Grant Thornton

New Developments Summary

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

Managing the exponential pace of change

Contents

The AICPA held its 2019 Conference on Current SEC and PCAOB Developments in Washington, D.C. on December 9-11, featuring representatives from the SEC, PCAOB, FASB, IASB, AICPA, and Center for Audit Quality (CAQ), along with others from the accounting profession. Shared themes discussed during the conference included

- The strength of the U.S. financial reporting system
- Evolving trends in the reporting environment

This publication provides a summary of these themes and other important matters highlighted at the conference. Links to speakers' publicly available speeches are included in Appendix A.

A. Conference overview

The 2019 AICPA Conference on Current SEC and PCAOB Developments, held in Washington, D.C. on December 9-11, featured representatives from regulatory and standard-setting bodies, as well as industry professionals, financial statement preparers, legal practitioners, decision-makers, and analysts. Speakers and panelists shared their views on current accounting, financial reporting, auditing, and other developing issues, which focused on two themes:

- The strength of the U.S. financial reporting system
- Evolving trends in the reporting environment

The strength of the U.S. financial reporting system

The conference featured a conversation between SEC Chairman Jay Clayton and SEC Chief Accountant Sagar Teotia, moderated by CAQ Executive Director Julie Bell Lindsay. Chairman Clayton began the conversation by stressing that day-to-day communication between the SEC, including the SEC's Office of the Chief Accountant (OCA), and issuers, professionals, and stakeholders in the marketplace is essential to the Commission's three-part mission: (1) protecting investors; (2) maintaining fair, orderly, and efficient markets; and (3) facilitating capital formation. Both Chairman Clayton and Mr. Teotia discussed how their offices and staff work in tandem to further that mission.

Chairman Clayton further stated that the SEC's rulemaking activity over the past year has focused on modernizing the regulatory environment to respond to evolving trends and the changing composition of the U.S. capital markets. He believes that focus on capital formation and investor protection is not a balancing act and that modernizing reporting and disclosure requirements moves forward all parts of the SEC's mission.

When asked his views on how the accounting standard-setting processes contribute to the SEC's mission, Chairman Clayton reminded the audience that audited financial statements are the "bedrock of our financial reporting system." Mr. Teotia indicated that the strength of the U.S. financial reporting system is the result of hard work by all participants in the system, including financial statement preparers, audit committees, auditors, standard setters, and regulators.

Chairman Clayton also stated that auditor independence is the foundation of the profession and that it is important for auditors to be independent both "in fact and appearance" to enhance the credibility of audited financial statements. In addition, he reiterated that compliance with the SEC's auditor independence rules is a responsibility shared by the audit committee and management of the audit client and its auditor. The staff will continue to focus on potential changes to the auditor independence rules.

Ms. Lindsay stated that audit quality is a focus not only in the United States but also globally, and asked Chairman Clayton to share why international matters are so important from an SEC perspective. He responded that investors are much more exposed to international companies and international financial reporting than ever before. He further stated that since the foreign operations of U.S. listed companies are generally audited by firms located in jurisdictions outside the United States, the need for consistency across financial reporting and audit quality is paramount to investor protection.

The PCAOB is also focused on improving audit quality as noted in goal one of the PCAOB's five-year Strategic Plan—to drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation. The conference featured a panel with all five PCAOB board members who expressed their views on the state of audit quality, noting that audit quality matters are key to maintaining the integrity of the U.S. capital markets and the trust of investors.

In her prepared remarks, Ms. Lindsay indicated that she is proud of the profession's focus on maintaining the capital markets' trust, as evidenced in the results of the CAQ's 2019 Main Street Investor Survey. The survey indicates that 78 percent of investors have confidence in audited financial information and that 83 percent of investors believe auditors are effective in investor protection. Both percentages have increased compared to prior-year results.

Evolving trends in the reporting environment

While Mr. Teotia commented that it was a busy year with the implementation of new accounting and auditing standards, other speakers focused their remarks on the future and how the profession can proactively respond to the pace of change in the reporting environment.

In her welcome address, AICPA Vice-Chair Tracey Golden said that emerging technologies are changing the profession and focused her remarks on how the profession can adapt. She cited the "explosion" of CPA services available today as a result of the increased use of technology by companies. However, she noted that the value that underpins those services—investor protection—remains the same.

Several speakers throughout the conference also discussed the continuing increased use of, and reliance on by investors and other stakeholders, company-reported information disclosed outside of the audited financial statements, including non-GAAP measures; environmental, social, and governance (ESG) reporting; key performance indicators; and a company's brand and intellectual property.

In her remarks, Ms. Lindsay emphasized that the profession cannot ignore these evolving trends. She indicated that auditors can fill existing and growing gaps in company information that has not been independently audited or reviewed but which stakeholders rely on. She also mentioned the recently issued CAQ whitepaper, "The Role of Auditors in Company-Prepared Information: Present and Future," which delineates where the auditor's role begins and ends today and suggests the need for the auditor's role to evolve to further benefit stakeholders.

Additionally, with the increase in the publication of sustainability reports in 2018 by the S&P 500 companies, as noted in the Governance & Accountability Institute's Flash Report, several speakers referred to sustainability reporting as "mainstream" and noted that investors expect this type of information. In late 2018, the Sustainability Accounting Standards Board published final standards for companies to voluntarily use as a framework for reporting. The growing use of sustainability reporting provides unique opportunities for auditors to recognize trends and to change the status quo ahead of time, noted Ms. Lindsay.

Other developing issues highlighted at the conference were Brexit, LIBOR, and cybersecurity. The SEC and its staff have proactively issued statements and interpretive guidance sharing disclosure considerations with registrants on these matters. Further, the staff highlighted that the Commission's principles-based disclosure regime works well. Chairman Clayton did state that he believes the consequences and complexities related to phasing out LIBOR are greatly underestimated and reminded registrants to consult early with the staff.

B. Accounting and reporting matters

Accounting standard-setting initiatives

In his final speech as FASB chairman at this annual conference, Russell Golden reflected on the process by which the FASB sets standards, which he called "open, inclusive, and thorough." Four areas are key to the FASB's mandate: (1) listening and responding to stakeholder needs, (2) performing quality research, (3) providing quality communication, and (4) welcoming accountability from stakeholders and capital markets. Mr. Golden discussed the role that each of these areas has played in projects since he assumed the chairman's role in 2013 and reviewed the projects on the technical agenda that he expects to be completed before the end of his term in 2020.

FASB member Susan Cosper and FASB Acting Technical Director Shayne Kuhaneck discussed near-term and long-term projects on the Board's technical agenda. In the near term, they highlighted the FASB's ongoing activities to support implementation of the leases and current expected credit losses standards through stakeholder education and recent standard setting. Ms. Cosper discussed the recently issued guidance deferring the effective dates for the leases, hedging, credit losses, and long-duration insurance contract standards, and outlined the Board's new "two-bucket" philosophy for determining the effective dates for future standards. Mr. Kuhaneck reviewed the steps the Board has taken in responding to reference rate reform, which is intended to simplify the accounting for entities transitioning contracts to new reference rates after LIBOR is discontinued. Other near-term projects include simplifying the accounting for convertible instruments and applying a scope exception for contracts in an entity's own equity, as well as the recently proposed update to the hedging guidance.

Many of the Board's long-term projects are still in the early phase, with activity centered on research and feedback. Ms. Cosper provided an update on three projects:

- On the segment reporting project, the Board has completed two field studies involving 32 companies: one on the aggregation criteria and another on the disclosure requirements.
- The FASB is currently performing outreach for its project on financial performance reporting, exploring new ways to disaggregate performance information to increase the decision usefulness of the income statement. At a recent meeting, the Board directed the staff to coordinate its next steps based on developments in the segment reporting project and learnings from the IASB's primary financial statements project.
- The feedback received on the Invitation to Comment on the goodwill and intangibles project reflected the diverse viewpoints held among stakeholders, and the Board will continue to engage with all constituents in determining the direction of the project.

Sue Lloyd, Vice-Chair of the International Accounting Standards Board (IASB), focused her remarks on the financial statements as the core of investor information and discussed three IASB projects intended to strengthen financial reporting:

- An upcoming proposal that would standardize the definitions of income statement subtotals to decrease diversity in practice.
- A proposal that would require a reconciliation in the notes to the financial statements for each management performance measure (in other words, each non-GAAP financial measure) to its closest income statement subtotal prescribed under IFRS Standards.
- A project to update the Practice Statement on Management Commentary, which is designed to provide investors with information about a company's future prospects. The IASB expects to publish an Exposure Draft in the second half of 2020.

SEC staff views on specific accounting matters

Revenue recognition

OCA staff mentioned that the top two topics in revenue consultations submitted to OCA during the last year were (1) determining whether an entity is a principal or an agent, and (2) identifying the performance obligations in a revenue contract. The staff discussed one consultation related to each topic that they have addressed with registrants this year.

Principal versus agent considerations

Repeating a theme discussed at this conference last year, 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. The staff noted that it can be particularly challenging when two parties are involved in providing services to a customer, especially if some of the services can only be provided by a specific service provider. The staff discussed one consultation where the registrant entered into contracts with customers to provide several related services in exchange for a fee. These contracts acknowledged that another service provider would provide some of the services, and the services were marketed to these customers using the brand names of both the registrant and the other service provider. However, due to certain regulatory restrictions, the registrant could not legally provide some of the services promised in the contract and had to rely entirely on the other service provider to deliver those services.

In this fact pattern, the registrant concluded, and OCA staff did not object, that the registrant was the principal in the transaction for each of the specified services because it controlled the services before transferring them to the customer. The registrant asserted that it was primarily responsible for fulfilling the promise to provide the specified services. In the staff's view, the registrant could control the specified services by entering into a contract with another service provider in which the registrant defined the scope of services to be performed on its behalf, even though the registrant could not legally provide certain services promised in the contract.

OCA staff encouraged registrants to carefully consider their specific facts and circumstances and contractual terms, as well as any changes to these terms over time, when applying this guidance.

Identification of performance obligations

In a recent consultation, OCA staff did not object to a registrant's conclusion that two promises, consisting of software and software updates, comprised a single, combined performance obligation. In this fact pattern, the registrant licensed software that allowed its customers, who were application developers, to build and deploy, and therefore monetize, their own applications on various third-party platforms, such as cellular phones and home entertainment systems that frequently experience their own updates. The registrant's software and software updates ensure that the application built using the registrant's software is compatible with all platforms that it supports, both when the application is initially deployed on a platform and over time as that platform is updated. In the staff's view, the registrant's promise to provide the software and the software updates are, in effect, inputs that (1) together fulfill a single promise that allows the customer to continually deploy and monetize content using third-party platforms, and (2) are integral to maintaining the utility of the software.

OCA staff reminded registrants that considering whether a promise to transfer a good or a service to the customer is separately identifiable or distinct within the context of the contract is another area of the revenue guidance that often requires significant judgment. Further, a registrant must support its assertion that its promises to transfer goods or services are not separately identifiable based on the revenue guidance in ASC 606-10-25-21, which describes the objectives of the analysis and provides factors to consider. The staff believes it is helpful for registrants to also consider the discussion in the Basis for Conclusions of the performance obligations guidance in ASU 2016-10, which includes the notion of considering whether the registrant's combined output is greater than, or substantively different from, the sum of the parts.

New leases standard

Transferring control in a sale-leaseback

OCA staff explained that, in a consultation on applying the guidance in ASC 842-40, *Sale and Leaseback Transactions*, the staff objected to a lessor registrant's conclusion that it transferred control of certain assets within a variable interest entity (VIE) to a third party. The registrant's conclusion was based on the third party having (1) obtained the benefits of the assets through a master prepaid lease, and (2) the ability to prevent other parties from obtaining the benefits from the assets by exercising a substantive purchase option.

The staff explained that an entity's ability to prevent others from directing the use of, and obtaining the benefits from, an asset is not sufficient in and of itself to establish control over the asset. With respect to the consultation, the staff determined that control over the assets had not transferred to the third party because, absent the third party exercising the purchase option, the registrant would regain a controlling financial interest in the VIE.

Collectibility of lease payments

OCA staff described a consultation where the staff objected to a registrant's conclusion that collectibility of the lease payments is probable, despite relevant historical collection data indicating that, on average, the registrant collects 60 percent of contractual lease payments. The registrant's position was based on its determination that, at the lease commencement date, the customer had the intent and ability to pay, as evidenced in part by a credit evaluation and a substantive down payment. Further, the registrant asserted that historical defaults were generally based on changes in circumstances after lease commencement, and therefore should not impact the assessment of collectibility at lease commencement.

The staff determined that the registrant lacked a sufficient basis to conclude that collectibility is probable at lease commencement, particularly given the credit quality of the registrant's customers and the registrant's collection history.

New credit losses standard

Considering potential future advances to a borrower

OCA staff described a consultation in which the staff did not object to a registrant's conclusion that when using a discounted cash flow method to estimate expected credit losses, certain potential future advances that the registrant does not have an unconditional contractual obligation to extend should not be considered until the advances are extended to the borrower.

The registrant in this consultation held mortgage loans, and the loan agreement required the borrower to make certain payments relating to the underlying collateral, such as property taxes, homeowners' association fees, and certain insurance premiums. The loan agreement also included a provision that gave the registrant a right, but did not obligate the registrant, to make such payments on behalf of the borrower if the borrower failed to make the payments, and to consider such payments as additional advances under the mortgage loan. The registrant asserted that an estimate of expected credit losses on these additional advances should not be recognized until the registrant makes these advances because

- The registrant does not have an unconditional contractual obligation to extend credit to the borrower for these amounts—it generally makes such advances to avoid additional losses or to safeguard the value of the underlying collateral;

- The guidance on credit losses in ASC 326 does not prescribe which specific cash flows should be included in the present value of expected cash flows;
- The borrower's costs that are funded by these advances do not become part of the amortized cost basis of the loan until they are funded by the registrant; and
- If the registrant were to apply the practical expedient to measure credit losses for collateral-dependent financial assets, these costs would not meet the definition of "costs to sell" and therefore would not be considered in the valuation allowance against the fair value of the collateral.

Reference rate reform

OCA staff reminded the audience about several helpful resources related to reference rate reform:

- At this conference last year, OCA staff delivered a speech regarding the impact of the expected cessation of LIBOR on cash flow hedges.
- In July 2019, the SEC staff released a statement on the LIBOR transition.
- In September 2019, the FASB issued a proposed ASU that would provide relief for financial statement preparers transitioning from LIBOR to replacement rates with respect to various contracts.

OCA staff also explained its response to a consultation regarding a registrant's amendment to perpetual preferred shares that pay LIBOR-based dividends. Anticipating the cessation of LIBOR, the amendment would solely cause the dividends to be linked instead to the Secured Overnight Financing Rate.

To account for the amendment, the registrant first applied a qualitative approach in accordance with its accounting policy to assess whether an amendment to an equity-classified instrument is a modification or an extinguishment of the instrument. The registrant considered the business purpose for the change and how the change might influence the economic decisions of the investor, and determined that the amendment was not significant enough to cause an extinguishment. OCA staff did not object to this conclusion.

Next, the registrant performed a qualitative assessment of whether any incremental value was transferred between the registrant and the preferred stockholder due to the amendment, and determined that any increase in the fair value of the preferred shares stemming from the amendment was minimal. In reaching its conclusion, the registrant considered that the sole business purpose of amending the instrument was to replace LIBOR, which will cease to be available in the future, rather than to transfer value to the preferred stock holders. OCA staff did not object to the registrant's conclusion that recognizing any change in fair value was unnecessary since the fair value immediately prior to the modification would have already incorporated the effect of the anticipated LIBOR cessation.

Application of equity method accounting to an investment in an LLC

OCA staff affirmed its long-standing position that an investor should apply equity method accounting to investments in limited partnerships, unless the investment is so minor that the investor may have virtually no influence over the partnership's operating and financial policies. In practice, an investment of more than 3 to 5 percent is generally considered to be more than minor.

In a recent consultation, the staff objected to a registrant's conclusion that equity method accounting did not apply to an investment in a limited liability company (LLC) where the registrant held over 25 percent of the member units and had significant ongoing commercial arrangements with the LLC.

The LLC was similar to an investment in a limited partnership because the LLC was required to maintain specific ownership accounts for each member. The registrant stated that it did not have voting rights over key operating and financial decisions or board representation, and noted that the member units only provided for certain limited rights, most of which were protective in nature. In addition, the member units had a preferential profit allocation. The registrant considered the staff's position that the equity method should be applied to investments in limited liability partnerships or similar entities, but the registrant concluded that an assessment of the overall significant influence indicators was more relevant, regardless of the form of ownership, since it held virtually no influence on the LLC and the nature and intent of its investment was truly passive. The registrant also believed that not applying the equity method would better reflect the economics of its investment.

However, the staff concluded that the registrant had more than *virtually no influence* over the LLC because of its significant ownership interest, certain limited rights other than protective rights, and ongoing commercial arrangements with the LLC, and that the registrant should therefore apply the equity method of accounting.

Determining primary beneficiary of VIEs

OCA staff discussed identifying the primary beneficiary of a VIE and noted that identifying the party with the power to direct the activities that most significantly impact a VIE's economic performance is an area that requires judgment and a careful evaluation of the VIE's purpose and design, along with the variability that the VIE is designed to create and pass along to its variable interest holders. The staff provided their observations on identifying the primary beneficiary in two separate fact patterns.

Fact pattern 1

To determine whether the limited partner or the general partner holds the power to direct the activities that most significantly impact a VIE's economic performance, a registrant should consider whether the limited partner's right to modify certain aspects of the investment guidelines would significantly limit the general partner's discretion over current and future investment decisions through its day-to-day management rights.

In the first fact pattern, a registrant forms a VIE, whose primary purpose is to manage the investable assets contributed by the registrant under broad investment guidelines established by the registrant. The staff did not object to the registrant's conclusion that it does not control the VIE's most significant activities under these circumstances. Even though the investment guidelines were established by the registrant and the registrant could modify certain aspects of the investment guidelines, the staff agreed that the registrant did not have the ability to significantly limit the general partner's discretion over current and future investment decisions because the guidelines provided the general partner with significant discretion to make day-to-day investment decisions.

Fact pattern 2

If a VIE has multiple risks and multiple activities that impact its economic performance, a registrant should not assume that all risks are identical. Rather, a registrant should identify the VIE's most significant activities in order to determine which variable interest holder has the power to direct those activities, because the importance of each risk and each activity is generally not the same.

In this second fact pattern, the registrant was leasing the only property held by a VIE for substantially all of the property's economic life. The staff determined that activities related to managing residual value risk as well as operation and maintenance risk were the VIE's most significant activities. Based on the VIE's purpose and design, the staff determined that the risks and activities that impacted the VIE's economic performance included lease negotiation, lessee credit, residual value, and operation and maintenance. The staff concluded that activities related to managing lease negotiation and lessee credit were not the most significant activities, since the lease term for substantially all of the property's economic life mitigated the lease negotiation risk and the registrant's financial condition, and the property's strategic importance to the registrant mitigated the lessee credit risk.

With regard to managing the property's residual value and operation and maintenance risk, the registrant was obligated under the lease to operate and maintain the property, including any significant structural maintenance. The staff objected to the registrant's conclusion that it did not have power over the VIE's most significant activities, since operation and maintenance decisions were made by the lessee during the lease term, which was for substantially all of the economic life of the property.

Application of the deferred adoption dates

The FASB recently issued ASU 2019-09 and ASU 2019-10, deferring the effective dates for the standards on long-duration insurance contracts and on credit losses, leases, and derivatives and hedging, respectively.

As a result of the deferrals, an emerging growth company (EGC) that elected to follow the accounting transition provisions applicable to nonissuers and that has not yet adopted the leases standard is not required to adopt that standard until fiscal years beginning after December 15, 2020 and interim periods within fiscal years beginning after December 15, 2021. The same is true for adopting the leases standard for entities that otherwise do not meet the definition of a public business entity and are required to file financial statements with the SEC under Regulation S-X, Rule 3-05, *Financial statements of businesses acquired or to be acquired,* or Regulation S-X, Rule 3-09, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*.

Financial statements of a non-SEC filer that are filed with the SEC

The staff of the SEC's Division of Corporation Finance's Office of Chief Accountant (CF-OCA) identified two situations where an entity may not meet the definition of an "SEC filer," as defined in the FASB Master Glossary, even if its financial statements are filed with the SEC.

First, an entity that has filed an initial registration statement with the SEC meets the definition of an SEC filer only after that registration statement is declared effective. Accordingly, an entity in the process of an initial public offering (IPO) may technically follow accounting standard adoption dates applicable to non-SEC filers during the registration process. However, the entity would immediately become an SEC filer when its IPO registration statement becomes effective. Therefore, unless the entity is an EGC that has elected to follow the accounting transition requirements applicable to nonissuers or qualifies to use the adoption dates for a smaller reporting company (SRC) filer, it would be required to adopt new accounting standards using the non-SRC filer adoption date in its next filing.

Consider this example: In June 2020, the IPO registration statement is declared effective for a calendar-year non-EGC that did not qualify to use the SRC filer adoption date for the credit losses standard. If the entity did not adopt the credit losses standard as of January 1, 2020 in its March 31, 2020 financial statements included in the IPO registration statement, it must adopt that standard as of January 1, 2020 for the financial statements included in its second-quarter Form 10-Q.

Second, the staff also clarified that an entity is not an SEC filer if its financial statements are filed with the SEC only due to a requirement under Regulation S-X, Rules 3-05 or 3-09. Such entities may follow the accounting standards adoption dates applicable to an entity that is not an SEC filer.

C. SEC compliance and reporting

SEC rulemaking and initiatives

During the SEC's Division of Corporation Finance (CorpFin) panel, CorpFin Director William Hinman discussed the division's current priorities, including current and future rulemaking as well as developing issues. Mr. Hinman mentioned the anticipated amendments to financial disclosures about acquired businesses and believes the amendments will improve the readability and usefulness of the disclosures while reducing preparation time and compliance costs for registrants.

Mr. Hinman further discussed other upcoming rulemaking focused on furthering the SEC's mission, such as amendments to financial disclosures for registered debt security offerings and amendments to the accelerated filer definition. He referred the audience to the Commission's Fall 2019 Agency Rule List for a complete list of planned rulemaking in 2020. Below is a snapshot of pending rulemaking from that list which CorpFin staff highlighted.

Expected final rules	**Planned 2020 timing**
Accelerated filer definition	Second quarter
Amendments to financial disclosures about acquired businesses	Third quarter
Amendments to financial disclosures for registered debt security offerings	Third quarter
Expected proposed rule	**Planned 2020 timing**
Modernization and simplification of disclosures regarding MD&A, selected financial data and supplementary financial information	Second quarter
Earnings release/quarterly reports	Third quarter
Guide 5 real estate limited partnerships and Form S-11	Third quarter
Regulation A amendments	Third quarter
Harmonization of exempt offerings	Third quarter

Mr. Hinman and the panel of CorpFin staff highlighted certain 2019 rulemaking activities, which focused on modernizing outdated rules, streamlining processes to help registrants comply with the rules without expending as many resources, and enhancing investors' usability of the information:

- Final Rule, *FAST Act Modernization and Simplification of Regulation S-K*, provides additional flexibility regarding the reporting periods discussed in Regulation S-K, Item 303, *Management's discussion and analysis of financial condition and results of operations* (MD&A) (effective May 2, 2019). The Final Rule also permits registrants to omit or redact certain confidential information from exhibits without first applying for confidential treatment (effective April 2, 2019), and requires registrants to tag all data points on the cover page of certain periodic and current reports using Inline XBRL (subject to a three-year phase-in).

- Proposed Rule, *Amendments to Financial Disclosures about Acquired and Disposed Businesses*, would amend Regulation S-X, Rule 3-05; Regulation S-X, Rule 3-14, *Special instructions for real estate operations to be acquired*; and Regulation S-X, Article 11, *Pro forma financial information.* The proposal would also add Regulation S-X, Rule 6-11, *Financial statements of funds acquired or to be acquired*, and amend Form N-14 to address financial reporting for acquisitions by investment companies, including business development companies.
- Proposed Rule, *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*, would amend these terms in Exchange Act Rule 12b-2, *Definitions*, to exclude an issuer eligible to be an SRC that had annual revenues of less than $100 million in its most recent fiscal year. The proposal would also increase the transition thresholds in Rule 12b-2 to exit accelerated filer and large accelerated filer status and would add a revenue test.
- Concept Release on Harmonization of Securities Offering Exemptions requests public comment on certain exemptions from registration under the Securities Act of 1933, and on possible ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation.

Developing issues

Mr. Hinman also discussed the emerging issue of digital assets and reminded the audience of the establishment of the SEC's Strategic Hub for Innovation and Financial Technology (FinHub) and the published framework, "Investment Contract" Analysis of Digital Assets. The framework helps entities that are considering an initial coin offering to determine whether a digital asset is an investment contract and therefore a security within the scope of U.S. federal securities laws. Mr. Hinman noted that progress has been made in the area of digital assets, including the qualification of Regulation A offerings.

Other developing issues discussed by Mr. Hinman included cybersecurity, Brexit, the LIBOR transition, and sustainability reporting. He reminded the audience that the Commission and staff have proactively provided interpretative guidance in a few areas, including cybersecurity and climate change.

He further reminded the audience of the statement issued by SEC staff highlighting the risks associated with the transition from LIBOR and encouraged market participants to proactively manage the transition.

Mr. Hinman believes the current principles-based approach to disclosure works well given the uncertainty in these areas and pointed out that the staff has seen improvement in disclosures. He acknowledged the difficulty registrants have in developing the disclosures, but noted that there should not be any gaps between the issues discussed at the board level and those included in the disclosure documents. He further stated that when a material risk is known, the staff expects to see disclosure explaining how the board is overseeing the risk.

Mr. Hinman also reminded the audience that the staff reviews companies' sustainability reports and other publicly available information for comparison against disclosure documents and directed registrants to a speech that he gave in March 2019, which discusses the disclosure of sustainability and Brexit, for more information.

CD&A

Mr. Hinman reminded registrants that compensation discussion and analysis (CD&A) disclosures should clearly describe how buyback activity impacts compensation targets and how compensation committees consider buyback activity in determining executive compensation. Further, when a non-GAAP measure is included in CD&A as a metric used to determine compensation, Mr. Hinman noted that, even though a full reconciliation to the most comparable GAAP amount is not required by the rules, clear disclosure of how the measure was calculated is needed so readers can better understand the compensation disclosures.

Filing reviews

In a panel discussion, CorpFin Office Chiefs Joel Parker and Mara Ransom along with a member of the legal community discussed filing review trends and CorpFin's recently announced disclosure program realignment.

The panelists noted that the areas most frequently commented on are revenue recognition, non-GAAP measures, and MD&A. CorpFin staff's remarks on ASC 606 were consistent with their remarks from the 2018 conference.

New accounting standards

While most public companies have already adopted the leases standard, CorpFin staff noted that it is too early to identify trends in comments related to applying the new standard. However, the staff reminded the audience about annual financial statement disclosures that are required in the period of adoption, noting that the disclosures should enable financial statement users to understand the amount, timing, and uncertainty of cash flows arising from the entity's leases. In addition, the staff encouraged registrants to tailor their disclosures to reflect the specifics of their lease arrangements and the assumptions used in applying the standard, and to avoid boilerplate language or reciting the accounting literature.

Non-GAAP financial measures

During the keynote conversation, Chairman Clayton and Mr. Teotia noted that well-thought-out non-GAAP measures, when presented along with GAAP numbers, may be informative and helpful to investors. However, they reminded registrants that non-GAAP measures should be consistent with metrics that management uses to manage the business and should be comparable from one period to another. Registrants were encouraged to include transparent disclosures for any changes between periods in computing such measures.

During the CorpFin panel, CF-OCA staff noted that they will object to a registrant's position that GAAP amounts are misleading as support for using certain non-GAAP measures. The staff noted that preparers should instead focus on what they are trying to convey to a reader of the information. Further, the staff shared the following observations from comment letters:

- *Changing principal versus agent conclusions*: Discussing transactions on a gross basis when a registrant is an agent or transactions on a net basis when a registrant is a principal constitutes an individually tailored accounting principle and is not permitted. The staff reminded registrants that whether to record transactions on a gross or net basis is not a policy decision.
- *Contribution margin*: The staff noted that the term "contribution margin" is not defined in GAAP but, as commonly used, is most directly comparable to gross margin. In such instances, registrants need to reconcile the measure to gross margin, even if gross margin is not presented on the face of the financial statements.

CF-OCA staff also noted that they will likely object to a non-GAAP performance measure that excludes the impact of adopting the new credit losses guidance or loan loss provision in its entirety. Registrants considering such presentation were encouraged to consider disclosing the impact of adopting the credit losses guidance in MD&A and contacting the staff with any questions.

MD&A

CorpFin staff noted an increase in incentive programs by companies that use a platform to connect users with suppliers. In some arrangements, incentives are paid to the end user rather than the entity's customer and may be material, particularly when the company is in a high-growth phase. If the incentives paid to an end user are not payments to a customer, as described in ASC 606, and the incentive program results in a material expense, registrants should discuss the impact of the incentive program on its operations in MD&A, including quantification of the expense.

CF-OCA staff also observed an increase in registrants' use of supplier finance programs involving trade payables, often referred to as structured trade payables, reverse factoring, or vendor payable programs. The staff noted that registrants are not always disclosing when these programs are being used as a strategy to improve liquidity and increase operating cash flows by extending the payment terms for trade payables. If these arrangements are material to the current period or are reasonably likely to materially affect future liquidity, the staff said that they expect registrants to disclose material terms of the program, along with general benefits and risks introduced, any guarantees provided by the parent or subsidiaries, plans to further extend terms to other suppliers, and any factors that limit their ability to continue to increase future cash flows using these programs. The staff also expects registrants to disclose the effects of such programs on liquidity for the current period as well as inter-period variability and whether the historical increase is sustainable for the business. Further, the staff encouraged registrants to consider Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis.

Tips for interactions with CorpFin staff

CorpFin staff provided the following advice for registrants to facilitate efficient filing reviews and other interactions:

- When submitting or filing a registration statement, provide email contact information for both the company and its SEC counsel.
- Prior to sending courtesy paper copies, ask the staff reviewer if they need or use them.
- Respond to comment letter questions directly and clearly, and if the staff has a question or comment on an immaterial item, explain the item's materiality in the initial response.
- Do not assume a particular disclosure practice is permitted based on precedence from another SEC filing, as the item may not be material to the entity or the example filing may not have been reviewed.
- In discussions on interpretive or procedural questions, do not assume the staff has all relevant information. Provide pertinent facts, clearly articulate the company's question or concern, and provide an analysis of applicable technical guidance, even if such analysis is preliminary.

- Communicate intended changes to the transaction structure, such as legal reorganizations, or equity transactions, such as stock splits, early in the registration statement review process to ensure the staff has time to consider and review the disclosures on the transaction to avoid delays later in the process.
- If the company does not understand a comment or question, call the staff reviewer.

Definition of a 'business'

With a change in the definition of a "business" in the business combinations guidance in ASC 805, CF-OCA staff acknowledged that there are more instances when an acquisition is not a business combination for accounting purposes, but meets the definition of a business under Regulation S-X, Article 11. The staff reminded registrants that for SEC reporting purposes, the objective is to determine whether additional financial statements are necessary for making investment decisions, which may not always align with the U.S. GAAP outcome. Further, the staff confirmed that the Commission is not considering amending its definition of a business.

The staff explained that in determining whether an acquisition constitutes a business under Regulation S-X, Article 11, registrants should focus on the continuity of operations. The staff also clarified that while revenue is one of the factors indicating whether there is continuity of operations, it is not the only factor, and that an acquired entity that does not have any revenue might still meet the definition of a business. The staff further stated that while there is a presumption that a separate entity, division, or subsidiary constitutes a business, registrants should consider all factors outlined in Regulation S-X, Article 11 in making their determination.

During the CorpFin panel, Chief Accountant Kyle Moffatt noted a significant increase in waiver requests under Regulation S-X, Rule 3-13, *Filing of other financial statements in certain cases*, related to acquired business financial statements required by Regulation S-X, Rule 3-05. He reminded registrants that the staff reviews each of these requests in light of individual facts and circumstances. While they are "open for business," the staff is primarily focused on investor protection when considering granting relief from SEC reporting requirements and lacks the authority to waive any form requirements. Any relief granted under Regulation S-X, Rule 3-13 is limited to the financial statements included in such forms.

Predecessor determination

CF-OCA staff noted an increase in questions related to the identification of the predecessor entity in connection with transactions conducted in anticipation of an IPO, such as spin-offs, carve-outs, or put-together transactions. In complex or unique fact patterns requiring significant judgment to identify the predecessor, companies are encouraged to submit an interpretive request to the CF-OCA on a pre-filing basis to confirm that the staff will not object to its predecessor determination.

In an IPO transaction where several operating entities are or will be combined in a new entity, companies may consider several factors to identify the registrant's predecessor(s), including (1) the order in which the entities were acquired, including which entity was acquired first; (2) the relative size of the entities on a revenue and fair value basis; and (3) the historical and go-forward management team.

The staff indicated that none of these factors is individually determinative; rather, the predecessor determination is based on the weight of all relevant factors. Further, in transactions involving more than one operating entity, it is possible to identify more than one predecessor entity.

The staff noted that as a reasonableness check, companies may consider the entity it plans to discuss in the description of the business and in MD&A, as these disclosures should be comparable to the primary financial statements. In addition, the staff said that companies may also find it helpful to identify the comparative financial statements they plan to include in their first Form 10-K to ensure that the IPO predecessor determination is consistent with the historical financial statements they expect to include in future filings.

Further, the staff pointed out that a newly created entity that qualifies as the accounting acquirer under ASC 805 would generally not be the predecessor entity for purposes of the registrant's historical financial statements, as it would not have any substantive pre-IPO operating activity.

Finally, the staff explained that in some carve-out transactions, companies have analogized to certain factors in Staff Accounting Bulletin (SAB) Topic 5.Z.7, *Accounting for the spin-off of a subsidiary*, to identify the components of the predecessor. When the predecessor or IPO entity is the parent company, SAB Topic 5.Z.7 may be directly applicable. Accordingly, companies should analyze all relevant conditions in that guidance.

SPAC transactions

CF-OCA staff has seen an increase in the number of special purpose acquisition company (SPAC) transactions, whereby a shell company goes through an IPO and raises money to acquire an operating company that is ordinarily privately held. The staff reminded registrants that in Form S-4 or a proxy, they expect the financial statements of the operating company to comply with public company GAAP and to be audited in accordance with PCAOB standards.

The staff also noted that if both the SPAC and the operating company qualify as an EGC and the SPAC has not filed its first Form 10-K, only two years of audited financial statements for the operating company are required in Form S-4 or a proxy, as well as in Form 8-K filed after the acquisition. Once Form 10-K is filed, the operating company must file its financial statements for three years, unless the company qualifies as an SRC. If the financial statements are required for three years, the staff stated, it is rare to receive a waiver from presenting the oldest year in SEC filings.

International reporting matters

During the CorpFin panel, CF-OCA staff noted that more than 50 percent of foreign private issuers prepare their financial statements in accordance with IFRS Standards. The staff went on to highlight certain reporting issues discussed at the CAQ's International Practice Task Force May 2019 meeting related to areas where requirements under IFRS Standards are more stringent than applicable SEC rules and regulations, primarily Rules 3-05 and 3-09 under Regulation S-X.

SEC enforcement matters

Matthew Jacques, the SEC Division of Enforcement's Chief Accountant, led a panel of accountants from his division. Mr. Jacques reported that in accounting and financial reporting investigations, the division focuses on whether the accounting reflects the true economic nature of the underlying transaction and whether financial statements are accurate and consistent and fully disclose all material information. The staff also provided a brief overview of the division's activities during fiscal year 2019, which are detailed in the Division of Enforcement 2019 Annual Report.

Mr. Jacques noted that enforcement actions in 2019 involved several aspects of financial reporting, including fraudulent accounting practices intended to misrepresent the underlying economic events, improper inflation of asset valuations, intentional distortion of key performance indicators and non-GAAP measures, failure to design and maintain internal controls, and misrepresentation or omission of risk factors and material disclosures.

With respect to audit-related matters, the staff further noted that enforcement actions continue to involve auditors' failure to discharge their professional responsibilities. The primary themes in these cases related to ethics and independence violations and failures to comply with applicable auditing standards.

In accounting- and disclosure-related cases, the division expects to continue to focus on gatekeepers (including auditors and their adherence to professional standards), revenue recognition, expense accruals, earning management cases, misstatement or omission of material information (including material trends and uncertainties), non-GAAP measures, and nonfinancial metrics.

D. Audit and corporate governance

PCAOB keynote address

PCAOB Chairman William D. Duhnke III was joined by the other members of the board to deliver this year's PCAOB keynote address. The board members discussed the current state of audit quality and reminded the audience why audit quality ultimately matters. Although we have seen historic low levels for restatements, board members noted that there is still room for improvement in audit performance. The board continues its inspection and enforcement efforts, and in the past year undertook efforts to proactively issue staff guidance and to interact with the profession related to the PCAOB's reporting requirements on critical audit matters (CAMs), which are now effective for large accelerated filers.

The board members also highlighted this past year's extensive stakeholder outreach efforts, which included investor and audit committee liaison meetings and the establishment of the Office of External Affairs, which provides a specific contact for stakeholders who want to engage in discussion with the PCAOB. A resounding theme in feedback from stakeholders was the desire for quality and accessible information. In response, the board is making strides to improve the relevance and usefulness of its inspections reports, among other things. The new format is expected to be published in early 2020 for the six largest global audit firms.

PCAOB standard-setting update

Megan Zietsman, PCAOB Chief Auditor, summarized the board's standard-setting and research projects and highlighted the implementation of CAMs and the PCAOB's commitment to supporting their successful implementation. She also discussed the new standards on auditing accounting estimates and the auditor's use of the work of specialists, which are both effective for 2020 audits. Ms. Zietsman described the Concept Release on a firm's system of quality control that was approved by the board subsequent to the conference. There are several drivers for undertaking this project at this time, including the PCAOB's view that the current quality control standards are outdated and do not reflect the current environment in which firms operate. She also observed a shift by the firms to a more preventative approach as opposed to relying primarily on detective measures for purposes of quality control. Ms. Zietsman noted that the Office of the Chief Auditor is monitoring the international efforts in this area and acknowledged that it is not practical for firms to operationalize different frameworks for systems of quality control depending on the auditing standards being used. However, she noted that there may be incremental or alternative requirements that may be needed in the U.S. environment.

Ms. Zietsman also described the PCAOB's research project on the advances in technology and the use of automated tools in the conduct of audits. The PCAOB currently has a task force comprised of auditors and other professionals analyzing the current trends and activities that could impact the PCAOB's standard-setting agenda. Based on the task force's recommendations, the Office of the Chief Auditor is initially focused on evaluating the use of data analytics and artificial intelligence in the audit. She noted that preliminary observations indicate that the current auditing standards are not impeding the use of these tools and techniques; however, the task force noted that the standards include references that are outdated and therefore do not necessarily encourage the use of new techniques. With respect to other related areas, Ms. Zietsman noted that members of the Office of the Chief Auditor are educating themselves on different areas, such as the use of digital assets and their potential implication for auditors. She emphasized the importance of auditors having the skills and knowledge to audit digital assets, including cryptocurrencies.

Implementation of CAMs

OCA Deputy Chief Accountant Marc Panucci discussed the initial implementation of the PCAOB's new requirements related to reporting CAMs in the auditor's report and noted that the initial feedback has been positive. Auditors' proactive efforts in engaging early and often with audit committees and management appear to have contributed to the initial success. Mr. Panucci encouraged auditors to keep the momentum going as the requirements become effective for other filers. Investor groups are also following CAMs closely, as discussed during the panel discussion at the conference, and such groups are considering publications regarding CAMs that would include investor-specific considerations and questions that could be posed to auditors. Mr. Panucci also cautioned registrants against making inappropriate inferences regarding CAMs. He emphasized that CAMs are neither inherently positive nor negative, and while there may be some consistency in topics within certain industries or for a company year over year, CAMs are intended to be engagement-specific. Therefore, although comparing CAMs from year to year or across peer groups may be an interesting data point, it is important not to generalize conclusions based on any differences as such conclusions may be inappropriate.

Auditor independence

During the OCA panel, OCA staff highlighted that auditor independence is a shared responsibility and is most effective when management, audit committees, and audit firms work together. It was noted that this objective can be achieved by issuer audit clients and audit committees establishing procedures to identify and monitor services and other relationships with the auditors, as well as providing current lists of affiliates to the auditors. Further, timely communication with auditors on the intent for filing future registration statements for private companies is a good practice, allowing audit firms to apply SEC and PCAOB independence rules in advance of this consideration.

During 2019, OCA staff reviewed and updated the Auditor Independence FAQs and the SEC issued a Final Rule on the loan provision rules under Regulation S-X, Rule 2-01, with an effective date of October 3, 2019. The Final Rule addresses practical compliance challenges associated with the rule, such as those experienced in the asset management industry. However, the amendments did not compromise the objective of preventing shareholders who have significant influence over the issuer audit client from having a lending relationship with the auditor.

PCAOB inspection and enforcement update

George Botic, Director of the PCAOB's Division of Registration and Inspections, discussed the inspection activities at the PCAOB, the state of audit quality based on recent inspection results, and the areas of focus for 2020. Mr. Botic described changes the division has undertaken to transform how they conduct inspections and communicate findings to drive enhancements in audit quality and better transparency to users of the reports, including audit committees and other stakeholders. These changes include format revisions to the PCAOB's inspection reports to minimize boilerplate language and enhance readability through the use of charts and graphs. To bring new and different perspectives to the inspection process, he further noted that the division instituted a “target team” approach, where one group reviews audits across multiple firms. The first audit area subjected to this approach was multi-location audits. The inspections group also focused greater efforts on firms’ systems of quality control, particularly practices that promote audit quality. They also used this targeted approach on the inspection of the implementation of CAMs, and recently the PCAOB published their observations in a Spotlight.

Mr. Botic noted focus areas for the 2020 inspection season, including auditor independence, firms’ system of quality control, implementation of new standards, and other areas, such as digital assets, cybersecurity, and the consideration of omitted procedures.

Mr. Botic noted that inspections continue to identify instances where firms or firm personnel either do not sufficiently understand applicable independence requirements or do not have appropriate controls in place to prevent violations. Two areas that gave rise to auditor independence issues, both in fact and appearance, were (1) financial statement preparation, and (2) the challenges of maintaining personal independence, including holding financial relationships with entities using trade names not easily associated with the client’s legal name. Firms were reminded to determine whether they have the appropriate senior-level support and resources devoted to independence to communicate a strong tone-at-the top.

Audit committee engagement

A panel on audit committee engagement provided valuable insights on communication among audit committees, management, and auditors during a period of change. Panelists resoundingly agreed that open, honest, and frequent communication enhances the audit committee’s ability to meet its responsibilities in overseeing financial reporting and external auditors, which is most helpful when adopting new standards. The panelists agreed that audit committees need to create time and space to enable management and the external auditor to educate audit committee members on processes and controls, implementation, and results.

Panelists also discussed audit committee disclosure transparency. The CAQ recently released its “2019 Audit Committee Barometer,” which highlighted an increasing trend in voluntary disclosures within audit committee reports. Panelist believe there is an opportunity for audit committees to communicate to investors how they fulfill their role in financial reporting oversight. The panel also touched on ESG matters given the significant emphasis in this area, and noted that stakeholders are demanding more transparency in this area. However, the applicability of these matters will vary from company to company, and audit committees should consider how these types of business risks may have a material financial impact on the company.

Blockchain and digital assets

A panel discussing blockchain and digital assets provided insights into what has transpired over the last year. The panel indicated that blockchain is not just bitcoin and that there are a variety of other uses for distributed ledger technology, so it is important for companies to take a step back to consider those other uses. The panel then focused on the efforts the AICPA’s digital assets working group in addressing the accounting for and auditing of digital assets. The panel cautioned that the working group is not setting standards or interpreting applicable rules and regulations, but noted that its whitepapers will nonetheless be helpful guidance for financial statement preparers and auditors.

The working group is divided into two subgroups: audit and accounting. The audit subgroup focuses on assurance under U.S. GAAS and considers the unique challenges in applying the auditing requirements to digital assets. The subgroup's first whitepaper will focus on client acceptance and continuance matters. The subgroup will then tackle other foundational concepts, such as risk assessment and processes and controls. The accounting subgroup is focused on U.S. GAAP and recently issued a Practice Aid that addresses matters related to digital assets, including its classification, initial and subsequent measurement, and derecognition. AICPA resources related to digital assets are available here.

Appendix A

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)	
Sagar Teotia, Chief Accountant, and a panel with Marc Panucci, Deputy Chief Accountant, and Jonathan Wiggins, Senior Associate Chief Accountant	"Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments" Topics discussed included OCA's ongoing priorities: engagement with stakeholders, oversight of the FASB and PCAOB as well as monitoring implementation of new standards, international matters, and staff guidance. Other key areas mentioned included effective internal control over financial reporting, independent audit committees, technology, and innovation.
Vassilios Karapanos, Associate Chief Accountant	Remarks of the Associate Chief Accountant Auditor independence was discussed with a focus on certain loans or debtor-credit relationships and updates to the independence FAQs.
Lauren K. Alexander, Professional Accounting Fellow (PAF)	Remarks of the PAF Topics discussed included observations from consultations related to principal versus agent guidance in the revenue standard and the measurement of expected credit losses under the new standard.
Erin Bennett, PAF	Remarks of the PAF Topics discussed included observations from consultations related to the application of equity method accounting to an investment in a limited liability company and assessing collectibility for lessors under the leases standard.
Louis J. Collins, PAF	Remarks of the PAF Topics discussed included observations on the implementation of CAMs.
Jamie N. Davis, PAF	Remarks of the PAF Topics discussed included the discontinuation of LIBOR and its effect on cash flow hedges and observations from a consultation on amendments to equity-classified preferred stock instruments.

Speaker	Summary and link to source
Susan M. Mercier, PAF	Remarks of the PAF Topics discussed included observations from revenue consultations related to the identification of performance obligations.
Nipa Patel, PAF	Remarks of the PAF Topics discussed included oversight of PCAOB standard-setting and the existing governance structure for audit-related standards at an international level.
Aaron Shaw, PAF	Remarks of the PAF Topics discussed included observations from consultations on the application of the revenue standard to a sale-leaseback transaction and the determination of the primary beneficiary of a VIE.
FASB	
Russell G. Golden, Chairman	Remarks of FASB Chairman Russell G. Golden Topics discussed included an overview of FASB activities, including the standard-setting process and the projects he expects to be completed before the end of his term.
IASB	
Sue Lloyd, Vice-Chair	"Enhancing relevance in 2020 and beyond" Topics discussed included the board's near-term priorities and how its work is evolving with the change in the financial reporting landscape.
CAQ	
Julie Bell Lindsay, Executive Director	"Center for Audit Quality Update" Topics discussed included an overview of the CAQ and its mission, the current state of the profession and audit quality, and the future evolution of the auditing profession.

Appendix B

Grant Thornton publications

SEC final rules

- New Developments Summary (NDS) 2018-09, "Revised 'smaller reporting company' definition: SEC expands scope of companies that qualify for scaled disclosures"
- NDS 2019-01, "SEC amends disclosure requirements: Final rule simplifies and modernizes Regulation S-K"
- Snapshot 2019-11, "SEC issues final rule to amend loan provision guidance"

SEC proposed rules

- Amendments to financial disclosures about acquired and disposed businesses:
  - Article: "SEC proposes amending certain financial disclosures"
  - Firm's comment letter
- Amendments to the accelerated filer and large accelerated filer definitions:
  - Article: "SEC proposes amending certain Exchange Act definitions"
  - Firm's comment letter
- Modernization of Regulation S-K, Items 101, 103, and 105:
  - Snapshot 2019-17, "SEC proposes to modernize Regulation S-K disclosures"
- Update of Statistical Disclosures for Bank and Savings and Loan Registrants:
  - Snapshot 2019-18, "SEC Proposed Rule updates required disclosures"

Staff statement

- Snapshot: "SEC staff issues statement on LIBOR transition"

Accounting guides

- *Revenue from Contracts with Customers: Navigating the guidance in ASC 606 and ASC 340-40*
- *Leases: Navigating the guidance in ASC 842*

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