CAQ PUBLIC POLICY & TECHNICAL ALERT

October 2018

As part of the Center for Audit Quality's ongoing effort to keep members and stakeholders informed on significant public policy and accounting matters, we are pleased to offer the Public Policy and Technical Alert (PPTA). Each month, the PPTA highlights and examines the regulatory, standard-setting, legislative, and broader financial reporting developments impacting the public company audit profession. Please note that the PPTA is intended as general information and should not be relied upon as being definitive or all-inclusive. The CAQ encourages member firms to refer to the rules, standards, guidance, and other resources in their entirety at the hyperlinks provided below. All entities should carefully evaluate which requirements apply to their respective organizations.

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Upcoming Events

PCAOB

George Botic appointed Director of Registration and Inspections

On November 1, the PCAOB announced that George Botic has been named the Director of the Division of Registration and Inspections. Since May 2018, Mr. Botic has served as acting Director, with responsibility for carrying out the PCAOB’s mission of investor protection through its statutory requirements to register and inspect domestic and foreign accounting firms that audit public companies or broker-dealers.

Prior to his role as acting Director, Mr. Botic served as Director of International Affairs, overseeing the PCAOB’s negotiations and relationships with foreign audit regulators and governments.

Ryan Sack named Director of Internal Oversight and Performance Assurance

The PCAOB on October 9 announced that Ryan Sack has been named Director of the Office of Internal Oversight and Performance Assurance. In that role, he will provide internal examination of the programs and operations of the PCAOB to help ensure the internal integrity, efficiency, and effectiveness of those programs and operations.

Sack has more than 20 years of internal audit and assurance leadership experience with major publicly-traded corporations. Most recently, he was vice president of internal audit at Orbital ATK, where he oversaw governance, risk, and control assessments during a period of rapid transformation resulting from a corporate merger.

SEC

SEC releases new strategic plan

The SEC on October 11 released a new strategic plan for fiscal years 2018-2022. The new plan's three goals reflect the SEC's commitment to its longstanding mission while leveraging the opportunities and addressing the challenges that come from fast-evolving markets, products and services. The new plan's three goals are for the SEC to:

- Focus on the long-term interests of Main Street investors. The SEC will strive to better understand how a wider range of investors participate in the capital markets and how to reach them while tailoring policy initiatives with retail investors in mind. Initiatives under this goal will include modernizing disclosure and expanding investor choice.

- Recognize significant developments and trends in the evolving capital markets and adjust efforts to ensure it is effectively allocating resources. Under this goal, the SEC will embrace innovation by analyzing market developments, evaluating existing rules and procedures, understanding the continually changing cyber-landscape and ensuring the appropriate resources are dedicated to each area.

- Elevate its performance by enhancing its analytical capabilities and human capital development. The SEC will invest in data and technology to leverage the experience, knowledge, creativity, leadership and teamwork of the SEC's staff and its leaders. The agency also is committed to recruiting and retaining a diverse workforce with a wide range of skills and expertise.

SEC report cautions companies to consider cyber threats when implementing internal accounting controls

On October 16, the SEC issued an investigative report cautioning that public companies should consider cyber threats when implementing internal accounting controls. The report is based on the SEC Enforcement Division's investigations of nine public companies that fell victim to cyber fraud.

The SEC's investigations focused on "business email compromises" in which perpetrators posed as company executives or vendors and used emails to dupe company personnel into sending large sums to bank accounts controlled by the perpetrators. The companies, which each had securities listed on a national stock exchange, covered a range of sectors, including technology, machinery, real estate, energy, financial, and consumer goods. Public issuers subject to the internal accounting controls requirements of Section 13(b)(2)(B)(i) and (iii) of the Securities

Exchange Act of 1934 must calibrate their internal accounting controls to the current risk environment and assess and adjust policies and procedures accordingly.

Stephanie Avakian, Co-Director of the SEC's Enforcement Division, said in a statement, "In light of the facts and circumstances, we did not charge the nine companies we investigated, but our report emphasizes that all public companies have obligations to maintain sufficient internal accounting controls and should consider cyber threats when fulfilling those obligations."

SEC provides regulatory relief and assistance for hurricane victims

The SEC on October 16 announced regulatory relief to publicly traded companies, investment companies, accountants, transfer agents, municipal advisors, and others affected by Hurricane Michael.

To address compliance issues caused by Hurricane Michael, the SEC issued an order that conditionally exempts affected persons from certain requirements of the federal securities laws for periods following the weather event. The SEC also adopted interim final temporary rules that extend the filing deadlines for specified reports and forms that companies must file pursuant to Regulation Crowdfunding and Regulation A.

SEC reopens comment period for capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants

The SEC on October 11 voted to re-open the comment period and request additional comment on the proposed rules and amendments for capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants and capital requirements for broker-dealers. The aim is to provide interested parties with an opportunity to submit comments that take into account regulatory and market developments since the publication of the proposals in 2012 and 2013.

The deadline for submitting comments is November 19, 2018.

SEC launches new strategic hub for innovation and financial technology

The SEC on October 18 launched the Strategic Hub for Innovation and Financial Technology (FinHub). The FinHub will serve as a resource for public engagement on the SEC's FinTech-related issues and initiatives, such as distributed ledger technology (including digital assets), automated investment advice, digital marketplace financing, and artificial intelligence/machine learning. The FinHub also replaces and builds on the work of several internal working groups at the SEC that have focused on similar issues.

The FinHub will be led by Valerie A. Szczepanik, Senior Advisor for Digital Assets and Innovation and Associate Director in the Division of Corporation Finance and staffed by representatives from the SEC's divisions and offices who have expertise and involvement in FinTech-related issues.

SEC Division of Corporation Finance updates C&DIs

The SEC's Division of Corporation Finance updated the following Compliance and Disclosure Interpretations (C&DIs):

- **Exchange Act Forms**
  - Section 105. Form 10-Q
    - Question 105.09 (Updated 10/4/18)

- **Cross-Border Exemptions**
  - Sections 100-105 (Updated 10/17/18)

SEC amends disclosure rules for mining companies

The SEC on October 31 adopted new rule amendments to modernize disclosures by mining companies. According to the press release, the amendments "will provide investors with a more comprehensive understanding of a registrant's mining properties, which should help them make more informed investment decisions. The amendments also will more closely align the SEC's disclosure requirements and policies for mining properties with current industry and global regulatory practices and standards."

FASB

FASB updates list of permissible U.S. benchmark interest rates for hedge accounting

The FASB on October 25 issued Accounting Standards Update (ASU) 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. The ASU provides guidance on the risks associated with financial assets or liabilities that are permitted to be hedged. Among those risks is the risk of changes in fair values or cash flows of existing or forecasted issuances or purchases of fixed-rate financial assets or liabilities attributable to the designated benchmark interest rate (referred to as interest rate risk).

The ASU adds the OIS rate based on the SOFR as a U.S. benchmark interest rate to facilitate the London Interbank Offered Rate -to-SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes.

The ASU will be effective concurrently with ASU 2017-12, *Topic 815: Targeted Improvements to Accounting for Hedging Activities*. For public companies that already have adopted ASU 2017-12, the new amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other companies and organizations that already have adopted ASU 2017-12, the new amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted in any interim period upon issuance of this ASU if a company or organization already has adopted ASU 2017-12.

FASB issues ASU on consolidation accounting for variable interest entities

On October 31, the FASB issued ASU No. 2018-17, Consolidation (Topic 810) – Targeted Improvements to Related Party Guidance for Variable Interest Entities. The new guidance supersedes the private company alternative for common control leasing arrangements issued in 2014 and expands it to all qualifying common control arrangements.

Under the new standard, a private company could make an accounting policy election to not apply variable interest entity guidance to legal entities under common control (including common control leasing arrangements) when certain criteria are met. Additionally, a private company electing the alternative is required to provide detailed disclosures about its involvement with, and exposure to, the legal entity under common control. The standard also amends the guidance for determining whether a decision-making fee is a variable interest.

International

IAASB modernizes auditing of accounting estimates

The IAASB on October 3 released the revised standard, ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* (ISA 540 (Revised)), to respond to the rapidly evolving business environment. The revision ensures that the standard continues to keep pace with the changing market and fosters a more independent and challenging skeptical mindset in auditors.

Significant revisions include:

- An enhanced risk assessment that requires auditors to consider complexity, subjectivity and other inherent risk factors in addition to estimation uncertainty.

- A closer link between the enhanced risk assessment and the methods, data and assumptions used in making accounting estimates, including the use of complex models.
- Specific material to show how the standard is scalable to all types of accounting estimates.
- Emphasis on the importance of applying appropriate professional skepticism when auditing accounting estimates to foster a more independent and challenging skeptical mindset in auditors.

ISA 540 (Revised) becomes effective for financial statement audits for periods beginning on or after December 15, 2019.

IAASB publication focuses on professional skepticism

The IAASB on October 12 published *Professional Skepticism Lies at the Heart of a Quality Audit*. The publication provides an update on the IAASB's efforts to appropriately reflect professional skepticism in its recently-issued, and soon-to-be-issued, standards and exposure drafts. It also includes other relevant news and information, and recent activities of the IESBA and IAESB, related to professional skepticism.

IAASB restarts search for new Chair

The IAASB on October 26 announced that the Interim Nominating Committee will restart its search for a Chair after Martin Baumann withdrew for personal reasons. Baumann was due to take up the position on January 1, 2019. Prof. Arnold Schilder, whose term as IAASB Chair is scheduled to conclude at the end of 2018, has agreed to stay on through early 2019, as necessary, to ensure a smooth transition to a new Chair.

IASB amends definition of business in IFRS standard on business combinations

The IASB on October 22 issued narrow-scope amendments to IFRS 3, *Business Combinations*, to improve the definition of a business. The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. In addition to amending the wording of the definition, the IASB has provided supplementary guidance.

Companies are required to apply the amended definition of a business to acquisitions that occur on or after January 1, 2020. Earlier application is permitted.

IASB issues amendments to its definition of 'material'

On October 31, the IASB issued amendments to its definition of material. According to the IASB, the amendments are intended to make it easier for companies to make materiality judgements. The updated definition amends IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS standards. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS standards.

FRC sets out new strategic focus to ensure audit serves the public interest

The U.K. Financial Reporting Council (FRC) on October 8 announced a strategic program, Developments in Audit, to help ensure audit better serves the public interest. The program encompasses work on auditor independence, audit quality, the future needs of investors, and corporate viability. It highlights key themes and issues and provides a robust evidence base to allow for an informed debate about the future of audit.

The themes include:

- *Independence*. The FRC will test the effectiveness of the rules on independence. The review will include determining whether further actions are needed to prevent auditor independence being compromised, including whether all consulting work for bodies they audit should be banned.

- *Viability*. The FRC will develop proposals to strengthen requirements on auditors when considering whether an organization is a going concern. This includes whether the responsibilities of auditors in assessing companies' statements on their longer-term viability should be enhanced and whether auditors should report publicly on their views of the realism of assessments made by companies.

- *Investor Needs*. The FRC is undertaking a review of the work auditors do on the front half of the annual report to assess whether auditors are undertaking enough work to conclude it is not materially misstated. The FRC shortly will launch a major review of stakeholders' needs for information in corporate reports and will consider to what extent such information needs to be assured.

- *Audit Quality*. The FRC has adopted an enhanced program of audit firm monitoring. It has also strengthened its enforcement capacity so that it can conclude cases more quickly and revised its sanctions framework to levy penalties that reflect the gravity of the issue.

FRC to examine the future of corporate reporting

The FRC on October 30 launched a project to challenge existing thinking about corporate reporting and consider how companies should better meet the information needs of shareholders and other stakeholders. The FRC will review current financial and non-financial reporting practices, consider what information investors and other stakeholders require and fundamentally, the purpose of corporate reporting, and the annual report. The different types of corporate communications produced by companies also will be examined.

The FRC expects the project will result in a series of calls for action for changes to regulation and practice. During the second half of 2019, the FRC will publish a thought leadership paper consolidating the project's outcomes.

The project will be supported by an advisory group and the FRC is calling for up to 15 participants to join a diverse group. The deadline for nominations for membership of the group is November 15, 2018.

FRC Stephen Haddrill to resign

Stephen Haddrill, who has led the FRC since 2009, is expected to depart before the end of the year, according to reports. The regulator has come under intense scrutiny this year. In April, the government launched an independent "root and branch" review of the FRC, led by Sir John Kingman.

CMA launches immediate review of audit sector

The U.K. Competition and Markets Authority (CMA) on October 9 announced that it has launched a detailed study of the audit sector to examine concerns that it is not working well for the economy or investors. As part of its review, the CMA will investigate whether the sector is competitive and resilient enough to maintain high quality standards.

The study will examine three main areas:

- *Choice and switching*. Changes put in place by the Competition Commission appear to have strengthened competition between the big four firms but the largest U.K. companies still turn almost exclusively to one of them when selecting an auditor to review their books.

- *Resilience*. The study will examine what the role of the big four firms means for resilience – the risk being that each of the big four auditors is "too big to fail," potentially threatening long-term competition.

- *Incentives*. Companies, rather than their investors, pick their own auditor. The CMA's study will examine concerns that this might result in a lack of incentive to produce challenging performance reviews.

The CMA said that, if it finds evidence the market is not working well after examining these areas, it will scrutinize all proposals for tackling them.

Other Developments

AICPA seeks feedback on working draft of credit loss accounting issue

On October 30, the AICPA Financial Reporting Executive Committee (FinREC) issued a working draft of an accounting issue related to the implementation of FASB's new standard on accounting for credit losses. FinREC is creating a new AICPA accounting and auditing guide devoted to the current expected credit loss guidance included in FASB Accounting Standards Update No. 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. FinREC is seeking feedback on this working draft that will be included in the guide.

The deadline for submitting comments is December 31, 2018.

New guidance addresses environmental, social, and governance-related risks

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the World Business Council for Sustainable Development on October 23 released the final version of *Enterprise Risk Management: Applying enterprise risk management to environmental, social and governance-related risks.* An executive summary is also available.

The guidance aims to bring environmental, social and governance (ESG) risks and opportunities into a clearer focus for mainstream business and other organizations around the world. It is designed to enhance organizations' resiliency as they confront the increasing prevalence and severity of ESG-related risks, ranging from extreme weather events to product safety recalls. The guidance aligns with COSO's *Enterprise Risk Management – Integrating with Strategy and Performance*.

CAQ

CAQ issues new 'Profession in Focus' video

In October, the CAQ issued one new episode of its online video series, *Profession in Focus*:

- Episode 64 features EY Partner and innovation expert Scott Zimmerman. In conversation with the CAQ's Catherine Ide, Zimmerman discusses data analytics, artificial intelligence, and the skillsets and mindsets that auditors will need in a profession facing disruption and transformative change.

Upcoming Events

November 7-9
PLI Annual Institute on Securities Regulation, New York, NY and Webcast (Link)

November 8
NACD-USC Marshall Corporate Directors Symposium, Los Angeles, CA (Link)

November 8
PCAOB Investor Advisory Group Meeting, Washington, DC (Link)

November 12-13
FEI Current Financial Reporting Issues Conference, New York, NY (Link)

November 12-13
PLI Annual SEC Reporting & FASB Forum, Dallas, TX (Link)

November 12-16
IASB Board Meeting, London, UK (Link)

November 15
Webcast: FASB Accounting Standards Update on Insurance (Link)

November 28-29
PCAOB Standing Advisory Group Meeting, Washington, DC (Link)

December 3-4
PLI Annual SEC Reporting & FASB Forum, San Francisco, CA (Link)

December 4
Baruch College Annual Audit Conference, New York, NY (Link)

December 10-12
AICPA Conference on Current SEC and PCAOB Developments, Washington, DC (Link)

December 12-14
IASB Board Meeting, London, UK (Link)

December 12
SEC Government-Business Forum on Small Business Capital Formation, Columbus, OH (Link)

December 17-18
PLI Annual SEC Reporting & FASB Forum, New York, NY and Webcast (Link)

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The Center for Audit Quality is an autonomous, nonpartisan, nonprofit organization dedicated to enhancing investor confidence and public trust in the global capital markets by fostering high-quality public company audits; collaborating with other stakeholders to advance the discussion of critical issues; and advocating policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of CPAs. For more information, visit www.thecaq.org.

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