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Heads Up

In This Issue:

Members of the following Deloitte teams contributed to this issue of *Heads Up*: Accounting Standards and Communications, Audit and Assurance Services, and SEC Services.

To our colleagues at Deloitte, our clients, and our other friends, we wish each of you a joyous and peace-filled holiday season and a happy new year.

Accounting in a Winter Wonderland

Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments

by Deloitte & Touche LLP's National Office Departments of Professional Practice

Executive Summary

Braving the snowy weather, accountants, auditors, and others made their way to Washington, D.C., for this year's AICPA[1] conference. The three-day event, which began on December 9, featured insights from numerous speakers and included discussion panels[2] on current accounting, reporting, and auditing practice issues.

Transparency and quality of financial reporting were again significant conference themes because of their important role in protecting investors. Several speakers referred to this objective in the context of improving disclosures in registrants' filings, evaluating internal controls, executing high-quality audits, and developing standards that reduce complexity and increase transparency.

The staff in the SEC's Division of Corporation Finance reminded registrants that by using disclosures to fully "tell their story," they can improve the transparency of their reporting, especially regarding significant judgments. In addition, the SEC staff highlighted the importance of (1) emphasizing material matters and reconsidering disclosures about potentially immaterial matters so that investors do not attach undue significance to them; (2) clearly disclosing accounting policies, especially when alternatives exist under U.S. GAAP; (3) appropriately "connecting the dots" to avoid inconsistent disclosures by considering interrelated disclosures within (and outside) registrants' filings; and (4) providing balanced disclosures and appropriate context for them. Echoing remarks about "disclosure overload" in a recent speech given by the newly appointed SEC chairman, Mary Jo White, various members of the SEC staff reiterated that registrants should assess materiality when considering their disclosures and clarified that the staff's comments to registrants on MD&A matters are not necessarily asking for more disclosure but for clearer, more precise, and more transparent disclosures about material matters.

[1] The abbreviations used in this publication are defined in Appendix B.
[2] For a list of panelists and selected sessions, see Appendix C.

Paul Beswick, chief accountant in the OCA, recounted investors' frustrations that accounting standards are too complex and urged the FASB to consider complexity in its standard-setting agenda and development of accounting standards. FASB Chairman Russell Golden discussed key considerations related to the Board's process for determining its standard-setting agenda. These include (1) looking for opportunities to reduce complexity and (2) continuing to ask investors whether wholesale changes are needed or targeted improvements to existing standards are more appropriate. Mr. Golden cited the joint revenue recognition project as an example of how efforts are being made to reduce complexity in financial reporting. He noted that through the FASB's and IASB's joint efforts, "scores of pieces of accounting literature in which revenue was recognized in dozens of different ways, depending on the industry," were put into a single standard "so that the same principles will apply to everyone." Mr. Golden also indicated that the Board would continue to work with the IASB and, as an example, cited the creation of joint transition resource groups to foster effective implementation of joint FASB and IASB convergence projects.

The topic of incorporation of IFRSs into the U.S. financial reporting system for public companies was also discussed. While SEC representatives made no announcements about whether and, if so, how and when IFRSs will be incorporated, Mr. Beswick noted that the SEC staff continues to evaluate its IFRS work plan; however, the staff's focus has been on its rulemaking responsibilities under the Dodd-Frank and JOBS Acts. IASB Chairman Hans Hoogervorst (1) detailed the progress the IASB has made in addressing concerns raised by the SEC staff in its final report on the incorporation of IFRSs and (2) called on the United States to act in "enlightened self-interest" by incorporating IFRSs into the U.S. financial reporting system.

Paul Beswick, chief accountant in the OCA, recounted investors' frustrations that accounting standards are too complex.

Another significant topic at the conference was auditor transparency and the importance of conducting high-quality audits. PCAOB Chairman James Doty stated, "It is the flow of expertly vouched-for information that, when perceived as both relevant to investment decisions and reliable, gives uninformed, diverse and dispersed investors the confidence to participate in a market as great as that which we enjoy in the U.S." He further noted that as part of its plan to increase transparency and improve audit quality, the PCAOB expects to (1) increase analysis of inspections, (2) enhance the usefulness of the PCAOB's inspection reports, (3) monitor the efforts of its recently formed Center for Economic Analysis, and (4) continue to work on its standard-setting agenda. In particular, Mr. Doty and other PCAOB staff members discussed their focus on the auditor reporting model and its audit transparency standards, noting that the latter would require audit firms to disclose the name of the audit engagement partner and other firms that helped perform the audit. Like the FASB, the PCAOB will also continue to emphasize outreach and cost-benefit analysis in developing its standard-setting agenda.

Other prominent themes at the conference were enforcement activities and FCPA. Ms. White, a former federal prosecutor, has indicated that her enforcement initiative includes obtaining admissions of wrongdoing in settlements of the most egregious cases, investigating minor violations, pursuing individual offenders, and increasing the staff's focus on accounting-related fraud. Speakers from the SEC highlighted the recently formed Financial Reporting and Audit Task Force and how it will use technology-based tools (e.g., its accounting quality model) to analyze electronic data — potentially including XBRL tags — for accounting anomalies, possible fraud, and other "outlier" information.

These themes, and other topics from the 2013 conference, are discussed below.

Selected Speakers

- Tricia Armelin, Associate Chief Accountant, SEC's Division of Corporation Finance
- Paul Beswick, Chief Accountant, SEC's Office of the Chief Accountant
- Kara Novaco Brockmeyer, Chief, SEC's Foreign Corrupt Practices Act Unit
- Andrew Ceresney, Co-Director, SEC's Division of Enforcement
- Kathy Collins, Senior Accountant, Disclosure Standards Office, SEC's Division of Corporation Finance
- Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance
- Cicely LaMothe, Senior Assistant Chief Accountant, Office of Real Estate and Commodities, SEC's Division of Corporation Finance
- Craig Lewis, SEC's Chief Economist and Director, SEC's Division of Economic and Risk Analysis
- Ryan Milne, Associate Chief Accountant, SEC's Division of Corporation Finance
- Dan Murdock, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance
- Nili Shah, Deputy Chief Accountant, SEC's Division of Corporation Finance
- David Woodcock, Enforcement Regional Director, SEC's Division of Enforcement

Developments in the Division of Corporation Finance

Observations on Comments to Domestic Registrants

In a Division of Corporation Finance panel discussion, the SEC staff discussed its observations on accounting and financial reporting topics related to reviews of registrants' filings of financial information reported under U.S. GAAP. The staff outlined key points that registrants should consider when assessing whether to provide disclosures in MD&A and determining the nature and extent of such disclosures. For example, the staff highlighted the importance of:

- Emphasizing material matters in disclosures. Registrants should focus on known trends and uncertainties that will have, or are reasonably likely to have, a material impact on their financial statements. In addition, they should reconsider disclosures about immaterial matters so that investors do not attach undue significance to them.
- Clearly disclosing accounting policies, especially when there are alternatives under U.S. GAAP (i.e., optionality exists).
- Appropriately "connecting the dots." The staff noted that it was important for registrants to avoid inconsistent disclosures by considering how disclosures within (and outside) registrants' filings are interrelated.
- Providing balanced disclosures. For example, while the staff encourages the use of metrics to help registrants "tell their story" in MD&A, such metrics should have appropriate context.
- Using precise terms that are defined in U.S. GAAP.

Echoing Ms. White's remarks about "disclosure overload" in a recent speech, various members of the SEC staff in the Division of Corporation Finance reiterated that registrants should assess materiality when considering their disclosures. For example, in its discussion of share-based compensation and disclosures about the impact of new accounting pronouncements (i.e., SAB Topic 11.M[3]), the staff stressed that registrants should avoid disclosing immaterial information. In response to a question about whether the staff's disclosure-related observations are inconsistent with its goal of reducing disclosure overload, the staff noted that its overall objective is to highlight how registrants can disclose material information more clearly and precisely, not add disclosures.

Detailed below are the SEC staff's specific observations, many of which are consistent with its comments to registrants over the past few years. However, in a manner reflecting its concerns about disclosure overload, the staff noted that a registrant should not feel compelled to disclose information unless it deems such information applicable and material.

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights* for a more detailed discussion about trends identified in the SEC staff's comment letters on these topics and many others.

Income Taxes

The SEC staff discussed registrants' income tax disclosures, primarily disclosures about (1) the reconciliation of statutory tax rates to effective tax rates (the "tax rate reconciliation"), (2) valuation allowances, and (3) registrants' assertions that foreign earnings are indefinitely reinvested.

[3] For the full titles of standards and other literature cited in this publication or links to them, see Appendix A.

The SEC staff noted the following issues with registrants' tax rate reconciliation disclosures:

- Labels related to reconciling items were unclear, and disclosures about material reconciling items did not adequately describe the underlying nature of these items.
- For material reconciling items related to foreign tax jurisdictions, registrants did not disclose in MD&A (1) each material foreign jurisdiction and its tax rate and (2) how each jurisdiction affects the amount in the tax rate reconciliation.
- Registrants have inappropriately aggregated material reconciling items. The SEC staff reminded registrants that Regulation S-X requires separate-line-item disclosure for reconciling items whose amount is greater than 5 percent of the amount calculated by multiplying the pretax income by the statutory tax rate.
- Amounts reflected in the tax rate reconciliation were inconsistent with related amounts disclosed elsewhere in a registrant's filing.
- Corrections of errors were inappropriately reflected as changes in estimates.

In remarks related to registrants' disclosures about valuation allowances on DTAs, the SEC staff discouraged registrants from providing "boilerplate disclosures" in the critical accounting estimates section of MD&A and instead recommended that they discuss registrant-specific factors (e.g., limitations on their ability to use net operating losses and foreign tax credits). The SEC staff also stated that it has asked registrants to disclose the impact of each source of taxable income on their ability to realize a DTA, including the relative magnitude of each source of taxable income. In addition, the staff recommended that registrants consider disclosing the material negative evidence they evaluated, since such disclosures could provide investors with information about uncertainties related to a registrant's ability to recover a DTA.

The SEC staff also reminded conference participants about the disclosures a registrant is required to provide when it asserts that foreign earnings are indefinitely reinvested. These disclosures include (1) the amount of the unrecognized deferred tax liability or (2) a statement that estimating an unrecognized tax liability is not practicable. In addition, the staff indicated that it evaluates such an assertion in taking into account registrants' potential liquidity needs and the availability of funds in U.S. and foreign jurisdictions.

Pensions and Other Postretirement Employee Benefits

The SEC staff indicated that this topic is receiving more attention because of factors such as the low-interest-rate environment, optionality in U.S. GAAP accounting methods, and significant assumptions used in accounting measurement of the liability. The staff noted that it particularly focuses on the discount rate and assumptions about the expected return on plan assets.

The SEC staff also indicated that it may be appropriate for a registrant to disclose the following:

- Whether the fair value or calculated value[4] of plan assets is used to determine the expected return and, if the calculated value is used, how this value is determined.
- Whether a corridor[5] is used to amortize the actuarial gains and losses; and, if so, how the corridor is determined. Also, the period for amortization of the actuarial gains and losses in excess of the corridor.
- A sensitivity analysis estimating the impact of a change in expected returns on income. This estimate should be based on a reasonable range of likely outcomes.

[4] ASC 715-30-20 defines the market-related value of plan assets as follows: "A balance used to calculate the expected return on plan assets. The market-related value of plan assets is either fair value **or a calculated value** that recognizes changes in fair value in a systematic and rational manner over not more than five years. Different ways of calculating market-related value may be used for different classes of assets" (emphasis added).

[5] See ASC 715-30-35-24 and ASC 715-60-35-29 for definitions and guidance.

- When disclosing the extent to which historical performance was used in developing the expected rate of return assumption, if use of the arithmetic mean to calculate the historical returns yields results that are materially different from the results yielded when the geometric mean is used to perform this calculation, it may be appropriate for an entity to disclose both calculations.
- The reasons why the expected return has changed or is expected to change in the future.
- The effect of plan asset contributions during the period on profit or loss, when this effect is significant. The SEC staff indicated that additional plan asset contributions reduce net pension costs even if actual asset returns are negative because the amount included in profit or loss is determined by using expected and not actual returns. They noted that such information can provide an understanding of unusual or nonrecurring items or other significant fluctuations so that investors can ascertain the likelihood of past performance being indicative of future performance.
- When the pension plan was funded with a noncash transaction (e.g., an entity's own stock), a description of how management funded the pension plan, with a reference to the associated cash flow statement line items.

The SEC staff discussed the difference between the definition of an asset and that of a business, reminding participants that the definition of a business in U.S. GAAP is different from that in Regulation S-X, Rule 3-05.

Business Combinations

The SEC staff discussed the difference between the definition of an asset and that of a business, reminding participants that the definition of a business in U.S. GAAP[6] is different from that in Regulation S-X, Rule 3-05. The SEC staff noted that registrants may encounter complexities in determining whether certain types of arrangements constitute a business. One complexity is whether a lease or other contractual arrangement is considered a process. With respect to this complexity, the staff suggested that registrants (1) use a market participant's viewpoint in applying the definition of a business,[7] (2) document the analysis contemporaneously with the transaction, and (3) consult with the OCA regarding complicated matters.

The SEC staff also remarked that it has seen measurement-period adjustments that should have been considered error corrections. The staff cited existing U.S. GAAP,[8] noting that all of the following criteria must be met for the adjustment to be considered a measurement-period adjustment:

- The acquirer obtained new information about facts and circumstances that existed at the time of the acquisition that, if known at that time, would have affected the amounts recognized.
- The registrant must have disclosed that the initial accounting for the assets and liabilities that were potentially subject to the business combination adjustment was incomplete.
- The measurement period is still in progress. The measurement period would be considered to have ended when the company obtained the additional information it desired or concluded that the additional information is unobtainable; this period would never last more than one year from the acquisition date.

Goodwill

The SEC staff noted that it may comment when a registrant observes significant indicators of impairment without recording a corresponding impairment charge. Examples of these indicators include adverse business changes or situations in which a registrant's book value exceeds its market capitalization.

6 As defined in ASC 805-10-20.

7 See ASC 805-10-55-8 for additional guidance.

8 See ASC 805-10-25-13 through 25-19, ASC 805-10-30-2 and 30-3, and ASC 805-30-35-1 for more information about measurement-period adjustments, including what qualifies as a measurement-period adjustment.

The staff further indicated that it continues to focus on goodwill-related disclosures in MD&A, particularly those required by Section 9510 of the FRM, which are intended to apprise investors of the risk of impairment associated with a registrant's reporting units. Such disclosures also inform readers about the quality of the fair value estimates and what factors and situations may cause these estimates to change.

Specifically, the SEC staff noted that registrants should avoid vague disclosures and should disclose, and appropriately contextualize, reporting units whose fair value is not significantly greater than their book value. Similarly, in the period of an impairment charge, registrants should avoid attributing the impairment to general factors such as "soft market conditions" or lower valuations of reporting units that resulted from expected reductions in price or volume. Instead, the disclosures should answer the following questions:

- Why did the charges occur?
- Why did the change in forecasts or results occur in the particular period of the impairment charge?
- What known developments or other doubts could affect the reporting unit's fair value estimate?

In addition, the SEC staff remarked that it would most likely comment when it is not clear what led a registrant to record a material amount of goodwill in a business combination. The staff noted that rather than disclosing generic reasons, registrants should detail the specific factors that led them to record goodwill. For example, if a registrant records goodwill because it expects synergies to occur as a result of the acquisition, it should disclose the specific synergies that it expects (e.g., improved purchasing power, reductions in duplicate facilities, or elimination of redundant staff positions). The goal of such disclosures is to inform investors of the reasons for the premium paid to acquire a business and management's future plans for that business.

Segments

Segment reporting remains a perennial topic of SEC staff focus and observation, particularly the aggregation of operating segments. The staff noted a situation in which "disparate" geographic locations were inappropriately combined because they were not economically similar. Registrants were reminded that (1) they need to consider all criteria and attributes in ASC 280 to support aggregation and (2) while they should consider future trends in drawing conclusions about the similarity of their operating segments, they should not ignore historical results. In addition, the SEC staff noted a recent enforcement action it brought against a Fortune 200 company because the registrant inappropriately aggregated and reported results from two businesses.

Issuers Based in China

The SEC staff discussed disclosures about risk factors that issuers with substantial operations based in China should consider, though similar disclosures could apply to issuers with operations in other jurisdictions. In many cases, these Chinese operations are controlled with contractual arrangements that convey power and economics such that consolidation by the registrant is appropriate under U.S. GAAP.

The staff noted that it would expect registrants to disclose the following risk factors related to these structures:

- A concentration of substantially all of the registrant's operations in China.
- The registrant's dependence on its contractual agreements with the VIE to consolidate the foreign operations. The SEC staff observed that registrants have been required to deconsolidate their foreign operations as a result of losing control over the VIE (e.g., contractual arrangements changing over time, expiration of the contracts, or through breach of the contracts).

- Uncertainty related to whether the Chinese government allows the use of such structures.
- Registrants may have only limited legal protection in China (e.g., China offers fewer legal remedies for breach of contract and violations by officers and directors than does the United States and lacks the safeguards that exist under U.S. regulatory regimes).
- Potential conflicts of interest between investors and the possibility that such conflicts could be resolved to the detriment of U.S. investors.
- Restrictions on cash transfers from these operations, which could limit the ability of registrants to use cash or subject them to significant penalties.

In addition, the SEC staff indicated that issuers should continue to provide the financial statement disclosures discussed at last year's conference. These focused on the terms of the arrangements, the key judgments related to the consolidation conclusion, and registrants' involvement with the entity.

Accounting for Virtual Goods in the Information Technologies and Services Industry

The SEC staff has asked registrants to enhance their disclosures about revenue recognition policies and critical estimates related to virtual goods. The staff noted that registrants that sell virtual goods should disclose (1) whether revenue is recognized on a gross or net basis and (2) the timing of revenue recognition. Registrants that recognize revenue over time should also disclose the assumptions and methods they used. Further, registrants should disclose the types of virtual goods sold. Some registrants categorize their virtual goods as "consumable" (i.e., those that have a predetermined life) or "durable." The staff noted that such registrants should describe how they differentiate between the two types of goods and how they account for each type.

Internet Sales in the Retail Industry

The SEC staff noted that registrants need to assess the materiality of Internet sales and provide MD&A disclosures about these sales if applicable. Further, the staff pointed out that registrants sometimes do not provide enough information about how Internet sales affect their strategies and financial results. The staff discussed an example in which some registrants had disclosed "growth" or "strong growth" in online sales or online presence even though Internet sales were not material to the company. The staff emphasized that it was important for registrants to consider materiality and to provide appropriate context in their disclosures.

Value of Tangible Assets Acquired in a Business Combination in the Utility Industry

The SEC staff described instances in which registrants disclosed that they are valuing tangible assets acquired in a business combination by using either regulatory or predecessor costs rather than fair value. The staff considers these disclosures confusing because U.S. GAAP requires the use of fair value for such valuations. It therefore asks registrants to explain how their recognition of these amounts complies with U.S. GAAP and to supply supplemental information on how they reached their conclusions about valuing their tangible assets.

Non-GAAP Financial Measures

The SEC staff noted that it continues to focus on disclosures of non-GAAP financial measures, particularly on whether registrants have (1) clearly labeled and described non-GAAP measures and adjustments, (2) used appropriate conventional accounting terminology, and (3) provided context for their presentation of non-GAAP measures.

The SEC staff noted that it continues to focus on disclosures of non-GAAP financial measures, particularly on whether registrants have (1) clearly labeled and described non-GAAP measures and adjustments, (2) used appropriate conventional accounting terminology, and (3) provided context for their presentation of non-GAAP measures.

To illustrate the importance of clear labeling of non-GAAP financial measures and adjustments, the staff gave an example of a situation frequently encountered in the mining industry in which a mining company presented a non-GAAP measure such as "Total Cash Cost per Ounce" for the principal mineral the company produces. In the production of that mineral, the company may identify by-products that generate revenue. The staff has noted that registrants sometimes calculate the non-GAAP measure by netting the revenue earned from the by-products with the production cost of the principal mineral. This may result in a non-GAAP measure that may be small relative to the gross production cost, or even negative, which could be confusing to investors. The staff emphasized that the SEC staff expects full disclosure of what the measure represents and clear labeling of the measure to highlight that the cash costs per ounce are actually after the reduction of by-product revenues. To provide additional transparency, registrants may use a "with or without" measure that adjusts for the by-product revenues. The staff further emphasized that when there are multiple by-products, registrants should present any related revenue separately, when material.

The SEC staff also indicated that in adjusting non-GAAP measures, registrants sometimes use conventional accounting terms differently from the way they are commonly understood by investors. Citing an example seen in the oil and gas industry, the staff noted that derivative gains and losses may be labeled in a way that suggests that the adjustments are calculated under GAAP even when they exclude net unrealized gains and losses. The SEC staff reminded registrants to stay true to the meaning of accounting terminology as defined in GAAP.

Editor's Note: As discussed in Deloitte's *SEC Comment Letters — Including Industry Insights*, some registrants may present non-GAAP financial measures, such as adjusted EBITDA, as well as adjustments (in the required reconciliation to the most directly comparable GAAP measure) for the effects of derivative transactions (e.g., excluding net unrealized gains/losses), which the SEC has indicated may not be in accordance with GAAP. Consequently, the SEC staff has asked registrants to present two separate reconciling items in the non-GAAP reconciliation for (1) total net gains or losses in accordance with U.S. GAAP (i.e., total net realized and unrealized gains/losses) and (2) net cash receipts or payments for derivatives settled during the period (i.e., net realized gains/losses).

The SEC staff indicated that if registrants provide non-GAAP pension-related adjustments, the staff will generally comment when (1) the disclosures are not clear and the pension-related adjustment (e.g., actuarial gains or losses) is not labeled; (2) an adjustment is labeled as a "non-cash" pension expense, because the pension liability will ultimately be settled in cash; and (3) context is not provided about adjustments related to actuarial gains and losses.

To clarify comments made at last year's conference regarding non-GAAP adjustments to remove actuarial gains and losses, the staff provided an example of a registrant that immediately recognizes its actuarial gains and losses. In the example, the adjustment in the non-GAAP measure includes the impact of changes in pension plan assumptions (e.g., changes in discount rate) as well as the difference between the actual return on plan assets and the expected return on plan assets. Because the adjusted non-GAAP measure will reflect only the expected return, which is always positive no matter how the market actually performs, investors might be confused. In these situations, the SEC staff has requested that registrants state that the non-GAAP measure reflects (1) an expected return on plan assets of X percent or $XX, (2) an actual return of Y percent or $YY, and (3) pension expense of $ZZ. Registrants that amortize actuarial gains and losses (rather than immediately recognize their actuarial gains and losses) should disclose similar information. That is, they should (1) quantify the expected return on plan assets reflected in the non-GAAP measure and (2) disclose the amount of pension expense reflected in the non-GAAP measure.

In closing, the staff reminded registrants to disclose how non-GAAP financial measures are useful to investors and how management uses those measures.

Stock-Based Compensation Disclosures in IPO Transactions

The SEC staff reiterated that it frequently comments on stock-based compensation disclosures related to IPO transactions. The staff noted that MD&A disclosures should clearly and precisely discuss the assumptions and methods registrants used to determine stock-based compensation. The staff also stated that such MD&A disclosures should focus on material items, including changes that occurred in the reporting period. Further, the staff indicated that if there is a substantial increase in the fair value of a registrant's stock over a short period (e.g., between the time when a registrant initially estimates its IPO stock price and a date that is around or as of the IPO date), the registrant should consider disclosing the cause of the increase because the staff is likely to ask about it.

Disclosure of Metrics

The staff noted that many registrants disclose metrics in MD&A and cited examples of such disclosures by registrants in the technology and retail industries. Metrics include monthly average users, average revenue per user, and stores opened and closed. Echoing recent remarks by Ms. White, the staff acknowledged that while metrics may be helpful for investors to understand a registrant's business (i.e., for a registrant to "tell its story"), registrants often present them without providing sufficient context or adequately linking them to revenues and profit. The staff stated that because metrics will differ among industries and even among registrants in the same industry, registrants should ensure that the metrics they use are clearly defined (e.g., by explaining what the metrics represent and how they were calculated). In addition to discussing why the metrics were chosen and how they are being used, registrants should disclose any inherent limitations in the metrics selected (e.g., whether the metrics were calculated on the basis of estimates).

The SEC staff also reminded registrants that if they discuss metrics in the forepart of their filings, they would be expected to "connect the dots" by also disclosing such metrics in MD&A. In addition, a registrant should clearly disclose how a metric affects its revenues and results regardless of whether the correlation is direct.

Internal Control Over Financial Reporting

In reviewing registrants' filings, the SEC staff looks for indicators of potential ICFR deficiencies. Common indicators include disclosures about changes in ICFR and corrections of errors.

If indicators are observed, the SEC staff routinely asks registrants about management's consideration of such indicators in relation to its conclusions about the effectiveness of ICFR (i.e., whether a material weakness should have been disclosed). The staff reminded registrants that they should disclose any material changes in ICFR (including those made to remediate material weaknesses) in the quarter of the change.

In addition, the SEC staff stated that registrants must disclose the internal control framework they applied in assessing the effectiveness of their ICFR. Because the COSO framework was updated in 2013 and provides for a transition period before the original framework is superseded, registrants should disclose whether they applied the 2013 or original framework.

Editor's Note: See Deloitte's June 10, 2013, *Heads Up* for an overview of the enhancements in the 2013 Framework, a discussion of considerations for entities that use the original framework in complying with Section 404 of the Sarbanes-Oxley Act of 2002, and information about making the transition from the original framework to the 2013 Framework, including impacts on other COSO-related documents.

Standard Setting and SAB Topic 11.M (SAB 74) Requirements

In light of the various proposed accounting standards that have been released — most significantly those issued as part of the FASB's and IASB's joint convergence projects — the SEC staff has received questions about (1) whether and, if so, how changes to SEC rules and regulations are expected; (2) the staff's expectations regarding SAB 74 disclosures; and (3) whether the staff will grant accommodations related to certain requirements under Regulation S-X or S-K, such as providing five years of summarized financial data in conjunction with retrospective adoption of accounting standards. The SEC staff indicated that it continues to work with the OCA staff to monitor standard-setting developments and that it will have more information after the standards are issued. In addition to recommending that registrants streamline disclosures to avoid disclosure overload, the SEC staff reminded registrants of its previous remarks encouraging them to limit SAB 74 disclosures to new accounting standards that will have a material impact on their financial statements.

The SEC staff indicated that it continues to work with the OCA staff to monitor standard-setting developments and that it will have more information after the standards are issued.

Observations Related to Foreign Private Issuers

Compliance With SEC Reporting Matters

As they did at last year's conference, Craig Olinger and Jill Davis shared their observations regarding how registrants that use IFRSs, as issued by the IASB, can comply with the SEC's reporting requirements.

They reiterated that (1) FPIs need to provide a statement of compliance with "IFRS as issued by the IASB" to be eligible to omit the U.S. GAAP reconciliation and (2) the going-concern language in a PCAOB auditors' report must contain the unconditional statement of "substantial doubt." See Deloitte's December 11, 2012, *Heads Up* for additional information.

Ms. Davis also reminded FPIs that if an entity's opening balance sheet is required by IFRSs, it must be audited. The entity must amend its periodic report to include an audit report that specifically addresses the opening balance sheet. Ms. Davis also addressed transition issues related to IFRS 11, which became effective in 2013. She cautioned that entities that were previously consolidated under the proportionate consolidation method may now be accounted for under the equity method, in which case a registrant may be required to include additional financial statements in its filings in accordance with Regulation S-X, Rule 3-09.

Mr. Olinger stated that FPIs reporting under IFRSs are not required to submit interactive data files (XBRL) with their 2013 filings because the SEC has not yet approved an IFRS XBRL taxonomy for use with the EDGAR system. He also stated that when an FPI that applies IFRSs files a registration statement after the occurrence of an event that requires retrospective application in the financial statements (e.g., a discontinued operation or adoption of a new accounting standard), the SEC allows dual-dating of the reissued financial statements even though IFRSs currently do not address this situation.[9]

Comment Letter Themes

Mr. Olinger noted that about 950 FPIs are registered with the SEC and that, over the past two years, the number of FPIs reporting under IFRSs has more than doubled (to about 500 companies). This is largely because companies in Canada and Latin America now file under IFRSs.

Ms. Davis indicated that the SEC staff's comments to FPIs have frequently addressed the following topics:[10]

- Presentation of financial statements. The majority of comments provided to FPIs concern whether they complied with basic IFRS disclosure requirements.
- Disclosures related to:
    - Income taxes.

[9] See the May 2013 *IFRIC Update*.

[10] These topics are nearly identical to those addressed at last year's conference. See Deloitte's December 11, 2012, *Heads Up* for more information.

- Provisions and contingent liabilities.
- Operating segments. In addition to reiterating last year's observations, Ms. Davis reminded FPIs that certain entity-wide disclosures also are required under IFRSs.

- Recognition and measurement related to:
  - Asset impairments.
  - Consolidation. In addition to reiterating some of the observations she outlined at last year's conference, Ms. Davis encouraged FPIs to clarify their rationale for consolidation conclusions.
  - Revenue recognition. In addition to reemphasizing last year's observations, Ms. Davis indicated that the SEC staff reviews an FPI's entire filing, as well as analyst and investor reports, to identify all revenue streams; therefore, FPIs should provide adequate disclosures (e.g., terms and details, recognition and measurement criteria, and accounting policies) about such revenue streams in their filings.

Cross-Border Transactions

Mr. Olinger and Ms. Davis joined other panelists to discuss financial reporting considerations related to cross-border transactions, which have become more common in recent years. In a typical transaction, a U.S. operating company and a foreign operating company combine to form a new operating company in a tax-advantaged jurisdiction to realize tax synergies. Companies may confront a number of challenges when entering into cross-border transactions, and they should try to identify potential financial reporting issues as early as possible. They also should consider whether a prefiling consultation with the SEC staff is advisable. Questions to consider include:

- How will the company report (e.g., as a domestic issuer or as an FPI)?
- If the new company is an FPI, will it report fully as an FPI (e.g., apply IFRSs and use foreign filer forms) or try to look more like a domestic issuer?
- Will the new company qualify as an FPI under SEC rules?
- Where will the combined entity be listed? Will it be single- or dual-listed?
- What GAAP or GAAS is appropriate for financial statements included in the filing?
- Who are the accounting acquirer and predecessor company?
- What are the pro forma requirements in each of the applicable jurisdictions? What kinds of adjustments are permitted or prohibited?
- What reporting periods must be included in the filing (the requirements to provide updated financial statements ("staleness" rules) vary from jurisdiction to jurisdiction; accordingly, it may be advisable to follow the requirements of the jurisdiction with the most stringent requirements)?
- What will the post-acquisition financial statements look like?
- What financial statements or financial statement schedules will be required in the registration statement (e.g., target company, acquiring company, equity method investee, recent acquiree)?
- What will be the MD&A and selected financial data requirements for the filing (e.g., the GAAP used by a predecessor entity may differ from that used by the new company)?
- What filings may be required after the transaction is consummated (e.g., a Form 8-K filing may be necessary)?

Other Observations

Real Estate Operations to Be Acquired

Regulation S-X, Rule 3-14, applies to the acquisition or probable acquisition of real estate operations. When a registrant acquires significant real estate operations, the registrant may be required to provide abbreviated financial statements for the underlying property. Cicely LaMothe highlighted the SEC staff's recent clarifications of Rule 3-14. In her discussion, Ms. LaMothe addressed (1) the scope of Rule 3-14 and the definition of real estate operations, (2) the use of pro forma information to calculate the significance of the real estate acquired, (3) how to perform the significance test in the aggregate for individually insignificant properties, (4) the significance test in the distribution period for blind pools, and (5) the net lease position. For more information, see Section 2300 of the FRM.

Guarantor Financial Information

Tricia Armelin gave some background on Regulation S-X, Rule 3-10. Under Rule 3-10, a registrant must provide full financial statements for each subsidiary issuer and guarantor of registered debt or preferred securities in its registration statements and periodic reports (e.g., a Form 10-K and Form 10-Q) unless relief is available. A registrant may be able to present more limited information in lieu of the full financial statements for each subsidiary if certain conditions are met. Ms. Armelin discussed one of the conditions that must be met for such relief: the guarantees must be "full and unconditional."

She referred to paragraph 2510.5 of the FRM, which indicates that a subsidiary whose guarantee is released automatically under one of the customary release provisions may still qualify for the relief provided by Rule 3-10. Ms. Armelin noted that registrants should not characterize a subsidiary guarantee with customary release provisions as full and unconditional without disclosing the circumstances under which it can be released. Ms. Armelin reminded registrants that although the staff has seen an improvement in these disclosures, the disclosures regarding the customary release provisions should be carried forward in periodic filings for as long as the debt is outstanding. Since the release provisions are material terms of the indenture agreement and significant to an investor's understanding of the guarantee, the disclosures should be included in registration statements as well as in subsequent periodic filings.

Editor's Note: For additional discussion of subsidiary release provisions, see Deloitte's *SEC Comment Letters — Including Industry Insights* and its December 11, 2012, *Heads Up*.

Waiver Requests

There may be situations in which registrants seek relief from complying with certain SEC reporting rules and regulations. For example, a registrant may seek relief from complying with Rule 3-05 under which the registrant must provide financial statements of an acquired business when the required significance test yielded a result that the registrant believes is unusual or anomalous. Mr. Olinger recognized that relief may be warranted in some cases and that registrants may seek to obtain a waiver from CF-OCA.

Ryan Milne provided best practices for registrants to consider when seeking reporting relief from the CF-OCA. He mentioned that the most efficient way to submit a waiver request is via e-mail at dcaoletters@sec.gov. Mr. Milne suggested that the waiver request include, at a minimum, the following:

- Background on registrant and the specific transaction.
- Clear identification of the issue and rules involved.
- Statement regarding the relief being sought and the reasons why it is needed.
- Analysis of why a result is anomalous and why the financial statements would not be material (e.g., under Rules 3-05 and 3-09).
- Description of proposed alternative disclosures.

Editor's Note: CF-OCA is a separate and distinct office from the OCA. For best practices for consulting with the OCA, see the guidance on the SEC's Web site.

Mr. Olinger also noted that registrants may be faced with complex reporting situations. While a waiver request may not be required, he encouraged registrants to submit a prefiling letter to the staff to resolve the complex issues before filing. This may help avoid significant changes to the document that may result from the SEC review process.

Mr. Milne noted that companies will generally receive a response to their waiver request (and often a conclusion about the subject of such request) within 10 days of receipt by the staff; however, the staff may sometimes respond by requesting additional information.

Other SEC-Related Matters

OCA Consultation Overview

Dan Murdock noted that the volume of prefiling consultations handled by the OCA's accounting group has decreased by 40 percent to its lowest level in seven years. Although he acknowledged that this decline could be attributable to the occurrence of fewer transactions in the marketplace or to the fact that few new accounting standards have been issued, Mr. Murdock was concerned that the decline could stem from a greater focus by registrants and their auditors on auditing issues at the expense of accounting issues. He reminded registrants and their auditors not to lose sight of accounting considerations and focus equally on accounting, auditing, and internal control considerations.

With regard to the accounting group's standard-setting activities, Mr. Murdock indicated that high-quality implementation of the anticipated revenue recognition standard will be of paramount importance and that the SEC staff will monitor the implementation efforts.

Role of Data Analysis in the Future of Financial Reporting

Division of Economic and Risk Analysis Accounting Quality Model

Craig Lewis discussed the SEC's AQM, which is a proprietary, automated tool that analyzes interactive data included in a registrant's filing and identifies anomalous deviations compared with the registrant's past financial results and peer group. The AQM "scores" the filing on the basis of identified "flags" or risk factors. Although the AQM is still in its developmental stage (i.e., "version 1.0"), Mr. Lewis envisions that staff from different SEC divisions will eventually be able to use this tool to (1) improve the efficiency and effectiveness of routine filing reviews, (2) identify filings that warrant more targeted reviews, and (3) support the SEC's enforcement efforts. He emphasized, however, that the AQM is merely a tool to assist the SEC staff and will not supplant staff judgment. Mr. Lewis also indicated that the AQM will continually evolve to incorporate the latest risk indicators.

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Interactive Data

An XBRL expert offered his view that the use of XBRL or other machine-readable, structured data can significantly improve financial reporting transparency and accountability. He noted that although the original goal of the SEC's XBRL mandate was to improve the usefulness of financial information by making it available sooner and more easily accessible, thus far this vision has not been achieved. This may be because the SEC and its staff have yet to convince preparers and investors that XBRL is a priority and that the benefits of XBRL outweigh its costs. He noted that a study reported that investors will have demand for machine-readable data if concerns about data accuracy can be overcome and investors can gain assurance that such data is consistent with information included in the HTML filings on EDGAR. This expert believes that the negative perceptions may be addressed if the SEC (1) enforces compliance with the interactive data rules, (2) expands its internal use of interactive data, (3) requires registrants to tag additional financial information (i.e., expands the scope of the interactive data requirements), and (4) simplifies the U.S. GAAP XBRL taxonomy.

Mr. Lewis also cited a number of benefits of interactive data and expressed his belief that such information will be used more broadly when additional years of data become available. He further acknowledged that the SEC must be cognizant of technological innovations, specifically noting that the SEC should seriously consider permitting registrants to use in-line XBRL (a technology that embeds XBRL tagging in a registrant's traditional HTML EDGAR filing). He also indicated that the SEC has approved an initiative to create a single, publicly accessible database of aggregated XBRL data, which will allow researchers, academics, and other stakeholders to more easily and efficiently analyze interactive data. Stage 1 of this database, which will incorporate interactive data for "core" financial statement elements, is expected to be released by the end of 2013 or in early 2014. Stage 2 will be released shortly thereafter and will incorporate the footnote elements. Such data will be aggregated "as filed" (i.e., the SEC staff will make no effort to fix the data or scrub it of errors).

Editor's Note: See Deloitte's September 19, 2013, *Heads Up* for a more detailed overview of the current state of interactive data and XBRL from both a regulatory and standard-setting perspective. The *Heads Up* also elaborates on implementation challenges, including concerns about data quality and compliance with the SEC's requirements, and provides insight into how financial statement users view interactive data.

Enforcement Initiatives

Division of Enforcement Update and Initiatives

Andrew Ceresney noted that the Division of Enforcement has seen a reduction in the number of investigations related to financial reporting and auditing violations in fiscal year 2012 when compared with fiscal years 2006 and 2007. He acknowledged that this decline could be attributable to the Sarbanes-Oxley Act and other reforms; however, he expressed his concern that it could stem from undetected audit violations. He emphasized the Division's renewed focus on financial reporting and audit violations and highlighted its creation of the Financial Reporting and Audit Task Force. He noted that the Division intends to carefully monitor compliance and focus on whether auditors (1) missed or ignored red flags, (2) had proper documentation, and (3) followed professional and auditing standards. He also pointed out that the recently established "Operation Broken Gate" initiative seeks to identify auditors who fail to comply with professional standards.

Mr. Ceresney noted that for public registrants, the Division is particularly interested in "bad faith" estimates that management makes about losses and reserves and "sham" revenue transactions (and auditors' procedures in testing such estimates). He also noted that the Division intends to identify violations related to (1) premature revenue recognition, (2) distortion of percentage of completion accounting, and (3) sales inflation schemes (e.g., billing for uncompleted products through a "prebooking" scheme).

David Woodcock noted that in addition to focusing on technical accounting fraud, the Division focuses on (1) non-GAAP measures, (2) omissions in MD&A, (3) ICFR, and (4) risky patterns and trends. For example, the Division might pay particular attention to an entity with considerable or multiple off-balance-sheet transactions or a demonstrated pattern of multiple financial reporting revisions (especially within a short period).

Mr. Woodcock discussed the sources that the Division uses to identify violations, including tips, complaints, and referrals, and the monitoring of private litigation and media and analyst reports. He noted that a program established under the Dodd-Frank Act allows the Division to incentivize whistleblowers to report frauds to the SEC and stated that the Division has received over 3,000 tips through the program (17 percent were attributable to financial statement disclosures).

In a separate panel discussion, Brian Croteau discussed a registrant's responsibility to maintain effective disclosure controls and procedures and directed registrants' management to (1) review the SEC's recent enforcement action that addressed a registrant's failure to maintain effective controls and (2) consider whether its own disclosure controls and procedures and ICFR processes and procedures could be improved in light of the issues raised in that order. He also indicated that the adequacy of such controls and management's evaluations and conclusions about them are likely to be a focus of future Enforcement Division investigations.

Implications of Alleged Foreign Corrupt Practices Act Violations and Other Illegal Acts

The FCPA unit (the "Unit") was formed three years ago as one of five specialized units in the SEC's Division of Enforcement to strengthen its enforcement of the FCPA. Because of the level of regulatory scrutiny associated with the FCPA, the SEC and the DOJ issued guidance to address compliance personnel's questions and concerns about it. This guidance addresses "hot-button" issues such as (1) what is a bribe, (2) who is a "foreign official," and (3) what is prohibited and permitted under the FCPA. It also describes hallmarks of a good compliance program.

Kara Brockmeyer emphasized that entities must maintain sufficient internal controls over compliance with the FCPA and ensure that such controls are operating effectively and cannot be circumvented. Ms. Brockmeyer noted that entities should pay particular attention to transactions involving gifts, travel and entertainment, and third-party intermediaries. Two-thirds of the Unit's cases have involved bribes paid through third-party intermediaries. Such cases have not solely involved traditional agents or business consultants but also distributors, joint venture or channel partners, and law firms. Ms. Brockmeyer emphasized the value of an effective anonymous internal reporting mechanism (i.e., a whistleblower program) because it allows management to identify potential issues early before they become significant problems. She also encouraged entities that discover issues to self-report to the government and fully cooperate with the staff. Further, she noted that for small, isolated violations that are self-reported and handled appropriately, the government may choose not to initiate an investigation or may ultimately close the investigation with no action.

Once an allegation is discovered, an entity should begin investigating the effectiveness of its internal controls immediately rather than wait for the government's findings. An entity should understand that a control failure related to compliance with the FCPA may have other financial reporting implications because the same internal controls (e.g., controls over petty cash or other cash disbursements) may address both FCPA and financial reporting (e.g., controls that prevent FCPA violations also may prevent embezzlement). Panelists also noted that there is no materiality threshold for FCPA violations; accordingly, such controls should be evaluated with greater scrutiny than would otherwise be warranted for an integrated financial statement audit under the requirements of the Sarbanes-Oxley Act. A company's evaluation of its internal controls should attempt to identify areas that are most vulnerable to potential FCPA violations.

The panel noted that when an FCPA violation has been alleged, the entity's independent auditor may "shadow" the investigation of the entity's outside counsel, forensic accountants, or other advisers as part of the auditor's response to the possible detection of the illegal act. The purpose of this shadowing is to determine whether (1) the investigation is being appropriately and thoroughly conducted by independent parties, (2) the conclusions reached are consistent with the facts collected, and (3) management's response is appropriate.

In certain settlement agreements, the SEC and DOJ may require an entity to use a corporate compliance monitor for a specified period to assist with its remediation efforts. Monitors are often required when (1) the entity's internal controls were significantly lacking, (2) the bribery or misconduct occurred at a high level in the company, or (3) the entity has started to remediate its internal control issues but has not completed implementation.

Conflict Minerals Reporting

During the panel discussion of the SEC's final rule on conflict minerals, panelists outlined certain implementation points for registrants to consider and highlighted aspects of the rule's audit requirement.

The purpose of an IPSA is to express an opinion or conclusion about (1) whether the design of the issuer's due diligence measures as set forth in the CMR, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer and (2) whether the issuer's description of the due diligence measures it performed as set forth in the CMR, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook.

As a panelist noted, the assertions are independent of each other. Furthermore, the auditor's responsibility does not extend to reaching a conclusion on (1) whether the due diligence measures undertaken were in accordance with the nationally or internationally recognized framework (e.g., OECD) or (2) the accuracy of the company's determination of whether conflict minerals are "DRC conflict-free" or "are not found to be DRC conflict-free." Consequently, because auditors are not responsible for auditing information in the CMR that is unrelated to the two objectives discussed above — including, for example, marketing and forward-looking information — panelists reminded registrants to carefully consider how much "other" information to include in the CMR and that any such information should be factually correct and understandable. They also suggested that "other" information could be disclosed separately from the due diligence measures undertaken that would be subject to an IPSA.

Editor's Note: For additional information about the conflict minerals rule, see Deloitte's September 11, 2012, *Heads Up* and the SEC's Conflict Minerals Frequently Asked Questions.

Audit Committees and Fees

Paul Beswick discussed the importance of considering audit quality in a company's decision about whether to hire or retain an auditor and expressed his hope that audit committees do not always choose the low-cost provider. He noted that focusing on audit quality is consistent with making sound business decisions and that the committee's decision should focus on which auditor will best protect the interests of the shareholders. He continued by cautioning registrants that "if the audit committee is solely fee hunting and if there was a subsequent audit failure, beyond the obvious problems for the auditor and the company, this may raise questions about the diligence of the members of the audit committee in fulfilling their responsibilities."

Broker-Dealer Considerations

Mr. Croteau also discussed recently finalized amendments to the financial responsibility requirements and financial reporting rules related to broker-dealers and the SEC's proposed rules for crowdfunding. He emphasized that (1) under the amendments, broker-dealers' auditors still must meet the SEC's independence requirements under Regulation S-X and therefore cannot both prepare and audit a broker-dealer's financial statements and (2) under the crowdfunding proposals, the SEC's independence rules would apply to auditors that either review or audit financial statements of companies that offer and sell securities through crowdfunding (when a review or audit is required).

In discussing independence violation investigations conducted by the Division, Mr. Ceresney clarified that although the SEC's independence rules typically apply to public companies, their application is not limited to public company audits. For example, auditors of broker-dealers are required to be independent from their clients.

Auditing and PCAOB Developments

Selected Speakers

- Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB
- Paul Beswick, Chief Accountant, SEC's Office of the Chief Accountant
- Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- James Doty, Chairman, PCAOB
- Robert Hirth, COSO Chairman
- Greg Jonas, Director of Research and Analysis, PCAOB
- Helen Munter, Director, Division of Registration and Inspections, PCAOB

PCAOB Chairman James Doty highlighted recent developments in what has been a busy year for the PCAOB and provided insights into what stakeholders can expect from the PCAOB in the future. Now in its 10th year of operation, the PCAOB has been closely examining how it serves the capital markets for the investing public. Accordingly, it has undertaken initiatives aimed at (1) dispelling the notion held by some that audits are irrelevant to investors and lenders and (2) raising awareness that audits are critical to the nation's economic success and investor confidence. The PCAOB has also increased its focus on outreach, particularly to audit committees.

Recent Developments

Mr. Doty and Helen Munter noted that the PCAOB reexamined its inspection and reporting process and made refinements that have resulted in more timely and informative inspection reports. Ms. Munter stated that the PCAOB focused on three priorities: (1) the timeliness and content of inspection reports; (2) analysis of inspection findings among firms and over time; and (3) remediation, including the timeliness of remediation determinations.

Ms. Munter explained that the PCAOB takes a risk-based approach to selecting audit engagements for inspection and also identifies high-risk areas on which PCAOB inspection teams should focus. The PCAOB reviewed its findings from this year's inspection cycle, the most common of which are related to (1) internal control, (2) management estimates, and (3) responses to risks of material misstatement. Ms. Munter remarked that although there continue to be problems related to audit quality throughout the profession, she believes that these problems are solvable. The PCAOB is working with the audit firms individually and broadly to identify problems and determine solutions. Ms. Munter also urged audit firms to communicate with the PCAOB early and often throughout their remediation efforts and noted that the PCAOB's remediation criteria are listed on its Web site.

The PCAOB continues to issue staff audit practice alerts to highlight new, emerging, or otherwise noteworthy developments that may affect how auditors conduct audits. The PCAOB will also continue to issue general reports on procedures, findings, and results related to its inspections. Martin Baumann noted two key releases this year: Staff Audit Practice Alert No. 11 and PCAOB Release 2013-011. Practice Alert No. 11 addresses the application of certain requirements of Auditing Standard No. 5 and other PCAOB standards related to audits of ICFR in which significant audit deficiencies have been observed. Mr. Baumann urged all auditors who perform audits of ICFR to read this practice alert.

Release 2013-011 indicates that while audit firms have generally incorporated the requirements of Auditing Standard No. 7 into their methodologies, such action has not always resulted in appropriately executed engagement quality reviews. An engagement quality reviewer's failure to identify a significant engagement deficiency (defined as failure to obtain sufficient appropriate audit evidence, an inappropriate overall audit conclusion, an inappropriate engagement report, or indications that the firm is not independent of its client) may cause markets to be misled about the integrity of the audit regardless of whether the financial statements are right or wrong.

Another important PCAOB development this year was its launch of the Center for Economic Analysis. Led by economist Luigi Zingales, the Center will study the role and relevance of the audit in capital formation and investor protection as well as advise the PCAOB on how the Board can make better use of economic theory, analysis, and tools to enhance its effectiveness in standard setting, inspections, and other oversight activities. The Center is expected to hire permanent staff and begin operations in early 2014. Also next year, the Center will host a conference on the role of the audit in the capital markets that features economic research by participating scholars on related topics.

Standard-Setting Update

Increasing the quality of audits through more effective standard setting remains a focus of the PCAOB. Mr. Baumann summarized the Board's current standard-setting activities. (See Deloitte's December 10, 2013, *Heads Up* for a table that outlines the PCAOB's recently completed, current, and upcoming standard-setting projects.)

Proposed Standards Related to the Auditor's Report

Two proposed auditing standards related to the auditor's reporting model were released in August 2013. Mr. Baumann noted that while investors value the audit, the audit report itself provides limited information to investors. There is a global movement to make meaningful changes to the standard auditor's report. Investors want to hear more from auditors about their work and findings.

To address investors' concerns, the proposals would require an auditor to report on (1) critical audit matters, (2) auditor independence, (3) auditor tenure, and (4) the auditor's responsibility for, and the results of, the auditor's evaluation of other information outside the financial statements. (For more information about these proposals, see Deloitte's September 5, 2013, *Heads Up*.)

Reproposed Standard on Transparency

Earlier this month, the PCAOB issued a reproposed standard[11] on auditor transparency that would require audit firms to disclose the name of the engagement partner as well as the names, locations, and extent of involvement (as a percentage of total audit hours) of other audit firms participating on the audit (that provided more than 5 percent of total audit hours). At the conference, Mr. Doty remarked that disclosure of the engagement partner's name will sharpen the mind of the auditors and remind them of their responsibilities to the public. He added that such disclosure will also provide meaningful information for audit committees to use and consider when assessing an engagement partner's qualifications and experience.

Mr. Baumann stated that he believes investors will collect data on the individual engagement partners as a data point similarly to the way they currently gather data on audit firms. For example, the data may help investors understand an engagement partner's previous association with other audits involving restatement of the financial statements. He added that information about other participating audit firms helps investors understand where and by whom the audit work was performed and is especially useful in identifying work performed in jurisdictions that do not allow PCAOB inspections.

Proposed Reorganization of PCAOB Audit Standards

The PCAOB has proposed a reorganization of its auditing standards to structure them more logically and to integrate the Board's interim standards with the standards issued since its inception. Mr. Doty expects the Board to finalize the reorganization in 2014. (For more information on this project, see Deloitte's April 9, 2013, *Heads Up*.)

Broker-Dealer Attestation Standards

On October 10, 2013, the PCAOB adopted two new attestation standards that apply to (1) examination engagements related to compliance reports of broker-dealers and (2) review engagements related to exemption reports of broker-dealers under Rule 17a-5 of the Exchange Act.

The same day, the PCAOB issued Auditing Standard No. 17, which requires auditors to perform certain audit procedures when reporting on supplemental information (e.g., supplemental information to be filed by broker-dealers under Rule 17a-5), including:

- "[Determining] that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable."

[11] Comments to the PCAOB on the reproposed standard are due by February 3, 2014.

- "[Testing] the completeness and accuracy of the supplemental information, to the extent that it was not tested as part of the audit of the financial statements."
- "[Evaluating] whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any."

These new standards are awaiting SEC approval. If the attestation standards are approved, they will be effective for examination and review engagements with fiscal years ending on or after June 1, 2014. If Auditing Standard No. 17 is approved, it will be effective for audit procedures and reports on supplemental information that accompanies financial statements with fiscal years ending on or after June 1, 2014.

Reproposed Standard on Related-Party Transactions

The PCAOB expects to issue in the first quarter of 2014 the reproposed auditing standard on related parties as part of a release that is expected to strengthen auditor performance in three critical areas: (1) relationships and transactions with related parties, (2) significant unusual transactions, and (3) financial relationships and transactions with executive officers. Aimed at reducing fraudulent activities, audit deficiencies, and inconsistent audit practices associated with related-party transactions, the reproposed standard introduces new procedures while maintaining and strengthening procedures already used by many auditors. Mr. Baumann expects the standard to take effect for audits of financial statements with fiscal years beginning on or after December 15, 2014. (For more information on this project, see Deloitte's June 21, 2013, *Heads Up*.)

Other Near-Term Standard-Setting Activities

Mr. Baumann also highlighted the following standard-setting activities, which the PCAOB will address in the near term:

- *Going concern* — The FASB has proposed a new standard related to the evaluation of going concern as part of management's financial reporting processes. The PCAOB's project to improve the requirements related to the auditor's responsibility to evaluate an entity's ability to continue as a going concern has been delayed until the FASB determines a timeline for revising its own proposed standard.
- *Auditors' responsibilities with respect to other accounting firms, individual accountants, and specialists* — This proposal is intended to improve planning, supervision, and communication, among other items, when other accounting firms, individual accountants, and specialists participate in an audit. The PCAOB will be addressing other auditors and specialists together in one standard because they require similar levels of supervision and review. The PCAOB expects to issue a proposed standard in the first quarter of 2014.
- *Auditing accounting estimates, including fair value measurements* — The PCAOB will propose a new standard on auditing accounting estimates, including fair value measurements, to replace a number of its interim auditing standards. The number and frequency of inspection findings related to this topic prompted the Board to undertake the project. The PCAOB expects to issue the proposal in late 2014.
- *Audit firm quality control system* — The PCAOB plans to issue a concept release seeking comments on how to address audit firm quality control issues. Mr. Baumann indicated that significant changes to the current quality control standards are needed given the deficiencies the PCAOB identified in its inspections and the time that has passed since the PCAOB adopted its interim quality control standards. He further noted that current quality control standards do not appropriately address various matters that are important to audit quality, including:
    - Tone at the top.
    - Risk assessment and response to risk.

- Accountability and supervisory activities by firm management.
- Professional skepticism.
- Alignment of individual incentives.
- Remediation and root-cause analyses.

Auditor Independence and Objectivity

Audit Committee and Management Independence Considerations

Brian Croteau emphasized the importance of auditor independence and stressed that management and audit committees are as responsible as auditors for ensuring such independence. In particular, Mr. Croteau noted that management and audit committees should establish processes and procedures that (1) ensure timely identification of the registrant's affiliates (for which the auditor must be independent) and (2) anticipate and plan for potential independence issues that may arise as a result of future auditor changes (e.g., ensuring that the registrant can find an independent auditor in a jurisdiction in which mandatory auditor rotation is required or maintaining a predecessor auditor's independence to obviate the need for a reaudit in case there is a need to restate the registrant's financial statements in the future).

Expansion of Firms' Consulting Services

Mr. Doty and Ms. Munter expressed concerns about the recent trend of audit firms to expand their nonaudit consulting services. The PCAOB plans to investigate the effect of this trend on audit quality and auditor independence. Issues to be studied include risks associated with the consulting service business lines and how they affect resource allocation and investment in audit, as well as the ability of firm management to meet the compensation and cultural challenges that such services present. The Board plans to hold roundtables in 2014 to explore these issues with firm leaders and other stakeholders.

Paul Beswick stressed the importance of quality and ethics in the audit profession. He expressed concern that audit firms' efforts to expand their consulting practices in recent years could undermine investors' perceptions of auditor independence. He emphasized prohibitions under the auditor independence rules against nonaudit services for audit clients and stated that independence concerns are not limited to the United States but are being raised across the globe.

ICFR and Other Audit-Related Matters

Internal Control Over Financial Reporting

Mr. Beswick discussed the importance of staying focused on ICFR, and he challenged management and auditors to think about what can be done "to ensure we don't find ourselves losing the ground we've gained over the last decade." Believing that COSO's updated framework will provide an opportunity to improve ICFR, and because the PCAOB is focusing on audits of ICFR as demonstrated by recent inspection findings and a recent audit practice alert, Mr. Croteau noted that the OCA will also "maintain or increase the intensity of our focus in this area."

Mr. Croteau remains convinced that "at least some of the PCAOB's inspection findings related to the audits of internal control over financial reporting are likely indicators of similar problems with management's evaluations of ICFR, and thus potentially also indicative of risk for unidentified material weaknesses." He also questioned whether all material weaknesses are being properly identified and noted that only in rare instances did management identify a material weakness in the absence of a material misstatement. He attributed this to the following possibilities: (1) the deficiencies are not being identified in the first place or (2) the severity of deficiencies is not being evaluated appropriately. Mr. Croteau mentioned that the OCA plans to work with the SEC's Division of Corporation Finance, the PCAOB, and the SEC's Division of Enforcement to address this matter in 2014.

Mr. Croteau remains convinced that "at least some of the PCAOB's inspection findings related to the audits of internal control over financial reporting are likely indicators of similar problems with management's evaluations of ICFR, and thus potentially also indicative of risk for unidentified material weaknesses."

Editor's Note: Mr. Croteau reminded management to compare the SEC's 2007 interpretive guidance to management's ICFR evaluation process to assess whether improvements are in order. He also noted that the interpretive guidance describes a way in which management can conduct its evaluation, and that SEC rules provide a safe harbor for the adequacy of evaluations conducted pursuant to the interpretive guidance. Furthermore, in addressing perceptions that auditors and the PCAOB have higher expectations than management regarding the adequacy of entity-level controls or the severity of control deficiencies, Mr. Croteau indicated that the SEC and PCAOB worked closely together to ensure that the interpretive guidance and Auditing Standard No. 5 were fully aligned. He also noted that the SEC staff has "not received any consultations that suggest otherwise."

Ms. Munter noted that more inspection findings are related to ICFR than any other topic and findings were concentrated in the area of testing of controls. She indicated that the following continue to cause auditors to struggle:

- Management review-type controls, which often are not precise enough to detect a material misstatement. Ms. Munter also noted that obtaining a sufficient understanding of these controls, and executing an audit that appropriately addresses all the risks identified, generally requires more than reading minutes or inspecting a sign-off.
- Identifying and sufficiently testing controls. Ms. Munter also noted that even if an effective control is in place, it can be overlooked by the auditor, and she stressed the importance of performing an appropriate risk assessment.

Editor's Note: See Staff Audit Practice Alert No. 11 for a discussion of the application of certain requirements of Auditing Standard 5 and other PCAOB standards to specific aspects of audits of ICFR.

The Revised COSO Framework

Robert Hirth and other panelists discussed COSO's 2013 Framework. They provided an overview of the revision process and enhanced framework, company preparation, and transition from the original framework to the 2013 Framework.

Editor's Note: For more information on the 2013 Framework, see Deloitte's June 10, 2013, *Heads Up*.

The panelists suggested that companies educate themselves about the 2013 Framework and conduct a preliminary assessment by mapping their controls to the 17 principles in the 2013 Framework, taking into account the Framework's "points of focus." They noted that this mapping exercise will not only support management's assertion under SEC regulations but may also reveal "gaps" in design, particularly those associated with the "softer" components of ICFR (i.e., control environment, risk assessment, information, and communication and monitoring) and opportunities to redesign or remove controls to enhance effectiveness and efficiency. Furthermore, the panelists suggested that management meet regularly with its auditors to get their perspectives on management's strategy for making the transition to the 2013 Framework, including the need for additional documentation, and to understand any changes the auditors might need to make in their audit procedures.

The panelists also noted that the potential impact of the 2013 Framework will vary depending on how closely a company's interpretation of the original framework reflects the 17 principles. They anticipate that the transition should not result in significant changes for companies that have appropriately applied the original framework to each of the five components of ICFR. The transition for other companies, however, might result in additional documentation, changes in controls, and the identification of deficiencies that require attention and remediation.

Although COSO does not have authority as a standard setter, the panelists encouraged companies to begin their transition of applications and related documentation to the 2013 Framework as soon as feasible, and they noted that during the transition period, external reporting should disclose whether the original or 2013 Framework was used.

Editor's Note: The highlights of the September 25, 2013, CAQ Regulations Committee joint meeting with the SEC staff noted that "the longer issuers continue to use the [original] framework, the more likely they are to receive questions from the staff about whether the issuer's use of the [original] framework satisfies the SEC's requirement to use a suitable, recognized framework," especially after the December 15, 2014, transition date.

Audit Quality Indicator Project

Greg Jonas provided background and an update on the AQI project. Mr. Jonas explained that the purpose of the AQI project is to learn how the PCAOB can develop a portfolio of quantitative measures to identify audit quality and accumulate and provide information to the public in a way that promotes audit quality. Mr. Jonas indicated that AQIs are expected to lead to improved dialogue between auditors and investors and promote competition among auditors on the basis of the quality of their audits.

In early 2014, the PCAOB expects to issue a concept release that will include a list of 20 to 30 potential AQIs. Examples of these AQIs include:

- Ratio of partners to staff.
- Staff utilization.
- Results of audit committee surveys.

The Board plans to narrow this list to 15 AQIs on the basis of comments received on the concept release and the results of field testing. Mr. Jonas explained that the concept release will most likely consist of three parts:

- Objectives and background.
- Definition, framework, and top AQI metrics.
- Potential use of metrics.

He indicated that the next steps are to continue soliciting feedback and to develop models for testing the selected AQIs.

For more information about this project, see Deloitte's June 25, 2013, and December 10, 2013, *Heads Up* newsletters.

Accounting and Financial Reporting Developments

Selected Speakers

- Paul Beswick, Chief Accountant, SEC's Office of the Chief Accountant
- Susan Cosper, Technical Director and EITF Chairman, FASB
- Russell Golden, Chairman, FASB
- Hans Hoogervorst, Chairman, IASB
- Richard Paul, Chairman, FinREC
- Amy Pawlicki, Director — Business Reporting, Assurance & Advisory Services, AICPA
- Alan Teixeira, Senior Director — Technical Activities, IASB

FASB and IASB Chair Remarks

IASB Continues Call for the United States to Adopt IFRSs

IASB Chairman Hans Hoogervorst called on the United States to act in "enlightened self-interest" by incorporating IFRSs into the U.S. financial reporting system. He observed that enlightened self-interest drove the SEC's support of the IASB's work after the financial crisis in Asia and declared his hope that the same enlightened self-interest would lead the United States to adopt IFRSs, although he acknowledged that such adoption might not happen quickly.

Mr. Hoogervorst also discussed the progress made by the IASB in 2013 to address certain concerns raised in the SEC's July 13, 2012, final report on its work plan on the potential incorporation of IFRSs. First, he noted that the IASB created the Accounting Standards Advisory Forum to increase cooperation among national standard setters, including the FASB. Second, he addressed what he described as "scary estimates about the cost of transition to IFRS for US issuers" in the SEC's final report. Specifically, as a potential proxy for U.S. transition costs, he cited a survey conducted by the Financial Executives Institute in Canada that found that 62 percent of Canadian companies surveyed spent less than 500,000 Canadian dollars to make the transition from Canadian GAAP to IFRSs, while larger companies with more than 1 billion Canadian dollars in revenue incurred less than .01 percent of revenues for such transition work. Third, he refuted the notion that there is uncertainty about the extent of IFRS adoption globally. He cited findings by former IASB Board Member Paul Pacter that (1) 122 countries have made a public commitment to IFRSs as a global set of accounting standards and (2) more than 100 countries have adopted IFRSs. Finally, he described an agreement between the IASB and the International Organization of Securities Commissions (of which the SEC is a member) that is intended to encourage consistent application and enforcement of IFRSs globally.

Editor's Note: Paul Beswick stated during a Q&A session that the SEC staff continues to evaluate its IFRS work plan; however, its focus has been on its rule-making responsibilities with regard to the Dodd-Frank and JOBS Acts.

FASB Focused on Improvements in Standard Setting

FASB Chairman Russell Golden discussed efforts that are either currently under way or that will be implemented soon to (1) improve FASB agenda setting, (2) complete certain foundational FASB projects, (3) promote transparency in financial reporting under U.S. GAAP, and (4) reduce complexity in U.S. GAAP.

Mr. Golden observed that since certain convergence projects will be concluded in the near future (e.g., revenue recognition, leases, accounting for financial instruments), the FASB will need to carefully set its standard-setting agenda by balancing major, long-term projects with more targeted projects that address specific stakeholder issues. Long-term projects may be foundational, such as the FASB's projects to update and improve its conceptual framework and to complete a disclosure framework. Short-term projects intended to promote transparency in U.S. GAAP financial reporting in the near term may include the accounting for pensions and for government grants. The FASB has already conducted some preagenda research related to both topics.

In an effort to reduce complexity, the FASB is evaluating existing standards that are either difficult to interpret or costly and time-consuming to apply. For example, some consider the accounting for liabilities and equity as well as the guidance on hedge accounting difficult to interpret because minor changes in the terms of an instrument could result in significantly different outcomes. The accounting for goodwill, on the other hand, may be easy to understand but costly and time-consuming to apply because many preparers (1) engage third parties to prepare accounting analyses and fair value measurements, (2) spend significant time with auditors to work through the analyses and measurements, and (3) disclose substantial amounts of related information. Mr. Golden observed that the FASB has made some progress to simplify the guidance on these topics. He also observed that current standard-setting projects, such as the revenue recognition project, are intended to reduce the number of models and sources of authoritative guidance by replacing such guidance with a single, principles-based model. He also noted that the FASB has developed an internal policy to publicly discuss the staff's analysis of a standard's complexity before issuing a ballot draft. Finally, Mr. Golden described efforts to create detailed implementation guidance and educational materials to aid (1) preparers in applying existing and new guidance and (2) users in analyzing financial statements. He noted that the FASB has created a transition resource group to develop educational and implementation guidance on the revenue recognition standard expected early next year.

Editor's Note: In response to constituent concerns, the FASB and IASB staffs stated that after the final standard is issued, the boards will establish the JTRG comprising 10 to 15 specialists, including financial statement preparers and users, auditors, regulators, and other stakeholders. The JTRG will be responsible for ensuring a smooth transition to the new standard by (1) soliciting, analyzing, and discussing issues related to common transactions that could reasonably give rise to diversity in practice and (2) helping the boards determine what actions will be needed to ensure that the new standard is applied consistently. The boards hope that by establishing the JTRG shortly after issuing the new standard, they can resolve implementation issues quickly to help preparers reduce the cost and complexity of transition.

Mr. Beswick remarked on improvements to the FASB's standard-setting progress, particularly its (1) increased focus on outreach to investors to understand what information would be useful to them and how they use it and (2) improved research and agenda-setting process. He also supported the FASB's efforts to reduce unnecessary complexity in current standards. He echoed investor frustrations that certain accounting standards are overly complex and do not facilitate a better understanding of the financial statements and recommended that in certain instances the FASB focus on making targeted improvements rather than improving entire standards.

Accounting Standard-Setting Developments

Standard-Setting Update

Susan Cosper and Alan Teixeira outlined the FASB's and IASB's progress on their convergence projects related to revenue recognition, leases, financial instruments, and insurance contracts. They summarized the history of the projects and the feedback received from the boards' constituents. They also noted milestones remaining as well as expected publication dates of final standards. In addition, Ms. Cosper discussed the status of other select FASB-only projects, including going concern, consolidation, repurchase agreements, and private-company accounting, while Mr. Teixeira discussed the status of the IASB's conceptual framework and disclosure framework projects. The table below outlines expected publication dates of final standards for the joint convergence projects.

Project	Expected Issuance Date of Final Standard
Revenue Recognition	First quarter of 2014
Leases	2014
Financial Instruments — Classification and Measurement	First half of 2014
Financial Instruments — Impairment	2014
Insurance	2015

During a Q&A session, Ms. Cosper indicated that the FASB is considering simplifying the current guidance on debt and equity accounting (and may develop flowcharts) but did not specify when the Board would undertake these efforts.

Editor's Note: For more information about the boards' projects, see the relevant project pages on Deloitte's US GAAP Plus Web site.

Revenue Recognition Nears Finalization

In a panel discussion about the new revenue standard expected to be issued by the FASB during the first quarter of 2014, panelists outlined key features of the forthcoming guidance, offered insight into certain expected changes, and discussed implementation considerations related to adopting the new standard. Topics discussed include the following:

- *Implementation considerations related to long-term contracts* — Panelists discussed potential challenges in applying the new standard retrospectively to long-term contracts that have been modified multiple times.

- *Accounting considerations for contract manufacturers and suppliers of customized products* — Panelists pointed out that the new guidance may dramatically change how contract manufacturers, suppliers of customized products, and similar manufacturers recognize revenue related to contracts with customers. Since many of these entities' arrangements could meet the new standard's criteria for recognizing revenue over time, revenue from such arrangements would no longer be recognized as the goods are delivered. Specifically, panelists noted that if an entity's obligation to produce a customized product meets the criteria specified in the new standard, revenue related to that product would be recognized (and inventory would be relieved to cost of goods sold) when the product is produced, not when the product is delivered to the customer. Accordingly, entities that maintain finished customer goods or have significant work in process would be required to recognize revenue and the related cost of goods much earlier under the new standard than they do currently.

- *Measuring progress toward complete satisfaction of a performance obligation* — The panel noted that many entities that currently measure progress toward completion of a performance obligation by using the units-of-delivery method under ASC 605-35 may instead use an input measure (such as costs) upon adopting the new standard, primarily to recognize contract costs and the related revenues simultaneously.

Panelists indicated that entities should consider whether appropriate systems, processes, and internal controls are in place to track, gather, and analyze the data they will need to meet the requirements of the new standard.

In addition, the panelists indicated that entities should consider whether appropriate systems, processes, and internal controls are in place to track, gather, and analyze the data they will need to meet the requirements of the new standard. Panelists also suggested that entities consider educating management, investors, and other stakeholders about the impact the new standard is likely to have on both financial statements and the significant metrics used to evaluate performance.

Post-Implementation Reviews

Ms. Cosper discussed the PIR process that has been implemented by the FASB[12] and IASB. The PIR is designed to help the boards (1) determine whether a standard is accomplishing its intended purpose, (2) evaluate implementation and compliance costs and benefits, and (3) improve the standard-setting process. Though the FASB's PIR team reviews standards independently, it discusses findings and conclusions with the Board to determine whether additional standard setting is needed.

Ms. Cosper outlined the FASB's PIRs and compared them with those of the IASB. She noted that since its establishment, the PIR team has completed reviews of a number of standards,[13] including:

- FASB Statement No. 141(R), *Business Combinations*.[14]
- FASB Statement No. 131, *Disclosure About Segments of an Enterprise and Related Information*.[15]
- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*.
- FASB Statement No. 109, *Accounting for Income Taxes*.

In addition, Ms. Cosper mentioned that the team is currently working on the PIR of FASB Statement No. 157, *Fair Value Measurements*.

[12] The Financial Accounting Foundation (FAF) introduced the PIR process to support the FAF Board of Trustees in its ongoing efforts to evaluate the effectiveness of the standard-setting process for both the FASB and the GASB.

[13] The standards have been superseded and codified in the *FASB Accounting Standards Codification*.

[14] The IASB is currently working on this subject.

[15] The IASB has also completed its review on this subject.

Feedback received during the PIR of Statement 141(R) focused on (1) high implementation costs, particularly related to fair value measurement; (2) valuation of intangible assets; and (3) the definition of a business. While some of these issues are being addressed as part of the Statement 157 PIR, the definition of a business was added to the FASB's agenda as a new project. However, to ensure that the boards' standards remain substantially converged, the FASB has temporarily delayed this project until the IASB completes its PIR.

During the PIR of Statement 131, the team received feedback from users and preparers about certain issues and difficulties related to segment reporting. The team noted that Statement 131 has been effective for about 15 years and that technology has evolved. Traditional paper CODM packages have been replaced with software programs that allow CODMs to quickly navigate information. The PIR team therefore identified the need to clarify the CODM's use of emerging technologies. In addition, the PIR revealed the need for more guidance on the aggregation of similar operating segments and segment disclosure requirements. The feedback received by the IASB during its review of IFRS 8 differed from that received by the FASB on Statement 131, primarily because of the standards' different issuance dates.

Ms. Cosper concluded by noting that the FASB and IASB are not likely to amend the core principles underlying these standards but will consider adding more implementation guidance.

Other Accounting and Reporting Topics

AICPA's Financial Reporting Executive Committee

FinREC Chairman Richard Paul indicated that the FinREC publishes nonauthoritative financial reporting guidance, including audit and accounting guides, topical accounting and valuation guides, technical practice aids, and other publications. In addition, FinREC participates in FASB and IASB standard setting through the comment letter process.

Mr. Paul described three topical accounting and valuation guides that FinREC updated or issued in 2013: (1) *Testing Goodwill for Impairment*, (2) *Assets Acquired to Be Used in Research and Development Activities*, and (3) *Valuation of Privately-Held Company Equity Securities Issued as Compensation*. Moreover, Mr. Paul noted that FinREC and the AICPA are working on three new guides related to business combinations, fair value measurements of portfolio company investments by investment companies such as venture capital and private equity firms, and revenue recognition.

Current Accounting Practice Issues

The panel on current accounting practice issues discussed four accounting topics that registrants have found challenging: (1) revenue recognition, (2) business combinations/goodwill, (3) income taxes, and (4) debt and equity accounting.

Revenue Recognition

Panelists discussed (1) complexities related to determining the best estimate of selling price (particularly whether a registrant can use a range as the best estimate of selling price) under the guidance on multiple-element arrangements in ASC 605-25, (2) challenges that entities in certain industries (e.g., Internet-based and service entities) encounter in applying the gross-versus-net revenue guidance, and (3) ways to enhance revenue-related accounting policy disclosures.

Some of the panelists' recommendations for improving revenue recognition disclosures included:

- Disclose the entity's revenue recognition policy for each type of revenue source.
- Clearly indicate the specific events or actions that trigger revenue recognition (i.e., avoid "boilerplate" language).

- Disclose relevant information about significant uncertainties related to revenue recognition (e.g., rights of return, variable consideration).
- For multiple-element arrangements, clearly disclose the different types of deliverables, how the transaction price is allocated, and how the entity determines the appropriate unit of account.

Business Combinations/Goodwill

Discussion focused on a registrant's need to (1) obtain a preferability letter when changing the date used to test goodwill for impairment and (2) consider the key inputs that affect the fair value of a reporting unit (and any changes in those inputs) when performing "step zero" of the goodwill impairment analysis (see ASC 350-20-35-3A through 35-3G).

Income Taxes

Panelists discussed (1) the determination of the appropriate presentation for tax credits, tax subsidies, and other taxes in the statement of comprehensive income; (2) weighting the different types of evidence required to support the recognition (or derecognition) of a valuation allowance against a DTA commensurate with the extent to which the evidence can be objectively verified; and (3) the importance of establishing internal controls to identify changes in tax rules and recent tax court rulings.

Debt and Equity Accounting

Topics covered included (1) how to apply the debt and equity accounting guidance to noncontrolling interests with put options and (2) items to consider in determining the appropriate accounting for the modification of an equity instrument (e.g., the modification of a warrant).

International Integrated Reporting Council

Amy Pawlicki indicated that the IIRC is a worldwide group of regulators, investors, companies, standard setters, the accounting profession, and nongovernmental organizations that believe future reporting should include more aspects of business value creation. Such information can be communicated through an integrated report that incorporates input from all relevant organizational functions and uses a market-driven conceptual framework to describe factors that create value (e.g., social and human capital) as well as traditional concepts like financial capital.

In addition, Ms. Pawlicki described concepts related to, and feedback received on, the IIRC's April 2013 consultation draft, which resulted in the release of the final International <IR> Framework on December 9, 2013.

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Appendix A: Glossary of Topics, Standards, and Regulations

The standards and literature below were cited or linked to in this publication.

FASB Literature

For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

See the FASB's Web site for the titles of citations to:

- Accounting Standards Updates.
- Proposed Accounting Standards Updates.
- Pre-Codification literature (Statements, Staff Positions, EITF Issues and Topics).
- Concepts Statements.

SEC Literature

- Staff Accounting Bulletin (SAB):
  - Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant" (SAB 74)
- Regulation S-X:
  - Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"
  - Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
  - Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"
  - Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired"
  - Rule 11-01, "Presentation Requirements"
- Interpretive Release:
  - 33-8810, "Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934"
- Forms:
  - Form 8-K — Current Reports (Item 2.01)
  - Form 10-K — General Form of Annual Report
  - Form 10-Q — Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
- Division of Corporation Finance's Financial Reporting Manual (FRM):
  - Topic 2, "Other Financial Statements Required"
  - Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"
- Securities Exchange Act of 1934 Rules:
  - Rule 17a-5, "Broker-Dealer Reports"

PCAOB Literature

- Staff Audit Practice Alert:
  - No. 11, *Considerations for Audits of Internal Control Over Financial Reporting*
- Releases:
  - 2013-005, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; the Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report; and Related Amendments to PCAOB Standards*
  - 2013-007, S*tandards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards*

- 2013-009, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit*
- 2013-011, *Observations Related to the Implementation of the Auditing Standard on Engagement Quality Review*

- Auditing Standards:
  - No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*
  - No. 7, *Engagement Quality Review*
  - No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards*

International Standards

See Deloitte's IAS*Plus* Web site for the titles of citations to:

- International Financial Reporting Standards
- International Accounting Standards
- IFRIC Interpretations

Appendix B: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
AQI	audit quality indicator
AQM	accounting quality model
ASC	FASB Accounting Standards Codification
CAQ	Center for Audit Quality (affiliated with the AICPA)
CF-OCA	SEC's Division of Corporation Finance, Office of the Chief Accountant
CMR	conflict minerals report
CODM	chief operating decision maker
COSO	Committee of Sponsoring Organizations of the Treadway Commission
COSO's 2013 Framework	COSO's *Internal Control — Integrated Framework* (originally issued in 1992 and updated in 2013)
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
DOJ	Department of Justice
DRC	Democratic Republic of the Congo
DTA	deferred tax asset
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EITF	FASB's Emerging Issues Task Force
Exchange Act	Securities Exchange Act of 1934
FAF	Financial Accounting Foundation
FASB	Financial Accounting Standards Board
FCPA	Foreign Corrupt Practices Act
FinREC	AICPA's Financial Reporting Executive Committee
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
GASB	Governmental Accounting Standards Board
HTML	HyperText Markup Language
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard

IIRC	International Integrated Reporting Council
IPO	initial public offering
IPSA	independent private-sector audit
JOBS Act	Jumpstart Our Business Startups Act
JTRG	Joint Transition Resource Group
MD&A	Management's Discussion and Analysis
OCA	Office of the Chief Accountant, SEC
OECD	Organisation for Economic Co-operation and Development
PCAOB	Public Company Accounting Oversight Board
PIR	post-implementation review
Q&A	question and answer
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

Appendix C: Selected Sessions and Speakers

The table below lists sessions and information about speakers on selected topics at the conference. The full text of conference speeches that are publicly available can be viewed by clicking the speaker's name.

Sessions/Speakers	Sessions/Speakers
AICPA Welcome Address • William Balhoff, Chairman, AICPA **Center for Audit Quality Update** • Cynthia Fornelli, Executive Director, CAQ **Keynote Address — SEC** • Hon. David M. Walker, Former U.S. Comptroller General **Remarks of the SEC Chief Accountant** • Paul Beswick, Chief Accountant, SEC's Office of the Chief Accountant **OCA Policy Initiatives** • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Dan Murdock, Deputy Chief Accountant, SEC's Office of the Chief Accountant **Remarks of the Director and Chief Accountant of the Division of Corporation Finance** • Keith Higgins, Director, SEC's Division of Corporation Finance • Mark Kronforst, Chief Accountant, SEC's Division of Corporation Finance **Keynote Address — PCAOB** • James Doty, Chairman, PCAOB **MD&A Panel** • Pratt Bhatt, SVP, Corporate Controller & CAO, Cisco Systems • Brian Lane, Partner, Gibson Dunn & Crutcher LLP **Current Practice Issues** • Douglas Barton, Partner, Deloitte LLP • Adam Brown, Partner, BDO USA LLP • Paul Kepple, Partner, PwC LLP • Scott Taub, Managing Director, Financial Reporting Advisors **End of Day Q&A** • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Jay Hanson, Board Member, PCAOB • Dan Murdock, Deputy Chief Accountant, SEC's Office of the Chief Accountant	**Developments in the Division of Corporation Finance** • Tricia Armelin, Associate Chief Accountant, SEC's Division of Corporation Finance • Kathy Collins, Senior Accountant, Disclosure Standards Office, SEC's Division of Corporation Finance • Cicely LaMothe, Senior Assistant Chief Accountant, Office of Real Estate and Commodities, SEC's Division of Corporation Finance • Ryan Milne, Associate Chief Accountant, SEC's Division of Corporation Finance • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance • Nili Shah, Deputy Chief Accountant, SEC's Division of Corporation Finance **FASB and IASB Chair Addresses** • Russell Golden, Chairman, FASB • Hans Hoogervorst, Chairman, IASB **FASB and IASB Accounting Standard-Setting Update** • Susan Cosper, Technical Director and EITF Chairman, FASB • Alan Teixeira, Senior Director — Technical Activities, IASB **Role of Data Analysis in the Future of Financial Reporting** • Dr. Craig M. Lewis, SEC's Chief Economist and Director, SEC's Division of Economic and Risk Analysis • Mike Starr, Director of Strategic Initiatives, WebFilings **PCAOB Auditing Standard-Setting Update** • Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB • Greg Jonas, Director of Research and Analysis, PCAOB **SEC Enforcement Division Update** • Andrew Ceresney, Co-Director, SEC's Division of Enforcement • David Woodcock, Enforcement Regional Director, SEC's Division of Enforcement **End of Day Q&A** • Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB • Susan Cosper, Technical Director and EITF Chairman, FASB • Todd Hardiman, Associate Chief Accountant, SEC's Division of Corporation Finance • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance **Cross-Border Transactions and International Reporting Matters** • Alexander Cohen, Partner, Latham and Watkins LLP • Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance • Paul Munter, Partner, KPMG LLP • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance

Sessions/Speakers	Sessions/Speakers
Implementing the New COSO Internal Controls Integrated Framework • Bob Hirth, COSO Chairman • Bill Schneider, Director of Accounting, AT&T • Stephen Soske, Partner, PwC LLP **AICPA's Update on Financial Reporting Initiatives** • Richard Paul, Chairman, FinREC and Partner, Deloitte & Touche LLP • Amy Pawlicki, Director — Business Reporting, Assurance & Advisory Services, AICPA **Revenue Recognition Implementation** • Christopher Bolash, Partner, Ernst & Young LLP • Stacy Harrington, Director — Revenue Assurance, Microsoft • Russell Hodge, Global Controller, General Electric Company	**PCAOB Registration, Inspection, and Enforcement Updates** • Claudius Modesti, Director, Division of Enforcement and Investigations, PCAOB • Helen Munter, Director, Division of Registration and Inspections, PCAOB **Implications of Alleged FCPA Violations and Other Illegal Acts** • Kara Novaco Brockmeyer, Chief, SEC's Foreign Corrupt Practices Act Unit • William Henderson, Partner, Ernst & Young LLP • Julia Symon, Director of Compliance, KBR Inc. **Getting Ready for Conflict Minerals Reporting** • Charles Harris, Partner, PwC LLP • Jim Low, Partner, KPMG LLP • John Ruebush, Director, Procurement Sustainability & Conflict Minerals Program, Johnson & Johnson

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- Quarterly Accounting Roundup: An Update on Important Developments (December 19, 2 p.m. (EST)).

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In addition, be sure to visit US GAAP Plus, our new free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and updates to the *FASB Accounting Standards Codification*™ as well as developments of other U.S. and international standard setters and regulators, such as the PCAOB, the AICPA, the SEC, the IASB, and the IFRS Interpretations Committee. Check it out today!