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Grant Thornton

New Developments Summary

Special Alert

Highlights of the 2018 AICPA Conference on Current SEC and PCAOB Developments

Embracing change in a dynamic environment

Summary

The AICPA held its 2018 Conference on Current SEC and PCAOB Developments in Washington, D.C. on December 10-12. The conference featured representatives from the SEC, PCAOB, FASB, IASB, AICPA, and Center for Audit Quality (CAQ), as well as others from the accounting profession, including auditors, financial statement preparers, legal professionals, and analysts.

Key themes shared throughout the conference included

- Importance of high-quality audits and financial reporting to the capital markets
- Navigation of shifts in a fast-paced and complex environment

This publication provides a synopsis of the themes as well as other important matters discussed during the conference. Links to speakers' publicly available speeches are included in the Appendix.

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A. Conference overview

The 2018 AICPA Conference on Current SEC and PCAOB Developments, held in Washington, D.C. on December 10-12, featured representatives from regulatory and standard-setting bodies, as well as industry professionals, legal practitioners, and analysts. Speakers and panelists shared their views on current accounting, financial reporting, auditing, and other emerging issues, which focused on two overarching themes:

- Importance of high-quality audits and financial reporting to the capital markets
- Navigation of shifts in a fast-paced and complex environment

Importance of high-quality audits and financial reporting to the capital markets

A conversation between SEC Chairman Jay Clayton and SEC Chief Accountant Wesley R. Bricker opened the conference, with moderator and CAQ Executive Director Cynthia Fornelli. The conversation began with Ms. Fornelli highlighting that investors continue to have confidence in U.S. markets, according to the CAQ's 2018 Main Street Investor Survey. Chairman Clayton stressed that high-quality audits and financial reporting are fundamental in maintaining confidence in U.S. markets and noted that high-quality, reliable financial statements are the "bedrock of the capital markets," a sentiment echoed in many of his speeches. Mr. Bricker showcased the "Financial Reporting Structure for Public Issuers Blue Print," a diagram that was developed by the SEC's Office of the Chief Accountant (OCA) to illustrate the financial reporting process and the role of each of the key stakeholders. He highlighted the importance of collaboration among stakeholders to ensure high-quality financial reporting.

As noted during the conversation, the importance of audit quality also flows into the global markets, where regulators have experienced challenges accessing audit-related information for U.S. listed companies with international operations. It was also noted that regulators agree that regulatory oversight in the global market is vital to maintaining high-quality audits, as evidenced in a recent joint public statement issued by Chairman Clayton, PCAOB Chairman William D. Duhnke III, and Mr. Bricker. The statement focuses on the vital role played by audit quality and regulatory access to audit and other information internationally, and includes a discussion of challenges that preclude access to current information for U.S. listed companies with significant operations in China. One common theme noted by both SEC and PCAOB presenters throughout the conference is that open and frequent communication with the international regulators is imperative to address these challenges.

The conference also featured an unprecedented panel with all five newly appointed PCAOB board members. PCAOB Chairman Duhnke began with a discussion of the Board's new strategic plan, highlighting its first goal: to drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation. The Board members emphasized a focus on regularly reassessing the Board's approach to oversight as a way to continuously improve audit quality, including researching data obtained from inspections and communicating to audit firms certain indicators of audit quality. One Board member underscored that a focus on an audit firm's quality control system will in turn reduce the number of deficiencies in future inspections.

In her prepared remarks, Ms. Fornelli reiterated that a collaborative approach between the SEC and PCAOB is needed to enhance audit quality. She went on to discuss the CAQ's recent efforts in this area, including audit quality indicators. Ms. Fornelli reported that the CAQ plans to issue a new disclosure framework in the first quarter of 2019 to assist audit firms in developing their annual audit quality reports.

Navigation of shifts in a fast-paced and complex environment

Another theme shared throughout the conference was the evolving financial reporting landscape, including technological advancements, geopolitical and economic developments, and recent changes to standards, as well as how these shifts impact the participants in the financial reporting ecosystem. Regulators recognize the need to keep pace with the shifting environment and are adjusting their strategic plans accordingly. During his comments, Chairman Clayton mentioned the three core elements of the SEC's strategic plan: (1) focus on the Main Street investor, (2) be flexible and adaptive and recognize changes in the market place, and (3) invest in people. The second core element is relevant for preparers and auditors as well, who need to stay vigilant and adapt to the changing environment in order to meet the needs of investors.

In his welcome address, AICPA President and CEO Barry Melancon highlighted emerging areas that accountants should be aware of, including cybersecurity risk management, blockchain, integrated reporting, sustainability, workforce changes, international regulatory issues, and the impact of emerging technologies on the profession. He encouraged the audience to embrace the changes prompted by technological evolution, and commit to unlearning what we currently know and learning new skillsets to keep up with the pace of change. Embracing change is certainly important in the accounting profession, with entities increasing or exploring the use of technologies such as data analytics, blockchain, artificial intelligence (AI), and robotics/automation.

Technological advancements

Two panels discussed innovation and technology and emphasized that the biggest challenge to embracing technology is change management. The panelists noted that one solution in overcoming this challenge is for entities to train employees in new technological advancements. During his remarks, Mr. Bricker also noted that technology can enable good reporting and auditing, but that stakeholders need to understand its risk and limitations. Chairman Clayton reminded the audience not to forget that the "human element" in the financial reporting process is as important today as it was before these new technologies emerged.

The CAQ also recently published "Emerging Technologies: An Oversight Tool for Audit Committees," to assist audit committees in their oversight of financial reporting in the emerging technological environment.

With the growing use of technology, cybersecurity continues to be a concern among stakeholders and was discussed at this year's conference. Chairman Clayton said that he appreciated the increased discussion around cybersecurity threats in the boardroom, as well as the increased expertise on boards that are looking at preventing threats in this area.

Finally, AICPA Chief Auditor Robert Dohrer and PCAOB Acting Chief Auditor and Director of Professional Standards Barbara Vanich said they do not believe that the current standards impede the use of technology, but that they also may not enable or facilitate the use of emerging technologies. A PCAOB task force is currently focused on the use of and perceived impediments inherent in data analytics and AI.

Geopolitical and economic developments

The conference speakers also discussed certain geopolitical and economic events that have recently impacted the capital markets, including Brexit, the potential transition away from LIBOR, fluctuating interest rates, and trade tariffs. Chairman Clayton noted that disclosures related to Brexit in the past have been diverse, with some companies providing specific details about the expected impacts and others providing only general risk factors. He recommended that companies review their operations in light of

Brexit and, to the extent the impact of this event is expected to be material to their operations, provide investors with disclosures indicating how the company is planning for the potential effects.

Another common topic among speakers and panelists was the potential transition away from the use of LIBOR and possible increases in interest rates, and how these changes will impact businesses. Several speakers encouraged companies to factor in these events when drafting new contracts and to discuss the potential impact on operations in their disclosures. With the recent increases in trade tariffs, companies were also encouraged to disclose the potential impact on operations, if material.

Recent changes in standards

As discussed at this conference last year, many speakers focused their discussions on the implementation of new accounting standards on revenue recognition, leases, and credit losses, as well as the implementation of the auditor reporting model standard. Presenters echoed the importance of successfully implementing these standards, stressing the importance of effective internal control over financial reporting (ICFR) both during the transition phase as well as after implementation of new accounting standards. Several presenters recommended entities take this opportunity to review ICFR and to implement new controls as needed.

B. Accounting and reporting matters

Accounting standard-setting initiatives

FASB Chairman Russell Golden spoke about the FASB's activities during 2018, highlighting his theme of making standards work, both today and in the future, by employing three objectives. In the short-term, the FASB is enhancing educational resources to help stakeholders understand and apply standards. The mid-term focus is on improving the standards that will be issued within the next three to five years by extending its outreach on identifying issues that should be added to the Board's technical agenda, as well as outreach on current projects such as financial performance reporting, segment reporting, and liabilities and equity. In the long-term, the FASB is studying technological advances in business and changes in information collection, distribution, and consumption, with a goal of adapting accounting standards to meet stakeholders' changing needs. Throughout his remarks, Mr. Golden emphasized the importance of the FASB working with stakeholders as it develops standards.

Susan Cosper, FASB Technical Director, provided an update on the Board's technical activities, which covered the effective dates of recent standards on revenue, financial instruments (recognition and measurement), leases, hedge accounting, and credit losses. She highlighted the recent amendment to the effective date of the credit losses standard for non-public business entities, along with the upcoming January 1, 2019 effective date for the leases and hedge accounting standards.

Ms. Cosper also reiterated the FASB's resources and intention to help entities with implementing new accounting standards and provided an update on recent improvements to the implementation web portal, which includes all implementation guidance for major standards in one convenient place. She also mentioned other implementation resources available to entities through the FASB, including technical inquiries; webcasts, webinars, and podcasts; information about public meetings; and issues discussed by the Board or by Transition Resource Groups.

She noted that the Board expects to issue a proposal in the near future that would permit not-for-profit entities to apply the private company alternatives related to the subsequent measurement of goodwill and the accounting for identifiable assets in a business combination. She also stated that the Board expects to issue an Invitation to Comment in 2019 on its projects on the subsequent accounting for goodwill, the accounting for certain identifiable intangible assets, and the scope of the project on these topics.

IASB Chair Hans Hoogervorst's remarks focused on the question, "Are we ready for the next crisis?" He discussed current economic conditions and asserted that recent improvements in accounting standards will help investors and regulators identify risks at an earlier stage. He noted that IFRS 9, *Financial Instruments,* was developed in response to the global financial crisis of 2008; while the guidance is not the same as the new credit loss standard in U.S. GAAP, both standards use an expected loss model and could result in earlier recognition of credit losses. In addition, he stated that IFRS 17, *Insurance Contracts,* is expected to contribute to financial stability in the insurance industry. He also stated that the IASB plans to issue a discussion paper presenting new approaches to the accounting and reporting for goodwill, such as improving disclosures in financial statements and reintroducing goodwill amortization.

Chairman of the AICPA's Financial Reporting Executive Committee (FinREC) James Dolinar provided an update on FinREC activities and noted the completion of the AICPA Audit and Accounting Guide, *Revenue Recognition*. The guide is available now in digital form and will be in print in 2019. Mr. Dolinar said that FinREC is working on upcoming guides on credit losses; valuation of portfolio company investments of private equity, venture capital, and other investment companies; and business combinations. He also mentioned that the Digital Asset Working Group, involving both the AICPA's Auditing Standards Board and FinREC, has plans to address accounting and auditing issues for cryptocurrency and similar digital assets.

SEC staff views on specific accounting matters

OCA staff provided an update of the staff's activities related to the implementation of the new accounting standards on revenue recognition, leases, and credit losses, and noted that the staff is in process of updating guidance in SEC Staff Accounting Bulletin (SAB) 102, "Selected Loan Loss Allowance Methodology and Documentation Issues." OCA staff also reminded the audience that the one-year anniversary of the Tax Cuts and Jobs Act is December 22, 2018, which means the end of the measurement period under SAB 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act."

OCA staff provided observations on the accounting consultation process, revenue recognition, leases, and financial instruments (including credit losses). As a reminder, the example consultations discussed by OCA staff are based on the specific fact patterns in the submissions they receive and should not be applied to other fact patterns.

Accounting consultations with the SEC's Office of the Chief Accountant (OCA)

One of the major tasks of OCA's accounting group is evaluating accounting issues through their consultation process. OCA staff reminded the audience that OCA "is available for consultation." The staff also noted that a consultation submission is the beginning of a dialogue between an entity, including its auditor and audit committee, and the staff as a regulator, and noted the following scenarios where a registrant might find it useful to consult:

- *When implementing a new accounting standard, particularly when an entity identifies an issue that requires significant judgment:* If an entity reaches an accounting conclusion after careful consideration but also identifies alternative conclusions, the entity might seek OCA's view to provide greater certainty regarding its conclusion.
- *When an entity enters into a significant transaction and identifies a material judgment or accounting conclusion, but the transaction has not yet been reflected in the financial statements:* The entity might seek OCA's views on how it has concluded on the transaction to avoid recognizing the costs involved if the conclusion is later found to be incorrect.

In addition, a group of entities might submit a joint consultation on either a pervasive accounting issue or a specific accounting issue where the entities have diverse views.

Revenue recognition

With public entities adopting the revenue standard in 2018, OCA staff mentioned that the number of revenue consultations submitted to OCA has declined, yet revenue remains the most frequently consulted topic. OCA staff discussed several topics they have addressed with registrants this year.

Principal versus agent considerations

Repeating a theme from the 2017 conference, OCA staff reiterated that there is a significant amount of judgment involved in determining whether an entity is acting as a principal or an agent and noted that the conclusion could impact the amount and timing of revenue recognition. The staff discussed one consultation with a healthcare-related distributor whereby certain goods were shipped directly from the manufacturer to retailers. Due to regulations, the registrant managed the returns process, but certain of the goods were returned directly to the manufacturer. In this fact pattern, OCA staff did not object to the registrant's conclusion that it had acted as a principal, noting that the registrant had considered control and evaluated the indicators of control in ASC 606, *Revenue from Contracts with Customers*. OCA staff reminded registrants that it is important to consider those indicators, noting that in some circumstances physical possession will not coincide with control.

OCA staff also stressed that applying the principal versus agent guidance is not optional, meaning that registrants should rigorously analyze their specific facts and circumstances to determine whether they are acting as a principal or an agent.

Identification of performance obligations

OCA staff reminded registrants that the evaluation of whether two or more promised goods are highly interdependent and interrelated (and are therefore considered a combined performance obligation under ASC 606) is based on whether the goods or services significantly affect each other, not merely on whether one item depends on the other.

In a recent consultation, OCA staff objected to a registrant's conclusion that two promises comprised a single performance obligation—in other words, they were two inputs into a combined output. The first promise was off-the-shelf software allowing the customer to process and submit patent applications electronically or by mail, and the second promise was a one-time service of electronically submitting an application to the government agency. In this fact pattern, the promised service was a convenience to the customer, but the choice of whether to use the service did not significantly impact the utility of the promise of the software, so the two promises were deemed to be separately identifiable.

OCA staff discussed their views on whether a promise to transfer a good or service is distinct within the context of the contract, noting one recent consultation with a commercial security service provider whereby a registrant's technology platform was integrated with cameras and sensors installed at the customer's location to create a "smart" monitoring service. The platform used AI to learn the customer's behavior as part of how to respond to potential issues. The registrant concluded that the service and equipment were capable of being distinct, but were not distinct within the context of the contract and therefore comprised a single performance obligation. The registrant also believed it was providing a significant service by integrating the goods and services into a bundle—a combined output—because the system would not be "smart" without the integration.

OCA staff did not object to this conclusion, noting that the registrant demonstrated reasonable judgment in concluding that the integration service transformed the equipment and services into a combined output whose overall service offering was greater than what each individual part could provide.

Existence of a significant financing component

In practice, it can be challenging for an entity to determine whether a contract contains a significant financing component, especially when a contract requires the customer to make an up-front payment. Under ASC 606, a contract would not have a significant financing component if the difference between the promised consideration and the cash selling price arises for reasons other than the financing, and the difference between those amounts is proportional to the reason for the difference. OCA staff noted that each evaluation must be made based on the facts and circumstances of the related contract.

In one consultation with OCA staff, a registrant concluded that a significant financing component did not exist in an arrangement that required the customer to make a significant up-front payment in exchange for the right to access the registrant's trademarks and brand. The registrant was looking to expand a non-core line of business and entered into the arrangement with a third party (the customer) to operate the non-core line of business. The registrant asserted that the up-front payment was to protect the registrant against the possibility that the customer might fail to adequately complete some or all of its obligations under the contract. Further, the difference between the promised consideration and the cash selling price arose for reasons other than financing, and the difference between the up-front payment, and what the customer would have paid had the payments been made over the term of the arrangement, was proportional to the reason identified for the difference. Based on the specific fact pattern, including the nature of the transaction and the purpose of the up-front payment, OCA did not object to the registrant's conclusion.

Ongoing monitoring of diversity in practice

In a Q&A session, OCA staff acknowledged that there is diversity in practice under ASC 606, stating that reasonable people making reasonable judgments could in fact arrive at different conclusions. The staff is monitoring the diversity in practice related to the revenue standard to understand the causes, and said that it would consider engaging standard-setters if it determines that there is a good reason to narrow the diversity.

New leases standard

Minimum rental payment composition policies

In a speech at the 2017 conference, OCA staff noted an example of diversity in practice under ASC 840, *Leases,* concerning whether to include executory costs in the calculation of minimum rental payments. In the 2017 speech, the staff concluded that it would not object if registrants consistently applied their historical accounting policy to either include or exclude executory costs in minimum rental payments when measuring the lease liability upon transition to ASC 842, *Leases*.

OCA staff stated that it had received a consultation this year on the acceptability of changing an entity's historical policy on whether to include or exclude executory costs in or from minimum rental payments, including upon transition to ASC 842. In response to the consultation, the staff stated that it did not object to a registrant applying the guidance in ASC 250, *Accounting Changes and Error Corrections*, including that Topic's requirement for preferability, to change its policy with regard to whether minimum rental payments under ASC 840 include executory costs.

Minimum rental payment measurement policies

ASC 840 does not provide specific guidance on whether a lessee disclosing future minimum rental payments based on an index or a rate should use the index or rate in effect at lease inception or the current index or rate at the reporting date. In response to a consultation, OCA staff noted that it did not object to a lessee continuing to apply its historical accounting policy under ASC 840 for measuring these future minimum lease payments when measuring leases upon transition to ASC 842. Further, the staff did not object to an entity applying ASC 250 to change its policy under ASC 840 with respect to using either the inception date or current index for measuring minimum rental payments, including when the entity transitions to ASC 842. The staff noted that it would be reasonable for an entity to consider whether measuring its lease obligation using the current index or rate represents a better measurement of the registrant's current lease obligations when assessing preferability under ASC 250.

Certain lessee and lessor costs

OCA staff addressed the accounting for certain costs incurred by the lessee and lessor. First, the staff discussed costs incurred by a lessee to place a leased asset into use, such as shipping the asset to the lessee's location. The staff indicated that, in response to a consultation, it did not object to a lessee making an accounting policy election to capitalize those costs by analogizing to the guidance in ASC 360, *Property, Plant, and Equipment*, rather than recognizing those costs in current-year earnings. Second, the staff discussed costs incurred by a lessor to fulfill its obligations under a lease, such as shipping an asset to the lessee. In response to a consultation, the staff did not object to a lessor making an accounting policy election to defer those costs by analogizing to the guidance in ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*, provided that the costs are not within the scope of other U.S. GAAP and would qualify for deferral if the lease was within the scope of ASC 606.

Leasing SAB 74 disclosures

In a Q&A session, OCA staff reminded participants that disclosures required under SAB Topic 11.M, "Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period" (SAB 74), should reflect an entity's status in the process of implementing the new leases standard. As the effective date of the leases standard draws near, the staff noted that if there is not a lot of information in an entity's SAB 74 disclosure, it would expect auditors and audit committees to ask management about whether the disclosures provided reflect the entity's implementation status.

New credit losses standard

Evaluating subsequent events

OCA staff discussed how to evaluate whether information related to the forward-looking estimate of expected credit losses received after the balance sheet date, but before the financial statements are issued or are available to be issued, represents a recognized or an unrecognized subsequent event. While each entity must consider materiality and its own facts and circumstances, the staff provided the following views on how certain types of information might be evaluated:

- Loan-specific information about factual conditions that existed at the balance sheet date would be recognized (for example, a servicer report showing the effects of payment experience occurring before the balance sheet date or an appraisal report showing information about the fair value of loan collateral as of the balance sheet date).
- Information relating to assumptions used in establishing expected credit losses that the entity receives before completing its appropriate estimation process is permitted to be included in the estimate (for example, the U.S. government's announcement of unemployment rates for a period that includes the balance sheet date). On the other hand, information relating to assumptions used in establishing expected credit losses that the entity receives after completing its appropriate estimation process is not recognized. Regardless of whether the entity receives this information before or after it completes an appropriate estimation process, it should consider whether the information indicates a

weakness or a deficiency in the estimation process if the information is significantly different from expectations, in which case, the information would be recognized.

Loan charge-offs

OCA staff discussed a consultation with two specific application questions related to a registrant's proposed accounting policy for loan charge-offs when adopting ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*.

The first question was whether the registrant should assess loans at the individual loan level or at the pool level in determining when they should be charged off. The registrant asserted that while the guidance in ASC 326-20, *Financial Instruments – Credit Losses: Measured at Amortized Cost,* requires an entity to pool loans based on similar risk characteristics when determining the allowance for credit losses, the loans retain their individual risk characteristics. The staff did not object to the registrant's conclusion that it would assess loans at the individual loan level for the purpose of determining when they should be charged off.

The second question was whether the registrant would consider all relevant information, including relevant portfolio information, when determining whether a loan is uncollectible. OCA staff did not object to the registrant's conclusion that it would consider all relevant information, including individual loan attributes and historical loss experience for similar loans, in determining when a loan is uncollectible.

Potential transition away from LIBOR

OCA staff discussed the potential transition away from LIBOR, noting that OCA has been monitoring efforts related to transitioning to an acceptable alternative and has been considering the accounting implications.

The staff also discussed a consultation comprised of two questions received from a stakeholder on the impact of transitioning away from LIBOR on existing cash flow hedging relationships. The first question related to whether LIBOR-based interest payments identified in cash flow hedge documentation are probable of occurring or, more specifically, whether registrants could continue to assert that these LIBOR-based interest payments are probable of occurring for variable-rate debt whose terms extend beyond the transition. OCA staff did not object to the stakeholder's view that hedge documentation involving LIBOR-based cash flows implicitly considers the replacement rate and that the entity may continue to assert that the hedged item is probable of occurring.

The second question was whether and how the transition would impact the effectiveness of a cash flow hedge of LIBOR-based variable-rate debt. OCA staff did not object to the stakeholder's view that expected changes to LIBOR will impact both the hedged item and the hedging instrument, and that the transition would not, in and of itself, impact hedge effectiveness.

In addition to the OCA staff discussion, Ms. Cosper also noted that the FASB has an ongoing project to address issues related to the potential transition from LIBOR.

C. SEC compliance and reporting

Current SEC rulemaking and initiatives

During the SEC's Division of Corporation Finance (CorpFin) panel, CorpFin Director William Hinman discussed the division's current priorities, noting that consistent with the Commission's priorities, its main focus continues to be capital formation to broaden the opportunities for Main Street investors, while ensuring that investors are provided with the necessary information to make informed decisions. This year, however, the division is also focused on diversifying investment opportunities for retail investors, he noted, one method being to harmonize private placement rules. Mr. Hinman said that the division is encouraged by the increase in initial public offerings (IPOs) in 2018, even though the uptick was largely driven by market valuations. He went on to note that although the Commission does not control market trends, it does control the regulatory environment. CorpFin staff highlighted the following 2018 rulemaking activities aimed at making the capital markets more accessible to companies, while maintaining strong protection for investors:

- Adoption of the Final Rule, *Amendments to Smaller Reporting Company Definition*, effective September 10, 2018, raises the financial thresholds in the definition of “smaller reporting company” (SRC). Mr. Hinman noted that the increased SRC thresholds have resulted in approximately 1,000 more entities eligible to take the benefit of certain scaled disclosures.
- Adoption of the Final Rule, *Disclosure Update and Simplification*, effective November 5, 2018, streamlines certain disclosure requirements to reduce redundant, duplicative, or outdated disclosures due to changes in U.S. GAAP, IFRS Standards, or other Commission disclosure requirements, or simply due to the passage of time. The amendments generally have the effect of eliminating disclosures in registrant filings, but also include one notable expansion for disclosures related to interim-period changes in stockholders’ equity and noncontrolling interests.
- Issuance of the Proposed Rule, *Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities*, that would amend the financial disclosures in Regulation S-X, Rules 3-10 and 3-16, required in certain registration statements and subsequent periodic filings. The amendments are intended to simplify and streamline the disclosure obligations of registrants and to better align those requirements with the needs of investors. The Commission is planning to finalize this rule in 2019.

Grant Thornton publications

- For more information on the Final Rule, *Amendments to Smaller Reporting Company Definition,* refer to our New Developments Summary 2018-09, “Revised ‘smaller reporting company’ definition.”
- For more information on the Final Rule, *Disclosure Update and Simplification*, refer to our New Developments Summary 2018-12, “SEC simplifies disclosure requirements.”
- Grant Thornton issued a comment letter on the proposed rule on amendments to S-X Rules 3-10 and 3-16.

Other 2018 rulemaking includes:

- Adoption of the Final Rule, *Inline XBRL Filing of Tagged Data*, requires operating companies to submit financial statement information, and mutual funds to submit risk/return summaries, using the Inline XBRL format, which allows filers to embed XBRL data directly into an HTML document. There is a phased-in compliance schedule, starting with large accelerated filers that prepare their financial statements in accordance with U.S. GAAP, required to comply beginning with fiscal periods ending on or after June 15, 2019. Consistent with prior regulations related to XBRL, there is no requirement in the Final Rule for auditors to provide any form of assurance on the Inline XBRL data.
- Adoption of the Final Rule, *Rule 701 – Exempt Offerings Pursuant to Compensatory Arrangements*, effective July 23, 2018, amends Securities Act Rule 701, which exempts from registration securities issued by non-reporting companies pursuant to certain compensatory benefit plans and compensation contracts.

- Adoption of Final Rule, *Modernization of Property Disclosure for Mining Registrants*, revises disclosure requirements and policies to be more consistent with current industry and global regulatory practices and standards. Registrants must comply with the Final Rule for the first fiscal year beginning on or after January 1, 2021.

Final Rule amends Regulation A

Subsequent to the conference, on December 19, the Commission adopted the Final Rule, *Amendments to Regulation A*, to allow companies subject to the reporting requirements of Exchange Act Sections 13 or 15(d) to rely on the Regulation A exemption from registration of their securities offerings. The Final Rule is effective upon publication in the *Federal Register.*

CorpFin staff also provided insight into future rulemaking expected in 2019, including proposing releases on amendments to (1) Regulation S-X, Rule 3-05, *Financial statements of businesses acquired or to be acquired*, (2) Regulation S-X, Rule 3-14, *Special instructions for real estate operations to be acquired*, and (3) Regulation S-X, Article 11, *Pro Forma Financial Information*.

Further, as part of issuing the amendments to the SRC definition, Chairman Clayton directed the staff to formulate recommendations for potential changes to the definition of an "accelerated filer" in Exchange Act Rule 12b-2, which could reduce the number of registrants subject to the attestation requirement in Sarbanes-Oxley Act Section 404(b). These items as well as others are more thoroughly explained on the Commission's Fall 2018 Agency Rule List.

Request for comment on quarterly earnings releases and quarterly reports

Subsequent to the conference, on December 18, the Commission issued a Request for Comment on the nature, content, and timing of earnings releases and quarterly reports made by reporting companies. The comment period ends 90 days after the request for comment is published in the *Federal Register.*

Waiver requests to omit or substitute financial statements

Mr. Hinman provided an update on CorpFin's process to evaluate waiver requests under Regulation S-X, Rule 3-13, *Filing of other financial statements in certain cases*, noting that CorpFin's Office of Chief Accountant (CF-OCA) has continued to build on its progress toward shortening the timeframe to respond to waiver requests. To further increase the transparency of staff actions, consistent with the division's August announcement regarding its intent to release through EDGAR additional types of documents (including interpretive guidance and no-action relief), Mr. Hinman indicated that CorpFin continues to explore how to make such information public without sharing registrants' confidential information, such as a pending acquisition that has not yet been publicly announced.

CorpFin Chief Accountant Kyle Moffatt explained that CF-OCA focuses on evaluating each registrant's individual facts and circumstances, the transaction in question, and the factors that trigger the registrant's disclosure requirement, as well as ensuring that relief granted is consistent with investor protection. CF-OCA staff continued to encourage registrants to approach the staff to request relief where appropriate and reminded the audience that CorpFin's Financial Reporting Manual (FRM) includes a section on communicating with CF-OCA, which directs registrants to the appropriate staff members based on subject matter. The staff also noted that registrants should be prepared to explain any difficulties that prevent them from fully complying with disclosure requirements and should discuss potential alternative information they could provide, including an explanation of how their proposal is consistent with investor protection.

CF-OCA staff stated that the majority of the requests for relief under Rule 3-13 relate to the requirements of Regulation S-X, Rule 3-05 and Rule 3-09, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*. CF-OCA staff described situations where they have, based on registrants' specific facts and circumstances, granted relief or would consider relief requests:

- *Presenting an audited abbreviated balance sheet when an acquired business is only significant under the investment test:* When an acquired business is only significant under the investment test and requests relief on that basis, the staff wants to understand why the registrant was willing to pay such a significant purchase price. The staff may consider relief requests to substitute audited pre-acquisition financial statements with an audited, abbreviated statement of assets acquired and liabilities assumed based on the allocation of the purchase price at fair value on the transaction date, if the substitution would be more meaningful to an investor than full compliance with S-X Rule 3-05.
- *Acquired related businesses[1] include an insignificant business:* In certain cases, the staff may consider providing relief from providing pre-acquisition financial statements for an individual business within a group of related businesses that is insignificant to the overall acquisition.
- *Acquired business in an IPO registration statement is no longer significant:* An entity may have a significant acquisition that took place in the earliest year presented in its IPO registration statement, but, due to the entity's subsequent growth, the acquiree is no longer significant. Depending on the specific facts and circumstances, the staff may consider requests to omit one or more years of pre-acquisition financial statements.
- *Initial registration statement on Form 10 by an SRC:* Irrespective of the guidance in FRM Section 2030.3, CF-OCA staff stated that written requests should be submitted when an SRC has difficulty obtaining the second year of audited financial statements for a significant acquired or to be acquired business that must be included in the SRC's initial registration statement on Form 10.
- *Substitution for financial statements of a significant equity method investee:* When an equity method investee is considered significant due to an anomalous significance test result, CF-OCA staff may consider requests to substitute the audited financial statements of the investee either with alternative disclosures proposed by the registrant, such as separate disclosure of the investee's summarized financial information as described in Regulation S-X, Rule 4-08(g), *Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons*, or with an expanded summary financial information of the investee.
- *Substitution for partial year financial statements of a significant equity method investee:* S-X Rule 3-09 requires partial year audited financial statements when the equity method investee is significant in the year of its acquisition or disposition. CF-OCA staff may consider requests to substitute full year audited financial statements when a registrant has difficulty obtaining partial year audited financial statements.

[1] S-X Rule 3-05 indicates that businesses are related if they are under common control or management or their acquisitions are dependent upon each other or a common event or condition. Related businesses are treated as a single business when evaluating significance. If acquired or to be acquired related businesses are significant in aggregate, the pre-acquisition financial statements of each of the individual businesses are required to be presented.

Filing reviews

Panelists, including CorpFin Associate Director in Disclosure Operations Cicely LaMothe, as well as representatives from the public accounting and legal communities, discussed current developments in filing reviews as well as future focus areas.

Increased efficiency in filing reviews

Consistent with the SEC's emphasis on capital formation and its disclosure effectiveness initiative, CorpFin staff strives to issue tailored, concise comments in response to their filing reviews. Comments provided over the phone have increased, particularly for less complex items in connection with an ongoing comment process or a time-sensitive situation, the staff reported. The staff has found that this approach facilitates a dialogue and improves the efficiency of the review.

Application of the revenue standard

Several panelists remarked that the number of publicly available comment letters is too small to provide meaningful trends or insights into the views of SEC staff. However, over the course of the conference, CorpFin staff discussed the review process as it relates to the revenue standard. The staff said that the application of the revenue standard, including the related disclosures, is included within the scope of routine filing reviews and is not subject to a separate review process. The staff said that it focuses on whether the accounting is consistent with the guidance and on whether the notes to the financial statements meet the disclosure objective of the revenue standard, to explain the nature, amount, timing, and uncertainty of revenue and cash flows from contracts with customers. When a significant judgment is unclear or a disclosure indicates a material item may conflict with the guidance in the revenue standard, the staff comments. Specific areas recently commented on include the following:

- *Performance obligations:* When a registrant's disclosures do not clearly explain how it identified a performance obligation or if its application of the revenue standard appears incorrect, CorpFin staff will likely issue a comment.
- *Timing of revenue recognition:* The staff may issue comments to understand how a registrant determined whether to recognize revenue at a point in time or over time. When revenue is recognized at a point in time, the staff may ask questions to clarify the point at which revenue is recognized. When revenue is recognized over time, the staff may ask questions to understand how the registrant measures its progress toward the complete satisfaction of the performance obligation.
- *Principal versus agent:* When a registrant's disclosure of significant judgments used to determine whether it is acting as a principal or an agent are not transparent, the staff will ask questions to understand how the registrant applied the revenue guidance.
- *Disclosure of disaggregated* revenue*:* The staff mentioned that the disclosure of disaggregated revenue has been and will continue to be an area of focus.

Based on the SEC comment letters that are publicly available, comments related to the revenue standard have generally been resolved without requiring registrants to amend their earlier filings. However, in many cases, registrants have offered to clarify or expand their disclosures in future filings. One panelist observed that comments issued recently are more in-depth and difficult to address than earlier comments.

CorpFin staff's helpful tips for effective disclosures

- Organize the disclosure so that it is clear which judgment(s) applies to a performance obligation or revenue stream.
- Understand that the staff assumes the items disclosed in a registrant's filing are material to the financial statements. If the staff asks a question about a revenue item that the registrant believes is immaterial, a best practice is to clarify the materiality of the item in the initial response. In the interest of disclosure effectiveness, registrants should also consider whether any immaterial items should be removed from the disclosure.

Non-GAAP measures

According to the SEC staff, non-GAAP measures continue to be an area of focus in filing reviews. The staff indicated that non-GAAP measures and key performance indicators should be consistent with how management views the business and evaluates its performance. The staff underscored the importance of disclosure controls and procedures, as well as the audit committee's involvement, to ensure high-quality non-GAAP reporting.

The staff also highlighted the importance of consistency in how a non-GAAP measure is calculated from one period to another. Registrants were reminded to disclose in their filings how management uses the non-GAAP measure and to have policies in place to document how changes in non-GAAP measures will be reported and how the correction of errors will be evaluated.

The staff further noted that with respect to highly tailored measures, they may potentially seek more evidence on how management or the board of directors is using that information or why such information is important to investors.

Individually tailored accounting principles

In the Compliance and Disclosure Interpretations, *Non-GAAP Financial Measures*, the staff has indicated that non-GAAP performance measures that use individually tailored recognition and measurement methods could be misleading. At the conference, the staff explained that non-GAAP measures are defined as measures that include or exclude certain amounts from the most directly comparable GAAP amounts; however, they do not encompass changing measurement or recognition principles required by GAAP. In determining whether an adjustment results in tailoring an accounting principle, the staff discussed certain considerations, which are summarized in the table below.

Considerations	Examples
Does the adjustment result in a shift from the accrual basis of accounting to cash or the modified basis of accounting?	Using billings or cash receipts as a proxy for revenue for a subscription-based business that recognizes revenue over time Recognizing revenue over time when GAAP requires recognition of revenue at a point in time

Considerations	Examples
Does the adjustment add transactions that are reported in another entity's financial statements?	Changing principal versus agent conclusions (recording revenue on a gross basis, when the registrant is an agent) Moving from significant influence to control (accounting for transactions as if the registrant controlled is an equity method investee)
Does the adjustment reflect only a part, but not all, of an accounting concept?	Adjusting for income tax effects of cash taxes, but not for temporary or permanent differences
Does the adjustment render the measure inconsistent with the economics of the transaction or agreement?	Accounting for sales-type or finance leases as operating leases

The staff also clarified that if a registrant has adopted ASC 606 using the modified retrospective method, any measure to reflect revenue under ASC 605 after the year of adoption will be considered to be an individually tailored accounting principle.

Upcoming areas of focus

SEC staff as well as other panelists discussed a variety of current events and trends that might impact registrants' disclosures in upcoming filings:

- *Current events:* Building on the comments of the SEC Chairman and Chief Accountant, other SEC staff discussed how recent developments (such as Brexit, the potential transition away from LIBOR, increases in interest rates, and trade tariffs) have impacted or may materially impact a registrant's financial position or operating results. Registrants should provide tailored disclosures that are specific to the expected impact and risks to their organization. For example, registrants with variable-rate debt whose overall liquidity could be adversely affected as a result of increasing interest rates should consider whether their liquidity disclosures adequately identify the potential impact of an interest rate increase.
- *Cybersecurity:* CorpFin staff mentioned they do monitor current events that might impact registrants' disclosures and that the staff may reach out to registrants to ask how they plan to disclose a particularly significant event, such as a recent cyber incident. The staff confirmed they will be reviewing cybersecurity disclosures in 2019 filings. Registrants were encouraged to read the Commission Statement and Guidance on Public Company Cybersecurity Disclosures, which was issued in February 2018, and to consider how the guidance applies to their company.

Cyber threats and ICFR

In October 2018, the SEC issued an investigative report that cautions registrants to consider cyber threats when implementing new, or evaluating existing, ICFR. The report is based on the SEC's Division of Enforcement's investigation of certain public companies that were victims of cyber-related frauds and incurred significant losses.

SEC reporting considerations for EGCs that elect to follow the accounting transition applicable to non-issuers

CorpFin staff discussed several SEC reporting issues related to the adoption of new accounting standards by emerging growth companies (EGCs) that have elected to follow the accounting transition applicable to non-issuers. The staff expects that CorpFin's FRM will be updated in the near future to include discussion of the guidance below, which was discussed during the conference.

Adoption of the revenue standard

An EGC that has elected to transition to ASC 606 by applying the guidance for non-issuers should apply the revenue standard to annual periods beginning after December 15, 2018 and to interim periods within annual reporting periods beginning after December 15, 2019. Consistent with the guidance in FRM Section 11110.2, an EGC is not required to accelerate the application of the revenue standard to interim periods solely for purposes of Regulation S-K, Item 302(a), *Selected quarterly financial data*, in its 2019 Form 10-K. However, CorpFin staff explained that in the 2019 Form 10-K, the EGC should provide clear disclosures to address the lack of comparability between the information provided under S-K Item 302(a) and the 2019 annual financial statements. Additionally, CorpFin staff encouraged such companies to revise the comparative 2019 interim periods when presented in the EGC's 2020 Forms 10-Q to reflect the adoption of the revenue standard.

Loss of EGC status

If an EGC elects to follow the transition guidance applicable to non-issuers, but loses its EGC status after it would have been required to adopt a standard absent the extended transition accommodation, it should adopt the standard in the next filing after losing its EGC status. As described in FRM 10230.1(f), if an EGC in this situation is unable to timely comply, it may discuss its facts and circumstances with the staff.

In response to inquiries,[2] CorpFin staff provided the examples summarized in the following table to illustrate the adoption of a new accounting standard when an entity loses its EGC status. The examples below assume that the issuer has a December 31 fiscal year-end and use the revenue standard; however, this guidance could also apply to other new accounting standards. Further, the staff clarified that non-EGCs that confidentially submit or publicly file an initial registration statement must follow the accounting standard transition dates applicable to issuers.

Period EGC status lost	Form 10-K for the year EGC status lost	Forms 10-Q in the year after EGC status lost
EGC status lost at 12/31/2018, the annual period in which issuers must adopt the revenue standard	Adopt the revenue standard for all 2018 periods presented in the 2018 Form 10-K, including the 2018 quarterly periods required under S-K Item 302(a). CorpFin staff would expect clear disclosure that the quarterly results in the previously filed	Reflect the adoption of the revenue standard in the 2018 comparative interim periods included in the 2019 Forms 10-Q.

[2] See the September 2018 Center for Audit Quality (CAQ) SEC Regulations Committee meeting highlights, Section II, Current financial reporting matters, under Topic C, "EGC Transition Issues."

	2018 Forms 10-Q do not mirror the quarterly periods presented in the 2018 Form 10-K.	
EGC status lost at 12/31/2019, the annual period in which non-issuers must adopt the revenue standard	CorpFin staff will not object if the issuer only adopts the revenue standard for its 2019 annual financial statements and 2019 interim periods required under S-K Item 302(a). CorpFin staff would expect clear disclosure that the quarterly results in the previously filed 2019 Forms 10-Q do not mirror the quarterly periods presented in the 2019 Form 10-K.	Reflect the adoption of the revenue standard in the 2019 comparative interim periods included in the 2020 Forms 10-Q.
EGC status lost in 2020, after the issuer has adopted the revenue standard using the non-issuer transition dates	If the EGC has already adopted the revenue standard using the non-issuer transition dates and later loses EGC status, there is no need to revise the historical financial statements to reflect an earlier adoption date.	

SEC enforcement matters

Stephanie Avakian, SEC Division of Enforcement Co-Director, and Matthew Jacques, the division's Chief Accountant, provided a brief overview of the division's priorities and activities during fiscal year 2018, which are detailed in the Division of Enforcement 2018 Annual Report. Ms. Avakian began her remarks by reminding the audience that accurate and reliable financial reporting is critical to investors and the capital markets. She also stated that the division continues to focus on retail investor protections, registrants' conduct, the cyber world (including cybersecurity, blockchain, and the initial coin offering market), financial fraud, and insider trading.

Mr. Jacques cited revenue recognition issues as one of largest areas of financial reporting enforcement. The root cause of the revenue recognition failures is often information improperly flowing within the organization or not communicated to the independent auditors. This in turn leads to financial decision makers assessing transactions without all the relevant facts, allowing "bad actors" to operate without the proper checks and balances. He stressed that with the implementation of ASC 606, companies should take this opportunity to strengthen their processes and controls.

Mr. Jacques also noted that financial reporting enforcement cases involved expense recognition issues, missing or inaccurate disclosures (including the improper use of backlog, non-financial metrics, or non-GAAP measures), balance sheet issues, internal control deficiencies, and inaccurate executive compensation expense. He reported that inadequate ICFR is a common theme in most financial reporting cases.

Finally, Mr. Jacques stated that many enforcement cases continue to involve a failure to adhere to relevant professional auditing standards as well as violations of auditor independence rules. The primary themes in these cases are the lack of professional skepticism, an overreliance on management's representations, a lack of sufficient evidence, poor audit documentation, manipulation of audit workpapers (such as pre-dating and back-dating workpapers), auditor independence violations, and breakdowns in audit firms' quality control policies and procedures.

D. Auditing and corporate governance matters

PCAOB keynote address

PCAOB Chairman Duhnke discussed the open and interactive approach the Board took to develop its recently approved five-year strategic plan. Referencing the diverse experiences of the Board members, Chairman Duhnke explained that the Board's motivation is to obtain diversity of thought in its "bottom-up rethink" of the Board's strategic priorities and goals, through broad external outreach with stakeholders and deep internal "in-reach" with both PCAOB leadership and employees.

PCAOB's goals noted in its five-year strategic plan

- Drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation
- Anticipate and respond to the changing environment, including emerging technologies and related risks and opportunities
- Enhance transparency and accessibility through proactive stakeholder engagement
- Pursue operational excellence through efficient and effective use of PCAOB resources, information, and technology
- Develop, empower, and reward people to achieve shared goals

Together with the other Board members, Chairman Duhnke elaborated on the Board's strategic priorities and goals in light of the PCAOB's four primary duties: registration and reporting, standard-setting, inspection, and enforcement.

PCAOB standard-setting update

In addition to discussing recently completed projects such as those related to Form AP and the auditor's reporting model, Ms. Vanich summarized recent PCAOB standard-setting and related activities. Regarding stakeholders' ongoing efforts to prepare for implementing the new auditor reporting requirements, Ms. Vanich emphasized the staff's commitment to being "proactive, accessible, transparent and clear" in their communications, including any additional direction or guidance that may be provided as a result of monitoring implementation-related activities.

Ms. Vanich remarked on the staff's effort to consider how current standard-setting projects align with the goals of the PCAOB's five-year strategic plan. She noted that the Board supports finalizing several projects, including those related to enhanced requirements for *Auditing Accounting Estimates, Including Fair Value Measurements* as well as amendments to standards to strengthen requirements for an *Auditor's Use of the Work of Specialists*. In his comments, Chairman Duhnke noted that the Board also plans to turn its attention to the proposals related to the *Supervision of Audits Involving Other Auditors* in 2019. The staff will work with the Board in early 2019 to evaluate existing research and standard-setting agendas to obtain additional direction from the Board on how to prioritize existing projects and identify new projects.

PCAOB open meeting

Subsequent to the conference, on December 20, the PCAOB unanimously approved the proposals to adopt enhanced requirements for *Auditing Accounting Estimates, Including Fair Value Measurements*, as well as amendments to the standards to strengthen requirements for an *Auditor's Use of the Work of Specialists*. Both are effective for audits of financial statements for fiscal years ending on or after December 15, 2020, subject to approval by the SEC.

Ms. Vanich also discussed the PCAOB's ongoing research project on the *Changes in Use of Data and Technology in the Conduct of Audits*. She emphasized that the use of data analysis tools and emerging technologies could fundamentally change how auditors approach the audit process. Ms. Vanich went on to highlight the challenges of this project, noting that (1) technologies continue to evolve and vary in their extent of use, (2) it is difficult to distinguish where the use of technology is today versus where it is headed, and (3) it can be difficult to determine if potential barriers between the standard and the use of technologies are real or perceived. A profession-wide task force of 11 members has been formed to help the PCAOB research team understand how technology is impacting current financial reporting processes and audits and the potential for future use, including potential changes needed in current audit standards.

The new auditor's report (reporting critical audit matters)

In June 2017, the PCAOB adopted Auditing Standard 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, to enhance the relevance and usefulness of the auditor's report. The standard retains the pass/fail opinion of the existing auditor's report but also made certain significant changes to the report. The provisions currently effective make a number of improvements that are intended to clarify the auditor's role and responsibilities, provide additional information about the auditor (that is, auditor tenure), and make the auditor's report easier to read.

A panel, including preparers, auditors, and PCAOB representatives, discussed the next phase of the auditor reporting project: the reporting of critical audit matters (CAMs). Provisions related to CAMs will first take effect for audits of financial statements of large accelerated filers for fiscal years ending on or after June 30, 2019. The panel discussed current activities audit firms are undertaking to prepare for the adoption, including conducting pilot testing and "dry runs" of CAMs to help prepare for the impending effective date. PCAOB staff noted that they are monitoring the pilot testing and "dry run" process and will be evaluating the need for additional guidance.

The adoption of CAMs in the U.S. market has been highly anticipated. PCAOB staff emphasized that they have heard consistently and emphatically from investors that they "want to hear from the auditor." SEC staff also noted that engagement with investors, the earlier the better, will help ensure that the full benefit from this opportunity is realized.

Finally, the CAQ released a new publication that presents early lessons learned from "dry runs," an illustrative example of a CAM, and a set of new questions to foster dialogue and understanding of the impact that CAMs will have on the audit process.

Auditor independence

During the OCA panel, OCA staff stressed the need for audit firms to maintain independence both in fact and in appearance, which are equally important under the federal securities laws. Audit firms are encouraged to promote ethical behavior and invest in improved policies, procedures, and training, among other elements of the audit firm's quality control system, to provide reasonable assurance that independence is maintained in fact and in appearance. Furthermore, the staff stressed that compliance with auditor independence rules is a shared responsibility of both the audit firm as well as the entity and its audit committee. Specifically, the staff noted that entities can help promote compliance by regularly monitoring corporate structural changes or other operational events that might result in new affiliates or business relationships and by timely communicating these changes to the audit firm. The staff urged management and audit committees, along with audit firms, to continue to evaluate whether their monitoring processes and practices are sufficient in supporting auditor independence.

The staff provided an update on the loan provision rules under Regulation S-X, Rule 2-01, *Qualifications of accountants,* as well as related amendments, which the SEC proposed in May 2018. The staff has received generally supportive comments on the proposed rule, in addition to recommendations for other changes to the independence rules. The staff is currently assessing the comments received and is considering next steps. The SEC's current regulatory agenda targets the loan provision rule for final rulemaking in 2019.

PCAOB inspection and enforcement update

The PCAOB Inspections and Enforcement Divisions provided a combined update on recent activities and priorities. George Botic, Director of the PCAOB's Division of Registration and Inspections, focused his remarks on inspection activities at the PCAOB, the state of audit quality, and the outlook for 2019.

Mr. Botic called the auditor a "vital pillar of well-functioning and efficient capital markets" and stressed the expanding need for auditors with diverse skillsets to address the burgeoning impact of technology on businesses and financial reporting. With respect to current activities, he described the division's "clean-sheet" approach to reevaluating people, processes, and technologies, which include (1) the objective of an inspection, (2) the selection of audit engagements for review, and (3) the nature, timing, and extent of the reviews, including quality control inspection procedures. As described during the PCAOB's keynote address at the conference, the Board's inspections focus on (1) increasing engagement with audit committees, particularly by communicating directly with audit committees of those issuers selected for inspection, (2) performing horizontal (cross-firm) thematic reviews, (3) reporting in a more timely manner to increase usefulness, (4) reevaluating how findings are communicated, and (5) utilizing a new "transformation leader" role in inspections.

In addition, Mr. Botic stressed the need for a greater focus on an audit firm's audit quality indicators, at the local, regional, and national level. He noted that the profession is at an inflection point in terms of audit quality, and that it is time for audit firms to reflect on how they have addressed audit quality issues in the past and to consider whether different approaches may be necessary in the future, including the adoption or enhancement of root cause processes. Finally, Mr. Botic noted that the division would be focusing next year on key inspection areas cited in the recent staff inspections brief, technology risks, and changes to the auditor's report, while reinventing its communications with stakeholders.

During his remarks, Mark Adler, Acting Director and Chief Trial Counsel for the PCAOB's Division of Enforcement and Investigations, described recent enforcement accomplishments, priorities, and trends. Enforcement actions over the past year have included settled charges related to audit firm quality control violations marked by policies and procedures that were either lacking or not followed; independence violations, primarily related to firm affiliates; and workpaper alteration. One other area of enforcement actions related to engagement quality reviews, including a failure to obtain such reviews or cases where the work was deemed substandard.

He went on to summarize a recent case involving sanctions to a non-U.S. auditor for failing to maintain its independence. Specifically, during three consecutive audits, an affiliated firm performed prohibited nonaudit services for an international subsidiary of the audit client. Further, the engagement team made use of the affiliate firm's work in connection with their audits, which placed the engagement team in the position of auditing its own work, impairing the firm's independence. The PCAOB charged an audit firm where national independence personnel were aware of the nonaudit services provided by the affiliate firm but failed to appreciate the threat to the firm's independence. This illustrates that the division will seek sanctions in these types of cases, which include undertakings aimed at the firm's policies and procedures related to the independence requirements.

Mr. Adler further noted that actions brought by the PCAOB and the SEC, as well as by enforcement inspectors' efforts, have acted as a deterrent for broker-dealer auditor independence violations. The PCAOB has also seen a drop in independence cases related to broker-dealer auditors improperly preparing clients' financial statements.

He stated that the division is undergoing a review of its entire program to assess opportunities to improve effectiveness and efficiency. Possible enhancements include earlier interaction with audit firm engagement personnel at the partner and manager levels, more frequent case assessments (to validate proceedings with the actions), and reduced witness time. From a technology perspective, Mr. Adler also indicated that the division may leverage data from outside the organization and refine how it leverages inspection findings. He highlighted the following focus areas for 2019: (1) non-U.S. affiliates of global network firms, (2) improper document alteration, and (3) engagement quality reviews.

Evaluating the operating effectiveness of ICFR

During the OCA panel, the staff stressed the importance of ICFR in the overall contribution to high-quality financial reporting and encouraged audit committees, auditors, and management to openly discuss ICFR, focusing on the company's policies, processes, and controls. Auditors will need to consider how it impacts risk assessment, the design of internal control testing, as well as proper audit documentation. The staff also recognized the progress management has made in assessing the severity of internal control deficiencies, but highlighted the importance of identifying and communicating material weaknesses absent a material error or restatement occurring. The significance of audit committee involvement in discussions around control deficiencies was also echoed by the staff.

Further, OCA staff noted that effective ICFR is even more important now, given changes to entities' ICFR structures with the adoption of new accounting standards. The staff went on to provide details of areas where management's annual assessment of ICFR and related disclosures could be improved. The staff also reminded management that when evaluating operating effectiveness, they should consider whether the control operated as designed and whether the evaluation of the effectiveness considers if the nature, timing, and extent links to the assessed risk of the control failure.

OCA staff also mentioned that when ICFR is deemed ineffective, meaningful disclosure around the material weakness should be provided to investors so that investors understand the full extent of the control deficiency and its actual or potential impact on financial reporting.

Finally, in a separate speech, OCA staff discussed ICFR-related observations and reminded management to focus on the potential impact when evaluating the severity of a control deficiency and whether the deficiency, alone or in combination with another deficiency, is a material weakness.

Sustainability reporting

A panel discussing disclosure trends, which included representatives from the Sustainability Accounting Standards Board (SASB), investor advocates, and company advisers, discussed the growing demand from investors for information outside the financial statements, including sustainability reporting. One panelist observed that more than 90 percent of all companies included in Standard & Poor's 500 Index currently provide some level of sustainability disclosures.

Another panelist noted that investors are seeking information on how companies will be able to adapt to uncertain changes, such as those related to a regulatory framework, climate, human capital, and international trade, in order to make long-term investment decisions. Another panelist highlighted the importance of communicating with investors the drivers of value in a registrant's business, which might not always be reflected on the balance sheet. The panelists also acknowledged that any sustainability standards for reporting cannot be a "one size fits all" proposition.

Sustainability accounting standards

In November 2018, SASB published certain industry-specific sustainability accounting standards covering financially material issues. These standards are designed to help businesses better identify and communicate opportunities for sustaining long-term value creation and are intended to help investors and companies make more informed decisions.

Appendix

Conference speeches

Below is a list of publicly available speeches from select sessions and speakers. Full text of the conference speeches can be accessed using the links below.

Speaker	Summary and link to source
SEC, Office of the Chief Accountant (OCA)	
Wesley R. Bricker, Chief Accountant, and a Deputy Chief Accountant panel with Jenifer Minke-Girard, Marc Panucci, and Sagar Teotia	"Statement in Connection with the 2018 AICPA Conference on Current SEC and PCAOB Developments" Topics discussed included OCA's current activities, including engagement with stakeholders, rulemaking initiatives and staff guidance, technological developments, FASB and PCAOB oversight, international matters, and risks arising from innovation. The statement also includes a list of speeches given by OCA staff in 2018 on accounting and auditing matters.
Kevin L. Vaughn, Senior Associate Chief Accountant	Remarks of the Senior Associate Chief Accountant Topics discussed included the accounting consultations process and a recent consultation on evaluating subsequent events in the current expected credit losses model.
Sarah N. Esquivel, Associate Chief Accountant	Remarks of the Associate Chief Accountant Topics discussed included observations from revenue consultations related to identifying performance obligations and evaluating the existence of a significant financing component.
Emily L. Fitts, Professional Accounting Fellow (PAF)	Remarks of the PAF Topics discussed included evaluating the operating effectiveness of ICFR and management's annual report on ICFR and the related material weakness disclosures.
Tom W. Collens, PAF	Remarks of the PAF Topics discussed included ICFR-related observations, including the evaluation of the severity of control deficiencies.
Sheri L. York, PAF	Remarks of the PAF Topics discussed included observations from revenue consultations related to principal versus agent considerations and the identification of performance obligations.

Speaker	Summary and link to source
Andrew W. Pidgeon, PAF	Remarks of the PAF Topics discussed included observations from leases standard consultations related to minimum rental payment composition policies, minimum rental payment measurement policies, and certain lessee and lessor costs.
Rahim M. Ismail, PAF	Remarks of the PAF Topics discussed included implementation activities related to the credit losses standard and transitioning away from LIBOR.
PCAOB	
George Botic, Director of Registration and Inspections	"Protecting Investors through Change" Topics discussed included transformation and other activities at the PCAOB, the current state of audit quality, a preview of 2018 inspection findings, and the inspection outlook for 2019.
FASB	
Russell G. Golden, Chairman	Remarks of FASB Chairman Topics discussed included an overview of the activities at the FASB, including supporting the implementation of new accounting standards.
IASB	
Hans Hoogervorst, Chairman	"Are we ready for the next crisis?" Topics discussed included current risks in the global financial system and the potential impact of the new accounting standards as well as pitfalls of the current accounting for goodwill.
CAQ	
Cynthia Fornelli, Executive Director	"Center for Audit Quality Update" Topics discussed included an overview of current CAQ activities, such as efforts to collaborate to enhance transparency, the audit of the future, and efforts to fight against financial statement fraud.