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Keeping You Informed

Fourth Quarter Accounting and Financial Reporting Developments

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Contents

Fourth Quarter Highlights

Implementation is underway for the FASB's three major accounting standards on revenue recognition, leases, and credit losses. See the latest in the section "Major Final Standards and Implementation Efforts," including a summary of the FASB's latest clarifying standard on revenue recognition.

This was a busy quarter (October through December) for the Financial Accounting Standards Board (FASB), which issued five standards:

- Technical corrections and improvements to the new revenue recognition guidance
- Technical corrections and improvements to existing accounting guidance
- Guidance on the presentation of restricted cash in the statement of cash flows
- A revision to the evaluation of a primary beneficiary when certain related parties are involved under the variable interest entity (VIE) model
- A revision to income tax accounting for intra-entity asset transfers other than inventory

The FASB issued three proposals this quarter: one on instruments with down-round features, one on share-based payment awards, and one on service concession arrangements that involve public sector (government) entities.

The focus this quarter for the Securities and Exchange Commission (SEC) continued to be on implementation of the major accounting standards and non-GAAP measures.

Finally, the Public Company Accounting Oversight Board (PCAOB) is expected to issue a significant audit standard on the auditor's reporting model in 2017.

From the FASB

Major Final Standards and Implementation Efforts

Beginning with the revenue recognition standard issued in May 2014 and ending with the issuance of the leases and credit losses standards in the first and second quarters of 2016, respectively, the FASB finalized three major accounting standards. Each one of these standards introduces significant changes to accounting and financial reporting, and given each standard's pervasiveness and complexities, Crowe has summarized each in a separate publication released this quarter, "Are You Ready for the Adoption of the Major Financial Reporting Standards?" That publication also addresses four of the five additional standards that the FASB issued in 2016 to clarify the revenue recognition guidance. In addition, it includes a table that illustrates when all three major accounting standards will become effective for public and private entities. We summarize the fifth clarifying standard next.

Technical Corrections and Improvements to Revenue Recognition Guidance

Accounting Standards Update (ASU) 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers," was released by the FASB on Dec. 21, 2016, to address narrow aspects of ASU 2014-09, "Revenue From Contracts With Customers (Topic 606)." The ASU addresses 13 issues, including clarifications of the following topics:

- Scoping considerations for loan guarantee fees in the scope of Topic 460, guarantees accounted for as derivatives, and insurance contracts in the scope of Topic 944
- Testing for impairment of capitalized costs for revenue contracts
- Provisions for losses on construction-type and production-type contracts
- Disclosures for remaining performance obligations for variable consideration in specific circumstances and for prior-period performance obligations satisfied in previous periods
- Illustrative examples related to contract modifications, a contract asset versus a receivable, and a refund liability
- Accrual of advertising costs
- Fixed-odds wagering contracts in the casino industry
- Cost-capitalization guidance for advisers to both public funds and private funds

Effective Dates and Transition

The effective date and transition requirements for this ASU will be the same as the requirements for ASU 2014-09. As a reminder, ASU 2015-14, "Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date," defers the effective date of ASU 2014-09, which for calendar year-end public business entities (PBEs) first applies to March 31, 2018, interim financial statements.

Final Standards Issued

Technical Corrections and Improvements

On Dec. 14, 2016, the FASB released ASU 2016-19, "Technical Corrections and Improvements," which seeks to clarify, correct errors to, and make minor improvements to the FASB ASC.

The changes include simplifications and minor improvements to topics on insurance, troubled debt restructuring, financial instruments, certain real estate sales, fair value measurement, and transfers and servicing of financial assets. In some cases, the modifications remove certain definitions from the master glossary or revise definitions to be more consistent among topics; in other cases, the amendments provide clarification of considerations in the analysis of applicable transactions.

The board noted six changes that may result in a change in practice for certain entities:

- An amendment to ASU 2015-05, "Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," adds a reference to guidance to use when accounting for internal-use software licensed from third parties that is in the scope of Subtopic 350-40.
- A correction includes the Emerging Issues Task Force (EITF) decision that loans insured by the Federal Housing Administration (FHA) or the Veterans Benefits Administration (VA) do not have to be fully insured by those government-insured programs to recognize profit using the full accrual method.
- The fair value measurement guidance now clarifies the difference between an approach and a technique when applying ASC Topic 820. Disclosure will be required when there has been a change in either a valuation approach or a valuation technique.
- ASC Subtopic 405-40, "Liabilities – Obligations Resulting From Joint and Several Liability Arrangements," is revised to clarify that for an obligation amount to be considered fixed, the entire obligation amount – and not the entity's portion of the obligation – must be fixed at the reporting date.

- ASC Subtopic 860-20, “Transfers and Servicing – Sales of Financial Assets,” is changed to align implementation guidance in ASC 860-20-55-41 with the recognition guidance in ASC 860-20-25-11. The change clarifies what should be considered in determining whether a transferor once again has effective control over transferred financial assets.
- ASC Subtopic 860-50, “Transfers and Servicing – Servicing Assets and Liabilities,” adds guidance that existed in AICPA Statement of Position 01-6, “Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others,” but was mistakenly omitted from the ASC. The addition addresses the accounting for the sale of servicing rights when the transferor retains loans.

Effective Dates

Most of the amendments (not listed above) in the ASU do not require transition guidance and are effective immediately. For the six changes listed above, the effective dates are as follows:

For PBEs, the ASU will be effective in annual periods beginning after Dec. 15, 2016.

For all other entities, it will be effective in annual periods beginning after Dec. 15, 2017.

Transition

With one exception for the amendment related to ASU 2015-05, prospective transition will be required.

For the amendment to ASU 2015-05, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” transition will follow the guidance in ASU 2015-05.

Cash Flow Statement Classification of Restricted Cash

On Nov. 17, 2016, the board issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash (a Consensus of the FASB Emerging Issues Task Force).” Originally part of the “Cash Flow Statement Classification Issues” project, this issue related to restricted cash was separately addressed by the EITF and by the FASB.

In current practice, transfers between cash and restricted cash are reflected as operating, investing, or financing activities, or a combination, on the cash flow statement. Also, some entities present direct cash receipts from and payments to a restricted cash bank account on the cash flow statement, and others disclose those cash flows as noncash activities.

The new guidance requires that the statement of cash flows include restricted cash and cash equivalents in total cash and cash equivalents, and therefore, the transfers solely between cash and restricted cash would not be reflected in the cash flow activities.

In addition, the balance sheet line items that include restricted cash and cash equivalents and the related amounts must be disclosed either in the cash flow statement or in the notes to the financial statements, and they should reconcile to total cash and cash equivalents on the cash flow statement, which will include restricted cash and cash equivalents. The FASB decided not to define "restricted" in the final standard. However, an entity will be required to disclose the nature of restrictions on the restricted cash and cash equivalent amounts.

Effective Dates

For PBEs, the amendments are effective for fiscal years beginning after Dec. 15, 2017, and interim periods in those fiscal years, which first applies to March 31, 2018, interim financial statements for calendar year-end PBEs.

For all other entities, the amendments are effective for fiscal years beginning after Dec. 15, 2018, and interim periods in fiscal years beginning after Dec. 15, 2019, which will be Dec. 31, 2020, for calendar year-end entities.

Early adoption is permitted, including adoption in an interim period.

Transition

Retrospective application to all periods presented in the cash flow statement upon adoption is required.

Changes to the Evaluation of a Primary Beneficiary for Related Parties

On Oct. 26, 2016, the FASB issued ASU 2016-17, "Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control," which revises the variable interest entity (VIE) consolidation model for single decision-makers evaluating certain interests held by related parties under common control.

The change addresses the evaluation of whether a reporting entity is the primary beneficiary of a VIE that is held by related parties under common control. In that evaluation, reporting entities no longer will treat indirect interests in a VIE held through related parties that are under common control as direct interests. Instead, such interests will be included on a proportionate basis consistent with indirect interests held through other related parties.

This standard eliminates the requirement in ASU 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis," that could have resulted in a single decision-maker consolidating a VIE held by a related party under common control even if that single decision-maker had little to no direct economic interests in the VIE. The guidance from ASU 2015-02 was effective in the first quarter of 2016 for calendar year-end PBEs.

Effective Dates

For PBEs, ASU 2016-17 is effective for fiscal years beginning after Dec. 15, 2016, including interim periods in those years.

For all other entities, the standard is effective for fiscal years beginning after Dec. 15, 2016, and interim periods in fiscal years beginning after Dec. 15, 2017.

Early adoption is permitted.

Transition

Entities that have already adopted ASU 2015-02 must apply these amendments on a retrospective basis to prior periods beginning with the fiscal year in which ASU 2015-02 was initially adopted.

Entities that have not yet adopted ASU 2015-02 must adopt these amendments at the same time, and apply these amendments using the same transition method, as when they adopt ASU 2015-02.

Accounting for Income Taxes: Intra-Entity Asset Transfers

As part of the FASB's simplification initiative, aimed at reducing the complexity of accounting standards, the board issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," on Oct. 24, 2016.

The standard eliminates the requirement to defer recognition of current and deferred-income tax consequences for intra-entity asset transfers until the asset or assets have been sold to an outside party. Therefore, an entity will be required to recognize the current and deferred tax consequences of such intra-entity transfers when the transfers occur.

The standard does not apply to inventory transfers. Therefore, current generally accepted accounting principles (GAAP) will be retained for intra-entity asset transfers of inventory; an entity will continue to recognize the income tax consequences when the inventory has been sold to an outside party.

Effective Dates

For PBEs, the ASU is effective for annual reporting periods beginning after Dec. 15, 2017, including interim reporting periods in those annual periods.

For other entities, it is effective for annual reporting periods beginning after Dec. 15, 2018, and interim periods in annual periods beginning after Dec. 15, 2019.

Early adoption is permitted as of the beginning of an annual reporting period for which financial statements have not been issued or made available for issuance.

Transition

Application is required on a modified retrospective basis with a cumulative-effect adjustment to retained earnings in the beginning of the adoption period.

Proposals Released

Down-Round Features and Mandatorily Redeemable Instruments

On Dec. 7, 2016, the FASB proposed amendments to remove some complexity for financial instruments that have both equity and liability characteristics. The two-part exposure draft, "Distinguishing Liabilities From Equity (Topic 480): I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception," addresses the following two issues.

1. The first issue relates to financial instruments with down-round features (that is, features that result in the exercise price declining based on the price of future equity offerings) and would more closely align the accounting with the economics of those features. Specifically, an entity would no longer consider down-round features when determining whether a financial instrument is indexed to its own stock under the liability or equity classification analysis. Instead, the effect of the down-round feature would be recognized when triggered:

   - For equity-classified instruments, the effect would be recognized in equity as a dividend.
   - For liability-classified instruments, it would be recognized in earnings.

   In the period when the down-round feature is triggered, disclosure would be required, including the quantitative effect of the feature being triggered and financial statement line item where the effect is recorded.

2. In 2003, the FASB deferred the effective date of FASB Statement 150, "Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity," for mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests, which is memorialized in ASC 480-10-65-1. Some find the content in the codification difficult to read and to navigate, so the board decided to replace the indefinite deferral with a scope exception. As such, there is no expected accounting impact.

Comments are due Feb. 6, 2017.

Modification Accounting for Share-Based Payment Awards

The FASB issued a proposed ASU, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting," on Nov. 17, 2016, to provide guidance for which share-based payment award changes require modification accounting (that is, accounting for a change in an award by recording the incremental difference in the fair value of the modified award as compensation expense). Today, some entities evaluate whether changes are substantive, some apply modification accounting for any change unless it's purely administrative, and others apply modification accounting when the change results in a change to the fair value, vesting, or classification. In addition, questions had been posed on whether changes for the adoption of ASU 2016-09, "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" – namely, changes to statutory tax withholding requirements – would require modification accounting.

For changes to the terms or conditions of a share-based payment award, the proposed amendments would provide guidance about when to apply modification accounting in Topic 718. Modification accounting would apply unless all of the following are the same immediately before and after the modification:

- The award's fair value (or calculated value or intrinsic value, if such an alternative measurement method is used)
- The award's vesting provisions
- The award's classification as an equity instrument or a liability instrument

Current disclosure requirements in Topic 718 would apply whether or not an entity is required to use modification accounting under the proposed amendments.

The amendments would be applied prospectively to awards modified on or after the effective date.

Comments were due Jan. 6, 2017.

Service Concession Arrangements

On Nov. 4, 2016, the FASB issued an exposure draft, "Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services (a Consensus of the FASB Emerging Issues Task Force)," to address diversity in practice in how an operating entity determines the customer in service concession arrangements. Service concession arrangements are between a public sector entity (grantor) and an operating entity; the operating entity operates the public sector entity's infrastructure (such as airports, roads, and bridges) for a specified period of time.

When applying existing revenue recognition guidance to these arrangements, clarity is needed on how to determine the customer of the operating services. It is expected that similar issues will arise when applying the new revenue recognition standard, ASU 2014-09, to these arrangements.

The proposal would require that the public sector entity, in all cases, be identified as the customer in service concession arrangements.

Effective Dates

For an entity that has not adopted the new revenue recognition guidance (including the original standard, ASU 2014-09, and subsequent revisions and clarifying standards), the effective dates and transition requirements for the amendments in this proposal would be the same as for the new revenue recognition guidance.

Effective dates for entities that early adopt the revenue recognition guidance are pending further consideration by the board.

Comments were due Jan. 6, 2017.

Other Projects on Our Watch List

Disclosure Framework Project Update

The FASB plans to hold a roundtable, on March 17, 2017, to discuss various topics within the Disclosure Framework projects. These projects include income taxes, inventory, fair value measurement, and defined benefit plans disclosure proposals – all of which are discussed here.

Income Taxes

The FASB issued for comment a proposed ASU on July 26, 2016. The proposed standard, "Income Taxes (Topic 740): Disclosure Framework – Changes to the Disclosure Requirements for Income Taxes," would require additional income tax disclosures and stems from the board's disclosure framework project.

All entities would be required to disclose a description of any enacted change in tax law that probably would affect the financial statements in a future period. The proposal also would reduce diversity in practice by requiring more specific disclosures about tax loss carry-forwards. Entities with foreign operations would be required to make additional disclosures about foreign earnings, foreign income tax expense and payments, and cash and marketable securities held by foreign subsidiaries. In addition, if an entity changes its assertion about permanently reinvesting undistributed foreign earnings, it would be required to disclose circumstances that caused the change and the corresponding amount of those earnings.

PBEs would be required to disclose separately any reconciling item that is more than 5 percent of the amount computed by multiplying pretax income by the statutory income tax rate, and to explain the changes in those reconciling items from year to year. The bright line of 5 percent for reconciling items in the proposal is aligned with Rule 4-08(h) of Regulation S-X, which is applicable to Securities and Exchange Commission reporting companies.

Comments were due Sept. 30, 2016.

Inventory Disclosures

Also stemming from the FASB's disclosure framework project and part of a trial run in applying the concepts of that project to existing inventory disclosure requirements, on Jan. 10, 2017, the FASB issued an exposure draft, "Inventory (Topic 330): Disclosure Framework – Changes to the Disclosure Requirements for Inventory."

In an effort to improve the effectiveness of inventory disclosures in the notes to financial statements, the proposal would require that all entities present the following additional disclosures:

- Inventory disaggregated by component
- Inventory disaggregated by measurement basis
- Changes to the inventory balance that are not specifically related to the purchase, manufacture, or sale of inventory in the ordinary course of business
- A qualitative description of the costs capitalized into inventory
- The effect of last-in, first-out (LIFO) liquidations on income
- The replacement cost for LIFO inventory

The proposal also includes additional guidance for specific entities:

- For entities that report inventory using the retail inventory method (RIM), qualitative and quantitative information would be required about the critical assumptions used in the calculation of inventory under that method.
- Public entities, as defined in ASC 280-10-15 (including SEC registrants), would be required to disclose, in annual and interim periods, inventory by reportable segment or by component for each reportable segment if that information is regularly provided to the chief operating decision-maker.

Transition is proposed to be on a prospective basis upon adoption.

Comments are due March 13, 2017.

Fair Value Measurement Disclosures

On Dec. 3, 2015, the board issued a proposed ASU, "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement," to suggest changes to the fair value measurement disclosures. If approved, the standard would apply to all entities that are required to make recurring or nonrecurring fair value measurement disclosures. Some disclosures would not be required for private companies. The proposal also promotes the use of discretion by reinforcing that an entity can assess disclosures on the basis of whether they are material.

Interestingly, the FASB proposed to use legacy definitions of "public" rather than conform to its newer "PBE" definition. The old terminology of "nonpublic entity" and "private company" does differ from non-PBEs. The following are the applicable terms from the ASC glossary.

> "Private Company – An entity other than a public business entity, a not-for-profit entity, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.
>
> "Nonpublic Entity – Any entity that does not meet any of the following conditions:
>
> "a. Its debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in an over-the-counter market, including securities quoted only locally or regionally.
>
> "b. It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).
>
> "c. It files with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market.
>
> "d. It is required to file or furnish financial statements with the Securities and Exchange Commission."

The following are the significant changes laid out in the FASB's proposal:

Disclosure	Public	Private
The amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy	Removed	Removed
The policy for timing of transfers between levels	Removed	Removed
The valuation policies and procedures for Level 3 fair value measurements	Removed	Removed
The change in unrealized gains and losses for the period included in earnings (or changes in net assets) on recurring Level 3 fair value measurements held at the end of the reporting period	Unchanged	Removed
Reconciliation of the opening balances to the closing balances of recurring Level 3 fair value measurements	Unchanged	Removed
For investments in certain entities that calculate net asset value (NAV), the timing of liquidation of an investee's assets and the date when restrictions from redemption will lapse only if the investee has communicated the timing to the entity or announced the timing publicly.	Clarified	Clarified
For the measurement uncertainty disclosure, information about the uncertainty in measurement as of the reporting date rather than information about sensitivity to changes in the future	Clarified	Clarified
The changes in unrealized gains and losses for the period included in other comprehensive income (OCI) and earnings (or changes in net assets) for recurring Level 1, Level 2, and Level 3 fair value measurements held at the end of the reporting period, disaggregated by level of the fair value hierarchy	Added	Not added
For Level 3 fair value measurements, the range, weighted average, and time period used to develop significant unobservable inputs	Added	Not added

Effective Date

The effective date would be determined after stakeholder feedback has been considered.

Comments were due Feb. 29, 2016.

The board discussed feedback received on the proposal at its June 1, 2016, meeting and asked the staff to conduct outreach to investors and other financial statement users on the proposal.

Defined Benefit Plans – Disclosures by Plan Sponsors

As part of a trial run in applying the Disclosure Framework project concepts to existing defined benefit pension and other postretirement plan disclosure requirements, the FASB issued an exposure draft, "Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans," on Jan. 26, 2016.

The proposal would *remove* the following disclosures:

- The amount of the pension accumulated benefit obligation
- The aggregate pension accumulated benefit obligation and aggregate fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets
- The amount and timing of plan assets expected to be returned to the entity
- The disclosures related to the June 2001 amendments to the *Japanese Welfare Pension Insurance Law*
- Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts, and significant transactions between the employer or related parties and the plan
- The amounts in accumulated other comprehensive income (AOCI) expected to be recognized as components of net periodic benefit cost over the next fiscal year
- For nonpublic entities, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy, with the exception that nonpublic entities would be required to disclose the amounts of transfers into and out of Level 3 of the fair value hierarchy and purchases of Level 3 plan assets

The proposal would *add* the following disclosures:

- A description of the nature of the benefits provided, the employee groups covered, and the type of benefit plan formula
- The weighted-average interest crediting rate for cash balance plans and other plans with a promised interest crediting rate
- Quantitative and qualitative disclosures from Topic 820, "Fair Value Measurement," about assets measured at NAV using a practical expedient
- A narrative description of the reasons for significant gains and losses affecting the benefit obligation or plan assets
- For nonpublic entities, the effects of a one-percentage-point change in assumed healthcare cost trend rates (a disclosure currently required only for public entities)

The proposal also would require disaggregation of domestic and foreign plans. Retrospective application would be required with one exception – that the qualitative disclosures about plan assets measured at NAV would be required in the most recent period presented upon adoption.

Comments were due on April 25, 2016.

The board discussed comments received on the proposal at its July 13, 2016, meeting and asked the staff to perform additional research on particular matters.

From the SEC

SEC Staff at AICPA Conference on Current SEC and PCAOB Developments

SEC staff members participated extensively in the annual American Institute of CPAs (AICPA) National Conference on Current SEC and Public Company Accounting Oversight Board (PCAOB) Developments in December 2016. A summary of speeches at that conference – including those of SEC staff, the SEC chief accountant, the FASB chair, and the PCAOB chair – appears in the Crowe article "Headline Speeches From the 2016 AICPA SEC Conference."

Staff Announcement on the Impact of Recent Major Accounting Standards

At the December 2016 AICPA National Conference on Current SEC and PCAOB Developments, Sylvia E. Alicea, a professional accounting fellow in the SEC's Office of the Chief Accountant (OCA), referred to "the SEC staff announcement at the EITF meeting in September regarding additional qualitative disclosures registrants are expected to provide about the impact that certain recently issued accounting standards (Accounting Standard Updates or 'ASUs') will have on a registrant's financial statements when those standards will be adopted in a future period (in accordance with SAB Topic 11.M)." In her speech, she reminded public companies to provide transition disclosures for the major accounting standards, which are defined as revenue, leases, and credit losses.

Financial Reporting Manual

The SEC's Division of Corporation Finance (Corp Fin) staff released an updated Financial Reporting Manual, on Nov. 9, 2016. This manual represents informal guidance prepared by and for the Corp Fin staff and is made available to readers, who may find the guidance useful in preparing SEC filings.

Among the changes in this update are additions, which can be found in Topic 11 of the manual, to the implementation guidance for the new major accounting standards on revenue recognition, lease accounting, and short-duration contracts for insurance entities.

Non-GAAP Measures

Non-GAAP at the CAQ's SEC Regulations Committee Meeting

On Nov. 8, 2016, the CAQ released highlights of the Sept. 27, 2016, CAQ SEC Regulations Committee joint meeting with SEC staff. Although the highlights do not represent authoritative SEC guidance, they do summarize the topics that were discussed at the meeting, including the following:

- SEC staff reminders about non-GAAP financial measures
  - Full non-GAAP income statements are prohibited.
  - Per-share non-GAAP measures that are presented as performance measures but appear consistent with liquidity measures are prohibited.
  - The staff will object if non-GAAP measures represent an individually tailored (non-GAAP) accounting principle, and an example of consolidating an unconsolidated entity was provided.
- SEC staff comment letters on non-GAAP measures
  - Comments are being issued for adjustments related to restructuring charges, acquisitions or purchase accounting items, and legal settlements in order to understand and evaluate the appropriateness of those adjustments. However, the staff generally is not objecting to these measures as long as the disclosure is appropriate and all applicable guidance is followed.
  - The staff is continuing to evaluate the appropriateness of non-GAAP adjustments related to derivatives and pensions.
  - To date, non-GAAP adjustments related to stock-based compensation have not been a focus.
  - Comment letters on non-GAAP measures may be sent to some registrants separate from comment letters relating to the routine review of periodic filings. It appears that staff reviews of non-GAAP measures, in some cases, are being performed separate from the routine review of periodic filings.

New CAQ Tool for Non-GAAP Disclosures

The CAQ released two tools during 2016 in an effort to get the financial community talking about improvements that may need to be made to the use and presentation of non-GAAP measures. In the fourth quarter, on Dec. 5, 2016, it released a paper, "Non-GAAP Financial Measures: Continuing the Conversation," which includes a list of suggested questions for all financial statement stakeholders (for example, investors, securities lawyers, regulators, and standard-setters) to consider in the quest to improve the use and presentation of non-GAAP measures. Prior to that, on June 28, 2016, it released an article that was targeted at audit committee members, "Questions on Non-GAAP Measures: A Tool for Audit Committees." The latter article is intended to be used by audit committee members as they evaluate the accuracy, appropriateness, and usefulness of their companies' non-GAAP measures.

From the PCAOB

Final Standard on the Auditor's Reporting Model

On May 11, 2016, the PCAOB re-exposed a proposal, "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion," to add critical audit matters (CAMs) (that is, certain matters that "involve especially challenging, subjective, or complex auditor judgment," among other criteria) to the auditor's report. The revised proposal retains the pass-fail model in the existing auditor's report (that is, the qualified-unqualified opinion model) but would add CAMs and make other improvements to the report. The PCAOB refined its prior proposal by limiting CAMs to those communicated or required to be communicated to the audit committee and material to the financial statements, and adding a requirement that the auditors describe how the CAM was addressed.

Generally, the proposal will apply to audits conducted under PCAOB standards; however, unlike the 2013 proposal, the requirements will not apply to the audits of 1) brokers and dealers, 2) investment companies other than business development companies, and 3) employee stock purchase, savings, and other similar plans.

The re-exposed proposal does not include the additional auditing standard from the 2013 proposal related to the auditor's responsibilities for other information outside the financial statements, but the board did state that it will determine how to proceed on that standard at a later date.

Comments were due Aug. 15, 2016. A final standard is expected from the PCAOB in 2017.

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