CAQ PUBLIC POLICY & TECHNICAL ALERT

March 2019

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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PCAOB staff provides guidance in advance of CAM effective dates

On March 18, the PCAOB released three staff guidance documents to support implementation of the requirement to communicate critical audit matters (CAMs) in the auditor's report under AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. The first phase of CAM implementation is effective for audits of large accelerated filers for fiscal years ending on or after June 30, 2019; the second phase, which impacts audits of all other companies to which the requirements apply, is effective for fiscal years ending on or after December 15, 2020.

The staff guidance consists of the following documents:

1. Implementation of Critical Audit Matters: The Basics
2. Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies
3. Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs

The documents were informed by discussions with auditors regarding their experiences conducting dry runs of CAMs with their audit clients, the staff's review of methodologies submitted by 10 U.S. audit firms that collectively audit approximately 85 percent of large accelerated filers, and other outreach efforts.

On March 29, the PCAOB also announced two upcoming webinars for auditors on the implementation of the new CAM requirements. The webinars will take place on Thursday, April 25, 2019, and on Wednesday, May 8, 2019 and will cover CAM determination, communication, and documentation requirements, as well as other considerations relevant to CAM requirements. Both webinars are expected to last 75 minutes and will cover the same material.

PCAOB posts 2019 Staff Inspections Outlook for Audit Committees

On March 14, the PCAOB's Division of Registration and Inspections posted a document on its website that outlines what audit committees should expect from the PCAOB's 2019 inspections. The document, *2019 Staff Inspections Outlook for Audit Committees*, is intended to supplement the *2019 Inspections Outlook*, which was issued in December 2018.

The document notes that 2019 inspections will focus on seven key areas:

- Technological developments
- Audit firms' actions addressing past inspection findings
- Audit procedures on new accounting standards
- Audit firms' use of Audit Quality Indicators
- Implementation of the new auditor's reporting model requirements
- Audit firms' systems of quality control
- Auditor independence

SEC

SEC adopts rules to implement FAST Act mandate to modernize and simplify disclosure

On March 20, the SEC voted to adopt amendments to modernize and simplify certain disclosure requirements in Regulation S-K. The amendments were mandated by the Fixing America's Surface Transportation (FAST) Act of 2015.

Among other things, the amendments:

- Simplify disclosure or the disclosure process, including changes that would allow registrants to omit confidential information from most exhibits without filing a confidential treatment request, and changes to Management's Discussion and Analysis that allow for flexibility in discussing historical periods;
- Revise rules or forms to update, streamline or otherwise improve the Commission's disclosure framework by eliminating the risk factor examples listed in the disclosure

requirement and revising the property requirement description to emphasize the materiality threshold;
- Update rules to account for developments since their adoption or last amendment by eliminating certain requirements for undertakings in registration statements; and
- Incorporate technology to improve access to information by requiring data tagging for items on the cover page of certain filings and the use of hyperlinks for information that is incorporated by reference and available on EDGAR.

The amendments also include parallel amendments to several rules and forms applicable to investment companies and investment advisers, including amendments that require certain investment company filings to include a hyperlink to each exhibit listed in the exhibit index of the filings and be submitted in HTML format.

The amendments will be effective 30 days after they are published in the *Federal Register*, except the amendments relating to the redaction of confidential information in certain exhibits which will become effective upon publication in the *Federal Register*. The requirements to tag data on the cover pages of certain filings are subject to a three-year phase-in, depending on the nature of the filer. All investment company registration statement and Form N-CSR filings made on or after April 1, 2020 must be made in HTML format and comply with the rule and form amendments pertaining to the use of hyperlinks.

SEC proposes offering reforms for business development companies and registered closed-end funds

On March 20, the SEC proposed rule amendments to implement certain provisions of the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act. The proposal would improve access to capital and facilitate investor communications by business development companies (BDCs) and registered closed-end funds.

The proposed amendments would modify the registration, communications, and offering processes available to BDCs and registered closed-end funds, building on offering practices that operating companies currently use.

The proposal will have a 60-day public comment period following its publication in the Federal Register

SEC accepts 2019 GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy

On March 12, the FASB announced that the SEC had accepted the 2019 GAAP Financial Reporting Taxonomy (FRT) and the 2019 SEC Reporting Taxonomy (SRT) (collectively, the "2019 Taxonomy Updates"). The 2019 GAAP FRT contains updates for accounting standards and other recommended improvements. The 2019 SRT includes elements to meet SEC requirements for financial schedules required by the SEC, condensed consolidating financial information for guarantors, and disclosures about oil and gas producing activities.

For the 2019 Taxonomy Updates, some elements included in the 2018 GAAP FRT have been relocated to the 2019 SRT. The 2019 SRT elements from the 2018 GAAP FRT correspond to the SEC's authoritative literature in which the underlying recognition and measurement are not specified by GAAP.

FASB

FASB issues new, proposed ASUs

The FASB issued three new Accounting Standards Updates (ASUs) in March:

- ASU 2019-01, *Leases (Topic 842): Codification Improvements*

  The ASU:

  1. Aligns the guidance for fair value of the underlying asset by lessors that are not manufacturers or dealers in Topic 842, with that of existing guidance;
  2. Requires lessors within the scope of Topic 942, *Financial Services – Depository and Lending*, to present all "principal payments received under leases" within investing activities; and
  3. Exempts both lessees and lessors from having to provide certain interim disclosures in the fiscal year in which a company adopts the new leases standard.

- ASU 2019-02, *Entertainment – Films – Other Assets – Film Costs (Subtopic 926-20) and Entertainment – Broadcasters – Intangibles – Goodwill and Other (Subtopic 920-350): Improvements to Accounting for Costs of Films and License Agreements for Program Materials*

  The ASU:

  1. Aligns the accounting for production costs of an episodic television series with the accounting for production costs of films by removing the content distinction for

capitalization. The ASU also requires that an entity reassess estimates of the use of a film for a film in a film group and account for any changes prospectively;

2. Requires that an entity test a film or license agreement for program material within the scope of Subtopic 920-350 for impairment at a film group level when the film or license agreement is predominantly monetized with other films and/or license agreements; and
3. Addresses presentation, requiring that an entity provide new disclosures about content that is either produced or licensed, and addresses cash flow classification for license agreements.

- ASU 2019-03, *Not-for-Profit Entities (Topic 958): Updating the Definition of Collections*

  The ASU modifies the definition of the term "collections" and requires that a collection-holding entity disclose its policy for the use of proceeds from when collection items are deaccessioned (that is, removed from a collection). If a collection-holding entity has a policy that allows proceeds from deaccessioned collection items to be used for direct care, it should disclose its definition of "direct care."

The FASB also issued two proposed ASUs:

- Proposed ASU, *Compensation – Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements – Share-Based Consideration Payable to a Customer*

  The proposed ASU would require entities to measure and classify share-based payments to a customer by applying the guidance in Topic 718. The amount that would be recorded as a reduction in revenue would be measured on the basis of the grant-date fair value of the share-based payment in accordance with Topic 718. The classification and subsequent measurement of the award would be subject to Topic 718 unless the share-based payment award is subsequently modified, and the grantee is no longer a customer.

  The deadline for submitting comments is April 18, 2019.

- Proposed ASU (Revised), *Income Taxes (Topic 740): Disclosure Framework – Changes to the Disclosure Requirements for Income Taxes*

  In July 2016, the FASB issued a proposed ASU that set forth enhanced disclosure requirements for income taxes. The FASB delayed finalizing the proposal because of potential tax reform. The federal government subsequently passed the Tax Cuts and Jobs Act in December 2017, which substantially changed how U.S. businesses are taxed. As a result, the FASB decided to revise its original proposal.

The resulting proposed ASU reflects these revisions, as well as stakeholder input on the original July 2016 proposal. The revised proposed ASU would (1) remove disclosures that no longer are considered cost beneficial or relevant and (2) add disclosure requirements identified as relevant to financial statement users.

The deadline for submitting comments is May 31, 2019.

Summary of March 6 FASB Board Meeting

The FASB posted on its website a summary of tentative decisions reached during the March 6 Board meeting. The Board:

- Considered whether to add a project to its technical agenda to address disclosures referred to the Board by the SEC and discussed whether and how those referred SEC disclosure requirements should be included in the FASB Accounting Standards Codification (Codification).

- Discussed the results of external review of *Topic 958*. The Board decided to clarify in the final ASU that the scope of the guidance on collections in Subtopics 958-360 and 958-605 includes both not-for-profit and business entities, consistent with the pre-Codification guidance in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*.

International

UK audit regime to be replaced with new regulator

On March 11, the British government announced that it will replace the Financial Reporting Council (FRC) with a new audit, corporate reporting, and corporate governance regulator. In accordance with the recommendations in Sir John Kingman's *Independent Review of the Financial Reporting Council* (Independent Review), the new Audit, Reporting and Governance Authority will for the first time:

- Be a statutory body with powers such as those to make direct changes to accounts rather than apply to court to do so, and to perform more comprehensive, visible reviews for greater transparency;
- Have strategic direction and duties to protect the interests of customers and the public by setting high standards of statutory audit, corporate reporting and corporate governance, and by holding companies and professional advisors to account;

- Regulate the biggest audit firms directly;
- Have a new, diverse board and strong leadership to change the culture and rebuild respect of those it regulates; and
- Have greater sanctions available in cases of corporate failure, including new powers to require rapid explanations from companies and in the most serious cases publish a report about the company's conduct and management.

The Department for Business, Energy and Industrial Strategy also opened a public consultation on the Independent Review's recommendations.

The deadline for submitting comments is June 11, 2019.

FRC consults on stronger going concern standard for auditors

On March 4, the FRC proposed to increase the work required of auditors when assessing whether an entity is a going concern. The proposed revisions to International Standard on Auditing (ISA) (UK) 570, *Going Concern*, would be significantly stronger than those required by international standards.

The FRC is proposing in particular:

- Auditors make greater effort to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;

- Improved transparency with a new reporting requirement for the auditor to provide a conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and

- A stand back requirement to consider all the evidence obtained, whether corroborative or contradictory, when the auditors draw their conclusions on going concern.

The deadline for submitting comments is June 14, 2019.

FRC issues position paper on next steps for the development of ethical and auditing standards

On March 5, the FRC issued a position paper which sets out how ethical and auditing standards will be developed to respond better to the needs of users of audited financial information. The paper sets out the issues that will be developed to support a public consultation on the text of revised standards over the summer.

It also sets out how the FRC's work on the standards responds to certain recommendations made by Sir John Kingman in his Independent Review, how proposals are being developed to support the Competition and Market Authority's Market Study of the UK Statutory Audit Market; and how revisions made to the international Code of Ethics will be incorporated into the FRC Ethical Standard.

The position paper also draws the attention of public interest entity (PIE) auditors to changes that will take place to UK law in the event that the UK exits the European Union with no deal or a transitional period. The most immediate issues will be (1) a change to the definition of a PIE and (2) implications for the provision of certain non-audit services which will be prohibited on a global basis rather than just within the European Union.

IFRS Foundation publishes project summaries

On February 28, the IFRS Foundation published two documents summarizing the IASB's work on possible improvements to IFRS 8, *Operating Segments*, and on discount rates in IFRS standards.

- The IFRS 8 Project Summary provides an overview of feedback on the IASB's proposals in its Exposure Draft, *Improvements to IFRS 8 Operating Segments – Proposed Amendments to IFRS 8* and *IAS 34*, *Interim Financial Reporting* published in March 2017. The summary also explains why the IASB Board (Board) decided not to proceed with those proposals.

- The Discount Rates Project Summary provides an overview of research considered by the Board from 2014 to 2017 in its project on discount rates in IFRS Standards.

The IFRS Foundation also published a document summarizing the IASB's work on the *Disclosure Initiative – Principles of Disclosure* research project (Disclosure Initiative). The Disclosure Initiative is part of the IASB's wider work under the theme "Better Communication in Financial Reporting."

The document summarizes:

- Research performed by the Board, including feedback received on the *Disclosure Initiative – Principles of Disclosure Discussion Paper* published in March 2017; and
- Conclusions reached in light of that research, including the Board's decision to undertake a *Targeted Standards-level Review of Disclosures* project.

Project summaries are overviews of information already available to the public through IASB papers. They do not provide any new material and do not form part of IFRS Standards.

IFRS Foundation publishes IFRS Taxonomy 2019

On March 27, the IFRS Foundation published the IFRS Taxonomy 2019. It includes changes resulting from a common practice update and a general improvement update to the IFRS Taxonomy 2018.

The IFRS Taxonomy 2019 compiles changes resulting from two final updates to the IFRS Taxonomy 2018, which also were published on March 27:

- IFRS Taxonomy 2018 – Update 1, *Common Practice* (IFRS 13 *Fair Value Measurement*). This update includes new elements and an enhanced taxonomy model that better reflect information companies commonly disclose about fair value measurement.

- IFRS Taxonomy 2018 – Update 2, *General Improvements*. This update includes changes designed to improve the quality of data tagged using the IFRS Taxonomy and to make it easier to navigate the IFRS Taxonomy.

IOSCO publishes first annual work program to enhance the efficacy of its work

On March 25, the Board of the International Organization of Securities Commissions (IOSCO) published its first annual work program, to enhance IOSCO's effectiveness and the impact of its policy work on global securities markets.

The IOSCO Board agreed on five priority issues for its work in 2019:

- Crypto-assets
- Artificial intelligence and machine learning
- Passive investing and index providers
- Retail distribution and digitalization
- Market fragmentation

AICPA

AICPA PEEC has adopted new and revised interpretations of the "Independence Rule"

The AICPA Professional Ethics Executive Committee (PEEC) adopted revised interpretations of the "Independence Rule" related to leases and client affiliates and a new interpretation under the "Confidential Client Information Rule" of the AICPA *Code of Professional Conduct*, the *Journal of Accountancy* reported.

- The revised "Leases" interpretation (ET §1.260.040) states that self-interest, familiarity, and undue influence threats to a covered member's compliance with the "Independence Rule" (ET §1.200.001) may exist when a covered member enters into or has a lease with an attest client.
- The revised "Client Affiliates" interpretation (ET §1.224.010) addresses an exception to the application of the "Independence Rule" to the affiliate of a financial statement attest client when related to the requirements of the leases interpretation under the "Independence Rule."
- A new interpretation discusses a member's responsibilities under the "Confidential Client Information Rule" (ET §1.700.001) when a member uses a third party for a quality review of the member's tax practice. The new interpretation, "Disclosing Information in Connection With a Quality Review" (ET §1.700.110), provides guidance on when the threat is reduced to an acceptable level.

AICPA issues guidance on prior-period audits

The AICPA issued non-authoritative guidance for performing an audit and reporting on an entity's prior-period financial statements.

For such audits, Technical Questions and Answers (TQA) 8100.03 states that the auditor should use, in their entirety, the auditing standards and form of the auditor's report that are in effect at the time the audit is performed – unless an auditing standard provides transitional guidance regarding its implementation. The TQA explains that because the previous auditing standards have been superseded by the current auditing standards, they are no longer in effect when the audit is performed.

AICPA FinREC taps BDO's Angela Newell as chair

On March 14, the AICPA named Angela Newell (CPA, CGMA) chair of the Financial Reporting Executive Committee (FinREC). Newell is a national assurance partner for BDO in Dallas, TX.

In her role at BDO, Newell's responsibilities include working with audit engagement teams to determine the appropriate accounting for a variety of topics. In addition, she has played a key role in BDO's response to the new revenue recognition and leasing standards. Prior to joining BDO, Newell served as Vice President – Corporate Controller for Fiesta Restaurant Group, Inc., Dallas, TX, and Vice President of Revenue Assurance and Corporate Controller for Clearwire Inc., Bellevue, WA.

Other Developments

IIA survey identifies potential misalignment in corporate risk landscape

The Institute of Internal Auditors' (IIA) 2019 North American Pulse of Internal Audit, *Defining Alignment in a Dynamic Risk Landscape*, found misalignment on the identification and management of risks in four key areas, including cybersecurity and third-party issues. The challenges, according to the IIA, are being brought on by dynamic geopolitical environments, shifting economic conditions, and disruptive technology.

The report, based on a survey of more than 500 internal audit executives, identified four key risk areas:

- *Cybersecurity and Data Protection*: Reputational damage related to cyber breaches remains a top concern for North American chief audit executives (CAEs). Three-year trending data reflect steady increases in the allocation of audit efforts to cybersecurity and information technology, but that still lags well-behind efforts focused on operational, financial reporting, and compliance, especially among publicly traded companies.

- *Third-party Risks*: CAEs have significant concerns about how organizations address risks associated with selecting and monitoring third-party vendors. Nearly half view organizational oversight of third-party relationships as weak.

- *Emerging and Atypical Risks*: While most CAEs express confidence in their organization's ability to identify and assess emerging or atypical risks, the reported frequency of management being surprised by these risks belies that confidence.

- *Board and Management Activity*: In substantially more than half of responding organizations, internal audit rarely or never provides assurance on management information sent to the board. What's more, variations in reporting structures may be hampering internal audit findings and insights from getting communicated to the board in key risk areas.

U.S. senators push for stronger cybersecurity by public companies

A bipartisan group of U.S. senators introduced S. 592, the *Cybersecurity Disclosure Act of 2019.* The bill would require publicly-traded companies to disclose in their annual reports or proxy statements whether any member of the board of directors is a cybersecurity expert, and if not, why having this expertise on the board is not necessary because of other cybersecurity steps taken by the company.

Under the bill, the SEC, in consultation with the National Institute of Standards and Technology, would define what constitutes expertise or experience in cybersecurity.

The companion bill, H.R. 1731, the *RECLAIM Act of 2017,* was introduced in the House of Representatives by Rep. Jim Himes (D-Conn.).

CAQ Updates

CAQ comments on SEC's "Request for Comment on Earnings Releases and Quarterly Reports"

In this letter, the CAQ provides input to the SEC on its *Request for Comment on Earnings Releases and Quarterly Reports*. Expressing overall support for the SEC's focus on this area, the letter conveys the CAQ's belief that "the current periodic reporting system provides investors, management, and boards with reliable, timely, and important information."

Through the lens of the public company auditing profession, the letter offers perspective, identifies challenges, and makes specific recommendations regarding the following topics:

- Benefits of existing safeguards related to form 10-Q
- Using the earnings release to satisfy some form 10-Q requirements
- Change in frequency of reporting considerations
- Opportunities for disclosure effectiveness in interim reporting

Upcoming Events

April 8-9
PLI: The SEC Speaks in 2019, Washington, DC (Link)

April 9-11
IASB Board Meeting, London, UK (Link)

April 12
PLI Webcast: Disclosure Effectiveness and FAST Act Amendments (Link)

April 25
PCAOB Webinar: Implementing Critical Audit Matter Requirements (Link)

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May 2
Baruch Financial Reporting Conference, New York, NY (Link)

May 6-8
AICPA Employee Benefit Plans Conference, New Orleans, LA (Link)

May 8
PCAOB Webinar: Implementing Critical Audit Matter Requirements (Link)

May 12-15
CFA Institute Annual Conference, London, UK (Link)

May 13-17
IASB Board Meeting, London, UK (Link)

June 9-13
AICPA Advanced Accounting and Auditing Conference, Las Vegas, NV (Link)

June 13-14
PLI Midyear SEC Reporting & FASB Forum, New York, NY and Webcast (Link)

June 17-18
PLI Midyear SEC Reporting & FASB Forum, San Francisco, CA (Link)

June 17-19
IASB Board Meeting, London, UK (Link)

June 20
KPMG/NACD Quarterly Audit Committee Webcast (Link)

June 23-28
ACFE Global Fraud Conference, Austin, TX (Link)

July 16-18
ICGN Annual Conference, Tokyo, Japan (Link)

July 22-26
IASB Board Meeting, London, UK (Link)

August 10-14
AAA Annual Meeting, San Francisco, CA (Link)

September 12
KPMG/NACD Quarterly Audit Committee Webcast (Link)

September 21-24
NACD Global Board Leaders' Summit, Washington, DC (Link)

September 23-24
PLI Annual SEC Reporting & FASB Forum for Mid-sized & Smaller Companies, Las Vegas, NV (Link)

September 23-27
IASB Board Meeting, London, UK (Link)

October 21-25
IASB Board Meeting, London, UK (Link)

November 6-8
AICPA Women's Global Leadership Summit, San Diego, CA (Link)

November 11-12
PLI Annual SEC Reporting & FASB Forum, Dallas, TX (Link)

November 18-22
IASB Board Meeting, London, UK (Link)

November 18-19
SIFMA Annual Meeting, Washington, DC (Link)

December 2-3
PLI Annual SEC Reporting & FASB Forum, San Francisco, CA (Link)

December 5-6
AICPA Construction & Real Estate Conference, Nashville, TN (Link)

December 9-11
AICPA Conference on Current SEC and PCAOB Developments, Washington, DC (Link)

December 9-12
IASB Board Meeting, London, UK (Link)

December 16-17
PLI Annual SEC Reporting & FASB Forum, New York, NY and Webcast (Link)

Questions and comments about the PPTA can be addressed to: aschumacher@thecaq.org.

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