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Heads Up

In This Issue:

- Executive Summary
- Management's and Auditors' Shared Responsibilities
- Audit Committee Disclosures
- Accounting and Financial Reporting Topics
- SEC Reporting Topics
- Accounting Standard Setting
- Auditing Developments
- Appendix A: Glossary of Standards and Regulations
- Appendix B: Abbreviations
- Appendix C: Selected Speakers

To our clients, our colleagues, and our other friends, we wish each of you a joyous and peaceful holiday season and a happy new year.

Baby, Disclose Outside

Highlights of the 2015 AICPA Conference on Current SEC and PCAOB Developments

by Deloitte & Touche LLP's National Office

Executive Summary

Against the backdrop of the headline-grabbing U.S. presidential race, financial statement regulators, preparers, and auditors converged on the nation's capital and epicenter of American politics to discuss topics that are highly unlikely to be the subjects of any election debate. Nevertheless, last week's three-day conference generated its own brand of accountant and auditor energy, inspired in part by the #AuditorProud social media blitz[1] that was spearheaded by the CAQ[2] and mentioned in conference remarks by the CAQ's Executive Director Cynthia Fornelli.

Continuing the historical theme of this annual event, the 2015 conference featured insights on current accounting, reporting, and auditing practice issues from numerous speakers and discussion panels with the common goal of improving the U.S. financial reporting system. Likewise, enhancing transparency and improving ICFR were again key topics because of the critical role they play in protecting investors. Several speakers[3] and panelists addressed these themes in the context of (1) ensuring that registrants' disclosures are useful, (2) providing high-quality financial information, (3) executing high-quality audits, and (4) developing new accounting standards that reduce complexity and increase transparency.

Disclosure Effectiveness

Disclosure effectiveness and its connection to high-quality financial reporting were at center stage throughout the event. Speakers focused on improving disclosure requirements, with the goal of enhancing the information provided to investors and promoting efficiency, competition, and capital formation. The SEC reiterated its continued focus on disclosure effectiveness, including its outreach to the investor community, its ongoing collaboration with the FASB, its recent release requesting public comment on certain disclosure requirements of Regulation S-X, an

[1] See the CAQ's press release on the media blitz.
[2] Abbreviations used in this publication are defined in Appendix B.
[3] For a list of speeches that were publicly available as of the date of this publication, see Appendix C.

expected release seeking feedback on certain aspects of Regulation S-K, and other near-term initiatives. An overarching theme of various discussions was the notion that disclosure effectiveness is a journey that many preparers can embark on today in advance of any formal standard setting and rulemaking. Representatives from the preparer, auditor, legal, and regulatory communities emphasized that effective disclosures do not necessarily mean *fewer* disclosures as much as they mean *better* disclosures. See discussion below for more information.

Internal Control Over Financial Reporting

As discussed in more detail below, ICFR continues to be a key focus for regulators, preparers, and auditors. SEC Chief Accountant James Schnurr stated that "[m]anagement's ability to fulfill its financial reporting responsibilities depends, in large part, on the design and effectiveness of internal control over financial reporting." Several speakers commented that the frequency of ICFR-related findings in PCAOB inspections highlights the need for management, auditors, and audit committees to work together to address potential underlying issues with controls and assessments.

International Financial Reporting Standards

The SEC's consideration of the potential incorporation of IFRSs into the U.S. financial reporting system has long been a topic at the conference, and this year was no exception. At the 2014 conference, Mr. Schnurr introduced a potential fourth alternative[4] regarding the use of IFRSs in the United States that would allow U.S.-based filers to voluntarily provide supplemental IFRS-based information without reconciliation to U.S. GAAP. In his remarks before the 2015 conference, Mr. Schnurr indicated that the OCA is likely to recommend that the SEC consider and commence rulemaking that is consistent with this fourth alternative.

Further, in their respective remarks, both SEC Chair Mary Jo White and Mr. Schnurr reemphasized the importance of continued FASB and IASB collaboration on standard-setting projects in an effort to improve the quality of financial reporting. These comments were echoed by IASB Chairman Hans Hoogervorst who, in a call for renewed commitment to ongoing collaboration and convergence, asked participants to "stay engaged [with the IASB] and help us in continuing to build our Standards in the future."

Audit Committees

Chair White and Mr. Schnurr each expressed concerns about the expanding and changing role of the audit committee. They observed that the roles and responsibilities now frequently imposed on audit committees in addition to their core SEC-required duties may interfere with their primary responsibility of overseeing the company's financial reporting. Chair White stated that the "increasing workload may dilute an audit committee's ability to focus on . . . selecting and overseeing the independent auditors; internal controls and auditing; setting up an appropriate system for the receipt and treatment of complaints about accounting; and reporting to shareholders."

In discussing audit committee reporting requirements, Mr. Schnurr recapped the SEC staff's efforts over the past year to address "(a) whether investors are interested in hearing from audit committees on *how* (not just *if*) they have fulfilled their responsibilities; and (b) whether the Commission's rules support such reporting." As part of these efforts, the Commission issued a concept release in July 2015 to seek feedback on the proposed changes to the reporting requirements as well as on additional disclosures investors may want. OCA Deputy Chief Accountant Brian Croteau discussed the comments received on the concept release, which generally indicated support for evaluating whether the current requirements could be improved. Commenters also noted that a principles-based disclosure framework would

[4] Before Mr. Schnurr's 2014 speech, alternatives under consideration by the SEC regarding the use of IFRSs in the United States included (1) adopting IFRSs outright, (2) giving U.S. registrants the option of filing IFRS financial statements, and (3) using the so-called "condorsement" approach.

give registrants the flexibility to tailor disclosures as well as potentially eliminate boilerplate disclosure language. The SEC staff is currently evaluating all comment letters received on the concept release and will determine whether to make any recommendations to the Commission.

The SEC staff also indicated that many comments in response to the concept release were about voluntary disclosure trends related to audit committee oversight of the external auditor. Audit committees' voluntary disclosure practices were also highlighted by Ms. Fornelli, who indicated that the CAQ and Audit Analytics recently released the second edition of their *Audit Committee Transparency Barometer*. The publication notes that there has been a substantial increase in the number of S&P 500 companies that are disclosing information related to key areas of external auditor oversight. See Audit Committee Disclosures below for more information.

Non-GAAP Measures

While no new rules on non-GAAP measures have been issued and none are expected at this time, such measures were still a key discussion topic at this year's conference (see discussion below). In her remarks, Chair White expressed concern that the prevalent use of non-GAAP measures in financial reporting may be a source of potential confusion for investors. She believes that close attention should be paid to this topic to ensure that the current rules are being followed. In addition, the staff in the SEC's Division of Corporation Finance (the "Division") reiterated that it continues to focus on the use of non-GAAP measures in determining whether such use complies with the disclosure requirements of Regulation S-K, Item 10(e). The Division staff highlighted that it is therefore focusing on whether non-GAAP measures should be given no greater prominence than GAAP measures and on whether the labeling of adjustments between the two measures is clear. Further, the staff noted that if the non-GAAP measures used in financial reporting for the current period are different from those used in prior period(s), registrants should provide effective disclosures that permit comparability with the prior periods.

Management's and Auditors' Shared Responsibilities

Internal Control Over Financial Reporting

In her keynote address, Chair White emphasized that management's ability to meet its financial responsibilities depends significantly on its ICFR, indicating that "it is hard to think of an area more important than ICFR to our shared mission of providing high-quality financial information that investors can rely on." Chair White also acknowledged that while stakeholders may face questions and challenges in the operation and assessment of ICFR, "at the end of the day, ICFR must remain the strong bulwark of reliable financial reporting that it has become."

When discussing various technical topics at the conference, the SEC staff often referred to ICFR and further emphasized that it is important for management and auditors to keep ICFR top of mind. The resounding theme of the ICFR discussions throughout the conference was the importance of early and frequent communication among management, auditors, and audit committees.

Mr. Schnurr and Mr. Croteau underscored the messages delivered by Chair White on the importance of ICFR, noting that both management's assessments and the auditor's attestation related to ICFR are critical to investor protection. They noted that some of the recent PCAOB inspection findings related to ICFR may not solely rest on audit execution but may indicate underlying issues involving management controls and assessments. There is, however, a positive trend of improvement: an increase in reporting of material weaknesses when a material misstatement has not been identified. Despite this positive trend, Mr. Croteau reminded auditors and management that before the severity of a control deficiency is assessed, it is important to properly identify and describe the nature of the deficiency in the context of the complete population of transactions that the control addresses. He noted that when the severity of the deficiency is evaluated, consideration of the likelihood and magnitude of the misstatement is important; this analysis often rests on the "could factor" aspect of the evaluation, which frequently requires management to look at additional information that is not otherwise part of the control.

Mr. Croteau also addressed the importance of ICFR in the context of implementing or redesigning controls, which may be necessary in the application of new accounting standards and policies. He noted that management's success in making the transition to new accounting standards often stems from effective design and operation of ICFR.

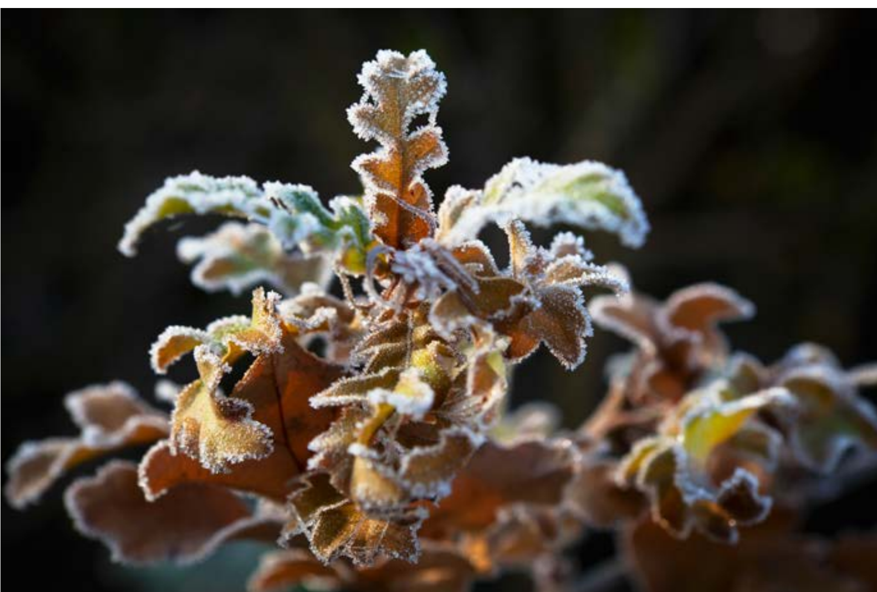
Subsequently, at a session on current topics related to the assessment of ICFR, panelists discussed how management review controls still pose a challenge, particularly in the context of determining whether a management review control is sufficient to operate and be tested at an appropriate level of precision or whether the sufficiency of the management review control depends on other lower-level controls. In addition to noting that it is critical for both the auditor and management to understand the flows of transactions (both lower-level controls and management review controls), the panelists stressed the importance of early and frequent communication among management, auditors, and audit committees.

Editor's Note: During a Q&A session, the OCA staff fielded a question similar to one it addressed at last year's conference about COSO's *Internal Control — Integrated Framework* (the "2013 Framework") and the continued use of that framework's predecessor (the "1992 Framework"). The OCA staff reiterated that although it will not necessarily object to the use of the 1992 Framework, companies over time may be asked by the SEC staff and investors to explain why they would use an outdated framework that is no longer supported by its authors.

For more information about the 2013 Framework, see Deloitte's September 5, 2014, and June 10, 2013, *Heads Up* newsletters.

Auditor Independence

In a manner consistent with their remarks at last year's conference, the PCAOB and OCA staffs stressed the importance of auditor independence. PCAOB Chairman James Doty noted that "[i]ndependence is the rock on which the audit profession takes its stand." Mr. Croteau added that it is important for the auditor to be independent in fact and in appearance. He reminded participants about the need to evaluate the permissibility of services against the four principles in the SEC's preliminary note to Regulation S-X, Rule 2-01,[5] as well as the need for management and the audit committee to monitor nonaudit services to avoid "scope creep." Scope creep can occur during the delivery of otherwise permissible nonaudit services when engagement activities deviate from the intended scope and thus become impermissible, impairing auditor independence. The SEC staff also reminded auditors of broker-dealers registered with the SEC that they cannot both prepare and audit the broker-dealer's financial statements but emphasized that this "prohibition" on bookkeeping and financial statement preparation is not intended to discourage two-way communication between the auditor and preparers. The staff highlighted that such communication may be a useful way for preparers to provide guidance on challenging topics, including the implementation of new accounting standards.



[5] The preliminary note states, in part, "The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in § 210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: creates a mutual or conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or an employee of the audit client; or places the accountant in a position of being an advocate for the audit client."

Audit Committee Disclosures

Mr. Croteau provided an update on the responses received related to the SEC's Concept Release, *Possible Revisions to Audit Committee Disclosures*, issued in July 2015. By the close of the comment period (September 2015), the SEC had received approximately 100 comment letters from a variety of respondents, many of which expressed support for considering whether and (if so) how to improve audit committee disclosures. A number of supporters encouraged consideration of principles-based requirements that would give audit committees the flexibility to tailor disclosures to their unique facts and circumstances, which would help avoid the common pitfall of boilerplate reporting. In addition, some respondents observed that instead of adding disclosure requirements, introducing voluntary disclosures may be a sufficient means of increasing transparency into *how* audit committees perform their responsibilities. Mr. Croteau noted that while the practice of voluntary disclosure has increased in certain areas, it is not common to all listed companies, and some commenters observed that the current increase in voluntary disclosure may merely be a response to the SEC's current interest in the topic. Pending further action by the SEC, audit committee members are encouraged to consider the usefulness of existing disclosures and whether additional insight into how the audit committee executes its responsibilities would make the disclosures more meaningful.

Editor's Note: While their comments were not directly related to the Concept Release, both Chair White and Mr. Schnurr expressed concerns about the additional demands being placed on some audit committees. Increased workloads that may result from leveraging the audit committee members' skills and knowledge in areas of major risk may also dilute an audit committee's ability to focus on its core SEC-required duties. Chair White counseled that "[c]ompanies and directors should carefully choose who serves on their audit committee, selecting only those who have the time, commitment, and experience to do the job well," while Mr. Schnurr suggested that a "back to basics" approach to the audit committee oversight responsibilities may be appropriate.

See Deloitte's July 15, 2015, *Heads Up* for more information about the steps the SEC and PCAOB have taken toward enhancing audit committee and auditor disclosures.

Accounting and Financial Reporting Topics

Revenue Recognition

Observations on the New Revenue Recognition Standard

SEC Deputy Chief Accountant Wesley Bricker highlighted the importance of the revenue metric to investors and suggested that a successful implementation of the new revenue standard is critical for the financial reporting system. He shared some recent survey results suggesting, however, that implementation efforts are lagging (i.e., a significant majority of responding companies had not completed their initial impact assessment and, of those, a third had not begun at all). In addition, informal polling results at the conference indicated that the majority of respondents were either still educating themselves on the standard or still performing their initial assessment, while a minority had completed their initial assessment or were making process and system changes necessary to implement the standard. Implementation of the new revenue standard was a common theme throughout the conference, and the following issues were discussed:

- Management's implementation efforts.
- Implementation resources available to preparers.
- Transition methods and timing of adoption.
- Other SEC implementation considerations.

Management's Implementation Efforts

OCA Professional Accounting Fellow Ashley Wright noted that all companies should expect some degree of change to their accounting, processes, controls, judgments, and disclosures as a result of implementing the new revenue standard. In light of this, Ms. Wright suggested that companies take a fresh look at their accounting policies and practices and to have candid discussions with their audit committees, executive management, and auditors about the status of implementation plans and impact assessments. A change-management project plan, including an assessment of resources needed to execute that plan, should be a priority of company management and audit committees.

During a panel discussion on revenue, panelists noted that the change-management project plan should include assessing the effects of the standard and developing policies and systems to facilitate its implementation. It was also suggested that companies consider the best leadership for the implementation efforts. One panelist observed that the source of such leadership may not be the person with the most technical knowledge of the standard; rather, it may be someone who can coordinate all key functions of the company (e.g., tax, human resources, contracting, sales, investor relations, and treasury in addition to technical accounting, external reporting, and internal audit).

Finally, while a company's auditors should be involved in the implementation efforts, the OCA staff cautioned that independence rules should be considered and that management should ensure that auditors are not acting in the place of management or auditing their own work.

Implementation Resources Available to Preparers

The OCA staff reiterated that it is focused on consistent application of the guidance to similar fact patterns both within and across industries. Companies should compare their application of the standard with that of other companies, and the appropriate implementation resources should be made aware of differences. The primary resource is the TRG, and Mr. Bricker expressed support for its continuation and highlighted the benefit it provides in fostering comparability between registrants that file under U.S. GAAP and foreign private issuers that file under IFRSs. Since its creation, the TRG has provided a

public forum for transparent discussion and education related to the new standard and has addressed more than 50 implementation questions. The 16 AICPA industry task forces also address implementation questions and will publish interpretive guidance that can be used as a resource to promote consistency among preparers. Companies can also contact the OCA for help in addressing implementation questions.

For more information about the TRG, see Deloitte's *TRG Snapshot* newsletters.

Transition Methods and Timing of Adoption

ASC 606 gives entities the option of using either a full retrospective transition method or a modified-retrospective transition method. Informal polling during the conference indicated that the majority of preparers were still undecided about their transition method and that those who had initially leaned toward one method were now split relatively evenly between the two. Panelists during the revenue session noted that in determining a transition method, companies should confer with key stakeholders and gain an understanding of the methods used by peer companies. Further, they should consider the impact of adopting the new standard since the greater the differences between a company's legacy accounting and the new accounting, the more the company may want to consider using the full retrospective transition method (see also SEC Reporting Considerations Related to the New Revenue Standard). Panelists also noted that early adoption may be difficult given the current status of implementation efforts, continued diversity in application, and the continued issuance of clarifying guidance by the FASB and IASB. However, companies should consider completing their implementation efforts in a timely manner to at least give themselves the option of early adopting.

Other SEC Implementation Considerations

During the Q&A session with panelists, Mr. Bricker reiterated that as companies perform assessments and develop their accounting policies under ASC 606, they may become aware of alternative views regarding their historical accounting under ASC 605. Mr. Bricker indicated that the OCA's focus regarding the transition to the new revenue standard is on narrowing diversity in practice going forward rather than addressing it under existing revenue standards. In addition, with respect to interpretations under U.S. GAAP and IFRSs, Mr. Bricker indicated that the SEC staff's interpretations will be the same on matters for which the standards are written the same or on matters for which the wording differs but the boards expect similar outcomes. When the wording differs under U.S. GAAP and IFRSs and the boards expected different outcomes, the SEC staff will respect those differences.

Customer Payments and Incentives

OCA Professional Accounting Fellow Christopher Semesky highlighted the guidance in ASC 605-50 on customer payments and incentives. Specifically, Mr. Semesky acknowledged the increase in intermediaries in the technology sector and, in particular, situations in which payments are made by a vendor to a party outside the distribution chain. He discussed an instance in which the staff consulted with a vendor that provided a technology platform to its direct customers to facilitate those customers' provision of revenue-generating services. In that situation, the OCA staff did not object to classifying payments made to a customer of the vendor's direct customer as an expense because the direct customer did not pass along the services associated with the vendor's technology platform to its own customer. Mr. Semesky noted that in reaching its conclusion, the staff carefully considered whether (1) "the vendor was in substance granting a broad pricing concession to its customers," (2) "there was a contractual requirement to pass along consideration to a direct customer's customer," and (3) "the vendor was acting as an agent of its customer in passing through consideration to a direct customer's customer." Finally, Mr. Semesky made it clear that while a registrant needs to use reasonable judgment when evaluating whether payments made to a customer's customer should be accounted for as a reduction of revenue or

expense, "clear disclosure of a registrant's presentation policy, assumptions and alternatives [is] critical to the decision usefulness of the financial reporting."

Consolidation

Evaluating Whether a Decision Maker's Fee Is a Variable Interest

Mr. Semesky discussed considerations associated with the determination of whether a decision maker's fee is a variable interest under the new consolidation guidance in ASU 2015-02. Under that guidance, a fee arrangement is not a variable interest if it meets all of the following criteria:

- The fees are commensurate with the level of effort required to perform the services provided ("commensurate").
- The arrangement only includes terms, conditions, or amounts that are customarily present in arrangements for similar services performed at arm's length ("at market" or "customary").
- The decision maker does not hold other interests in the VIE that would absorb more than an insignificant amount of the VIE's expected losses or residual returns ("other interests").

See Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for more information about the new consolidation guidance in ASU 2015-02, including a discussion of consolidation-related comments made by the SEC staff at the conference.

The OCA staff made the following observations related to these criteria:

- *Commensurate and at market* — A qualitative analysis of a fee arrangement will often result in evidence that supports a conclusion that the fees are commensurate with the level of effort used to supply the related services if the fee agreement was negotiated at arm's-length. However, in the analysis of whether the fee arrangement is at market or customary, the arm's-length fee arrangement alone will not be sufficient evidence; the decision maker would need to benchmark the arrangement to those of other market participants or other arrangements entered into by the decision maker.

  See Section 4.4.1 of Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for more information.

- *Other interests* — The guidance is clear that in determining whether the other-interests criterion has been satisfied, reporting entities should include in their evaluation indirect determining interests held **through** related parties that are under common control with the decision maker as if such indirect interests were held directly by the decision maker in their entirety. However, views have been mixed regarding situations in which the decision maker does not have a direct interest in the related party under common control. Mr. Semesky clarified that in these situations, an interest held by a related party under common control would not be included in the decision maker's other-interests criterion analysis **unless** the controlling party in the common control group designed a legal entity structure in a manner such that the related party under common control holds the interest (instead of having the decision maker hold the interest directly) in an effort to avoid consolidation.

  See Section 4.4.2.3.2 of Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for more information.

Risk Retention Structures

OCA Professional Accounting Fellow Christopher Rickli observed that the OCA staff has recently received questions about structures established in connection with the risk retention rules finalized in October 2014 as a result of mandates under the Dodd-Frank Act. Mr. Rickli commented on a scenario in which the staff did not object to a reporting entity's conclusion that a collateralized management vehicle (CMV) that it established was a voting interest entity because of substantive equity ownership held by the equity investors. Mr. Rickli emphasized that entities should not analogize to this accounting conclusion for other CMV structures without carefully considering their specific facts and circumstances. He also observed that the staff's conclusions were limited to the registrant's GAAP analysis and did not extend to the legal question of whether the CMV would qualify as a legal sponsor of securitization transactions. Mr. Rickli encouraged registrants to consult with their primary regulator if they have questions about sponsorship determination.

See Section E.2.7 of Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for further information.

Considerations as a Result of Foreign Exchange Restrictions

The OCA staff discussed foreign subsidiaries of registrants operating in jurisdictions with foreign currency exchange or government restrictions, particularly when those restrictions are so severe that they cast doubt on registrants' ability to control the foreign subsidiaries. Specifically, Mr. Semesky discussed the lack of currency exchangeability in, and other government restrictions related to, registrants' foreign operations in Venezuela.

In commenting on these situations, Mr. Semesky noted that deconsolidation of a foreign subsidiary may be appropriate if the foreign exchange or government restrictions are so severe that the registrant lacks control of the subsidiary. He indicated, however, if the equity investors have lost control of the subsidiary, registrants should carefully consider whether the foreign subsidiary is a VIE, emphasizing that in such circumstances, a registrant would need to consider ongoing disclosure of its variable interests, if any, in the foreign VIE in accordance with the disclosure requirements of ASC 810. In addition, Mr. Semesky cautioned that registrants would need to have internal controls to monitor changes in the facts and circumstances of the foreign exchange restrictions and government-imposed controls to determine whether a registrant has regained control and, thus, should reconsolidate the foreign subsidiary.

See Section D.3.2 of Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for further information.

International Series Funds

In a Q&A session, Wesley Bricker was asked whether the SEC would be providing implementation guidance on the application of ASU 2015-02 for non–1940 Act series funds. Mr. Bricker acknowledged that many questions have been raised about how an international series fund would apply the consolidation guidance in ASU 2015-02. He explained that a key issue is determining whether the series fund is sufficiently distinct and therefore a separate legal entity. In addition, Mr. Bricker clarified that, in his view, there is no prescriptive guidance on determining whether an entity is a legal entity and that such a determination must be made on the basis of judgment.

See Section 3.2.1 of Deloitte's *Consolidation — A Roadmap to Identifying a Controlling Financial Interest* for further information.

Leases Project

The FASB's project on lease accounting was highlighted in a separate panel discussion at this year's conference because of the significant forthcoming changes in lease accounting under both U.S. GAAP and IFRSs. Final standards are expected to be issued in January 2016 after many years of deliberations by both the FASB and IASB and are expected to be effective in 2019 for calendar-year public reporting entities. In addition, various speakers throughout the conference referred to the upcoming lease standards and highlighted that the boards have accomplished their primary joint objective of bringing most leases onto the balance sheet of the lessee. At the same time, it was acknowledged that certain guidance in the final standards will remain diverged, most notably on lessee income statement presentation, for which the FASB will provide a dual model while the IASB will treat all leases as financings.

The leases panel, which included a FASB practice fellow in addition to an auditor and a preparer, discussed the key provisions of the upcoming standard and made constituents aware of expected changes since the latest exposure draft (issued in 2013). Panelists acknowledged that entities will often be required to use judgment when applying the final standard, as they are required to do under the current guidance. In particular, they highlighted judgments involved in the assessment of a lease's term (which will affect whether the lease meets the short-term exemption and therefore qualifies for off-balance-sheet treatment). It was also noted that the definition of a lease is changing under the new guidance, and while there is a general expectation that leases today will still be leases tomorrow, this may not always be the case. The distinction between leases and services, which becomes more critical under the new guidance, was also emphasized. On the other hand, the panelists acknowledged that many aspects of lease accounting will remain largely unchanged from current U.S. GAAP, including income statement impact and cash flow statement presentation, many concepts in the lessor accounting model, and lease classification considerations. Panelists further discussed implementation, operational, and auditing implications that preparers and auditors should consider as companies adopt the new standard.

Because of its importance, the leases project was also discussed by a number of conference speakers, including FASB Chairman Russell Golden. Mr. Golden emphasized the Board's extensive analysis of the expected costs and benefits of the new standard, indicating that the results of the analysis confirmed the need for changes to improve the financial reporting of lease transactions. He noted that the FASB expects implementation costs to be mitigated by the Board's decision to maintain certain aspects of current U.S. GAAP, such as lease classification, since preparers will be able to leverage existing systems and processes. In addition, Mr. Golden reported that the Board is not planning to establish a TRG for leasing given the extensive input received over the course of the project. However, he noted that the Board will carefully monitor discussions with stakeholders during implementation and will expand education efforts if deemed necessary.

Acknowledging recent opposition to the upcoming lease accounting standard, Mr. Golden also addressed the standard's potential economic impact and behavioral effects, stressing that standard setting should reflect, not direct, economic activity and behavior. He emphasized that the FASB's objective is always to develop a neutral model that faithfully presents the financial condition and results of a company so that users of financial statements are provided with the best possible information. Mr. Golden noted that the FASB does not establish economic policy and acknowledged that the issuance of the new standard may have both positive and negative economic consequences.

Stay tuned for our *Heads Up* publication that will be issued shortly after the issuance of the FASB's final standard.

Discontinued Operations

OCA Associate Chief Accountant Barry Kanczuker noted that entities will need to use judgment when applying the new discontinued operations guidance in ASU 2014-08 on determining when a component or group of components that has been disposed of or classified as held for sale represents a "strategic shift that has (or will have) a major effect on an entity's operations and financial results." In considering how an entity should determine what constitutes a financial result, Mr. Kanczuker observed that certain "primary" metrics, such as revenue, total assets, and net income, are prominently presented in the financial statements and communicated to investors. However, he also noted that an entity may have to exercise judgment to identify other financial results when performing an evaluation of major effect, "with an eye toward what is relevant from an investor's perspective." Mr. Kanczuker indicated that it may be helpful to understand alternative measures since certain operating metrics may also be relevant, particularly when the company has consistently used those measures to communicate operating and financial results. Further, he observed that "it is prudent to consider the effect of [a] relevant financial metric on the entity from the perspective of current, historical and forecasted results."

Segment Reporting

OCA Professional Accounting Fellow Courtney Sachtleben reiterated views on segment reporting expressed by the SEC staff last year. In addition, Ms. Sachtleben observed that appropriate application of the guidance in ASC 280 will sometimes result in the identification of a single operating segment, which "can be a significant signal to investors about how management has allocated resources." In these circumstances, "registrants should disclose that they allocate resources and assess financial performance on a consolidated basis and should explain the basis for that management approach [since it] would seem counter to the objectives of segment reporting if the business description indicates the entity is diversified across businesses or products, yet is not managed in a disaggregated way."

See Deloitte's November 10, 2014, *Financial Reporting Alert* for a summary of the views on segment reporting expressed by the SEC staff.

Further, Ms. Sachtleben discussed management's controls related to segment reporting, noting that an entity is required to use reasonable judgment when applying the guidance on segment reporting. She indicated that effective ICFR would support the entity's judgment-based determinations, such as those related to operating segments, aggregation, and entity-wide disclosures. Engagement with the CODM to determine how it allocates resources and assesses performance may be important in the design of effective ICFR. Ms. Sachtleben added that "documenting the design and effective operation of management's controls over [the entity's judgment-based determinations] is an integral part of management's support for the effectiveness of its ICFR . . . and will be essential to the auditor's ability to evaluate these controls."

In other remarks, the Division staff noted that it continues to work with the OCA on segment reporting matters and reemphasized the remarks made by the OCA staff. In addition, the Division staff observed that the ultimate decision maker of a registrant (e.g., the CEO) is not necessarily the CODM; therefore, the registrant should identify the CODM by determining which individual (or group of individuals) is responsible for allocating resources to and assessing the performance of the segments of the registrant. Further, the Division staff commented on the identification of operating segments, noting that the absence of fully allocated costs to a component does not preclude the component from having discrete financial information to satisfy one of the criteria necessary to qualify as an operating segment.

See Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* for a more detailed discussion of trends identified in the SEC staff's comment letters on this topic.

Fair Value Measurement

Principal Market or Most Advantageous Market

OCA Professional Accounting Fellow Kris Shirley discussed considerations related to identifying the principal or most advantageous market in accordance with ASC 820. He noted that if a reporting entity does not have access to a certain market on the measurement date, that market may not be the principal or most advantageous market. In addition, Mr. Shirley commented that (1) the ability to transact in a market may be a relevant consideration when a fair value measurement relies on observable pricing as an input and (2) differences in the characteristics of an asset or liability from observable pricing may prevent a reporting entity from accessing a particular market. Characteristics that may prevent a reporting entity from accessing a certain price in a market include:

- The need to transform the reporting entity's asset or liability to match the asset or liability in an observable market.
- Restrictions on the reporting entity's asset or liability that do not exist in the asset or liability in an observable market.
- Differences in marketability or liquidity between the reporting entity's asset or liability and the asset or liability in an observable market.

Further, Mr. Shirley observed that even if a reporting entity is not precluded from using observable prices from a particular market for a fair value measurement, it may need to make adjustments to the fair value measurement if its asset or liability possesses characteristics that differ from observable pricing.

Use of Cost Basis as Fair Value

Mr. Shirley noted that preparers sometimes use an illiquid asset's or liability's initial cost basis inclusive of capitalized transaction costs as its fair value measurement for a period after the initial transaction. Further, he acknowledged that the transaction price may be a good starting point for determining fair value for some time after the transaction occurs. In light of this, Mr. Shirley commented that since fair value measurements require consideration of current market conditions, it is important for reporting entities to reasonably support their conclusions about fair value measurement with sufficient quantitative or qualitative evidence regardless of whether they conclude that the initial cost basis continues to approximate fair value.

Disclosure

Division Deputy Chief Accountant Craig Olinger noted that fair value disclosures remain a significant focus. He added that the Division continues to identify issues on this topic related to (1) the level of disaggregation of asset and liability classes from the line items presented in the statement of financial position and (2) the description of the valuation techniques and inputs used. Further, Mr. Olinger discussed whether the following examples of fair value disclosures would meet the disclosure objectives of ASC 820:

- Level of disaggregation:
  - U.S. treasury securities and CDOs generally possess different characteristics. Accordingly, aggregating them in fair value disclosures would generally not be appropriate under ASC 820.

    - The significant inputs used to value agency mortgage-backed securities are observable, whereas the significant inputs used to value nonagency subprime mortgage-backed securities are unobservable. Since these securities are generally categorized in different levels of the fair value hierarchy, aggregating them in fair value disclosures would generally not be appropriate under ASC 820.
- Description of valuation techniques and inputs:
    - *Describing a valuation technique as "third-party valuation specialist" or "income approach"* — Sufficient detail regarding the valuation technique used should be disclosed in a manner consistent with the disclosure objectives of ASC 820.
    - *Listing the various valuation inputs or techniques that may be used for a particular asset or liability class* — To meet the disclosure objectives of ASC 820, fair value disclosures should (1) clearly link inputs with the valuation techniques to which they apply and (2) only include inputs and valuation techniques used in the periods presented.

Financial Instruments

Proposed Standards

Wesley Bricker discussed the FASB's and IASB's proposed standards on the impairment of financial instruments. He noted that while the boards' proposals are not fully converged, each would require entities to consider future economic conditions when estimating expected losses. In addition, he indicated that consistent implementation of converged guidance on the topic will be important to investors.

Further, Mr. Bricker observed that (1) some of the concepts underlying the FASB's proposed standard are also reflected in accounting estimates related to servicing rights and the other-than-temporary impairment of debt securities and (2) preparers and auditors that are evaluating the impact of the FASB's proposed standard may find this overlap helpful when considering the design of scalable processes and effective internal controls. More specifically, he stated that the proposed standard, coupled with existing Commission and SEC staff guidance (e.g., SAB Topic 6.L), would:

- Reflect an objective of reporting management's best estimate of losses at the reporting date, reasonably developed and adequately supported.
- Require the company to incorporate all of its available information when developing and supporting the estimate, without misusing or overlooking available information.
- Require the estimate to be determined with a procedural discipline, including the identification of relevant data, assumptions, and methodologies, and adequate documentation to support review, validation, and audit of the estimate.

FASB Technical Director and EITF Chairman Susan Cosper discussed various standard-setting projects related to the accounting for financial instruments. Her remarks focused primarily on developments related to the FASB's projects on impairment, classification and measurement, and hedging.

For information about:

- *Impairment* — See Deloitte's March 13, 2015, *Heads Up* and its November 12, 2015, journal entry.
- *Classification and measurement* — See Deloitte's February 2, 2015, *Heads Up* and its November 12, 2015, journal entry.
- *Hedging* — See Deloitte's February 2, 2015, *Heads Up* and its June 30, 2015, journal entry.

Allowance for Loan Losses

The OCA staff highlighted the importance of management's responsibilities in the development of estimates related to the allowance for loan losses. In particular, Mr. Rickli focused his commentary on data reliability and documentation of adjustments.

Employee Benefits

Share-Based Payment Awards With Post-Vesting Restrictions

The OCA staff discussed observations related to the impact of post-vesting restrictions (i.e., prohibitions against the transfer or sale of an award or its underlying shares after vesting) on the measurement of share-based payment awards. Specifically, Mr. Kanczuker observed that a registrant should consider post-vesting restrictions in estimating the grant-date fair value of the award, and a discount may be expected for a share with a post-vesting restriction that cannot be freely traded relative to the market value of a share that can be freely traded. However, he also acknowledged the guidance in ASC 718-10-55-5, which states, in part, that "if shares are traded in an active market, post-vesting restrictions may have little, if any, effect on the amount at which the shares being valued would be exchanged." Accordingly, Mr. Kanczuker encouraged registrants to consult with the staff when incorporating a post-vesting restriction results in a significant discount to the grant-date fair value of an award. Further, he explained that the assumptions used to estimate fair value should be attributes that a market participant would consider rather than attributes specific to the individual holder of the award.

Changes in Key Assumptions to Certain Pension Accounting Measurements[6] — Alternatives for Applying Discount Rates to Measure Benefit Cost

Ashley Wright discussed recent observations related to the approaches preparers use in performing certain defined benefit accounting computations under ASC 715.

As a result of recent discussions between the OCA staff and companies and accounting firms, the staff is aware that there are two common approaches preparers use to apply discount rates to measure the components of net periodic benefit cost: (1) the single weighted-average discount rate approach and (2) the disaggregated approach (also referred to as the "spot rate" approach), which is an alternative method developed recently by actuaries.

Ms. Wright indicated that the staff has also observed that some companies have recently considered using the spot rate approach instead of the single weighted-average approach to measure certain components of their net periodic benefit cost. In a recent consultation with a registrant related to such a change in approach, the OCA did not object to the company's change in approach or the treatment of the change as either a change in estimate or a change in estimate inseparable from a change in accounting principle.

The approaches to measuring components of net periodic benefit cost described above are based on situations in which a registrant uses a yield curve approach for selecting discount rates to measure its benefit obligation. Ms. Wright stated that some registrants have asked whether it would be permissible to change their methods for measuring their benefit obligation from a bond-matching approach to a

[6] We believe that the observations related to pension accounting measurements are applicable to both pension and other postretirement obligations that apply defined benefit accounting under ASC 715.

yield curve approach since a spot rate method for computing interest cost can be generated directly from the yield curve model. Ms. Wright indicated that the staff has not dealt with individual registrants on this question; however, she provided the following considerations for registrants contemplating a change from a bond-matching approach to a yield curve approach:

- Although using discount rates to measure the present value of the benefit obligation and interest cost are integrated concepts under ASC 715, the measurement of the benefit obligation is the starting point.
- A registrant should evaluate the approach for its current selection of discount rates to measure the benefit obligation and should change its method only if the alternative approach results in better information for measuring the benefit obligation. The decision to choose or change an approach to selecting discount rates should be consistent with the objective described in ASC 715 of making a best estimate of the rate at which the benefit obligation could be effectively settled.
- The rationale to justify a change in the approach to selecting discount rates should not be based on materiality.
- A change in method for selecting discount rates should occur only when facts and circumstances change.
- A registrant should consider its prior rationale for choosing or changing to a bond-matching approach and why that was deemed a best estimate.
- A change in approach to applying discount rates to measure interest cost (e.g., from the single weighted-average approach to the spot rate approach) would not be considered a sufficient change in facts and circumstances on its own to justify a change in approach to selecting discount rates to measure the benefit obligation.

Editor's Note: We understand that while the OCA staff did not take a formal view on this topic, it would consider permitting registrants to assess whether to switch from a bond-matching approach to a yield curve approach on the basis of their specific facts and circumstances.

In light of the considerations described above and in the absence of other entity-specific changes in facts and circumstances, we believe that it could be challenging to justify or support a change from the bond-matching approach to the yield curve approach. Historically, entities have generally only made the switch from a yield curve approach to a bond-matching approach, suggesting that of the two methods, the bond-matching approach results in the best estimate. This historical practice, along with the OCA staff's position that the acceptability of the spot rate approach would not by itself be a change in facts and circumstances that justifies a change in approach to selecting discount rates, reduces the likelihood that switching from a bond-matching approach to a yield curve approach would be considered a better estimate in accordance with the best-estimate objective of ASC 715. However if a registrant believes that its facts and circumstances would support a switch from the bond-matching approach to the yield curve approach, it should consider submitting a preclearance request to the OCA staff to confirm that the staff will not object.

See Deloitte's September 28, 2015, *Financial Reporting Alert* for more information.

Income Taxes

The Division staff reemphasized the need for registrants to improve disclosures and increase transparency related to (1) the potential tax and liquidity ramifications of cash held outside the United States and (2) the tax rate reconciliation. Specifically, the staff noted that in situations in which a registrant has asserted that its foreign earnings are indefinitely reinvested, but also has significant amounts of cash located in foreign jurisdictions that would be subject to tax if such amounts were repatriated, it has requested disclosure of the amount of cash that is held in those foreign jurisdictions.

The staff also remarked that in the tax rate reconciliation, registrants continue to use boilerplate language that is not especially helpful in describing the components shown, and that explaining both why certain events occurred that affected the effective tax rate and how those events will affect the tax rate going forward would provide more meaningful information to investors. The staff also noted that in situations in which the "foreign rate differential" and other components of the tax rate reconciliation are not easily understood or transparent, registrants might consider preparing the tax rate reconciliation on a disaggregated basis (e.g., by country) in a tabular format.

Government Assistance

Susan Cosper discussed the proposed ASU recently issued by the FASB to enhance the transparency of government assistance arrangements, which she believes has been "flying under the radar." Ms. Cosper highlighted that the Board's decision to issue proposed guidance related only to disclosures about government assistance, as opposed to prescribing a recognition and measurement model, was based on investor feedback that the transparency of these types of arrangements is more important than the accounting for them. Further, Ms. Cosper noted that developing a recognition and measurement model could be difficult because there are many types of government assistance.

See Deloitte's November 20, 2015, *Heads Up* for more information about the proposed ASU on government assistance.

Oil and Gas Prices

The SEC staff discussed declining oil prices and noted that while many parties initially expected the declines to be short lived, registrants should now consider the potential impact of a year of continued decline on their financial statements.

See Deloitte's March 11, 2015, journal entry on the SEC's discussion of the effects of declines in oil and gas prices.

SEC Continues Its Focus on Disclosure Effectiveness

The SEC staff discussed its disclosure effectiveness initiative, a broad-based staff review of (1) the disclosure requirements in the SEC's rules and (2) the presentation and delivery of those disclosures. As part of the initiative, the SEC issued a release in late September requesting public comment on the effectiveness of the financial disclosure requirements in Regulation S-X that apply to certain entities other than the registrant.

See Deloitte's October 6, 2015, *Heads Up* for more information and its comment letter for views on the topic.

The comment period on the release ended on November 30, and the SEC received over 40 comment letters. Division Chief Accountant Mark Kronforst provided insights into the comments, noting that respondents included accounting firms, registrants, an investor group, and law firms. He indicated that while the comments provided a wide range of views, commenters generally were in favor of "at least several targeted changes at a minimum" to the SEC regulations described in the release. The SEC is continuing to go through the comments and is summarizing them for further evaluation. In her opening remarks at the conference, Chair White stated that she anticipates "further output in the coming year on Regulation S-K, as well as on various technical changes related primarily to financial statement disclosures."

The Division staff also stressed that registrants continue to (1) focus only on material and relevant matters, (2) reduce or eliminate redundant disclosures, and (3) tailor their disclosures to the entity's facts and circumstances.

The staff discussed next steps related to the SEC's disclosure effectiveness efforts. The staff stated that it continues to look for ways to improve Regulation S-K's requirements and noted that there are "some prescriptive requirements that might be obsolete or outdated." In addition, the staff discussed the dynamics of prescriptive-based disclosures and principles-based disclosures and the need to achieve the appropriate balance between the two types. The staff is also continuing its discussions of how Regulation S-K disclosures may be scaled for EGCs and is planning to update the rest of its industry guides in a manner similar to the updates it made to its oil and gas industry guide.

Further, the staff indicated that it is considering improvements to the technology used on the SEC's Web site and the EDGAR database. The staff indicated that it wants to improve search functionality and navigability and referred to a joint comment letter it received from the CAQ, U.S. Chamber of Commerce, BRT, and FEI that contained helpful suggestions for improving such technology.

See Appendix D of Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* for detailed information about how to effectively search the EDGAR database.

Non-GAAP Measures

Non-GAAP measures were covered by a number of conference presenters and continue to be a focus of written SEC staff comments issued to registrants.

Chair White observed that the use of non-GAAP measures warrants registrants' close attention to ensure compliance with the current rules.[7] In addition, Chair White stated that companies should consider the following questions when using non-GAAP measures to communicate financial performance:

- "Why are you using the non-GAAP measure, and how does it provide investors with useful information?"
- "Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules?"
- "Are your explanations of how you are using the non-GAAP measures — and why they are useful for your investors — accurate and complete, drafted without boilerplate?"
- "Are there appropriate controls over the calculation of non-GAAP measures?"

The Division staff reinforced Chair White's comments and further reminded registrants to (1) clearly label and describe non-GAAP measures and adjustments, (2) use appropriate conventional accounting terminology, and (3) disclose any changes in the method of calculating a non-GAAP measure that may affect comparability with the prior years.

Specifically, the Division staff discussed the following examples of disclosures related to non-GAAP measures:

- *Pension adjustments* — The Division staff observed that disclosures related to non-GAAP pension-related adjustments often (1) are not clearly labeled (e.g., actuarial gains or losses, cash contributions), (2) refer to "noncash" pension expense even though the pension liability is expected to be ultimately settled in cash, and (3) inconsistently reflect adjustments related to actuarial gains and losses. For example, the staff noted that it may be confusing to investors when a company that has elected to immediately recognize actuarial gains and losses provides a non-GAAP measure that removes such recognized gains and losses without the appropriate disclosures.

  At the 2013 AICPA Conference, the SEC staff provided an example of disclosure of non-GAAP adjustments that removes actuarial gains and losses. For more information, see Deloitte's December 16, 2013, *Heads Up*.

- *System-wide sales* — Such sales are generally defined as the combination of sales generated by corporate-owned and franchised locations. Although the staff has historically objected to such presentation, it indicated that during the past year, it has not objected to the use of this non-GAAP measure in certain situations (when the registrant complied with all of the other non-GAAP rules) after considering how the measure is generally understood in the marketplace and how it is relied on by investors (e.g., to assess the strength of the overall brand).
- *Normalized market prices* — Another non-GAAP measure that drew the staff's attention this year was the presentation of results adjusted for normalized market prices. This non-GAAP measure was used to illustrate the results of operations that do not reflect the impact of significant changes in commodity prices. The staff specifically noted that the adjustment for normalized market prices was a new measure that emerged this year when the movement in commodity prices had a negative effect on results. The staff indicated that it objected to the presentation of such a non-GAAP measure because ever-changing market conditions and volatility in commodity prices present a challenge for registrants to ascertain a "normal" market price.

[7] Refer to Regulation S-K, Item 10(e).

In closing, the Division staff reminded registrants that it would continue to object to any non-GAAP measures that are misleading. Therefore, it is critical to evaluate non-GAAP measures in the context of a company's specific facts and circumstances, notwithstanding the use of non-GAAP measures and disclosures by other registrants.

Predecessor Financial Statements

The Division staff indicated that for certain transactions (e.g., spin-offs, put-together transactions, drop-down transactions, and carve-outs), registrants should consider whether any predecessor financial statements are required. An acquired business is a predecessor when (1) it succeeds to substantially all of the business of another entity and (2) its own operations before succession appear insignificant relative to the operations assumed or acquired. The staff indicated that it has noticed an increase in put-together transactions in which a newco is formed to acquire multiple entities. In such transactions, some of the entities are acquired before the IPO and others are acquired with the proceeds of the IPO. This has led to questions about how to identify the predecessor and the appropriate financial statements to include in an IPO registration statement.

The staff believes that instances in which there is no predecessor would generally be rare, even if the newco is substantive and was deemed the accounting acquirer. The staff highlighted a number of factors for registrants to consider in determining the predecessor, including (but not limited to) (1) the order in which the entities are acquired, (2) the size of the entities, (3) the fair value of the entities, and (4) the ongoing management structure. The staff indicated that no one item is determinative on its own and that there could also be more than one predecessor.

In addition, the staff stated that determining the appropriate predecessor is important since such determination will affect which financial statements are included in the registration statement as well as other considerations. The predecessor must provide full financial statements audited in accordance with PCAOB standards, which may differ from financial statements prepared under Regulation S-X, Rule 3-05. A business description and MD&A will also be required for any predecessor.

The staff also commented on predecessor considerations related to real estate IPO transactions. Under Regulation S-X, Rule 3-14, abbreviated financial statements of an acquired real estate property may be provided. The staff noted that for IPOs involving real estate, registrants should consider whether such property is a predecessor; if so, they would provide different financial statements from those they would provide under Rule 3-14.

Further, the Division staff reminded conference participants to consider the legal form of the arrangement when identifying a predecessor in a carve-out or spin-off transaction; the financial statements of the predecessor may consist of more than the entity the investor ultimately invests in.

Organizational Changes in the Division

The Division, which contains various assistant director (AD) offices with specialized industry expertise, has undergone some organizational changes during the past year. It merged two of its AD offices responsible for small and large financial institutions into one AD office for financial services. In addition, each of the associate chief accountants in the Division's Office of the Chief Accountant (CF-OCA) are now responsible for specific topics rather than for certain AD offices and industries, which will allow them to develop more subject-matter expertise. The reorganization will also make the CF-OCA's organizational structure more consistent with that of the OCA.

FAST Act

The Division staff discussed the FAST Act, which was signed into law on December 4, 2015. Among its many provisions, the FAST Act amends the JOBS Act and certain SEC disclosure requirements. The Division issued an announcement highlighting the FAST Act's amendments to the federal securities laws.

See Deloitte's December 8, 2015, journal entry for a summary of the key provisions of the FAST Act.

The Division staff addressed one of the key provisions that simplify the disclosure requirements for EGCs. The FAST Act permits an EGC to omit financial information for historical periods that is otherwise required by Regulation S-X from registration statements on Form S-1 or Form F-1 if the EGC reasonably believes that such information will not be required at the time of the contemplated offering. Under this provision, a company will not need to include audited financial statements for a fiscal year that will not be included in the registration statement as of the effective date.

Editor's Note: Although this provision will not become effective until 30 days after the date of enactment, the Division indicated in its announcement that it will not object if EGCs apply the provision immediately.

The Division staff clarified that interim financial information, including financial information for the comparative prior period, pertains to both the interim period and a component of any longer interim or annual period for which financial information will ultimately be included in the registration statement. Thus, interim financial statements would be required in each filing of a registration statement, since any such periods will ultimately be included in either the year-to-date interim periods or the annual periods presented in the registration statement as of the effective date.

Editor's Note: In a Q&A session, the Division staff remarked that such provision would also apply to SEC rules requiring financial statements for other entities (e.g., an acquired business under Regulation S-X, Rule 3-05) within the registration statement. For additional Division staff views, refer to the C&DIs related to the FAST Act.

SEC Reporting Considerations Related to the New Revenue Standard

While acknowledging that registrants may not have fully evaluated the implications of the new revenue recognition standard, the Division staff reminded conference participants that SAB Topic 11.M requires registrants to disclose their conclusions to date regarding the impact of the new revenue standard, such as the planned adoption date. The Division expects the level of disclosures to increase as the effective date of the new revenue standard approaches.

As it did at last year's conference, the Division staff noted that it will not object if a registrant's adoption of the new revenue standard is reflected in its selected financial data table required by Regulation S-K, Item 301, on a basis that is consistent with such adoption in the periods covered in the registrant's financial statements (e.g., a registrant would not be required to retrospectively adjust the earliest two years). During a Q&A session, the Division staff indicated that it would not object if a foreign private issuer adopts a similar approach in the five-year table required under Form 20-F during the period in which the foreign private issuer adopts IFRS 15.

See Deloitte’s December 15, 2014, *Heads Up* on the 2014 AICPA Conference and its September 12, 2014, journal entry for additional information.

The Division staff indicated that it intends to provide some guidance to ease the burden associated with the retrospective application of the new standard. With respect to Regulation S-X, Rule 3-09, regarding equity method investees, the staff indicated that it will allow registrants that are adopting the standard retrospectively to continue to use the results of pretransition significance tests for years preceding adoption. The staff also mentioned other topics on which it may provide guidance, including (1) MD&A presentation and other Regulation S-K disclosures, (2) financial statements of other entities, and (3) the interplay between EGC accommodations and the new revenue standard.

The Division staff has received questions regarding the new revenue standard and its impact on the requirements of Form S-3, Item 11b.[8] During a Q&A session, the Division staff indicated that a registrant is permitted to adopt the new revenue standard by using either the full retrospective method or the modified retrospective method. If a registrant elects the full retrospective method of adoption and subsequently files a Form S-3 that incorporates by reference interim financial statements reflecting the impact of the adoption of the new revenue standard, it would be required under the current form requirements to retrospectively restate its annual financial statements in its Form 10-K, which would include one more year of retrospectively restated financial statements than what would otherwise be required if the registrant did not file a registration statement.[9] The SEC staff indicated that it will continue to consider the implications of this issue.

Editor’s Note: The above guidance would also apply to any new or amended registration statement that is filed after a registrant files a Form 10-Q that reports the material retrospective change.

8 Item 11b requires a registrant to provide restated financial statements when there has been a change in accounting principle if the change requires a material retroactive restatement of financial statements.

9 For example, suppose that Registrant A adopts the new revenue standard on January 1, 2018, by using the full retrospective method and that A files its first-quarter Form 10-Q on May 1, 2018. If A files a Form S-3 on June 1, 2018, it is required under Form S-3, Item 11b, to restate its financial statements retrospectively for the years ending 2017, 2016, and 2015 since financial statements for these years are required in the registration statement. If A did not file a Form S-3, it would only have to restate 2017 and 2016 retrospectively when it files its 2018 Form 10-K.

Accounting Standard Setting

Remarks of Russell Golden, FASB Chairman

Mr. Golden emphasized that it is important for the FASB to maintain its independence from outside influences and remain accountable to all stakeholders. He was reassured in earlier remarks by Chair White and Mr. Schnurr that both share the same view.

When discussing the FASB's standard-setting efforts (discussed elsewhere in this *Heads Up*), Mr. Golden expressed concern about the amount of misinformation being circulated about certain projects. In addressing specific misconceptions or concerns about the FASB's projects on the impairment of financial instruments and leasing, Mr. Golden emphasized that the FASB and its staff performed extensive outreach with numerous stakeholder and industry groups, including regulators, to analyze the scope, implementation costs, and economic impact of those proposals, and that aspects of those proposals were amended on the basis of that feedback. With respect to the FASB's materiality project, Mr. Golden stressed that the Board is not attempting to change the accepted, working definition of materiality or its legal definition.

Mr. Golden then discussed the Board's future agenda and noted that the FASAC recently surveyed stakeholders to identify topics on which financial reporting improvements are most needed. The top five priorities indicated in the survey were:

- Financial performance reporting.
- Cash flow classification.
- Pensions and other postretirement benefits.
- Liabilities and equity.
- Intangible assets.

The FASB will summarize the survey results in a discussion paper that will be issued in early 2016, and Mr. Golden encouraged stakeholders to provide feedback on where the Board should focus its efforts.

In a Q&A session, Mr. Golden noted that the Board is asking its advisory groups to assess whether the volume and pace of standard setting is appropriate for all stakeholders. Further, in response to questions about future convergence efforts with the IASB, Mr. Golden noted that the global capital markets benefit when the FASB and IASB are able to work together to minimize differences between accounting standards, and that the costs of not converging standards are factored into the FASB's cost-benefit analysis.

FASB Standard-Setting Update

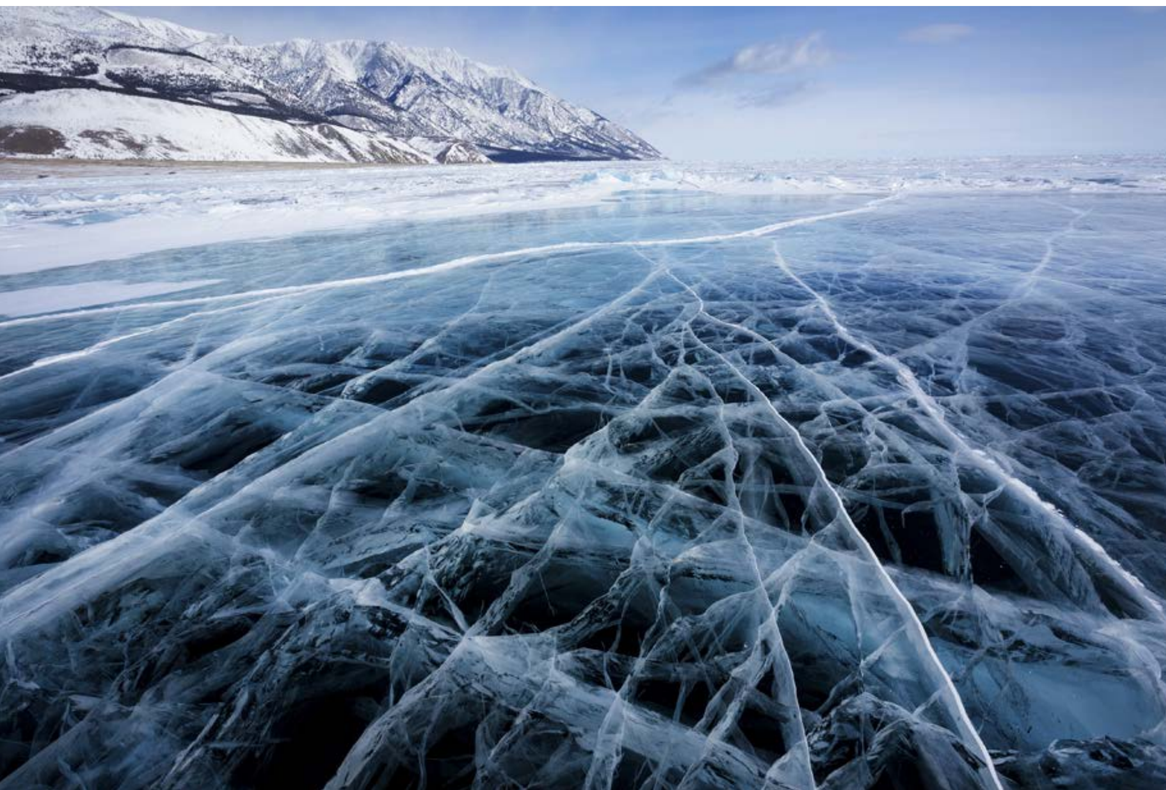
Susan Cosper discussed the status of certain FASB projects, including leasing, classification and measurement, impairment, hedging, and the disclosure framework. For more information about the FASB's current projects, refer to the FASB's technical agenda and the respective sections elsewhere in this *Heads Up*.

Remarks of Hans Hoogervorst, IASB Chairman

Mr. Hoogervorst observed that the quality of IFRSs continues to improve, as evidenced by the IASB's work on its revenue recognition and lease accounting standards, and he characterized the convergence achieved with the revenue recognition project as a huge success. He also is encouraged by the increased interest in IFRSs expressed by stakeholders in the economies of Japan, India, and China. With such expansion of IFRSs, Mr. Hoogervorst believes that the accounting world has moved to being virtually bilingual with its use of IFRSs and U.S. GAAP, which, although imperfect, represents significant progress from 10 years ago.

However, Mr. Hoogervorst noted that sustaining and consolidating such progress will require the IASB to further strengthen the relevance of IFRSs in the world's complicated and ever-evolving markets. Such efforts will require enhancing the communication value of financial reporting by improving performance reporting and disclosure effectiveness and considering how financial reporting should relate to broader corporate reporting issues, such as integrated reporting. To that end, the IASB (along with the IFRS Foundation) will complete consultations in the next year on its work plan and the effectiveness of its structures.

Mr. Hoogervorst believes that a strong commitment to IFRSs is in the self-interest of the United States because there are substantive U.S. interests at stake.



Auditing Developments

Audit and Auditor Considerations

In her keynote address, Chair White credited the PCAOB's inspection program and its improved standard-setting activities for raising the bar on enhancing audit quality. These themes, together with a continued emphasis on ICFR (discussed above) were key areas of focus for both the SEC and the PCAOB this year.

PCAOB Chairman James Doty's opening remarks highlighted the importance and impact of the inspection process, particularly as the Board expands its global reach and effectiveness. Improvements are being noted in audit quality, especially for audit firms that have committed to remediating the root causes of their deficiencies, as evidenced by a decrease in inspection findings. He indicated that while it is still too early to declare "victory," the PCAOB's inspection process appears to be operating as intended. Similar sentiments were expressed by Mr. Schnurr, who observed that the "trend of improvement in audit quality is not universal among audit firms or even within a firm. Audit firms are at different points in the audit quality improvement process, and it is critical that further efforts to improve audit quality are undertaken."

Mr. Schnurr also stressed the importance of continuing to develop high-quality auditing standards. He noted that while standard-setting bodies play a pivotal role in this effort, it is imperative for the process to be both transparent and a collaborative effort by all capital market participants. Previously, the OCA staff raised concerns about the PCAOB's standard-setting process. At this year's conference, both Mr. Schnurr and Mr. Croteau discussed the cooperative relationship between the OCA staff and the PCAOB and noted that they were pleased with the positive steps being undertaken by the PCAOB to enhance its standard-setting process, which included hiring an outside consultant to take a "fresh look" at the process. PCAOB Board Member Jay Hanson elaborated, indicating that much work is in progress to refine the process and that the intended result is a standard-setting agenda that is informed by appropriate research and clearly articulates the problems being addressed. In addition, when solutions need to be made through rulemaking, the resulting rules (1) should address the problem in a timely and cost-effective way and (2) should be established only after consideration of all relevant alternatives.

Auditing and PCAOB Developments

Recent Developments

The PCAOB continues to increase the amount of information it shares with the public. This year, the Board expanded its inspection reports to include industries inspected and findings by industry and also introduced staff inspection briefs. In addition, the PCAOB staff noted that on October 15, 2015, the Board issued a report, *Inspection Observations Related to PCAOB "Risk Assessment" Auditing Standards (No. 8 Through No. 15)*, which expresses the Board's concerns about the number and significance of deficiencies related to the risk assessment standards.

Inspection Staff Update and Common Findings

PCAOB Director of Registration and Inspections Helen Munter discussed the state of audit quality 13 years into the regulated environment. She indicated that regulators around the world are placing greater focus on auditors and setting expectations for auditors to "step up their game."

Ms. Munter emphasized that since many audits result in no findings, there should be a focus on celebrating these successes. She also noted that the goal of inspections has never been simply to identify deficiencies and that "righting the ship" is what she cares about most. Her goal is to address systemic problems in audit firms' quality control systems, and she noted that doing so will contribute to higher-quality audits that add value, both to the investing public and to audit clients.

Overall, the PCAOB is pleased with the improvements being made in inspections of audits. Audit firms and individual partners are more engaged and focused on effectively identifying and responding to risks of material misstatements. Ms. Munter noted five key areas in which audit quality has improved: tone at the top, training, new practice aids and checklists, coaching and support to teams, and monitoring. However, she indicated that despite these improvements, challenges remain related to the following: recurring audit deficiencies (internal control, fair value, and revenue recognition), effective remedial actions, root cause analysis, consistent execution of audit methodology, and monitoring of independence (including on a global basis). Ms. Munter noted that findings this inspection season were frequently related to ICFR, assessing and responding to risks of material misstatements, and auditing accounting estimates.

Global Inspections Update

Mr. Doty summarized the global environment in which the PCAOB operates, citing bilateral agreements that as of the current year permitted the Board to conduct inspections in previously restricted countries; namely, Greece, Hungary, and Luxembourg. He also commented on the status of access to perform inspections in China, noting that while there are signs of moving toward implementing a pilot program, finalizing its details with Chinese regulators is proving challenging. Continued collaboration between the PCAOB and local regulators of foreign jurisdictions will remain instrumental in the global advancement of audit quality. Ms. Munter noted that when possible, the PCAOB coordinates with other regulators in sharing information and performing certain cross-border inspections. However, she raised concerns regarding the consistent application of a firm's audit methodology across affiliated accounting firms within a global network and indicated that this area will continue to be a focus for cross-border inspections of such firms going forward.

Looking Ahead to the 2016 Inspection Cycle — Areas of Focus

The PCAOB staff noted that some newer areas of PCAOB focus will include (1) economic and environmental risk (including the appreciation of the U.S. dollar), (2) segment disclosures, (3) M&A activity, (4) income taxes, (5) going concern, (6) technology risk (cybersecurity), and (7) new auditing standards (e.g., PCAOB Auditing Standard No. 18 and related amendments).

Looking past 2016, Mr. Doty noted that the inspections staff and the Center for Economic Analysis have begun a project with statisticians to explore whether some portion of inspection resources should be allocated to randomly selected engagements. They are specifically considering whether "randomizing" some of the inspections will result in better inferences being made about the pervasiveness of audit deficiencies.

Standard Setting and Other Activities

Throughout the conference, the PCAOB and SEC staffs discussed their progress and developments in 2015. Developments include newly adopted and effective auditing standards, advances in key projects such as audit quality indicators and audit committee disclosures, and progress on key proposed auditing standards.

At the November 12–13, 2015, SAG meeting, the PCAOB also provided an update of recent developments, including current and future standard-setting activities. See Deloitte's December 10, 2015, *Heads Up* for more information.

Recently Adopted or Effective Auditing Standards

Key adopted auditing standards discussed by PCAOB Chief Auditor and Director of Professional Standards Martin Baumann were:

- *Reorganization of PCAOB Auditing Standards* — Effective December 31, 2016 (with early adoption permitted), the new standard reorganizes auditing standards to follow the logical flow of an audit by using a topical structure and a single, integrated numbering system for easier navigation. No substantive changes were made to the existing standards.
- *PCAOB Auditing Standard No. 18 and related amendments* — The standard and related amendments became effective for audits of financial statements for fiscal years beginning on or after December 15, 2014, including reviews of interim financial information within those fiscal years. The guidance addresses the following critical aspects of the audit that have been prone to a number of financial reporting irregularities: related-party transactions, significant unusual transactions, and transactions between a company and its executive officers. Mr. Baumann emphasized that the standard and amendments "up the game for auditors in understanding, identifying and truly auditing these transactions and including the need for full and complete disclosure in the financial statements around them."

See Deloitte's June 23, 2014, *Heads Up* for a description of the changes and requirements of PCAOB Auditing Standard No. 18 and related amendments.

Editor's Note: Mr. Hanson addressed a concern about apparent challenges being raised by preparers regarding their ability to give auditors a full listing of related parties. He indicated that the prior standard effectively required such a related-party listing and that international standards currently require it. He also reiterated that providing a full listing of related parties to the auditors is what is **intended** under PCAOB Auditing Standard No. 18. He further noted the PCAOB did not receive any "push back" on this requirement throughout the process leading up to the standard's issuance.

Status of Key Proposed Auditing Standards

Key proposed auditing standards of interest to investors, audit committees, and auditors are:

- *Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits* — When finalized, the rule will require a new PCAOB form, *Auditor Reporting of Certain Audit Participants* ("Form AP"), which represents a middle-ground approach to balancing the benefits of such disclosure with the potential impact on an auditor's private liability and litigation risk. Form AP names the engagement partner and will also list the names, locations, and extent of audit participation by other firms whose hours exceeded 5 percent of the total hours, and the aggregate percentage of all the hours of all firms participating in the audit. It is anticipated that the rule will be effective for audit reports issued after June 30, 2016, or three months after the SEC approves the final rule, whichever is later. Mr. Hanson noted that the PCAOB staff is working on developing implementation guidance for issuance after the SEC's approval of the rule.
- *Auditor's Reporting Model* — In August 2013, the PCAOB proposed revisions to the auditor's reporting model in response to investor demands for a more informative and meaningful auditor's report. The PCAOB plans to issue a reproposal in the first half of 2016 after it has finished analyzing the significant number of comments received on the proposal. The revisions

would require auditors to include in their reports a discussion of "critical audit matters," which are the most complex aspects of the audit, often described as matters related to the audit that "keep the auditor awake at night." Mr. Hanson expressed optimism that the reproposal would address these important concerns and result in a meaningful, operational standard. Enhanced auditor reporting standards have already been adopted in the United Kingdom, where they have received much investor support. Similarly, the IAASB has also adopted a new auditing standard that is effective for periods ending on or after December 15, 2016, and requires disclosure of "key audit matters" and the engagement partner's name in the auditor's report for all audits of listed companies that apply the International Standards on Auditing.

Key performance standards with expected proposals to be issued for comment in 2016 are:

- *Supervision of Other Auditors and Multi-Location Audit Engagements* — This performance standard is intended to strengthen the oversight of other auditors performing work by ensuring that the lead auditor determines (1) the scope of the work to be performed by the other auditor, (2) the documentation required, and (3) the level of assurance. It would also require the lead auditor to assess the qualifications and capabilities of the other auditor(s).
- *Auditing Accounting Estimates, Including Fair Value Measurements and Related Disclosures* — The PCAOB staff continues to analyze the comments received on its consultation paper and other input. The new standard would better address changes in the financial reporting frameworks related to complex accounting estimates and the increasing use of fair value measurements, and it would be more closely linked to the Board's risk assessment standards. Similar issues have been identified related to the PCAOB's project on the auditor's use of the work of specialists, and as a result the PCAOB staff intends to keep these two projects closely aligned. The IAASB is currently also revisiting its auditing standard related to auditing accounting estimates. Mr. Baumann indicated that the two standard-setting bodies would be coordinating their efforts with the intent of harmonizing the standards.
- *The Auditor's Use of the Work of Specialists* — The use of specialists on audits has increased in recent years, partly because of the complexity of transactions. Auditors often use the work of specialists whom they employ or engage or the work of specialists who are employed or engaged by the company being audited. Questions have arisen about whether all information provided to the auditor by a specialist should be evaluated in a similar manner. The staff plans to create generally common requirements for the oversight of an auditor's specialist, whether employed or engaged, and plans for somewhat more rigorous requirements for using the work of management specialists. The Board's decisions on the necessary degree of scrutiny by auditors of this type of information could have significant effects on many aspects of an audit.

Editor's Note: Mr. Hanson encouraged preparers to follow the progress of the performance standards closely, especially *The Auditor's Use of the Work of Specialists*, since these standards may have significant implications for the audit and, in turn, preparers.

Audit Quality Indicators

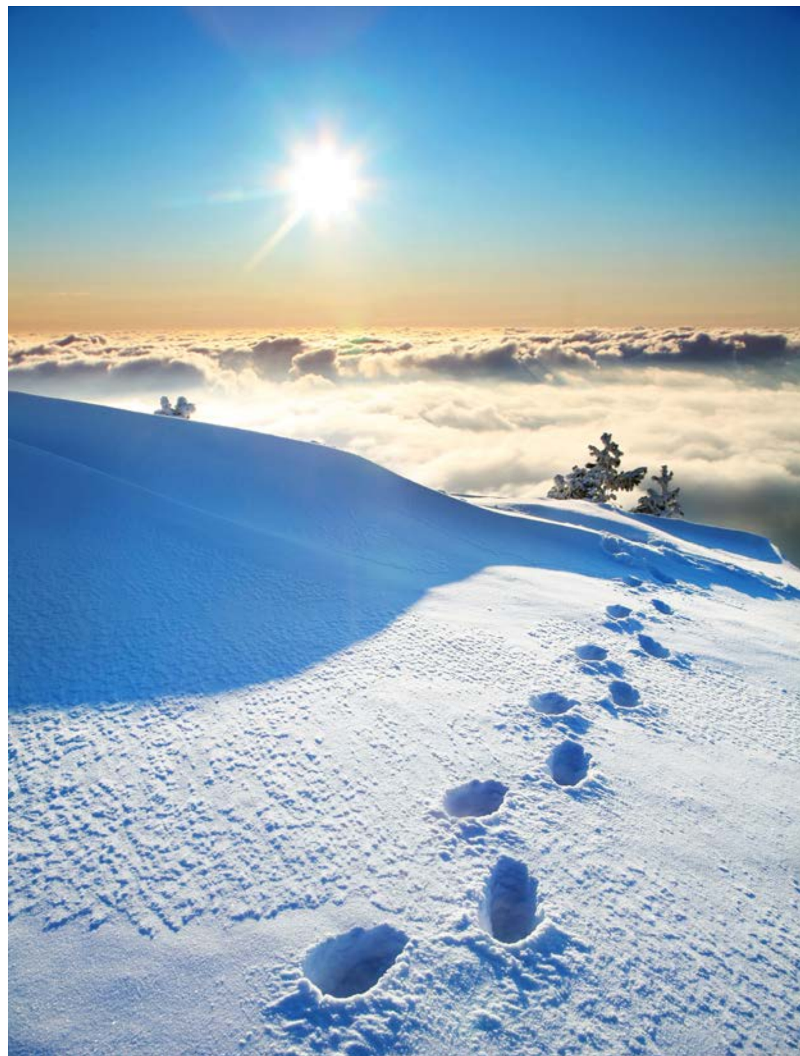
Throughout the conference, there was much discussion of AQIs. Mr. Hanson commended the CAQ for its work as well as its contribution to the PCAOB's efforts in this area. He also elaborated on the comments received in response to the June 2015 concept release and recommended next steps for the project, which would include validating which of 28 AQIs have the strongest correlation to a high-quality audit. Further, he encouraged audit firms to continue their efforts to publish their own audit quality reports that provide timely and relevant information and to make them available to investors and other interested parties.

See Deloitte's December 10, 2015, *Heads Up* for a detailed discussion of the PCAOB's AQI project, including comments received on its *Concept Release on Audit Quality Indicators* and stakeholder views on next steps in the project. See also Deloitte LLP's *2015 Transparency Report* for foreign regulators, which discloses our legal structure, governance, and the system of quality controls we use in our audit practice.

Standard Setting and Other Activities — Looking to 2016 and Beyond

Certain projects that Mr. Baumann discussed and that are on the PCAOB's standard-setting agenda require further outreach and research; namely, those related to going concern, the auditor's responsibility for other information, and audit firm quality control standards. In Mr. Baumann's concluding remarks, he briefly highlighted some emerging issues identified by the SAG, including whistleblower activities, economic developments, and the use of data, that may be the subject of the PCAOB staff's attention in the future.

See Deloitte's December 10, 2015, *Heads Up* for a description of these emerging issues, which could affect audits, auditors, or the PCAOB.



Appendix A: Glossary of 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 (exposure drafts and public comment documents).

SEC Literature

- Regulation S-K
  - Item 10(e), "General — Use of Non-GAAP Financial Measures in Commission Filings"
  - Item 301, "Selected Financial Data"
- Regulation S-X
  - Rule 2-01, "Qualifications of Accountants"
  - 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 3-14, "Special Instructions for Real Estate Operations to Be Acquired"
- Staff Accounting Bulletins (SABs)
  - Topic 6.L, "Financial Reporting Release 28 — Accounting for Loan Losses by Registrants Engaged in Lending Activities"
  - Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period"
- Releases
  - Final Rule No. 33-8995, *Modernization of Oil and Gas Reporting*
  - Proposal No. 33-9929, *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*
  - Concept Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*
- Financial Reporting Manual
  - Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"

PCAOB Literature

- Release No. 2015-007, *Inspection Observations Related to PCAOB "Risk Assessment" Auditing Standards (No. 8 Through No. 15)*
- Release No. 2015-005, *Concept Release on Audit Quality Indicators*
- Release No. 2015-002, *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*
- Auditing Standard No. 18, *Related Parties*
- Staff Consultation Paper No. 2015-01, *The Auditor's Use of the Work of Specialists*

Center for Audit Quality (CAQ) and Audit Analytics

- *2015 Audit Committee Transparency Barometer*

Appendix B: Abbreviations

Abbreviation	Description
1940 Act	Investment Company Act of 1940
AD	assistant director
AICPA	American Institute of Certified Public Accountants
AQI	audit quality indicator
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
BRT	Business Roundtable
C&DI	SEC Compliance and Disclosure Interpretation
CAQ	Center for Audit Quality
CDO	collateralized debt obligation
CEO	chief executive officer
CF-OCA	SEC's Division of Corporation Finance, Office of the Chief Accountant
CMV	collateralized management vehicle
CODM	chief operating decision maker
COSO	Committee of Sponsoring Organizations of the Treadway Commission
Division	SEC's Division of Corporation Finance
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EGC	emerging growth company
EITF	FASB's Emerging Issues Task Force

Abbreviation	Description
FASAC	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FEI	Financial Executives International
GAAP	generally accepted accounting principles
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IPO	initial public offering
JOBS Act	Jumpstart Our Business Startups Act
MD&A	Management's Discussion and Analysis
OCA	SEC's Office of the Chief Accountant
PCAOB	Public Company Accounting Oversight Board
Q&A	question and answer
SAB	SEC Staff Accounting Bulletin
SAG	PCAOB's Standing Advisory Group
SEC	Securities and Exchange Commission
S&P	Standard & Poor's
TRG	transition resource group
VIE	variable interest entity

Appendix C: Selected Speakers

The table below lists speeches that were publicly available as of the date of this publication.

Sessions/Speakers	Sessions/Speakers
Keynote Address — SEC • Mary Jo White, Chair, SEC **Keynote Address — PCAOB** • James Doty, Chairman, PCAOB **PCAOB Auditing Standard-Setting Update** • Jay Hanson, Board Member, PCAOB **FASB and IASB Chair Addresses** • Russell Golden, Chairman, FASB • Hans Hoogervorst, Chairman, IASB **Remarks of the SEC Chief Accountant** • James Schnurr, Chief Accountant, SEC's Office of the Chief Accountant **Center for Audit Quality Update** • Cynthia Fornelli, Executive Director, CAQ **OCA Policy Initiatives** • Wesley Bricker, Deputy Chief Accountant, SEC • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant	**OCA Current Projects** • Michael Husich, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant • Barry Kanczuker, Associate Chief Accountant, SEC • Chris Rickli, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Courtney Sachtleben, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Christopher Semesky, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Kris Shirley, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Ashley Wright, Professional Accounting Fellow, SEC's Office of the Chief Accountant

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