New Developments Summary

Special Alert

Highlights of the 2017 AICPA Conference on Current SEC and PCAOB Developments

Matching regulations to the realities of today

Summary

The 2017 AICPA Conference on Current SEC and PCAOB Developments, held in Washington, D.C. on December 4–6, featured representatives from the SEC, PCAOB, FASB, IASB, AICPA, and Center for Audit Quality (CAQ), in addition to auditors, financial statement preparers, and legal and other professionals.

Themes shared throughout the conference included

- Promotion of U.S. capital formation while maintaining and building investor confidence
- Continued focus on implementing new standards
- Innovation and technology in a dynamic environment

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

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A. Conference overview

The 2017 AICPA Conference on Current SEC and PCAOB Developments, held in Washington, D.C. on December 4–6, featured representatives from regulatory and standard-setting bodies, as well as industry professionals and legal practitioners. Presenters and panelists shared their views on current accounting, financial reporting, auditing, and other emerging issues, which focused on these themes:

- Promotion of U.S. capital formation while maintaining and building investor confidence
- Continued focus on implementing new standards
- Innovation and technology in a dynamic environment

Promotion of U.S. capital formation while maintaining and building investor confidence

A conversation between SEC Chairman Jay Clayton and SEC Chief Accountant Wesley R. Bricker set the tone of the conference. Chairman Clayton began the conversation by emphasizing that the SEC’s three-part mission—to protect investors; to maintain fair, orderly, and efficient markets; and to facilitate capital formation—has served the Commission well and remains its touchstone. He went on to highlight several other core principles guiding his leadership, including

- The long-term interests of “Main Street” investors
- The focus on ensuring that regulation of the markets and industry matches the realities of today
- The need to maximize, without overloading or diluting, the value of audit committees and disclosures

Chairman Clayton said that he believes the U.S. public capital markets are the most efficient way for retail investors to invest in the long-term growth of our economy. He noted that private capital markets have remained robust but, while he acknowledged their importance to the economy, he expressed concern regarding the declining number of public companies in the United States, which has resulted in fewer investment opportunities for Main Street investors. Therefore, it is important to him that regulations allow an efficient way for these participants to invest in the public U.S. and global economies.

Chairman Clayton and Mr. Bricker then reminded the audience of the important role that audited financial statements play in the capital markets, adding that the work of auditors is fundamental to the disclosures investors rely on.
In her prepared remarks, CAQ Executive Director Cynthia Fornelli reported that the CAQ’s 2017 Main Street Investor Survey showed an overall increase in investor confidence in both the capital markets as well as in audited financial statements. Even with the growth in investor confidence, PCAOB Chairman James R. Doty stated in his keynote address that investors still demand better quality assurance and that the profession needs to be agile and adaptable to investor needs in an ever-changing environment.

Many speakers echoed the importance of collaboration and dialogue among key stakeholders, including financial statement preparers, audit committee members, and auditors, in maintaining and building investor confidence to facilitate U.S. capital formation.

**Continued focus on implementing new standards**

Along with several significant new accounting standards issued in recent years, the three most notable being the revenue standard, the leases standard, and the credit losses standard, stakeholders also need to pay attention to the new auditor reporting model standard that the SEC approved in October 2017. Both the new accounting standards and the new auditing standard require significant implementation efforts. Representatives from regulators, standard-setters, industry professionals, and others reiterated the need for timely planning, collaboration, and communication among management, audit committee members, and auditors for effective implementation of these new standards.

Mr. Bricker reminded financial statement preparers that the Commission expects companies to provide the anticipated effects of a new accounting standard on the financial statements in transition disclosures to allow investors adequate time to absorb the information. In addition, SEC staff encouraged companies to prioritize implementation efforts, noting that understanding the required disclosures (both transition-related and ongoing disclosures) is key to successful implementation. Management, audit committee members, and auditors were also reminded to assess the impact that the new accounting standards may have on existing business processes and internal control over financial reporting (ICFR).

Mr. Bricker also commented on implementation of the new auditor’s reporting model. He believes an opportunity exists for audit committees and auditors to communicate early on the potential impact that the new model will have on the auditor’s report and on the potential disclosures that will be required in the future around critical audit matters (CAMs).

PCAOB Board Member Jeanette M. Franzel discussed the Board’s near-term priorities, including monitoring the implementation of new auditing standards as well as their potential impact, and conducting post-implementation reviews of recently adopted standards and rules. The post-implementation review efforts will include a review of the auditor’s reporting model standard after the initial adoption phase of CAMs, she noted.

**Innovation and technology in a dynamic environment**

The effects of innovation and technology are present in all aspects of the marketplace, from auditors and regulators using data analytics in their respective activities, to companies investing in artificial intelligence, robotic process automation, and other technologies, as well as the public’s growing interest in cryptocurrency, such as bitcoin. Technological advances have in turn generated an increased susceptibility to cyberattacks. Many presenters mentioned recent high-profile data breaches during the conference, with AICPA Chairman Kimberly Ellison-Taylor noting that transformations in technology bring both new opportunities, such as expanded attestation services, as well as new risks, including financial and reputational risks for companies.

Regulators, standard-setters, and organizations in the profession are closely monitoring these technological advancements and responding in various ways, particularly around cybersecurity issues. The AICPA developed a voluntary cybersecurity risk management reporting framework for companies to use in assessing their cybersecurity risk management programs and for audit firms to use in connection
with reporting on a company’s cybersecurity risk management program. The PCAOB has included a project on its research agenda focused on changes in how data and technology are being used in conducting audits and plans to create a task force in 2018 to further research this topic. William Hinman, Director of the SEC’s Division of Corporation Finance (CorpFin), reminded the audience that the principles-based CorpFin Disclosure Guidance: Topic No. 2 – Cybersecurity, published in 2011, remains relevant; however, to underscore its importance, considerations are underway to refresh this guidance at the Commission level.

Cryptocurrency and initial coin offering markets

Subsequent to the conference, SEC Chairman Clayton issued a statement on the growth of the cryptocurrency and initial coin offering markets, directing his remarks to Main Street investors and market professionals. He expressed concerns regarding investor protection and the increased risk of fraud and manipulation in these markets. He also reminded market professionals that activity that includes an offering of securities must be accompanied by the necessary disclosures, processes, and other investor protections required by the federal securities laws, or it must qualify for an applicable exemption from the registration requirements.

As the landscape evolves, the need exists for a sustained focus on innovation and technology by audit committee members, along with ongoing communication with management, auditors, and advisers, to understand how the use of new technology, including cybersecurity risks, might affect a company’s financial reporting.

B. Accounting and reporting matters

Accounting standard-setting initiatives

FASB Chairman Russell G. Golden spoke about the FASB’s activities during 2017, which included setting standards, supporting implementation efforts, educating investors and others, and developing the Board’s current Technical Agenda. He discussed the Board’s decision to add three technical projects to the agenda based in part on stakeholder feedback:

- Distinguishing Liabilities from Equity (Including Convertible Debt)
- Financial Performance Reporting – Disaggregation of Performance Information
- Segment Reporting

Mr. Golden also stated that the Board’s first priority in 2018 will be to monitor and assist entities’ implementation efforts on major new standards—particularly ASC 606, Revenue from Contracts with Customers; ASC 842, Leases; and ASC 326, Financial Instruments – Credit Losses—as well as the completion of the long-duration insurance contracts project. Mr. Golden communicated other expectations for 2018, such as completing the Board’s work on the disclosure framework project, redeliberating topic disclosure reviews in several areas, and making further progress on simplifying U.S. GAAP and the conceptual framework project.

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1 The PCAOB’s current research agenda is contained on pages 5–7 of its September 30, 2017 Standard-Setting Update.
Susan M. Cosper, FASB Technical Director and EITF Chairman, provided a detailed update on the FASB’s implementation activities related to the new guidance on revenue recognition, leases, and credit losses. She noted that the FASB staff welcomes technical inquiries and, in 2017, addressed a number of questions related to revenue recognition and leases implementation. Both Mr. Golden and Ms. Cosper emphasized the FASB’s resources and intention to help with implementing new accounting standards, including the Board’s implementation web portal, which provides implementation guidance for major standards in one location.

Ms. Cosper also presented a summary of the new guidance in ASC 815, Derivatives and Hedging, and discussed the FASB’s Technical Agenda projects. She noted that the newly added segments project will address the operating segment aggregation criteria and potential improvements to segment disclosures, but is not intended to revisit the basic concepts of segment reporting.

Ms. Cosper also stated that the FASB staff is monitoring the status and accounting implications of pending tax reform in the United States, including the timing of enacting any new tax laws, to ensure that the existing guidance in ASC 740, Income Taxes, is sufficient. She reminded the audience that the period when a tax law change is enacted is important because the guidance in ASC 740 requires an entity to record the effects of an enacted tax law or rate change in the period that includes the enactment date. The Board will wait to see the outcome of tax reform before it proceeds with its existing income taxes disclosures project.

Grant Thornton tax reform resources

Grant Thornton’s Tax Reform Center includes the latest news and impacts to organizations, as well as resources for businesses to embrace new policy shifts.

Touching on another emerging issue, Ms. Cosper commented that the FASB staff, in response to an agenda request, will present its research on the nature of cryptocurrency, such as bitcoin, at a future FASB meeting.

Finally, James Dolinar, Chair of the AICPA’s Financial Reporting Executive Committee (FinREC), provided an update on the Committee’s activities, and discussed the status of the AICPA Revenue Recognition Guide. The guide, which was first issued in 2016 and is regularly updated, includes implementation issues developed by 16 AICPA Industry Task Forces. Mr. Dolinar provided an overview of how these nonauthoritative implementation issues are developed and approved, and explained that these issues interpret the guidance in ASC 606 and ASC 340-40, Other Assets and Deferred Costs: Contracts with Customers, but do not create new GAAP.

Grant Thornton revenue guidance

The following Grant Thornton resources are available to assist with implementing the new revenue guidance in ASC 606 and ASC 340-40:

- A comprehensive guide on the new revenue standard titled “Revenue from Contracts with Customers – Navigating the Guidance in ASC 606 and ASC 340-40”
- Industry-specific bulletins for audit committees and management to evaluate implementation efforts in the following industries:
  Manufacturing
Sue Lloyd, Vice-Chair of the IASB, discussed the impact of recent IFRS guidance—in particular, the guidance on financial instruments, revenue recognition, leases, and insurance contracts—and how the IASB supports entities’ implementation efforts. Ms. Lloyd also discussed the IASB’s future focus on making financial reports better communication tools between entities and investors.

**SEC staff views on specific accounting matters**

The staff from the SEC’s Office of the Chief Accountant (OCA) provided observations on transition issues related to new accounting standards issued in recent years, including revenue, leases, and credit losses. The staff’s views are summarized below, with certain observations discussed further in the “Implementing new accounting standards” section.

**New revenue standard**

**Accounting for pre-production arrangements**

Pre-production arrangements generally require an entity to undertake activities (such as engineering, design, molds, and tooling) before production of a good, and the customer to pay for those activities through either an upfront payment or as part of the cost per unit when, or if, the goods are produced. Under the legacy guidance in ASC 605, Revenue Recognition, these activities were typically considered either a service deliverable or a non-revenue arrangement, and these historical determinations could impact how a registrant approaches its analysis of the facts and circumstances of these arrangements under ASC 606.

Registrants that have treated pre-production activities as a service deliverable under legacy GAAP must now evaluate the activities to determine whether they qualify as a performance obligation under the new revenue guidance. OCA staff noted that this might result in a registrant concluding that a service deliverable under legacy GAAP is not considered a performance obligation under ASC 606. In one prefiling consultation evaluated by the OCA staff, a registrant determined that a pre-production arrangement for the design of a specialized good did not transfer control of a good or service to the customer. In arriving at this conclusion, the registrant considered that the information provided to the customer during the design process would not be sufficient to avoid reperformance of the completed design work if the customer were to select a different manufacturer, which indicates that the customer does not obtain control of the design work. The staff did not object to the registrant’s determination that the pre-production design activities should be accounted for as research and development expenses and that the payments received should be considered an advance payment for the future sale of the specialized goods. The staff also noted that this would not be considered a voluntary change in accounting principle under ASC 250, Accounting Changes and Error Corrections, and is instead an application of the transition guidance under ASC 606, because the registrant began its analysis under the revenue guidance, consistent with its policy under ASC 605, and applied reasonable judgment to reach its conclusion under ASC 606.

For registrants that have considered pre-production a nonrevenue arrangement (for example, research and development, fulfillment activities with the consideration received from the customer accounted for as an advance payment for goods, or a contra-expense under a cost reimbursement model), OCA staff noted that they would not object to those registrants continuing to apply their historical nonrevenue model.
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when they transition to ASC 606. However, registrants applying a nonrevenue model that are considering making changes to that nonrevenue model or applying a revenue model under ASC 606 are encouraged to first consult with the staff.

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 a portfolio of patents, coupled with a promise to provide when-and-if available additions, were inputs into a combined output because the two promises were deemed to be separately identifiable.

Principal versus agent considerations

OCA staff noted that they have received numerous prefiling consultations related to the principal versus agent analysis and reminded registrants that although this is an area of significant judgment, registrants are not permitted to merely make a policy election. Rather, registrants need to consider all of their specific facts and circumstances when making the principal versus agent analysis in light of the guidance in ASC 606. The indicators of control should be considered based on their relevance to the assessment of control, and not as a checklist of criteria. The staff also noted that applying this guidance may be more challenging in certain industries, such as digital advertising or other technology industries where multiple parties are involved and transactions occur simultaneously.

Shipping and handling expenses

Legacy GAAP contained an explicit policy election regarding the classification of shipping and handling expenses that were accounted for as activities to fulfill a promise to transfer goods. In contrast, the new revenue standard does not address the classification of shipping and handling, which has prompted questions from stakeholders. OCA staff noted that entities should apply reasonable judgment in determining the appropriate classification of these expenses and said that they would not object to an entity either classifying these expenses within cost of sales, or continuing to apply their historical approach, which could be outside cost of sales. The staff did recommend that entities choosing to classify shipping and handling outside cost of sales should consider disclosing the amount of such costs and the income statement line item(s) where the costs are reported.

New leases standard

Minimum rental payments

Upon adoption of ASC 842, lessees will be required to report a lease liability for operating leases on the balance sheet, which, according to the transition guidance in ASC 842, is calculated based on remaining minimum rental payments "as defined under ASC 840" [emphasis added]. However, the ASC Master Glossary does not define "minimum rental payments," although under ASC 840 entities must disclose, in aggregate and for each of the following five years, the future minimum rental payments required as of the latest balance-sheet date. Currently, there is diversity in practice regarding how minimum rental payments are calculated: Some entities include executory costs, such as insurance, maintenance, and taxes, in minimum rental payments, while others exclude executory costs. OCA staff noted that, given the lack of an explicit definition, they would not object to registrants consistently applying their historical policy, whether it included or excluded executory costs, for determining the composition of minimum lease payments.
Incremental borrowing rate

When lessees measure lease liabilities upon transitioning to ASC 842, the new guidance requires them to use the discount rate established as of the beginning of the earliest period presented or, if later, the lease commencement date. The standard does not, however, specify whether the discount rate should be based on the original or the remaining lease term. For example, a lessee in an operating lease with a five-year term at the commencement date that has three years remaining as of the beginning of the earliest period presented when adopting ASC 842 might question whether it should use a discount rate reflecting a three- or five-year term, established as of the beginning of the earliest period presented. OCA staff concluded that they would not object to either approach, as long as it is applied consistently.

New credit losses standard

OCA staff noted that the new current expected credit loss (CECL) guidance in ASC 326 has a broader impact beyond banks and other financial institutions. The staff encouraged stakeholders to submit issues on implementing the new CECL guidance to the FASB’s Transition Resource Group for CECL. Ms. Cosper commented that the “phased” effective date for the new standard is intended to afford certain public business entities (PBEs), such as community banks that do not file with the SEC, more time for implementation.

OCA staff discussed their active monitoring of CECL implementation activities and noted that they are pleased with the meaningful increase in activity, including prefiling consultations. The staff cited a CECL implementation consultation related to a portfolio of collateral-dependent loans where the registrant was aware of borrower bankruptcies but did not believe foreclosure was probable. The standard permits an entity to elect a practical expedient to measure the expected credit loss using the collateral’s fair value for collateral-dependent loans when foreclosure is not probable. For this fact pattern, OCA staff did not object to applying the general expected credit losses approach, which incorporates all relevant information about expectations of future cash flows, rather than the practical expedient.

In addition, OCA staff outlined a consultation on applying the new standard’s purchased credit deteriorated (PCD) model to consumer installment loans made by a retailer in connection with the sale of goods that a registrant purchased immediately after origination. In this consultation, OCA staff objected to using the PCD model because there was no credit deterioration for the loans in the short time between origination and purchase. Similarly, OCA staff objected to applying the PCD model to a registrant’s loans to a retailer that are collateralized by consumer installment loans made by the retailer, because the registrant’s loans to the retailer are originated, not purchased.

Implementing new accounting standards

SEC reporting considerations

Transition disclosures

Mr. Bricker reminded financial statement preparers of the importance of robust disclosures regarding the effect of recently issued accounting standards required by SEC Staff Accounting Bulletin (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). He emphasized the need for companies to inform the marketplace about the anticipated effect of new accounting standards so that investors have sufficient time to absorb the anticipated effect prior to the standard’s adoption. For many registrants, the company’s 2017 Annual Report on Form 10-K filing is the final opportunity to provide the required transition disclosures regarding the new revenue standard. OCA staff indicated that the audit committee is charged with holding management accountable for its implementation of new accounting standards, particularly when implementation is behind schedule.
SAB 74 disclosures

As a reminder, SAB 74 disclosures that a registrant should generally consider are as follows:

- A brief description of the new standard, the date when adoption is required, and the date when the registrant plans to adopt, if earlier.
- A discussion of the method(s) of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless it is not known or reasonably estimable. In that case, the registrant may include a statement to that effect. The SEC staff has also stated that the registrant should provide additional qualitative disclosures to help stakeholders assess the significance of the impact that new guidance will have once adopted, including (1) the effect of accounting policies that the registrant expects to apply and a comparison to the registrant's current accounting policies, and (2) the implementation status of the new standard, including significant implementation matters yet to be addressed.
- Disclosure of the potential impact of other significant matters that the registrant believes might result from adopting the standard, such as technical violations of debt covenant requirements, and planned or intended changes in business practices.

The SEC staff expects SAB 74 disclosures to include known, material information, for example, material information that may be presented to senior management or to the audit committee.

Recent updates to CorpFin’s Financial Reporting Manual (FRM)

CorpFin staff discussed recent updates to the FRM to address certain SEC reporting issues related to the adoption of new accounting standards, as outlined below.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Summary conclusion</th>
<th>FRM reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro forma financial information prepared under Regulation S-X, Article 11, <em>Pro forma financial information</em>, when a registrant adopts a new accounting standard as of a different date and/or under a different transition method than a significant acquired business</td>
<td>Required to conform the date and method of adoption of a significant acquired business to those of the registrant; however, the staff will consider requests for relief.</td>
<td>FRM Section 3250.1(m)</td>
</tr>
<tr>
<td>Pro forma financial information prepared under S-X, Article 11, when a registrant retrospectively adopts a new accounting standard and subsequently adopts a new accounting policy to the pro forma information for periods prior to adoption until the new standard is reflected in the historical financial statements for those periods. A registrant should</td>
<td>Not required to apply the new accounting policy to the pro forma information for periods prior to adoption until the new standard is reflected in the historical financial statements for those periods. A registrant should</td>
<td>FRM Section 3250.1(n)</td>
</tr>
<tr>
<td>Topic</td>
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<tr>
<td>makes a significant acquisition</td>
<td>make appropriate disclosure if the effect is material to periods prior to adoption.</td>
<td></td>
</tr>
<tr>
<td>An emerging growth company (EGC) that has elected to follow the</td>
<td>Adopt the standard in the filing after losing EGC status.</td>
<td>FRM Section 10230.1(f)</td>
</tr>
<tr>
<td>accounting transition applicable to non-issuers loses its EGC status</td>
<td>However, if unable to timely comply, discuss the facts and circumstances with the staff.</td>
<td></td>
</tr>
<tr>
<td>it would have been required to adopt a standard absent the extended transition accommodation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective date of the new revenue and leases standards if an entity</td>
<td>The PBE may apply the effective dates for non-PBEs when adopting the new revenue and leases standards.</td>
<td>FRM Sections 11100 and 11200</td>
</tr>
<tr>
<td>meets the definition of a PBE solely because it includes, or is</td>
<td></td>
<td>See also ASC 606-10-S65-1, Revenue from Contracts with Customers: Transition and Open Effective Date Information – General</td>
</tr>
<tr>
<td>required to include, its financial statements or financial information in another entity’s SEC filing</td>
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</tbody>
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**Revenue recognition**

OCA noted that its members are available to answer both formal and informal questions as calendar-year registrants are nearing the finish line in implementing the new revenue standard. The staff also reminded registrants that the new revenue standard includes a robust disclosure package that may take significant effort and may require significant judgment. In addition, a registrant may find that it needs to capture new data to meet those disclosure requirements. Specifically, management will need to use significant judgment to disclose disaggregated revenue, which might require disaggregating revenue into multiple categories. Registrants were also reminded to ensure that appropriate internal controls are in place for areas where new data is needed to fulfill the disclosure requirements.

Representatives from CorpFin provided insight into the division’s expected approach regarding registrants’ application of the new revenue standard. Echoing remarks from OCA staff, CorpFin staff explained that the division plans to respect reasonable judgments made in applying the new revenue standard, but will comment if the accounting appears to be incorrect or disclosures appear incomplete. The staff also indicated that CorpFin does not intend to regulate the “nuanced aspects” of the new revenue standard one registrant at a time, because it has learned from prior experience that such an approach is not effective or efficient. Further, CorpFin will continue to collaborate with OCA on all major revenue issues.

CorpFin staff also discussed certain SEC reporting issues related to the adoption of the new revenue standard, as outlined in the table below.
<table>
<thead>
<tr>
<th>Topic</th>
<th>Summary conclusion</th>
<th>FRM reference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Periods to be recast in Regulation S-K, Item 301, Selected Financial Data, upon adoption using full retrospective method</strong></td>
<td>Not required to recast periods prior to the earliest period included in the primary financial statements, but must provide the comparability information required by Instruction 2 to S-K Item 301.</td>
<td>FRM Section 11110.1</td>
</tr>
<tr>
<td><strong>Presenting Regulation S-K, Item 302(a), Selected Quarterly Financial Data, in the annual report in the period of adoption by an EGC that has elected to follow the accounting transition applicable to non-issuers</strong></td>
<td>Not required to accelerate the application of the new revenue standard to interim periods solely for purposes of S-K Item 302(a). An EGC may adopt the new revenue standard for annual reporting periods beginning after December 15, 2018 and for interim periods within annual periods beginning after December 15, 2019.</td>
<td>FRM Sections 11110 and 11110.2</td>
</tr>
<tr>
<td><strong>Significance tests required under Regulation S-X, Rule 3-09, Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons, and Regulation S-X, Rule 4-08(g), Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons, upon adoption using full retrospective method</strong></td>
<td>Not required to re-compute significance for historical periods.</td>
<td>FRM Sections 2410.8 and 11120.1</td>
</tr>
<tr>
<td><strong>Significance tests required under Regulation S-X when the registrant and entity being tested have differing adoption dates and/or transition methods</strong></td>
<td>Not required to conform the transition dates and methods for purposes of significance tests of other entities required under Regulation S-X.</td>
<td>FRM Section 11120.2</td>
</tr>
</tbody>
</table>

**Leases**

OCA staff reminded registrants of the importance of exercising careful planning, management, and oversight when implementing the new leases standard. Registrants were encouraged to begin by identifying the contracts that are or contain a lease and to educate themselves on the differences between the transition guidance and the guidance to be applied on a go-forward basis in order to be fully prepared for implementation. Registrants were also reminded to raise accounting questions early to maximize the benefits of early implementation efforts.
The conference also featured a panel, including representatives from two financial statement preparers, which discussed their experiences with implementing the new lease accounting standard. The panelists acknowledged the following tentative decisions reached by the FASB at its November 29 meeting:

- Permitting entities to transition to ASC 842 by recognizing a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption rather than recasting all comparative periods presented in the period of adoption.
- Permitting lessors to combine lease and nonlease components, provided that (1) the income statement recognition pattern is the same for both components, and (2) the combined lease component would be accounted for as an operating lease.

The panelists noted that these recent tentative FASB decisions would not alter their pace of implementing the standard and implored other financial statement preparers to remain focused on implementation activities, including compiling a complete inventory of arrangements that are or contain a lease as defined in ASC 842.

One panelist, representing a multinational financial statement preparer with a decentralized reporting structure, noted that identifying leases in a decentralized organization is a major challenge. This panelist stressed that the data-collection effort is not a one-time effort. Data-collection processes must be designed to operate prospectively to ensure that new and modified leases are continually identified throughout the organization, and are evaluated based on the criteria in ASC 842.

One panelist indicated that her organization is still considering whether to apply a quantitative threshold, whereby leases falling below the threshold would not be accounted for under ASC 842. In the meantime, she said that all leases are being inventoried, regardless of magnitude. Although applying such a threshold might seem like a time-saver, the panelist reminded the audience that taking such an approach requires ongoing procedures to document the fact that using the threshold does not materially affect the financial statements, including disclosures.

Finally, the panelists discussed which data elements entities should collect for each lease. One approach is to collect only the data required to comply with ASC 842, while another is to gather additional data that could be used to assess and improve operational performance. The former approach might be preferable for financial statement preparers with a large lease portfolio dispersed across a global organization, since the time and effort needed for data collection directly correlates with the size of the lease portfolio and the number of data elements captured. However, the latter approach may assist an entity’s finance group in securing support and participation from other areas of the organization, including the C-suite, which is critical to successful implementation of ASC 842.

C. SEC compliance and reporting

Current SEC rulemaking and initiatives

The SEC’s disclosure effectiveness initiative continues to be a focus for the Commission as it is an important part of the SEC’s three-part mission. Multiple panels at the conference discussed the history of the disclosure effectiveness initiative since 2012 when the Jumpstart Our Business Startups (JOBS) Act mandated that the SEC review Regulation S-K, along with rulemaking efforts in the current year. An overview of certain of the SEC’s disclosure effectiveness activity from 2013 to 2016 is included in Appendix II.

Much of the SEC’s rulemaking in 2017 also relates to disclosure effectiveness, including the following:

- Adoption of Final Rule, Exhibit Hyperlinks and HTML Format, requiring certain registrants to include a hyperlink to each exhibit required under Regulation S-K, Item 601, Exhibits, in filings submitted on or
after September 1, 2017. Smaller reporting companies and non-accelerated filers that submit their filings in ASCII format are required to comply with the Final Rule in filings submitted on or after September 1, 2018.

- Adoption of Final Rule, Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act, on technical amendments and inflation adjustments, effective April 12, 2017, as follows:
  - Conforms several existing rules and forms with certain provisions of Title I of the JOBS Act.
  - Amends certain Securities Act and Exchange Act forms to provide EGCs with new check boxes on the cover pages of the amended forms to notify the Commission and the public about its EGC status and its election to use the extended transition period for complying with any new or revised financial accounting standards.
  - Effectuates inflation adjustments required every five years by Titles I and III of the JOBS Act, including adjusting both the EGC gross revenue threshold to $1.07 billion and the dollar amounts used in connection with the Regulation Crowdfunding exemptions.

- Issuance of the following proposed rules to implement provisions of the Fixing America’s Surface Transportation (FAST) Act, which included certain amendments to federal securities laws, many seeking to address disclosure modernization and simplification:
  - Inline XBRL Filing of Tagged Data would require 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. The proposed rule would also eliminate the requirement for filers to post Interactive Data Files to their websites.
  - FAST Act Modernization and Simplification of Regulation S-K would largely implement recommendations contained in the “Report on Modernization and Simplification of Regulation S-K.” The proposed amendments are intended to modernize and simplify certain disclosure requirements in Regulation S-K and related rules and forms, as well as improve the readability and navigability of disclosure documents. The proposal addresses specific amendments to Regulation S-K disclosure items, including a proposed amendment to Item 303, Management’s discussion and analysis of financial condition and results of operations (MD&A), to allow for flexibility in the discussion of historical periods by eliminating the explicit requirement to discuss the earliest year when three years of financial statements are included in the filing, if certain requirements are met.

In March, the SEC also issued a Request for Comment on the disclosures required by Industry Guide 3, “Statistical Disclosure by Bank Holding Companies.” The SEC requested comments on how to modernize the nature, timing, scope, and applicability of this guide and encouraged respondents to consider registrants with material amounts of activities in the areas addressed in the guide, other than those that already apply the guide’s requirements.

Mr. Hinman mentioned that he believes CorpFin will continue to focus on improving the disclosure regime for investors and registrants, which is consistent with one of Chairman Clayton’s core principles of matching regulations with the realities of today. Mr. Hinman went on to discuss the staff’s plans to release updates from its comprehensive review of the FRM to ensure that it reflects the realities of today, without the need for further rulemaking. CorpFin staff is also currently working on developing recommendations and initiatives based on public input in relation to proposed rules and requests for comments issued during 2015 through 2017. Three areas of forthcoming rulemaking were highlighted:

- Amendments to Regulation S-X related to the financial information of entities other than the registrant, specifically those required in Rule 3-05, Financial statements of businesses acquired or to
be acquired, and Rule 3-10, Financial statements of guarantors and issuers of guaranteed securities registered or being registered (Request for Comment on the effectiveness of financial disclosures about entities other than the registrant issued in September 2015)

- Amendments to update industry-specific disclosures requirements, primarily in the mining and banking industries (Proposed Rule, Modernization of Property Disclosures for Mining Registrants, issued in June 2016, and Request for Comment on disclosures required by Industry Guide 3 issued in March 2017)

- Amendments to eliminate redundant and overlapping disclosure requirements (Proposed Rule, Disclosure Update and Simplification, issued in July 2016)

**Disclosure effectiveness best practices**

The conference also featured a panel discussing disclosure effectiveness that included various stakeholders, including representatives from CorpFin and the FASB, preparers of financial statements, and company advisers. Consistent with recommendations in prior years, the panel identified actions that preparers can take now to improve the effectiveness of their SEC filings in advance of any SEC rulemaking. Overall, the panel’s comments focused on SEC filings that strike a balance between compliance with the requirements and effective communication.

CorpFin staff reminded registrants that they are “open for business” and that registrants should not hesitate to contact the staff as they undertake their own initiatives in improving disclosures. CorpFin staff noted that they are interested in finding ways to support registrants in these improvement efforts. For example, registrants can reach out to the staff to review new disclosures prior to including them in their next filing. Additionally, the staff reminded registrants that simply making a change to their disclosures should not result in a comment.

**Nonpublic review process**

Consistent with one of Chairman Clayton’s core principles of facilitating capital formation, CorpFin staff announced in June 2017 the expansion of its nonpublic review process to include draft registration statement submissions from all issuers in connection with certain securities offerings, including Securities Act initial public offerings (IPOs) and initial registrations under Section 12(b) of the Exchange Act for listing securities on a national securities exchange. In these submissions, the staff said that an issuer should confirm in a cover letter that it will publicly file the registration statement and its nonpublic draft submissions at least 15 days prior to any road show or, in the absence of a road show, at least 15 days prior to the requested effective date of the registration statement.

The staff will also accept for nonpublic review draft registration statements submitted within one year of the effective date of an issuer’s Securities Act IPO registration statement or an Exchange Act Section 12(b) registration statement, but such review is limited to only the initial submission. An issuer submitting a draft registration statement for nonpublic review in these circumstances should confirm in its cover letter that it will publicly file its registration statement and nonpublic draft submission at least 48 hours prior to any requested effective time and date.

CorpFin staff noted that consistent with the confidential review process for EGCs, draft registration statements submitted for nonpublic review are expected to be substantially complete. Issuers may omit certain financial statements and related financial information that they reasonably believe will not be required at the time the registration statement is publicly filed.
The staff also noted that the nonpublic review process reduces the market risk exposure to issuers and is expected to encourage companies to commence their IPO process at an earlier stage. Further, the nonpublic review process in connection with follow-on offerings assists registrants in standing ready to access the market in short order, even though they are not eligible for filing a short-form registration statement on Form S-3.

The staff further reminded the audience of the frequently asked questions on the draft registration statement processing procedures, as well as the Compliance and Disclosure Interpretations, Securities Act Forms, which provides guidance on related financial statements requirements, both accessible on the SEC’s website.

The staff noted that they will consider reasonable requests to expedite the review of registration statements and encouraged issuers to communicate their anticipated timing with the respective reviewer promptly, especially when new financial statements or material information is expected to be included in the registration statement shortly before the requested effective date.

**Interpretive and waiver process**

Mr. Hinman and other staff members noted that CorpFin’s Office of Chief Accountant (CF-OCA) is also “open for business” and encouraged registrants to contact CF-OCA staff with any prefile interpretive or waiver requests if they believe that (1) existing rules and regulations are resulting in anomalous conclusions, and (2) their proposal is reasonable and consistent with investor protection. CorpFin Chief Accountant Mark Kronforst clarified that the rules are clear on investor protection, and that the staff will not grant any request that could result in the omission of information material to investors.

CorpFin staff recently updated the FRM to add a section on communications with CF-OCA, which lists the respective staff members to be contacted based on the subject matter of the request. Mr. Kronforst encouraged registrants to contact the respective staff members to have a dialogue prior to submitting a formal request or to seek guidance on a subject matter, including the content of written requests, to ensure that the level of detail in the letter is consistent with the complexity of the issue. The staff also noted that except for situations involving complex fact patterns, registrants should expect a response within 10 business days.

CorpFin staff received over 150 requests in the past fiscal year and granted the following relief in a number of those requests, based on the given facts and circumstances:

- **Determining the significance of an acquired business**: Regulation S-X, Rule 3-05, requires filing separate pre-acquisition historical financial statements when the acquisition of a significant business has occurred or is probable. The significance of an acquired business is measured using three tests described in Regulation S-X, Rule 1-02(w), *Significant subsidiary*: the income test, the asset test, and the investment test. The staff acknowledged that in several situations, the income test may indicate that an acquired business has a higher level of significance compared to the asset and investment tests. Based on facts and circumstances, the staff has considered other metrics, such as revenue, operating income, or operating metrics (such as reserves or production data in the case of energy
companies), which could be more indicative of the significance of the acquired business. If the relative size of the acquired business using the asset and investment tests is small, but is considerably higher based on the income test (for example, if the registrant is operating at or near break-even), the staff may not object to the omission of the financial statements of the acquired business if other relevant metrics indicate that its relative significance compared to the registrant is small.

- **Presenting pre-acquisition and post-acquisition financial statements of an acquired business:** Depending on the level of significance, registrants have historically been required to present at least a specified number of months of financial statements for an acquired business, which, in certain circumstances (as outlined in FRM Section 2030.4), is accomplished by presenting both pre- and post-acquisition periods. The staff acknowledged that in some situations, this has resulted in an odd collection of disparate periods, without much useful trend value. Further, the staff noted that in certain situations, stub period financial data may be less meaningful to an investor. The staff is focusing on what is meaningful to investors and is placing greater weight on the significance and relative importance of the acquired business using post-acquisition periods, as operated by the registrant. Based on this analysis, the staff may not object to the omission of the acquired business’s financial statements for one or more pre-acquisition periods.

- **Financial statements of the predecessor:** The staff discussed another fact pattern where (1) reliable carve-out financial statements could not be prepared for a predecessor entity that was previously only a portion of another business, and (2) a full set of the registrant’s post-acquisition financial statements were presented in an IPO registration statement. In such a fact pattern, the staff may permit the registrant to present abbreviated financial statements for the predecessor stub period in lieu of full or carve-out financial statements for the earliest period presented.

- **Presenting financial statements prepared in accordance with IFRS Standards as issued by the IASB:** The staff may permit a registrant to file financial statements of an acquired business or an equity method investee that are prepared in accordance with IFRS Standards as issued by the IASB if such business or investee does not meet the definition of a foreign business, as defined in Regulation S-X, Rule 1-02(l), but would have qualified as a foreign private issuer if the entity were an issuer filing its own registration statement.

CorpFin staff also shared certain best practices with respect to such requests and encouraged registrants to send letters via email, to provide all facts in a clear and concise manner, and to describe why their proposed conclusion is consistent with investor protection.

At this same conference last year, Mr. Kronforst emphasized that the staff expects a registrant to provide the prefiling interpretive or waiver request to its external auditors for review prior to submitting it to CF-OCA so that the registrant can benefit from the knowledge and experience that is ordinarily resident in accounting firms. At this year’s conference, he noted that such involvement has proved beneficial.

**Filing reviews**

The conference featured a panel of professionals that included CorpFin Associate Director in Disclosure Operations Kyle Moffatt and representatives from the financial statement preparer and legal communities who discussed the following areas, which frequently elicited reviewer comments in the current year:

- **Non-GAAP financial measures:** This was an area of staff focus separate and apart from the routine filing review process in 2016 and early 2017. While non-GAAP financial measures was the topic most frequently commented on in 2017, the staff confirmed that their targeted efforts have now concluded and the comment levels have dropped. However, given the importance of such measures to investors, it will continue to be a focus area in future filing reviews, as the staff continues to monitor compliance with existing rules and interpretive guidance. Mr. Kronforst noted that the most common
change registrants made to their non-GAAP financial measure disclosures was in the area of prominence and that a lot of attention was paid to individually tailored accounting principles. One of the areas of concern that Mr. Moffatt highlighted was how certain registrants used terms similar to those used in GAAP for labeling non-GAAP financial measures.

With respect to questions on presenting certain non-GAAP financial measures to show the impact of implementing the new revenue standard, registrants were encouraged to contact the staff for guidance with their specific fact pattern. Further, the staff updated their non-GAAP guidance in October 2017 to clarify that measures used in certain communications related to merger and acquisition transactions are exempt from the requirements of Regulation G and Regulation S-K, Item 10(e).

- **MD&A**: Registrants were reminded that if the variance in a financial statement line item is caused by multiple factors, the impact of each of those factors should be quantified. The panelists also noted that once any tax reform is enacted, registrants will be expected to include robust disclosures about the impact of the new tax reform on their results of operations and on cash balances held in non-U.S. jurisdictions. The staff also encouraged registrants to provide meaningful disclosures with respect to tax reform, including resulting changes in deferred tax assets.

The panelists further emphasized that pay ratio disclosures and cybersecurity could be additional areas of staff focus in upcoming filings. Mr. Moffatt noted that the staff always reviews information related to new accounting standards and said that such reviews might not always result in comments, but could lead to the issuance of additional guidance or speeches, as deemed appropriate. He added that another area of focus in upcoming filings is the use of key operating metrics and how such information is presented in MD&A to explain trends and the results of operations.

**International reporting matters**

CorpFin staff noted that areas eliciting frequent comments for foreign private issuers who present financial statements prepared in accordance with IFRS Standards as issued by the IASB are consistent with other registrants who present financial statements prepared in accordance with U.S. GAAP. An area where the staff has issued a higher number of comments on IFRS-based financial statements is the presentation of the income statement. International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, provides general guidance on presentation matters, which has resulted in a variety of presentations in the financial statements. In some instances, the staff has issued comments to understand how the income statement presentation complies with IAS 1.

CorpFin staff also acknowledged certain challenges that registrants face in connection with cross-border transactions, including, but not limited to, (1) dealing with different GAAP standards, (2) computing the significance of acquired businesses, (3) preparing pro forma information in accordance with Regulation S-X, Article 11, and (4) IPOs involving complex structuring, where the guidance under IFRS Standards is limited. The staff is receptive to approaches that do not compromise investor protection and encouraged registrants to contact them on challenging reporting issues.

Other panelists reminded registrants to assess the impact of macro factors in evaluating the adequacy of their risk factors and MD&A disclosures. Foreign private issuers that prepare their financial statements in accordance with IFRS Standards as issued by the IASB were also reminded to submit their financial statements in XBRL using the IFRS taxonomy for their first annual report on Forms 20-F or 40-F for fiscal periods ending on or after December 15, 2017.

**SEC enforcement matters**

SEC Division of Enforcement Co-Director, Stephanie Avakian, and Chief Accountant, Michael Maloney, provided a brief overview of the division’s five core principles and activities during fiscal year 2017, which
are discussed in the Division of Enforcement 2017 Annual Report. While the number of actions and judgments are consistent with the last three years, the number remains higher when compared with several years preceding that block of time. Ms. Avakian further discussed the division’s focus on its efficient and proactive use of technology and data analytics. She also mentioned the recently formed Retail Strategy Task Force and Cyber Unit, which align with the division’s top priorities, including protecting retail investors.

Mr. Maloney stated that financial reporting enforcement cases involved revenue recognition issues, expense recognition issues, faulty valuation and impairment decisions, missing or inaccurate disclosures (including the improper use of non-GAAP financial measures), balance-sheet issues, and misappropriation through accounting misrepresentations. Mr. Maloney commented that revenue recognition continues to be a leading driver of financial reporting enforcement actions, which can generally be split into two main categories: false revenues and accelerated revenues. He further noted that inadequate ICFR is a common theme in most financial reporting cases and said that the division expects it to be a contributing factor in any eventual enforcement cases related to the new revenue standard.

In the area of audit-related matters, Mr. Maloney noted that cases continue to involve failures to adhere to professional auditing standards and auditor independence frameworks. The primary themes in these cases are the lack of professional skepticism, overreliance on management’s representations, the lack of sufficient audit evidence, and poor or nonexistent audit documentation. These cases occurred in the overall quality control of accounting firms, as well as at the individual auditor level.

In a separate panel, OCA staff shared general observations surrounding OCA’s role in the Commission’s Rule 102(e) program and the importance of individual accountability and responsibility. OCA staff noted the importance of robust ICFR, both by design and through effective operations. Ms. Avakian also echoed the importance of individual accountability and internal controls, noting that nearly all financial reporting matters involve culpable individuals, so establishing the right tone at the top is critical. She also noted that everyone directly or indirectly involved in the financial reporting process should fulfill their responsibilities honestly, diligently, and transparently. Mr. Bricker highlighted that OCA will continue to work with the division to hold accountable those who fail to meet their responsibilities under accounting, audit, and independence requirements.

Mr. Maloney commented that the division continues to collaborate closely with OCA and CorpFin along with the SEC’s Division of Economic and Risk Analysis and the Division of Investment Management, as well as with the PCAOB’s Division of Enforcement. He noted that collaboration with the PCAOB continues to help the efficiency and effectiveness of both organizations’ enforcement programs.

D. Auditing and corporate governance matters

The new auditor’s report

A number of sessions during the conference devoted attention to the PCAOB’s recently adopted Auditing Standard, The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards. During his remarks, PCAOB Chief Auditor Martin Baumann characterized the new standard and related amendments as “completely transforming the audit report issued on financial statements.” The new audit report is intended to convey useful information about the audit to help investors better understand the financial information reported by management.

The major aspect of the new audit report is the requirement for the auditor to communicate critical audit matters (CAMs). CAMs are matters that are either communicated or required to be communicated to the audit committee that (1) relate to material accounts or disclosures, and (2) involve especially challenging,
subjective, or complex auditor judgments. CAMs will be unique to each audit and are intended to provide investors with important information about the audit that can further inform their investment decisions.

The auditor’s report is also now required to disclose an auditor’s tenure with a company by including the year in which the firm began consecutively serving as the company’s auditor. While there has been growing voluntary disclosure of auditor tenure in registrants’ proxy statements over recent years, the requirement will result in timely and consistent disclosure of this information in the auditor’s report.

These changes, and many other enhancements, to the audit report will generally apply to all audits conducted under PCAOB standards, except that the communication of CAMs will not be required for audits of EGCs, brokers and dealers, investment companies (other than business development companies), and benefit plans. The standard also provides a phased-in approach for the effective date. All changes to the audit report, except for CAMs, are required for audits of financial statements for fiscal years ending on or after December 15, 2017. CAMs will become effective as follows:

- For audits of large accelerated filers: fiscal years ending on or after June 30, 2019
- For all other audits to which CAMS apply: fiscal years ending on or after December 15, 2020

A panel discussion was also held to provide the views of other participants in the financial reporting supply chain, including audit committees, financial statement preparers, and investors, on the new auditing standard. Panel members discussed the best approach to implement the CAM requirements, including early and robust discussions with management and the audit committee on matters identified by the audit team that may rise to the level of CAMs. The panelists acknowledged that there could be challenges in fielding potential questions from investors. One panelist noted that CAMs are based on audit risk, and that there is a distinction between risks within the context of the registrant’s business and risks within the context of financial reporting. While often aligned, different approaches to these risks could be a source of confusion for some investors. Therefore, auditors were encouraged to obtain management’s perspective on how stakeholders may react to CAM disclosures and to discuss potential questions that investor relations departments may receive.

**PCAOB standard-setting update**

In addition to discussing the new auditor’s reporting standard, Mr. Baumann provided a summary of recent PCAOB standard-setting and related activities. He described the staff’s commitment to providing timely guidance to the profession, such as the recent Staff Audit Practice Alert 15, *Matters Related to Auditing Revenue from Contracts with Customers*, which addresses significant matters relevant to auditing registrants’ implementation of the new revenue standard. The most significant aspect for the 2017 year-end will likely be auditing management’s transition disclosures about the anticipated effects of adopting ASC 606 on the financial statements. Mr. Baumann also described how the guidance could be relevant to auditing the impending adoption of both the new leasing and credit losses standards.

Standard-setting activities continue to focus on improving quality in key aspects of the audit. The proposals on auditing accounting estimates, including fair value measurements, and on using the work of specialists, were developed in tandem given the interrelation of the two topics. Mr. Baumann reported that comments received on both proposals were generally supportive. Additionally, in September, the PCAOB issued a supplemental request for comment on the staff’s proposal related to supervising the work of other auditors in order to address some questions raised in comment letters on the original 2016 proposal. Providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements under PCAOB standards should help address the unique aspects of supervising other audit firms involved in the audit.
Mr. Baumann also summarized the major projects currently on the Board’s research agenda and said that interdivisional teams are performing research, outreach, and economic analysis to assess whether there is a need to change any PCAOB standards. The projects relate to

- Audit firm quality controls
- The auditor’s role regarding other information and company performance measures, including non-GAAP measures
- The auditor’s consideration of noncompliance with laws and regulations
- Changes in the use of data and technology in the conduct of audits

**Auditor independence**

Independence issues, including those related to scope creep when providing advisory and consulting services, partner rotation, determination of affiliates, business relationships, cross-border accountability among network firms, and unethical behaviors/actions of individuals, will continue to be areas of focus for the staffs of the SEC and the PCAOB in 2018.

The staff from the SEC’s Office of the Chief Accountant (OCA) shared that there has been a decrease in independence consultations over the past few years, but that the nature and complexity of the consultations have changed due to changes in the use of technology by audit firms in delivering professional services and the loan provision rule included in Regulation S-X, Rule 2-01(c)(1)(ii)(A). When evaluating nonaudit services from an independence perspective, services that would violate the SEC’s overarching independence principles should continue to be avoided, including (1) performing a management function, (2) creating a mutuality of interest or conflict of interest, (3) performing work that would be subject to audit, and (4) creating advocacy.

The staff discussed the loan provision rule and the no action letter extending relief, and noted that they are currently working on recommendations for potential amendments to the provision to address the circumstances that gave rise to the no action letter.

When evaluating auditor independence, OCA staff continues to place emphasis on whether the auditor is objective and impartial under the general standard of independence. OCA staff highlighted the need for auditors to maintain independence in fact and in appearance when considering whether nonaudit services are permitted. Specifically, the staff cited the need for auditors to review the lookback periods related to an IPO or other transactions where SEC and PCAOB independence rules were not previously required, and to conclude on whether they are objective and independent under the rules for the applicable years in order to issue an opinion on the financial statements.

OCA staff stressed that robust communication and dialogue between the auditor and management is key to understanding the framework of what the auditor can and cannot do to avoid scope creep that might lead to an independence violation. The staff provided examples of scope creep, such as when the auditor provides advisory services and management asks the auditor to do more (or the auditor offers to do more) than they should, or when services could morph into a management function, causing the auditor to act as an employee or to audit its own work, impairing independence. Auditors need to continue to be mindful of the independence rules and to use professional judgment. In addition, the staff stressed the importance of maintaining lists of affiliates and business relationships in the private equity industry and investment company complex area. They suggested that management and auditors should not go it alone and instead should request assistance from the management of a private equity firm to keep lists current to protect auditor independence.

OCA staff considers auditor independence a shared responsibility among audit committee members, management, and the external auditors, leading to transparency and credibility to the audit. Audit firms
are encouraged to hold their professionals accountable by continuing to invest in policies, procedures, and training as part of their quality control standards in an effort to promote and foster auditor independence.

**PCAOB inspection update**

Helen A. Munter, Director of the PCAOB’s Division of Registration and Inspections, focused her remarks on the “foundation” of quality audits—a firm’s system of quality control. Ms. Munter said that inspections indicate that such systems are moving in a good direction, but that there are still high rates of findings among firms. She acknowledged that firms have generally put much effort into strengthening this foundation but encouraged them to consider systemic risks to audit quality and to identify long-term solutions that will help to identify and monitor risks, retain competent personnel, and adapt to changes in the audit environment. As such, the inspection staff will continue to focus on evaluating all aspects of firms’ systems of quality control. Ms. Munter encouraged firms to focus on their own systems of quality control, to challenge themselves to establish and maintain appropriate controls, and to promote a culture where all personnel respect that system of quality control.

Reflecting on the 2017 inspection cycle, Ms. Munter discussed areas of high deficiencies, which are similar to those in previous cycles: risk assessment, ICFR, and estimates. In preparing for the 2018 inspection cycle, she anticipates the areas of focus will include (1) new accounting and auditing standards, (2) the use of technology in audits, and (3) environmental risks, particularly audit challenges presented by natural disasters, the low interest-rate environment, and likely domestic policy changes in the fourth quarter of 2017. Inspections will also continue both on issuers based outside the United States and on work referred from U.S. firms to other jurisdictions, she said.

**PCAOB enforcement update**

Claudius B. Modesti, Director of the PCAOB’s Division of Enforcement and Investigations, provided an overview of the division’s 2017 activities and the outlook for 2018. The division’s top four priorities are investigating the following areas:

- Indications of a lack of due care and professional skepticism
- Situations where auditor independence and the integrity of the audit have been compromised
- Indications where the integrity of the Board’s oversight processes are being undermined through the improper alteration of audit documentation
- Risks associated with cross-border audits

Mr. Modesti noted that enforcement cases during 2017 aligned with these priority areas and that many cases involved cross-border engagements. He summarized the larger settlements involving foreign firms in 2017, many of which included refusals to provide audit documentation or significant alterations of audit documentation. He did note a slight uptick in firms that are taking the initiative to self-report this type of conduct. Domestically, Mr. Modesti also noted recently settled cases involving the audits of broker-dealers and said that the division continues to work closely with the SEC and the Financial Industry Regulatory Authority (FINRA) to address misconduct in the broker-dealer industry.

**Innovation and technology**

Mr. Baumann, among other conference speakers, acknowledged the significant advances in technology in recent years, including data analytics, and noted that the increased use of data technology-based tools could have a fundamental impact on the audit process. As a result, the PCAOB is exploring whether there is a need for guidance, changes to auditing standards, or other regulatory action to align with the technological developments. Mr. Baumann stated that the formation of a task force that will focus on
changes in the use of data and technology was announced at the most recent PCAOB Standing Advisory Group meeting. This task force will focus on what could be coming in the area of technology that may have a transformational impact on audits, among other things. Mr. Baumann emphasized that auditing standards and guidance must permit, or promote, such advances, as well as address potential audit risks these new tools may introduce.

Ms. Franzel highlighted how the emergence and use of new audit technologies will require professional skepticism and critical thinking by auditors in new ways. In turn, it is imperative that advances are made in accounting education to promote the necessary critical thinking and analytical skills that new technologies require, she noted.

**Auditing in the future**

A panel discussed the disruptive impact that new and evolving technologies have exerted, and will continue to exert, on financial reporting and the auditing profession. The panelists explained three driving factors that have led to the increased impact of technology:

- The exponential decrease in the cost to perform computations
- The decrease in the cost to store data
- The ever-increasing ability to quickly access information

The panelists provided high-level summaries of blockchain, robotic process automation, and artificial intelligence developments, as well as several initiatives jointly developed by the Data Analytics Research Initiative, Rutgers University, and the AICPA, known as RADAR. The RADAR initiatives include projects related to multidimensional audit data selection (MADS), process mining, and digitalization.

The panelists provided insights into how these technologies may change auditing in the future. For example, the MADS project seeks to develop a prioritization methodology that will enable an auditor to classify exceptions identified through data analytics by risk, allowing the auditor to focus its efforts appropriately. RADAR’s process mining project will allow auditors to follow entire populations of transactions when obtaining an understanding of a company’s system of processes and controls, rather than performing a walkthrough of only a few transactions.

The implications of these new and emerging technologies on auditing standards and, more broadly, on financial reporting and the auditing profession were also discussed. The panelists mentioned several audit tools, such as the AICPA’s recently released Guide to Audit Data Analytics as well as a pending AICPA mapping tool expected in the first half of 2018, that will provide suggestions of the types of data analytics that might replace traditional audit procedures. Panelists also discussed how current auditing standards, particularly those related to the hierarchy of audit evidence, may require revision to address the new technology, and the application of professional skepticism in those changing circumstances. Robert Dohrer, Chairman of the AICPA’s Assurance Services Executive Committee, noted that he is leading a recently formed task force to develop recommended changes to the existing standards to address these matters.

**Cybersecurity risk management**

Certain advancements in cybersecurity since last year’s conference were the topic of this year’s cybersecurity risk management panel discussion. During 2017, the AICPA introduced its cybersecurity risk management reporting framework, which is unique compared to other cybersecurity-related frameworks in that it provides guidance on ways to communicate with stakeholders how companies are managing cybersecurity risks. Panelists said this framework creates a common language that provides for consistency and transparency, and commended it for being robust, relevant, and useful to any professional that has a role in cybersecurity risk management, not just CPAs in public practice.
As previously noted, the SEC is considering the issuance of future cybersecurity Commission-level guidance that may include a focus on disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(d)). This guidance would encourage registrants to consider matters such as whether they have controls in place to notify the appropriate members of management when a cyberattack occurs to ensure appropriate consideration is given to the registrant’s disclosure obligations.

The panelists also discussed the auditor’s responsibility to gain an understanding of an entity’s information systems during a financial statement audit within the context of cybersecurity or in light of a cyber breach. In particular, an auditor would generally obtain this understanding by acquiring information at the applicable database, applications, or operating systems level, whereas an understanding of cybersecurity generally resides at the network or perimeter level. As a result, this activity may or may not fall within the scope of an ICFR or a financial statement audit. Nevertheless, when a material breach occurs, auditors are required to understand how the breach impacts the company’s financial statements, including disclosures.

**Sustainability reporting and assurance developments**

In a discussion on sustainability reporting, panelists noted a growing interest in investments that, in addition to delivering financial returns, seek positive social or environmental impacts. Registrants’ voluntary environmental, social, and governance (ESG) disclosures have increased in recent years, with one panelist observing that over 80 percent of companies included in the Standard & Poor’s 500 Index now provide voluntary ESG disclosures. In light of this growing interest, the panelists explained two sustainability reporting frameworks:

- **Sustainability Accounting Standards Board (SASB) Standards** provide guidance across a variety of industries to help companies address material sustainability information that may be included in SEC filings. The SASB is currently seeking comments on certain proposed changes to its standards, which are expected to be ratified in early 2018.

- **Global Reporting Initiative (GRI) Standards** include universal and topic-specific standards to help companies prepare sustainability reports to communicate their contributions toward sustainable development.

Panelists mentioned that companies may be able to leverage existing control structures to support sustainability reporting, as examined in a 2017 paper titled “Leveraging the COSO Internal Control – Integrated Framework to Improve Confidence in Sustainability Performance Data,” authored by an independent group of sustainability and management experts, including former FASB Chairman Robert Hertz.

Finally, the panel noted that investors’ focus on sustainability reporting creates new opportunities for assurance service providers to add value to companies. In 2017, the AICPA’s Sustainability Assurance and Advisory Task Force published a guide, “Attestation Engagements on Sustainability Information (Including Greenhouse Gas Emissions Information),” which provides practical guidance, but no new requirements, to help service providers apply attestation standards to sustainability subject matter.
Moreover, nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this document may be considered to contain written tax advice, any written advice contained in, forwarded with, or attached to this document is not intended by Grant Thornton to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.
### Appendix I

## Conference speeches

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

<table>
<thead>
<tr>
<th>Speaker</th>
<th>Summary and link to source</th>
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<tr>
<td><strong>SEC, Office of the Chief Accountant (OCA)</strong>&lt;br&gt;Wesley R. Bricker, Chief Accountant, and a Deputy Chief Accountant panel with Julie Erhardt, Jenifer Minke-Girard, Marc Panucci, and Sagar Teotia</td>
<td>“Statement in Connection with the 2017 AICPA Conference on Current SEC and PCAOB Developments”&lt;br&gt;Topics discussed included OCA’s current activities and ongoing priorities, new GAAP standards including observations regarding implementation and updated guidance, PCAOB matters, international matters, and innovations and emerging issues in technology and commerce. The statement also includes a list of speeches given by the OCA staff in 2017 on accounting and auditing matters.</td>
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<td>Ryan Wolfe, Senior Associate Chief Accountant</td>
<td>Remarks of the Senior Associate Chief Accountant&lt;br&gt;Topics discussed included the Commission’s enforcement program and the accounting profession, including individual accountability and responsibility.</td>
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<tr>
<td>Nigel J. James, Associate Chief Accountant</td>
<td>Remarks of the Associate Chief Accountant&lt;br&gt;Topics discussed included the importance of the Monitoring Group (MG), a group of international financial institutions and regulatory bodies committed to advancing the public interest that monitors and oversees the governance structure of international audits, ethics, and educational standard-setting for accountants, as well as a consultation paper the MG issued.</td>
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<tr>
<td>Barry Kanczuker, Associate Chief Accountant</td>
<td>Remarks of the Associate Chief Accountant&lt;br&gt;Topics discussed included principal versus agent considerations and the classification of shipping and handling expenses for activities that are not a separate performance obligation, both issues under the new revenue standard.</td>
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<td>Michael P. Berrigan, Professional Accounting Fellow (PAF)</td>
<td>Remarks of the PAF&lt;br&gt;Topics discussed included an update on OCA’s efforts related to the implementation of the new leases standard, including observations related to certain consultations and implementation activities.</td>
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<td>Michal P. Dusza, PAF</td>
<td>Remarks of the PAF&lt;br&gt;Topics discussed included ICFR in the ever-changing environment and ways to design effective controls.</td>
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<td>Speaker</td>
<td>Summary and link to source</td>
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<td>Robert B. Sledge, PAF</td>
<td>Remarks of the PAF&lt;br&gt;Topics discussed included the new credit losses standard and observations from completed prefiling consultations.</td>
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<tr>
<td>Joseph R. Epstein, PAF</td>
<td>Remarks of the PAF&lt;br&gt;Topics discussed included observations from consultations OCA has conducted on the new revenue standard, including the accounting for pre-production arrangements and the identification of performance obligations.</td>
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<td><strong>PCAOB</strong></td>
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<td>James R. Doty, Chairman</td>
<td>“The PCAOB’s Initiatives to Bolster Investor Trust in the Audit”&lt;br&gt;Topics discussed included the PCAOB’s progress toward the goal of securing the public’s trust and interest, the new transparency disclosures, and the revised auditor’s report.</td>
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<td>Jeanette M. Franzel, Board Member</td>
<td>“Update on PCAOB Efforts to Enhance Audit Quality”&lt;br&gt;Topics discussed included an overview of important activities currently underway at the PCAOB.</td>
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<td>Martin Baumann, Chief Auditor</td>
<td>Remarks at the AICPA Conference on SEC and PCAOB Developments&lt;br&gt;Topics discussed included an overview of significant developments and progress made in the area of standard-setting.</td>
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<td>Claudius B. Modesti, Director of Enforcement</td>
<td>“Crossing Borders, Digging Deep: DEI’s Investor Protection Efforts in 2017”&lt;br&gt;Topics discussed included an overview of the Division of Enforcement and Investigations’ work in 2017 and what is on the horizon.</td>
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<td>Helen A. Munter, Director of Registration and Inspections</td>
<td>“Building a Foundation for Audit Quality”&lt;br&gt;Topics discussed included the PCAOB’s inspection process, a preview of firms’ 2017 inspection results, and inspection focus areas for 2018.</td>
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<td><strong>FASB</strong></td>
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<td>Russell G. Golden, Chairman</td>
<td>Remarks of the FASB Chairman&lt;br&gt;Topics discussed included an overview of the activities at the FASB, including the priority of supporting implementation of the new standards.</td>
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<td>IASB</td>
<td>Remarks of the IASB Vice-Chair</td>
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<td>Sue Lloyd,</td>
<td>Topics discussed included the</td>
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<td>Vice-Chair</td>
<td>impact on companies of new</td>
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<td>IFRS Standards and how the</td>
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<td>IASB supports implementation.</td>
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<thead>
<tr>
<th>CAQ</th>
<th>“Center for Audit Quality Update”</th>
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<tr>
<td>Cynthia Fornelli, Executive Director</td>
<td>Topics discussed included an overview of current CAQ activities, such as efforts to collaborate and create dialogue across the financial reporting supply chain.</td>
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Appendix II

SEC’s disclosure effectiveness initiative

Below is an overview of certain of the SEC’s disclosure effectiveness initiative activities from 2013 to 2016.

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<td>• Former Chair Mary Jo White speech, “The Path Forward on Disclosure” (October 2013)</td>
<td>• Request for Comment on financial disclosure requirements in Regulation S-X for certain entities other than a registrant (September)</td>
<td>• Interim Final Rule, Simplification of Disclosure Requirements for Emerging Growth Companies and Forward Incorporation by Reference on Form S-1 for Smaller Reporting Companies (January)</td>
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<td>• JOBS Act Section 108 Report to Congress on Review of Disclosure Requirements in Regulation S-K (December 2013)</td>
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<td>• Concept Release on modernizing certain Regulation S-K business and financial disclosure requirements (April)</td>
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<td>• Former CorpFin Director Keith F. Higgins speech, “Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting” (April 2014)</td>
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<td>• Interim Final Rule, Form 10-K Summary (June)</td>
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<td>• Proposed Rule, Modernization of Property Disclosures for Mining Registrants (June)</td>
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<td>• Proposed Rule, Amendments to Smaller Reporting Company Definition (June)</td>
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<td>• Proposed Rule, Disclosure Update and Simplification (July)</td>
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<td>• Request for Comment on certain Regulation S-K disclosures included in Subpart 400 relating to management, certain security holders, and corporate governance matters (August)</td>
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<td>• Proposed Rule, Exhibit Hyperlinks and HTML Format (August)</td>
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<td></td>
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<td>• Staff report, “Modernization and Simplification of Regulation S-K” (November)</td>
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