Highlights of the 2019 AICPA Conference on Current SEC and PCAOB Developments

Executive Summary

The AICPA Conference on Current SEC and PCAOB Developments provides a forum for key stakeholders involved in the financial reporting process to come together and discuss issues and trends affecting accounting, financial reporting, auditing, and other matters. Attendees at this year’s conference left with a greater appreciation for the critical role stakeholder communication plays in maintaining investor confidence and in the delivery of high-quality financial reporting.

Topics that dominated the conversation at the conference included implementation and application of the FASB’s new standards on revenue recognition, leases, and credit losses; emerging issues, including reference rate reform, digital assets, and cybersecurity; SEC reporting matters; audit quality; auditor independence; and critical audit matters (CAMs). A theme addressed in many sessions was the effect of technology and innovation on auditors, practitioners, and regulators.

AICPA Vice Chairman and Deloitte & Touche LLP Partner Tracey Golden emphasized the exponential pace of change affecting the accounting industry. She highlighted the need to maintain the profession’s commitment to “providing services with honesty and integrity” and “protecting the public interest.” She also discussed proposed updates to the CPA licensure model that would focus on deepening foundational skill sets while also giving candidates the opportunity to build their knowledge in a specific discipline. The flexibility offered by a more adaptive approach is expected to better equip the “auditor of the future” with the skills necessary to react to emerging technologies and leverage data analytics.
In a keynote session, SEC Chairman Jay Clayton and SEC Chief Accountant Sagar Teotia discussed 2019 accomplishments and 2020 priorities, non-GAAP measures, international matters, and the role of the PCAOB, in addition to many of the topics outlined above. Mr. Clayton highlighted the SEC's focus on opportunities to modernize the Commission's approach to accomplishing its mission.

Mr. Teotia's remarks generally aligned with his statement issued in connection with the conference. His comments were related to stakeholder engagement, implementation of new GAAP standards, current standard-setting projects, interactions and collaboration with the PCAOB, audit quality, CAMs, international accounting and auditing matters, internal control over financial reporting (ICFR), audit committees, and innovation.

During the PCAOB panel discussion, Chairman William Duhnke III summarized the Board’s five-year plan and key priorities. He noted that in response to feedback from constituents on the need for changes within the PCAOB, the Board has been revisiting its internal operations, increasing outreach to external stakeholders, and looking into ways to innovate its own oversight.

These and other topics of discussion are summarized throughout this Heads Up. For additional details, see the published speeches from the conference.

**Accounting and Financial Reporting**

Adoption of the recent major FASB accounting standards on revenue recognition, leases, and credit losses remains a key focus for preparers, auditors, standard setters, and regulators. During the session on policy initiatives of the SEC Office of the Chief Accountant (OCA), Mr. Teotia commented on registrants’ implementation activities, which are discussed in more detail below.

In addition, the SEC staff discussed reference rate reform (i.e., the expected phaseout of LIBOR), equity method investments, and consolidation of variable interest entities (VIEs).

**Revenue Recognition**

The new revenue standard, ASC 606, has now been adopted by virtually all entities and continues to be a focus of the SEC staff. In his conference statement, Mr. Teotia acknowledged “the extensive and constructive efforts by standard setters, preparers, auditors, and others to successfully implement the new revenue standard.” He also commended stakeholders for their contributions to the “various industry task forces and forums to address questions on revenue recognition, measurement, presentation, and disclosure.”

The session on current OCA projects included remarks from OCA professional accounting fellows Susan Mercier and Lauren Alexander, who provided observations about two recent ASC 606 prefiling consultations. The consultations were related to the identification of performance obligations and the determination of whether an entity is a principal or an agent in a transaction and were summarized as follows:

- **Identifying performance obligations** — The consultation shared by Ms. Mercier involved a registrant that licenses software to its customers. The registrant's customers are application (“app”) developers, and the software allows customers to build and deploy apps on various third-party platforms. Those third-party platforms undergo frequent updates, which the registrant monitors. It then updates its own software product to maintain the software's utility for its customers.

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1 Public business entities (PBEs), certain not-for-profit entities, and certain employee benefit plans were required to implement the new revenue standard in annual reporting periods beginning after December 15, 2017, including interim reporting periods therein. All other entities were required to implement the guidance in annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.
The SEC staff did not object to the registrant’s conclusion that the initial software license and ongoing updates represent a single performance obligation. A key fact was that without the updates provided by the registrant, the customer’s ability to benefit from the software would significantly diminish over the term of the contract. The staff thought that the software and frequent updates were “inputs that together fulfill a single promise to the customer” since the combined output was “substantively different” from the individual promises of the software and updates.

However, Ms. Mercier emphasized that while a registrant may assert that its contract with a customer makes reference to a combined “solution,” such an assertion is insufficient on its own to support a conclusion that the combination of multiple promises into a single performance obligation is appropriate.

- **Principal-versus-agent determination** — The consultation shared by Ms. Alexander addressed whether a registrant is a principal or an agent when two parties are involved in providing services to a customer. The contract with the customer acknowledged that another vendor would be providing some of the services. The registrant was legally precluded from providing the services fulfilled by the other vendor, and the related marketing materials included the brands of the registrant and the other vendor. However, the other vendor did not have a contractual arrangement with the customer, and the registrant concluded that it was primarily responsible for fulfilling the promised services to the customer.

The SEC staff did not object to the registrant’s conclusion that it was acting as the principal in the arrangement and thus should record revenue on a gross basis. Although the registrant was legally precluded from performing some of the services, the registrant’s ability to enter into a contract with a different service provider, to define the scope of services to be performed on its behalf, and to direct the other vendor to provide services on its behalf were key facts supporting the view that the registrant controlled the services before they were transferred to the customer.

See Chapters 5 and 10 of Deloitte’s *A Roadmap to Applying the New Revenue Recognition Standard* for more information about identifying performance obligations and principal-versus-agent determinations.

The Division of Corporation Finance (the “Division”) is also focused on the new revenue standard. During the comment letter panel session, Chief of the Division’s Office of Real Estate and Construction Joel Parker noted that comments have focused on areas of the standard that require the application of judgment, such as the identification of performance obligations, the timing of revenue recognition, and the determination of whether the registrant is acting as a principal or as an agent.

The Division staff also noted an emerging trend related to incentive programs, especially for entities that manage a platform that connects suppliers to end users. Sometimes, incentives under these programs are paid to the end user in such a way that a registrant may conclude that the guidance on consideration payable to a customer is not applicable and that the incentives should be recognized as an expense. The importance of providing clear disclosures in MD&A about these types of arrangements, including both qualitative and quantitative information, was emphasized.

See Sections 2.17.1.1 and 2.17.2.4 of Deloitte’s *A Roadmap to SEC Comment Letter Considerations, Including Industry Insights* for more information about SEC comment letters related to the identification of performance obligations and the determination of whether the registrant is acting as a principal or as an agent in a transaction.
Lease Accounting

Most PBEs adopted the new leases standard, ASC 842, on January 1, 2019, and are therefore preparing to issue their first annual financial statements under the new guidance. The SEC staff noted that the standard’s implementation has been an area of focus, and Mr. Teotia encouraged stakeholders to continue to provide constructive feedback to the SEC and FASB staffs regarding any implementation challenges.

During the session on current OCA projects, OCA professional accounting fellows Erin Bennett and Aaron Shaw provided observations about two recent prefiling consultations on ASC 842. The consultations addressed specific fact patterns regarding (1) a lessor’s assessment of collectibility in a sales-type lease and (2) the transfer of control in a sale-and-leaseback transaction:

- **Lessor’s assessment of collectibility in a sales-types lease** — Ms. Bennett discussed a consultation involving a lessor with a history of high default rates on its leases. In accordance with ASC 842, lessor income recognition on a sales-type lease is deferred if collectibility is not probable at lease commencement. The registrant noted that its customers passed a credit evaluation at lease commencement and that its historical experience of default was “generally due to a change in the lessee’s circumstances subsequent to” the commencement date of the lease. The registrant believed that those considerations and other factors were sufficient to support an assertion that collectibility was probable as of the commencement date despite the registrant’s historical experience and its expectation that those high default rates would continue because of the lessees’ credit quality. The SEC staff objected to the registrant’s view that collectibility was probable. Ms. Bennett emphasized the importance of considering “all factors” in the analysis, which in this fact pattern included “the registrant’s assessment of the lessee’s credit quality and the registrant’s history of collections with similar lessees.”

- **Transfer of control in a sale-and-leaseback transaction** — Mr. Shaw discussed a consultation that focused on whether control was transferred in a sale-and-leaseback transaction. The registrant had transferred assets to a wholly owned VIE, the VIE leased those assets to a third party, and the third party leased a portion of those assets back to the registrant. In addition, the third party obtained a “substantive fixed price purchase option to acquire the underlying assets at the end of the lease term.” The registrant determined that (1) the combination of the lease and the purchase option gave the third party a “controlling financial interest in the VIE,” (2) transferring a controlling financial interest in the VIE along with a “leaseback” of the assets should be evaluated as a sale-and-leaseback transaction subject to ASC 842, and (3) the third party obtained control of the assets. The SEC staff objected to the registrant’s conclusion that the third party obtained control of the assets as required in the ASC 842 analysis and therefore objected to accounting for the transfer as a successful sale-and-leaseback transaction in accordance with ASC 842. The basis for the staff’s objection was that “control had not transferred because if the purchase option was not exercised the registrant would regain its controlling financial interest in the VIE.” The staff further noted that “an entity’s ability to prevent others from directing the use of and obtaining the benefits from the asset does not in and of itself establish control.”

The Division staff also discussed the new leases standard. During the comment letter panel session, Mr. Parker indicated that the Division staff is still in the early stages of reviewing
disclosures. While it is too soon to identify any trends or themes, Mr. Parker provided the following disclosure reminders for registrants as they prepare their annual financial statements:

- Consider the new standard's changes to disclosure requirements.
- Avoid boilerplate types of disclosures that simply restate the requirements of ASC 842.
- Tailor disclosures to specific lease arrangements and the assumptions that were used in applying the standard to those arrangements.

FASB member Susan Cosper discussed the new leases standard as well. She described the Board's post-effective-date procedures and indicated that the FASB will hold a leases roundtable in the spring of 2020 that will focus on (1) areas of the standard that continue to present challenges and (2) potential improvements to the standard. She specifically noted that the discount rate for lessees and embedded leases are two areas that have already been identified for discussion. Ms. Cosper also mentioned the deferral of the effective date of the new leases standard for certain entities. See the Adoption Dates and Transition Requirements for Accounting Standards section for more information.

See Deloitte’s A Roadmap to Applying the New Leasing Standard for an overview of the new standard.

Credit Losses

In his conference statement, Mr. Teotia noted that “[s]takeholders have been active in the implementation of [the credit losses] standard” and that the SEC has “observed significant progress” over the past year. The SEC staff has provided views through various consultation requests as well as through the issuance of SAB 119, which was codified as SAB Topic 6.M, in November 2019. SAB 119 makes conforming edits (related to ASC 326) to SAB Topic 6.L (often referred to as SAB 102), which contains the preexisting SEC staff guidance on methods and documentation related to loan loss allowances. As noted in SAB Topic 6.M, many of the concepts from SAB Topic 6.L continue to be relevant under the current expected credit loss (CECL) model.

Connecting the Dots

Various methods can be used by entities to estimate expected credit losses under the standard. SAB 119 states that the SEC staff “normally would expect a registrant to have a systematic methodology to address the development, governance, and documentation to determine its provision and allowance for credit losses.”

Ms. Alexander discussed observations about a recent CECL consultation that involved a registrant that holds mortgage loans and intends to estimate expected credit losses by using a discounted cash flow method upon adopting ASC 326. The mortgage loan terms require the borrower to make certain payments related to the underlying collateral (e.g., property taxes, homeowners’ association fees, and certain insurance premiums). The registrant has the right, but not the contractual obligation, to pay those amounts on behalf of the borrower if a borrower fails to do so (adding those advances to the amount due from the borrower). The registrant observed that the guidance in ASC 326-20 does not prescribe which specific cash flows should be included in the present value of expected cash flows under the discounted cash flow method. The registrant further observed that the underlying costs do not meet the definition of costs to sell the asset and that those costs are not included in the amortized cost basis of the loan. The SEC staff did not object to the registrant’s conclusion that it should not include potential future advances in its measurement of expected credit losses when it uses the discounted cash flow method.
In addition, Mr. Teotia, in a Q&A session, emphasized the importance of registrants’ SAB 74 transition disclosures leading up to the adoption of new standards. Mr. Teotia explained that the purpose of SAB 74 disclosures is to describe the implementation progress to investors, including progress to date and work yet to be completed.

The Division staff discussed non-GAAP measures that make adjustments specifically related to the credit losses standard. See the Non-GAAP Measures section for more information.

See Deloitte’s *A Roadmap to Accounting for Current Expected Credit Losses* for an overview of the new standard.

**Reference Rate Reform**

Chairman Clayton highlighted the Commission’s current focus on reference rate reform and indicated that registrants need to assess their exposure to LIBOR and decide how to actively manage that risk. Mr. Teotia echoed that sentiment in his conference statement, in which he cautioned registrants that “[t]he risks associated with this expected discontinuation and transition will be exacerbated if the work necessary to effect an orderly transition to an alternative reference rate is not completed in a timely manner.”

Given the complexity of the expected transition from LIBOR, Mr. Teotia strongly encouraged registrants that have not already done so to begin assessing their risks associated with it. His recommendation is consistent with the advice in the recent joint statement issued by SEC staff in the OCA, the Division, and the Divisions of Investment Management and Trading and Markets.

During the session on current OCA projects, OCA Professional Accounting Fellow Jamie Davis gave an update on OCA activities related to reference rate reform and highlighted the following three observations:

- **Cash flow hedges** — At the 2018 AICPA Conference on Current SEC and PCAOB Developments, the OCA staff described a consultation request related to how the anticipated transition away from LIBOR would affect the assessment of hedge effectiveness of a cash flow hedge of LIBOR-based variable rate debt. Ms. Davis indicated that registrants may continue to consider the SEC’s views expressed at the 2018 conference in the absence of authoritative guidance from the FASB.

- **FASB standard setting** — In September 2019, the FASB issued a proposed ASU that would provide optional guidance for a limited time to ease the potential burden of accounting for (or recognizing the effects of) reference rate reform. Ms. Davis noted that the OCA is “supportive of the FASB’s efforts in this area.”

**Connecting the Dots**

During the session on accounting standard setting, Acting FASB Technical Director Shayne Kuhaneck explained that the proposed ASU is intended to give entities relief by letting them account for amendments to instruments that are solely related to reference rate reform (e.g., simply changing LIBOR to another reference rate) as a continuation of the contract. Mr. Kuhaneck stressed that this optional guidance is not intended to apply if an entity rewrites other terms of the instrument in addition to changing the reference rate.

For more information about reference rate reform, see Deloitte’s August 6, 2019, *Heads Up* and July 22, 2019, journal entry.
Amendments to equity-classified preferred stock instruments — Ms. Davis discussed a recent consultation that involved the accounting implications of a potential amendment to an equity-classified preferred stock instrument as a result of the expected discontinuation of LIBOR. A feature of the preferred stock instrument was periodic dividend payments based in part on LIBOR. The potential amendment to the preferred stock instrument would solely be to replace the reference to LIBOR in the dividend formula with another rate. The registrant evaluated the amendment by applying a qualitative approach and concluded that since the changes were not significant, the amendment should be treated as a modification to the preferred stock. The SEC staff did not object to that conclusion. Ms. Davis highlighted that “[t]here is currently no explicit guidance in U.S. GAAP on how to account for amendments to preferred stock” and that “there are various acceptable approaches for analyzing . . . changes to determine whether they represent a modification or extinguishment.”

In the accounting for the modification of preferred stock, generally only incremental fair value is recognized. The registrant concluded that it would not recognize any change in fair value as a result of the modification. The SEC staff did not object to that determination.

Equity Method Investments

During the session on current OCA projects, Ms. Bennett described a recent prefiling consultation related to whether the equity method should be applied to an investment in a limited liability company (LLC) that maintained separate investor capital accounts. In accordance with ASC 323-30-599-1, investments in limited partnerships (LPs) and in LLCs that maintain separate capital accounts should be accounted for under the equity method in accordance with ASC 970-323-25-6 unless the investor’s interest “is so minor that the limited partner may have virtually no influence over partnership operating and financial policies.” In the prefiling consultation described by Ms. Bennett, the registrant held a 25 percent interest in the member units of an LLC with separate capital accounts. The registrant argued that the “virtually no influence” threshold did not apply to its investment since this threshold was (1) intended for real estate companies with “less complicated fact patterns” and (2) not appropriate for an investment whose nature and intent was “passive.” Accordingly, the registrant believed that an evaluation of the indicators of significant influence was more appropriate. Ms. Bennett stated that the SEC staff objected to that view and that its “longstanding position on the application of the equity method to investments in limited partnerships should be applied.” In this fact pattern, the staff concluded that “the registrant had more than ‘virtually no influence’ over the LLC.”

See Section 2.2.1, Table 3-1 in Section 3.2, and Section 3.2.3 of Deloitte’s A Roadmap to Accounting for Equity Method Investments and Joint Ventures for more information.
Consolidation of VIEs

During the session on current OCA projects, Mr. Shaw provided observations about two recent consultations related to the determination of the primary beneficiary of a VIE. Each consultation included a discussion of (1) the purpose and design of the VIE and (2) the variability that the VIE was designed to create and pass along to its variable interest holders. The consultations were summarized as follows:

- **Investment partnership** — The first consultation involved a registrant that invested in a newly formed LP that met the definition of a VIE. The registrant received LP interests in exchange for investable assets. The LP’s primary purpose was to manage the investable assets in accordance with broad investment guidelines. The general partner of the LP had the unilateral ability to make investment decisions to the extent permitted by those guidelines, which were, in part, developed by the registrant. Although the registrant could modify certain aspects of the investment guidelines, the intent of the guidelines was to allow the general partner to make day-to-day investment decisions. The registrant concluded that the activity that most significantly affected the VIE’s economic performance was directing the investment decisions of the LP. The SEC staff did not object to the registrant’s conclusion that the registrant was not the primary beneficiary of the VIE and therefore should not consolidate the LP.

  Mr. Shaw noted that among the factors the SEC staff considered was its observation that “while the registrant could modify certain aspects of the guidelines, it did not have the ability to significantly limit the general partner’s discretion over current and future investment decisions.”

- **Single-asset lessor** — The second consultation focused on the determination of the primary beneficiary in circumstances in which a VIE had multiple activities that affected the entity’s economic performance. The registrant in the consultation was the lessee of the VIE’s single asset — a single property. The lease term covered substantially all of the property’s economic life. The lease required the registrant to operate and maintain the property during the lease term; this obligation included significant structural maintenance. At the end of the lease term, the VIE had the right to sell the property. The VIE’s primary purpose was to provide investors with a return on their investment derived from the lease payments and the sale of the property at the end of the lease term. The registrant concluded that although it had multiple variable interests in the VIE, it did not have power over the activities that most significantly affected the VIE’s economic performance.

  Mr. Shaw noted that in light of the VIE’s purpose and design, variability was caused by risks that included lease negotiation risk, lessee credit risk, residual value risk, and operation and maintenance risk. He stressed that each activity does not necessarily have the same relative weight in a consolidation analysis. For example, the lease term represented substantially all of the property’s economic life. Lease negotiation risk, therefore, was not determined to be the most significant risk. In addition, as Mr. Shaw explained, “[a]ctivities related to lessee credit risk were not the VIE’s most significant activities because the registrant’s financial condition and the property’s strategic importance mitigated credit risk.”

  In the consultation, the SEC staff observed that the activities related to residual value risk and operation and maintenance risk were the most significant activities because the decisions related to these risks would most significantly affect the VIE’s economic performance. The registrant held the power to direct operation and maintenance decisions during the lease term, which would most significantly affect the VIE’s economic performance. Consequently, the staff objected to the registrant’s conclusion that the registrant did not have power over the activities that most significantly affected the VIE’s economic performance.
See Chapter 7 of Deloitte’s *A Roadmap to Consolidation — Identifying a Controlling Financial Interest* for more information related to the identification of the primary beneficiary of a VIE.

**SEC Reporting**

**Disclosure Areas of Focus**

**Complex and Emerging Risks**

Throughout the conference, presenters spoke about certain complex and emerging risks that companies may face, such as the expected phaseout of LIBOR, Brexit, and risks related to cybersecurity. In his remarks, Chairman Clayton stated that he believes that the consequences and the complexity that the anticipated phaseout of LIBOR will involve, particularly with respect to companies’ legacy assets and liabilities, are greatly underestimated. He encouraged registrants to assess the impact of LIBOR phaseout early and plan for the transition, emphasizing that “hope [that LIBOR will not be phased out] is not a strategy.”

In a comment letter panel session, Division staff noted the need for registrants to make transparent disclosures related to these emerging risks, which are not limited to Brexit, the expected transition away from LIBOR, and cybersecurity but may include other world events (e.g., tariffs; unrest in Hong Kong; and environmental, social, and governance matters). Chief of the Division’s Office of Trade and Services Mara Ransom emphasized that if companies expect the impacts of these evolving risks to be material, they should consider disclosures to address:

- How management assesses the risks.
- What management is doing to mitigate and manage the risks.
- What the board’s role is in risk oversight.

Ms. Ransom stated that in certain circumstances, companies should consider disclosing the status of their efforts to evaluate the impact of these risks as well as other significant matters that they have yet to address. In doing this, companies will need to monitor their disclosures and continually assess when their disclosures need to evolve. Ms. Ransom also stated that if a company has a potential risk that management cannot yet reasonably estimate, it should consider adding disclosures to alert investors that (1) the potential risk exists and (2) management cannot estimate the impact of the risk or identify what steps, if any, management needs to take to address the risk.

During a panel discussion of Division developments, Division Director William Hinman stated his view that when these risks have a material financial impact on companies, the current principles-based approach to disclosure within MD&A enables companies to use judgment in developing disclosures that provide investors with information that is consistent with the information management uses when evaluating risks.

**Connecting the Dots**

Mr. Hinman stated that a good practice for management is to consider what it is communicating to the board of directors when preparing disclosures related to emerging risks. He emphasized that there should not be a significant gap between the risks that are discussed at the board level and those disclosed to investors.
For additional information regarding disclosure considerations related to complex and emerging risks, see Section 3.3.2 of Deloitte’s A Roadmap to SEC Comment Letter Considerations, Including Industry Insights; Deloitte’s August 6, 2019, Heads Up; and the SEC’s 2010 interpretive release, Commission Guidance Regarding Disclosure Related to Climate Change.

**Non-GAAP Measures**

The SEC continues to focus on non-GAAP measures presented by registrants. In his remarks, Chairman Clayton emphasized that when registrants choose to present non-GAAP measures, they should use consistent calculations of the measures with adjustments that do not change from quarter to quarter; however, if changes to measures or adjustments are made, there should be clear and transparent disclosure of those changes. Mr. Clayton also suggested that such non-GAAP measures presented should be consistent with measures used by management to run the business. Further, when summarizing certain recent enforcement actions related to incorrect or misleading non-GAAP disclosures, SEC Enforcement Division Senior Enforcement Accountant Justin Sutherland emphasized that while non-GAAP measures can be useful to management and investors, these measures must be “accurate, consistent, and appropriately disclosed.”

Building on remarks made at last year’s conference, Division Deputy Chief Accountant Patrick Gilmore noted that the Division continues to see non-GAAP measures that apply individually tailored accounting principles. While the Division staff is open to understanding what such measures are intended to communicate to investors, Mr. Gilmore reminded participants that individually tailored accounting measures may not reflect the underlying economics of a transaction and that the staff will often object to such measures. Mr. Gilmore noted that non-GAAP measures that change the presentation of revenue required under GAAP from net (i.e., the entity is acting as an agent) to gross (i.e., the entity is acting as a principal), or vice versa, are examples of individually tailored accounting measures and are unlikely to be permitted.

See Section 4.3.3 of Deloitte’s A Roadmap to Non-GAAP Financial Measures for further guidance on individually tailored accounting principles.

Mr. Gilmore also highlighted certain considerations related to the presentation of “contribution margin,” a non-GAAP measure. He cautioned registrants that excluding costs that are necessary to generate revenues could result in a misleading measure. Further, he reminded registrants that the most comparable GAAP measure to contribution margin is generally a “fully loaded” GAAP gross margin. GAAP gross margin should be used as the starting point of the non-GAAP reconciliation of contribution margin and should be disclosed even if it is not otherwise presented on the face of the GAAP income statement.

See Section 3.2.1 of Deloitte’s A Roadmap to Non-GAAP Financial Measures for further guidance on the presentation of contribution margin.

Division Chief Accountant Kyle Moffatt discussed non-GAAP measures that make adjustments related to the new credit losses standard, noting that generally it would not be “appropriate to present a non-GAAP performance measure . . . to exclude the effects or impact of CECL or to . . . exclude the loan loss provision in its entirety.” Mr. Moffatt encouraged registrants to alternatively consider disclosing the impact of the new standard in MD&A. Further, Mr. Parker noted that for entities that adopted ASC 606 on a modified retrospective basis and included non-GAAP
measures with adjustments related to the transition to ASC 606, such adjustments generally would not be appropriate after the year of transition (because disclosure of the impact of adoption is not required under GAAP after the year of transition).

**Supplier Finance Programs**

Division Deputy Chief Accountant Lindsay McCord noted that the SEC staff has seen an increase in the use of supplier finance programs related to registrants’ trade payables. Those programs may also be referred to as supply chain financing, structured trade payables, reverse factoring, or vendor payables programs and may involve a paying agent or a financial institution. Ms. McCord commented that such programs often affect registrants’ liquidity and capital resources and operating cash flows by increasing the number of days that payables are outstanding. However, the SEC staff has observed a lack of disclosure regarding the use and, in some cases, the existence of those programs within MD&A.

When those programs are material to a registrant’s liquidity in the current period or are reasonably likely to materially affect liquidity in the future, the SEC staff expects registrants to consider disclosing the following information about them in MD&A:

- Their material and relevant terms.
- Their general benefits and risks.
- Any guarantees provided by subsidiaries or the parent.
- Any plans to further extend payable terms and factors that may limit registrants’ ability to continue to increase either the payment terms or the volume of transactions.
- Their trends and uncertainties, including information about the period-end accounts payable balance related to such programs and interperiod variations.

Ms. McCord encouraged registrants to consider the Commission’s interpretive guidance, issued in September 2010, on the presentation of liquidity and capital resources disclosures in MD&A. Although that guidance is related to repurchase agreements, registrants may wish to consider it by analogy, given that both repurchase agreements and supplier finance programs affect a registrant’s short-term financing.

**Connecting the Dots**

Recent SEC comment letters have requested analysis from registrants supporting the classification of amounts settled under supplier finance programs as trade payables or bank financing, including classification and noncash disclosure considerations in accordance with ASC 230. In October 2019, the FASB received an agenda request to provide guidance on (1) financial statement disclosures for supplier finance programs involving trade payables and (2) presentation in the statement of cash flows for such programs. Because there is no specific guidance in GAAP on such programs, registrants are encouraged to consider consulting with their accounting advisers.

**Stock Buybacks and Compensation Discussion and Analysis**

Mr. Hinman discussed the potential impact of stock buybacks on incentive compensation and related compensation discussion and analysis (CD&A) considerations. He noted that while registrants’ compensation committees often take stock buybacks into account when setting executive compensation, the CD&A disclosure may not include explanation or analysis of the committees’ considerations, and he encouraged registrants to expand their disclosures accordingly.

Further, Mr. Hinman noted that non-GAAP measures may be used as targets in the determination of compensation levels. While such non-GAAP measures are not subject to the reconciliation requirements of SEC Regulation G and SEC Regulation S-K, Item 10(e), when
included in CD&A, Mr. Hinman reminded registrants to disclose their method of calculating these measures, as required by SEC Regulation S-K, Item 402(b). Registrants may accomplish this by cross-referencing to the non-GAAP disclosures in other parts of their filing (e.g., MD&A) that outline a full reconciliation for these measures.

Working With the Division Staff

Ms. Ransom discussed the realignment of the Division and noted that it was intended to “promote collaboration, transparency and efficiency” in the work it does to protect investors and facilitate capital formation. For more information on the Division’s new organizational structure, including the names of the chief and the senior adviser of each review office, see the Division’s announcement.

During a panel discussion on SEC comment letter trends, the Division staff commented on several best practices for promoting efficient dialogue between registrants and the staff and offered the following tips for responding to comment letters:

- Provide the staff with contact e-mail addresses for the responding company and its outside counsel.
- Before providing courtesy paper copies, ask the reviewer if copies are needed or will be used.
- Clearly and directly address the issues raised in the comments.
- Share views on materiality with the staff early in the process to increase overall efficiency.
- Do not assume that the SEC has accepted an item solely because it has been reported similarly in another registrant’s filing.
- When calling the staff with an interpretive or procedural question, do not assume that the staff has all the facts. Responding companies should do the appropriate research, provide sufficient background information, and present an analysis that points to relevant authoritative literature.
- Communicate the intended use of novel transactions up front.
- Call the staff to discuss or get clarification on a staff comment.

See Appendix B of Deloitte’s A Roadmap to SEC Comment Letter Considerations, Including Industry Insights for additional information about best practices for working with the SEC staff.

Adoption Dates and Transition Requirements for Accounting Standards

On November 15, 2019, the FASB issued ASU 2019-10, which provides a framework to stagger effective dates for future major accounting standards and amends the effective dates for some new standards to give implementation relief to certain types of entities. Specifically, the standard (1) introduces a new “two-bucket” framework for determining the effective dates for future major accounting standards and (2) amends the effective dates for the new hedging, leases, and credit losses standards for certain types of entities.² The FASB had previously issued ASU 2019-09 to extend the adoption date for long-duration insurance contracts.

² In amending the effective dates for the new hedging and leases standards by issuing ASU 2019-10, the Board adjusted the newly developed framework because those standards were already effective for PBEs.
Under the Board's new framework, the buckets are defined as follows:

- **Bucket 1** — All PBEs that are SEC filers (as defined in GAAP), excluding smaller reporting companies (SRCs) (as defined by the SEC).
- **Bucket 2** — All other entities, including SRCs, other PBEs that are not SEC filers, private companies, not-for-profit organizations, and employee benefit plans.


**Entities Filing an Initial Registration Statement**

The two-bucket system is based on the FASB's definition of an SEC filer; SEC filers are a subset of PBEs. Ms. McCord explained that an entity that is in the process of an IPO does not meet the definition of an SEC filer until its initial registration statement is declared effective. Therefore, an entity may apply the Bucket 2 adoption dates for the financial statements included in its initial registration statement. After the initial registration statement is declared effective, however, the registrant must apply the Bucket 1 adoption dates for the financial statements included in its next filing unless the entity is an SRC or an emerging growth company (EGC) that has elected to defer adoption of the new standards.

For registrants that qualify as an SRC when they file their initial registration statement, Ms. McCord indicated that the staff would not object if they continue to apply the Bucket 2 adoption dates for the financial statements included in filings after their initial registration statement becomes effective. Ms. McCord suggested that participants look to the Division staff's Small Entity Compliance Guide for Issuers for additional information on the SRC definition and other matters related to SRCs.

**Connecting the Dots**

Registrants that apply the Bucket 2 adoption dates for the financial statements included in their initial registration statement should ensure that robust and comprehensive transition disclosures under SAB Topic 11.M (SAB 74) are provided in the footnotes to their financial statements and MD&A to disclose the expected effects of the new standard on their financial statements in the period of adoption.

Examples 1 and 2 below illustrate our understanding of the application of the transition requirements for the new credit losses standard (ASC 326).
Example 2 — SRC Registrant Files an Initial Registration Statement on Form S-1

Consider the same facts in Example 1, except that Registrant A qualifies as an SRC when it files an initial registration statement.

- Registrant A may apply the Bucket 2 adoption date for the financial statements included in its initial registration statement. Therefore, such financial statements would not be required to reflect the new credit losses standard.
- Registrant A may continue to apply the Bucket 2 adoption date for the financial statements included in filings after the initial registration statement is declared effective. Therefore, A may continue to apply the Bucket 2 adoption date for the financial statements included in its June 30, 2020, Form 10-Q.
- Registrant A will be required to adopt the new credit losses standard for fiscal years beginning after December 15, 2022, and interim periods therein.

Emerging Growth Companies

As noted in Topic 10 of the Division’s Financial Reporting Manual (FRM), “Title I of the Jumpstart Our Business Startups (JOBS) Act, which was effective as of April 5, 2012, created a new category of issuers called ‘emerging growth companies, or EGCs,’ whose financial reporting and disclosure requirements in certain areas differ from [those of] other categories of issuers.” For example, under SEC rules, an EGC is not required to comply with new or revised accounting standards as of the effective dates for PBEs and may elect to take advantage of the extended transition provisions by applying non-PBE (or private-company) adoption dates for as long as the issuer qualifies as an EGC.

See Deloitte’s A Roadmap to Initial Public Offerings for information about the criteria that must be met for an issuer to qualify as an EGC.

Ms. McCord addressed transition requirements related to the adoption of the new credit losses standard for EGCs. She clarified that ASUs 2019-09 and 2019-10 do not benefit non-SRC registrants that are EGCs that plan to adopt a new standard by using Bucket 2 adoption dates but subsequently lose their EGC status. Therefore, a registrant’s loss of EGC status before the non-PBE adoption date (Bucket 2) would affect its adoption date of a new standard.

In a manner consistent with Ms. McCord’s remarks and our understanding of the requirements, Example 3 below illustrates the application of the transition requirements for the adoption of the new credit losses standard (ASC 326). Although not explicitly discussed by the staff, Example 4 below further demonstrates our understanding of the transition requirements when a registrant loses EGC status after the end of the year of the Bucket 1 adoption date.
Example 3 — Calendar-Year-End Non-SRC Registrant Loses Its EGC Status on December 31, 2020

Assume that a non-SRC registrant is a calendar-year-end EGC that has elected to take advantage of the extended transition provisions and adopt the new credit losses standard by applying private-company adoption dates (Bucket 2).

If the registrant loses its EGC status on December 31, 2020, the registrant should:

<table>
<thead>
<tr>
<th>Adopt ASC 326:</th>
<th>For the annual period beginning on January 1, 2020.</th>
</tr>
</thead>
<tbody>
<tr>
<td>First present the application of ASC 326 in its:</td>
<td>2020 annual financial statements included in its 2020 Form 10-K.</td>
</tr>
<tr>
<td>Present the application of ASC 326 in its selected quarterly financial data (SEC Regulation S-K, Item 302(a)) for its:</td>
<td>2020 quarterly periods in its 2020 Form 10-K. Further, we believe that the registrant should provide clear and transparent disclosures that the quarterly financial data presented in its 2020 Form 10-K do not mirror the information in its 2020 Forms 10-Q for the current year.</td>
</tr>
<tr>
<td>Present the application of ASC 326 in its quarterly interim financial statements for its:</td>
<td>Comparable 2020 quarterly periods presented in Forms 10-Q in 2021.</td>
</tr>
</tbody>
</table>

Example 4 — Calendar-Year-End Non-SRC Registrant Loses Its EGC Status on December 31, 2021

Assume the same facts as in Example 3, except the registrant loses its EGC status on December 31, 2021. The registrant should:

<table>
<thead>
<tr>
<th>Adopt ASC 326:</th>
<th>For the annual period beginning on January 1, 2021.</th>
</tr>
</thead>
<tbody>
<tr>
<td>First present the application of ASC 326 in its:</td>
<td>2021 annual financial statements included in its 2021 Form 10-K.</td>
</tr>
<tr>
<td>Present the application of ASC 326 in its selected quarterly financial data (SEC Regulation S-K, Item 302(a)) for its:</td>
<td>2021 quarterly periods in its 2021 Form 10-K. Further, we believe that the registrant should provide clear and transparent disclosures that the quarterly financial data presented in its 2021 Form 10-K do not mirror the information in its 2021 Forms 10-Q for the current year.</td>
</tr>
<tr>
<td>Present the application of ASC 326 in its quarterly interim financial statements for its:</td>
<td>Comparable 2021 quarterly periods presented in Forms 10-Q in 2022.</td>
</tr>
</tbody>
</table>

**Effective Date for New Leases Standard for Entities That Meet the Definition of a PBE Solely Because Their Financial Statements or Financial Information Is Included in a Filing With the SEC**

The SEC staff announcement codified in ASC 842-10-S65-1 provides relief from the requirement to apply the PBE effective date for ASU 2016-02 for entities that meet the definition of a PBE solely because their financial statements or financial information is included in a filing with the SEC.\(^3\) The dates specified in the SEC staff announcement were not amended in connection with the issuance of ASU 2019-10.\(^4\) Ms. McCord suggested that such entities would be afforded the relief provided to other private entities through ASU 2019-10. Therefore, our understanding is that the staff would not object if these entities adopted ASC 842 for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

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\(^3\) For example, a disclosure required by SEC Regulation S-X, Rule 3-05, 3-09, 3-14, or 4-08(g).

\(^4\) ASC 842-10-S65-1 states that the “SEC staff would not object to a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity’s filing with the SEC adopting . . . ASC Topic 842 for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020” (emphasis added).
SEC Rulemaking Initiatives

Mr. Hinman discussed recent rulemaking initiatives, including efforts to streamline disclosure requirements, and the SEC’s fall 2019 regulatory agenda. He also encouraged stakeholders to provide feedback on proposed rules and other releases, including the SEC’s request for comment on earnings releases and quarterly reports, even after the comment period has closed.

Mr. Hinman discussed the SEC’s proposed rule on financial disclosures for significant acquired or disposed businesses, which, among other changes, would amend the presentation of pro forma information to require “management’s adjustments” to reflect synergies that (1) are reasonably estimable and (2) have occurred or are reasonably certain to occur. The Commission has received substantial feedback on this aspect of the proposed rule that underscores the potential challenges of estimating such pro forma adjustments. On the basis of the feedback received to date, the SEC staff is considering modifying the requirements related to management’s adjustments in the forthcoming final rule.

See Appendix A of this Heads Up for a summary of selected SEC rulemaking initiatives related to financial reporting as well as Deloitte resources that provide additional information about them.

Mr. Moffatt discussed Rule 3-13 waivers and noted that while the SEC has proposed several rules to streamline disclosure requirements, the Division will not “front run” rulemaking. That is, until such rules are finalized, the Division staff does not intend to grant waivers (1) in situations in which the Division staff has historically not provided relief under Rule 3-13 or (2) on the basis of concepts that the SEC may have included in a rule proposal but has not historically contemplated when evaluating requests for relief under Rule 3-13.

See Section B.2.1 of Deloitte’s A Roadmap to SEC Comment Letter Considerations, Including Industry Insights for more information about Rule 3-13 waiver requests.

Capital Formation (IPOs, Mergers, and Acquisitions)

Business Versus Asset Acquisition

Mr. Gilmore noted that the definition of a business for SEC reporting purposes in SEC Regulation S-X, Rule 11-01(d), differs from the definition in ASC 805. Mr. Gilmore acknowledged that in light of the recent changes in the definition of a business under ASC 805, there may be more instances in which an acquisition does not meet the definition of a business for accounting purposes but qualifies as a business for SEC reporting purposes. Mr. Gilmore stated that the SEC does not intend to change the SEC’s definition of a business to align with the GAAP definition, explaining that from an SEC reporting perspective, the objective is to evaluate whether financial statements of the acquired business would be useful for an investment decision. He observed that the underlying principle in the definition of a business for SEC reporting purposes is the determination of whether there is sufficient continuity of the acquired entity’s operations before and after the transactions, noting that revenue is just one factor for a registrant to consider. He emphasized that an acquired business that does not have revenue may still meet the definition of a business under SEC Regulation S-X, Article 11.

5 SEC Regulation S-X, Rule 3-13, gives the SEC staff the authority to permit the omission or substitution of certain financial statements otherwise required under Regulation S-X “where consistent with the protection of investors.”
Predecessor Financial Statements

When an IPO involves a reorganization of the entity (e.g., a spin-off or put-together transaction), identification of the registrant’s predecessor(s) may be necessary if the registrant did not have substantive operations for all periods presented in the IPO registration statement. Senior Advisor to Division Chief Accountant Craig Olinger emphasized the importance of identifying any predecessors early in the IPO process and encouraged consultation with the Division’s Office of the Chief Accountant. He reminded registrants that identifying the predecessor(s) is a balance between providing the history of the business and providing information on the specific operations in which the IPO investor is investing.

Mr. Olinger reiterated several criteria that registrants should consider when identifying their predecessors: (1) the order in which the entities were acquired, (2) the size of the entities, (3) the fair value of the entities, and (4) the historical and ongoing management structure. Mr. Olinger also encouraged registrants to evaluate their determination of predecessors in light of how management intends to discuss its business in the IPO registration statement as well as whether financial information in its subsequent Forms 10-K would provide sufficient information to investors. He noted that while there may be situations in which there is more than one predecessor, it would be rare for no predecessor to be identified unless the registrant is a start-up business.

Financial Statements in Special-Purpose Acquisition Company Transactions

The Division staff noted that it has seen an increase in the number of transactions involving special-purpose acquisition companies (SPACs). SPAC transactions and reporting requirements are unique and often complex. Mr. Gilmore commented that the Division staff has received a number of questions regarding the financial statement requirements related to an entity acquired by a SPAC, such as those involving the number of years of audited financial statements that need to be included when both the SPAC and the target are EGCs. Mr. Gilmore indicated that the number of years required depends on whether the SPAC has filed its initial Form 10-K after its IPO. If the SPAC has not yet filed its initial Form 10-K, the staff would not object to including only two years of the SPAC’s operating target’s audited financial statements in the filings. In contrast, if the SPAC has filed its initial Form 10-K, three years of the SPAC’s operating target’s audited financial statements are generally required in the filings.

Ms. McCord commented that the Division staff has also received questions regarding the audit requirements of the financial statements for the entity acquired by a SPAC. She explained that the private operating company financial statements included in a SPAC’s merger proxy or other filings must be audited in accordance with PCAOB standards. She further advised that the Division staff would also expect the financial statements of the acquired entity to include the GAAP presentation and disclosure elements required for public companies (e.g., earnings-per-share presentation and segment disclosures).

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6 If a business is not identified as a predecessor, it would generally be evaluated under SEC Regulation S-X, Rule 3-05. Therefore, in an IPO registration statement, the financial statements of nonpredecessor entities may be provided under Rule 3-05. However, for subsequent Forms 10-K, only the financial statements of the registrant and its predecessor(s) would be required.
Connecting the Dots

SPAC acquisition transactions are often treated as reverse recapitalizations or reverse mergers. In those cases, the acquired entity succeeds to the SPAC’s filing status. Given their complexity, we recommend early engagement with Division staff, and consultation with a qualified adviser.

See Deloitte's *A Roadmap to Initial Public Offerings* for additional information about reporting considerations related to SPAC transactions.

SEC Reporting Issues Related to Foreign Nonissuer Financial Statements

Mr. Olinger discussed certain reporting issues that have arisen in practice related to foreign nonissuer financial statements required by SEC Regulation S-X (e.g., financial statements provided to satisfy the requirements of SEC Regulation S-X, Rule 3-05 or Rule 3-09, for foreign acquirees or investees, respectively). Cross-border acquisitions and investments make these issues relevant for both domestic and international registrants.

Use of IFRS Standards

Financial statements provided under Rule 3-05 or Rule 3-09 must be prepared in accordance with or reconciled to GAAP unless the acquiree is a foreign business, in which case the financial statements may be prepared in accordance with IFRS® Standards as issued by the International Accounting Standards Board (IASB®). Mr. Olinger noted that the SEC staff considers relief requests under Rule 3-13 in circumstances in which a foreign acquiree does not qualify as a “foreign business” but would qualify as a foreign private issuer and thus could present financial statements in accordance with IFRS Standards if it filed a registration statement.

See Section 1.12.1 of Deloitte's *A Roadmap to SEC Reporting Considerations for Business Combinations* and Section 1.1.2 of Deloitte’s *A Roadmap to SEC Reporting Considerations for Equity Method Investees* for further details.

Financial Statement Periods Required by SEC Regulations and IFRS Standards

Mr. Olinger highlighted that there are certain circumstances in which the periods required for financial statements provided in accordance with SEC regulations may not be considered a full set of financial statements as defined under IFRS Standards. While the SEC rarely accepts qualified audit opinions, Mr. Olinger indicated that for financial statements of nonissuers that are filed to comply with Rule 3-05 or Rule 3-09, the SEC would accept an audit opinion that is qualified solely with respect to omissions of the following:

- The comparative period required by IFRS Standards when only one year of financial statements is required in accordance with Rule 3-05.
- The comparative period required by IFRS Standards when a registrant acquires an equity method investment and Rule 3-09 requires financial statements to be provided only for the period in which the investee is accounted for under the equity method.
- The balance sheet as of the date of adoption required by IFRS 1 when the financial statements provided reflect the first-time adoption of IFRS Standards and such adoption date precedes the periods required under SEC regulations.
**Abbreviated Financial Statements**

In certain circumstances, the SEC accepts a statement of assets acquired and liabilities assumed and revenue and direct expenses (i.e., abbreviated financial statements) in lieu of full financial statements. Mr. Olinger explained that, when appropriate and consistent with existing SEC guidance on abbreviated statements (e.g., the guidance in Section 2065 of the FRM), such abbreviated financial statements may be prepared in accordance with IFRS Standards provided that certain additional disclosures are included. The specific considerations and disclosure requirements were discussed at the CAQ's International Practices Task Force joint meeting with the SEC staff on May 21, 2019.

**Audit Standards**

Mr. Olinger reminded registrants that the SEC requires financial statements that are filed to satisfy the requirements of Rule 3-05 or Rule 3-09 to be audited in accordance with U.S. GAAS or the standards of the PCAOB, as applicable. The SEC staff noted that it does not have delegated authority to waive the requirement that the financial statements be audited in accordance with the standards of the PCAOB or AICPA (e.g., to provide relief by allowing a registrant to submit financial statements that are audited under International Standards on Auditing or jurisdictional auditing standards).

**Accounting Standard Setting**

**Remarks of Russell Golden, FASB Chairman; Susan Cosper, FASB Member; and Shayne Kuhaneck, Acting FASB Technical Director**

Mr. Golden expressed gratitude for the support he has received during his term as FASB chairman, which will conclude in June 2020. He emphasized the importance of open communication between the Board and stakeholders and noted that such dialogue is crucial to both the development and implementation of new accounting standards. Mr. Golden, Ms. Cosper, and Mr. Kuhaneck discussed the FASB's short- and long-term projects.

**Short-Term Projects**

**Reference Rate Reform Relief**

The FASB has proposed guidance to help entities navigate the expected phaseout of LIBOR to a successor rate (e.g., SOFR). Mr. Kuhaneck explained that the proposed guidance is intended to alleviate the “chaotic accounting” that rate reform could cause. The proposed guidance is intended to provide relief related to hedge accounting, modification of contracts, and the ability to reclassify held-to-maturity instruments to available for sale. See the Reference Rate Reform discussion for additional information.

**Hedge Accounting**

The FASB issued a proposed ASU on hedging on November 12, 2019. Mr. Kuhaneck explained that while the proposed ASU is lengthy, its overall purpose is to simplify the guidance in ASC 815 and clarify the Board’s intent related to ASU 2017-12.

See Deloitte’s November 26, 2019, Heads Up for more information about the proposed ASU.
Distinguishing Liabilities From Equity

Ms. Cosper explained that determining whether an instrument should be classified as a liability or within equity can be onerous and that the complexity of the determination frequently results in financial statement restatements. The FASB has proposed amendments under which events or contingencies that have a remote probability of occurring would not affect the classification analysis. The proposal would simplify the classification evaluation by reducing the number of conditions that must be considered. In addition, the proposed ASU would remove the treasury stock method as a means of calculating diluted earnings per share and the requirement to separately recognize certain embedded conversion options.

See Deloitte's August 8, 2019, Heads Up for more information about the proposed ASU.

Long-Term Projects

The Board is conducting research with relevant stakeholders to assess whether it can improve its guidance on segments. Also, as part of its financial performance reporting (FPR) project, it is researching an approach for further disaggregating expenses in either the income statement or footnote disclosures. The Board developed, and is seeking feedback from stakeholders on, an “internal view” approach under which the disaggregation of expenses would reflect how an entity internally manages its expenses. Ms. Cosper acknowledged that the segments and FPR projects are related and that the Board is evaluating the potential overlap between them. In addition, the FASB is researching potential improvements to the accounting for goodwill. Stakeholders’ views on the accounting for goodwill are diverse, and they have shown unprecedented interest in the project.

Remarks of Sue Lloyd, IASB Vice Chair

Ms. Lloyd outlined the IFRS Standards that have been significantly enhanced in the past decade, including those on financial instruments (IFRS 9), revenue recognition (IFRS 15), leases (IFRS 16), and insurance contracts (IFRS 17). In addition, she discussed the following IASB priorities:

- Increasing the consistency and comparability of financial metrics disclosed by entities by potentially standardizing common metrics, such as operating profit.
- Researching nonfinancial reporting metrics that investors and stakeholders find meaningful.
- Ensuring that the IASB provides the interpretive guidance needed to support the consistent application of IFRS Standards.

Emerging Technologies and Sustainability

Accounting and Auditing Aspects of Blockchain and Digital Assets

Various conference presenters and panelists spoke about the impact of emerging technologies, such as blockchain and digital assets, on capital markets and financial reporting. During a panel discussion on blockchain and digital assets, commenters highlighted the establishment of a joint Digital Assets Working Group under the AICPA's ASEC, ASB, and FinREC committees that is developing nonauthoritative guidance for preparers and auditors to consider when accounting for and auditing digital assets.
Deloitte & Touche LLP Partner Amy Steele highlighted challenges that practitioners may face when auditing companies that are involved in the digital asset ecosystem. In response to these challenges, the working group plans to issue sets of Q&As that will provide guidance on both accounting and auditing matters related to digital assets. The first set of accounting Q&As, which is expected to be issued soon, will focus on providing guidance to address the initial measurement, subsequent measurement, and derecognition of digital assets. The second set of accounting Q&As will focus on specialized topics, including accounting-specific considerations for investment companies and broker-dealers. Auditing Q&As are expected to be released as a series beginning in the first quarter of 2020. For more information, see the AICPA’s Digital Asset Resources page.

Connecting the Dots

The SEC staff noted that its Strategic Hub for Innovation and Financial Technology published a Framework for “Investment Contract” Analysis of Digital Assets, which focuses on the analysis of whether a digital asset is offered and sold as an investment contract and therefore is a security.

See Deloitte’s 2019 Global Blockchain Survey for more insights into the evolving digital assets and blockchain ecosystem.

Beyond the Financial Statements — Sustainability Disclosures

During a panel on sustainability matters, commenters discussed (1) requests for more transparent and accessible sustainability disclosures; (2) challenges associated with those disclosures, including inconsistency among companies; and (3) the auditor’s role in providing assurance over the sustainability information. Further, panelists highlighted a recently issued CAQ article, The Role of Auditors in Company-Prepared Information: Present and Future.

See Deloitte’s September 24, 2019, Heads Up, which discusses various developments in the marketplace that have resulted in increased pressure on companies to disclose or improve the transparency of environmental, social, and governance topics and the move by some companies toward disclosing such information in their financial filings.

The Auditor’s Communication of CAMs

The requirement to communicate CAMs is now effective for audits of large accelerated filers and thus was a consistent focus at the conference. Throughout the conference, panelists recognized the implementation efforts undertaken as a result of this requirement, including the efforts made by the PCAOB to provide timely staff guidance and resources for investors and audit committees.

OCA Observations About CAMs

During the session on current OCA projects, OCA Professional Accounting Fellow Louis Collins observed that CAMs do not have a one-to-one relationship with the critical accounting estimates disclosed by management. In some instances, CAMs have related to components of critical accounting estimates; in other cases, they are not related to critical accounting estimates at all.

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7 Effective dates are as follows:
- Communication of CAMs for audits of large accelerated filers: audits for fiscal years ending on or after June 30, 2019.
- Communication of CAMs for audits of all other companies: audits for fiscal years ending on or after December 15, 2020.
Mr. Collins indicated that when describing how matters were addressed in the audit, auditors have provided a brief overview of the audit procedures performed, including the related internal control procedures. He emphasized the importance of meaningfully describing the procedures that were responsive to the principal considerations that led the auditor to identify the matter as a CAM. Mr. Collins also encouraged users of the financial statements to focus on those principal considerations rather than simply comparing the number and nature of CAMs year over year or across companies and industries.

Mr. Collins also reminded participants that “[i]t’s important to remember that CAMs are not intended to be inherently positive or negative, so quantitative comparisons involving the number of CAMs across companies may not be meaningful.” His remarks were echoed by the PCAOB staff, other SEC staff members, and other panelists.

Other Observations About CAMs

In a separate panel discussion with investors, PCAOB staff members, and auditors, commenters noted that drafting CAMs early in the audit process allows the auditor to have timely discussions with management and the audit committee about the consistency of CAMs and the company's disclosures. To the extent that information about the company is necessary to describe the CAMs and has not been made (or is not planned to be made) publicly available by the company, such discussions provide an opportunity for management and the audit committee to consider making changes to the company’s financial statement disclosures or other sections of the filings. During the panel discussion on developments in the Division, the SEC staff also emphasized that it will be reviewing CAMs for consistency with the financial statements and other sections of the registrant’s filing (e.g., MD&A).

Connecting the Dots

Note 2 to Paragraph 14 of PCAOB Auditing Standard 3101 states that “the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit.”

During the PCAOB Board discussion, PCAOB member James Kaiser commented that the most frequently communicated CAMs were goodwill and intangible assets, revenue recognition, taxes, and business combinations.

To support the implementation of CAMs and provide more timely and useful information, the PCAOB selected 12 audits of large accelerated filers with fiscal years ending on or after June 30, 2019, and reviewed auditors’ implementation of the CAM requirements. Observations from those reviews were similar to the OCA's CAM observations. For more information about the PCAOB’s activities related to CAM implementation, see its Critical Audit Matters Spotlight. See Appendix B of this Heads Up for a summary of CAMs by topic as of December 6, 2019.

See Deloitte’s April 2019 On the Board’s Agenda for more information about some of the biggest challenges regarding the communication of CAMs in the auditor’s report and how the challenges can be overcome.

In addition, see Deloitte’s August 30, 2019, Heads Up for more information about some of the lessons learned during the dry runs related to the communication of CAMs in the auditor’s report.
Other Auditing and PCAOB Developments

PCAOB Developments

During the PCAOB’s keynote panel discussion, Board members reflected on the past year. In particular, they discussed the progress the PCAOB has made on executing its 2018–2022 strategic plan.

Panelists also discussed the PCAOB’s continued focus on outreach and transparency. Chairman Duhnke described the Board’s focus on engagement with stakeholders, including the creation of an office of external affairs within the PCAOB and meeting with more than 800 investors and approximately 600 audit committee members.

The PCAOB’s (1) new standard for auditing accounting estimates and (2) amendments to the existing auditing standards related to an auditor’s use of the work of specialists during an audit were both adopted in 2018 and were approved by the Commission this year.

Audit Firms’ System of Quality Control

The PCAOB announced that it will be holding a public meeting on December 17, 2019, at which the Board will vote on a concept release seeking comments on potential changes to the existing PCAOB quality control standards. The concept release will seek input on elements of a good system of quality control, including topics such as governance, risk assessment, monitoring, continuous improvement, and firm reporting on quality. PCAOB Chief Auditor Megan Zietsman indicated that this project has been prioritized because the PCAOB believes strongly that “an effective quality control system is a key foundational element in promoting the performance of consistent high-quality audits” and that requiring firms to establish strong systems of quality control is key to the Board’s strategic objective of shifting toward a more preventive regulatory approach.

Use of Data and Technology in Audits

Ms. Zietsman provided an update on the PCAOB’s research project related to the use of data analytics and certain emerging technology in audits.

- The PCAOB continues to monitor the insights from its Standing Advisory Group’s Data and Technology Task Force (the “Task Force”). The Task Force helps Board members understand how auditors and preparers are using data analytics and technology.

- The PCAOB began a deep dive into two auditing standards (PCAOB Auditing Standard 2110 and PCAOB Auditing Standard 1105) to understand how data and technology are being used by auditors in performing audits today.

Ms. Zietsman acknowledged that the current standards do not prescribe or prohibit the use of technology (e.g., data analytics) in the performance of an audit and indicated that the PCAOB staff is being thorough before proceeding with changes to the standards in this area.

See Deloitte’s Cognitive Technologies: Bringing Value to the Audit Process for more information.

PCAOB Inspections

The PCAOB continues to evaluate its processes and the structure of its inspections program. Board member Duane DesParte stated that the Board is working to ensure that there is consistency across inspections to improve inspections and audit quality. The Board also established a team to review the systems of quality control at audit firms and an inspection team to specifically focus on certain “targeted areas” that will change over time.
During a session focused on PCAOB inspection updates, PCAOB Division of Registration and Inspections Director George Botic described the redesigned inspection report, which is intended to be clearer and easier to read. The report is expected to be available beginning in the first quarter of 2020. The new format adds comparative information, reduces boilerplate language, and classifies Part I findings. The Part I classifications will differentiate between deficiencies that relate to obtaining sufficient information to support the audit report and other deficiencies, such as those related to workpaper archiving, audit committee communications, or Form AP.

Mr. Botic communicated common themes from the 2019 inspection cycle, including ICFR, revenue recognition, allowance for loan losses and other accounting estimates (including fair value measurements), and auditor independence.

The key areas of focus for 2020 inspections will include firms' system of quality control, auditor independence, implementation of new auditing standards, recurring inspection deficiencies, and other areas such as digital assets, cybersecurity risks, and consideration of omitted procedures.

**Auditor Independence**

Throughout the conference, auditor independence was a focus of the SEC staff members in their comments related to rulemaking and enforcement. The staff noted the importance of auditors' being independent both “in fact and appearance,” as outlined in SEC Regulation S-X, Rule 2-01, to enhance the credibility of audited financial statements.

OCA Associate Chief Accountant Vassilios Karapanos stated that the staff became aware of “significant practical challenges” associated with applying the requirements in SEC Regulation S-X, Rule 2-01(c)(1)(ii)(A) (the “Loan Rule”), specifically when the auditor has a lending relationship with certain shareholders of an audit client. For example, the Loan Rule in certain situations was triggered by an auditor’s lending relationship with a shareholder when that shareholder passed a 10 percent bright-line shareholder ownership test, even in situations in which the shareholder “would not have been able to assert any influence over the audit client whose shares it owned.” Accordingly, the SEC adopted amendments to the Loan Rule to address “some of the practical compliance challenges associated with the rule . . . without compromising the objective of preventing shareholders who have a ‘special and influential role’ with the audit client from having a lending relationship with the auditor. The amendments became effective on October 3, 2019.

In addition, the OCA staff revised its frequently asked questions (FAQs) on auditor independence matters. The revisions, posted to the Commission's Web site in June 2019, reorganized the structure of the FAQs to match that of the independence rules and included the addition of 10 new FAQs. Further, the staff made substantial changes to certain FAQs as a result of consultation trends it had observed.

Conference speakers reiterated ongoing statements by SEC staff that compliance with the SEC’s auditor independence rules is a responsibility shared by the audit client and its auditor. Mr. Karapanos provided examples of how auditors, management, and the audit committee can help prevent independence violations from occurring. The staff expects to continue to focus on potential changes to the auditor independence rules.
## Appendix A — Summary of SEC Rulemaking Initiatives and Deloitte Resources

The table below (1) summarizes certain SEC rulemaking initiatives related to financial reporting and (2) provides links to relevant Deloitte resources that contain additional information about those projects.

<table>
<thead>
<tr>
<th>Project</th>
<th>Summary and Relevant Resources</th>
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<td><strong>Final Rules</strong></td>
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| *Inline XBRL Filing of Tagged Data* (effective for first Form 10-Q filed after June 15, 2019, for large accelerated filers; June 15, 2020, for accelerated filers; and June 15, 2021, for all other operating companies)* | **Summary:** Amendments that require registrants to use the inline XBRL format for the submission of operating company financial statement information and mutual fund risk/return summaries.  
**Deloitte Resource:** July 3, 2018, *Heads Up*.                                                                                                        |
| *FAST Act Modernization and Simplification of Regulation S-K* (generally effective for filings on or after May 2, 2019) | **Summary:** Rule that simplifies certain disclosure requirements in SEC Regulation S-K and related rules and forms. The changes affect requirements related to MD&A, the description of properties, risk factors, the redaction of confidential information, hyperlinks, and cross-references.  
**Deloitte Resource:** March 25, 2019, *Heads Up*.                                                                                                         |
| *Disclosure Update and Simplification* (effective for filings on or after November 5, 2018) | **Summary:** Amendments to certain disclosure requirements that were redundant, duplicative, overlapping, outdated, or superseded.  
| *Smaller Reporting Company Definition* (effective September 10, 2018) | **Summary:** Amendments that expand the definition of an SRC to include companies with less than $250 million of public float or less than $100 million in annual revenues and either no public float or a public float that is less than $700 million. SRCS are permitted to take advantage of certain scaled disclosure requirements in SEC Regulation S-X and SEC Regulation S-K.  
**Deloitte Resource:** July 2, 2018, *Heads Up*.                                                                                                         |
| **Proposed Rules**                                |                                                                                                                                                                                                                                |
| *Update of Statistical Disclosures for Bank and Savings and Loan Registrants* (issued September 17, 2019) | **Summary:** Proposal to update the statistical disclosures that bank and savings and loan registrants provide to investors and to eliminate disclosures that overlap with the Commission's rules, GAAP, or IFRS Standards. The Commission's proposed rules would also add disclosure requirements related to certain credit ratios and information about bank deposits, including uninsured amounts.  
**Deloitte Resources:** September 18, 2019, *news article* and November 25, 2019, *comment letter*.                                                                 |
<table>
<thead>
<tr>
<th>Project</th>
<th>Summary:</th>
<th>Deloitte Resources:</th>
</tr>
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<tbody>
<tr>
<td><strong>Proposed Rules</strong></td>
<td><strong>Summary:</strong> Proposal to change the disclosure requirements related to a registrant’s description of its business, legal proceedings, and risk factors. The proposed amendments would expand the use of a principles-based approach that would give registrants more flexibility to tailor their disclosures with respect to the description of their business and the risk factors. The amendments would also add human capital disclosures to the business section and require risk factors to be organized under relevant headings.</td>
<td>August 20, 2019, <em>Heads Up</em>.</td>
</tr>
<tr>
<td><em>Modernization of Regulation S-K Items 101, 103, and 105</em> (issued August 8, 2019)</td>
<td><strong>Summary:</strong> Proposal to amend the accelerated filer and large accelerated filer definitions to exclude issuers with both annual revenues of less than $100 million and public float of less than $700 million. The proposed amendments would expand the number of issuers that qualify as nonaccelerated filers and are thus eligible to take advantage of certain reporting accommodations offered to such issuers. The most significant of these accommodations is the elimination of the requirement that an issuer obtain an audit report on ICFR from its independent auditor, as currently required under Section 404(b) of the Sarbanes-Oxley Act of 2002.</td>
<td>May 14, 2019, <em>Heads Up</em> and July 26, 2019, <em>comment letter</em>.</td>
</tr>
<tr>
<td><em>Amendments to the Accelerated Filer and Large Accelerated Filer Definitions</em> (issued May 9, 2019)</td>
<td><strong>Summary:</strong> Proposal to amend the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations and related pro forma financial information. These changes are intended to improve the information that investors receive regarding acquired or disposed businesses, reduce the complexity and costs of preparing the required disclosures, and facilitate timely access to capital.</td>
<td>May 9, 2019, <em>Heads Up</em> and July 26, 2019, <em>comment letter</em>.</td>
</tr>
<tr>
<td><em>Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities</em> (issued July 24, 2018)</td>
<td><strong>Summary:</strong> Request for comment on a number of items related to current quarterly reporting requirements and practices, including (1) the frequency of periodic reporting, (2) the extent of quarterly disclosures, (3) the relationship between required Forms 10-Q and voluntary earnings releases, and (4) the relationship between quarterly reporting and a focus on short-term results.</td>
<td>December 21, 2018, <em>Heads Up</em> and March 20, 2019, <em>comment letter</em>.</td>
</tr>
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</table>
Appendix B — Summary of CAMs by Topic

The chart below summarizes CAMs by topic from 196 Forms 10-K, 20-F, and 40-F that were filed as of December 6, 2019, from data obtained from Audit Analytics.
Appendix C — Titles of Standards 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).
- Superseded Standards (including FASB Interpretations, Staff Positions, and EITF Abstracts).

SEC and SEC Staff Literature

- Regulation S-K
  - Item 10, “General”
  - Item 101, “Description of Business”
  - Item 103, “Legal Proceedings”
  - Item 105, “Risk Factors”
  - Item 302, “Supplementary Financial Information”
  - Item 402, “Executive Compensation”

- 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 3-10, “Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”
  - Rule 3-13, “Filing of Other Financial Statements in Certain Cases”
  - Rule 3-14, “Special Instructions for Real Estate Operations to Be Acquired”
  - Rule 3-16, “Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered”
  - Rule 4-08, “General Notes to Financial Statements”
  - Article 11, “Pro Forma Financial Information”
  - Rule 11-01, “Presentation Requirements”

- SAB Topics
• Releases
  o Final Rule No. 33-10513, Smaller Reporting Company Definition
  o Final Rule No. 33-10514, Inline XBRL Filing of Tagged Data
  o Final Rule No. 33-10532, Disclosure Update and Simplification
  o Final Rule No. 33-10618, FAST Act Modernization and Simplification of Regulation S-K
  o Final Rule No. 33-10648, Auditor Independence With Respect to Certain Loans or Debtor-Creditor Relationships
  o Interpretation No. 33-8350, Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations
  o Interpretation No. 33-9106, Commission Guidance Regarding Disclosure Related to Climate Change
  o Interpretation No. 33-9144, Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management’s Discussion and Analysis
  o Proposed Rule No. 33-10526, Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities
  o Proposed Rule No. 33-10635, Amendments to Financial Disclosures About Acquired and Disposed Businesses
  o Proposed Rule No. 33-10668, Modernization of Regulation S-K Items 101, 103, and 105
  o Proposed Rule No. 33-10688, Update of Statistical Disclosures for Bank and Savings and Loan Registrants
  o Proposed Rule No. 34-85814, Amendments to the Accelerated Filer and Large Accelerated Filer Definitions
  o Request for Comment No. 33-10588, Request for Comment on Earnings Releases and Quarterly Reports
• FRM Topics
  o Topic 2, “Other Financial Statements Required”
  o Topic 10, “Emerging Growth Companies”
• Other Literature
  o Staff Statement on LIBOR Transition
  o Framework for “Investment Contract” Analysis of Digital Assets

**PCAOB Literature**

• Auditing Standards
  o No. 1105, Audit Evidence
  o No. 2110, Identifying and Assessing Risks of Material Misstatement
  o No. 3101, The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion
• Release
  o No. 2017-001, The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards
• Other Literature
  o The Role of Auditors in Company-Prepared Information: Present and Future
  o Investor Resource: Critical Audit Matters — Insights for Investors
  o Audit Committee Resource: Critical Audit Matters — Insights for Audit Committees
  o Critical Audit Matters Spotlight

**CAQ Resource**

_The Role of Auditors in Company-Prepared Information: Present and Future_
International Standards

IFRS 1, *First-Time Adoption of International Financial Reporting Standards*

IFRS 9, *Financial Instruments*

IFRS 15, *Revenue From Contracts With Customers*

IFRS 16, *Leases*

IFRS 17, *Insurance Contracts*
## Appendix D — Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>ASB</td>
<td>AICPA's Auditing Standards Board</td>
</tr>
<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
</tr>
<tr>
<td>ASEC</td>
<td>AICPA's Assurance Services Executive Committee</td>
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<tr>
<td>ASU</td>
<td>FASB Accounting Standards Update</td>
</tr>
<tr>
<td>CAM</td>
<td>critical audit matter</td>
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<tr>
<td>CAQ</td>
<td>Center for Audit Quality</td>
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<tr>
<td>CD&amp;A</td>
<td>compensation discussion and analysis</td>
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<tr>
<td>CECL</td>
<td>current expected credit loss</td>
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<tr>
<td>CPA</td>
<td>certified public accountant</td>
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<td>EGC</td>
<td>emerging growth company</td>
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<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<tr>
<td>FAST Act</td>
<td>Fixing America's Surface Transportation Act</td>
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<tr>
<td>FAQ</td>
<td>frequently asked question</td>
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<td>FinREC</td>
<td>AICPA's Financial Reporting Executive Committee</td>
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<td>FPR</td>
<td>financial performance reporting</td>
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<tr>
<td>FRM</td>
<td>SEC Division of Corporation Finance Financial Reporting Manual</td>
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<tr>
<td>GAAP</td>
<td>generally accepted accounting principles</td>
</tr>
<tr>
<td>GAAS</td>
<td>generally accepted auditing standards</td>
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<td>IASB</td>
<td>International Accounting Standards Board</td>
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<td>ICFR</td>
<td>internal control over financial reporting</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<tr>
<td>IPO</td>
<td>initial public offering</td>
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<tr>
<td>ISQM</td>
<td>International Standard on Quality Management</td>
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<td>JOBS Act</td>
<td>Jumpstart Our Business Startups Act</td>
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<tr>
<td>LIBOR</td>
<td>London Interbank Offered Rate</td>
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<tr>
<td>LLC</td>
<td>limited liability company</td>
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<tr>
<td>LP</td>
<td>limited partnership</td>
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<tr>
<td>MD&amp;A</td>
<td>Management's Discussion &amp; Analysis</td>
</tr>
<tr>
<td>OCA</td>
<td>SEC Office of the Chief Accountant</td>
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<td>PBE</td>
<td>public business entity</td>
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<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
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<tr>
<td>Q&amp;A</td>
<td>question and answer</td>
</tr>
<tr>
<td>SAB</td>
<td>SEC Staff Accounting Bulletin</td>
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<td>SAG</td>
<td>PCAOB's Standing Advisory Group</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SOFR</td>
<td>Secured Overnight Financing Rate</td>
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<tr>
<td>SPAC</td>
<td>special-purpose acquisition company</td>
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<tr>
<td>SRC</td>
<td>smaller reporting company</td>
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<tr>
<td>VIE</td>
<td>variable interest entity</td>
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<tr>
<td>XBRL</td>
<td>eXtensible Business Reporting Language</td>
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