too late to take action.

In addition, Ms. Munter identified areas in which inspections continue to identify significant findings. These areas include:

- *ICFR* — ICFR findings continue to be identified, with testing of management review controls being at the top of the list. Ms. Munter did note that ICFR is evaluated more than any other area during PCAOB inspections, which may contribute to the concentration of findings. She also highlighted that since many teams successfully test management review controls, there is evidence that the testing can be done well.
- *Assessing and responding to risks of material misstatement* — This remains on the list of challenging areas, although the PCAOB staff has seen improvements in testing system-generated data and reports. Ms. Munter noted that the teams that do a good job with the risk assessment and design of their audit approach have few, if any, inspection findings.
- *Accounting estimates, including fair value measurements* — This also remains a challenging area, but firms are taking significant remedial actions and building tools to improve the results.

Ms. Munter mentioned that during 2016, the PCAOB staff also focused on implementation of AS 18. She noted that there were many more findings in the broker-dealer audits than in the audits of issuers, adding that this was probably because broker-dealers have more related-party transactions.

Areas of Focus in 2017 Inspection Cycle

Ms. Munter discussed areas of focus in 2017, which will include data analytics and technology and the implementation of new PCAOB standards (e.g., transparency and related Form AP). New for 2017, there will be a group of inspectors dedicated to looking at financial services audits across firms. The PCAOB staff will also focus on audit areas affected by economic trends (e.g., oil and gas prices and the search for higher-yielding investments) and recurring areas discussed above. With respect to ICFR and risk assessment, the staff will focus on how the teams designed and performed their audit procedures to address the risks identified, including fraud risks. Other areas of focus will include implementation of new accounting standards (e.g., revenue recognition and leases) at a national office level to see what tools and requirements the firms have put in place with respect to what their clients are doing and how the teams are addressing the pending changes with their clients while maintaining auditor independence in the process. The staff will remain focused on going concern and will also inspect auditors' work related to companies' performance measures to see what, if anything, auditors are doing with respect to non-GAAP measures and whether their approach changes when a company is particularly aggressive in its use of non-GAAP measures. Multinational audits and the impact of European Union regulation related to mandatory auditor rotation, including the resulting impact on referred work, will also be subject to review in the next inspection cycle.

Data Analytics

Members of the panel on data analytics discussed the increased use of data analytics and technology to vastly transform how external and internal audits are conducted. In particular, panelists highlighted the use of data analytics to create visualizations, identify trends and anomalies in underlying data, and better understand businesses. From an external audit perspective, one panelist noted that data analytics can be used in risk assessment and further audit procedures to contribute to a more efficient and higher-quality audit. The panelist also acknowledged the potential need for auditing standards to evolve to address data analytic techniques, which may change the way auditors define audit evidence and evolve the thinking related to audits being viewed in separate and distinct phases. Another panelist discussed the use of data analytics in internal audits to enhance risk assessment, continuous monitoring, audit efficiency, and business advisory services.

Appendix A: SEC's Disclosure Effectiveness Initiative — Project Summaries and Deloitte Resources

The table below (1) summarizes certain projects that are directly or indirectly related to the SEC's disclosure effectiveness initiative and (2) provides relevant Deloitte resources that contain additional information about the projects. For additional information, see the SEC Spotlight and Deloitte's August 26, 2014, *Heads Up* on the initiative.

Disclosure Effectiveness Initiative

Project	Summary and Relevant Deloitte Resources
Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant (September 2015)	**Summary:** Assessment of the effectiveness of financial disclosure requirements in Regulation S-X that apply to certain entities other than the registrant (i.e., acquired businesses, equity method investees, guarantors, and issuers of guaranteed securities and affiliates whose securities collateralize registered securities). **Deloitte Resources:** October 6, 2015, *Heads Up* and November 23, 2015, comment letter.
Business and Financial Disclosure Required by Regulation S-K (Concept Release, April 2016)	**Summary:** Potential modernization of certain of Regulation S-K's business and financial disclosure requirements. **Deloitte Resources:** April 18, 2016, *Heads Up* and July 15, 2016, comment letter.
Modernization of Property Disclosures for Mining Registrants (Proposed Rule, June 2016)	**Summary:** Proposed modernization of the property disclosure requirements for mining properties to align them with current industry and global standards and regulatory requirements. **Deloitte Resource:** June 17, 2016, news article.
Disclosure Update and Simplification (Proposed Rule, July 2016)	**Summary:** Proposed amendments to disclosure requirements that may be redundant, duplicative, or outdated, or may overlap with other SEC, U.S. GAAP, or IFRS disclosure requirements. **Deloitte Resources:** July 18, 2016, *Heads Up* and October 5, 2016, comment letter.
Request for Comment on Subpart 400 of Regulation S-K Disclosure Requirements Relating to Management, Certain Security Holders and Corporate Governance Matters (August 2016)	**Summary:** Assessment of the disclosure requirements in Regulation S-K, Subpart 400, related to compensation as well as requirements related to corporate governance matters. **Deloitte Resource:** August 26, 2016, news article.
Exhibit Hyperlinks and HTML Format (Proposed Rule, August 2016)	**Summary:** Proposed requirements to make filings more navigable and require registrants to include hyperlinks to exhibits listed in the index of certain filings. **Deloitte Resource:** August 31, 2016, news article.

SEC Actions Complementing the Disclosure Effectiveness Initiative	
Project	**Summary and Relevant Deloitte Resources**
Form 10-K Summary (Interim Final Rule, June 2016)	**Summary:** Revisions to requirements that permit, but do not require, registrants to provide a summary of business and financial information in Form 10-K as long as the summary contains cross-references with hyperlinks to the related disclosures in Form 10-K. **Deloitte Resource:** June 2, 2016, journal entry.
Order Granting Limited and Conditional Exemption Under [the 1934 Securities Act] (June 2016)	**Summary:** Order allowing certain companies to use inline XBRL to voluntarily file structured financial statement data through March 2020. **Deloitte Resource:** June 13, 2016, news article.
Amendments to Smaller Reporting Company Definition (Proposed Rule, June 2016)	**Summary:** Proposal to increase the public float threshold from the current $75 million to less than $250 million to expand the number of companies that qualify for this classification and therefore take advantage of certain scaled disclosure requirements in Regulation S-X and Regulation S-K. **Deloitte Resource:** June 29, 2016, journal entry and August 23, 2016, comment letter.
Report on Modernization and Simplification of Regulation S-K (November 2016)	**Summary:** Report on certain specific SEC staff recommendations regarding ways to streamline and improve disclosures. **Deloitte Resource:** November 29, 2016, news article.

Appendix B: Selected Speakers

The table below lists speeches that were publicly available as of the date of this publication.

Sessions/Speakers
Keynote Address — SEC
Wesley Bricker, Chief Accountant, SEC
Keynote Address — PCAOB
James Doty, Chairman, PCAOB
FASB and IASB Chair Addresses
Russell Golden, Chairman, FASB
Hans Hoogervorst, Chairman, IASB
Center for Audit Quality Update
Cynthia Fornelli, Executive Director, CAQ
PCAOB Registration, Inspection, and Enforcement Updates
Claudius Modesti, Director, Enforcement & Investigations, PCAOB
OCA Policy Initiatives
Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant
Jenifer Minke-Girard, Assistant Deputy Chief Accountant, SEC's Office of the Chief Accountant
Marc Panucci, Deputy Chief Accountant, SEC's Office of the Chief Accountant
OCA Current Projects
Sylvia Alicea, Professional Accounting Fellow, SEC's Office of the Chief Accountant
Sean May, Professional Accounting Fellow, SEC's Office of the Chief Accountant
Brian Staniszewski, Professional Accounting Fellow, SEC's Office of the Chief Accountant
Jennifer Todling, Professional Accounting Fellow, SEC's Office of the Chief Accountant
Ruth Uejio, Professional Accounting Fellow, SEC's Office of the Chief Accountant
Jonathan Wiggins, Associate Chief Accountant, SEC's Office of the Chief Accountant

Appendix C: Glossary of Standards, Regulations, and Other Literature

The standards and literature below were cited or linked to in this publication.

FASB Literature

For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

See the FASB's Web site for the titles of citations to:

- Accounting Standards Updates.
- Proposed Accounting Standards Updates (exposure drafts and public comment documents).

SEC Literature

- Regulation S-K
  - Item 301, "Selected Financial Data"
  - Item 512(a), "Undertakings; Rule 415 Offering"
- Regulation S-X
  - Rule 2-01, "Qualifications of Accountants"
  - Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"
  - Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
  - Rule 4-08(g), "General Notes to Financial Statements; Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
- Staff Accounting Bulletins (SABs)
  - SAB Topic 13, "Revenue Recognition"
  - SAB No. 74, "Disclosures Related to New Accounting Standard on Revenue" (codified in SAB Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period")
  - SAB No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues"
- Releases
  - Proposed Rule 33-10201, *Exhibit Hyperlinks and HTML Format*
  - Release 33-10198, *Request for Comment on Subpart 400 of Regulation S-K Disclosure Requirements Relating to Management, Certain Security Holders and Corporate Governance Matters*
  - Proposed Rule 33-10110, *Disclosure Update and Simplification*
  - Proposed Rule 33-10107, *Amendments to Smaller Reporting Company Definition*
  - Proposed Rule 33-10098, *Modernization of Property Disclosures for Mining Registrants*
  - Release 34-78041, *Order Granting Limited and Conditional Exemption Under Section 36(a) of the Securities Exchange Act of 1934 from Compliance With Interactive Data File Exhibit Requirement in Forms 6-K, 8-K, 10-Q, 10-K, 20-F and 40-F to Facilitate Inline Filing of Tagged Financial Data*
  - Interim Final Rule 34-77969, *Form 10-K Summary*
  - Concept Release No. 33-10064, *Business and Financial Disclosure Required by Regulation S-K*
  - Proposal No. 33-9929, *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*
  - Final Rule No. 33-8176, *Conditions for Use of Non-GAAP Measures*

- *Financial Reporting Manual*
  - Topic 11, "Reporting Issues Related to Adoption of New Revenue Recognition Standard"
  - Topic 13, "Effects of Subsequent Events on Financial Statements Required in Filings"
- Financial Reporting Release
  - FRR No. 28, "Accounting for Loan Losses by Registrants"
- Other Literature
  - *Report on Modernization and Simplification of Regulation S-K*, November 2016
  - Industry Guide 6, *Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters*

PCAOB Literature

- Release No. 2016-003, *Proposed Auditing Standard — The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*
- Auditing Standard No. 18, *Related Parties*
- Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern*

CAQ and Audit Analytics

- *Cybersecurity: How CPAs and Their Firms Are Addressing a Dynamic and Complex Risk*

Appendix D: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
AS	PCAOB Auditing Standard
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
C&DI	SEC compliance and disclosure interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CEO	chief executive officer
CF-OCA	SEC's Division of Corporation Finance, Office of Chief Accountant
CPA	certified public accountant
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EITF	Emerging Issues Task Force
ETR	effective tax rate
FASB	Financial Accounting Standards Board
FPI	foreign private issuer
FRR	SEC Financial Reporting Release
FVO	fair value option
GAAP	generally accepted accounting principles
HTML	Hyper Text Markup Language
IAASB	International Auditing and Assurance Standards Board

Abbreviation	Description
IASB	International Accounting Standards Board
IAG	PCAOB's Investor Advisory Group
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing
IT	information technology
MD&A	Management's Discussion and Analysis
OCA	SEC's Office of the Chief Accountant
OCI	other comprehensive income
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PIR	post-implementation review
Q&A	question and answer
QC	quality control
SAB	SEC Staff Accounting Bulletin
SAG	PCAOB's Standing Advisory Group
SEC	U.S. Securities and Exchange Commission
TRG	transition resource group
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

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