SEC Issues & Trends

AICPA Conference on Current SEC and PCAOB Developments

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Advancing the quality of financial reporting

The overarching theme at the 2018 AICPA Conference on Current SEC and PCAOB Developments was that high-quality financial reporting and reliable audits are a shared responsibility among all participants in the financial reporting architecture.

The conference saw SEC Chairman Jay Clayton and Chief Accountant Wes Bricker deliver a clear message when they shared the Office of the Chief Accountant's (OCA) blueprint of the US Financial Reporting Structure for Public Issuers. That message? Each participant in this structure – including management, audit committees, auditors, standard setters and regulators – has a role and responsibility in preserving and advancing the quality of financial reporting for investors. In Bricker's words: "It takes a community to protect a community … financial reporting really is the production of a community of accountants."

The blueprint illustrates the financial reporting structure with the following four general stages.

Regarding this structure, Bricker noted that "quality starts at the front-end and the more investments we make in the preparation of financial statements, the stronger our standards and preparation of financials, the better our audit process will be, the better our delivery will be, and ultimately the more useful our product."

These sentiments have never been truer than in this period of emerging issues and risks, and in light of the substantial changes in standards and technology. To meet the challenges in addressing these risks and changes, the structure's participants must:

- embrace collaboration and coordination throughout the financial reporting structure; and
- focus on preventing defects in financial reporting, which should be the collective first priority of the structure's participants, with detecting and remedying defects a secondary priority.

Throughout this publication we discuss how the emerging issues and risks, and upcoming changes in financial reporting that were discussed during this year's conference, will affect the roles and responsibilities of management, audit committees and auditors during the calendar year-end financial reporting process and into the next year.

Contents

1

Are you adequately preparing for the new accounting standards?

This year marks the beginning of companies implementing three comprehensive accounting standards. Many companies have already adopted the new revenue recognition standard in 2018. Next up is leasing in 2019, followed by the current expected credit losses (CECL) standard in 2020.

Not surprisingly, application and implementation issues related to these new standards were a hot topic at this year's conference. OCA staff reiterated its message from previous public remarks that it will continue to accept reasonable judgments in the application of the new accounting standards.

OCA staff also observed that well-reasoned judgments frequently require the essential element of time to gather the facts, consider the accounting alternatives, and rigorously analyze the facts to faithfully apply the new accounting standards to a company's specific facts and circumstances.

Implementation of the new revenue recognition standard

Staff from OCA highlighted three areas that require the use of significant judgment when implementing the new revenue standard.

Applying the principal versus agent guidance

Determining whether a company is a principal (gross) or an agent (net) in a revenue transaction can be challenging, particularly in situations when a company never obtains physical possession of a good (e.g. when goods are shipped directly from a manufacturer to a third party).

Sheri York, Professional Accounting Fellow in OCA, observed that applying the principal versus agent model requires a consideration of the definition of control, and often includes consideration of the indicators of control, of which inventory risk is only one of the indicators.

Identifying performance obligations

Significant judgment is required in determining whether a revenue transaction consists of a promise to transfer to the customer a combined item or multiple items individually. Sarah Esquivel, Associate Chief Accountant, OCA, observed that the staff previously commented that in analyzing performance obligations companies should not merely evaluate whether one item, by its nature, depends on the other. Rather, companies should evaluate whether those items (i.e. goods or services) significantly affect each other. The judgment required for this analysis may have a significant effect on the timing and amount of revenue recognized.

Assessing whether a contract has a significant financing component

Significant judgment is also required in evaluating the existence of a significant financing component in a revenue transaction, which would require accounting recognition for the time value of money. Esquivel observed that in some situations, the difference between a transaction's contract price and the cash selling price may occur for reasons other than the provision of finance.

KPMG has published numerous industry insights on the new revenue standard. Additionally, KPMG's Handbook, Revenue recognition, provides additional best practices, and discusses a myriad of technical issues that companies will encounter in accounting for and making disclosures about their contracts with customers.

Disclosure observations

Staff from the Division of Corporation Finance (DCF) indicated that it is focusing its comments related to the new revenue standard on significant judgments that might involve material errors or omitted disclosures. Companies may receive a comment letter if the nature, amount, timing or uncertainty of revenue being recognized is unclear or conflicts with other publicly available information.

DCF staff also indicated that it will continue to assess disclosures in future periods as disclosures continue to evolve over time and new transactions arise. Therefore, companies should still expect to receive comment letters about revenue recognition in periods subsequent to adoption.

Leases – implementation is proving difficult

Many companies will be required to adopt the new leases standard in the first quarter of 2019. Generally, panelists at the conference observed that implementing the standard is requiring more time and is more costly than anticipated. For example, many companies are spending considerable time accumulating all of the necessary information. Complicating matters is the fact that many software vendors are still refining their solutions. Companies may need to employ significant manual processes to collect the required data and as part of their internal controls to adopt the standard.

Despite these issues, Sagar Teotia, Deputy Chief Accountant, OCA, and Russell Golden, Chairman of the FASB, both emphasized that there are no plans to defer the effective date of the standard.

Some general advice from panelists to companies is to collaborate with other stakeholders – operational teams, legal staff – and address issues early with external auditors. Panelists also noted that management needs to establish processes and internal controls to support implementation and ongoing application of the leases standard.

Andrew Pidgeon, Professional Accounting Fellow in OCA, explained some of the technical issues OCA staff has been working on with companies through its consultation process including:

— lessee transition – minimum rental payment composition and measurement policies; and
— lessee and lessor accounting for certain costs relating to a lease.

Panelists also discussed the challenges in determining the appropriate incremental borrowing rate.

KPMG's Handbook, Leases, provides additional best practices and discusses technical issues that an issuer may encounter during the implementation process, including those discussed above.

Credit impairment on the near horizon

The effective date of the new credit impairment standard is quickly approaching, with many companies preparing to adopt in the first quarter of 2020.

OCA staff stated that it is currently in the process of evaluating conforming changes to Staff Accounting Bulletin (SAB) 102, Selected Loan Loss Allowance Methodology and Documentation Issues, to align the guidance with the relevant concepts for an expected loss measurement model in the new credit impairment standard. OCA staff emphasized that procedural discipline and documentation applicable under today's incurred loss model will continue to be relevant under the new standard.

Staff from OCA also discussed various implementation questions. For example, Kevin Vaughn, Senior Associate Chief Accountant, OCA, discussed the application of the subsequent events guidance when developing the forward-looking estimate of expected credit losses following adoption of the new standard.

Also, Rahim Ismail, Professional Accounting Fellow in OCA, discussed application questions related to accounting policies for loan charge-offs on the adoption of the new credit losses standard including whether:

— the determination of the loans to be charged off should be performed at the individual loan level or at the pool level; and
— all relevant information should be considered, including relevant portfolio-level information, in determining whether a loan is uncollectible for accounting purposes.

KPMG's Handbook, Credit impairment, provides additional insight into the new credit impairment standard.

2 Does your approach to assessing ICFR incorporate best practices?

Implementation of the new accounting standards shines a spotlight on the importance of effective internal control over financial reporting (ICFR). Marc Panucci, Deputy Chief Accountant, OCA, observed that the more management can define upfront appropriate processes and controls, including when implementing new accounting standards, the greater the likelihood that material misstatements of financial statements will be prevented or detected on a timely basis and the better the chance of success around the new GAAP implementation.

Panucci also highlighted increased dialogue in the preparer community about the design and attributes of 'good controls'. As an example, he referenced two recent publications by Financial Executives International that address internal control considerations for a company's' adoption of the new leases standard and the new credit impairment standard. While the publications are not authoritative, he believed that they represent a good starting point for a conversation about the design of controls related to the two new accounting standards.

The theme of considering ICFR in the context of implementing the new accounting standards was also reflected in the speech by Emily Fitts, Professional Accounting Fellow in OCA. She provided reminders for management's evaluation of the operating effectiveness of ICFR and stated that this evaluation would be particularly important this year given the first-time evaluation of new or revised controls implemented in connection with the adoption of the new revenue recognition standard.

The two guiding principles Fitts highlighted for management's evaluation of the effectiveness of ICFR are (a) whether the controls are operating as designed and (b) whether the nature, timing and extent of management's work to evaluate the controls are commensurate with the assessed risk of control failure and the risk of material misstatement. She stressed that as these risks increase, generally more persuasive evidence is needed to sufficiently evaluate whether a control is operating effectively. To assist in this evaluation, Fitts shared a number of questions that management could consider when planning the evaluation of ICFR.

Control deficiencies

Evaluation of control deficiencies was another area of focus by OCA staff during the conference. Tom Collens, Professional Accounting Fellow in OCA, stated that while the staff has seen improvements in this area, some consultations, as well as a recent enforcement action, suggest that there are still some bad habits. Collens encouraged management to take a more holistic approach to determining the severity of identified control deficiencies.

In particular, Collens emphasized that management should evaluate the level of detail and assurance needed to support its conclusions by considering what the views of a 'prudent official' would be in conducting their own affairs.

Collens further stressed the importance of accurately defining the identified control deficiency. This is a prerequisite for: (a) performing a holistic evaluation of the control deficiency, (b) developing an effective remediation strategy, and (c) making appropriate disclosures, if required.

Further, Collens reminded management of the need to evaluate the potential magnitude of a misstatement that is reasonably possible to result from the deficiency, and not focus solely on the actual misstatement that might have occurred. In a separate session, Panucci also reminded management and auditors that when evaluating the potential magnitude of a control deficiency, it is necessary to consider any actual and potential misstatements on an absolute-value basis rather than focusing on the net effect of offsetting misstatements. Further, the materiality considerations used to evaluate the magnitude of potential misstatements when determining the severity of control deficiencies, including deficiencies that may result only in classification misstatements, are consistent with the considerations applied when evaluating the materiality of actual financial statement misstatements.

Material weakness disclosures

Last, but not least, Fitts discussed the importance of providing investors with meaningful material weakness disclosures, including going beyond describing the mere existence of a material weakness. The disclosures should provide enough information to understand the root cause of identified material weaknesses and assess their potential effect on the issuer's financial reporting. To assist in developing the appropriate disclosure, Fitts highlighted questions that management should consider.

KPMG's ICOFR Reference Guide provides additional insight into many of the topics discussed by OCA staff that are summarized above.

3

What are today's emerging issues and risks?

In 2018, there have been several emerging trends that significantly affected participants throughout the financial reporting structure – some expected, and others, not so much. These trends are expected to be hot topics for discussion between management, audit committees and other stakeholders in the coming months.

Cybersecurity disclosures

In February 2018, the SEC issued the "Commission Statement and Guidance on Public Company Cybersecurity Disclosures," which includes interpretive guidance to assist public companies in preparing disclosures to ensure investors are sufficiently informed about material cybersecurity risks and incidents.

The guidance emphasizes the importance of disclosure controls and procedures that enable public companies to make accurate and timely disclosures about material cybersecurity events, and policies that protect against corporate insider trading in advance of company disclosures of material cyber incidents.

During the conference, DCF staff emphasized that issuers should avoid boilerplate disclosures and instead tailor disclosures to their facts and circumstances.

In October 2018, the SEC issued a report on its investigation of whether certain public issuers that were victims of cyber-related frauds may have violated the federal securities laws by failing to have a sufficient system of internal accounting controls. The SEC issued this report to make public issuers and other market participants aware of cyber-related threats and to consider them when devising and maintaining a system of internal accounting controls as required by the federal securities laws.

Panelists observed that they found the report informative and that it was a "must read." While the report focuses on internal accounting controls, Panucci stressed that aspects of cybersecurity affecting financial information systems would also be relevant to an issuer's assessment of ICFR.

For additional details, see KPMG's publications on the SEC's investigative report and cybersecurity disclosures.

Brexit disclosures

The SEC is closely monitoring how issuers disclose the effect of the United Kingdom's exit from the European Union (Brexit) on their business and operations. Clayton has commented that he's concerned the potential adverse effects of Brexit are not well understood and, in the areas where they are understood, are underestimated. He also added that, based on corporate disclosure, some of those effects are already upon us.

The SEC has seen a wide range of disclosures – some have been fairly detailed about how Brexit may affect issuers, while others simply state that Brexit presents a risk. Clayton stated that he would like to see issuers provide more robust disclosure about how management is considering Brexit and the effect it may have on issuers and their operations.

LIBOR

Banks that currently report information used to set LIBOR are expected to stop doing so after 2021. Efforts to transition away from LIBOR as a benchmark reference for short-term interest rates have been ongoing and OCA has been attentive to the related accounting considerations.

Ismail acknowledged that OCA has been encouraged by the ongoing dialogue among various stakeholders, which has identified a number of potential accounting considerations, including several related to hedge accounting.

Also, issuers may face significant risks and uncertainties related to managing the transition from LIBOR to a new rate such as the Secured Overnight Financing Rate. DCF staff commented that it expects to see disclosures addressing these risks and uncertainties, if material.

4

What's new from the SEC in 2018 and what can you expect in 2019?

This section summarizes several important SEC reporting items and initiatives that have affected management and audit committees in 2018 and will continue into 2019.

Non-GAAP financial measures

SEC staff acknowledged that non-GAAP financial measures can play an important role for investors in making their investment decisions. However, these disclosures are often developed outside of the financial reporting process and therefore are not subject to the same internal controls or audit. For this reason, Clayton emphasized the need for the same diligence in preparing non-GAAP financial measures as in preparing audited financial statements.

These sentiments were echoed by DCF staff, who expressed the need for issuers to have controls in place designed to ensure consistency in non-GAAP measures and to prevent errors and manipulation. DCF staff further stated that if errors are detected subsequent to communication of the non-GAAP financial measures, issuers should have policies in place to deal with errors, including how to correct and communicate them.

DCF staff noted that its evaluation of a non-GAAP measure includes asking questions, such as why and how is management using the measure in the evaluation of its business? The answers to these questions are relevant because it then informs investors about the measure's importance to running the business. The expectation of DCF staff is that the answer to these questions will be in the disclosures accompanying the non-GAAP financial measures.

In addition, non-GAAP financial measures should not change from one period to the next unless there is an underlying change in the business or in the way management is running the business. When a change is necessary, DCF expects management to provide disclosures explaining the reasons underlying the change.

During the conference, DCF staff observed that it can be challenging to differentiate between an acceptable non-GAAP financial measure and an individually tailored accounting principle, which DCF would object to issuers using. To help mitigate the risk of using an individually tailored accounting principle, DCF staff provided questions that management and audit committees can ask themselves as they develop non-GAAP financial measures. Positive responses to these questions may indicate that a non-GAAP adjustment would be an individually tailored accounting principle that the staff would object to.

Question	Example
Does the adjustment shift GAAP from an accrual basis of accounting to a cash or modified basis of accounting?	Using cash receipts or billings as a proxy for revenue for a subscription-based business that recognizes GAAP revenue over time.
Does the adjustment add transactions that are also reportable in another company's financial statements?	Making adjustments to gross up revenue transactions as if an entity were a principal versus an agent in the transactions.
Does the adjustment reflect part, but not all, of a transaction?	Adjusting income tax effects for cash taxes paid, but not for temporary or permanent differences.
Does the adjustment render the measure inconsistent with the economics of a transaction or ignore certain terms of an agreement?	Adjusting revenue for sales-type or financing leases as if they were operating leases.

Disclosure update and simplification rule

DCF staff highlighted the adoption of the Disclosure Update and Simplification Rule, which was effective for filings made on or after November 5, 2018. The rule is intended to address disclosure requirements that became redundant, duplicative, overlapping, outdated or superseded by other SEC disclosure requirements, US GAAP or changes in the information environment. In the final rule, the SEC requested that the FASB determine whether it will add certain incremental disclosures to its standard-setting agenda.

The rule also included a new requirement to disclose changes in stockholders' equity in interim reports. Subsequently, DCF released guidance advising it would not object to a registrant adopting the requirements to include changes in stockholders' equity in the Form 10-Q for the first quarter beginning after the effective date of the rule – e.g. for a calendar year-end company, the first quarter of fiscal year 2019.

KPMG reported on this final rule in its Defining Issues, SEC simplifies and updates disclosure requirements.

Emerging Growth Company transition issues

DCF staff made remarks about various situations related to the timing of an EGC's adoption of accounting standards using the private company adoption dates and subsequently losing EGC status. Generally, if an EGC loses its status after it has adopted a new accounting standard, the SEC would not expect the company to revise its adoption date. DCF staff indicated that the Financial Reporting Manual would be updated for these remarks.

The various situations discussed by DCF staff and the reporting nuances that accompany these remarks are discussed in detail in KPMG's Defining Issues, SEC provides clarification for EGCs adopting new accounting standards.

Modification or waiver of financial statement requirements

Rule 3-13 of Regulation S-X, Filing of other financial statements in certain cases, allows the SEC to modify or waive financial statement requirements. DCF staff encouraged registrants to contact them for Rule 3-13 waivers if they believe the required disclosures are burdensome to prepare and may not be material to the overall mix of information available to investors.

DCF staff clarified that while not all requests can be granted, they will keep an open mind to the specific facts and circumstances presented, but investor protection is always central to their analysis. They also presented several examples of Rule 3-13 waivers to offer insight into the waiver request process.

Some of the examples of Rule 3-13 waivers related to financial statement requirements under Rule 3-05, Financial statements of businesses acquired or to be acquired, and included situations in which significance was triggered by:

- the income test when the issuer was in a break-even position;
- the investment test only;
- aggregated financial information for the acquisition of related businesses when one of the acquired businesses was individually insignificant; and
- an acquired business being significant to the earliest year presented in an initial registration statement, but over time the acquisition is no longer significant.

Other examples of Rule 3-13 waivers presented related to financial statement requirements under Rule 3-09, Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons, and included situations in which:

- full financial statements of investees may not be necessary when significance test results are anomalous; and
- partial year financial statements of the investee are required in the year of acquisition or disposition by the registrant.

Auditor independence matters – loan rule

In May 2018, the SEC proposed an amendment to its auditor independence rules regarding lending relationships with certain shareholders of an audit client (the Loan Rule). The comment period on the proposal closed on July 9, 2018 and the SEC received over 30 comment letters.

According to Panucci, the SEC staff is working through the feedback received, and the loan rule amendments remain on the SEC's rule making agenda for 2019. Panucci also used the opportunity to remind conference participants of the fundamental importance of auditor independence and that it remains a shared responsibility that requires attention not only from auditors but also from management and audit committees.

What's ahead in 2019 and beyond?

DCF staff provided an overview of the Division's 2019 rulemaking priorities. These rulemaking activities aim to streamline disclosures and lessen regulatory burdens as part of the SEC's mission to facilitate capital formation and protect investors.

During the remainder of 2018 and in 2019, the SEC may seek public comment on or undertake rulemaking related to the following, among others:

— Rule 3-10 of Regulation S-X, Financial statements of guarantors and issuers of guaranteed securities registered or being registered;
— Rule 3-16 of Regulation S-X, Financial statements of affiliates whose securities collateralize an issue registered or being registered;
— Rule 3-05 of Regulation S-X, Financial statements of businesses acquired or to be acquired;
— Article 11 of Regulation S-X: Pro forma financial information
— Regulation A: Exempt offerings;
— Guide 3: Statistical disclosure by bank holding companies; and
— Ways to ease the quarterly reporting burden on publicly listed companies.

5 How might auditing developments affect your company?

Audit quality and access to audit and other information internationally

At the outset of the conference, Clayton and Bricker emphasized the vital role that audit quality plays in building confidence in the quality and reliability of financial statements. Oversight of audit quality for US-listed companies, in turn, requires that US regulators have access to audit-related information of these companies on a global basis. However, they noted that there are issues impeding access to vital information and that new access issues are likely to arise in the future.

Bricker stated that it is important for investors and analysts to understand those issues and limitations placed on the ability of US regulators (in particular the PCAOB) to inspect the audit work and practices of PCAOB-registered auditing firms in China (including Hong-Kong-based audit firms, to the extent their audit clients have operations in mainland China) with respect to their audit work of US-listed companies with operations in China. Bricker encouraged participants to read the joint statement of the SEC Chairman, SEC Chief Accountant and PCAOB Chairman that includes a detailed discussion of current challenges in accessing information about such audits.

New Board refines PCAOB's approach

This year's conference featured a panel discussion by the five members of the PCAOB Board. All five Board members were appointed by the SEC in December 2017; this is the first time since its inception in January 2003 that the PCAOB has all new Board members. According to Bill Duhnke, Chairman of the PCAOB, this represents a significant opportunity to:

— reflect on the lessons learned in the past 15 years;
— take a fresh look across the organization; and
— identify opportunities to enhance how the PCAOB delivers on its mission to protect investors, and further the public interest in the preparation of informative, accurate and independent audit reports.

This sentiment was shared during the panel discussion by all the Board members, and is reflected in the PCAOB's Strategic Plan for 2018 – 2022, which the Board recently approved.

The strategic plan sets out several objectives for the PCAOB. During their panel discussion, the Board members highlighted the steps they are taking to pursue some of the objectives. These objectives and the Board members' comments about them should be of particular interest to audit committee members because, as explained below, one of the Board's initiatives is to enhance its outreach to -- and engagement with – audit committees.

Continuous improvement in audit quality

One of the PCAOB's strategic objectives relates to driving continuous improvement in audit quality. The PCAOB's audit inspection program will remain a critical element of the PCAOB's activities in pursuit of this objective. However, the Board and staff of the PCAOB are taking steps to enhance certain elements of the inspections process. For example, in addition to its traditional focus on detection and remediation, the PCAOB intends to place greater emphasis on matters that may help audit firms prevent audit deficiencies from occurring in the first place. To this end, the PCAOB intends to look closely at audit firms' systems of quality control and revisit its own standards on quality control.

The PCAOB also plans to supplement its inspections process of individual firms with horizontal, cross-firm, thematic inspections. Through this new approach, the PCAOB will assemble targeted teams to look at specific issues across audit firms. That will be in addition to the more traditional inspections teams focused on the audits of individual firms.

Yet another pillar supporting the objective of continuous improvement in audit quality is the PCAOB's ongoing evaluation and refinement of its standards, rules and guidance in an ever-changing environment. To this end, the PCAOB announced an open meeting on December 20 when the Board will consider adopting new standards for auditing accounting estimates (including fair value measurements) and the auditor's use of the work of specialists. Further, the Board intends to finalize its standard-setting project on the supervision of audits involving other auditors in the first half of 2019. In the spring of 2019, the Board also plans to perform a comprehensive evaluation of its research and standard-setting priorities for the coming years.

Improving responsiveness to the changing environment

Another strategic objective relates to anticipating and responding to the changing audit environment, including emerging technologies and their related risks and opportunities. For example, many issuers are increasingly using advanced data analytics and performing finance tasks with algorithms and robots, which could fundamentally change financial reporting. The Board wants to ensure that auditors not only understand how their clients are using these technologies, but also how they can deploy new approaches to technology and data analytics to perform their assurance function. Moreover, the Board will be looking for ways to use emerging technologies and data analytics to more effectively perform its oversight role.

To further this strategic objective, the Board has established a task force on data and technology to explore the use of innovative technologies, including data analytics and artificial intelligence. Based on its research and outreach to stakeholders, the task force has preliminarily concluded that the current auditing standards appear flexible enough to allow for development and use of innovative technologies. In fact, the Board stressed that issuers and auditors should not shy away from using emerging technologies that enhance audit quality and the overall financial reporting process just because these technologies are not specifically addressed in the current auditing standards.

Transparency

Another of the PCAOB's strategic objectives stresses the importance of transparency in promoting investor confidence in audits of public companies and registered broker-dealers. The Board demonstrated its strong focus on enhanced transparency through the process it undertook to develop its new strategic plan. For the first time, the Board exposed its draft strategic plan for public comment and considered feedback from all interested parties, both inside and outside the organization.

The Board is also working on ways to enhance its outreach to -- and engagement with -- key stakeholder groups, including investors, management and audit committees. In connection with the 2019 audit inspections, the PCAOB intends to reach out to all audit committees whose audits have been selected for inspection. The Board is also considering appointing liaisons for outreach to specific stakeholder groups. Another objective for the Board is to make its communications about audit firm inspections more timely and easier to read and understand.

New auditor's reporting model

Changes to the auditor's report, including in particular the requirement to include a description of critical audit matters (CAMs), was a significant area of focus during this year's conference for regulators, standard setters, management and auditors alike. This is understandable given that the inclusion of CAMs in auditor's reports is quickly approaching. CAMs are scheduled to appear in reports for large accelerated filers in the second half of 2019, and in reports for most other filers in late 2020 and early 2021.

Both the PCAOB and the SEC are committed to helping make the rollout of CAMs successful. Staff from both organizations as well as the PCAOB Board members emphasized the importance of appropriate preparation for the reporting of CAMs. That should include close coordination and communication between auditors and issuers, in particular audit committees.

Pre-implementation activities

Many audit firms are currently in the midst of conducting dry runs of CAM reporting. This includes drafting CAM disclosures based on prior-year filed financial reports and discussing them with audit committees and management. The PCAOB is closely monitoring the results of these pilot programs and other actions that firms are taking to implement the new reporting requirements and encouraged feedback as the implementation efforts progress. Additionally, the PCAOB is engaging with audit committees to understand their level of involvement in the implementation work, and asking for audit committee views on the costs, benefits or unintended consequences of the new reporting requirements.

Post-implementation expectations

Representatives of both the PCAOB and the SEC stated that they were satisfied with the pre-implementation process thus far. However, during the conference, they also laid out some of their expectations for post-implementation practices. First, they expect almost every audit to have at least one CAM reported. Second, and more significantly, they warned that CAMs should not be boilerplate; rather they should convey issuer-specific information.

And last, but not least, CAMs are intended to be disclosures about the audit and not to replicate or replace any of the disclosures in the issuer's financial statements.

The PCAOB and the SEC staff also emphasized that judgment will be required in identifying what types of issues are appropriate for CAMs, and gave some informal guidance. Specifically, they reiterated that a CAM by definition is a matter that involved especially challenging, subjective or complex auditor judgment; therefore, for example, it is not expected that every significant accounting policy or critical accounting estimate will have a corresponding CAM disclosure.

The PCAOB also reiterated its position laid out in the adopting release for the new auditor's report that significant deficiencies in ICFR are not CAMs. However, the existence of a significant deficiency could be among the principal considerations that lead the auditor to determine that a matter is a CAM.

To further the dialogue and stakeholder education about CAMs, the Center for Audit Quality announced at the conference the release of a publication that summarizes the lessons learned to-date from CAMs implementation, questions to consider by audit committees and others as well as an illustrative example of a CAM.

KPMG provided more information about the changes in the auditor's reporting model in its Defining Issues, PCAOB issues auditing standard to enhance auditor's report.

6 Demystifying emerging technologies

A significant discussion topic during the conference centered on changing technology and the effect on management, auditors and regulators. Clearly, the pace of change isn't slowing, and neither is the hype surrounding certain technologies – namely data analytics and blockchain.

The value proposition for data analytics

The Data Analytics Panel, featuring Bob Dohrer, Chief Auditor of the AICPA, highlighted four macro drivers behind the proliferation of data analytics in the preparation and audit of financial statements – volumes of newly available data; vastly increased data processing speeds; more sophisticated tools to analyze data; and symbiotic artificial intelligence and other tools that help synchronize technologies.

Management and auditors aren't the only ones affected by data analytics. The panel also shared some thinking from the audit committee perspective. Of note, there is a broad awareness of data analytics among audit committee members, but they are interested in learning more, often seeking information about how data analytics are being used, or can be used, in the preparation and audit of financial statements.

Distributed ledger technology, digital assets and initial coin offerings

Clayton discussed concerns that have been raised about the digital asset and initial coin offering (ICO) markets. These concerns include the difference between the type of fundraisings and quality of companies in the ICO market versus a market that requires audited financial statements. As a result, there is substantially less investor protection than in the traditional equities and fixed income markets, with correspondingly greater opportunities for fraud and manipulation. As Clayton observed, "You do not have the protections that our securities laws require of public companies in many of these situations and a fundamental protection is audited financial statements."

Resources for audit committees

On December 12, 2018, the Center for Audit Quality published Emerging Technologies: An Oversight Tool for Audit Committees, which provides a framework and questions that audit committees may ask management and auditors to help inform their oversight of the financial reporting process. The tool highlights how two technologies — artificial intelligence and robotic process automation — are gaining significant traction in the financial reporting environment.

Appendix:

Index of published speeches

The text of speeches can be accessed using the links below.

The Chief Accountant, Wesley R. Bricker, and his deputies did not give prepared speeches, but Bricker did release a detailed statement.

SEC OCA staff speakers	Topics
Tom W. Collens, Professional Accounting Fellow	Internal control over financial reporting
Sarah N. Esquivel, Associate Chief Accountant	Revenue
Emily L. Fitts, Professional Accounting Fellow	Internal control over financial reporting
Rahim M. Ismail, Professional Accounting Fellow	Credit impairment
Andrew W. Pidgeon, Professional Accounting Fellow	Leases
Kevin L. Vaughn, Senior Associate Chief Accountant	Credit impairment
Sheri L. York, Professional Accounting Fellow	Revenue

CAQ

Cynthia M. Fornelli, Executive Director, CAQ

FASB

Russell G. Golden, Chairman, FASB

PCAOB

George Botic, Director, Division of Registration and Inspections, PCAOB

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