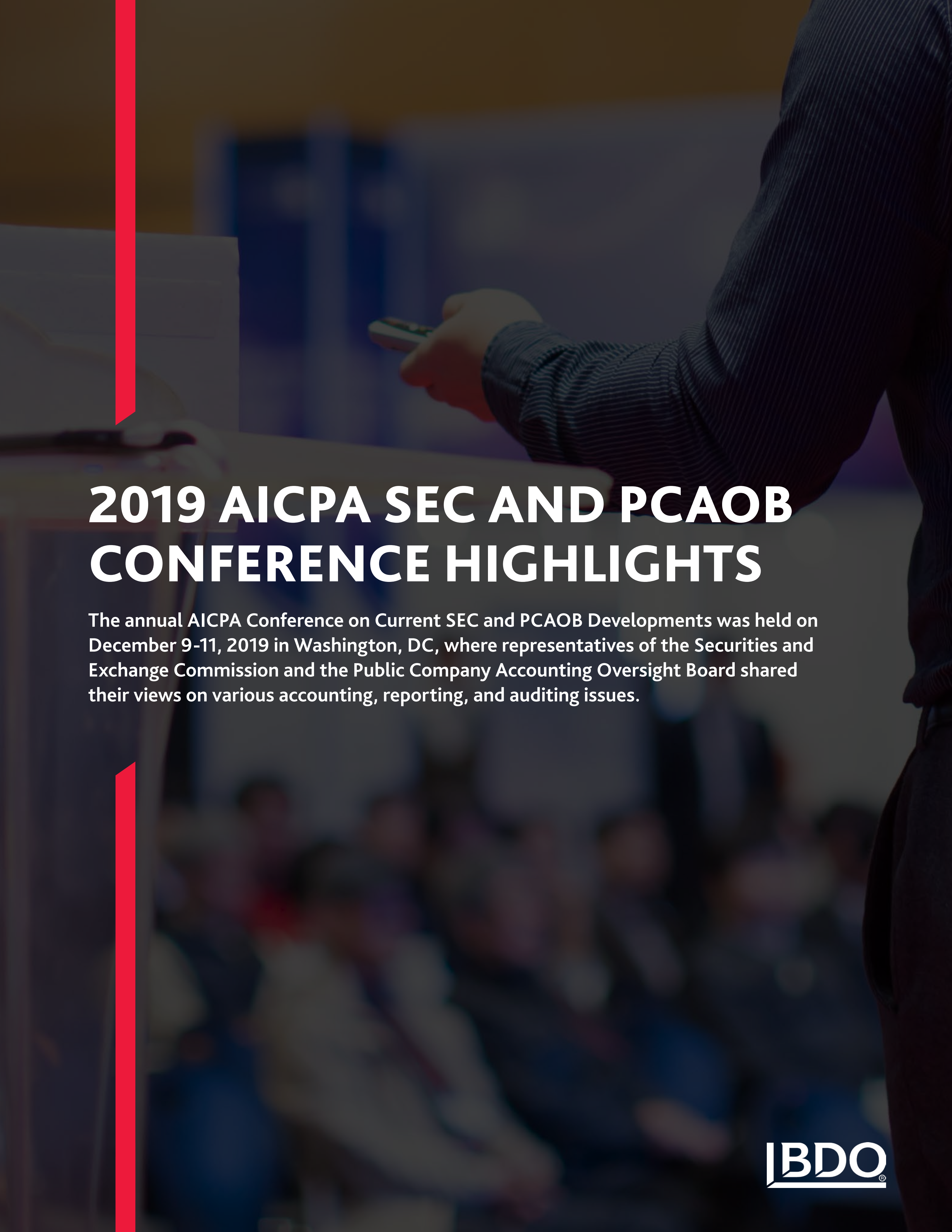
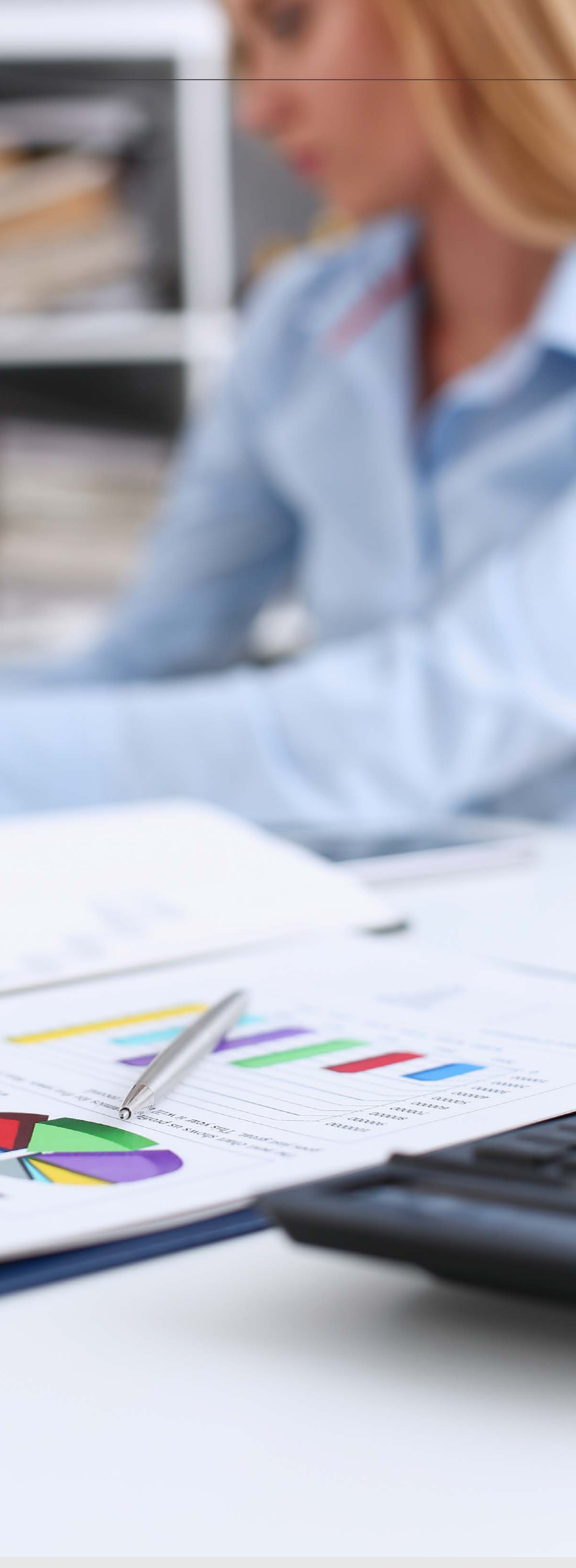


2019 AICPA SEC AND PCAOB CONFERENCE HIGHLIGHTS

The annual AICPA Conference on Current SEC and PCAOB Developments was held on December 9-11, 2019 in Washington, DC, where representatives of the Securities and Exchange Commission and the Public Company Accounting Oversight Board shared their views on various accounting, reporting, and auditing issues.

BDO

Table of Contents



Overview

The reporting, accounting, and auditing environment continues to experience significant change. The consequences of a volatile political and economic environment, significant new accounting standards, an enhanced auditor reporting model, a changing regulatory landscape, and evolving technologies are dominating the conversation of stakeholders in the financial reporting process. This year's Conference focused on these matters and provided insight into the regulators' perspective on these and other accounting and reporting matters. Some of the highlights include:

- **SEC Reporting Matters** – reminders for registrants to pay particular attention to the risks and corresponding disclosures arising from the pending phase-out of the London Interbank Offered Rate (LIBOR) as a key reference rate, the United Kingdom's anticipated exit from the European Union (Brexit), and cybersecurity issues. Additionally, the SEC staff discussed non-GAAP financial measures as it remains one of the most frequently-commented on topics in the staff's review of filings.
- **Accounting Matters** – implementation observations related to the new revenue, leases, and current expected credit loss (CECL) standards. Consistent with prior years, staff within the Office of the Chief Accountant provided several examples of consultations with registrants on these standards and other topics, including equity method accounting and the primary beneficiary determination for a variable interest entity.
- **Auditing Matters** – insights and reactions to the disclosure of Critical Audit Matters (CAMs) in audit reports, which appeared for the first time in 2019. Other focus areas included the importance of audit committee communications, auditor independence, and the impact of evolving technologies on the audit profession and process.

The following summary provides additional insight into these matters and other accounting and reporting issues addressed at the Conference. Our publication, ***2019 SEC Reporting Insights***, may be referenced for a summary of SEC rulemaking and related staff activities during 2019.

SEC Reporting Matters

SEC RULEMAKING UPDATE

As the global economy evolves, the SEC continues to consider its three pillars – investor protection, capital formation, and efficient markets – when evaluating its rules. At the Conference, Chairman Clayton stated his belief that the modernization of rules may advance each of those pillars, as evidenced by rulemaking activities during 2019. Chairman Clayton and the SEC staff provided updates on rulemaking activities, including the following proposals which the Commission intends to finalize during the next year:

- ***Amendments to Financial Disclosures About Acquired Businesses*** — In May 2019, the SEC proposed amendments to S-X Rules 3-05 and 3-14 relating to financial statement requirements for acquired businesses as well as Article 11 pro forma financial information requirements. Based on stakeholder feedback, the SEC staff is re-evaluating the proposed presentation of "Management's Adjustments" within pro forma financial statements.
- ***Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*** — Also in May 2019, the SEC staff proposed amendments to the definitions of an accelerated and large accelerated filer. As proposed, certain smaller reporting companies would not be required to obtain an audit of their internal control over financial reporting (ICFR).
- ***Amendments to the Financial Disclosures for Registered Debt Security Offerings*** — Given the significant disclosure requirements associated with registered debt offerings, the SEC staff proposed amendments to reduce the financial information disclosures for guarantors and issuers of guaranteed securities and affiliates the securities of which collateralize a registrant's securities pursuant to S-X Rules 3-10 and 3-16.

BDO Observation: As permitted by S-X Rule 3-13, the SEC staff may waive or modify certain financial statement requirements when such requests are consistent with investor protection. The staff regularly receives requests for relief from the financial statement requirements for acquired businesses. Prior to the effective date of rule amendments, the staff will not grant waiver requests based on the proposed rules. Registrants should refrain from explicitly discussing the proposed rules in any requests for relief.

When evaluating the impact of the proposed changes in the definitions of an accelerated or large accelerated filer, registrants are reminded that management must continue to assess the design and effectiveness of ICFR. As such, any exemption from obtaining an audit of ICFR received by some smaller registrants will not alleviate the requirement for a thoughtful, rigorous approach to ICFR.

NEW ACCOUNTING STANDARDS

In November 2019, the FASB postponed the effective dates of the credit loss, hedging and insurance (long-duration contracts) accounting standards by introducing a two-bucket approach. The buckets are defined as follows:

- Bucket 1 - all public business entities that are SEC filers, excluding smaller reporting companies (SRCs); and
- Bucket 2 - all other entities, including SRCs.

Private companies whose financial statements are included in another entity's SEC filing (e.g., S-X Rule 3-05 or 3-09 entities) do not meet the definition of an SEC filer. Similarly, prior to the effectiveness of its initial registration statement, an entity in the process of an IPO is not an SEC filer. As a result, financial statements included in an initial registration statement may reflect the Bucket 2 effective dates. Once the initial registration statement is declared effective, an entity would meet the definition of an SEC filer and must adopt the new standards using the Bucket 1 adoption date in its next filing, unless the entity is an SRC or an emerging growth company (EGC) that elects to defer adoption of the new standards.

The following examples illustrate the application of the two-bucket approach to the effective date of the new credit loss standard:

- Example 1 - a calendar year-end company's 2020 IPO registration statement is declared effective in June 2020. In the company's next SEC filing, the June 30, 2020 Form 10-Q, the financial statements would need to reflect the adoption of the new credit loss standard (if it is not already reflected in the historical financial statements in the IPO registration statement) using the Bucket 1 adoption date (i.e., January 1, 2020). However, if the company meets the definition of a SRC, the staff would not object to the use of the Bucket 2 adoption date (i.e., fiscal years beginning after December 15, 2022).
- Example 2 - an EGC may elect to adopt new accounting standards using Bucket 2 effective dates. However, upon the loss of its EGC status, a non-SRC must adopt the accounting standard in the year status is lost. For example, if EGC status is lost on December 31, 2020, the registrant must apply the new credit loss standard, effective as of January 1, 2020, in its 2020 Form 10-K.

In November 2019, the FASB also delayed the effective date of the new lease standard to years beginning after December 15, 2020 for entities other than public business entities. This delay impacted private companies and EGCs that elected to defer compliance with new accounting standards. All other SEC filers previously adopted ASC 842 for years beginning after December 15, 2018.

PREDECESSOR FINANCIAL STATEMENTS

IPO transactions often involve a reorganization, such as the merger of two or more entities in a "put-together" transaction. In these circumstances, presentation of predecessor financial statements and other financial information, such as MD&A and selected financial data, may be required. The determination of the predecessor entity (or entities) involves considerable judgment. The SEC staff provided the following non-exclusive list of criteria for registrants to consider when identifying a predecessor:

- The order in which the entities were acquired;
- The size of the entities;
- The fair values of the entities; and
- The historical and ongoing management structure.

The staff also encouraged registrants to think about the future presentation of comparative financial statements and other Form 10-K disclosures when performing this assessment.

It would be rare not to have a predecessor, even when a newly formed company is considered substantive and deemed to be the accounting acquirer. Certain situations may also result in the identification of more than one predecessor.

SPECIAL PURPOSE ACQUISITION COMPANIES

Special Purpose Acquisition Companies (SPACs) raise capital to acquire an existing private operating company. Generally, the SPAC must file a Form S-4 or merger proxy to solicit shareholder approval for the merger transaction. Such filings must include audited financial statements of the private operating company. When both the SPAC and the operating target qualify as EGCs, the number of years of audited financial statements required depends on the whether the SPAC has filed its initial Form 10-K. The SEC staff would not object to the inclusion of only two years of audited target company financial statements prior to the SPAC's initial Form 10-K filing. After an initial Form 10-K filing, a Form S-4 or merger proxy must include three years of the private operating company's audited financial statements. The staff does not anticipate any waivers of the third-year financial statement requirement in these circumstances.

Audits of the private operating company financial statements included in SPAC filings should be conducted in accordance with PCAOB standards and the staff will not waive this requirement. The staff also reiterated its view that private operating company financial statements in a SPAC filing should include all required public company disclosures (e.g., segment reporting, earnings per share, etc.).

DEFINITION OF A BUSINESS

The definition of a business pursuant to S-X Rule 11-01(d) differs from the accounting definition under ASC 805, as amended in 2017. The objective of the SEC definition is to provide meaningful historical financial statements to investors. As a result, the staff does not expect to change the SEC's definition. When evaluating the financial statement requirements for an acquisition, the SEC staff focuses on the continuity of operations, including an assessment of whether revenue producing activities will remain the same after the acquisition, and other factors. The staff does not have the delegated authority to waive specific form requirements (e.g., Form 8-K, 10-K, etc.) or their due dates; however, the staff may waive financial statement requirements for acquired companies when such a waiver is consistent with investor protection.

CROSS-BORDER TRANSACTIONS

The SEC staff also acknowledged certain reporting issues resulting from the application of S-X Rules 3-05 (acquired businesses) and 3-09 (equity method investees) to acquisitions of international businesses.

The staff provided insights relating to non-issuer financial statement requirements for foreign businesses:

- **Use of IFRS in Rule 3-05 and 3-09 financial statements** - An acquired business meeting the definition of a foreign business may present its financial statements in accordance with IFRS as issued by the IASB. If the foreign business definition is not met, acquired company financial statements must be prepared in accordance with US GAAP or include a reconciliation to US GAAP.

  The staff may permit the use of IFRS as issued by the IASB when an acquired business fails to meet the foreign business definition but qualifies as a foreign private issuer.
- **Qualified audit reports** - The staff generally does not accept qualified audit reports. However, the staff has not objected to certain qualified audit reports relating to financial statements prepared under IFRS as issued by the IASB.

  A full set of financial statements prepared under IFRS must include comparative annual periods, whereas, SEC rules and regulations may allow financial statements for a shorter period. For instance, certain acquisitions under S-X Rule 3-05 may only require a single year of acquired company financial statements. Similarly, S-X Rule 3-09 requires investee financial statements for the period it is accounted for under the equity method, which may be less than a full year. Additionally, upon the initial adoption of IFRS, a company must provide a balance sheet as of the adoption date, which may not be included in a SEC filing. As a result, an auditor may qualify its audit opinion for those financial statements that do not constitute a full set of financial statements under IFRS. The staff indicated it would accept qualified audit reports in these instances, if the qualification relates solely to the omission of comparative financial information.
- **Abbreviated financial statements.** When allowed by the SEC staff, registrants may present abbreviated financial statements of acquired companies in lieu of full financial statements. The staff would accept abbreviated financial statements prepared under IFRS as issued by the IASB when accompanied by full disclosure of the basis of presentation and an appropriate reference in the audit report.
- **Auditing standards.** Financial statements filed with the SEC, including those pursuant to S-X Rules 3-05 or 3-09, must be audited in accordance with either PCAOB or AICPA standards. The SEC staff does not have the delegated authority to waive the audit standard requirements and therefore, waiver requests to permit the use of other standards will not be granted.

OTHER SEC REPORTING MATTERS

SUPPLY CHAIN FINANCE PROGRAMS

The SEC staff observed an increase in the usage of supplier finance programs involving trade payables (sometimes referred to as structured trade payables, reversed factoring vendor payable programs or supply chain financing). These programs improve a registrant's liquidity by extending the payment terms for accounts payable. The staff reminded registrants to disclose such finance programs in sufficient detail to allow investors to understand the impact on liquidity. The staff expects the following disclosures for programs that materially impact current or future liquidity:

- The material and relevant terms of the program;
- General benefits and risks introduced by the arrangements;
- Any guarantees provided by subsidiaries and/or the parent;
- Any plans to further extend terms to suppliers;
- The factors that may limit the company's ability to continue to increase operating cash flows using this strategy in the future; and
- Trends and uncertainties related to extended payment terms for these arrangements.

Comment Letters - Focus Areas and Other Insights

During 2019, the SEC staff monitored recurring comment letter topics such as revenue recognition, non-GAAP financial measures, and MD&A disclosures.

REVENUE RECOGNITION

For revenue recognition, the staff concentrates its reviews on the significant judgments required by ASC 606, such as the identification of performance obligations, the timing of revenue recognition, principal versus agent considerations, and disclosures related to those judgments.

Additionally, transition disclosures were required in the year of adoption of ASC 606 using the modified retrospective method to facilitate comparability between the years presented. The staff noted that some registrants also provided supplemental MD&A to compare revenue recognition under ASC 606 to the prior period revenue recognition. The staff emphasized that they would object to such presentation in years after adoption.

NON-GAAP FINANCIAL MEASURES

Chairman Clayton highlighted the importance of comparability and consistency in the presentation of non-GAAP measures. Registrants should clearly communicate changes in the calculation of non-GAAP measures from prior periods to investors. Given the weight placed on non-GAAP financial measures by investors, registrants need appropriate disclosure controls and procedures in place to ensure complete, accurate and consistent presentation of these measures. Non-GAAP measures should also provide insight into how management views the business and how management evaluates the company's performance. To that point, Chairman Clayton stressed that publicly disclosed non-GAAP measures should mirror the internal metrics used by management to monitor and manage the business.

The staff continues to challenge "individually tailored accounting principles." In this regard, the staff observed that the principal versus agent determination is a significant judgment under ASC 606 and not a policy election. Therefore, non-GAAP financial measures that reflect an application of the standard differently than the financial statements (e.g., presentation of gross revenues instead of net revenues, or vice versa) are prohibited.

Similarly, upon the adoption of CECL, the staff would likely object to non-GAAP adjustments to remove the effects of adoption or exclude the loan loss provision.

A registrant must also reconcile non-GAAP measures to the most comparable GAAP measure. The staff stated that such reconciliation must be provided, regardless of whether the face of the financial statements present the comparable GAAP measure. For example, registrants must reconcile a non-GAAP metric, such as contribution margin, to its most comparable GAAP measure (i.e., gross margin) even if the income statement does not include a gross margin caption. Further, when lengthy non-GAAP reconciliations are presented, the staff may ask questions to understand what the registrant is trying to convey to investors.

MD&A DISCLOSURES

MD&A disclosure comments tend to focus on material trends and uncertainties and their impact on historical and future operations. The staff emphasized the need for appropriate disclosures around various complex, uncertain and evolving risk areas (such as the expected discontinuation of LIBOR, Brexit, and cybersecurity). For risk areas with a current or expected material impact, registrants should disclose:

- How management assesses and analyzes the risks;
- The potential impact on the company and its operations;
- Management's strategy to mitigate and manage those risks; and
- The nature of the board's oversight of management related to such risks.

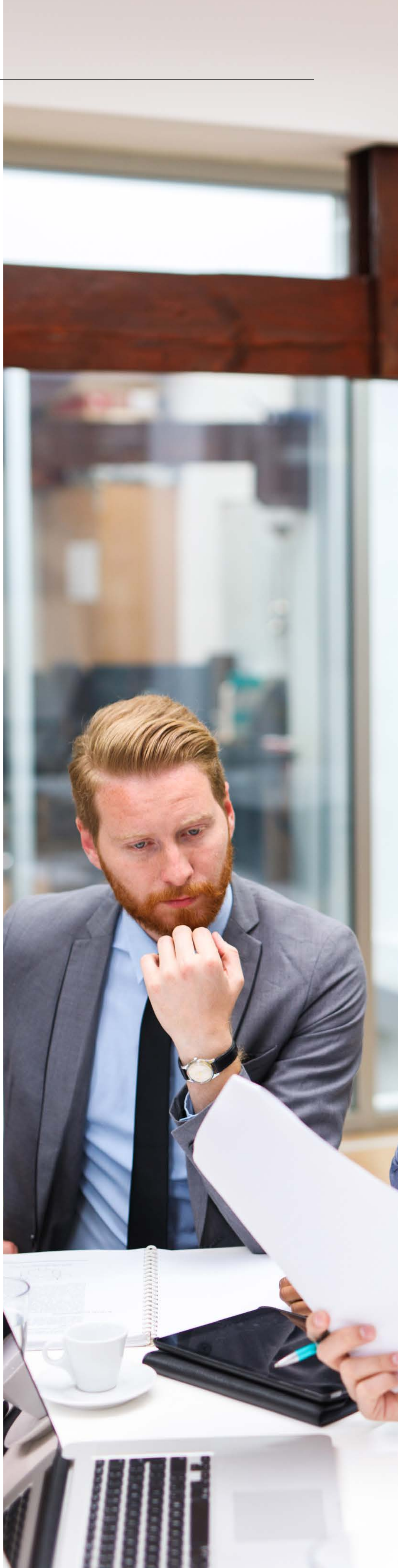
The staff also noted that the evaluation and mitigation of risks related to some of those areas (such as the discontinuation of LIBOR) require a continual assessment over several reporting periods. In those circumstances, the staff encourages registrants to disclose the status of company efforts to address the risks to date as well as significant matters yet to be addressed. If management cannot reasonably estimate a risk's impact on the company, the staff recommended disclosures of that fact to indicate the registrant is aware of, and continues to evaluate, the risk.

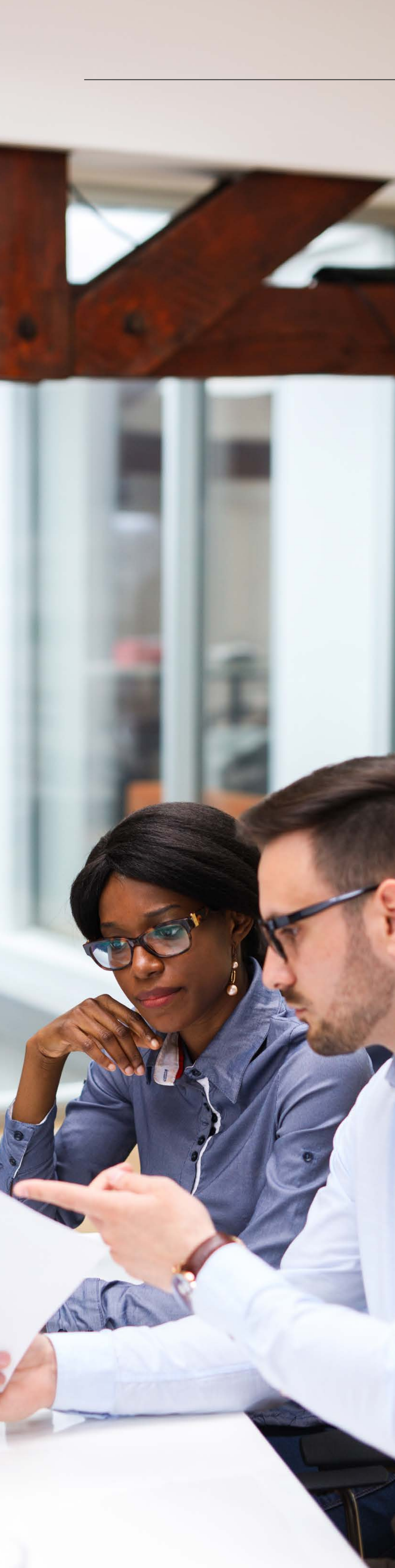
OTHER DISCLOSURES

In their upcoming filing reviews, the SEC staff will also focus on the implementation of new standards, such as the new leasing standard (ASC 842) and CAMs. Registrants should keep the disclosure objective in mind when preparing lease disclosures pursuant to the new accounting standard and tailor disclosures to reflect the registrant's specific lease arrangements and related assumptions.

The SEC staff also encouraged registrants to provide additional disclosures about stock buybacks in a company's compensation disclosure and analysis. Registrants should discuss how their compensation committees consider stock buybacks when setting and evaluating executive compensation targets.

Additionally, the staff observed an emerging trend with respect to the increase in supplier incentive programs. Companies may record certain program costs paid to end users (who are not customers) as marketing expenses. The impact of such programs on a company's operations should be quantified and thoroughly discussed to the extent material.





BEST PRACTICES FOR COMMUNICATING WITH THE SEC STAFF

At the Conference, the SEC staff also provided the following best practices for registrants when communicating with the staff:

- Provide e-mail contact information;
- Ask the staff if they need or use courtesy paper copies prior to sending them;
- Address issues raised in comments clearly and directly;
- Explain to the staff early in the process why comment areas are not material;
- Communicate the intended use of novel transactions at the outset;
- Do not assume the staff has all the facts when making an interpretive or procedural inquiry. The staff expects registrants to research the issue, articulate the specific facts, and provide an analysis, even if informal, that points to the relevant authoritative literature;
- Do not rely on precedent filings. The staff may not have reviewed the precedent filing or may have cleared a comment for other reasons, such as materiality; and
- Call the staff with questions. A dialogue with the staff may accelerate the process.

Accounting Matters

REVENUE RECOGNITION

Consistent with the prior year, the SEC staff frequently consulted on revenue recognition matters during 2019. The staff reiterated that thoughtful, well-reasoned judgments would be respected. Based upon consultations to date, the staff shared the following observations:

Principal versus agent – The principal versus agent model in a revenue transaction requires significant judgment. Based on the individual facts and circumstances in each arrangement, a registrant must assess whether it controls the specified goods or services provided to a customer. These judgments may be especially challenging when multiple parties are involved in the provision of services to a customer. Additionally, changes to customer agreements over time may change initial conclusions.

In one **consultation**, due to regulatory restrictions, a registrant relied on another service provider to deliver certain services promised to a customer. While the third-party service provider did not have separate contractual relations with the customer, the registrant's contract with the customer acknowledged the services provided by the third-party and marketing materials included the branding of both service providers.

While the third-party service provider had discretion in how to fulfill its obligations, the registrant had the ability to control when services were delivered. Additionally, the SEC observed that the registrant could control the specified services by defining the services to be performed on its behalf by entering into a contract with another service provider. The staff did not object to the registrant's conclusion that it was the principal in the transaction for each service because it controlled the services prior to transferring them to the customer.

Identification of Performance Obligations – A registrant must also determine whether a promised good or service is distinct in the context of the contract or whether it is providing a combined item for which the promised goods or services are inputs. The assessment requires an understanding of customer expectations about the final product. Simply labeling promises in a contract as a combined "solution" does not persuade the staff. Rather, the registrant must perform a well-reasoned analysis consistent with the revenue recognition standard. The staff described a **consultation** in which the registrant demonstrated that software updates were integral to the functionality of the related software. Based on this and other facts and circumstances, the staff did not object to the treatment of software and related updates as a combined performance obligation.

LEASES

While many registrants adopted the new leasing standard, ASC 842, during 2019, the SEC staff continued to address leasing matters in several consultations. ASC 842 requires a lessor to evaluate the collectability of lease payments at lease inception, including amounts necessary to satisfy a residual value guarantee. In a sales-type lease, if collectability is not probable, the lessor should defer recognition of any gain or loss and reflect lease payments received as deposit liabilities. The lessor accounts for the sales-type lease in this manner until either: (a) collectability becomes probable, or (b) the contract is terminated or the lessor has taken back the asset and the lease payments are nonrefundable.

When assessing collectability, registrants must evaluate all factors including, but not limited to, the lessee's credit quality and the registrant's history of collections with similar lessees. The staff discussed an **example** in which a lessor structured its leases to compensate for high expected rates of defaults by requiring substantive down payments, a high implicit lease rate, and residual value guarantees. The registrant determined that a specific customer's credit evaluation and substantive down payment indicated that the customer had the intent and ability to pay. However, the staff objected to the lessor's determination that collectability was probable given the registrant's historical levels of default from similar lessees.

CREDIT LOSSES

As the CECL effective date approaches for many registrants, the SEC staff is monitoring implementation efforts. Based upon a recent **consultation**, the staff shared its views about whether the measurement of expected credit losses should include certain potential future advances of costs on a borrower's behalf. Upon adoption of the standard, the registrant expects to use a discounted cash flow analysis to measure the expected losses of its mortgage loans. In its loan agreements, the registrant has the right, but not the obligation, to pay amounts relating to the underlying collateral, such as real estate taxes and insurance payments, on behalf of the borrower. As the registrant is not obligated to provide such advances and CECL does not prescribe which cash flows to include in the model, the staff did not object to the registrant's decision to exclude such cash flows from its estimate of expected losses.

REFERENCE RATE REFORM

During the Conference, Chairman Clayton stated his belief that the complexity presented by the impending discontinuation of LIBOR has been underestimated. As such, registrants were encouraged to identify issues early and consult, as necessary, in advance of the discontinuation.

The SEC staff also **described** certain issues that arise when a company modifies its financial instruments in anticipation of the LIBOR transition. In one example, a registrant's equity-classified preferred stock requires dividend payments based on LIBOR. The registrant amended the preferred stock to designate a replacement index for the dividend rate.

The staff has observed various acceptable approaches when analyzing such a modification of preferred stock given the lack of explicit accounting guidance within existing GAAP. When an agreement is amended to replace LIBOR with another acceptable reference rate, the staff has not objected to the consistent application of a qualitative approach to analyze such amendments. The registrant considered the business purpose for the changes and how the changes impact the economic decisions of the investor, noting the changes were not significant, and the registrant concluded that the amendment constitutes a modification of the preferred stock. The staff did not object to this view.

The staff also discussed the accounting recognition, if any, on the modification date. The staff indicated that an analogy to the modification guidance contained in ASC 718-20 for share-based payments would be acceptable, resulting in the recognition of incremental changes in the fair value of the financial instrument at the modification date.

For modifications solely in contemplation of the LIBOR discontinuance, the SEC staff did not object to the determination that there was no change in fair value resulting from the modification. This conclusion presumed that the fair value prior to the modification already reflects the expected impact of the cessation of LIBOR. Therefore, any incremental changes in fair value associated with such a modification would be minimal.

OTHER ACCOUNTING MATTERS

The SEC staff also provided additional insights on various other accounting topics.

SALE AND LEASEBACK TRANSACTIONS

In a **consultation**, a registrant discussed a transaction in which it had transferred fixed assets into a variable interest entity (VIE) in exchange for 100% of the VIE's equity. Additionally, the VIE leased the assets to a third party pursuant to a master prepaid lease agreement and the registrant leased back certain of those assets. The staff observed that the ability to direct the use of, and obtain all the remaining benefits from, an asset constitutes control over the asset. As part of the consultation, the registrant determined that control of the leased assets was transferred to the third party because the third party was currently obtaining the benefits of the underlying assets and the third party could prevent others from obtaining the benefits of those assets because of a substantive purchase option exercisable at the end of the lease. The staff objected to this conclusion since the registrant would regain its controlling interest in the VIE if the purchase option was not exercised.

VARIABLE INTEREST ENTITIES – IDENTIFICATION OF A PRIMARY BENEFICIARY

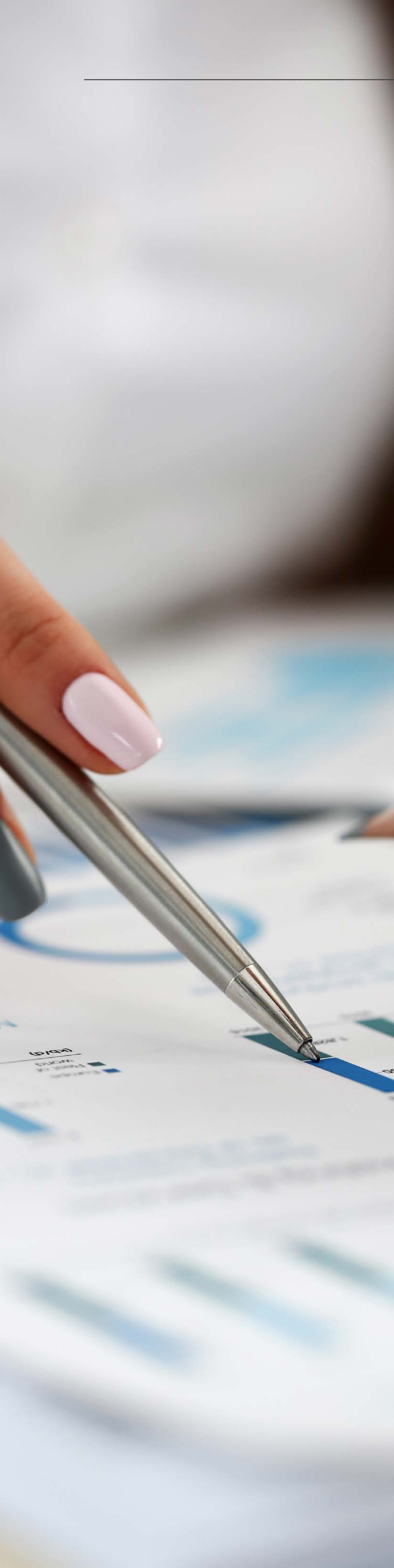
In another recent **consultation**, a registrant determined that it did not have the power to direct investment decisions of a VIE, which was the activity most significantly impacting the VIE's economic performance. The registrant was involved in the establishment of the VIE's investment guidelines and had the ability to modify certain aspects of those guidelines. However, the VIE's general partner had the unilateral discretion to make investment decisions in accordance with the investment guidelines. The staff did not object to the registrant's conclusion that it did not control the VIE's most significant activity since the registrant could not limit the general partner's current and future investment decisions.

Additionally, VIE's are often subject to multiple risks and activities that impact its economic performance. When conducting a consolidation analysis, the importance of each risk and activity varies with specific facts and circumstances. In a recent **consultation**, a single asset LLC was designed to lease its property to a registrant for substantially all of the property's economic life. This VIE had the right to sell the property while the lease obligated the registrant to operate and maintain the property. The registrant determined that it did not have power over the activities that most significantly impact the VIE's performance. Of the identified risks creating variability in the VIE (lease negotiation risk, lessee credit risk, residual value risk, and operation and maintenance risk), the staff observed that operating and maintenance decisions by the registrant during the lease term most significantly impact the VIE's performance. Lease negotiation activities were not considered significant as the term of the existing lease covered substantially all of the property's economic life. Similarly, the registrant's financial condition and the property's strategic performance limited the lessee credit risk. As a result, the staff objected to the registrant's conclusion not to consolidate the VIE.

APPLICATION OF EQUITY METHOD ACCOUNTING

When a company does not control an investee but is able to exert significant influence over the operating and financial policies of that investee, the investment is accounted for under the equity method of accounting. The nature of the investee impacts a registrant's ability to exert influence. In general, registrants should apply the equity method to corporate investments if the investment exceeds 20%. Additionally, the staff repeated their historical position that an investor should apply the equity method to investments in a limited partnership unless the interest is so minor (i.e., less than 3-5%) that the investor has virtually no influence over operating and financial policies.

The staff **noted** that an LLC may have characteristics of both corporations and partnerships. As such, a registrant must first analyze whether an investment in an LLC is similar to a limited partnership due to the presence of specific ownership accounts and, if so, consider whether it has more than "virtually no influence." This is a lower threshold than "significant influence" and therefore, equity method accounting typically applies in these situations.



Audit Matters

CRITICAL AUDIT MATTERS

Beginning with audit reports for large accelerated filers issued after June 30, 2019, auditors must communicate CAMs as required by PCAOB Auditing Standard 3101. CAM disclosures will provide more relevant insights about audit areas involving especially challenging, subjective, or complex auditor judgment. The auditor must describe the principal considerations in the determination of a CAM as well as how the auditor addressed the matter. The SEC and PCAOB staff continue to monitor the implementation of CAM reporting.

The SEC staff made several **observations** about the relationship between CAMs and critical accounting estimates. While CAMs identified by the auditor and critical accounting estimates disclosed in MD&A have similarities, the objective of each disclosure differs. CAMs may generally represent a subset of critical accounting estimates; however, certain CAMs, such as related party transactions, may not require subjective management estimates or assumptions.

Also, CAMs may represent a specific component of a critical accounting estimate. In this regard, the staff provided an example where the CAM was limited to the goodwill impairment analysis for a specific reporting unit, whereas management described its critical accounting estimate related to goodwill impairment more broadly.

BDO Observations: While CAMs are auditor communications, audit committees play a crucial role in the development and presentation of CAMs. As CAM implementation moves forward, the PCAOB will focus on auditor interaction with audit committees and management. To be effective, we believe these interactions should begin early in the audit process and occur as frequently as necessary to ensure expectations are aligned. We also encourage companies to conduct "dry runs" with their auditors prior to implementation.

Investors and other financial statement users are also reminded that CAMs relate to the specific facts and circumstances of each individual audit. Therefore, the number or nature of CAMs may not be comparable between companies in the same industry. Additionally, individual companies may have certain issues that are reported as CAMs each year (i.e., complex revenue recognition arrangements), while other issues may arise from significant or unusual transactions that are reported as a CAM for a single year (i.e., accounting for the issuance of a complex financial instrument).

The PCAOB's **Critical Audit Matters Spotlight** also provides timely and relevant observations for auditors and other key stakeholders. For additional information, refer to the CAM resource page on the **PCAOB** and **BDO** websites.

PCAOB INSPECTIONS

Members of the PCAOB highlighted a few key efforts undertaken in 2019 to improve the overall effectiveness of the inspection program, which included:

- Evaluating the consistency of the inspection process across registered firms;
- Increasing the focus on audit firms' quality control systems to prevent audit deficiencies; and
- Introducing target teams to inspect specific audit areas across multiple firms to obtain a comparison of how audit firms design and implement various aspects of their quality control systems, audit methodologies and approaches relating to that area of focus.

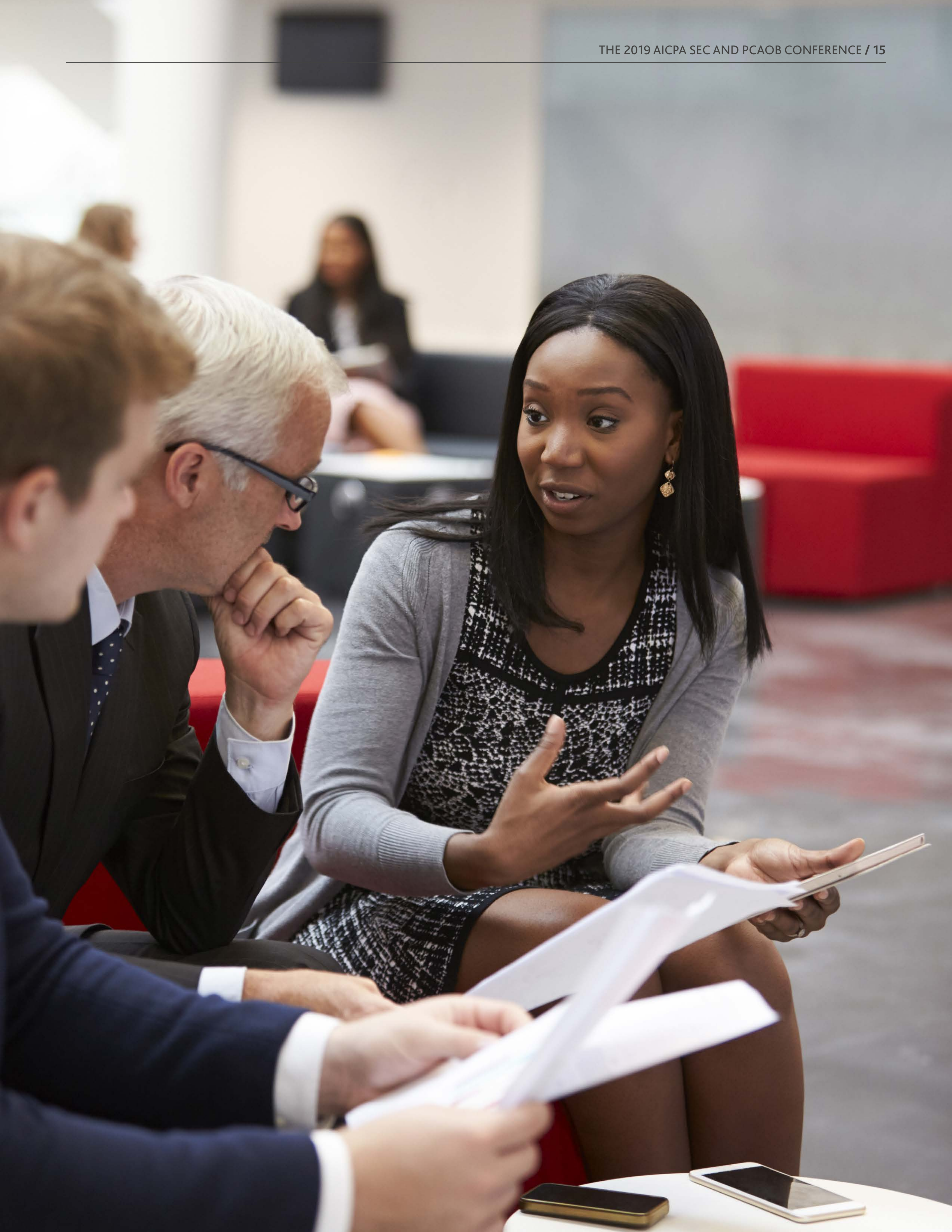
The PCAOB staff noted the areas of recurring inspection findings include ICFR, revenue recognition, allowance for loan losses and other accounting estimates (including fair value measurements), and auditor independence violations.

The key areas of focus for the 2020 PCAOB inspections cycle will include:

- The audit firms' system of quality control;
- Auditor independence;
- Firm remediation efforts in areas of recurring audit deficiencies identified through the PCAOB inspections process;
- Considerations of omitted audit procedures after the auditor's report date and subsequent discovery of facts existing at the date of the auditor's report;
- Implementation of new accounting and auditing standards; and
- Cybersecurity and emerging technologies such as digital assets and blockchain.

Design of the inspection report - The staff also discussed the redesign of the PCAOB inspection reports of the six largest network firms for the 2018 inspections cycle, which will be released in 2020. The inspection reports will include additional comparative information presented in a more concise, easier to read manner. A new section will be added to separately communicate inspection deficiencies that did not result in a failure to gather sufficient audit evidence to support the audit opinion, but the PCAOB staff deemed important to communicate (e.g., deficiencies relating to Form AP filings, audit committee communications and workpaper archiving matters).

BDO Observations: The SEC also continues to focus on auditor independence rules as evidenced by final amendments to the Loan Provision rules and an update of the staff's auditor independence FAQs during 2019. At the Conference, Chairman Clayton highlighted that auditor independence is necessary for the credibility of financial statements. The SEC staff further emphasized the shared responsibility between management, audit committees and auditors to ensure compliance with independence rules.



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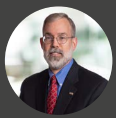

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