Issues In-Depth

2015 AICPA National Conference on Current SEC and PCAOB Developments

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2015 AICPA Conference Highlights

The AICPA's National Conference on Current SEC and PCAOB Developments held December 9-11, 2015, featured speakers from the SEC, PCAOB, FASB, IASB, Center for Audit Quality (CAQ), AICPA, preparers, auditors, and others who discussed recent developments and initiatives in accounting, auditing, and financial reporting.

You, together with the standard setters and the regulators, have a vital stake in ensuring that our capital markets remain the safest and strongest in the world – and we all share the responsibility. Key to our mutual success is maintaining high-quality reporting of reliable and relevant financial information that investors can use to make informed investment decisions.

Mary Jo White, *SEC Chair*

ICFR as a Foundation of Reliable Financial Reporting

A consistent message focused on the importance of internal control over financial reporting (ICFR) in the development of high-quality, reliable financial reporting. Specifically, the respective roles of preparers, auditors, and audit committees in the financial reporting process were highlighted.

- ***Preparers***. Financial statement preparers are critical to producing high-quality, reliable financial reporting and the effectiveness of ICFR is a key element of the financial reporting process.
- ***Auditors.*** While investor confidence in audited financial statements is improving and financial statement restatements have decreased, auditors need to continue to improve their audits of the effectiveness of ICFR.
- ***Audit Committees.*** Audit committees fulfill a critical role in their oversight of preparers and auditors, and concern was expressed over the increasing demands being placed on their members in addition to their key function as a gatekeeper to the public securities markets.

Implemention of New and Forthcoming Accounting Standards

Successful implementation of the new joint revenue recognition standards, including the continued collaboration among industries and countries to promote consistent application, was highlighted as critically important to investors. Speakers noted that lessons learned from the implementation of the revenue standards will be important to apply to the forthcoming changes to lease accounting and impairment of financial assets.

High-Quality, Decision-Useful Reporting

Whether preparing financial statement disclosures, reviewing management's discussion and analysis, considering disclosures about how audit committees fulfill their responsibilities, or navigating the expected impacts of the new standards, speakers emphasized the need to set aside a checklist mentality. At the same time, preparers must adhere to existing disclosure rules and requirements, and apply reasoned judgments so that they are able to provide the most useful, high-quality, and reliable information to investors. Speakers described a positive trend of preparers treating periodic filings as more of a communication document than a compliance exercise.

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Development of High Quality Financial Reporting

Internal Control over Financial Reporting (ICFR)

The accounting profession must remain focused on one overarching goal, which is to provide investors with high-quality, decision-useful information that allows for informed investment decisions and facilitates capital formation.

James Schnurr, *Chief Accountant, OCA*

Mary Jo White, SEC Chair, emphasized the importance of preparers recognizing that management's ability to fulfill its financial reporting responsibilities significantly depends on the design and effectiveness of ICFR. While some initially questioned the value of ICFR, the SEC now generally hears from stakeholders that the ICFR requirements have improved financial reporting. "It is hard to think of an area more important than ICFR to our shared mission of providing high-quality financial information that investors can rely on," said Chair White.

She also commented on the debate about whether companies and auditors are being required to prepare documentation and perform testing of controls that is unnecessary. Chair White referred to ongoing discussions about these issues among the PCAOB, investors, the audit profession, and preparers that the staff of the Office of the Chief Accountant (OCA) has been observing. She said that any challenges in the operation and assessments of ICFR need to be addressed to the extent appropriate, "but at the end of the day, ICFR must remain the strong bulwark of reliable financial reporting that it has become."

James Schnurr, Chief Accountant, OCA, noted that deficiencies in ICFR audits continue to be one of the most frequent findings in PCAOB inspections. Mr. Schnurr encouraged preparers to take a broader view of these inspection findings. He said that ICFR audit deficiencies may also be indicative of deficiencies in management's controls and assessments. As a result, auditors, management, and audit committees need to focus on the ongoing maintenance, improvement, and assessment of ICFR. He encouraged these parties to engage in robust dialogue about the effectiveness of ICFR in the context of existing guidance from the SEC and PCAOB.

Assessing ICFR. Mr. Schnurr discussed current ICFR matters with a panel that included Brian Croteau, Deputy Chief Accountant, OCA; Jeanette Franzel, PCAOB Board Member; and Helen Munter, Director, Registrations and Inspections, PCAOB, as well as representatives from preparers and auditors.

Panel Discussion on Current Topics in ICFR

Entity-level and Management Review Controls

- Mr. Croteau indicated that the SEC's 2007 Management Guidance highlights three levels of entity-level controls: indirect controls, monitoring controls, and direct controls.[1] Only direct entity-level controls, also known as management review controls (MRCs), might be designed at a level of precision that would adequately prevent or detect on a timely basis misstatements that could result in a material misstatement of the financial statements.
- Some preparers expressed concern about a diminishing reliance on MRCs by auditors and increased testing of transaction or process-level controls in response to PCAOB inspections.

[1] SEC Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available at https://www.sec.gov/rules/interp/2007/33-8810.pdf.

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- Ms. Franzel, Mr. Croteau, and other panelists emphasized the need for management and auditors to adequately understand the flow of transactions and related financial reporting risks and to design and test controls that adequately address these risks.
- Both management and auditors have experienced difficulties with assessing the precision of MRCs. Mr. Croteau emphasized that without understanding the precision at which an MRC functions, it is not possible to understand whether the control sufficiently addresses the relevant financial reporting risks.
- Ms. Munter reminded preparers and auditors to consider whether an entity-level control is sufficient to operate on its own in isolation, or whether it depends on the effective design and operation of other controls.
- If an MRC relies on other controls, Mr. Croteau stated that the effectiveness of those lower-level controls will also need to be evaluated. Mr. Croteau and Ms. Munter pointed to COSO 2013, the SEC's 2007 Management Guidance, and PCAOB Staff Practice Alert No. 11 as resources in evaluating precision of MRCs.[2]

Evidence and Documentation

- Panelists noted that the level of evidence needed to support the design and operating effectiveness of controls should vary based on the related financial reporting risk and the risk of control failure. Neither the SEC's 2007 Management Guidance nor PCAOB Auditing Standards prescribe a "one size fits all" approach to the evidential matter required of management or the auditor.
- Ms. Munter and Mr. Croteau said that as the risk of material misstatement increases, the evidence required to support the proper functioning of a control also increases.
- Panelists agreed that checklists and templates used by auditors have been helpful, but should be flexible and tailored to the level of risk.

Communication

- The panelists emphasized the need for ongoing communication between management and auditors, especially when there are different views about what levels of controls are necessary to test and how much documentation and evidence is necessary. These discussions are best held early in the ICFR evaluation process.
- Mr. Croteau indicated that it may be appropriate for the audit committee to become engaged when there are different views between management and the auditor about risk assessment, the population of controls to test, and the nature and extent of evidence related to ICFR.
- The PCAOB and SEC staffs plan to continue their outreach with preparers and auditors on these topics during 2016.

[2] PCAOB Staff Audit Practice Alert No. 11, Considerations for Audits of Internal Control Over Financial Reporting, available at http://pcaobus.org/Standards/QandA/10-24-2013_SAPA_11.pdf.

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Control Deficiencies. Mr. Croteau pointed out that for the second year, reporting of material weaknesses increased in circumstances when no associated material misstatement was identified. He said this indicated that some ICFR reminders recently given by the SEC staff are being heard. However, he noted that a further reminder is still warranted to properly identify and describe the nature of a control deficiency and to understand the complete population of transactions that a control is intended to address before assessing the severity of any identified deficiencies.

Mr. Croteau stated that the final conclusions on severity of deficiencies contemplates both known errors, if any, and the potential misstatements for which it is reasonably possible that the misstatements would not be prevented or detected in light of the control deficiency, or the "could" factor. Too often this part of the evaluation appears to be an afterthought in a company's analysis. Further, it is important that information used in evaluating the severity of control deficiencies is reliable.

Other ICFR Considerations. Mr. Croteau emphasized the importance of ongoing consideration to implementing or redesigning controls as necessary in connection with the application of new accounting standards and policies. He said that to a large degree, management's ability to successfully transition to new accounting standards will depend on the effective design and operation of ICFR.

Mr. Croteau reminded management to consider its quarterly obligations to disclose material changes to ICFR, including situations where the changes are made before adopting a new standard, when those changes also affect current period financial reporting.

Audit Committee

Mr. Schnurr highlighted that oversight of preparers and auditors by qualified, independent, and tough-minded audit committees can further enhance the quality of financial reporting. He warned that many audit committees have assumed a number of responsibilities that extend beyond their specific regulatory obligations. He reinforced how important it is not to lose sight of the key SEC and exchange listing requirements for audit committee performance.

In the environment of growing audit committee agendas, it is important not to lose sight of the key SEC and exchange listing requirements for audit committee performance.

James Schnurr, *Chief Accountant, OCA*

Mr. Schnurr spoke about audit committees' responsibilities to oversee independent auditors, and emphasized that in fulfilling this responsibility, audit committee members should not act as management advocates. James Doty, PCAOB Chairman, also expressed this concern and said that what an audit committee signals about matters such as fees may create incentives for auditors that do not promote audit quality. He emphasized the importance of the audit committee's role in championing auditor objectivity by maintaining appropriate oversight of the auditor.

An additional responsibility of the audit committee is the requirement to report to investors on the audit committee's work and conclusions. With the backdrop of evidence that some audit committees are disclosing supplemental information about key areas of auditor oversight, and in an effort to make reporting more meaningful to investors, the SEC is undertaking a project to consider whether improvements could be made to the audit committee's reporting requirements.

The OCA staff is currently analyzing comments on its concept release on possible revisions to audit committee disclosures, which was issued this

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summer.[3] The release highlights a range of areas related to the audit committee's oversight of the independent auditor as well as the desire of investors for additional disclosures about the audit committee's work in other areas.

Many commenters supported considering whether and how to improve existing disclosure requirements. However, there were mixed views about whether additional detailed disclosure requirements were needed. Some suggested that voluntary efforts could be sufficient. The OCA staff is continuing to evaluate the responses received and determining what it should recommend to the SEC. In the meantime, Mr. Croteau encouraged audit committee members to continue to evaluate the usefulness of their disclosures and to consider whether additional insight about how the audit committee executes its responsibilities would make the disclosures more meaningful.

Audit Quality

Audit committee members report that audit quality has steadily improved and has never been higher. However, the perceived improvement cannot lead to complacency.

James Schnurr, *Chief Accountant, OCA*

Mr. Schnurr said that the audit committee members that he has spoken with have said that audit quality has steadily improved and has never been higher. However, he warned that the perceived improvement cannot lead to complacency. He also emphasized that now is the time to anticipate and proactively respond to new and emerging risks to audit quality to ensure the gains achieved in recent years can be sustained. This is particularly important in light of major accounting changes, such as the changes to revenue recognition.

Mr. Doty spoke about the changing cycle of inspection findings over the last several years. In 2011, there was a peak in inspection findings, and many of the firms' remediation activities were being challenged. Over time, remediation has begun to yield positive results for some firms.

Mr. Doty also spoke about the PCAOB's interim inspection program for audits of SEC-registered brokers and dealers. He explained that the PCAOB is using the interim program to learn where PCAOB oversight can most effectively protect customers, who do not necessarily rely on a broker-dealer's financial statements as much as they focus on compliance with customer protection requirements. The PCAOB plans to use this analysis to develop rules for a permanent inspection program.

Cynthia Fornelli, Executive Director, CAQ, spoke about the CAQ's Audit Quality Indicators (AQI) pilot program, which was designed to gather feedback from external auditors and audit committees about the extent of auditors' efforts in collecting AQI information and their usefulness to audit committees in discharging their oversight responsibilities.[4] The findings from the program suggested that audit committees are the appropriate audience to receive information about AQIs, and highlighted that engagement-level AQIs are more valuable than firm-level AQIs. Further, both audit committees and audit firms were proponents of the voluntary and flexible use and reporting of AQIs. The next step for the CAQ will be to gather empirical evidence to evaluate how potential AQIs correlate with audit quality.

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[3] SEC Release No. 33-9862; 34-75344, Possible Revisions to Audit Committee Disclosures, available at www.sec.gov.

[4] CAQ Approach to Audit Quality Indicators, available at http://www.thecaq.org/docs/reports-and-publications/caq-approach-to-audit-quality-indicators-april-2014.pdf?sfvrsn=2.

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In July 2015, the PCAOB released for public comment its *Concept Release on Audit Quality Indicators*, which seeks input on the content and possible uses of a group of potential AQIs.[5] Jay Hanson, PCAOB Board Member, noted that the AQI project is one where he believes the PCAOB can experiment with driving improvements in audit quality by providing information and encouraging voluntary compliance and disclosure before determining whether regulation is needed.

Independence

Mr. Croteau indicated that auditor independence is the foundation of the auditing profession and is necessary to reduce threats to auditors' objectivity and lend credibility to the fair presentation of the financial statements. Mr. Croteau warned of the risk of "scope creep," in which a once-permissible non-audit service becomes impermissible and impairs the auditor's independence as the nature of the service changes. It is important for management and audit committees to have policies and procedures for ongoing monitoring of the independent auditor's non-audit services throughout their execution.

The OCA staff stated that regularly monitoring corporate structural changes or other operational events that may result in new affiliates is crucial to effective compliance. Incomplete or inappropriate assessments of a company's affiliates make it more likely that independence violations will go unidentified. Management should have its own records concerning affiliates, which the auditor could refer to in determining whether its list of affiliates is complete and accurate.

The OCA staff reminded companies and auditors that performing bookkeeping and financial statement preparation services for registered broker-dealer audit clients is an independence violation, and has been the target of recent SEC and PCAOB enforcement activity.

Mr. Schnurr highlighted the potential effect on both audit quality and auditor independence of accounting firms' growing consulting practices. While this may have some positive impacts on audit quality, it continues to raise independence concerns and could undermine investors' confidence in the work of the external auditors.

Implementation of New Revenue Recognition Standard

Wesley Bricker, Deputy Chief Accountant, OCA, praised standard setters' progress over the past year to address implementation questions; however, he cautioned that there is still significant work to do. Mr. Bricker and the OCA staff emphasized the continued focus on consistent interpretation and application of the new revenue standard, even for areas where diversity in practice exists today.

For example, the OCA staff highlighted the need for consistent interpretation of the standard among companies within the same industry and across industries, both domestically and globally.[6] Russell Golden, FASB Chairman, stressed that

[5] PCAOB Release No. 2015-005, Concept Release on Audit Quality Indicators, available at http://pcaobus.org/Rules/Rulemaking/Docket%20041/Release_2015_005.pdf.

[6] FASB ASU 2014-09, Revenue Contracts with Customers, available at www.fasb.org, and IFRS 15, Revenue from Contracts with Customers.

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the FASB and IASB revenue standards are converged in all significant areas, but the current converged status may be affected by the FASB's proposed changes to the identification of performance obligations, licensing, and other narrow-scope improvements.

Mr. Bricker emphasized the importance of resolving areas of diversity during the implementation phase of the project. He encouraged continued discussions among industry groups and timely escalation of unresolved questions to the joint FASB/IASB Transition Resource Group for Revenue Recognition (TRG), the audit firms, the AICPA Industry Task Forces, or the OCA staff. Additionally, Mr. Golden highlighted how important it was for the TRG to suggest practical expedients that are expected to reduce costs and complexity, and to identify areas where clarity is needed to foster global comparability.

Mr. Bricker also stressed that the overall state of readiness by companies to implement the new standard may be lagging, as illustrated in a recent survey where 75 percent of respondents had not completed their initial impact assessment, and 27 percent had not yet begun.[7] Based on its experience from monitoring the implementation phase, the OCA staff noted that all companies will experience some degree of change in the following areas:

- New business processes;
- New IT systems and controls;
- Additional estimates and judgment; and
- Expanded disclosures.

It should be a high priority for companies to develop a change management plan that involves detailed implementation plans and impact assessments that can be discussed with audit committees, executive management, and the auditors. In addition, companies should allocate sufficient and appropriately qualified resources to complete the work on a timely basis.

Mr. Bricker said that companies should provide more detailed disclosures about the expected effect the new standard will have on the financial statements in its periodic filings.[8] If the effect is unknown, that should be communicated and investors should be told when the assessment is expected to be completed. The Division of Corporation Finance (DCF) staff reiterated that they expect disclosures to evolve and become more refined as companies begin to implement the new standard.

In addition, the DCF staff is considering the reporting implications of adopting the new standard. For example, Craig Olinger, Deputy Chief Accountant, DCF, mentioned that DCF will allow companies that are applying the significance test under S-X Rule 3-09 to use their pre-transition measures for the years prior to the standard's adoption when determining whether separate audited financial statements of significant investments are required when the new standard is adopted retroactively.

On the other hand, the DCF staff reminded preparers that a registration statement must include or incorporate by reference financial statements that retrospectively reflect a change in accounting principle. For calendar year-end

[7] PwC - Financial Executives Research Foundation 2015 Survey, The new revenue recognition standard: Assessing impact and implementation, available at www.pwc.com.

[8] Staff Accounting Bulletin No. 74 (Topic 11:M), available at www.sec.gov.

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companies that adopt the standard for January 1, 2018 using the retrospective transition method, current rules would require that registration statements filed during 2018 after the first quarter 10-Q is filed include or incorporate by reference retrospectively restated historical financial statements for the three-year period ended December 31, 2017. This would include 2015, which is a period that would not otherwise require retrospective revision for annual reporting requirements. The DCF staff stated that this requirement was under review.

Disclosure Effectiveness

Mr. Schnurr and the DCF staff emphasized the importance of exercising judgment in developing financial statement disclosures that meet the objective of providing high-quality, decision-useful information to investors. Mr. Schnurr said that applying judgment to financial statement disclosures also requires appropriate processes and internal controls. The DCF staff noted that many companies are voluntarily improving their disclosures, with a viewpoint that the Form 10-K is more of a communication document than a compliance exercise.

Mr. Schnurr reminded the audience that disclosure decisions are not static and must be periodically reevaluated. Mr. Schnurr commented that it is critical to consider the perspective of a reasonable investor, which may require input from others within the organization, including investor relations, and potentially outreach to users and analysts.

I support recent efforts by the FASB to explore a disclosure framework that facilitates clear communication of the information material to the users of a company's financial statements and moving from a checklist model to a principles-based model. If designed and implemented appropriately, the quality of information provided to investors should improve.

James Schnurr, *Chief Accountant, OCA*

Companies were encouraged to take a fresh look at opportunities to streamline disclosure by removing outdated or redundant disclosures, eliminating immaterial disclosures, using tables and graphics more frequently, and adding disclosure where necessary to keep the financial statements from being misleading and to enhance communication with investors. The DCF staff noted that discrete sections of the 10-K and 10-Q outside the financial statements do not need to stand alone, and they encouraged cross-referencing to eliminate redundancy.

The OCA and DCF staffs are continuing work on several disclosure effectiveness initiatives. The goal is not principally to reduce the volume of disclosure, but to make disclosures more understandable and comprehensive. In some cases this may mean reducing repetitive or cumbersome disclosures that may distract from meaningful financial reporting, while in other cases adding disclosures that more meaningfully describe the financial position and operations of the company. Further, the SEC staff is coordinating with the FASB on ways to improve the effectiveness of financial statement disclosures and to minimize duplication between U.S. GAAP and SEC disclosure requirements.

Division of Corporation Finance Focus Areas

A panel of the DCF staff highlighted the following areas of focus and frequent comment in the filing review process.

Non-GAAP Financial Measures

Several of the speakers, including Chair White, commented on the appropriate use of non-GAAP financial measures. Preparers should carefully consider the use and disclosure of these measures to ensure they are clear and useful to investors by asking several questions.

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- Why are we using the non-GAAP financial measure, and how does it give investors useful information?
- Are non-GAAP financial measures no more prominent than the GAAP measures, as required under the SEC rules?
- Are the explanations of how we use the non-GAAP financial measures and why they are useful to investors accurate and complete? Have they been drafted without boilerplate language?
- Are there appropriate controls over the calculation of non-GAAP financial measures?

The DCF staff commented that, although appropriate use of non-GAAP financial measures can be an effective tool for management to describe its business and operations, the inappropriate use of non-GAAP financial measures is a continued area of focus.

Common Issues Associated with Non-GAAP Financial Measures
Unclear labeling of non-GAAP financial measures, their underlying components, and how each adjustment is calculated
Non-GAAP financial measures to smooth earnings or adjust for "non-recurring" items that regularly recur
Non-GAAP financial measures that are more prominent than the corresponding GAAP measures
Accounting terms that do not conform to an accounting definition
Failure to disclose changes in how a non-GAAP financial measure is calculated year-to-year
Boilerplate disclosures

In addition, they shared specific examples of their observations on the use of certain non-GAAP financial measures.

- ***Pension Adjustments.*** The DCF staff has seen an adjustment to a non-GAAP financial measure inadequately labeled as a *pension adjustment* without describing what the adjustment represented and what its basis was in the GAAP financial statements. Similarly, adjustments for *non-cash pension expense* do not accurately describe pension costs, because pensions generally settle in cash. Including certain pension adjustments also could result in a non-GAAP financial measure that reflects expected returns on plan assets and obscures the actual return, which may not be useful to investors.
- ***System-wide Sales.*** The DCF staff will no longer object to the use of a system-wide sales non-GAAP financial measure, which combines the sales of owned and franchised locations, if it complies with all non-GAAP rules. In some circumstances, investors find this measure useful in evaluating trends in the strength of a brand.

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- ***Normalized Price.*** The DCF staff has objected to the use of a non-GAAP financial measure adjusting sales to eliminate drastic declines in commodity prices. Underlying volatility in commodity prices in the industry makes it challenging to identify what constitutes a "normal price" and, thus, the amount of the adjustment. The DCF staff noted that the measure typically was included only when commodity prices moved in a direction that had a negative effect on reported results.

The DCF staff emphasized that evaluating the appropriateness of a non-GAAP financial measure requires careful consideration of the specific facts and circumstances. In addition, the use of a non-GAAP financial measure by one entity does not necessarily mean it is appropriate for all entities to make similar disclosures because the focus should be on why the measure is useful for a particular company's investors.

Segment Identification and Disclosure

Segment disclosure continues to be a focus of the DCF staff because users regularly indicate that segment disclosures are a critical element of understanding the company and its management. Segment determination impacts the financial statements broadly, affecting such aspects as goodwill impairment testing. The DCF and OCA staff provided specific observations.

- ***Identification of the Chief Operating Decision Maker (CODM).*** It is incorrect to conclude that the CODM is the CEO simply because that individual has "ultimate decision-making authority." The DCF staff cautioned that ultimate decision-making authority is not included in the definition of the CODM in U.S. GAAP.[9]

- ***Operating Segment Identification.*** The OCA staff indicated that a variety of information sources can enhance and corroborate the evaluation of operating results reviewed by the CODM, such as the periodic financial reporting package, organizational structure, the basis on which budgets and forecasts are prepared, and the basis on which executive compensation is determined. None of these are individually determinative to the analysis.

  Additionally, DCF staff noted that companies sometimes erroneously conclude that discrete financial information is not available; therefore, a component is not an operating segment because all shared costs are not allocated to the component. The DCF staff reminded companies that the allocation of shared costs is not required to meet the definition of discrete financial information in the standard.

  The OCA staff further cautioned that when this analysis results in identification of a single operating segment, it may be a significant signal to investors about how management has allocated resources. If a single operating segment is identified, registrants should disclose that they allocate resources and assess financial performance on a consolidated basis and explain the basis for that approach. If the entity is managed on an aggregated basis, the business description should not indicate that the entity is diversified across businesses or products.

- ***Aggregation.*** The DCF staff provided guidance about aggregation of operating segments into one or more reportable segments.

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[9] FASB ASC paragraph 280-10-50-5, available at www.fasb.org.

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- Companies must consider whether aggregation is consistent with the objective and principles of the segment guidance.
- Companies should not attempt to apply a bright line test to economic similarity of operating segments (sometimes referred to as the quantitative test). No bright line exists in the standard, and the range of acceptably similar margins may be tighter in businesses with relatively lower margins or volatility in profitability. The likelihood that future margins are expected to be similar does not outweigh the dissimilarity of historic margins.
- The similarity of qualitative factors such as class of customer and production processes should be evaluated in the context of the company's business, not of peer companies or the industry as a whole.

The DCF staff emphasized that all criteria must be met in order to aggregate operating segments. They gave an example where the quantitative criteria were met but the qualitative criteria were not; therefore, the DCF staff objected to aggregation. In this case, management was regularly making decisions to manage the profitability of its operating segments within a narrow range of each other. The DCF staff concluded that it was not appropriate to aggregate two operating segments because an investor would find it useful to understand management's execution of this strategy.

- ***Change in Segment Disclosure.*** In a circumstance when the identification of operating or reportable segments may not have been correct (but did not affect the goodwill impairment test), the DCF staff, in some cases, has not objected to applying the retrospective change in accounting principle in future filings without amending prior filings.
- ***ICFR Considerations.*** The OCA staff emphasized that reasonable judgments are necessary in the determination of operating segments, aggregation, and entity-wide disclosures. Documenting the design and effective operation of management's controls over those judgments is an integral part of management's support for the effectiveness of its ICFR.

Income Tax Disclosure

The DCF staff continues to focus on clear disclosure of income tax activity and positions, especially for multinational corporations. One area that needs continued improvement is the disclosure of overseas profits, taxes, and cash. When an entity asserts that overseas cash is indefinitely reinvested and that it does not expect to incur tax liabilities on repatriation to the parent's jurisdiction, the DCF staff asks companies to disclose the amount of that cash. Effectively this discloses the portion of the consolidated cash balance available to satisfy long-term obligations of the parent and distribute to shareholders.

The DCF staff also recommends using the income tax rate reconciliation as a starting point for clear, comprehensive income tax disclosure, whether in the financial statement footnotes or in Management's Discussion and Analysis (MD&A). This disclosure should aim to describe material information about what is happening, why, and its susceptibility to change. The DCF staff gave several examples of insufficient disclosures related to income taxes.

- Insufficient details describing the foreign tax rate differential, especially when many foreign tax jurisdictions are grouped together.

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- Aggregation of individually significant tax transactions or outcomes with recurring transactions in rate reconciliation line items, such as a non-deductible goodwill impairment charge.
- Unclear linkage between amounts in the qualitative discussion and the information in the rate reconciliation.
- Use of boilerplate disclosure to describe changes in tax estimates, such as changes in valuation allowances or reinvestment decisions.
- Unclear description of what is included in *Other*.

To remediate these problems, the DCF staff encouraged companies to use a disaggregated, tabular rate reconciliation by country. While this tabular reconciliation is not required, companies may find it useful because the table can describe the tax outcomes that occurred and allow the narrative to provide a qualitative discussion about why the outcomes occurred and how they may change.

Fair Value Disclosure

Mr. Olinger discussed the continued focus on the disclosure of fair value measurements.

Disclosure of Each Class of Assets and Liabilities Measured at Fair Value. The appropriate disclosure of each class of assets and liabilities is based on the nature, characteristics, and risks of the asset or liability, and the level of the fair value hierarchy (Level 1, 2, or 3). Therefore, aggregation of multiple types of securities for disclosure purposes is not appropriate. Also, the number of classes may need to be greater when dealing with Level 3 securities, because they have a greater degree of uncertainty and subjectivity. For example, U.S. Treasury securities should not be aggregated with collateralized debt obligations because of their different risk characteristics. Agency mortgage-backed securities (i.e., issued by government-sponsored enterprises such as Fannie Mae or Freddie Mac), valued using observable information, and non-agency sub-prime mortgage-backed securities, valued using unobservable information, should not be aggregated.

Description of Valuation Techniques and Inputs. The DCF staff reminded companies to consider the following when evaluating disclosure of the valuation techniques and inputs used to measure fair value.

- How much detail is necessary to satisfy the disclosure requirements?
- How much emphasis should be placed on each of the disclosure requirements?
- How much aggregation or disaggregation should be undertaken?
- Do financial statement users need additional information to evaluate the quantitative information that is disclosed?

The DCF staff shared several examples of inadequate disclosures related to valuation techniques:

- Disclosing only that a third-party valuation specialist is used to determine fair value is not the same as disclosing the technique used.

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- Disclosing only that the income approach is used to determine fair value without identifying the specific model that is applied, such as a direct capitalization approach, discounted cash flow, or gross income multiplier.
- Disclosing a list of valuation techniques that may be used, but not specifically disclosing what technique was used for the measurement.

Oil and Gas Price Declines

The DCF staff said that due to the continued actual and expected low prices of oil, it will continue to look for:

- Effects on oil and gas reserve estimates for companies that are involved in oil and gas producing activities;
- Potential impairment of assets that are significantly affected by oil and gas price changes;
- Disclosure of potential material uncertainties when a company has concluded it has no impairment, or when reported results may not be indicative of future results;
- Disclosure of significant estimates and assumptions that address the effects that may result from a range of potential outcomes; and
- Boilerplate disclosures that do not address the unique effects on the company.

Companies should also consider disclosing the operational effect of distressed oil prices, including whether lower prices affect a company's growth plan. While the DCF staff did not address the implications of price declines on other extraction companies, similar consideration may be appropriate given the significant decline in other commodity prices.

FAST Act

On December 4, 2015, the Fixing America's Surface Transportation (FAST) Act, which included several amendments to current securities law, became law. Keith Higgins, Director, DCF, summarized the key provisions.[10]

Relief for Emerging Growth Companies (EGCs)

- Allows an issuer that is an EGC when it filed an initial registration statement, but thereafter loses that status, to keep the EGC status for up to a year;
- Reduces from 21 to 15 the number of days a registration statement must be on file before commencing the road show; and
- Allows an EGC to omit financial information from an initial registration statement that it reasonably expects will not be required in a final effective registration statement.

Other Provisions of the New Law:

- Creates a new exemption for secondary sales of securities to accredited investors in transactions that do not involve general solicitation;

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[10] For more information, see Defining Issues 15-59, available at www.kpmg-institutes-com, and the Fixing America's Surface Transportation (FAST) Act, which became law on December 4, 2015, available at https://www.transportation.gov/fastact.

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- Allows smaller reporting companies to forward-incorporate by reference in Form S-1; and
- Requires the SEC to make other changes to forms and rules, including a rule that allows companies to include a summary section in Form 10-K.

IPO Financial Statement Requirements

Mr. Olinger commented that the DCF staff continues to see carve-outs, spin-offs, put-together transactions, and other complex reorganization transactions where it is challenging to determine the proper set of financial statements to include for a predecessor business in an initial registration statement. While no one factor is determinative, companies should consider the order in which entities were acquired, their size, value, and management structures. The DCF staff said that it would be rare not to identify a predecessor.

International Reporting Matters

Mr. Olinger and Paul Dudek, Chief, Office of International Corporate Finance, highlighted several reporting issues that could affect domestic companies with foreign operations and foreign private issuers (FPI).

- A company with significant operations in Venezuela, both foreign and domestic issuers, should consider potential accounting effects and disclosure of the exchange rate that is used for remeasurement; whether there are impairment issues; and whether the company should continue to consolidate its operations. When material, disclosures should be made in either the financial statement notes or MD&A to discuss the nature and size of Venezuelan operations, exchange rate being used, and the effect on the results of operations and liquidity, as well as uncertainties facing the company including consolidation considerations.
- Companies that lose their FPI status should transition to domestic filing forms beginning with the first quarter of the following year. They should include three years of audited U.S. GAAP financial statement information in their first 10-K submission (i.e., the two-year accommodation for first-time U.S. GAAP adoption is not available).

MD&A

A panel of preparers, auditors, and securities counsel discussed emerging trends and pitfalls in MD&A, and touched on many of the points raised by the DCF staff. The panel said that MD&A, together with the business overview section of the 10-K, should tell a complete, consistent story of how management thinks about its business strategy, long-term trends, and current year results in the context of those trends. MD&A should bridge reported results to management's expectations of the business, be updated regularly and thoroughly, and be written in plain English.

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Summary of MD&A Do's and Don'ts	
Do	**Don't**
• Discuss the why behind changes in reported results, including underlying components when multiple forces are at play. • Consistently evaluate the completeness of MD&A. SEC enforcement actions focus not only on inaccurate disclosure, but incomplete description of the underlying trends and components necessary to understand the business. • Reduce disclosure to the clearest description of what occurred, why, and how that compares with the overall trends and expectation of the business. • Remove repetitive, confusing, or immaterial disclosure with the aim of emphasizing and clarifying the important disclosures.	• Simply update the numbers from the prior period filing, or assume that just because last year's MD&A did not receive questions or comments it should be repeated. Always take a fresh look. • Prepare MD&A as a compliance document. Instead, it should be prepared as a communication document that is consistent with other public communications. • Use non-GAAP disclosures because peer companies use them or to paint the company in a better light. Rather, use non-GAAP financial measures that are important to investors to understanding the business trends.

Current Accounting Practice Issues

Mr. Bricker discussed OCA's consultation process and highlighted that the three most frequent consultation areas are revenue recognition, business combinations, and identification of reportable segments. He provided suggestions for companies to consider when consulting with the OCA staff, including focusing on identifying what information is useful to investors, and cautioning against overreliance on benchmarking to other peer company disclosures.

The three most commonly identified restatement areas are debt/equity, statement of cash flows, and accounting for income taxes.

Wesley Bricker, *Deputy Chief Accountant, OCA*

Mr. Bricker stated that the three most commonly identified restatement areas are debt/equity, statement of cash flows, and accounting for income taxes.[11] OCA interactions on these restatement topics show that there should be an increased focus on financial reporting competencies in complex areas, and internal controls over the preparation and review process.

Revenue

The OCA staff recently evaluated how customer incentive guidance should be applied when evaluating whether payments made by a vendor outside the distribution chain should be netted against revenue. The OCA staff described a fact pattern in which it did not object to a view that payments made to

[11] Based on 2014 and 2015 data from the Audit Analytics database, available at www.auditanalytics.com.

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customers and potential customers of a vendor's direct customers would be classified as an expense and not be evaluated under the customer payments and incentives guidance.[12] To reach that conclusion, the OCA staff gave careful consideration to whether:

- The vendor was in substance granting a broad pricing concession to its customers;
- There was a contractual requirement to pass along consideration to a direct customer's customer; and
- The vendor was acting as an agent of its customer in passing through consideration to a direct customer's customer.

The OCA staff stated that reasonable judgment is required when evaluating these fact patterns as this guidance may not apply to the accounting for payments made outside of the distribution chain. However, discussion with financial statement users showed that clear disclosures of a company's presentation policy, assumptions, and alternatives are critical to the decision usefulness of the financial reporting, regardless of whether a company reported incentives gross or net.

Pension and Other Postretirement Benefit Accounting

The OCA staff recently indicated that it would not object if a company uses a spot-rate approach to determine the interest cost component of a sponsor's net benefit cost for a defined benefit pension or other postretirement benefit plan under ASC Topic 715, if the discount rates used to calculate interest cost are embedded in the yield curve used in the measurement of the benefit obligation.[13]

The OCA staff has received questions about whether companies that use a different method to measure the benefit obligation (i.e., hypothetical bond matching model) could change to a yield-curve model to measure the benefit obligation and simultaneously adopt the spot-rate approach. The OCA staff commented that the measurement of the benefit obligation is the relevant starting point of the analysis. A company should only change its methodology to determine the obligation if a particular methodology provides the *best* rate(s) to effectively settle the obligation even if the company believes the spot-rate approach provides a better measure of interest cost. The OCA staff also clarified that this determination is generally not based on materiality.

Changes in the methodology used to determine the best estimate of the rate(s) for which the obligation could be effectively settled should be made when facts or circumstances change. As part of that analysis, a company should consider its prior analysis, such as when it decided to change to a bond matching methodology from a yield-curve model. The OCA staff indicated that a change in the approach used to measure interest cost would not make a persuasive argument about why a new basis should be selected for measuring benefit obligations.

[12] FASB ASC Subtopic 605-50, Revenue Recognition—Customer Payments and Incentives, available at www.fasb.org.

[13] FASB Topic 715, Compensation—Retirement Benefits, available at www.fasb.org.

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Consolidations

The OCA staff discussed how to evaluate whether a decision-maker's fee arrangement is customary and commensurate.

Application of New Consolidation Guidance. The OCA staff discussed how to evaluate a decision maker's fee under ASU 2015-02 when the fee would not otherwise meet the criteria to be considered a variable interest, but the decision maker is under common control with an investor whose interest would absorb more than an insignificant amount of variability.[14] In this circumstance, the decision maker's fee would not be considered a variable interest as the decision maker does not have a direct or indirect interest in the entity being evaluated for consolidation. This OCA staff view represents a change from previous interpretations.

The OCA staff discussed how to evaluate whether a decision-maker's fee arrangement is customary and commensurate. It noted that the determination of whether fees are commensurate may be made through a qualitative evaluation of whether an arrangement was negotiated on an arm's-length basis when there are no obligations beyond the services provided to direct the activities of the entity being evaluated for consolidation. Consideration should be given to the services provided by the decision-maker in relation to the fees.

While the OCA staff explained that there are no bright lines in evaluating whether an arrangement is customary and reasonable, judgment is required. A decision-maker should evaluate the terms, conditions, or amounts included in the arrangement and may consider benchmarking against other market participant arrangements or other arm's-length arrangements entered into by the decision-maker.

Risk Retention. The OCA staff noted that it has received consolidation questions related to companies' involvement with a collateralized manager vehicle (CMV). CMVs are investment entities that are designed to sponsor securitization transactions and comply with credit risk-retention requirements for asset-backed securities under the Dodd Frank Act.

The OCA staff described an example where the company's consolidation analysis related to whether the CMV was a voting interest entity under the consolidation guidance.[15] The CMV was required to hold an ownership interest in the underlying securitization to which it acted as a sponsor. The company purchased an equity interest in the CMV, received one of three seats on the CMV's board of directors, and entered into a services agreement with the CMV to provide certain support functions. The CMV's remaining equity was funded by third-party investors, several of whom were individually significant. The equity holders of the CMV, through the Board of Directors, had power over the CMV's most significant activities, including the development of the investment strategy, the hiring and firing of service providers, and appointments to the investment committee.

Based on these facts, the OCA staff did not object to the company's conclusion that the CMV was a voting interest entity under the consolidation guidance. It also said that there were many variations of this type of transaction and it would not be appropriate to analogize the above conclusion to other CMV fact patterns. In addition, the OCA staff clarified that it did not consider the legal analysis of whether the CMV would qualify as a legal sponsor. To the extent there is

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[14] FASB ASU 2015-2, Consolidation (Topic 810): Amendments to the Consolidation Analysis, available at www.fasb.org.

[15] FASB ASC Topic 810, Consolidation, available at www.fasb.org.

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uncertainty related to legal questions, entities should consult with their primary regulator.

Foreign Exchange Restrictions. Over the past year, the OCA staff has observed disclosures indicating that companies no longer have a controlling financial interest in subsidiaries domiciled in Venezuela. The disclosures indicated that the loss of control was based on the other-than-temporary lack of exchangeability between the U.S. dollar and the Venezuelan bolivar and, in some instances, the severity of government imposed controls over the company's Venezuelan subsidiary.

The OCA staff expects consistency in a company's judgments about whether it has lost control or regained control of a subsidiary, and expects that companies would have internal controls that include a continuous reassessment of foreign exchange restrictions and the severity of government-imposed controls.

In situations where a majority owner concludes that it no longer has a controlling financial interest in a subsidiary, careful consideration should be given to:

- Whether the subsidiary would be considered a variable interest entity upon deconsolidation, because power may no longer reside with equity-at-risk holders and;
- Whether it should make the required variable interest entity disclosures.[16]

Fair Value Measurements

The OCA staff reminded companies that fair value under ASC 820 is an exit-price concept, and items should be measured using the principal market, or in the absence of the principal market, the most advantageous market.[17] When a company is relying on observable pricing as an input into a fair value measurement, it must consider whether it is able to transact in that market on the measurement date. The following were identified as characteristics that may prevent an entity from accessing a particular price within a market and may lead to a different principal or most advantageous market:

- The company is required to transform the asset or liability in some way to match the asset or liability in the observable market;
- The company's asset or liability contains unique restrictions that are not embedded in the asset or liability in the observable market; and
- The company has marketability or liquidity differences between the asset or liability in the observable market relative to the company's asset or liability.

A company may be able to use observable prices in a market that does not constitute the principal market if it makes appropriate adjustments to reflect differences in the characteristics of the asset or liability being measured and the price observed within a market.

In addition, the OCA staff said that some companies use their cost basis as a fair value measurement, especially during the period of time shortly following an initial transaction. Because historical cost is not a fair value measurement, the OCA staff reminded companies to consider the variety of events and conditions that could result in necessary adjustments to the fair value of assets, including changes in interest rates or general macro-economic conditions; changes in the

[16] FASB ASC Subtopic 810-10, Consolidation—Overall, available at www.fasb.org.

[17] FASB ASC Topic 820, Fair Value Measurement, available at www.fasb.org.

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principal or most advantageous market; or changes in the performance of the asset or liability.

The OCA staff also reminded companies about their responsibility for ICFR with respect to fair value measurements, including valuations of illiquid assets and liabilities made by a third-party service provider. Management should be aware of the particular risks associated with illiquid assets and liabilities, and should design effective controls and understand what controls their service provider uses.

Presentation of Discontinued Operations

Under the new guidance on the accounting for discontinued operations, only disposals that represent a strategic shift that has (or will have) a major effect on operations and financial results are reported as discontinued operations. The OCA staff emphasized that this guidance requires judgment when determining whether a disposal should be accounted for as a discontinued operation. The OCA staff also clarified that the quantitative examples in the new guidance are illustrative and do not establish bright lines or safe harbors.[18]

Judgment should be used to determine which financial results indicate a strategic shift. Although revenue, total assets, and net income are relevant metrics, alternative measures may be relevant when investors and the company have consistently used those alternatives to communicate operating and financial results. The totality of the evidence must be evaluated, and there is no single measure that can be used to conclude that a disposal had a major effect on the operations and financial results. In addition, the less quantitatively significant the financial effect of the disposal is, the stronger the qualitative evidence would need to be to conclude the disposal is a discontinued operation.

Post-vesting Restrictions on the Measurement of Share-Based Awards

The OCA staff commented that post-vesting restrictions, such as limitations on the transfer of shares after vesting, should be factored into the grant date fair value determination of share-based awards and may result in it being discounted. However, if shares are traded in an active market, post-vesting restrictions may have little, if any, effect on the amount at which the shares being valued would be exchanged. Therefore, if a company determines that it has post-vesting restrictions that would result in a significant discount to the grant date fair value of a share-based award, it should consider consulting with the OCA staff.

Reminders about Staff Accounting Bulletin (SAB) No. 102

The OCA staff reminded the audience about SAB 102, which establishes expectations of management related to the development, documentation, and application of a systematic methodology for determining the allowance for loan losses (ALLL) estimate under U.S. GAAP.[19] It is helpful to reflect not only on the auditor's responsibility to audit the ALLL estimate, but also management's responsibilities in developing the estimate.

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[18] FASB ASC Subtopic 205-20, Presentation of Financial Statements—Discontinued Operations, available at www.fasb.org.

[19] SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues, available at www.sec.gov.

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The OCA staff believes that an ALLL process that would meet the expectations of SAB 102 would include effective internal accounting controls designed to ensure that relevant, reliable, and sufficient data was used to develop the estimate. Companies should consider the sufficiency of controls, specifically transaction-level controls, related to the aggregation and evaluation of the data to assert the relevance, sufficiency, and reliability of the data used.

The OCA staff discussed adjustments to the ALLL, including that it is important to adequately understand what data is used in the loss estimation model, as well as the methods and judgments being applied to arrive at an estimate. This starting point allows management to, in turn, be able to evaluate the necessity and reasonableness of potential adjustments. Also, the OCA staff reminded management that it should maintain sufficient, objective evidence to support the amount of the adjustment and an explanation of why it is necessary.

Standard Setting

U.S. Engagement with IFRS

Mr. Schnurr commented that OCA will ask the SEC to consider permitting domestic companies to provide voluntary, unaudited IFRS-based information as a supplement to U.S. GAAP financial statements as a next step on the journey to further incorporating IFRS into the domestic reporting system.

Hans Hoogervorst, IASB Chairman, said that although it is unlikely that progress will be made towards the domestic use of IFRS in the United States in the next several years, strong American leadership is needed to bring the United States back to the center of decision-making in the IASB's work in promoting and improving IFRS. Chair White and Mr. Schnurr encouraged the FASB and IASB to continue to build on their progress on issuing converged standards (e.g., revenue recognition) and to continue to collaborate in support of the objective of developing a single set of high-quality, globally accepted accounting standards.

It is important to maintain the FASB's independence from the influence of politics and special interests when setting high-quality financial accounting and reporting standards.

Russell Golden, *FASB Chairman*

FASB

Importance of Standard Setter Independence. Mr. Golden emphasized the importance of maintaining the FASB's independence from the influence of politics and special interests when setting high-quality financial accounting and reporting standards. He commented that it is the FASB's responsibility to sort through differing opinions and points of view, and make decisions that will best meet the needs of investors and other financial statement users.

Leases. Mr. Golden gave an overview of the status of the leasing project and discussed some common concerns. He clarified that given the extensive input received, it is not expected that a leases transition resource group will be formed. Although the FASB received feedback that additional liabilities on companies' balance sheets will affect debt covenants and accounting judgments, the FASB's outreach with lenders underscored that the addition of lease liabilities to a company's balance sheet is not expected to significantly alter a lender's view of the organization's financial position because lenders typically estimate a greater liability for leases than what will be capitalized under the new standard.

Impairment of Financial Instruments. Mr. Golden highlighted the importance of the FASB's completing its project on the accounting for impairment of financial instruments. Using lessons learned from the new revenue recognition standard implementation experience, the FASB has created a transition resource

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group for impairment, which has already begun to identify significant issues requiring attention before the final standard is implemented.

Mr. Golden described one of the major issues the transition resource group will have to deal with as the "cascade of misinformation about the impairment standard." These include misconceptions such as:

- Companies will need to develop and install costly, complex new systems;
- Bank examiners will take a more conservative view;
- Large banks were affected by the credit crisis, not small ones; and
- Companies will be hampered by the standard's unrealistic view of the economics of loan financing.

Future Agenda. Mr. Golden highlighted the results of the Financial Accounting Standards Advisory Council's recent survey, which identified as the five projects requiring the highest priority on the FASB's future agenda: (1) financial performance reporting, (2) improving cash flow classification, (3) pensions and other post-retirement benefits, (4) liabilities and equity, and (5) intangible assets. Mr. Golden indicated that the FASB will be issuing a public consultation document to solicit feedback from stakeholders about the Board's prioritization of its projects. He encouraged constituents to respond and participate in the prioritization process.[20]

PCAOB

Martin Baumann, Chief Auditor, PCAOB, and Mr. Hanson discussed key PCAOB standard-setting initiatives.

Adopted Standards and Rules

Transparency. On December 15, 2015, the PCAOB adopted new rules and amendments to its rules to improve transparency of audits by requiring the auditor to disclose the name of the engagement partner and information about certain other participants in the audit.[21] The rules and amendments, if approved by the SEC, will require auditors to file the information on a new PCAOB Form AP, which will be publically available in a searchable database.

Reorganization of PCAOB Auditing Standards.[22] The PCAOB recently reorganized its existing interim and PCAOB-issued auditing standards into a topical structure with a single, integrated numbering system. The reorganization does not impose new requirements on auditors or change the substance of the requirements for performing and reporting on audits under PCAOB standards.

Related Parties and Related Amendments.[23] The standard and amendments are effective for audits of fiscal years beginning on or after December 15, 2014, and strengthen auditors' requirements when auditing related parties, significant unusual transactions, and a company's financial relationships and transactions

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[20] For a full discussion of ongoing FASB projects see KPMG's Defining Issues publications, available at www.kpmg-institutes.com.

[21] PCAOB Release No. 2015-008, Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards, available at www.pcaobus.org.

[22] PCAOB Release No. 2015-002, Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules, available at www.pcaobus.org.

[23] PCAOB Release No. 2014-002, available at http://pcaobus.org/Rules/Rulemaking/Docket038/Release_2014_002_Related_Parties.pdf.

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with its executive officers. Mr. Baumann and Mr. Hanson commented on two concerns that some have expressed about the ability of companies to produce a complete list of all related parties and the requirement to obtain management's representation about the absence of (1) unrecorded transactions, and (2) side agreements or other arrangements (either written or oral) that have not been disclosed to the auditor. They said that they are trying to better understand these concerns, but that the requirement for companies to maintain a complete listing of related parties is not new. The standard also requires the auditor to obtain specific management representations about the availability of the names of all related parties and all relationships and transactions with related parties. Mr. Baumann said effective ICFR requires maintaining accurate books and records, which should allow companies to sufficiently identify unrecorded transactions and side agreements. PCAOB staff commented that this standard will be a focus area of inspections.

Selected Standard-Setting Agenda Projects

Auditor's Reporting Model. In 2013, the PCAOB issued a proposed auditor reporting standard that would retain the pass/fail model in the existing auditor's report. However, it would require auditors to provide additional information to financial statement users about the audit, including the communication of critical audit matters and how the auditor responded to them. The PCAOB staff is considering the comment letters received on the proposal as well as the developments in other countries, including in the United Kingdom, where auditor reporting of key audit matters has been adopted. Mr. Baumann said he expects the PCAOB to re-propose a standard that includes reporting of critical audit matters in the first half of 2016.

Auditing Accounting Estimates, Including Fair Value Measurements. The PCAOB staff plans to ask the PCAOB to propose a single standard in 2016 to replace several current auditing standards relating to auditing accounting estimates and fair value measurements. Mr. Baumann indicated that the new standard would be more closely linked to the PCAOB's risk assessment standards and would address challenging areas such as the use of pricing services and estimates of fair value measurements with wide ranges of measurement uncertainty.

Use of Specialists. Auditors often use the work of specialists whom they employ or engage, or the work of specialists who are employed or engaged by the company being audited. Mr. Baumann stated that the PCAOB staff plans to ask the PCAOB to propose a standard in 2016 designed to improve auditing procedures performed by the auditor with respect to the use of specialists.

Going Concern. Mr. Baumann highlighted differences between the FASB's and the PCAOB's definitions of substantial doubt about the ability of a company to continue as a going concern. While the FASB defines going concern as *probable* that a company will be unable to meet its obligations as they become due, the existing PCAOB auditing standard was designed more qualitatively to be an early warning signal to investors of financial difficulty, in line with a legislative requirement of auditors.[24] The PCAOB is evaluating how best to proceed with standard setting in this area.

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[24] Section 10A of the Securities Exchange Act of 1934, available at https://www.sec.gov/about/laws/sea34.pdf.

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PCAOB Inspection Trends and Focus Areas

Ms. Munter discussed recent inspection findings, highlighting that improvements by some firms suggest audit quality is trending in the right direction. Improvements are largely driven by a firm's tone at the top, targeted and focused training on audit execution topics, the use of practice aids and checklists to drive consistency, providing coaching and support to engagement teams, and enhancing internal monitoring programs.

Ms. Munter said that the PCAOB continues to find deficiencies in recurring areas relating to ICFR, auditing fair value measurements, and auditing revenue. She also highlighted that the PCAOB has found deficiencies related to the consistent execution of audit methodology and approaches for those networks that operate in multiple countries. This remains an inspection priority.

With respect to 2016 inspections, Ms. Munter highlighted areas that the PCAOB plans to focus on, including areas that have had recurring deficiencies, the audit response to the effects of the appreciation of the U.S. dollar and other economic factors such as the decline in oil prices, segment disclosures, business combinations, income taxes, going concern, technology risks, and the auditor's compliance with the new auditing standard for related parties and related amendments.

Enforcement and Other Initiatives

SEC Enforcement Update

Andrew Ceresney, Director, Division of Enforcement, and Michael Maloney, Chief Accountant, Division of Enforcement, discussed recent trends in enforcement actions, including a significant increase in the number of findings of financial reporting and audit violations.

During the past year, the Division of Enforcement brought several gatekeeper cases against auditors and audit committee members. The auditor cases related to a lack of professional skepticism and independence, a failure to properly document audit findings, and inadequate audit evidence for accounting judgments.

Mr. Ceresney discussed the admission of wrongdoing by individuals in recent cases, stating that the SEC would seek such admissions when the cases involve egregious behavior, a large number of individuals are harmed, when the SEC's investigation is obstructed, and when an appropriate message is necessary to discourage similar future violations.

Recent Enforcement Focus and Trends. In addition to gatekeeper cases, Mr. Ceresney stated that the Division of Enforcement is also focused on insider trading, complex financial instruments, manipulative trading, and inadequate disclosures of investment advisory and asset management companies. Additionally, it is watching for violations of the Foreign Corrupt Practices Act. Mr. Maloney highlighted areas such as revenue recognition, fair value measurement, impairment of financial assets, internal controls, and financial statement disclosures as common areas of investigation related to accounting issues.

Mr. Ceresney discussed the SEC's continued focus on using big data to identify anomalies and other unusual activity to detect misconduct and advance investigations.

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Cybersecurity Panel

A panel discussion highlighted ongoing challenges of cybersecurity risks for companies and boards. Panelists discussed the importance of taking a continuous and long-term approach to developing and implementing processes and controls to mitigate business risks related to cybersecurity. They emphasized that the way cybersecurity breaches may occur can change at a rapid pace because of evolving technology and hacker capabilities. Panelists also highlighted that cybersecurity is not only a technology issue, and that bringing expertise from various disciplines within and outside a company will be important in addressing the risks.

The panelists stated that they had not yet seen evidence of cybersecurity breaches with the motive of attacking financial reporting or ICFR. However, attacks on other aspects of the business can affect financial reporting in the event of business disruption or data theft. While cybersecurity risks have been a focus of many audit committees, the panelists agreed that the board of directors and company executives should be keenly aware of the risks and understand what is being done to mitigate the risks.

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Appendix: Index of Published Speeches

The text of speeches can be accessed using the links below.

SEC

Mary Jo White, SEC Chair

James Schnurr, Chief Accountant, Office of the Chief Accountant

Wesley Bricker, Deputy Chief Accountant, Office of the Chief Accountant

Brian Croteau, Deputy Chief Accountant, Office of the Chief Accountant

SEC OCA Staff Speakers	Topics
Michael Husich, Senior Associate Chief Accountant	Auditor Independence
Barry Kanczuker, Associate Chief Accountant	Presentation of Discontinued Operations; Post-vesting Restrictions of Share-Based Awards
Christopher Rickli, Professional Accounting Fellow	Reminders about Staff Accounting Bulletin No. 102; Consolidation-Risk Retention
Courtney Sachtleben, Professional Accounting Fellow	Segment Identification and Disclosure
Christopher Semesky, Professional Accounting Fellow	Revenue; Consolidation
Kris Shirley, Professional Accounting Fellow	Fair Value Measurements
Ashley Wright, Professional Accounting Fellow	Pension and Other Postretirement Benefit Accounting; New Revenue Recognition Standard

AICPA/CAQ

Cynthia Fornelli, Executive Director, CAQ

FASB/IASB

Russell Golden, Chairman, FASB

Hans Hoogervorst, Chairman, IASB

PCAOB

James Doty, Chairman PCAOB

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Jay Hanson, Board Member, PCAOB

Helen Munter, Director, Registrations and Inspections, PCAOB

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