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2019 AICPA Conference on Current SEC and PCAOB Developments

Compendium of significant accounting and reporting issues

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Summary

Regulators and standard setters discussed a broad range of financial reporting topics and emerging issues last week at the annual AICPA Conference on Current SEC and PCAOB Developments (Conference) in Washington, DC.

The speakers and panelists included representatives of the Securities and Exchange Commission (SEC or Commission), the Financial Accounting Standards Board (FASB or Board), the International Accounting Standards Board (IASB) and the Public Company Accounting Oversight Board (PCAOB) who shared their views on various accounting, financial reporting, auditing and regulatory issues.

The theme of the Conference was how regulators, standard setters, preparers and auditors are increasing stakeholder engagement to achieve consistent, high-quality financial reporting, which is the bedrock of the US capital markets.

Highlights included:

New accounting standards **—** The FASB staff and SEC staff commended the successful implementation of the major new accounting standards on revenue recognition and leases and anticipate the successful implementation of the credit losses standard. The SEC staff emphasized that it has consistently accepted well-reasoned judgments applied by registrants adopting the new accounting standards. The FASB staff emphasized that they continue to provide implementation support and will evaluate whether reporting under the new standards is meeting the FASB's objectives.

Critical audit matters **—** PCAOB and SEC officials expressed appreciation for the efforts of auditors to implement the PCAOB requirement to discuss critical audit matters (CAMs) in the auditor's report. The PCAOB noted that it is proactively monitoring auditors' initial reports

with CAMs by performing selected reviews and publishing observations and additional staff guidance. Representatives of company management and audit committees noted that the auditor's reporting of CAMs has resulted in companies challenging and improving the quality of their own disclosures.

Reference rate reform — The SEC staff highlighted the risks and complexities associated with phasing out the London Interbank Offered Rate (LIBOR), a process often referred to as reference rate reform. Because LIBOR is a reference rate that is widely used in loans and commercial contracts, the SEC staff is actively monitoring transition activities to address financial reporting and disclosure issues that might arise. The FASB expects to issue final guidance in early 2020 to temporarily ease the accounting burden for entities changing the reference rate in contracts if they meet certain criteria.

Non-GAAP financial measures — The SEC staff encouraged registrants to engage in "responsible" non-GAAP reporting by, among other things, making sure these measures are calculated consistently period to period. SEC staff members also discussed non-GAAP financial measures calculated using accounting principles that have been superseded by new standards (e.g., the new credit losses standard). The SEC staff believes that measures that exclude the effects of the new standard will be inappropriate because they are considered to have been prepared using "individually tailored accounting principles" that cause them to be misleading.

Auditor independence — SEC officials stressed the importance of auditor independence and compliance with the Commission's independence rules. The SEC recently amended its Loan Rule and expects to propose revising other independence rules in 2020. Both the SEC and the PCAOB continue to focus on independence violations in their enforcement activities.

A conversation with SEC Chairman Clayton and SEC Chief Accountant Teotia

SEC Chairman Jay Clayton and SEC Chief Accountant Sagar Teotia discussed the SEC's priorities and shared their views on its accomplishments in 2019 and its rulemaking agenda for 2020.

Chairman Clayton reiterated his view that "high-quality financial reporting is the bedrock of our system." He said the Commission has modernized its rulemaking approach in ways that help it carry out its mission to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation.

Messrs. Clayton and Teotia also commended the efforts of preparers and auditors in the transition to the major new accounting standards on revenue recognition and leases. They noted that the benefits to investors include enhanced disclosures and global consistency related to revenue recognition. They said that allowing adequate time for implementation and robust communication with the audit committee were important for "high-quality implementations" of the major new accounting standards and the new PCAOB standard on reporting CAMs.

Messrs. Clayton and Teotia also said the SEC staff continues to focus on non-GAAP financial measures and encouraged registrants to engage in "responsible" non-GAAP reporting. For example, they stressed the importance of making sure these measures are comparable and consistent from quarter to quarter and registrants clearly explain the adjustments they make to develop non-GAAP measures. They also emphasized that non-GAAP measures used by management to run the business are more meaningful to users of the financial statements than non-GAAP measures prepared solely for disclosure to investors (which Mr. Clayton referred to as "window dressing"). Overall, they concluded it is important for registrants to have well-developed, rigorous disclosure controls and procedures over non-GAAP financial measures.

How we see it

Item 10(e)(1)(i)(D) of Regulation S-K requires a disclosure, if material, of any ways in which management uses the non-GAAP measure. While the regulation does not require that management use the non-GAAP measure in running its business, such measures would be consistent with providing a discussion and analysis of the results through the eyes of management under S-K Item 303.

Mr. Clayton also stressed the importance of auditor independence and how audit committees are responsible for making sure that auditors comply with the Commission's independence rules. He noted that the SEC based recent amendments to its Loan Rule on the SEC staff's experience with consultations and said the SEC expects to propose revising other independence rules in 2020.

Messrs. Clayton and Teotia emphasized the importance of the audit committee having highly qualified members who are proactive and have a direct relationship with the auditor.

Mr. Clayton also observed that international matters remain a critical priority for the SEC because American investors have significant exposure to companies based overseas and domestic companies with significant foreign operations. He stressed the importance of global consistency of both financial reporting and external auditing, noting that the SEC will continue to advocate for consistent high-quality audits in foreign jurisdictions.

"Hope is not a strategy," Mr. Clayton said regarding preparation for reference rate reform.

Finally, Messrs. Clayton and Teotia highlighted the risks and complexities associated with phasing out LIBOR and moving to alternative reference rates by the end of 2021 (i.e., reference rate reform). Given the pervasive consequences of changing the reference rate that is widely used in loans and commercial contracts around the world, Mr. Clayton said "[the] complexity is greatly underestimated. The earlier addressed, the better."

Remarks by Russell Golden, Chairman of the FASB

FASB Chairman Russell Golden spoke about the importance of the FASB's standard-setting process and what he expects the Board to accomplish before his term ends on 30 June 2020.

FASB's standard-setting process

Mr. Golden enumerated the key aspects of the FASB's standard-setting process as listening and responding to stakeholders, performing quality research, engaging in quality communication and welcoming accountability from all capital market stakeholders. He said that listening and responding to stakeholders is "perhaps most important, and the foundation of all quality standard setting." For example, he said, "Every accounting standard we ever developed exists because stakeholders alerted us to an issue we should address." Mr. Golden noted that the FASB has responded to recent feedback by taking a more hands-on approach in helping stakeholders apply new standards. The FASB currently devotes about 40% of its resources to implementation support.

Mr. Golden said quality research has become an increasingly important part of the standard-setting process. He highlighted the FASB's research agenda, which allows the Board to determine before adding a project to its technical agenda whether an issue can be addressed with a standard-setting solution that could provide benefits to users of the financial statements and justify the likely costs to preparers.

Regarding the importance of quality communication, Mr. Golden identified the FASB's best source of information as interaction with stakeholders through meetings, roundtables, conferences and other outreach.

Lastly, Mr. Golden said the FASB is accountable to all capital market stakeholders and meets regularly with regulators, industry leaders and others who support the FASB's process. He said the FASB's "number one client is the capital markets," and its "number one product is trust."

Project status

Mr. Golden discussed what he hopes the Board will accomplish by the end of his term, including:

- Distinguishing liabilities from equities project — Mr. Golden expects this project, which is intended to reduce complexity and provide investors more useful information, to be completed by the end of his term.
- LIBOR reform — Mr. Golden said the FASB expects to issue final guidance in early 2020 to provide transition relief. This guidance will be intended to ease the accounting burden for entities that change the interest rate on contracts and meet certain criteria due to the anticipated phaseout of LIBOR or other reference rates.
- Accounting for goodwill and identifiable intangible assets — Mr. Golden expects the Board to hold an "interesting" discussion on this topic in early 2020, based on the diverse views from about 100 respondents to the Board's invitation to comment and 30 stakeholders who participated in public roundtables in 2019. He hopes the Board will make decisions about the direction of the project before his term ends.
- Continuing to monitor implementation activities for all standards — Mr. Golden said the FASB will closely monitor the implementation of the new credit losses standard when SEC filers that are not smaller reporting companies (SRCs) adopt it next year.

Finally, Mr. Golden said the FASB's projects on performance reporting and segment disclosures are likely to continue after his term ends.

The PCAOB is revising its inspection reports to make them more informative for users.

A discussion with the PCAOB

All five PCAOB members participated in a panel at the Conference and shared their views about the PCAOB's priorities. Chairman William Duhnke said the PCAOB remains committed to the five-year strategic plan it adopted in 2018.

Stakeholder engagement

The PCAOB has significantly increased its level of engagement with key stakeholders and expects to continue to do so in the coming year. This included establishing the Office of External Affairs and increasing outreach with important stakeholders, including auditors, preparers, audit committee members and investors. For instance, the PCAOB has committed to seeking feedback from the audit committee chair for every US audit inspection in 2019 and going forward.

Mr. Duhnke said the PCAOB received generally positive feedback from audit committee members and investors through roundtable discussions and interviews, which the PCAOB will consider in future standard-setting activities. Board member J. Robert Brown said the PCAOB wants the information it provides to be more accessible to investors. Mr. Brown added that planned changes to the PCAOB's inspection reports, discussed below, are intended to provide a more complete picture of its inspection findings.

Critical audit matter (CAM) monitoring

Board member James Kaiser noted that the PCAOB has been proactive as auditors have implemented the requirement to discuss CAMs in their auditor's reports. This included reviewing the methodologies of the 10 largest audit firms used to identify and communicate CAMs and providing feedback before the requirements became effective. The PCAOB has also been monitoring auditors' initial reports with CAMs and performed targeted reviews of 12 of these reports. During the Conference, the PCAOB published its initial observations and feedback about reports with CAMs from its targeted reviews.[1]

Audit firms' quality control systems

Board members James Kaiser and Duane DesParte discussed the PCAOB's views on the quality control systems that audit firms are required to maintain under PCAOB standards. They noted that the PCAOB continues to view this area as a strategic priority and a foundational element of the PCAOB's shift toward a more preventive regulatory approach. They also acknowledged the International Auditing and Assurance Standards Board (IAASB) recently proposed amending its standard on firms' quality control systems.

The PCAOB is expected to vote on 17 December 2019 to publish a concept release seeking comments on a potential approach for revising the PCAOB standards related to a firm's quality control system.

Inspections reporting

Messrs. Kaiser and DesParte discussed the upcoming changes to PCAOB inspection reporting. The changes are designed to improve the format of PCAOB inspection reports and make them more informative and easier for users to read. The expected changes include using plain English and more graphics, providing more context about the nature of audit findings and highlighting good practices observed by the PCAOB staff during inspections. The PCAOB expects to release the redesigned report in 2020, beginning with reports for the 2018 inspection year for the largest US firms.

The board members also described changes implemented in the inspection process, including the creation of teams to perform targeted reviews of various audit firms for certain focus areas. In 2019, these focus areas included the quality control systems at the large firms and selected multi-location/group audits. The board members also noted that the PCAOB has been conducting an internal review of its inspection program to promote greater consistency.

Auditors are generally expected to identify at least one CAM and the average in issued reports has been two.

Critical audit matters

Staff members from both the PCAOB and the SEC discussed their observations on the initial auditor's reports with CAMs. The new requirements apply to audits of large accelerated filers for fiscal years ending on or after 30 June 2019. The SEC staff expressed its hope for a high-quality implementation, and SEC staff members praised efforts by both audit firms and the PCAOB to support this process. The PCAOB staff also reiterated the Board's commitment to supporting a successful implementation.

Specifically, SEC and PCAOB staff members commended audit firms for performing dry-run programs in advance of the standard's effective date. SEC staff members also commended the PCAOB staff's release of **staff guidance** on the implementation of CAMs prior to the effective date. The guidance was intended to help audit firms understand the PCAOB's expectations and prevent deficiencies in reporting CAMs.

SEC staff members said that the collaboration among audit firms and regulators was critical to preparing audit committees, audit firms and company management for the new requirements. Both SEC and PCAOB staff members said regulators and audit firms need to stay engaged as the requirements are phased in for audits of other issuers.

Early observations since the effective date of the standard

Members of both the SEC and PCAOB staff discussed early observations and items to consider regarding CAMs reporting, based on their review of initial reports. The CAMs reporting process appears to have resulted in more dialogue among auditors, preparers and audit committees on important matters in the audit, despite concerns raised by some stakeholders that the requirements could discourage these communications. Auditors' reports also don't appear to be disclosing original information about the company, as some stakeholders had feared.

Preparer and audit committee representatives also noted that CAMs reporting has resulted in companies challenging and improving the accuracy of their disclosures. Investor representatives expressed interest in CAMs and said they don't view CAMs as a negative indicator about any aspects of the audit or the financial statements. There was general acknowledgment among various stakeholders of the importance of assessing CAMs early in the audit process because identifying, drafting and discussing CAMs with management and audit committees may take longer than expected. Additional observations included the following:

- *Number of CAMs* — SEC and PCAOB staff members said the average number of CAMs discussed in auditors' reports to date has been around two. Marc Panucci, Deputy Chief Accountant in the Office of the Chief Accountant (OCA), reminded auditors that, with rare exceptions, auditors are generally expected to identify at least one matter as a CAM in each audit of an operating company.

- *Consistency of CAMs within industries and with critical accounting estimates* — Mr. Panucci and Louis Collins, a professional accounting fellow in OCA, said auditors of companies in similar industries might or might not report similar CAMs because the identification of CAMs depends on the facts and circumstances of each audit. This may make it difficult if investors attempt to compare the number and nature of CAMs among peer companies. Mr. Louis also noted that CAMs may relate to critical accounting estimates disclosed in Management Discussion and Analysis (MD&A), but a one-to-one correlation is not expected.

- *Engagement-specific considerations* — Messrs. Panucci and Collins cautioned that descriptions of CAMs should not be "boilerplate." Instead, the principal considerations and audit response should be specific to the unique circumstances of each audit. This requires taking a fresh look at the entity and evaluating items that need to be reported as CAMs in each audit year. Information included in the discussion of a CAM also should be consistent with the audit procedures documented in the audit file and should not contradict information presented in the company's filing.

Both SEC and PCAOB staff members promised to monitor audit firms as they issue more reports with CAMs and engage stakeholders in the post-implementation period to learn about their experiences, evaluate the effectiveness of the new requirements and determine whether any additional guidance is needed. PCAOB staff members identified no significant gaps in existing guidance based on their reviews of initial reports.

How we see it

It is important for management and auditors to have open dialogue to consider the company's existing disclosures about critical accounting estimates and the interplay with matters identified as CAMs. They should assess the appropriateness of any dissymmetry between these disclosures and with other disclosures in the filing.

Accounting and disclosure matters

New accounting standards

General observations by the FASB staff

Sue Cosper, FASB board member and Chair of the Emerging Issues Task Force (EITF), and Shayne Kuhaneck, Acting FASB Technical Director, provided an overview of the FASB's activities related to the implementation of the new accounting standards on leases and credit losses. The FASB continues to focus on supporting entities as they adopt new accounting standards and on evaluating whether financial reporting under the new standards is meeting the FASB's objectives.

Ms. Cosper also discussed the FASB's new two-bucket approach for effective dates of major standards that will give private companies, not-for-profit organizations, employee benefit plans and SRCs more than one year after the public company effective date to implement major new standards. This approach will provide these entities with additional time and resources to implement those standards, including more time to learn from implementation challenges faced by the larger public companies.

Credit losses

Ernst & Young LLP (EY US) resources

- *Financial reporting developments, **Credit impairment under ASC 326***

Mr. Teotia said the SEC staff has been monitoring implementation of the new credit losses standard, including issues discussed by the FASB's Transition Resources Group, the AICPA's Depository Institutions Expert Panel and the AICPA's Financial Reporting Executive Committee.

Mr. Teotia noted that, in November 2019, Staff Accounting Bulletin (SAB) 119[2] was issued to align SEC staff guidance on appropriate documentation of the allowance for loan losses with the new standard. Mr. Teotia reiterated the point made in SAB 119 that many of the concepts from SAB 102 remain relevant under the expected credit loss model. Mr. Teotia also emphasized that OCA is available for consultations to resolve any remaining interpretive accounting questions.

Lauren Alexander, a professional accounting fellow in OCA, shared observations from a recent consultation about whether certain potential future advances that may be made by the lender on behalf of a borrower for costs such as property taxes, homeowners' association fees and certain insurance premiums should be included in the estimate of expected credit losses. The SEC staff did not object to the registrant's conclusion that such potential future advances should not be included in its measurement of expected credit losses when using the discounted cash flow method because (1) these advances are not unconditional obligations of the lender, (2) the guidance on the discounted cash flow method does not specify which specific cash flows must be included in the present value computation and (3) such advances do not meet the definition of a cost to sell and are not part of the amortized cost basis of the loan.

How we see it

SEC filers that are neither SRCs nor emerging growth companies (EGCs) that use private company effective dates should be in the final phase of the adoption. To timely resolve any remaining interpretive questions and issues, companies are encouraged to discuss them with their auditors as soon as possible.

Reference rate reform

Mr. Teotia noted that the OCA staff, along with staff from the Division of Corporation Finance, the Division of Investment Management, and the Division of Trading and Markets, recently issued a joint statement[3] on the transition from LIBOR that encourages stakeholders to identify and address the related risks. He added that the SEC is actively monitoring market activities to address financial reporting issues that might arise in connection with the LIBOR transition. Mr. Teotia encouraged companies to discuss any questions about this topic with the OCA staff.

Jamie Davis, a professional accounting fellow in OCA, reminded preparers about a consultation the SEC staff described at last year's conference involving the effect of the phaseout of LIBOR on hedge accounting and noted that the staff's position still applies until a company adopts the reference rate reform standard the FASB is expected to finalize in early 2020. In that consultation, the SEC staff did not object to an entity considering it probable that a hedged forecasted transaction (i.e., LIBOR-based interest payments) would occur, even though some of the forecasted payments were expected to be made after LIBOR is no longer quoted. The SEC staff also did not object to the expected phaseout of LIBOR not having an effect on an entity's current assessment of hedge effectiveness.

Equity-classified preferred stock instruments

Ms. Davis discussed a consultation on the accounting for amendments to equity-classified preferred stock instruments due to the cessation of LIBOR (i.e., amendments solely to designate the Secured Overnight Financing Rate (SOFR) as the replacement rate) when dividend payments were previously indexed to LIBOR.

To evaluate the amendment relating to LIBOR, the issuer considered the business purpose of the amendment and whether the amendment may influence investors' decisions. Since the change was not considered significant, the OCA staff did not object to the issuer's conclusion that the amendment would be treated as a modification to the preferred stock rather than an extinguishment.

Ms. Davis also addressed whether the amendment required accounting recognition. The SEC staff has previously accepted an analogy to the modification guidance in Accounting Standards Codification (ASC) 718-20, which requires recognition of the increase in fair value of the modified instrument as a result of the modification. Because there was no business purpose other than to designate the replacement rate for LIBOR, the SEC staff did not object to the issuer's conclusion that the modification is presumed to be negotiated at fair value, and, therefore, no accounting recognition is necessary.

Determining the discount rate and accounting for embedded leases were two areas in which companies had challenges in implementing the leases standard.

How we see it

The views expressed by the SEC staff for preferred stock are consistent with the relief the FASB has proposed that would provide temporary optional expedients and exceptions to the US GAAP guidance on contract modifications (e.g., debt, leases) and hedge accounting. Entities should monitor developments in this area.

Leases

Mr. Teotia commended the efforts of preparers and other stakeholders in connection with the implementation of the new leases standard, which was effective on 1 January 2019 for most calendar year-end public companies. He said that the SEC staff continues to welcome consultation questions as stakeholders' focus shifts to the ongoing accounting for leases under the new standard.

Ms. Cosper said that the FASB staff has started conducting a post-adoption evaluation of the new leases standard. She indicated that, during implementation, the FASB staff received the most questions on lessee accounting and reporting and transition, which are areas where changes were made to the standard to respond to stakeholder feedback. Ms. Cosper announced plans for a roundtable discussion in spring 2020, where stakeholders can discuss any difficulties they have had in implementing the standard and how the standard could be improved. She said that determining the discount rate and accounting for embedded leases were two areas to be discussed at the roundtable.

Erin Bennett and Aaron Shaw, professional accounting fellows in OCA, discussed recent consultations related to the new leases standard.

Collectibility of lease payments for lessors

Ms. Bennett reminded registrants that ASC 842, *Leases,* requires lessors to assess whether the collectibility of lease payments, including any amount necessary to satisfy a residual value guarantee, is probable at the lease commencement date.

Ms. Bennett said that, in a recent consultation, the SEC staff objected to a registrant's conclusion that collectibility of the lease payments for its sales-type leases of equipment was probable at lease commencement. The registrant had concluded that the customer had the intent and ability to pay the lease payments at the lease commencement date as evidenced by

a credit evaluation and a substantive down payment, among other factors. In reaching its decision, the staff considered the registrant's specific facts and circumstances, including the registrant's evaluation of the lessee's credit quality and the registrant's history of collections with similar lessees, and concluded that there was not a sufficient basis to assert that collectibility of the lease payments was probable at the lease commencement date.

As a reminder, in a sales-type lease, if collectibility is not probable, the lessor does not derecognize the asset or recognize any income or loss. Instead, the lessor recognizes lease payments received as a deposit liability and defers income recognition until either (1) collectibility becomes probable or (2) the contract has been terminated, or the lessor has taken back the asset and the lease payments are nonrefundable.

Sale and leaseback transactions

Mr. Shaw discussed a recent consultation involving the application of the revenue standard to a sale and leaseback transaction. The SEC staff objected to the registrant's conclusion that control of assets had transferred in accordance with ASC 606 because the terms of the arrangement could result in the registrant regaining control over the transferred assets. As a reminder, both the seller-lessee and the buyer-lessor are required to apply ASC 842 and certain provisions in ASC 606 to determine whether to account for a sale and leaseback transaction as a sale and purchase of an asset.

SEC staff members said they will continue to accept well-reasoned judgments that registrants make in applying the principles of ASC 606.

Revenue recognition

Mr. Teotia and Jonathan Wiggins, a Senior Associate Chief Accountant in OCA, said revenue recognition under ASC 606 was a top accounting consultation topic for OCA over the past year. Messrs. Teotia and Wiggins commended preparers, auditors and other stakeholders for their commitment to implementing ASC 606 and said they hope that preparers and auditors can apply the lessons learned from the implementation of ASC 606 to other new standards.

Susan Mercier, a professional accounting fellow in OCA, said that the top two areas of consultation for ASC 606 over the past year involved evaluating whether an entity is a principal or an agent and identifying performance obligations.

Principal versus agent considerations

Ms. Alexander stressed the importance of evaluating the facts and circumstances of a contract, as well as contractual terms, when evaluating whether an entity is a principal or an agent. This assessment may require significant judgment if the entity does not perform the identified services for the customer and fully relies on another service provider to deliver those services. Ms. Alexander said it is critical to evaluate whether the entity can control the specified services before transferring them to a customer.

EY US resources

- Financial reporting developments, ***Revenue from contracts with customers (ASC 606)***

Ms. Alexander discussed a consultation in which a registrant was able to demonstrate that it had the contractual ability to control the service provider by determining *when* the service provider delivered the services because the service provider could not contractually deny services to the customer, even though the service provider had discretion in *how* it fulfilled its obligations. The registrant concluded, and the SEC staff did not object, that the registrant was the principal in the arrangement, based on this analysis and an analysis of the other relevant indicators of control.

Identifying performance obligations

Ms. Mercier focused on considerations for determining whether a promise to transfer a good or service to the customer is separately identifiable from other promises in the contract, which could require significant judgment. The objective of this requirement of ASC 606 is to determine whether the nature of the promise is to transfer each of the goods or services individually or to transfer a combined item to which the promised goods or services are inputs.[4]

Ms. Mercier emphasized the importance of supporting a registrant's conclusions by providing a well-reasoned analysis of the guidance in ASC 606, rather than just referring to the manner in which the goods and services are sold to customers. Ms. Mercier said the SEC staff is not persuaded that promises should be combined into a single performance obligation simply because they are provided as part of a "solution." Instead, she said the SEC staff expects registrants to provide a robust assessment of the requirements in ASC 606 to support an assertion that the promises to transfer goods are not separately identifiable.

Ms. Mercier suggested that, as part of its assessment, a registrant should consider the FASB's discussion in the Background and Basis for Conclusions of Accounting Standards Update (ASU) 2016-10[5] and address whether the customer receives a combined item that is greater than (or substantively different from) the sum of the underlying promised goods and services, among other things.

To illustrate this, Ms. Mercier discussed a consultation in which the staff did not object to a registrant's conclusion that software and software updates represent a combined performance obligation. The registrant was able to demonstrate that the software updates were integral to maintaining the utility of the software. That is, without the software updates, the customer's ability to benefit from the software would be significantly limited over the contract term. Based on this point and other facts and circumstances, the registrant was able to demonstrate that the combined output was greater than, or substantively different than, the individual promises of the software and software updates.

How we see it

Evaluating whether an entity is a principal or an agent and identifying performance obligations continue to be top areas of consultation for the SEC staff due to the significant judgments that may be required to apply these aspects of ASC 606. We encourage entities to support their conclusions with a robust analysis of the requirements of ASC 606, including a discussion of any relevant points made in the Background and Basis for Conclusions of ASU 2016-10, and related amendments.

Other accounting matters

Equity method accounting

Ms. Bennett discussed the application of the equity method of accounting, which generally applies when an investor has the ability to exercise significant influence over the operating and financial policies of an investee. For an investment in a corporation, this is presumed to be the case when an investor holds 20% or more of the voting common stock of the investee but does not control the investee.

However, Ms. Bennett reminded the audience that, for an investment in a limited partnership (and similar entities, such as a limited liability company that maintains specific ownership accounts), the SEC staff has a long-standing position, codified in ASC 323-30-S99-1, that the equity method should be applied unless the investor's interest is so minor that the limited partner has virtually no influence over the partnership's operating and financial policies. The SEC staff understands that practice generally has viewed investments of more than 3% to 5% to be more than minor.

How we see it

We believe the presumption that investment interests greater than 3% to 5% in a limited partnership (and similar entities) should be accounted for as equity method investments may only be overcome in limited circumstances where it is readily apparent, based on the facts and circumstances, that the investor has virtually no influence over the partnership's financial and operating policies. This guidance also is generally applied in practice to investments in limited partnerships held by nonpublic entities.

Primary beneficiary determination of a VIE

Mr. Shaw discussed two consultations involving the determination of the primary beneficiary of a variable interest entity (VIE) under ASC 810. In determining the primary beneficiary of a VIE, a reporting entity must identify which party, if any, has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

Mr. Shaw reminded the audience that, when identifying the primary beneficiary of a VIE, the significant activities and the risks that cause variability should be determined based on the VIE's purpose and design, which is an area of significant judgment.

SEC regulatory update

SEC comment letters and other focus areas

SEC staff members in the Division of Corporation Finance (DCF) discussed the topics most frequently addressed in comment letters to registrants as well as areas of expected focus. Joel Parker, an office chief in DCF, said non-GAAP financial measures and MD&A have been two of the top areas for SEC staff comments over the past several years.

EY US resources

- SEC Reporting Update, *Highlights of trends in 2019 comment letters*
- *SEC Comments and Trends: an analysis of current reporting issues*
- Technical Line, *Spotlight on non-GAAP financial measures*

Non-GAAP financial measures

The SEC staff's remarks on non-GAAP financial measures focused on companies using non-GAAP financial measures to present financial results prepared using accounting principles that have been superseded by new standards such as ASC 606, *Revenue from Contracts with Customers*, and ASC 326, *Financial Instruments — Credit Losses*, which public companies will begin adopting in 2020.

While companies may contemplate using non-GAAP measures to make it easier for investors to compare their current results with those for prior periods when a new standard has been adopted without full retrospective application, SEC staff members reminded registrants that in many cases, these measures will be inappropriate because they are considered to have been prepared using individually tailored accounting principles that cause them to be misleading.

Mr. Parker said companies that adopted ASC 606 using the modified retrospective approach were required to include footnote disclosures of the effect of the transition during the year of transition (i.e., they were required to present revenue calculated in accordance with ASC 605, *Revenue Recognition*). Many of these companies also included MD&A discussion comparing this adjusted revenue measure to reported revenue in prior periods.

Mr. Parker reminded companies that, while the SEC staff did not object to measures presented to show the effect of adopting ASC 606 for the purpose of facilitating a comparison to prior periods during the transition year, measures that continue to reflect legacy accounting after transition disclosures are no longer required are viewed by the staff to be inappropriate.

Kyle Moffatt, DCF Chief Accountant, said the SEC staff believes that it will not be appropriate for companies that adopt ASC 326 next year to present a non-GAAP measure that excludes the effect of the new standard, including any measures that exclude the effect of a company's allowance for credit losses in its entirety.

How we see it

Preparers need to consider carefully the SEC rules and staff guidance on the use of non-GAAP financial measures when they are adopting a new accounting standard. Although the SEC staff encourages detailed MD&A discussion that facilitates period-to-period comparability, the staff typically considers a non-GAAP financial measure that unwinds the effect of a newly adopted accounting principle to be misleading, even when presented for the purposes of discussing comparability with prior periods, unless similar information is required by the standard.

Separately, Patrick Gilmore, a deputy chief accountant in DCF, discussed the presentation of contribution margin or similar measures by companies. He noted that such measures are considered to be non-GAAP financial measures and that gross margin would be considered the most directly comparable GAAP measure.

Accordingly, companies that present contribution margin (or other similar measures) must provide the appropriate non-GAAP disclosures and a reconciliation to gross margin calculated in accordance with GAAP, even if gross margin cannot be calculated from amounts in its income statement.

How we see it

Although S-X Rule 5-03 requires presentation of revenue and cost of revenue, SAB Topic 11.B allows companies to exclude depreciation and amortization from cost of revenue. Companies applying that SAB and that present a non-GAAP margin must allocate depreciation and amortization to cost of revenue in order to calculate GAAP gross profit for purposes of the non-GAAP reconciliation.

Management's discussion and analysis

Mr. Parker said the staff has observed an increase in incentive programs offered by entities that provide platforms that connect users with suppliers. These arrangements often involve multiple parties and may require judgment to determine whether the registrant is the principal or the agent and which party is the customer in the arrangement.

He said some registrants have concluded that they are the agent in these arrangements, and the consideration payable to a customer guidance in ASC 606 does not apply because the incentives are paid to the end user, whom they have determined is not their customer. Therefore, these registrants are recording the incentives as marketing expenses, which can be significant, especially when the registrant is in a high-growth phase. Mr. Parker emphasized the importance of thoroughly disclosing and quantifying the effect of these incentives in MD&A so investors understand how they affect the statement of operations.

Lindsay McCord, a deputy chief accountant in DCF, also discussed a recent increase in the use of supplier finance programs involving trade payables by registrants. These programs may also be commonly referred to as structured trade payables, reverse factoring, vendor payable programs and supply chain financing. While the use of these programs frequently improves operating cash flows, she observed that registrants do not always disclose their use of this strategy.

Ms. McCord suggested that companies consider the following MD&A disclosures if the effects of a supplier finance program are material to the current period or are reasonably likely to materially affect liquidity in the future:

- The material terms of the program
- The general benefits and risks of the program
- Any guarantees provided by subsidiaries and/or the parent
- Plans to further extend terms to suppliers
- Any factors that may limit the company's ability to continue using similar programs to further improve operating cash flows
- Trends and uncertainties related to the extension of payment terms (e.g., period-end accounts payable balances, intra-period variations in accounts payable)

Areas of focus and other disclosures

William Hinman, the Director of DCF, said that his staff has continued to review companies' disclosures related to Brexit, cybersecurity and the phaseout of LIBOR. While he said disclosures in all of these areas have become more thoughtful and specific, he said there is still room for improvement.

How we see it

Registrants should update Brexit disclosures following the results of the recent election in the United Kingdom (UK) that make it more likely that the UK will withdraw from the EU by 31 January 2020.

"There shouldn't be a big gap between the risks that are discussed at the board level and the risks that are highlighted in your disclosure documents.

— William Hinman, Director of the SEC Division of Corporation Finance

To facilitate that improvement, he reiterated a suggestion he has made in the past that companies look to their communications with the board of directors to inform the timing and content of disclosures to investors.[6] SEC staff members also discussed disclosures about environmental risks and risks resulting from social and political unrest in certain regions. They said that if these risks are material, registrants should disclose them, consistent with SEC rules and interpretative guidance.

How we see it

Companies should monitor and review their communications with their boards of directors and evaluate any risk disclosures and other topics for potential disclosure in their next SEC filings. These communications can help a company determine when it should update an earlier disclosure or add additional detail as its evaluation of the risk and its impact evolves.

Mr. Hinman also discussed stock buybacks and observed that they are frequently perceived as a way for management to unfairly increase executive compensation that is tied to stock price or earnings-per-share targets.

He noted that most compensation committees have considered the effect of stock buybacks and adjusted the targets accordingly. He suggested companies include additional compensation discussion and analysis disclosures about how the compensation committee takes stock buybacks into account in the targets it sets for incentive compensation for executives.

Finally, Mr. Hinman noted that interest in digital assets has continued to grow, and some entities have sought to make Regulation A and Securities Act offerings. DCF has issued guidance[7] to help companies determine whether digital assets qualify as securities and has issued several no-action letters to companies on related fact patterns. Mr. Hinman also said he has been working closely with OCA on matters related to digital assets.

Tips for working with the DCF

Mara Ransom (an office chief in DCF), Mr. Parker and their fellow panelists offered a number of best practices to assist companies responding to comment letters, requesting waivers from DCF or otherwise working with DCF to navigate their reporting and compliance obligations:

- When requesting interpretive or procedural guidance, do not assume that the SEC staff has all of the relevant facts. Opening with a discussion of the background and related analysis can help the staff understand the fact pattern.
- If a company is approaching the SEC staff with a novel or complex transaction, it is usually helpful to describe the objectives or business purpose of the transaction up front.
- Don't hesitate to call the SEC staff with questions or to request an extension when responding to comments.

- Clearly and directly address all questions and issues raised when responding to comments from the SEC staff.
- The SEC staff assumes that any policies and transactions disclosed in the financial statements are material. If the SEC issues a comment letter on a policy or transaction that is not material, registrants should communicate that fact in the first response to resolve the comment in a timely manner.
- Don't assume that the SEC staff permitted something just because it was included in another registrant's filing. Some filings or filing sections may not have been reviewed by the SEC staff, and certain items may have been immaterial to the other registrant.

SEC rulemaking update

Mr. Hinman discussed rulemaking initiatives that the SEC hopes to finalize before the end of 2020, including the following:

- Amendments to S-X Rule 3-05 and Article 11 to improve the disclosure requirements for acquisitions and dispositions of businesses, which Mr. Hinman expects to address feedback the SEC received expressing concerns about the proposed requirement for pro forma financial information to reflect management's expectations for synergies and other plans that are reasonably estimable and reasonably expected to occur (management's adjustments)
- Amendments to S-X Rule 3-10 to reduce compliance costs and burdens and encourage issuers to conduct registered offerings of guaranteed debt
- Amendments to the accelerated and large accelerated filer definitions in Exchange Act Rule 12b-2 to reduce the number of companies subject to accelerated filing deadlines and the internal control over financial reporting (ICFR) auditor attestation requirement by exempting SRCs that have yet to generate significant revenues

How we see it

We provided feedback to the SEC regarding its proposal to change the requirements for pro forma financial information and suggested that the SEC give registrants the option to include forward-looking management adjustments rather requiring these adjustments.

Division of Corporation Finance practice matters

FASB adoption date deferral implications for certain SEC Filers

Ms. McCord discussed questions the staff has received related to the FASB's recent deferral of certain effective dates for major accounting standards.

With ASU 2019-10, the FASB created a "two-bucket approach" for adopting major accounting standards in which SEC filers other than SRCs adopt a major new accounting standard at least two years before all other entities.

However, because public business entities (PBEs) have already adopted the improvements to the hedge accounting guidance and the new leases standard, the FASB deferred the effective dates for those standards only for entities that have not yet adopted them. That includes EGCs that use private company effective dates and, based on SEC staff guidance, entities that are PBEs solely because their financial statements are included in another entity's SEC filing, such as in accordance with S-X Rules 3-05 or 3-09.

EY US resources

- To The Point, ***FASB defers certain effective dates for major standards***

The changes to the effective dates for the new standards on credit losses and long-duration insurance contracts affect a much broader population of SEC filers because those standards are not yet effective. Ms. McCord said the definition of an SEC filer used in ASU 2019-10 excludes:

- An entity whose financial statements are included in another entity's SEC filing (e.g., Items 3-05 and 3-09 of Regulation S-X)
- An entity that is preparing to conduct an initial public offering (IPO), because it would not become an SEC filer until its registration statement is declared effective

Ms. McCord clarified that, because entities conducting IPOs become SEC filers when their registration statements are declared effective, they must adopt the new credit losses standard as of the Bucket 1 adoption date in their next SEC filing. For example, a calendar-year company that becomes an SEC filer in June 2020 must adopt the new credit losses standard as of 1 January 2020 in its calendar second-quarter Form 10-Q.

How we see it

Entities that submit IPO registration statements should consider adopting new accounting standards on the timeline for SEC filers to avoid the complexity of having to retrospectively apply the new accounting and revise previously issued financial statements immediately after the IPO.

Even though ASU 2019-10 says companies should determine whether they are SRCs on 15 November 2019, the SEC staff has said that it would not object to a newly public company that qualified as an SRC at the time of its IPO deferring adoption of the credit losses standard until the Bucket 2 effective date (i.e., 2023 for a calendar-year company).

How we see it

The SEC staff's position levels the playing field for companies that go public and qualify as SRCs after 15 November 2019, the date the FASB set as the determination date in ASU 2019-10.

Finally, Ms. McCord said that EGCs that have elected to use private company effective dates[8] for new or revised accounting standards but lose their EGC status before they would have adopted those standards need to adopt the new accounting standards as of the beginning of the year they lose their EGC status. That is, a company that loses its EGC status during 2021 would have to adopt the new credit losses standard as of 1 January 2021 in its 2021 Form 10-K. Consistent with guidance previously provided by the SEC staff, an EGC that loses its status in 2020 would apply the new credit losses standard as of 1 January 2020 in its 2020 Form 10-K.

Special purpose acquisition company (SPAC) transactions

Mr. Gilmore said more companies are entering the public markets by merging with SPACs. He observed that there are more rigorous reporting requirements for these transactions than for traditional mergers. This is because, unlike traditional mergers, SPAC mergers effectively result in a nonpublic operating company becoming a public reporting company through a merger with a public shell company.

For example, operating companies undergoing SPAC mergers must provide financial statements that include public company disclosures and are audited under PCAOB standards for all periods. Our Technical Line publication on these transactions examines the reporting and filing requirements for companies pursuing SPAC mergers and addresses many of the issues Mr. Gilmore discussed.

EY US resources

- Technical Line, ***Navigating the requirements for merging with a special purpose acquisition company***

The SEC's definition of a business differs from the US GAAP definition and primarily focuses on whether historical financial statements of the acquired business would be useful to investors.

Determining the predecessor in IPO transactions

Craig Olinger, Senior Advisor to the DCF Chief Accountant, discussed various IPO transactions, including those that combine multiple entities in a "put-together" transaction and those that that will result in a new registrant that will succeed to a business when or before the IPO becomes effective.

Mr. Olinger said that these transactions require a careful evaluation of the facts and circumstances to determine which entity is the predecessor. Factors that are typically considered and evaluated include the order in which the parent company obtained control of each entity in sequential acquisitions, the relative size and fair value of each entity, the financial characteristics of each entity, and historical and ongoing management structures involved, he said, emphasizing that none of the factors is determinative.

Mr. Olinger said an entity conducting an IPO that disposes of a business prior to effectiveness may be able to omit that business from its historical financial statements if it complies with the conditions of SAB Topic 5.Z.7. He cautioned, however, that companies should not apply this guidance to other fact patterns.

Definition of a business

Mr. Gilmore said that since the FASB issued revisions to the US GAAP definition of a business in 2017, more acquired businesses have met the definition of an asset acquisition under US GAAP while continuing to meet the SEC's definition of a business. He does not expect the SEC to change its definition of a business given its objective of providing historical financial statements that are meaningful to investors.

Mr. Gilmore noted that the SEC staff has the authority to waive the reporting requirements for acquired entities that meet the SEC's definition of a business if applying the definition does not accurately reflect the nature of the transaction. However, he emphasized that the staff's analysis of whether an acquired entity is a business focuses primarily on the continuity of operations before and after the acquisition, rather than the factors considered under US GAAP.

Cross-border matters

Mr. Olinger discussed issues that were addressed in the May 2019 Center for Audit Quality International Practice Task Force Joint Meeting with SEC Staff.[9] He highlighted a few situations in which either a complete set of financial statements (as defined in IFRS) is not required by SEC regulations or accommodations to provide less than a complete set are provided by the SEC staff.

Mr. Olinger said that the staff would not object to the inclusion of auditors' reports that are qualified with respect to the lack of certain information that is required by IFRS. Examples he cited include the omission of the comparative period of financial statements for a recently acquired investee or business to satisfy the requirements of S-X 3-09 or 3-05, or the omission of an opening balance sheet for carve-out financial statements prepared for the first time using IFRS to satisfy S-X 3-05. However, Mr. Olinger emphasized that auditors' reports on such financial statements must refer to the PCAOB or AICPA auditing standards rather than International Standards on Auditing.

Mr. Olinger also said that, if pre-cleared by the SEC staff, abbreviated financial statements prepared using IFRS may be used to satisfy the requirements of S-X Rule 3-05. In such cases, the audit opinion and financial statement disclosures may be modified to reflect the unique nature of these financial statements.

Remarks from the SEC Division of Enforcement staff

Matt Jacques, Chief Accountant in the SEC's Division of Enforcement, and five members of the Division of Enforcement staff discussed the SEC's enforcement actions over the past year.

Mr. Jacques said the Commission brought enforcement actions in matters involving virtually all aspects of the financial reporting process, including actions charging registrants and individuals with fraudulent accounting practices (e.g., overstating revenues, improperly inflating asset valuations, intentionally misstating non-GAAP measures and key performance indicators (KPIs)), failures to design and maintain internal accounting controls, and misrepresentations or omissions of risk factor and other material disclosures.

Mr. Jacques also emphasized the importance of auditor independence and described several enforcement actions against auditors for violations of the independence requirements in Rule 2-01 of Regulation S-X, *Qualifications of Accountants*, and other improper conduct. He said auditors must be independent of their audit clients both in fact and in appearance, and the SEC will consider all relevant facts and circumstances, even those not specifically addressed in Rule 2-01.

Members of the SEC enforcement staff provided more details about some of the actions Mr. Jacques described, including those involving non-GAAP measures and KPIs, on which the staff appears to have had increased focus this year. For example, the enforcement staff discussed charges against registrants and individuals for intentionally misstating both non-GAAP measures and KPIs and manipulating those measures over multiple periods by using "cookie jar" accounting. The enforcement staff also noted that the SEC charged an entity with disclosing a non-GAAP measure more prominently than its corresponding GAAP measure.

The SEC enforcement staff also discussed how the division identifies matters to pursue. The staff members said they rely on both external sources (e.g., self-reporting by companies, tips from whistleblowers, and other tips) and internal research.

Mr. Jacques also referred interested parties to the Division of Enforcement 2019 Annual Report,[10] which provides more information on the SEC's enforcement program and its accomplishments.

International matters

Sue Lloyd, Vice-Chair of the IASB, discussed the following aspects of the IASB's work.

Performance reporting — The IASB plans to issue an exposure draft soon that would standardize the definitions of subtotals (e.g., operating profit, profit before financing and income taxes) and make other changes to the income statement to improve comparability and consistency of financial statements. The IASB also plans to propose new footnote disclosures that would require entities to disclose the following when a management performance measure (MPM) is disclosed:

- Why management believes the MPM is a relevant measure of performance
- How the MPM has been calculated
- A reconciliation from the MPM to the closest IFRS-specified subtotal

Management commentary — The IASB is deliberating updates to its Practice Statement on Management Commentary, which Ms. Lloyd noted was analogous to MD&A in a Form 10-K, and it expects to issue an exposure draft in the second half of 2020. While providing management commentary is voluntary, the IASB believes that investors should have more visibility into factors that may affect an entity's ability to create value and its future cash flows (e.g., climate change, risks and opportunities related to its intangible assets).

Reference rate reform — The IASB is drafting an exposure draft to, among other things, provide relief related to the transition away from LIBOR, including enabling hedge accounting to continue in the interim and providing relief from potentially adverse accounting consequences when amending contracts and instruments to substitute an alternative reference rate. The objective of this project is like that of the FASB's discussed above.

PCAOB update

PCAOB auditing standard-setting update

Megan Zietsman, Chief Auditor and Director of Professional Standards at the PCAOB, provided an update on the PCAOB's standard-setting activity.

System of quality controls

Ms. Zietsman said that updating the PCAOB's quality control standards is a key priority. She noted that the current quality control standards are outdated and the PCAOB's objective is to develop quality control standards that are responsive to both internal and external risks that audit firms currently face in complying with professional standards. Ms. Zietsman added that the PCAOB is exploring an integrated, risk-based framework that is scalable so it can be implemented by audit firms of all sizes.

Ms. Zietsman said that the PCAOB has been closely monitoring the activities of the IAASB, which in March 2019 proposed updating its quality control standard with the exposure draft of International Standard on Quality Management 1. The PCAOB is considering using that proposal as a baseline to help promote consistency in frameworks across jurisdictions. Ms. Zietsman cautioned that the PCAOB may explore some different requirements to reflect the audit environment in the US.

The PCAOB is focused on the use of technology in the audit and its effect on audit quality.

As previously discussed, the PCAOB is expected to vote on whether to issue a concept release on the PCAOB's quality control standards at an open meeting on 17 December 2019. Ms. Zietsman encouraged stakeholders to comment and said the PCAOB hopes the feedback it receives will reflect a diverse set of perspectives.

How we see it

Updating these standards is an important project, and stakeholders, including auditors and audit committees, should review the concept release the PCAOB is expected to issue and share their perspective on potential changes to the quality control standards. The PCAOB has not updated its quality control standards since it adopted the AICPA's standards in 2003. We believe that alignment among the various quality control standards would benefit audit quality and promote consistent application for global audit firms.

Data and technology

Ms. Zietsman discussed her views on the PCAOB's research project on understanding how emerging technology is being used in the audit and how it affects audit quality. She noted that the PCAOB's data and technology task force, which is comprised of PCAOB staff members, auditors and other stakeholders with insights into audit technology, is currently focusing on understanding the role of data analytics and artificial intelligence in the audit. The task force is developing an understanding of the new technologies audit firms are using so it can help the PCAOB consider next steps.

Ms. Zietsman said the PCAOB wants to understand the landscape better before proceeding with standard-setting or other guidance that could impede the use of technology in the audit. She noted that using data analytics has helped audit teams perform risk assessments and planning procedures.

As it has done with other projects, the PCAOB will continue to monitor the activities of other standard setters and regulators, Ms. Zietsman said. She added that the PCAOB is focusing on being practical and avoiding the development of standards that differ significantly from those issued by other standard setters or that stifle innovation.

Accounting estimates and use of specialist's standard

Ms. Zietsman also discussed the final standards on auditing accounting estimates, including fair value measurements, and the use of specialists, which are effective for audits of financial statements for periods ending on or after 15 December 2020.

Ms. Zietsman said auditors should read PCAOB Release No. 2018-005[11] and PCAOB Release No. 2018-006[12], obtain the appropriate level of training on the standards and understand the importance of performing the appropriate risk assessment procedures for accounting estimates early in the audit.

She also reminded audit firms of the staff guidance[13] issued on 22 August 2019 that was designed to raise awareness and help auditors understand the requirements before they become effective. The PCAOB plans to continue to actively engage with audit firms to understand any implementation challenges and issue further guidance if needed.

PCAOB inspections and enforcement matters

George Botic, Director of Registration and Inspections at the PCAOB, discussed the state of audit quality, observations from 2019 inspection activities and the focus areas for inspections in 2020. Mr. Botic said that the audit quality continues to improve, as indicated by the recent declines in both the number and severity of financial statement restatements and the number of PCAOB inspection findings. He also said the PCAOB remains committed to transforming the inspection process in accordance with its strategic plan.

Among recent changes implemented by the PCAOB, Mr. Botic highlighted the introduction of target inspection teams that review selected focus areas of audits across multiple firms. With respect to targeted reviews of CAMs, he noted that the target inspection teams identified as good practices the early engagement by stakeholders, adequate preparation (e.g., dry runs by audit firms, the creation of tailored audit tools) and making sure the words in the auditor's report are consistent with the audit workpapers.

Mr. Botic highlighted the following good practices observed by PCAOB inspectors during the targeted reviews of multi-location/group audits:

- Using a local engagement quality reviewer on component auditor work, even when such a review is not required by professional standards
- Using a forensic specialist to assist with global risk assessment
- Using automated software tools to prepare Form AP

Reflecting on the recent inspection results, Mr. Botic emphasized the importance of an audit firm's quality control system. He said that the PCAOB views root cause analysis as a key component of a quality control system and encouraged audit firms to focus on evaluating the root causes for all audit deficiencies identified through PCAOB inspections as well as positive audit quality events.

Inspections outlook for 2020

Mr. Botic said the PCAOB's 2020 inspections and activities will likely focus on:

- The design and operating effectiveness of audit firms' systems of quality control
- Auditor independence matters
- Implementation of new accounting and auditing standards
- Firms' remedial efforts related to recurring audit deficiencies
- Engagement team considerations of omitted procedures
- Other areas, such as digital assets, including evaluation of reliability of audit evidence from blockchains, fair value considerations and audit procedures related to ownership of digital assets

Enforcement matters

Mark Adler, Acting Director of Enforcement and Investigations at the PCAOB, discussed recent trends and priorities for the PCAOB enforcement division. He said that the division is primarily focused on significant audit violations, including lack of due professional care and skepticism, and threats to the PCAOB's oversight process, such as alterations to audit workpapers in anticipation of inspections. In addition, independence continues to be a focus area for the enforcement division. Mr. Adler expects these areas to remain high priorities for enforcement in 2020.

How we see it

The PCAOB's inspection findings, enforcement matters and areas of focus should be considered by registrants as well as auditors.

Endnotes:

[1] PCAOB Critical Audit Matters Spotlight.
[2] Staff Accounting Bulletin No. 119.
[3] Staff Statement on LIBOR Transition.
[4] ASC 606-10-25-21.
[5] Paragraph BC29 of ASU 2016-10.
[6] Speech by Bill Hinman: Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks.
[7] SEC Statement on "Framework for 'Investment Contract' Analysis of Digital Assets" — April 3, 2019.
[8] The Jumpstart our Business Startups Act provides scaled disclosure relief for EGCs and allows EGCs to use private company effective dates for new or revised accounting standards.
[9] CAQ International Practices Task Force Highlights of the joint meeting with the SEC staff on 21 May 2019.
[10] US SEC Division of Enforcement 2019 Annual Report.
[11] PCAOB Release No. 2018-005.
[12] PCAOB Release No. 2018-006.
[13] PCAOB Staff Guidance for New Requirements on Auditing Estimates & Auditor's Use of the Work Specialists.

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Appendix — Conference speeches

	Speech and link to source
SEC Chief Accountant Sagar Teotia	‣ Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Associate Chief Accountant Vassilios Karapanos	‣ Speech by SEC Associate Chief Accountant: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Erin Bennett	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Nipa Patel	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Jamie N. Davis	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Aaron Shaw	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Lauren K. Alexander	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Louis J. Collins	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
SEC Professional Accounting Fellow Susan M. Mercier	‣ Speech by SEC Professional Accounting Fellow: Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments
FASB Chairman Russell G. Golden	‣ Speech by FASB Chairman: Remarks of FASB Chairman Russell G. Golden AICPA Conference on Current SEC and PCAOB Developments
IASB Vice-Chair Sue Lloyd	‣ Speech by IASB Vice-Chair: Enhancing relevance in 2020 and beyond
CAQ Executive Director Julie Bell Lindsay	‣ Speech by CAQ Executive Director: Center for Audit Quality Update