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2016 AICPA National Conference on Current SEC and PCAOB Developments

Compendium of significant accounting and reporting issues

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Summary

Representatives of the Securities and Exchange Commission (SEC or Commission), the Financial Accounting Standards Board (FASB or Board) and the International Accounting Standards Board (IASB) (collectively, the Boards) and the Public Company Accounting Oversight Board (PCAOB) shared their views on various accounting, financial reporting and auditing issues at the annual AICPA National Conference on Current SEC and PCAOB Developments (Conference) last week in Washington, DC.

Highlights included:

New accounting standards — The chairmen of the FASB and IASB discussed implementation efforts related to the significant new accounting standards on revenue, leases and financial instruments under both US GAAP and IFRS. Members of the SEC staff also discussed recent consultations related to implementation of the new standards, including their approach in evaluating the questions. The SEC staff stressed the importance of timely implementation efforts and robust disclosure that communicates how a company will be affected by the new standards and the status of its implementation efforts.

Non-GAAP financial measures — Regulators, standard setters, investors and preparers shared their perspectives on the use and disclosure of non-GAAP financial measures. Members of the SEC staff said companies have made significant progress in complying with the interpretations the staff updated in May 2016. They also discussed their views on specific measures and adjustments, as well as presentations that might give non-GAAP measures undue prominence. Standard setters discussed how and why investors use alternative performance measures and whether revisions to current presentation and disclosure requirements may be warranted to better meet the needs of investors. The PCAOB staff is monitoring the need for greater auditors' involvement with non-GAAP information derived from the audited financial statements, with input from the PCAOB's advisory groups.

EY

Building a better working world

Upcoming changes — Overall, change was the common theme at the Conference. Corporate executives spoke about their efforts to implement the major new accounting standards on revenue and leases, and the anticipated ongoing effects on resources, systems and processes. Staff members from the SEC Division of Corporation Finance (DCF) spoke about the future of the Commission's disclosure effectiveness initiative and other rulemaking activities. And PCAOB Chairman James Doty discussed the enhanced research and stakeholder outreach that the PCAOB is incorporating into its standard setting process. The PCOAB is also nearing completion of its proposed standard to redesign and modernize the audit report.

Remarks of senior representatives

Remarks by Wesley Bricker, Chief Accountant

SEC Chief Accountant Wesley Bricker focused his remarks on the importance of cooperation and coordination to advance high quality financial reporting in the US capital markets. Specifically, he focused on the roles of preparers, audit committees, auditors and standard-setters in advancing that shared responsibility.

'Investors look to [preparers] to evaluate, challenge, and ultimately address transactions, judgments, and risk areas with accurate and informative disclosures. Effective internal control supports your work.'

— Wesley Bricker, Chief Accountant

Role of preparers

Mr. Bricker said that high-quality financial reporting begins with preparers. Strong and effective internal controls and rigorous independent audits are necessary for companies to communicate reliable financial information to investors so they can raise necessary capital. Deficiencies in internal control over financial reporting (ICFR) can lead to lower quality financial reporting and, ultimately, higher restatement rates and a higher cost of capital. It will be important for companies to update and maintain effective internal controls as they implement the significant new accounting standards on revenue, leases, financial instruments and credit losses, which Mr. Bricker referred to as the "new GAAP standards."

Mr. Bricker encouraged preparers to implement the new GAAP standards in a timely manner, provide useful transition disclosures and adhere to the objectives of the new guidance. Regarding the new revenue standard, he commented that revenue is one of the single most important measures used by investors in assessing a company's performance. Given market expectations of comparability, companies cannot afford to "get the accounting for revenue wrong."

Consistent with Staff Accounting Bulletin (SAB) Topic 11.M, Mr. Bricker reiterated that the SEC staff expects registrants to disclose how they will be affected by Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* (ASC 606) and the other new GAAP standards as they make progress on implementation. For example, the SEC staff expects registrants to make more specific quantitative and qualitative disclosures in 2016 annual reports and in their 2017 periodic reports about the effects (quantitative or qualitative) of adopting the new revenue standard.

While Mr. Bricker observed that most companies have made progress on ASC 606 implementation since last year's Conference, he believes there is more to do. He encouraged companies that are behind in their implementation of the revenue standard to discuss the reasons for the delay with their audit committee and auditor. He also suggested that those companies provide enhanced disclosures about their implementation status in addition to the disclosures required by SAB Topic 11.M.

Mr. Bricker also said the staff of the Office of the Chief Accountant (OCA) has been working with companies on prefiling submissions on accounting positions related to the adoption of the new GAAP standards. When forming its conclusions, the staff of OCA considers the nature, design and substance of the transaction, the standard setter's basis for conclusions, relevant discussions by groups such as the Transition Resource Group (TRG) for Revenue

Recognition and the objectives of consistency and comparability. Mr. Bricker emphasized that it is important for preparers to fully understand the registrant's contracts with customers in order to clearly articulate the basis for the proposed accounting under the new standard. He also reminded the audience that similar considerations apply for the other new GAAP standards.

Mr. Bricker said that substantial progress has been made over the past year in addressing many of the problematic practices related to disclosures of non-GAAP financial measures. However, he still believes companies can further improve their evaluation of the appropriateness of particular non-GAAP measures, the prominence of their presentation and the effectiveness of the registrant's disclosure controls and procedures (DCP). Mr. Bricker encouraged audit committee members to understand management's judgments about the use of non-GAAP measures and how the company's approach differs from those followed by other companies.

Role of audit committees

Audit committees are critical to reliable financial reporting, and Mr. Bricker encouraged audit committee members to stay current on emerging issues and engage outside expert advisers when necessary. He also stressed the importance of the audit committee's relationship with the auditor in overseeing management's activities. To promote better communication, he suggested that audit committee members pose the following questions to auditors:

- If you were management and were solely responsible for preparing the company's financial statements, would the financial statements have in any way been prepared differently?
- If you were an investor, would you believe that you received the information you needed to understand the company's financial position and performance?
- Is the company following the same ICFR and internal audit procedures that would be followed if you were the chief executive officer?
- Have you made any recommendations that management has not followed?

Mr. Bricker also emphasized the audit committee's role in overseeing the terms of the audit engagement and the auditor's compensation. In particular, he recommended that audit committees make sure that an issuer's cost-cutting initiatives don't adversely affect audit scope, staffing or compensation. He also warned that normal corporate procurement policies and procedures may be inappropriate for auditor selection, retention and compensation.

Mr. Bricker said he was encouraged by audit committees' voluntary reporting, which was highlighted in a recent EY survey.[1]

Auditors and their independence

Auditors are the key gatekeepers for high-quality financial reporting, and Mr. Bricker emphasized the importance of rigorous and objective audits by independent auditors. Mr. Bricker reminded auditors of the general standard of independence,[2] adding that both auditors and audit committees should review their policies to make sure that the standard is met. Mr. Bricker also reminded auditors to remain aware of limitations on involvement with their clients' activities in implementing the new GAAP standards.

Role of the PCAOB

Mr. Bricker commended the PCAOB for the ongoing improvements to its inspection program and its decision to implement a new research agenda. He encouraged the PCAOB to continue to advance and finalize other important and challenging projects on its standard-setting agenda, including auditing accounting estimates.

Role of the FASB and IASB

Standard setters play an important role in assuring that new standards result in objective, neutral and useful information about economic activities even if the updated information affects the business decisions of market participants. Mr. Bricker commended both the FASB and IASB on their standard-setting activities for the benefit of investors and emphasized how important it is for the Boards to respond to investors' needs in a timely manner and to effectively use post-implementation reviews.

Mr. Bricker stated that his staff monitors the development of IFRS standards and interprets their application through the consultation process, thus integrating IFRS into all aspects of OCA's work. At the same time, he believes that for the foreseeable future, US GAAP will continue to best serve the needs of investors and other users who rely on financial reporting by US issuers. Mr. Bricker said it is worth continuing to consider his predecessor's proposal to allow domestic issuers to provide IFRS-based information as a supplement to their US GAAP financial statements without reconciliation as a non-GAAP measure.

Remarks by Russell Golden, Chairman of the FASB

FASB Chairman Russell Golden, who was recently appointed to another term ending in 2020, discussed the five priorities he set when he became Chairman in 2013: improvements, implementation, ideals, inclusiveness and international, which he referred to as the five "I's."

'Technology gives us our greatest opportunity to improve financial reporting.'

– Russell Golden, FASB Chairman

Improvements

Mr. Golden said the Board has improved US GAAP by completing several major projects. He called the new revenue recognition standard a major achievement in the Board's efforts to improve and converge US GAAP with IFRS on an important area of financial reporting that affects all companies. The new leases standard will result in a more faithful representation of leasing activities because it requires lessees to recognize most leases on their balance sheets. The current expected credit loss (CECL) model in the new credit loss standard also represents an improvement to today's "incurred loss" approach. Mr. Golden also said the FASB's simplification initiative has succeeded in reducing costs for preparers without compromising the quality of information provided to investors.

Mr. Golden said the FASB plans to continue improving US GAAP by issuing final standards in 2017 on hedge accounting and the accounting for long-duration contracts issued by insurers (e.g., life insurance, annuities). The FASB also plans to issue final standards on classifying debt as current or noncurrent and the accounting for non-employee share-based payment awards.

Mr. Golden said the Board received valuable feedback on its Invitation to Comment on future agenda priorities. Mr. Golden noted that some constituents said the Board should slow down on new projects until stakeholders have the chance to implement the major new standards, and the Board will consider this feedback when determining how to manage the pace of change while continuing to improve US GAAP.

How we see it

Over the next few years, we believe that the Board should focus its efforts on monitoring implementation of the new standards, completing major projects, including the Conceptual Framework, addressing additional issues that may arise and completing targeted improvements already on its agenda rather than beginning any major new projects.

Implementation

The FASB has taken a more proactive approach to support the implementation of new accounting standards. Mr. Golden commented on the success of the TRG for Revenue Recognition in which various stakeholders around the globe were involved. Mr. Golden said input from these stakeholders helped the Board quickly identify issues that could have led to diversity in practice. Based on that success, the Board convened a TRG on credit losses to address implementation issues before it issued that final standard. Members of that TRG were able to weigh in on the draft guidance, which Mr. Golden said should reduce the need to make technical corrections later.

Mr. Golden said the FASB did not create a TRG for the new leases standard because, in the Board's view, the changes in lease accounting are not as significant as revenue recognition and credit losses. He noted, however, that the FASB staff is monitoring the questions that are arising about implementation of the new leases standard and stands ready to address them.

Inclusiveness

Mr. Golden said the Board is making standard setting more inclusive by focusing on gaining a better understanding of the differences between large and small public companies, nonpublic companies and not-for-profit organizations and when those differences require different accounting. The FASB also has promoted inclusiveness through its outreach and through the introduction of new, plain English communications materials.

'By improving our economic analysis of standards under development, we can have greater confidence that the benefits of those new standards will justify their costs.'

– James Doty, PCAOB Chair

Ideals

The FASB continues to focus on its foundational projects on the conceptual framework and the disclosure framework. The conceptual framework gives the Board a starting point for addressing an accounting issue. The disclosure framework would serve a similar function, providing the FASB with a consistent methodology for approaching decisions about disclosures. Mr. Golden emphasized that the objective of the disclosure framework project is making disclosures more meaningful, not necessarily reducing the volume of disclosures.

International

Mr. Golden said the FASB continues to collaborate with the IASB and other international standard setters. The FASB has contributed to improving IFRS through its membership in the IASB's Accounting Standards Advisory Forum, and the FASB has met with standard setters from Canada, Japan, China, Korea and other nations to share ideas on how to improve accounting standards. The FASB expects to have joint meetings with these standard setters in 2017 to talk about priorities and future initiatives.

Mr. Golden reiterated that the completion of the joint revenue recognition standard by the FASB and the IASB will contribute to more comparable global accounting standards. Although the Boards reached different conclusions on certain aspects of the leases and credit losses standards, Mr. Golden emphasized that the Boards agree on the important principles that most leases belong on the balance sheet and that a more forward-looking model for credit losses is needed.

Remarks by James Doty, Chairman of the PCAOB

Mr. Doty said the PCAOB "has a unique and indispensable role in helping companies maintain investor trust, avoid financial reporting failures, and in turn has helped our economy and capital markets remain resilient and grow." He also said that the PCAOB has improved the overall landscape by improving audits and by changing firms' mindsets and execution.

Mr. Doty said that the PCAOB has forged a constructive relationship with audit firms, "albeit a somewhat adversarial one." Such a relationship "benefits our economic system, protects investors, provides clarity on essential standards, helps companies stay on track and contributes to capital formation," he said.

Inspections update

Mr. Doty said that the "issuance of regular inspection reports provides meaningful information that didn't exist before, and that helps all parties, including investors, audit committees, and companies, make better decisions." To preview its 2015 inspection findings and describe the scope and objectives of 2016 inspections of audits of public companies and broker-dealers, the PCAOB issued Staff Inspection Briefs this year. The PCAOB also issued its fifth annual inspection report on the temporary broker-dealer program, and Mr. Doty said the Board plans to develop a proposal for a permanent program based on the insights gained through past inspection cycles.

Improvements to the PCAOB's standard-setting process and other outreach efforts

Mr. Doty provided an overview of the PCAOB's standard-setting activities and discussed improvements the PCAOB has made to its process to issue "better and clearer standards related to the performance of audits." He also noted that the PCAOB created a research agenda to allow the PCAOB staff to perform "deeper research before embarking on new projects as well as enhancing outreach at all stages."

In 2016, the PCAOB continued to increase its outreach efforts to audit committees to enhance the Board's awareness of audit risks and challenges. The PCAOB also met with preparers, auditors and SEC staff members to understand challenges they have faced in assessments of ICFR. Finally, Mr. Doty noted that the PCAOB was nearing completion of its project to make the auditor's report more informative, and he highlighted some of the benefits that have been expressed by stakeholders in other jurisdictions that have implemented similar requirements.

'[DCF staff] will begin issuing comments on these [transition] disclosures when they are materially deficient.'

– Cicely LaMothe, Associate Director in the Division of Corporation Finance

PCAOB Center for Economic Analysis

Mr. Doty also discussed the PCAOB's efforts to build its capabilities in research and economic analysis through the Center for Economic Analysis (Center). Mr. Doty said the Center is evaluating both the potential effect of proposed rules and the effects of rules and audit standards the PCAOB has issued. "By improving our economic analysis of standards under development, we can have a greater confidence that the benefits of those new standards will justify their costs," he said. Mr. Doty also noted that the Center issued for public comment the PCAOB's first post-implementation review analyzing the effect of Auditing Standard (AS) 7, *Engagement Quality Review*. The Center also is studying many of the potential audit quality indicators on which the PCAOB sought comment in 2015.

Accounting and disclosure matters

New accounting standards

Transition disclosures

Sylvia Alicea, a staff member in OCA, reminded registrants that they need to disclose the effect of adopting new accounting standards in future periods in accordance with SAB Topic 11.M. She said that if a registrant does not know or cannot reasonably estimate the effect that the adoption of a new standard will have on its financial statements, it should make a statement to that effect and consider providing qualitative disclosures to help the reader assess the potential significance of the effect on the registrant's financial statements. These qualitative disclosures should include a description of the new standard's effect on the registrant's accounting policies and provide a comparison to the registrant's current accounting policies.

Jenifer Minke-Girard, Assistant Deputy Chief Accountant in OCA, said that in addition to the requirements of SAB 11.M, companies should consider qualitative disclosures that include a description of the process they are using to assess the effect of the new standard, where they are in the implementation process, what matters still need to be addressed and what additional steps they plan to take.

SEC staff members offered the following observations on transition disclosures:

- A registrant should not be reluctant to disclose reasonably estimable quantitative information (even if it's only for a subset of the registrant's arrangements such as one product category or revenue stream) merely because the ultimate effect of adoption may differ from the information disclosed.
- If a registrant's transition disclosures were prepared based on the best information available at the time and that information subsequently changes, the resulting change in disclosure would likely not indicate the existence of a control deficiency. However, if transitional disclosures are based on information that may subsequently change, the registrant should include a statement that the disclosures are preliminary in nature.
- Transition disclosures should be consistent with other information provided to the audit committee and investors, and the disclosures should be subject to effective ICFR.

How we see it

In addition to the disclosures discussed above, companies should consider the need for Management's Discussion and Analysis (MD&A) disclosures that discuss the effect the standards may have on their business (e.g., expected changes in contract arrangements, effect compliance with debt covenants).

Ernst & Young LLP (EY) resources

- *Financial reporting developments, Revenue from contracts with customers (ASC 606)* (SCORE No. BB3043)

Revenue recognition

Ms. Alicea and Ruth Uejio, staff members in OCA, discussed several matters related to the new revenue standard.

Definition of a contract

Certain contracts may be executed as part of a loss leader strategy in which a good is sold at a loss with an expectation that future sales contracts will result in higher sales and/or profits. In determining whether these anticipated contracts should be part of the accounting for the existing loss leader contract, Ms. Alicea observed that the definition of a contract in ASC 606 is based on enforceable rights and obligations in the existing contract. While it may be likely that the customer will enter into a future contract or the customer may even be compelled economically or by regulation to do so, it would not be appropriate to account for an anticipated contract due to the absence of enforceable rights and obligations.

Contract combination

The combination guidance in ASC 606 explicitly limits which contracts may be combined to those with the same customer or related parties of the customer. The SEC staff objected to extending the contract combination guidance beyond those parties even though other criteria for combination were met.

Consideration paid or payable to a customer

Ms. Uejio discussed accounting under the new revenue standard for payments made to customers. Given there are many reasons why a company may make payments to its customers, the accounting conclusions will depend on specific facts and circumstances. A company must first determine why the payment was made to determine its nature and substance, she said.

The staff in OCA would consider the following questions when evaluating the accounting for payments made to a customer under ASC 606:

- What are the underlying economic reasons for the transaction? Why is the payment being made?
- How did the company communicate and describe the nature of the customer payment to its investors?
- What do the relevant contracts governing the payment stipulate? Does the payment secure an exclusive relationship between the parties? Does the payment result in the customer committing to make a minimum level of purchases from the vendor?
- What is the accounting basis for recognizing an asset or recognizing an up-front payment immediately through earnings?

Once a company has determined the substance of the payment, a company should account for the payment using an accounting model that is consistent with the identified substance of the payment and relevant accounting literature, Ms. Uejio said. In doing this, companies should carefully and impartially evaluate all of the facts and circumstances and establish accounting policies that are consistently applied. In addition, Ms. Uejio expressed her view that matching the cost of the payment to the anticipated future revenue is not a determinative factor to support asset recognition for an up-front payment made to a customer.

Gross versus net presentation

Under the new revenue standard, an entity is a principal and therefore records revenue on a gross basis if it controls a specified good or service before transferring that good or service to the customer. An entity is an agent and records as revenue the net amount it retains for its agency services if its role is to arrange for another entity to provide the goods or services.

Ms. Uejio said that the determination of whether a company is the principal or the agent could be challenging for evolving business models and could be different from the conclusion reached under current US GAAP. In adopting ASC 606, companies should revisit their current principal versus agent conclusions based on whether they control the specified good or service before it is transferred to the customer.

Ms. Uejio cautioned against viewing either gross or net reporting as a default or a safe harbor. Instead, the specific facts and circumstances of an arrangement should drive the final accounting conclusion. Finally, Ms. Uejio said that the disclosures related to the principal versus agent determination are important because they allow investors to understand the registrant's role in the arrangement.

How we see it

Consistent with legacy US GAAP, entities will need to carefully evaluate whether a gross or net presentation is appropriate. While the new standard includes guidance that is similar to legacy GAAP, the key difference is that the new guidance focuses on control of the specified goods and services as the overarching principle for entities to consider in determining whether they are acting as a principal or an agent. This could result in entities reaching different conclusions than they do under legacy GAAP.

SAB Topic 13

Ms. Alicea said SAB Topic 13, *Revenue recognition,* will continue to apply to registrants prior to the adoption of the new revenue standard. However, for implementation-related consultations, the SEC staff's starting point is the new revenue standard, and registrants should apply ASC 606 instead of SAB Topic 13 when evaluating the post-adoption accounting for their revenue arrangements.

Disclosure matters

Cicely LaMothe, Associate Director in DCF, cautioned registrants that the staff will look outside of the financial statements (e.g., investor presentations, earnings releases, financial information reviewed by the chief operating decision maker (CODM)) to determine the adequacy of the disclosures of disaggregated revenue required by ASC 606-10-50 (e.g., disaggregation by type of goods or services, geographical region, customer).

EY resources

- *Technical Line, A closer look at the new credit impairment standard* (SCORE No. 03320-161US)

Credit losses

Sean May, a staff member in OCA, said that, given the wide range of financial assets that are affected by the new standard on credit losses, virtually every registrant will be affected. Mr. May encouraged registrants to start the implementation process early. He said the standard does not specify a "one-size-fits all" method for measuring expected credit losses, and he encouraged registrants to identify challenging implementation issues.

Mr. May also said that the guidance in Financial Reporting Release No. 28[3] and SAB No. 102[4] will continue to be relevant, given the need to incorporate reasonable and supportable forecasts in applying the new standard. He emphasized that in planning for implementation of the new standard, registrants engaged in lending activities should be preparing to support their expected credit loss estimates by documenting the systematic methodology they plan to apply, including the rationale supporting each reporting period's conclusion that these estimates are consistent with the principles of the standard.

Susan Cosper, FASB Technical Director and Chair of its Emerging Issues Task Force, highlighted some implementation activities relating to the credit losses standard. No implementation issues have been submitted for consideration by the TRG to date. The FASB staff has responded to technical inquiries seeking clarification about the standard's requirements, which were mostly confirmatory in nature regarding acceptable methodologies for determining expected credit losses.

Leases

Ms. Cosper discussed questions the FASB has received to date on implementation of the new leases standard, most of which relate to lessee accounting and transition. She said the FASB has not received many questions on the definition of a lease, which was surprising given the increased focus under the new standard on the definition of a lease.

No questions or issues raised to date have required formal standard setting. In the absence of a TRG, Ms. Cosper said a majority of the implementation questions have been raised by representatives of a professional accounting association, but questions also have been raised by large accounting firms and through the FASB's technical inquiry service.

Ms. Uejio said OCA has consulted with registrants on implementation questions and is actively monitoring the activities of stakeholders to understand how implementation issues will be addressed. She encouraged preparers, accounting firms and others to continue to work together to achieve consistent application of the new standard. She also emphasized the importance of ICFR and said it will be a key factor for preparers in arriving at well-reasoned judgments that are grounded in the principles of the new leases standard.

EY resources

Technical Line, A closer look at the new guidance on classifying and measuring financial instruments (SCORE No. BB3145)

Financial instruments recognition and measurement

Brian Staniszewski, a staff member in OCA, shared observations about implementation of the new standard on classifying and measuring financial instruments.[5] The new standard, among other things, requires entities that elect the fair value option in ASC 825, *Financial Instruments*, for financial liabilities, to present the change in fair value caused by a change in instrument-specific credit risk (i.e., the entity's own credit risk) separately in OCI.

Mr. Staniszewski discussed the applicability of the new standard to hybrid financial liability instruments such as a debt obligation that is indexed to the price of gold and requires cash settlement. Rather than bifurcating the embedded gold derivative under ASC 815,[6] the entity makes an irrevocable election under ASC 815[7] to initially and subsequently measure the entire hybrid financial liability at fair value through earnings. Mr. Staniszewski stated that US GAAP does not prescribe a sequence that must be followed when making a fair value election pursuant to ASC 815 or ASC 825. As such, he believes an entity that elects the fair value option under either guidance for an eligible hybrid instrument should follow the presentation requirements in the new guidance related to presenting a change in instrument-specific credit risk. Moreover, because the fair value of the instrument described in the example above would be affected by the price of gold, Mr. Staniszewski believes that use of the "base market risk method" (described in ASC 825-10-45-5) would not faithfully represent the portion of the total change in fair value attributable to instrument-specific credit risk.

Mr. Staniszewski also discussed the application of the new presentation guidance to nonrecourse financial liabilities. A nonrecourse financial liability is an instrument for which the payment is solely tied to the value or cash flows of an asset(s) pledged as collateral. That is, there is no recourse to the debtor. The risk of nonpayment, and the corresponding changes in the financial liability's fair value, are directly affected by the risk attributable to the performance of the underlying assets. In this fact pattern, Mr. Staniszewski believes that no portion of the change in the nonrecourse financial liability's fair value would be attributable to instrument-specific credit risk. Therefore, the entire change in fair value would be reported in earnings.

Insurance disclosures

Craig Olinger, Deputy Chief Accountant in DCF, discussed how insurance companies should present material acquisitions, dispositions and foreign currency in the claims development tables required by Accounting Standards Update (ASU) 2015-09, which does not prescribe specific requirements for such transactions or foreign currency translation.

Mr. Olinger said that retrospectively restating the claims development tables for material acquisitions generally would achieve the objectives of ASU 2015-09 while reflecting the acquisitions prospectively from the acquisition date might not. If registrants nevertheless choose to use a prospective approach to depict the acquired business, separate claims development tables should be presented for the acquired liabilities and the registrants' existing business, said Mr. Olinger. He also stressed that registrants should carefully evaluate the definition of accident year under the new standard, and depicting the year of acquisition as the accident year for acquired liabilities would not be consistent with that definition.

For material dispositions, Mr. Olinger said a retrospective approach that removes the disposed business from the claims development tables would be consistent with the objectives of the new standard to reflect liabilities that exist at the most recent balance sheet date.

As for the effect of foreign currency exchange rates, Mr. Olinger said that recasting all of the data in the claims development tables using current-period exchange rates or presenting separate claims development tables by each functional currency would be consistent with the objectives of the new standard. In his view, the use of multiple foreign currency translation rates may not be appropriate because it could distort trends and other useful information.

Mr. Olinger said insurance companies do not need to continue to disclose a consolidated 10-year claims development table in MD&A once they begin disclosing the claims development tables required by ASU 2015-09, and the staff has updated its Financial Reporting Manual to reflect this view.[8]

Reporting considerations for new standards

Nili Shah, Deputy Chief Accountant in DCF, explained how a company's adoption of a new accounting standard will affect registration statements filed or amended in the year of adoption. In new or amended registration statements filed after reporting the first interim period reflecting adoption of the new standard, companies that use the full retrospective transition method to adopt ASC 606 must provide retrospectively recasted financial statements for the most recent annual periods required to be included (or incorporated by reference). This would not apply if a company uses the modified retrospective method because it does not require recasting any periods before the date of adoption.

While the same requirements also apply to new or amended registration statements filed after a company adopts the leasing standard, the modified retrospective transition provisions in ASC 842, *Leases,* limit recasting to the date of initial application, which is defined as the beginning of the earliest comparative period presented in the year of adoption. As a result, only the most recent two years (one year for a smaller reporting company) would need to be retrospectively revised for purposes of the registration statement.

While the SEC does not intend to change the registration form requirements to eliminate or modify this requirement, the SEC staff did highlight that ASC 250-45-5 related to accounting changes provides an exception if retrospective revision is impracticable. While preclearance would not be required to rely on the exception, DCF-OCA staff is available to discuss fact patterns with companies.

Keith Higgins, Director of DCF, highlighted that the SEC staff would not object if companies and their securities counsel conclude that the adoption of new accounting standards like revenue and leasing are not "fundamental changes" for purposes of drawing on an effective shelf registration statement. A fundamental change would require a post-effective amendment to the shelf registration statement, which would trigger the need to recast as discussed above.

Existing accounting standards

Accounting policies

ASC 250[9] provides guidance on the accounting for and reporting of accounting changes. ASC 250 is clear that once an accounting principle is adopted, it must be used consistently in accounting for similar events and transactions. An entity may change an accounting principle only if it justifies the use of an allowable alternative accounting principle on the basis that it is preferable.

Mr. May said that OCA has had recent consultations with registrants that, unrelated to the adoption of a new ASU, applied an alternative accounting policy to certain new transactions or events. He observed that judgment is required when determining whether transactions or events are clearly different in substance from those occurring in the past and could warrant adoption of a new accounting principle rather than applying an existing accounting principle. Mr. May emphasized the following:

- Clear documentation regarding the nature of the transactions or events that resulted in the existing accounting policy is the starting point of the analysis
- Determining whether transactions or events are clearly different in substance from those occurring in the past requires judgment

- That identifiable differences between certain transactions or events do not necessarily equate to a clear difference in substance that justify applying a new or revised accounting principle

Equity method accounting and the definition of 'public business entity'

US GAAP defines a public business entity (PBE) broadly, saying a business is a PBE if it meets certain criteria including:

> "(a) it is required to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in the filing)."

As a result, equity method investees whose financial statements or summarized financial information are included in a registrant's filing under Regulation S-X, Rule 3-09, *Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons*, Regulation S-X, Rule 3-05, *Financial Statements of Businesses Acquired or to Be Acquired*, or Regulation S-X, Rule 4-08(g), *Summarized Financial Information*), are considered PBEs for the purposes of such financial statements or financial information. This would require those investees to use PBE effective dates for new accounting standards such as ASC 606.[10]

When equity method investees meet the definition of a PBE, Jonathan Wiggins, a staff member in OCA, said that the registrant's equity method accounting should be based on the investees' financial statements prepared using the PBE effective dates of new standards.

Mr. Wiggins said this wouldn't be the case for an equity method investee that doesn't otherwise meet the definition of a PBE such as when a registrant just uses the investee's financial information as a basis for recording equity method earnings or losses. Mr. Wiggins said that "amounts recognized by a registrant in applying the equity method of accounting would not be considered financial information included in a filing with the SEC under the FASB's definition of public business entity." Therefore, such equity method investees would not be required to use the effective dates for PBEs solely for purposes of the registrant's equity method accounting.

EY resources

- *Financial reporting developments, Equity method investments and joint ventures* (SCORE No. BB02230)
- *Financial reporting developments, Consolidation: Determination of a controlling financial interest and accounting for changes in ownership interests* (SCORE No. BB02856)
- *Technical Line, A closer look at the new definition of a public business entity* (SCORE No. BB2708)

Equity method investees that trigger summarized information or separate financial statements will need to apply PBE adoption dates in the registrant's financial statements for purposes of equity method accounting.

How we see it

Rule 4-08(g) requires summarized financial information about equity method investees in the notes to the financial statements if the investees individually or *in the aggregate*, exceed 10% significance under any of the significant subsidiary tests in Rule 1-02(w) of Regulation S-X. For this reason, individually insignificant equity method investees may meet the definition of a PBE if their significance, when considered in the aggregate with the investor's other equity method investments, requires disclosure of summarized financial information to be included in the investor's financial statements (whether such information is presented individually or in the aggregate with other investees).

Joint ventures, strategic alliances and other collaborative-type arrangements

Mr. Wiggins discussed the accounting implications of joint ventures, strategic alliances and other collaborative-type arrangements. He said a company may need to consider several accounting topics to determine the appropriate accounting for these arrangements. In addition, the facts and circumstances of an arrangement can significantly affect the accounting for that arrangement. For example, Mr. Wiggins reminded companies that they should carefully consider whether their conclusions regarding decision-making authority are consistent with the substance of the underlying arrangements and the objective of the consolidation guidance.

Alternatively, when the activities of an arrangement are conducted outside of a legal entity or the entity is not consolidated, Mr. Wiggins encouraged registrants to carefully evaluate the facts and circumstances of the arrangement to identify the applicable accounting guidance. For example, he said a company will need to determine whether an arrangement meets the definition of a joint venture or collaborative arrangement or whether it is in the scope of ASC 606.

Income taxes

Accounting considerations

ASC 740 includes a presumption that all undistributed earnings of a subsidiary will be transferred to the parent entity, resulting in the parent entity accruing taxes on the undistributed earnings[11] unless the parent has sufficient evidence of specific plans such that the remittance to the parent company will be postponed indefinitely.[12]

Mr. Staniszewski said that OCA has questioned registrants when disclosures made outside of the audited financial statements appeared to contradict assumptions relied upon in asserting indefinite reinvestment, and in certain cases, has objected to a deferred tax liability not being recognized. Mr. Staniszewski suggested companies consider coordination among multiple business functions within a company's global organization (e.g., accounting, treasury, tax) when considering the accounting for undistributed earnings.

MD&A disclosure considerations

Ms. Shah expressed concerns about the quality of MD&A disclosures related to income taxes. She said that registrants' income tax disclosures in MD&A often aren't cohesive and don't tell a complete story about the company's tax positions and related trends and uncertainties.

Ms. Shah said that when reviewing the income tax disclosures in MD&A, the staff is primarily looking for robust MD&A disclosures related to:

- Reasons for historical changes in the effective tax rate
- Discussion about changes in reconciling items between the effective and statutory tax rates
- Insight into the extent to which past income tax rates are indicative of future tax rates
- Trends and uncertainties related to changes in unrecognized tax benefits
- Differences between trends in income tax expenses and cash taxes paid

Ms. Shah also said that companies could improve the quality of their MD&A disclosures related to income tax rate reconciliations and cash in foreign jurisdiction that is subject to permanent reinvestment assertions. Ms. Shah also expressed concerns about boilerplate disclosures in MD&A related to changes in valuation allowances on deferred tax assets, particularly when valuation allowances are released. She said companies should provide more specific disclosures about the possible sources of taxable income used to support the reversal of valuation allowances on deferred tax assets.

Discount rates used to measure the interest cost of defined benefit pension plans

Following up on a speech at last year's Conference on the discount rate used to measure the interest cost in defined pension plans, Ms. Uejio said that the SEC staff in OCA consulted on a different fact pattern this year proposing to use the spot rate approach when the yield curve methodology was not used to measure the pension benefit obligation (PBO) but a hypothetical bond matching methodology was used instead.

Recently, the staff objected to the use of the spot rate approach when the yield curve methodology was not used because the measurement of the PBO and the determination of interest cost are integrated concepts, she said. That is, the information used to measure the PBO was not proposed to be used to calculate interest cost. Ms. Uejio said companies should measure the PBO first and then attribute the change in the PBO to the various components of net pension cost, including interest expense. In computing the interest expense, a company should use the same information it used to measure the PBO.

Establishing a grant date for share-based payments

Mr. May discussed the need for careful consideration when determining under ASC 718[13] whether a grant date has been established for share-based payment awards that include key terms or conditions subject to discretion of the compensation committee or the board (e.g., clawback provisions). Mr. May said that when determining whether a mutual understanding has been reached and a grant date has been established, a registrant also should assess the past practices exercised by those with authority over compensation arrangements and how those practices may have evolved over time. As part of this evaluation, Mr. May said registrants should consider whether appropriate ICFR exists to monitor those practices and support the judgment made by the company.

EY resources

- *Financial reporting developments, Segment reporting (SCORE No. BB0698)*

Segment disclosures

Ms. Shah discussed themes in recent staff comments on segment reporting and said segment disclosures continued to be one of the top areas of staff comments in 2016.

Ms. Shah highlighted the following broad categories of recent comments on segments:

- *Identification of operating segments* — The SEC staff generally objects to a company's assertion that a component is not an operating segment because no shared operating costs are allocated to the component. Ms. Shah noted that if gross margins are available for a component, it may indicate that discrete financial information is available to classify a component as an operating segment.

- *Aggregation of operating segments* — Some registrants do not perform a robust analysis for qualitative similarities if their analysis of economic similarities supports the aggregation of operating segments. Ms. Shah emphasized the importance of performing an analysis of qualitative similarities because all the criteria for aggregation must be met. In particular, she said qualitative similarities should be considered in light of the scope and diversity of a company's products and services. Regarding the analysis of economic similarities, she noted that there is no bright line quantitative threshold in ASC 280, and registrants should use reasonable judgment, taking into account their understanding of the business and industry.

Ms. Shah also reminded registrants that they should evaluate all relevant data points when reaching their conclusions on operating segments including the CODM report, organization chart, compensation arrangements and budgeting process.

How we see it

In our latest SEC Comments and Trends publication, segment reporting was the fifth most frequent topic of staff comment during the 12 months ended 30 June 2016, up two spots from seventh in the prior year.

EY resources

- *To the Point, SEC staff updates guidance on non-GAAP financial measures* (SCORE No. 01108-161US)
- *Technical Line, Spotlight on non-GAAP financial measures* (SCORE No. 00785-161US)
- *Technical Line, A closer look at the SEC staff's scrutiny of non-GAAP financial measures* (SCORE No. 03290-161US)

In most cases, the staff is unlikely to object to non-GAAP measures that remove restructuring charges.

Non-GAAP financial measures

The SEC staff has stepped up its focus on non-GAAP measures over the past year. Mr. Higgins reiterated comments made at last year's Conference that the staff is focusing on non-GAAP financial measures because of the growing divergence between these measures and GAAP measures and the emphasis by third parties on non-GAAP measures.

Mark Kronforst, Chief Accountant in DCF, told the audience that the SEC staff is not trying to "eradicate" non-GAAP financial measures. He noted that companies' use of non-GAAP financial measures has improved over the course of the year, especially relating to prominence of their presentation, but that there is still some work to be done.

Mr. Kronforst expressed the staff's views on some specific non-GAAP measures and adjustments.

- *Stock compensation* — Mr. Kronforst indicated that the staff would not object to non-GAAP measures that include adjustments for stock compensation, but that there are best practices companies could follow to determine whether stock compensation adjustments are appropriate (e.g., considering whether stock compensation is integral to understanding the business).

- *Restructuring charges* — Despite recent staff comment letters asking companies whether adjustments for restructuring charges removed recurring cash operating expenses, the staff indicated it is unlikely to object to such adjustments in most cases. Any objections would likely be limited to fact patterns involving the constant monitoring and streamlining of costs to drive efficiency rather than individual "discrete restructuring plans," he said.

- *Business combinations* — Following a business combination, the staff will not object to non-GAAP adjustments that eliminate the effects of recording inventory or deferred revenue at fair value. However, the staff did not offer additional insight into other common non-GAAP adjustments related to business combinations such as acquisition costs or amortization of acquired intangibles.

- *Individually tailored accounting principles* — Mr. Kronforst said the staff has objected to a few types of non-GAAP measures that use individually tailored accounting principles.[14] These measures include those that accelerate revenue recognition, change the number of shares used in calculating earnings per share or alter consolidation principles by presenting financial statement measures using proportionate consolidation, for example. Mr. Kronforst clarified that, in limited situations, companies may make certain adjustments to revenue based on facts and circumstances (e.g., adjustments that reflect the expected effects of ASC 606) and that companies should discuss these adjustments in advance with the staff.

- *Prominence* — Companies' compliance with the rules on the relative prominence of non-GAAP financial measures has improved in recent earnings releases and filings. However, the staff is now issuing comments requesting that companies present the GAAP measure first in the required non-GAAP reconciliation (i.e., reconciling from GAAP to the non-GAAP measure) because presenting the non-GAAP measure first would give it undue prominence.

Mr. Kronforst said that until the staff performs additional outreach and research, it is unlikely to comment on measures with adjustments for certain aspects of pension accounting or unrealized gains or losses on derivatives. As it relates to non-GAAP measures and ASC 280 segment disclosures, companies cannot circumvent the non-GAAP rules by presenting multiple segment measures of profit in their financial statements nor should they present a segment measure of profit when there is only one reportable segment.

Members of a panel on non-GAAP measures also discussed whether non-GAAP measures presented in an earnings release or other communication would need to be included in the subsequent SEC filing (e.g., 10-K or 10-Q). While there is no legal requirement to do so, the consensus was that companies should consider whether the non-GAAP measures are integral to understanding the business through the eyes of management and therefore should be disclosed in MD&A.

Other non-GAAP considerations

Mr. Kronforst said the staff has given companies some flexibility to adjust their non-GAAP measures to conform to the updated interpretations over more than one interim period. This transition period was helpful for companies to give users time to adjust to using the revised non-GAAP measures.

The staff also mentioned that it will not consider changes made to implement the updated interpretations to be a deficiency in the company's prior DCP. However, companies should strengthen their DCP to help prevent future non-compliance. Representatives from the SEC's Division of Enforcement emphasized the importance of DCP and said that non-GAAP measures have become a significant area of focus for them.

Standard setters on non-GAAP

Standard setters within and outside the US are focusing on non-GAAP measures. The FASB and PCAOB are discussing with their advisory committees and stakeholders how and why investors use non-GAAP measures. In addition, Hans Hoogervorst, IASB Chairman, said that IASB members "share the SEC's concern that non-GAAP generally paints a rosier picture of a company's performance than GAAP … non-GAAP measures that consistently flatter a company's performance are probably not the best basis for sound business decisions." He said companies' audit and compensation committees need to challenge whether such measures are used appropriately.

The SEC staff has challenged whether PCAOB inspections findings are also indicative of deficiencies in management's assessment of ICFR.

ICFR, audit standards and independence matters

Internal control over financial reporting

The PCAOB held a number of outreach sessions in 2016 with various stakeholders to continue the dialogue that began in 2015 regarding concerns about ICFR assessments. PCAOB members and staff participated, along with auditors, audit committee members, financial statement preparers and observers from the SEC staff.

In a panel discussion on ICFR, PCAOB member Jay Hanson and Kevin Stout, Senior Associate Chief Accountant in OCA, characterized these discussions as constructive. They noted that while initiatives undertaken in 2015 hadn't yielded all the benefits that were expected due to their timing, progress appears to have been made in a number of areas. As a result, they emphasized the need for ongoing interaction between these parties to improve both the effectiveness and efficiency of ICFR assessments.

As they did at last year's Conference, members of the SEC staff stressed the importance of open and timely communication among management, the auditor and the audit committee regarding risk assessments, the extent of tests of controls and the level of evidence needed to support both management's assessment and the auditor's conclusions on ICFR.

Marc Panucci, who took over recently as Deputy Chief Accountant for Professional Practice in OCA, said that "timely and effective communication between these parties on ICFR remains of continued importance, not only for accurate assessments of ICFR, but also ultimately for more reliable financial reporting for the benefit of investors." Mr. Stout added that this

dialogue is critical to bridging the differences that may exist between management's and the auditor's risk assessments. Mr. Stout also emphasized that this dialogue should occur timely and at an appropriate level of detail to have a meaningful effect on the development of an effective and efficient ICFR audit plan.

ICFR continues to be a significant source of PCAOB inspection findings. Mr. Stout encouraged management and audit committees to view those findings broadly and consider whether they indicate deficiencies in management's processes. Specifically, Mr. Stout asked registrants to consider whether PCAOB inspection findings may indicate that management is:

- Placing unwarranted reliance on controls that are not designed at a sufficient level of precision to address the risk(s) of material misstatement
- Not considering whether the effectiveness of a control depends on the effectiveness of other controls, and properly assessing the effectiveness of those controls
- Improperly concluding on the design and operating effectiveness of certain controls without sufficient evidence

Members of the SEC staff also reminded management, auditors and audit committees that they need to consider ICFR when implementing and adopting new accounting standards, including controls over the transitional disclosures required prior to adoption of new accounting standards. Mr. Panucci stressed that "qualified accounting resources and appropriate processes and controls will be of vital importance in connection with the adoption of the new accounting standards."

How we see it

We continue to support the efforts of the SEC and the PCAOB to encourage dialogue between financial statement preparers, auditors and audit committees to promote more efficient and effective audits of ICFR. We also encourage the PCAOB to continue its efforts with respect to improving its standard-setting process and other outreach efforts.

Implementation and monitoring of new audit standards

Jennifer Todling, a staff member in OCA, stressed the importance of having a wide range of constituents involved in monitoring the implementation of new audit standards. Ms. Todling noted that while auditors will have direct responsibility for implementation, "other stakeholders, including audit committees, management, investors and academics should consider how they can contribute to help maximize the intended benefits and minimize potential unintended consequences of new auditing standards."

Specifically, Ms. Todling emphasized the importance of frequent communication among stakeholders to promote the efficient implementation of new auditing standards and the early identification of challenges. Regulators, including the PCAOB, "should also consider whether they have provided adequate guidance to facilitate successful implementation" and remain engaged with and responsive to stakeholders during the post-implementation period.

Auditor independence matters

Mr. Panucci emphasized that compliance with the auditor independence rules continues to be a significant topic of consultations with OCA, particularly with regard to the adoption and implementation of new accounting standards. The SEC staff has seen an increase in questions about relationships and/or services not specifically prohibited by Rule 2-01(c) of Regulation S-X and that require consideration under the general standard of auditor independence.

Mr. Panucci said these rules are important to keep in mind not only when the audit committee pre-approves permissible non-audit services but also throughout the delivery of the service. As non-audit services are provided, "scope creep" into prohibited services would impair the auditor's independence.

Mr. Panucci emphasized that the growth of audit firms' consulting practices continues to be an important area to monitor as audit quality and independence are critical to investor's confidence in the audit. Mr. Panucci said the PCAOB's recently issued strategic plan identifies the firms' multidisciplinary structure as an emerging threat to auditor independence that the PCAOB will continue to monitor. He added, "A sustainable and viable audit profession is critically important for investors."

Accounting and SEC standard-setting update

FASB Invitation to Comment

Ms. Cosper gave an overview of the responses to the FASB's Invitation to Comment, *Agenda consultation*. The FASB received 45 comment letters, and the majority were from practitioners and preparers. The top priorities cited by the respondents included addressing the complexity of distinguishing liabilities from equity and concerns about the balance sheet classification of intangible assets. She said that users generally believe that reporting performance and cash flows should be a priority. One general concern respondents had was that, given the significant efforts required to implement new accounting standards, the FASB should allocate sufficient resources to practice issues and implementation support. Some respondents said the FASB should slow the pace of accounting change.

Disclosure effectiveness and SEC rulemaking

Regulation S-X and S-K concept releases

Mr. Higgins highlighted the SEC's rulemaking initiatives, particularly in the area of disclosure effectiveness. DCF made significant progress over the last year on disclosure effectiveness initiatives and SEC rulemaking required by the Fixing America's Surface Transportation (FAST) Act. Mr. Higgins noted the issuance of the recent report to Congress as required under the FAST Act with recommendations to modernize and simplify Regulation S-K. He observed that the report is distinct from the broader disclosure effectiveness initiative and does not provide a comprehensive list of changes under consideration to enhance disclosure effectiveness. Based on comment letters received in response to the SEC's Request for Comment, DCF is working on recommendations to the Commission on the rules in Regulation S-X about financial statements for entities other than the registrant.

DCF is also considering feedback on its Regulation S-K concept release. While some respondents favored additional environmental, social and governance (ESG) disclosure requirements, Mr. Higgins said there are diverse views on whether mandating ESG disclosures would be relevant for investors. A separate panel discussed efforts by the Sustainability Accounting Standards Board and other groups to develop standards for ESG disclosures.

Disclosure Update and Simplification Proposing Release (DUSTR)

The SEC staff views DUSTR as a "technical clean up" to remove outdated and redundant disclosure requirements, or refer to the FASB the current SEC disclosure requirements that overlap with US GAAP, without significantly altering the mix of information available to investors. The SEC staff said the level of support for the specific proposals in this release varied significantly. Investors generally asked for more rather than less disclosure, such as in the area of income taxes, while others supported removing substantially all the redundant and duplicative disclosure requirements identified in DUSTR.

Future rulemaking

Looking ahead, Mr. Higgins suggested that the proposed legislation in the Financial CHOICE Act, which has been passed by the House Financial Services Committee, could affect past and future SEC rulemaking. Among other things, the bill calls for repeal of certain disclosures mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, including those on conflict minerals, mine safety, resource extraction and the CEO pay ratio, in addition to other disclosures not yet adopted by the Commission. The CHOICE Act also would limit compensation clawbacks due to restatements to executives with responsibility for financial reporting, and it would expand exemptions under Section 404(b) of the Sarbanes-Oxley Act.

Interactions with the staff

OCA accounting consultation requests

Ms. Minke-Girard said OCA responded to approximately 125 accounting consultation requests over the past year, half of which came directly from registrants, while the rest came from the other SEC divisions and offices. She also said that approximately 30% of the accounting consultation requests involved smaller registrants and audit firms. She said the top three consultation topics were revenue recognition, business combinations and financial assets.

Division of Corporation Finance process matters

‘Remember that a comment letter process is a dialogue and don’t add disclosures just to end the review.’

– Cicely LaMothe, Associate Director in the Division of Corporation Finance

DCF staff provided practical advice about the SEC comment letter process. The staff characterized the comment letter process as a dialogue, observing that a registrant that receives a question from the staff should not necessarily presume that a change is warranted. The staff also recommended that registrants discuss materiality in their responses because the staff will not pursue further action on immaterial items. SEC staff members cautioned companies against analogizing to other registrants’ fact patterns in published comment letters because the basis of resolution may not always be apparent from what is publicly available.

For transactional filings, the staff recommended that the registrants allow sufficient time for the staff to evaluate significant new information added to filings, which could influence the offering schedule and timing of the road show.

On interpretive and waiver letters submitted to DCF-OCA, the staff recommended that registrants seek the input and feedback of their auditors prior to submission to make the review more efficient. DCF staff is planning to revise their protocol to require the independent auditor be involved in requests to waive or modify financial statement requirements.

International matters

The IFRS footprint and outlook for IFRS

Mr. Hoogervorst thanked Chair White “for the constructive cooperation [between the SEC and the IASB]… and for the considerable time and effort she devoted to [the IASB’s] cause.” He also noted that the FASB and IASB have a very cordial relationship that will continue in the future.

Mr. Hoogervorst said that three quarters of the G20 countries will be using IFRS when Saudi Arabia adopts the standards in 2017. He added that the number of companies voluntarily using IFRS in Japan is rising and that there have been significant developments in India towards adopting IFRS.

Mr. Hoogervorst also discussed the outlook for the IASB’s standard setting over the next 12 months. The IASB is in the process of finalizing its Conceptual Framework and will issue a new insurance contracts standard in the first half of 2017 that is expected to result in more consistent reporting across the globe. He said that with completion of this standard, the IASB will have filled most of the gaps in the IFRS suite of standards and that the IASB will focus in

the next couple of years on improving the current standards. He said the IASB needs to improve the communication value of financial reporting by addressing disclosure effectiveness, performance reporting and changes in how users obtain and use financial information.

Finally, Mr. Hoogervorst noted that the US continues to have an interest in IFRS given its widespread and expanding use around the globe. While IFRS is not required in the US, he noted that US investors have more than $7 trillion dollars invested in companies that report under IFRS.

Foreign private issuers and cross-border reporting challenges

Mr. Olinger said that as of 31 December 2015, about 500 of the approximately 900 foreign private issuers (FPIs) registered with the SEC prepared their financial statements in accordance with IFRS as issued by the IASB, and about 400 FPIs prepared their financial statements in accordance with US GAAP. Very few FPIs prepare financial statements in accordance with home-country GAAP reconciled to US GAAP.

Mr. Olinger said that the staff's comments to companies reporting under IFRS are similar to those it issues to companies reporting under US GAAP. Many of these issues are complex, and the IFRS and US GAAP accounting standards that govern them are converged or largely converged. As a result, he said the staff's comments tend to be driven by the nature of the events or transactions at the company rather than differences in the accounting standards.

Mr. Olinger also shared insights about the staff organization and process when evaluating accounting issues. DCF-OCA's staff and OCA staff are generally organized by accounting topics and not by category of issuers (domestic vs FPI) or by GAAP (US GAAP vs IFRS). He emphasized that the staff is careful to adhere to the IFRS standards when applicable rather than applying a US GAAP bias.

SEC enforcement and PCAOB inspection matters

Remarks of SEC enforcement staff

Andrew Ceresney, Director of the SEC's Division of Enforcement, and Michael Maloney, Chief Accountant in the Division of Enforcement, discussed the SEC's enforcement actions over the past fiscal year. Mr. Ceresney said the SEC filed a record number of cases (868) and ordered over $4 billion of disgorgement and penalties in the fiscal year ended 30 September 2016. Mr. Ceresney said that these enforcement actions involved the full spectrum of the federal securities laws.

Mr. Ceresney said that the Commission continued to enhance its use of data analysis and other tools to identify potential cases of misconduct. In a separate panel discussion, Scott Bauguess, a Deputy Director and Deputy Chief Economist in the SEC's Division of Economic and Risk Analysis, said the SEC has enhanced its data analysis tools to more effectively gather and analyze unstructured data in SEC filings to identify anomalies that may indicate potential fraud or misconduct.

Mr. Maloney discussed enforcement actions related to financial reporting matters and observed that the number and nature of accounting and auditing enforcement cases did not significantly change from the last fiscal year. Mr. Maloney said that these cases were primarily related to allegations of recording unsupported revenues, inappropriate acceleration of revenue recognition, untimely rebate income and expense recognition, understatement of expenses and accrued liabilities, and asset valuation and impairment issues.

Mr. Maloney also said that the SEC has brought enforcement actions against auditors for independence violations involving close personal relationships with management, and for audit failures stemming from a lack of sufficient professional skepticism, overreliance on management representations, and failure to obtain adequate audit evidence.

Mr. Maloney highlighted one recent enforcement action in which fraudulent journal entries to reduce the effective tax rate were masked by complex and convoluted explanations by certain members of management to mislead the auditors. Mr. Maloney emphasized that auditors need to use professional care and seek help from experts as appropriate when dealing with complex accounting areas.

PCAOB inspections

Helen Munter, Director of Registration and Inspections at the PCAOB, said that she believes audit quality is improving as inspection findings continue to trend downward. Ms. Munter stated that audit firms are more engaged, and firms are focusing on timely root cause analyses and taking substantive remedial actions. However, Ms. Munter noted there are still opportunities for improvement in certain areas of recurring inspection findings, including management review controls and other aspects of ICFR, assessing and responding to risks of material misstatement, and auditing accounting estimates, including fair value measurements. Therefore, despite the extensive remedial actions taken by audit firms, "We are approaching a critical point where without elimination or significant reduction of the most troubling recurring findings, firms should not expect that they will be able to satisfy remediation requirements easily," Ms. Munter said.

The PCAOB staff also identified three positive trends during 2016 inspections:

- Auditors are doing a better job of understanding issuers' processes, transactions and controls.
- Auditors are doing a better job of coaching at both the team level and the individual level.
- Firms are doing a better job of monitoring audit team performance during the execution phase of the audit.

Ms. Munter addressed the PCAOB's inspection methodology, noting that it continues to evolve. In 2017, she anticipates the formation of a team of inspectors dedicated to inspecting financial services audits across multiple firms to give the PCAOB the ability to consistently articulate concerns "in an effort to drive rapid remediation efforts in this very challenging area." Ms. Munter also said the PCAOB plans to issue a report summarizing the PCAOB's inspection findings associated with the implementation of AS 2410, *Related Parties*.

Ms. Munter said the PCAOB's 2017 inspections will likely focus on:

- Areas of recurring deficiencies, including ICFR, assessing and responding to risks of material misstatement and auditing accounting estimates, including fair value measurements
- Going concern evaluations
- Audit areas affected by economic risks and higher financial reporting risks, such as those affected by fluctuations in oil and gas prices
- Implementation of the PCAOB's new auditing standard on auditor transparency

- Implementation efforts for new accounting standards, including how firms are managing change and preparing audit teams to evaluate a company's transition, how they are monitoring and maintaining independence in connection with the transition and how they are reporting any concerns about an issuer's readiness to the audit committee

As part of the inspection process, the PCAOB will also inform their standard setting agenda through:

- Gathering information about the auditor's consideration, if any, of a company's use of non-GAAP measures, and what auditors do if a company is more aggressive in its use of these measures

- Gathering information about firms' use of technology in the performance of audits, including data analytics

Endnotes:

[1] EY Center for Board Matters, *Audit Committee Reporting to Shareholders in 2016*

[2] Rule 2-01(b) of Regulation S-X.

[3] 401.09.b Procedural Discipline in Determining the Allowance and Provision for Loan Losses to be Reported.

[4] SEC SAB Topic 6.L, Accounting for Loan Losses.

[5] For public business entities (PBEs), ASU 2016-1, *Financial Instruments — Overall (Subtopic 825-10),* is effective for fiscal years beginning after 15 December 2017, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019. Non-PBEs may adopt the standard as of the effective date for PBEs. Early adoption is permitted for certain provisions, including the provision requiring the presentation of the fair value change from instrument-specific credit risk in Other Comprehensive Income (OCI) for financial liabilities measured using the Fair Value Option(FVO) in ASC 825.

[6] ASC 815-15-25-1.

[7] ASC 815-15-25-4 through 5.

[8] Financial Reporting Manual (Question 11310.1).

[9] ASC 250, *Accounting Changes and Error Corrections*.

[10] ASC 606, *Revenue from Contracts with Customers*.

[11] ASC 740-30-25-3.

[12] ASC 740-30-25-17.

[13] ASC 718-10-30-3.

[14] Compliance and Disclosure Interpretations on Non-GAAP Financial Measures - Question 100.04

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Appendix — Conference speeches

	Speech and link to source
SEC Chief Accountant, Wesley Bricker	‣ Speech by SEC Chief Accountant: Working Together to Advance High Quality Information in the Capital Markets
SEC Deputy Chief Accountant, Julie Erhardt	‣ Speech by SEC Deputy Chief Accountant: Remarks at the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Deputy Chief Accountant, Marc Panucci	‣ Speech by SEC Deputy Chief Accountant: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Assistant Deputy Chief Accountant, Jenifer Minke-Girard	‣ Speech by SEC Assistant Deputy Chief Accountant: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Associate Chief Accountant, Jonathan Wiggins	‣ Speech by SEC Associate Chief Accountant: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Sylvia Alicea	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Sean May	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Brian Staniszewski	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Jennifer Todling	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow, Ruth Uejio	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2016 AICPA National Conference on Current SEC and PCAOB Developments
PCAOB Chair, James Doty	‣ Speech by PCAOB Chair: PCAOB's Role in Enhancing Public Trust and Integrity in Audits
PCAOB Director of Enforcement, Claudius Modesti	‣ Speech by PCAOB Director of Enforcement: Protecting Investors through Enforcement
FASB Chairman, Russell Golden	‣ Speech by FASB Chairman: Remarks at the 2016 AICPA Conference on Current SEC & PCAOB Developments
IASB Chairman, Hans Hoogervorst	‣ Speech by IASB Chairman: Safety in numbers
CAQ Executive Director, Cindy Fornelli	‣ Speech by CAQ Executive Director: Profession Proud