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Annual SEC and PCAOB Update for Public Companies

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From the author

In this update, we share recent financial reporting developments from the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and the Center for Audit Quality (CAQ) that affect financial reporting by public companies.

The SEC began the year with a focus on federal income tax reform as a result of the December 2017 income tax law changes and ended the year with speeches at the annual American Institute of Certified Public Accountants (AICPA) conference on SEC and PCAOB developments. Other SEC headlines continue to include audit committee effectiveness and the implementation of major accounting standards (on revenue recognition, leases, and credit losses) from the Financial Accounting Standards Board (FASB), as well as cybersecurity and digital technology matters. The commission also is proceeding with further capital raising and disclosure simplification initiatives that include a revision to the smaller reporting company (SRC) definition and a request for comment on quarterly reports and earnings releases. See more on these and other SEC topics in the section “From the SEC.”

Highlights from the newly installed PCAOB include a publicly available strategic plan and – as a continuation from last year – the recent auditing standard on the auditor’s reporting model, especially with the second phase becoming effective for audits of Dec. 31, 2019, annual financial statements for calendar year-end large accelerated filers.

We also offer information on a variety of tools for audit committees and others made available by the CAQ related to cybersecurity and technology, critical audit matters, and lease accounting, among other resources.

We hope you find this information useful, and we welcome your feedback.

Sydney K. Garmong
Partner, Crowe LLP

From the SEC

Big picture

Strategic plan

The SEC announced its new strategic plan on Oct. 11, 2018. It features three goals:

- “Focus on the long-term interests of our Main Street investors. ... Initiatives under this goal will include modernizing disclosure and expanding investor choice.”
- “Recognize significant developments and trends in our evolving capital markets and adjust our efforts to ensure we are effectively allocating our resources. ... by analyzing market developments, evaluating existing rules and procedures, understanding the continually changing cyber-landscape and ensuring the appropriate resources are dedicated to each area.”
- “Elevate the SEC’s performance by enhancing our analytical capabilities and human capital development. The SEC will invest in data and technology ... ”

Previously, on June 19, 2018, the SEC requested comment on its draft strategic plan to guide the agency in its priorities through fiscal year 2022.

Public statement on U.S.-listed companies with significant operations in China

On Dec. 7, 2018, SEC Chairman Jay Clayton, SEC Chief Accountant Wesley Bricker, and PCAOB Chairman William Duhnke issued a public statement in light of current information access issues to entities in China. According to the statement, “One of the most significant current issues relates to the ability of 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 U.S.-listed companies with operations in China.” The statement covers information access issues in more detail as well as remedial measures that have been used in the past to address those issues.

New commissioner

On Sept. 11, 2018, Elad Roisman was sworn in as an SEC commissioner, replacing outgoing Commissioner Michael Piwowar. Roisman was nominated by President Donald Trump and confirmed by the U.S. Senate on Sept. 5. He most recently served as chief counsel to the Senate Banking Committee; prior to that, he served as counsel to former SEC Commissioner Daniel Gallagher.

Culture at financial institutions – Jay Clayton, SEC chairman

In Clayton’s address at the Federal Reserve Bank of New York conference on governance and culture reform in New York on June 18, 2018, he shared several ideas related to corporate culture at financial institutions and the SEC:

- Culture is not an option. Every organization has a culture.
- Know your culture. In order to effectively manage a firm, you must know its culture.
- Culture is a collection of countless internal and external actions. Culture is not related solely to the words of management; rather, it is a collection of all the actions carried out within the organization at every level on a daily basis.
- Culture is preserved and enhanced through a clear and constant mission. The SEC’s mission is furthering the interests of long-term retail investors.
- Culture goes beyond the law and regulations. “The law may not prohibit all forms of lying, but your culture should reject it.”
- The SEC does not expect perfection; it does expect commitment and action. People will make mistakes, and those mistakes should be assessed to determine what remediation efforts are needed.

Cybersecurity

Investigative report on cyberthreats

On Oct. 16, 2018, the SEC released an investigative report with a recommendation: “public companies should consider cyber threats when implementing internal accounting controls.” The report analyzes the SEC Enforcement Division’s investigations of nine public companies that experienced financial losses as a result of cyberfraud. It emphasizes the need to consider cyberthreats as part of a public company’s obligation to maintain internal accounting controls.

Remarks by Commissioner Robert J. Jackson Jr.

In a speech on March 15, 2018, Commissioner Robert Jackson Jr. covered cyber risk and the limited amount of disclosure that is provided by public companies related to cyberattacks. He shared his recommendation to his colleagues that Form 8-K requirements governing cyber events should be re-evaluated. He also highlighted the need for policies and procedures to deter insider trading on nonpublic cybersecurity information as well as the risk of hackers profiting from their own cyberattacks. In addition, he covered the requirement to develop internal controls to address cybersecurity, which will require lawyers (and other professionals) to interact with IT experts.

Disclosure guidance

On Feb. 21, 2018, the SEC released interpretive guidance on cybersecurity disclosures, “Commission Statement and Guidance on Public Company Cybersecurity Disclosures,” which reiterates what is already included in the Division of Corporation Finance (Corp Fin) Disclosure Guidance: Topic No. 2 issued in 2011. It expands upon Corp Fin’s existing guidance by emphasizing the need for disclosure controls and procedures for material cybersecurity events and for insider trading policies in the context of nonpublic cyber event information. The guidance is for both companies that have experienced cyberattacks and those that have not yet been the target of a cyberattack.

As an interpretive release, the guidance includes the SEC’s views on cybersecurity risk and incident disclosure obligations under existing securities laws, including on Forms 10-K, 10-Q, and 8-K. As an SEC interpretation, approved by the SEC commissioners, as compared to the previous Corp Fin disclosure guidance (which represents only Corp Fin’s views), it implicitly raises the bar on the authoritative nature of the guidance. The interpretive release enumerates the applicable disclosure rules and related matters for public companies to consider as they evaluate their cybersecurity disclosures. It also includes the SEC’s expectations with regards to detailed, timely, accurate, and specific disclosure, as well as acceptable and unacceptable limitations of cybersecurity disclosures.

Disclosure matters addressed by the guidance include the following:

- Examples of costs and negative consequences from cyberattacks or incidents (pages 3-4)
- Disclosure obligations – materiality (pages 7-13)
 - Periodic reporting on Forms 10-K and 10-Q (page 8)
 - Registration statements (page 9)
 - Current reports on Form 8-K (page 9)
 - Acceptable and unacceptable limitations of disclosure (pages 11-13)
 - Level of detail should not compromise cybersecurity (page 11)
 - Impact of ongoing internal/external investigations (page 12)
 - Correction of untrue statements (page 12)
 - Generic versus specific disclosure (page 13)
- Risk factors (pages 13-15)
- Management’s discussion and analysis (MD&A) (pages 15-16)
- Description of business (page 16)
- Legal proceedings (page 16)
- Financial statement disclosure (page 17)

- Board risk oversight (pages 17-18)
- Disclosure controls and procedures (pages 18-20)
- Insider trading laws and company policies (pages 21-22)
- Regulation FD – when certain material nonpublic information is required to be publicly disclosed (pages 22-24)

Finally, according to the interpretive release and Chairman Jay Clayton's statement, Corp Fin staff will remain focused on registrants' disclosures in this area as part of their filing reviews.

Innovation and technology: Digital assets

Offerings of virtual currencies – Chairman Jay Clayton

In a testimony on the use of distributed ledger technologies to facilitate capital raising including the issuance of cryptocurrencies and initial coin offerings (ICOs), SEC Chairman Jay Clayton emphasized the role and responsibilities of professional gatekeepers to protect Main Street investors in the securities markets. Speaking before the Senate Committee on Banking, Housing, and Urban Affairs on Feb. 6, 2018, Clayton said that to the extent that ICOs represent an offer and sale of securities (and he believes most do), they are subject to the securities laws. However, many ICOs are not currently being conducted under the securities laws, and, therefore, investors in those offerings are not benefiting from the protections offered by those laws. The SEC is seeking to enforce the securities laws for ICOs as evidenced by recent enforcement actions referenced in Clayton's testimony. Cryptocurrencies, on the other hand, are more akin to money than a security and are not under the SEC's jurisdiction.

Prior to testifying before the Senate committee, Clayton delivered opening remarks at the Securities Regulation Institute on Jan. 22, 2018, where he provided his expectations for market professionals in the ICO space.

Corp Fin senior adviser for digital assets and innovation

On June 4, 2018, the SEC named Valerie A. Szczepanik as the senior adviser for digital assets and innovation for Corp Fin Director William Hinman. This new position was created to focus on emerging digital asset technologies and innovations, including initial coin offerings and cryptocurrencies, and coordinate work across the SEC on these matters. Most recently, Szczepanik was an assistant director in the Division of Enforcement's Cyber Unit.

Website for innovation and technology engagement

The SEC on Oct. 18, 2018, launched its Strategic Hub for Innovation and Financial Technology (FinHub), which will serve as a resource for issues such as distributed ledger technology (including digital assets), automated investment advice, digital marketplace financing, and artificial intelligence and machine learning.

In its press release, the SEC outlined five FinHub activities:

- "Provide a portal for industry and the public to engage directly with SEC staff on innovative ideas and technological developments;
- "Publicize information regarding the SEC's activities and initiatives involving [financial technology] on the FinHub page;
- "Engage with the public through publications and events, including a FinTech Forum focusing on distributed ledger technology and digital assets planned for 2019;
- "Act as a platform and clearinghouse for SEC staff to acquire and disseminate information and FinTech-related knowledge within the agency; and
- "Serve as a liaison to other domestic and international regulators regarding emerging technologies in financial, regulatory, and supervisory systems."

Clayton said, “The FinHub provides a central point of focus for our efforts to monitor and engage on innovations in the securities markets that hold promise, but which also require a flexible, prompt regulatory response to execute our mission.”

RegTech Data Summit – Commissioner Michael S. Piwowar

In a speech on March 7, 2018, Commissioner Michael Piwowar addressed the 2018 RegTech Data Summit, providing his views on the SEC’s recent activity in the technology space. He covered the Enforcement Division’s report on decentralized autonomous organizations (the DAO report) that presented its view that the federal securities laws apply to virtual entities that issue securities by using distributed ledger or blockchain technology (see also the following section, “Offerings of Virtual Securities – Chairman Jay Clayton”). Piwowar also discussed the use of extensible business reporting language (XBRL) data by various market stakeholders, HyperText Markup Language (HTML) hyperlinks in the exhibit index of SEC filings, the SEC’s Electronic Data Gathering, Analysis, and Retrieval (EDGAR) redesign program, and various technologies used by the SEC to monitor the securities markets.

Digital asset transactions – William Hinman, Corp Fin director

In Corp Fin Director William Hinman’s address to the Yahoo Finance All Markets Summit on June 14, 2018, he covered the application of aspects of the securities laws to digital assets. He addressed whether a digital asset offered as a security can, over time, become something other than a security. He shared his views related to certain specified circumstances in which a digital asset can no longer be a security – that is, when there no longer is any central enterprise being invested in or when the digital asset is sold only to be used to purchase a good or service available through the network on which it was created. He also provided factors to consider when determining whether a digital asset is a security or whether it is structured more like a consumer item (such as a good or service to be purchased).

Public statement on digital asset transactions

On Nov. 16, 2018, the SEC’s Divisions of Corporation Finance, Investment Management, and Trading and Markets released “Statement on Digital Asset Securities Issuance and Trading.” It covers recent enforcement actions and the interaction of existing federal securities laws with the innovative technologies used for digital asset securities transactions. Specifically, it addresses offers and sales of digital asset securities, investment vehicles investing in digital asset securities (such as managers of hedge funds that invest in digital asset securities). For those involved in trading digital asset securities, the statement addresses both exchange and broker-dealer registration requirements.

Potentially unlawful online platforms for trading digital assets – enforcement statement

In a statement on March 7, 2018, the SEC’s Division of Enforcement and Division of Trading and Markets signaled to entities involved directly or indirectly in online trading of digital (or virtual) assets that they might be subject to a gamut of securities regulation. For example, a trading platform that operates as an “exchange,” as defined by the federal securities laws, is required to register as a national securities exchange unless an exemption applies, and a platform that is not an exchange but offers other trading-related services might be required to register under the securities laws as a broker-dealer, transfer agent, or clearing agency. The statement also provides resources for investors and other participants in the digital asset markets.

From the Office of the Chief Accountant

Big picture

Financial reporting – Wesley Bricker, SEC chief accountant

In his address to the Institute of Management Accountant's 2018 Annual Conference and Expo on June 19, 2018, SEC Chief Accountant Wesley Bricker covered topics similar to his June 6, 2018, speech. Referencing the new financial reporting illustrations on the SEC's website, he discussed the financial reporting process and the involvement of all participants in the process including management, auditors, audit committees, and the external auditor. Regarding the financial reporting responsibilities of management, he emphasized the importance of strong ethics and culture as well as financial training and literacy. He concluded with the topic of emerging technologies.

Financial reporting and innovation – Wesley Bricker, SEC chief accountant

On June 6, 2018, in London, Bricker addressed the Institute of Chartered Accountants in England and Wales. He covered the following topics:

- Highly connected global investing markets
- Financial reporting information available in markets, including information other than what is in the financial statements
- Financial reporting processes, including reference to the "U.S. Financial Reporting Structure for Public Issuers" that illustrates the financial reporting structure in three different ways
- Critical role of audit regulators and audit standard-setters
- Critical role of auditors, including auditor choice and audit quality, and the auditors of tomorrow

Implementing major standards and other observations

FASB role, new standards, non-GAAP, market risk disclosures, audit firm governance – Wesley Bricker, SEC chief accountant

Bricker addressed the 2018 Baruch College Financial Reporting Conference on May 3, 2018. He began by sharing his view on the objective of general purpose financial reporting and how the FASB's general purpose financial reporting standards are formulated to meet that objective. He then contrasted general purpose financial reporting with *special* purpose financial reporting – noting that the latter fulfills more limited purposes – and observed that both types of financial reporting best serve their intended purpose when their objectives are kept separate.

He next touched on the new accounting standards on revenue, leases, and credit losses as well as the SEC staff guidance related to income tax reform, discussing how these changes will strengthen the overall financial reporting system. In addition, he briefly mentioned the new requirement to record the fair value changes of equity securities in the income statement rather than through other comprehensive income (OCI) as a result of Accounting Standards Update (ASU) 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which is effective for public companies beginning in 2018. For companies that choose to present non-GAAP information related to this change, he emphasized "non-GAAP reporting may supplement but is not a substitute for GAAP reporting."

Further, on non-GAAP measures, Bricker noted the requirement to have disclosure controls and procedures that would “prevent error, manipulation, or mischief with the numbers” and “a policy that addresses how any changes in the non-GAAP measure will be reported and how corrections of errors will be evaluated.” He encouraged audit committees that do not already do so to “review the [non-GAAP] metrics to understand how management evaluates performance, whether the metrics are consistently prepared and presented from period to period, and the related disclosure policies.”

In light of the recent rise in market interest rates, he reminded both audit committees and management of the market risk disclosure requirements, noting that some companies’ financial statements are particularly sensitive to market factors including market liquidity and pricing.

On the topic of audit firm governance, Bricker noted the need for constant efforts to “maintain and nurture trust.” He observed the largest accounting firms have appointed or are appointing independent directors or advisory council members and voluntarily produce audit quality reports to communicate “about the design of an audit firm’s governance and culture.”

Major accounting standards – Sagar Teotia, deputy chief accountant

On June 7, 2018, Deputy Chief Accountant Sagar Teotia, in the SEC’s Office of the Chief Accountant (OCA), addressed the 37th Annual SEC and Financial Reporting Institute Conference in Los Angeles. In his remarks, he covered implementation of major accounting standards:

- Revenue recognition (Topic 606)
 - Teotia covered the activities that his office has undertaken with respect to Topic 606 implementation, including the speeches OCA staff made during 2017 on revenue recognition implementation matters.
- Lease accounting (Topic 842)
 - Echoing his previous speeches, Teotia re-emphasized that lease accounting implementation will take time and require numerous steps. He focused on the identification of all arrangements that include leases, or embedded leases, saying that, “it may require time to complete.” Registrants, audit committees, and auditors are responsible for ensuring that any implementation issues are identified and resolved with the appropriate parties. (Update: Registrants with calendar year-ends are required to adopt ASC 842 on Jan 1, 2019.)
- Credit losses (Topic 326)
 - Teotia summarized the OCA’s involvement with credit loss implementation including consultations discussed in a previous OCA staff speech. He also noted the work of the TRG for Credit Losses.

Credit losses, digital assets, and critical audit matters – Wesley Bricker, SEC chief accountant

On Sept. 17, 2018, SEC Chief Accountant Wesley Bricker addressed the AICPA National Conference on Banks and Saving Institutions. He covered CECL standard implementation, technology innovations in digital assets, and changes to the auditor’s report. For CECL, he noted certain aspects of applying the standard that companies may already have experienced – in particular, assessing expected cash flows over the life of a financial asset. He emphasized processes, controls, and adoption plans to implement accounting changes, and he reminded the audience that SEC Staff Accounting Bulletin (SAB) 102 principles will continue to be applicable and that audit committees have a vital role in implementation. He also shared the following concepts regarding CECL transition disclosures:

- Definition of key terms
- Description of methodology and judgments
- Tabular presentation of economic assumptions
- Quantified impact of moving from incurred to expected model, disaggregated by lending portfolio

He shared illustrations addressing SEC requirements that uniquely affect digital asset transactions:

- Maintaining accurate books and records and internal controls
- Identifying related parties in order to appropriately account for and disclose those transactions
- Considering loss contingencies due to legal matters
- Dealing with potential illegal acts
- Reviewing the ability of the external auditors to carry out their professional responsibilities

About auditor's report changes, Bricker noted that he is pleased with the dry runs for CAMs that firms are undertaking ahead of the effective date for including CAMs in the auditor's report.

SEC oversight activities, internal controls over financial reporting and major standards – Wesley Bricker, SEC chief accountant, and other SEC staff

At the annual AICPA Conference on Current SEC and PCAOB Developments took place in Washington, D.C., on Dec. 10 through 12, 2018, the following SEC representatives delivered remarks:

- Wesley Bricker, chief accountant – Statement on matters discussed with Julie Erhardt, Jenifer Minke-Girard, Marc Panucci, and Sagar Teotia during a deputy chief accountant panel, including those related to the financial reporting structure, FASB standard-setting activities, PCAOB oversight, accounting consultations, monitoring the International Financial Reporting Standards Foundation's activities, and monitoring the Public Interest Oversight Board's activities
- Tom W. Collens, professional accounting fellow – Remarks on internal control over financial reporting (ICFR), specifically on the evaluation of control deficiencies
- Emily L. Fitts, professional accounting fellow – Remarks on ICFR, including the evaluation of operating effectiveness of controls and preparation of material weakness disclosures
- Sarah N. Esquivel, associate chief accountant – Remarks on revenue recognition consultations, including identifying performance obligations and evaluating the existence of a significant financing component
- Sheri L. York, professional accounting fellow – Remarks on revenue recognition consultations, including the application of the principal versus agent guidance and the identification of performance obligations
- Andrew W. Pidgeon, professional accounting fellow – Remarks on lease accounting, including lessee transition for minimum rental payment composition policies, lessee transition for minimum rental payment measurement policies, and certain lessee and lessor costs
- Rahim M. Ismail, professional accounting fellow – Remarks on current expected credit loss (CECL) implementation and a consultation on the shift away from the London Interbank Offered Rate (LIBOR)
- Kevin L. Vaughn, senior associate chief accountant – Remarks on accounting consultations in general and subsequent events in the CECL model

Tax Reform

Federal income tax reform

The *Tax Cuts and Jobs Act* (tax reform law) was signed into law by President Trump on Dec. 22, 2017. Concurrently, the SEC's OCA and Corp Fin staff issued interpretive guidance for public companies, auditors, and other stakeholders to consider related to the accounting impacts of the tax reform law. SAB 118 permitted registrants to record provisional amounts for the accounting impact of the act up to one year after the enactment. As a reminder, the one-year measurement period has expired. Registrants should have completed their accounting for the act in the fourth quarter of 2018.

Crowe resources

On Jan. 23, 2018, Crowe released an article, "[Financial Reporting for Tax Reform: The SEC and FASB Weigh In](#)," to highlight the guidance issued separately by the SEC and the FASB staff in response to the implementation challenges faced by entities as a result of the tax reform law.

Also, on Dec. 28, 2017, the Crowe article "[Securities and Exchange Commission \(SEC\) Provides Clarity and Assistance on Income Tax Reform](#)" was released.

Auditor independence

Auditor independence for certain lending relationships

On June 20, 2016, the SEC issued a no-action letter to an investment management company stating that, if certain conditions were met, the SEC would not recommend enforcement action even though the company's funds were not in compliance with the "Loan Provision" found in Rule 2-01 of Regulation S-X. The provision specifically relates to determining whether an auditor is independent when the auditor has a lending relationship with certain shareholders of the audit client. Subsequent to the release of the no-action letter, registrants and auditors continue to seek clarification from the SEC on various aspects of the provision.

On May 2, 2018, the SEC proposed a rule, "[Auditor Independence With Respect to Certain Loans or Debtor-Creditor Relationships](#)," that would revise guidance on the Loan Provision. Covering both the audit and professional engagement periods, the proposal would revise the analysis to determine independence as follows:

- Center only on beneficial ownership, thus removing the owners of record (such as financial institutions and broker-dealers that register shares for the benefit of customers) from the analysis.
- Establish a new "significant influence" test to replace the 10 percent bright-line shareholder ownership test.
- Add a "known through reasonable inquiry" standard to identify beneficial equity owners.
- Revise, for a fund, the definition of "audit client" to exclude funds that would be considered affiliates of the audit client.

Comments were due July 9, 2018.

From the Division of Corporation Finance

Big picture

Director's speech on Corp Fin's agenda

On Feb. 1, 2018, William Hinman, director of Corp Fin, delivered the keynote address at the Practising Law Institute's Seventeenth Annual Institute on Securities Regulation in Europe. In his address, Hinman covered recent Corp Fin actions that reflect efforts to facilitate capital formation in the public markets, such as these:

- Expanding the confidential review process to all issuers conducting initial public offerings, initial *Securities Act and Exchange Act* registrations, and certain follow-on offerings within a year of initial registration
- Allowing non-EGCs (non-emerging growth companies), in addition to EGCs, to omit annual and interim financial information that they reasonably believe will not be required when the registration statement is filed publicly
- Assisting companies with the pay ratio disclosure by providing guidance for the calculation and use of statistical sampling
- Clarifying certain Form 8-K filing requirements for reporting events like the act
- Reminding entities of the option to submit requests for waiver of certain financial statement requirements to Corp Fin under Rule 3-13 of Regulation S-X

Corp Fin chief accountant

On Feb. 15, 2018, the SEC announced that Kyle Moffatt is the new Corp Fin chief accountant. He has been the acting chief accountant since January, and prior to that, he was an associate director in Corp Fin's disclosure review program.

Resumption of operations following partial government shutdown

On Jan. 27, 2019, Corp Fin issued a statement on returning to normal operations following the partial government shutdown. Corp Fin indicated that, in general, it will address filings and other submissions and respond to requests for staff action in the order they were received. The staff is available to answer questions related to filings and federal securities laws, but response time may be longer than ordinary.

Quarterly reports and earnings releases – request for comment

On Dec. 18, 2018, the SEC released a request for public comment, "Request for Comment on Earnings Releases and Quarterly Reports," on potential changes to earnings releases and quarterly reports. The SEC is exploring ways to promote efficiency in periodic reporting by reducing unnecessary duplication that companies disclose and examining how such changes could reduce costs and affect capital formation while enhancing, or at least maintaining, appropriate investor protection. The release also seeks comment on whether the SEC should provide companies, or certain classes of companies, with flexibility as to the frequency of their periodic reporting. Last, the SEC is seeking comment on how the existing periodic reporting system, earnings releases, and earnings guidance may affect corporate decisionmaking and strategic thinking, whether positive or negative, and whether the result is an inefficient outlook by focusing on short-term results.

The comment period closes on March 21, 2019.

Smaller reporting company

New smaller reporting company definition

On June 28, 2018, the SEC voted to expand the “smaller reporting company” definition to include entities with public float of less than \$250 million, which is an increase from the previous public float threshold of \$75 million. Additionally, those entities with no public float or with public float of less than \$700 million will qualify as an SRC if annual revenues are less than \$100 million during the most recently completed fiscal year. This means that more entities will qualify for the SRC scaled disclosure accommodations. The SEC did not change the threshold for the definition of “accelerated filer,” which includes the requirement for an auditor attestation of management’s assessment of ICFR. Accordingly, for those entities with public float between \$75 million and \$250 million, Section 404(b) of the *Sarbanes-Oxley Act of 2002* (Sarbanes-Oxley) (that is, the auditor attestation of ICFR) remains applicable. SEC Chair Jay Clayton has directed the SEC staff to consider providing further relief on Section 404(b) of Sarbanes-Oxley.

Additional SRC interpretive and transition guidance

On Nov. 7, 2018, the SEC’s Division of Corporation Finance updated its interpretive guidance to reflect recent changes in the SRC definition:

- The Compliance and Disclosure Interpretations (C&DIs) for Regulation S-K address questions on the interaction between SRC and accelerated filer status as well as SRC qualifications.
- The C&DIs for Exchange Act forms address a question that may arise related to executive compensation and other disclosure required by Part III of Form 10-K.
- Certain C&DIs for Exchange Act rules were removed.

On Aug. 10, 2018, the SEC released guidance on transitioning to the revised SRC definition, which is included in the Small Entity Compliance Guide for Issuers. When determining SRC status under the revised definition after Sept. 10, 2018, a company should use the date it measures its public float. Newly qualified SRCs have the option to use the SRC scaled disclosure accommodations in filings in one of these ways:

- In the next periodic or current report due after Sept. 10, 2018
- For transactional filings without a due date, in filings or amended filings made on or after Sept. 10, 2018

A calendar year-end reporting company newly qualified as an SRC under the revised definition and using public float and annual revenue amounts as of June 29, 2018, could have first used the SRC scaled disclosure accommodations in its Form 10-Q for the quarter ended Sept. 30, 2018. The revised SRC definition was summarized in the second quarter accounting and financial reporting update, in “From the SEC.”

Other rules, guidance, and proposals

Disclosure update and simplification rule (DUSTR)

On Aug. 17, 2018, the SEC amended its disclosure requirements in order to simplify them and eliminate redundancies with GAAP and other SEC guidance. In addition, the commission referred a number of topics to the FASB for further consideration.

Some of the specific changes include elimination of:

- Ratio of earnings to fixed charges
- Market price information – high and low trading prices
- Dividends per share on face of income statement (instead moves required disclosure to changes in stockholders' equity)
- Financial information about segments and geographic area in description of business
- Accounting policy for derivatives

In addition, the rule adds a new interim requirement for changes in stockholders' equity in Form 10-Q, which requires registrants to disclose changes in shareholders' equity, in the form of a reconciliation, for "the current and comparative year-to-date periods, with subtotals for each interim period." Registrants may present the activity in a separate statement of changes in stockholders' equity or in the notes to the interim financial statements. On Sept. 25, 2018, the SEC issued guidance (see question 105.09 of the Compliance and Disclosure Interpretations) to clarify the effective date for this portion of the amendments. The staff will not object if the first presentation of the changes in shareholders' equity is included in its Form 10-Q for the quarter that begins after the effective date of the amendments, which is Nov. 5, 2018. Therefore, a calendar year-end institution must first comply with the new stockholders' equity disclosure in its Form 10-Q for the quarter ended March 31, 2019.

Exchange Act reporting companies and Regulation A exemption

On Dec. 19, 2018, the SEC adopted final rules to allow *Exchange Act* reporting companies to apply the registration exemption offered by Regulation A. This will allow those companies to complete *Securities Act* offerings of securities up to \$50 million in a 12-month period without separately registering those offerings with the SEC and without additional reporting obligations.

The final rules are effective upon publication in the Federal Register.

Disclosure simplifications for guarantor registered debt offerings

On July 24, 2018, the SEC proposed amendments to Rules 3-10 and 3-16 of Regulation S-X to simplify the requirements for financial disclosure that apply to registered debt offerings for guarantors and issuers of guaranteed securities and for affiliates whose securities collateralize a registrant's securities. The proposed simplifications are intended to result in the registration of additional debt offerings and, in turn, provide additional investor protections as compared with unregistered offerings.

Comments were due Dec. 3, 2018.

Compensatory securities offerings

On July 18, 2018, the SEC issued a final rule for nonreporting companies that amends *Securities Act* Rule 701(e) as mandated by the *Economic Growth, Regulatory Relief, and Consumer Protection Act*. The rule expands the securities registration exemption for compensatory securities issued by nonreporting companies by increasing the value of exempt equity securities from \$5 million to \$10 million. It was effective on July 23, 2018.

Also, the SEC issued a concept release to request feedback on whether the rules for compensatory offerings (employee benefit plans) should be expanded further for reporting and nonreporting companies as well as modernized.

Comments on the concept release were due by Sept. 24, 2018.

Corp Fin deficiency letters for certain registration statements

On June 12, 2018, Corp Fin announced that it will be releasing letters that identify certain registration statements and offering documents as seriously deficient earlier than in the past. To promote transparency, within 10 calendar days of issuing a letter that identifies a registration statement or offering document as not minimally compliant with regulatory requirements, it will be released to the public through the company's filing history on EDGAR. This process began with letters issued on June 15, 2018.

Other disclosure matters

Non-GAAP measures

The SEC's Corp Fin updated its C&DIs on Non-GAAP Financial Measures on April 4, 2018, by adding two questions related to business combinations. The new answers clarify when certain forecasts disclosed by registrants would not meet the definition of a non-GAAP measure.

Additionally, the SEC staff has noted that it continues to comment on non-GAAP measures related to individually tailored accounting principles.

Mining disclosures

On Oct. 31, 2018, the SEC adopted amendments to modernize property disclosure requirements for mining registrants. The amendments require a registrant with material mining operations to disclose specified information in its SEC filings concerning its mineral resources, in addition to its mineral reserves. Currently, nonreserve estimates are permitted to be disclosed only in limited circumstances. The final rules provide a two-year transition period. Compliance is required in a registrant's first fiscal year beginning on or after Jan. 1, 2021. The press release includes a fact sheet that summarizes the new rules.

From the Division of Enforcement

Division of enforcement – annual update

On Nov. 2, 2018, the SEC's Division of Enforcement released its annual update for 2018 in which the co-directors qualitatively evaluate the performance of the division against five priorities:

- Focus on the Main Street investor
- Focus on individual accountability
- Keep pace with technological change
- Impose remedies that most effectively further enforcement goals
- Constantly assess the allocation of resources

In addition, the annual report provides discussion and analysis of enforcement actions on a quantitative basis.

From the PCAOB

Big picture

New strategic plan

Since their appointment by the SEC on Dec. 12, 2017, the PCAOB chairman and board members have been sworn into office. The board includes Chairman William Duhnke and members Kathleen Hamm, J. Robert Brown, James Kaiser, and Duane DesParte.

On Nov. 15, 2018, the PCAOB approved its five-year strategic plan for 2018 through 2022, which emphasizes the PCAOB's core values: integrity, excellence, effectiveness, collaboration, and accountability.

The plan includes the following strategic goals:

- “Drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation
- “Anticipate and respond to the changing environment, including emerging technologies and related risks and opportunities
- “Enhance transparency and accessibility through proactive stakeholder engagement
- “Pursue operational excellence through efficient and effective use of our resources, information, and technology
- “Develop, empower, and reward our people to achieve our shared goals”

Previously, on Aug. 10, 2018, the PCAOB released a draft of its five-year strategic plan and, for the first time ever, sought public comment on the plan.

Board speeches

During the year, board members including PCAOB Chairman William D. Duhnke spoke about the new board and its new strategic initiatives. The following speeches were delivered:

- Nov. 30, 2018, Kathleen M. Hamm – “Quality Control: The Next Frontier” on the PCAOB's focus on quality control at audit firms in the context of the PCAOB's primary activities: registrations, inspections, standard-setting, and enforcement; and five things that an audit firm can do to improve its quality control related to a firm's strategy, governance, risk and control assessment, processes for monitoring audit quality, and periodic re-evaluations of its quality control strategy and programs
- Nov. 2, 2018, Kathleen M. Hamm – “Mexican Mangos, Diamonds, Cargo Shipping Containers, Oh My! What Auditors Need to Know About Blockchain and Other Emerging Technologies: A Regulator's Perspective”
- Nov. 1, 2018, James G. Kaiser – “A Board Member's Perspective: PCAOB's 5-Year Strategic Plan, Transformation Initiatives, and Current Developments” on the strategic plan; transformation initiatives for inspections, standard-setting, and data and technology; and current developments related to standard-setting, the auditor's reporting model, new accounting standards, inspections, cybersecurity, and interim inspections for broker-dealer audits

- Oct. 22, 2018, Hamm – “Driving Audit Quality Forward: PCAOB 2.0” on the new board, creation of the board, the board’s mission and core duties, the state of audit quality, five strategic goals of the new board, and emerging technologies
- Oct. 18, 2018, Duhnke – “Keynote Speech to ALI’s Accountants’ Liability 2018 Conference” on inspections, enforcement, standard-setting, and external engagement
- May 17, 2018, Duhnke on the PCAOB’s Future – Address to the University of Kansas Auditing Symposium, where he discussed the first-ever request for public comment on the PCAOB’s strategic plan and covered principles that will guide the board’s actions and decisions. He shared a number of items that the board is considering in order to improve audit quality through inspections, as well as improving the reporting and communicating inspection results. The chairman also discussed approaches by audit regulators in other countries that could inform the board’s views.

Before closing, he posed a number of questions that the board must consider as it evaluates improvements to its programs that go beyond the inspections program.

All speeches and public statements by board members and staff are available on the PCAOB’s website.

Standing Advisory Group (SAG) meetings

The PCAOB’s SAG comprises various stakeholders – investors, auditors, audit committee members, public company executives, and others – and advises the PCAOB on audit and professional practice standards.

The PCAOB held a SAG meeting on Nov. 29, 2018, and the agenda included the following topics:

- Governance and leadership in firm quality control systems
- Communications about PCAOB standards

The PCAOB’s SAG also met June 5-6, 2018, in Washington, D.C. Meeting topics included the following:

- Panel discussion with the new board
- PCAOB standard-setting update
- Data and technology
- Cybersecurity
- Corporate culture implications for the audit
- Revised auditor’s reporting model implementation

Staffing updates

The PCAOB named Megan Zietsman as chief auditor on Dec. 13, 2018. Zietsman is expected to assume her role in early 2019. She will join the PCAOB from Deloitte, where she has served as a partner in its professional practice network. She has served on the International Auditing and Assurance Standards Board since 2014, currently as the deputy chair. She also served on the AICPA's Auditing Standards Board from 2007 to 2011.

On Nov. 12, 2018, the PCAOB announced that Torrie Miller Matous was named director of the newly formed Office of External Affairs. The new office combines certain existing offices and will include new liaison staff for the investor and business communities to assist the board in achieving the transparency and accessibility goals outlined in its draft strategic plan.

On Nov. 1, 2018, the PCAOB announced that George Botic was named the director of the Division of Registration and Inspections. Botic had been the acting director of the division since May and will lead the PCAOB's efforts related to registration and inspection of domestic and foreign accounting firms that audit public companies or broker-dealers. Also on Nov. 1, the board announced that Liza McAndrew Moberg was named director of the Office of International Affairs. She had been the acting director since May and "will lead the PCAOB's efforts to advance cross-border engagement with others involved in investor protection efforts and to implement and maintain cooperative agreements that facilitate the PCAOB's oversight activities outside of the U.S."

On Oct. 9, 2018, the PCAOB announced the appointment of Ryan Sack as director of the Office of Internal Oversight and Performance Assurance, which provides examination of the PCAOB's internal operations and programs. Sack has more than 20 years of experience in the internal audit and assurance field and was most recently at Orbital ATK as internal audit vice president.

Previously, the PCAOB announced departures of various senior staff. On May 22, 2018, that Chief Auditor Martin F. Baumann would leave the board after 12 years of service. The PCAOB also announced, on May 18, 2018, that Director of Registration and Inspections Helen Munter would leave the board after 14 years of service. Finally, the PCAOB announced that Director of Enforcement and Investigations Claudius Modesti would leave the agency after 14 years of service, and Director of the Office of Information Technology Nirav Kapadia left after seven years of service.

All departures were effective by the end of May 2018.

Standard-setting

New audit standard for estimates and using the work of others

The PCAOB adopted a new auditing standard, “Auditing Accounting Estimates, Including Fair Value Measurements,” on Dec. 20, 2018, to replace three existing PCAOB auditing standards on auditing accounting estimates. Changes to the auditing standard address the auditor’s professional skepticism, including potential management bias, and specific direction on auditing fair values of financial instruments that are based on information from third-party pricing sources. Concurrent with the new standard, the PCAOB adopted amendments related to using the work of a company’s employed or engaged specialists and the work of an auditor’s employed or engaged specialists. Subject to approval by the SEC, the new and amended standards are effective for audits of financial statements for fiscal years ending on or after Dec. 15, 2020.

Auditor’s report changes: Staff guidance

The PCAOB updated, on Aug. 23, 2018, its staff guidance on changes to the auditor’s report that took effect for calendar year-end audits of Dec. 31, 2017, annual financial statements. The updates to the guidance relate to the following topics:

- Voluntary disclosure of certain audit participants
- Auditor tenure
- Auditor reporting on internal control over financial reporting
- Explanatory and emphasis paragraphs
- Auditor reporting on supplemental information, interim financial information, and special reports

Inspections

Staff speech

On Dec. 12, 2018, George Botic, director of the Division of Registration and Inspections gave a speech – “Protecting Investors Through Change” – at the AICPA Conference on Current SEC and PCAOB Developments in Washington, D.C. He covered changes at the PCAOB under the new board that will affect the 2019 inspection cycle, including the PCAOB’s assessment of a firm’s quality control system and control environment, engagement of U.S. company audit committee chairs to provide insight into the inspection process, and establishment of a program to share audit firm practices that promote or enhance audit quality. He also shared his expectation for changes to the inspection reports and the process for remediation. In the PCAOB’s information-gathering activities in 2019, the staff will consider which metrics may be predictive of audit quality (audit quality indicators), and Botic recommends that audit firms do the same.

Additional topics included:

- Frequent inspection findings for revenue, accounting estimates, and internal control over financial reporting
- Root cause analysis as a good audit firm practice
- Form AP
- Others areas of focus for 2019 inspections including technology risks and implementation of the new auditor’s reporting model including critical audit matters (CAMs)

Inspections outlook for 2019

The PCAOB posted the “Inspections Outlook for 2019” to its website on Dec. 6, 2018. The report includes key areas of focus for planned 2019 inspections of audits of issuers and brokers and dealers. It covers the following topics:

- System of quality control
- Independence
- Recurring inspection deficiencies
- External considerations
- Cybersecurity risks
- Software audit tools
- Digital assets
- Audit quality indicators
- Changes in the auditor’s report
- Implementation of new accounting standards

Broker-dealers

Sample auditor’s report for broker-dealer audits

On Dec. 17, 2018, the board posted a sample unqualified auditor’s report under Auditing Standard (AS) 3101 (which went into effect on Dec. 15, 2017) on the financial statements of a broker or dealer reporting under Rule 17a-5 of the *Securities Exchange Act of 1934*. The sample report includes marked changes that result from AS 3101.

Broker-dealer inspection report

On Aug. 20, 2018, the PCAOB released its report on 2017 inspections of broker-dealer auditors. The executive highlights accompanying the report include the following important points:

- “Auditors should focus on improving their quality control systems to perform high quality audits and attestation engagements.
- “Overall deficiencies remained high, although inspectors found fewer independence violations than in past years.
- “Broker-dealer owners and audit committees (or equivalent) are encouraged to discuss these results with their auditors.”

From the Center for Audit Quality (CAQ)

Emerging technologies: Tool for audit committees

On Dec. 12, 2018, the CAQ released a new tool, “Emerging Technologies: An Oversight Tool for Audit Committees,” that highlights artificial intelligence and robotic process automation. According to the CAQ, the tool “provides a framework and questions that audit committees may ask management and auditors to help inform their oversight of financial reporting as emerging technologies take hold.”

Cybersecurity: Tool for board members

On April 12, 2018, the CAQ released a new tool, “Cybersecurity Risk Management Oversight: A Tool for Board Members,” that board members can use to enhance their oversight of enterprisewide cybersecurity risk management. The tool includes questions that boards can ask management and financial statement auditors (or other CPA firms, depending on the engagement type).

The tool is organized into four sections:

- Understanding how the financial statement auditor considers cybersecurity – in the context of financial statement and, if applicable, internal control over financial reporting audits
- Understanding the role of management and responsibilities of the financial statement auditor related to cybersecurity disclosures – of both cybersecurity incidents and cybersecurity programs
- Understanding management’s approach to cybersecurity risk management – including whether a framework has been used to design a cybersecurity risk management program
- Understanding how CPA firms can assist boards of directors in their oversight of cybersecurity risk management – including independence considerations for entities subject to SEC independence rules and their financial statement auditors

Also, the CAQ released, on May 15, 2018, a one-page overview of how CPAs can help companies as they seek to manage cybersecurity risks. On June 6, 2018, the CAQ hosted a webinar, “Putting Cyber Risk in Context.”

Audit committee disclosures: Transparency barometer report

On Nov. 1, 2018, the CAQ and Audit Analytics jointly issued their fifth annual report, “2018 Audit Committee Transparency Barometer.” The report shows an increase from 2014 (the first year these barometer reports were issued) in the percent of public company audit committees disclosing the following in proxy statements:

- Considerations in appointing the audit firm
- Length of audit firm engagement
- Criteria considered when evaluating the audit firm
- That the audit committee is involved in audit partner selection
- That the evaluation of the external auditor is at least an annual event

The report also presents examples of public company disclosures to illustrate best practices.

Critical audit matters: Lessons learned from dry runs

The CAQ released a publication, “Critical Audit Matters: Lessons Learned, Questions to Consider, and an Illustrative Example,” on Dec. 10, 2018, offering initial observations from applying the new PCAOB guidance related to CAMs. Included are lessons learned from the dry runs of applying the CAMs guidance related to:

- The determination of which matters are CAMs
- Auditor communication with management and the audit committee
- Planning and timing of implementation
- Challenges in drafting CAMs

It also offers 10 questions for audit committees to consider related to including CAMs in the auditor's report as well as an illustrative example of a CAM disclosure.

Previously, on July 24, 2018, the CAQ released a resource, “Critical Audit Matters: Key Concepts and FAQs for Audit Committees, Investors, and Other Users of Financial Statements,” to help audit committees, investors, and other users understand critical audit matters (CAMs). CAMs will be included in the auditor's report for large accelerated filers in fiscal years ending on or after June 30, 2019, and for other public companies (except for emerging growth companies, brokers and dealers reporting under *Exchange Act* Rule 17a-5, investment companies other than business development companies, and benefit plans) in fiscal years ending on or after Dec. 15, 2020.

The CAQ states that “many audit firms are performing dry runs” with respect to CAM implementation in auditors' reports, and this resource is “a first step in raising awareness about the underlying requirements of CAMs.” The publication addresses the identification and reporting of CAMs, and it includes answers to eight questions frequently asked by audit committees and others.

In addition, an appendix compares the PCAOB CAMs and the International Auditing and Assurance Standards Board (IAASB) key audit matters (KAMs) in their respective expanded auditor reporting standards. The PCAOB has acknowledged similarities between CAMs and KAMs.

Lease accounting: Tool for audit committees

On April 4, 2018, the CAQ released a new tool, “Preparing for the Leases Accounting Standard: A Tool for Audit Committees,” that audit committees can use to enhance their oversight of management's implementation of Accounting Standards Codification Topic 842, “Leases,” which begins to take effect for many public companies in January 2019. The tool includes questions that audit committees can ask management and their auditors, and is organized into four sections:

- Understanding the new leases standard – identifying all contracts with leases and, for lessees, measurement of the new right-of-use asset and lease liability
- Evaluating the company's impact assessment – addressing disclosure of the expected impact on the financial statements as well as the impact on debt covenants, income tax effects, investor relations, regulatory compliance, and other considerations
- Evaluating the implementation project plan – including an evaluation of the timeline, the corporate culture and resources, involvement of key stakeholders, accounting policies and judgments, and systems and controls
- Other implementation considerations – including transition methods and disclosure requirements

Non-GAAP measures

On March 16, 2018, the CAQ released a new tool, “[Non-GAAP Measures: A Roadmap for Audit Committees](#),” that public company audit committees can use to enhance their oversight of management’s use of non-generally accepted accounting principles (non-GAAP) measures. The road map includes themes that came up during a series of roundtables in 2017. It also presents leading practices for assessing whether a company’s use of non-GAAP measures provides a balanced perspective of its performance. When presented appropriately – that is, when they are transparent, consistent, and comparable to measures disclosed by other companies – information about non-GAAP measures is useful to investors.

To add context and give some real-life examples, the CAQ also released a [companion video](#) featuring interviews with audit committee chairs.

Audit quality reporting framework for audit firms

On Jan. 8, 2019, the CAQ released a framework, “[Audit Quality Disclosure Framework](#),” to assist audit firms in developing their transparency or audit quality reports.

The framework is voluntary, is flexible, and addresses disclosure of quality control at the firm level. Under these principles, the framework provides “points of focus” for six elements of audit quality and examples of firm-level audit quality indicators (AQIs):

1. Leadership, culture, and firm governance
2. Ethics and independence
3. Acceptance and continuance of clients and engagements
4. Engagement team management
5. Audit engagement performance
6. Monitoring

Broker-dealers use of a service organization

The CAQ [released](#) a tool, on Aug. 22, 2018, for broker-dealers that use service organizations. Although the tool is addressed to auditors, it contains matters that broker-dealer management also would want to consider in assessing internal controls related to the use of service organizations.

Learn more

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