

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: SEC



SEC YEAR IN REVIEW

► SIGNIFICANT 2014 DEVELOPMENTS

Rulemaking to implement the Jumpstart Our Business Startups (JOBS) Act of 2012 and Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was expected to dominate the Commission's agenda in 2014. Indeed, the Commission devoted substantial attention to implementing provisions of the Dodd-Frank Act that affect matters other than financial reporting. The Commission finalized rules related to money market funds, asset-backed securities reform, and credit rating agency reform and proposed rules to conform its requirements for registration, termination of registration and suspension of reporting under the Securities Exchange Act of 1934 with the thresholds in the JOBS Act. With the Commission's time dedicated to the issuance of these rules, other rules, such as JOBS Act rules proposed in 2013 related to crowdfunding and Regulation A amendments, were not finalized.

A notable change took place among the staff during 2014. In May, the Commission's Chief Accountant, Paul Beswick, announced that he was leaving the SEC. Chair White subsequently appointed James Schnurr in August and he began his post in October. Schnurr's arrival brings a renewed focus on making progress on the Commission's decision whether, and if so, how and when, to incorporate International Financial Reporting Standards into financial reporting by domestic issuers. Three approaches have previously been considered: (1) wholesale adoption of IFRS as U.S. GAAP for domestic issuers, (2) permitting domestic issuers to voluntarily report using IFRS, and (3) an approach

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colloquially referred to as “condorsement.”¹ In a December speech, Schnurr highlighted his focus on the matter and suggested a fourth alternative for incorporating IFRS into the domestic financial reporting system. That approach would be to make it easier for domestic issuers to voluntarily provide financial data prepared in accordance with IFRS in addition to their primary U.S. GAAP financial statements. This would be accomplished by allowing the IFRS data to not be considered non-GAAP financial measures and not require the reconciliations and other disclosures otherwise required when issuers present non-GAAP financial measures.

In addition to making progress in the question of usage of IFRS, Schnurr can also be expected to focus on the SEC's staff's role in addressing implementation issues related to the new revenue standard issued in May, the pending accounting standards on leases, financial instruments and credit losses, and the new COSO framework. Schnurr has also been critical of the focus and pace of the PCAOB's standard-setting activities, encouraging the PCAOB to improve audit quality by focusing on updating the standards that directly address auditor performance and volunteering to work with the PCAOB to take a fresh look at its standard-setting process.

The staff has made considerable focused outreach efforts related to implementing the new revenue standard. They have indicated that this standard is so important that they want to be involved upfront with implementation questions and concerns rather than identifying them through the review process after registrants have adopted the standard. The staff has been discussing implementation with registrants, accountants and other constituents to understand the issues and where there may be diversity in practice. The staff is also reviewing its existing guidance related to revenue recognition and will determine whether it is still needed.

The staff was also busy with various other initiatives in 2014. In December 2013, following the issuance of a study of the disclosure requirements of Regulation S-K mandated by the JOBS Act, Chair White directed the staff to develop recommendations for updating the SEC's disclosure rules in order to improve the disclosure regime for both companies and investors. Thereafter, the “Disclosure Effectiveness Project” was born. The staff's initial focus is on a review of business and financial disclosures required by periodic and current reports as well as certain aspects of Regulation S-X which require financial statements of entities other than the registrant to be filed.

As we noted in our past SEC Year in Review publications, the conflict minerals rule mandated by the Dodd-Frank Act has been the subject of debate in the courts since it was first issued in 2012. While a federal court judge upheld the conflict minerals rule in 2013, a court of appeals ruled that certain aspects of the rule violated a company's constitutional right of free speech in 2014. Consequently, the SEC staff issued guidance to clarify how registrants should comply with the rule in their 2014 conflict minerals reports in light of the court's ruling. The staff also issued interpretive guidance in the form of FAQs to assist registrants with applying the rule.

In addition to providing conflict minerals interpretive guidance, the staff issued other guidance throughout the year to assist registrants and others with interpreting and complying with the SEC's rules and regulations. Specifically, the staff updated its Compliance and Disclosure Interpretations (C&DIs) and the Financial Reporting Manual (FRM).

Looking forward to 2015, rulemaking to implement the JOBS Act and the Dodd-Frank Act is expected to continue to dominate the Commission's agenda. The Commission also hopes to make progress in 2015 on its decision whether to incorporate IFRS into financial reporting for domestic issuers. The SEC staff is expected to make continued progress on the Disclosure Effectiveness Project through the issuance of a concept release and further address implementation issues related to the new revenue standard.

This publication summarizes 2014 Commission and staff activities that affect financial reporting. We discuss rulemaking first, followed by staff guidance provided during 2014. While not the focus of this publication, we also discuss the PCAOB's 2014 standard-setting and related activities.

► RULEMAKING

REPORTING OF AUDITOR TERMINATIONS

In May, the SEC approved rule changes made by the PCAOB to its rules requiring auditors of SEC registrants to notify the SEC directly when a client-auditor relationship has ceased. The release is available [here](#) on the SEC's website. The changes affect what are commonly referred to as “SECPS letters” or “5 day letters.” The changes do not affect the reporting registrants must follow pursuant to Item 4.01 of Form

¹ The condorsement approach is discussed in our SEC Year in Review – Significant 2011 Developments publication available [here](#).

8-K and Item 304 of Regulation S-K and the related letters auditors provide. The changes are designed to make the auditors' notices more meaningful by generally requiring them only when the registrant has not timely reported the auditor change on Form 8-K.

If an entity is required to file current reports on Form 8-K, the former auditor is not required to submit a 5-day letter unless the entity does not report the termination in a timely filed Form 8-K. Conversely, if an entity is not required to file current reports on Form 8-K,² the former auditor is required to submit a 5 day letter, presumably even if the entity reports the information in a timely filed Form 8-K. These requirements are relatively straightforward when the entity clearly is or is not required to report an auditor termination pursuant to Item 4.01 of Form 8-K. However, the requirements are less clear for employee benefit plans that file reports on Form 11-K and voluntary filers. The SEC staff has since informally indicated that 5 day letters are not required to be issued for Form 11-K filers, but are required for voluntary filers if the termination is not timely reported on Form 8-K (i.e., voluntary filers should be treated the same as registrants that are required to file Form 8-Ks).

The reporting requirements were expanded to require auditors to report the end of the relationship to the PCAOB as well as the SEC in certain circumstances. If the entity is required to file current reports on Form 8-K, the former auditor is required to report the termination to the PCAOB on Form 3 if the entity does not report the termination on Form 8-K. Otherwise, or if the former client is not required to file current reports on Form 8-K, the former auditor is not required to report the termination to the PCAOB.

► STAFF GUIDANCE

Some of the SEC staff guidance discussed below was provided during meetings held in 2014 with the Center for Audit Quality's (CAQ's) SEC Regulations Committee. Minutes of those meetings can be found [here](#) on the CAQ's website.

EFFECTS OF THE DEFINITION OF A PUBLIC BUSINESS ENTITY

In 2013, the Financial Accounting Standards Board adopted ASU 2013-12, *Definition of a Public Business Entity*. That definition determines which entities may be eligible for the accounting alternatives developed by the Private Company Council (PCC), but does not affect the definitions in previously issued accounting standards. The definition of a public business entity includes one whose financial statements or financial information is required to be or is included in a filing with the SEC. Accordingly, entities whose financial statements or financial information are included in a public filing pursuant to Rules 3-05, 3-09, 3-14, and 4-08(g) of Regulation S-X (among others) are considered public business entities. Consequently, such entities are not able to apply any of the PCC alternatives in their financial statements included in an SEC filing. Many of the reporting requirements for such entities are based on significance calculations. At the March meeting of the CAQ SEC Regulations Committee, the SEC staff indicated that such calculations may not be performed using financial statements of a target or investee in which PCC alternatives have been applied. Therefore, any PCC alternatives applied in the historical financial statements of a target or investee must be removed for purposes of measuring significance as well as when presenting any needed financial statements or information.

RESCISSION OF STAFF ACCOUNTING BULLETIN TOPIC 5.J

In connection with the FASB's issuance of ASU 2014-17, *Pushdown Accounting*, in November, the SEC staff issued Staff Accounting Bulletin No. 115 to rescind its legacy pushdown guidance for SEC registrants in Topic 5.J, *New Basis of Accounting Required in Certain Circumstances*. Accordingly, SEC registrants are not required to apply pushdown accounting in any circumstance, even when the change of control is greater than 95% of the outstanding equity. In addition, the "collaborative group" concept, under which two or more investors' holdings in an acquiree may have been aggregated under Topic 5.J to evaluate pushdown accounting in the past, no longer applies. An additional ASU is expected to rescind the SEC staff guidance on collaborative groups appearing in ASC 805-50-S99-2. Further information on the guidance in ASU 2014-17 can be found [here](#).

² Examples of entities that are required to file Exchange Act reports but are not required to file current reports on Form 8-K are foreign private issuers (that are required to report auditor changes on Item 16F of Form 20-F) and investment companies other than business development companies (that are required to report auditor changes on Item 77K of Form N-SAR).

PRESENTATION OF GAINS AND LOSSES ON SALES OF PROPERTIES BY REAL ESTATE INVESTMENT TRUSTS

Rule 3-15 of Regulation S-X contains certain income statement presentation requirements for real estate investment trusts (REITs). The rule requires a “gain or loss on sale of properties” to be presented after income or loss before extraordinary items and cumulative effects of changes in accounting principles. Assuming a sold property meets the criteria to be reported as a discontinued operation under ASC Subtopic 205-20, *Discontinued Operations*, practice under ASC 360, *Property, Plant and Equipment*, has historically been to classify such amounts as gain or loss from discontinued operations. Upon adoption of ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, fewer property sales of REITs are expected to qualify as discontinued operations. Consequently, GAAP will more often call for REITs to classify gains or losses on sales of long lived assets (disposal groups) in continuing operations above any operating income subtotal on the income statement.

At the June meeting of the CAQ SEC Regulations Committee, the Committee and staff discussed how registrants are expected to apply the requirements of Rule 3-15 given that the recent change in GAAP would require many REITs to classify gains and losses on the sale of properties as a component of income from continuing operations. The staff stated that it will not object to a REIT’s presentation that complies with either GAAP or Rule 3-15 as long as the approach taken is clearly disclosed.

PRESENTATION OF DIVIDENDS PER SHARE

Rule 10-01(b)(2) of Regulation S-X requires disclosure of dividends declared per common share on the face of an interim income statement. Rule 3-04 requires disclosure of dividends per share on the annual statement of changes in stockholders’ equity. However, ASC 260-10-45-5 states that any per-share amounts not required to be presented by ASC 260 shall only be disclosed in the notes to the financial statements, leading some to question whether disclosure of dividends per share is appropriate on the face of an annual income statement. In March, the SEC staff clarified that it will not object to the presentation of dividends per share on the face of an annual income statement.

APPLICATION OF RULE 4-08(g)

Under Rule 4-08(g) of Regulation S-X, summarized financial information of a registrant’s equity method investees must be presented in the footnotes to the annual financial statements when their significance, individually or in the aggregate, exceeds any of the 10% threshold tests. If separate financial statements of a significant equity method investee are provided within the registrant’s annual report under Rule 3-09, SAB Topic 6K(4)(b) indicates that such investee may be excluded from the summarized financial information provided under Rule 4-08(g). The summarized financial information for the remaining investees would generally be provided in the Rule 4-08(g) disclosure unless it is impracticable to accumulate the information and the omitted information is de minimis. If the financial statements of an equity method investee are provided when a registrant files its Form 10-K and the aggregate significance of the remaining investees is less than 10% (and not deemed material to investors), some have questioned whether the 4-08(g) disclosure for the remaining investees is necessary. At the March meeting of the CAQ SEC Regulations Committee, the SEC staff indicated that it would not object to the exclusion of Rule 4-08(g) information in this fact pattern.

DUE DATES FOR LESSEE FINANCIAL STATEMENTS

When a registrant has a significant asset concentration due to one or more of its properties being triple net leased to a single lessee, Section 2340 of the Division of Corporation Finance’s Financial Reporting Manual (FRM)³ indicates that a registrant should generally provide financial statements of the lessee in its annual report. In prior years, the FRM did not address the timing of when the lessee financial statements were required to be filed. In October, following clarification by the SEC staff at the March CAQ SEC Regulations Committee meeting, the FRM was updated to clarify that registrants may provide the lessee financial statements in their annual reports on the same timetable as they provide financial statements of significant equity method investees, based on an analogy to Rule 3-09. The due dates depend on a number of factors, all of which are specified in paragraphs 2405.7 through 2405.11 of the FRM.

³ The FRM is an internal SEC staff reference document that provides general guidance covering several SEC reporting topics and is available [here](#). While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues.

PRO FORMA CONDENSED INCOME STATEMENT PRESENTATION

In 2013, the SEC staff revised the FRM to clarify that pro forma presentation is required for all required annual periods and the subsequent interim period for discontinued operations that are not yet reflected in the annual historical statements of the registrant. Prior to the update, the FRM specified that pro forma income statements were required for all required annual periods and the comparative interim periods. Accordingly, a registrant may, but is not required to, provide a pro forma income statement for the comparative interim period. In March, the SEC staff confirmed that the same policy applies to the pro forma presentation requirements of a business combination to be accounted for as a reorganization of entities under common control.

RULE 3-12 COMPLIANCE IN REGISTRATION STATEMENTS ON FORM 10

The Securities Exchange Act of 1934 prescribes the date on which a registration statement on Form 10 becomes effective. A Form 10 filed pursuant to Section 12(g) of the Exchange Act automatically becomes effective 60 days after the initial filing (or earlier if acceleration is requested and granted). A Form 10 filed pursuant to Section 12(b) of the Exchange Act automatically becomes effective 30 days after certification by the applicable exchange (or earlier if acceleration is requested and granted). Rule 3-12 of Regulation S-X contains the requirements with respect to the age of financial statements at the effective date of a registration statement. Given that a Form 10 may go effective automatically as described above, it has not been clear whether a registrant is required to file an amendment to Form 10 to comply with Rule 3-12 at the effective date.

At the June meeting of the CAQ SEC Regulations Committee, the staff clarified that the age of financial statement requirements in Rule 3-12 apply to Form 10. The staff also clarified that the appropriate method for updating the financial statements in a Form 10 is to file an amendment to the form. In practice, registrants often update the financial statements by instead filing a periodic report (i.e., a Form 10-K or 10-Q). The staff stated that it will not object if a registrant updates its financial statements in this manner.

CONFLICT MINERALS REPORTING

Exchange Act Rule 13p-1 requires companies to determine and publicly disclose on an annual basis their use of conflict minerals from the Democratic Republic of the Congo (DRC) or adjoining countries.⁴ In early April, the SEC staff issued a second set of frequently asked questions to assist companies with the application of the Rule. The FAQs provide guidance related to reporting under Item 1.01 of Form SD, which was created for the purpose of reporting information required by Rule 13p-1. The FAQs can be accessed [here](#).

In mid-April, a U.S. Court of Appeals issued a ruling which determined that a portion of the conflict minerals rule infringed upon a company's constitutional right of free speech. Specifically, the Court ruled that the requirement for a company to describe its products as "having not been found to be 'DRC conflict free'" violates the company's constitutional rights. The matter was sent back to a district court for further proceedings.

Form SD is due on May 31st of each year. In light of the ruling and the impending reporting deadline, the SEC staff issued a [statement](#) on how a company should comply with the aspects of the conflict minerals rule which were not impacted by the Court's decision. The statement clarified the following:

- Form SD should describe the company's reasonable country of origin inquiry procedures and the results.
- If otherwise required by the rule, a conflict minerals report should be filed as part of the Form SD and should describe the due diligence procedures undertaken by the company.
- The conflict minerals report need not describe any of the products as being "DRC conflict free," having "not been found to be 'DRC conflict free'," or "DRC conflict undeterminable."
- If any of the products would have been labeled in the latter two categories mentioned above, a company should identify those products, the facilities used to produce the conflict minerals, the country of origin, and the company's efforts to determine the mine or location of origin.
- If a company *voluntarily* elects to describe its products as being "DRC conflict free," it must obtain an independent private sector audit. In the absence of such a description, an audit is not required.

Pending further action by the courts, the guidance above remains in effect for 2014 calendar year reporting on Forms SD to be filed in 2015.

⁴ The BDO Flash Report [here](#) summarizes the rule and the report [here](#) summarizes the first set of FAQs, which the staff issued in 2013.

BDO OBSERVATIONS:

The conflict minerals rule has been the subject of debate and court battles since it was first issued in August 2012. Subsequent to the Court's ruling in April, various trade groups as well as two Commissioners recommended a stay of the rule in its entirety. The request was denied (by both the Court and the SEC) and the SEC has since asked the Court to reconsider its decision on the basis that the Court is already rehearing a separate case concerning meat labeling requirements that raise similar legal issues. The Court has not yet decided whether to grant the request.

FINANCIAL REPORTING MANUAL

In February, the staff of the SEC's Division of Corporation Finance published an update to the Division's FRM. The update marked the beginning of a new approach by the staff to maintaining the FRM. Previously, updates to the FRM were published quarterly. Now, the staff plans to publish updates as it considers them necessary. Consistent with previous updates, the staff includes a summary immediately following the FRM cover that describes the nature of the changes and lists the paragraphs that were updated. Additionally, the staff continues to annotate the FRM to communicate the date a paragraph was most recently updated.

The February update amended Section 9520, which provides guidance on stock-based compensation disclosures in the management's discussion and analysis section of IPO registration statements. Stock-based compensation is generally a critical accounting estimate for a private company going public. Since the stock is privately held, the fair value estimates can be complex and highly subjective. Prior to the update, Section 9520 called for tabular disclosures about recent grants and a detailed discussion of the factors contributing to significant changes in fair value. At the 2013 AICPA Conference on SEC and PCAOB Developments, the staff noted that the disclosures appearing in IPO registration statements were voluminous and often exceeded the requirements and intent of FRM Section 9520.

In that spirit, the new guidance allows companies to scale back stock-based compensation disclosures in IPO registration statements. Specifically, the updates request registrants to consider the following disclosures:

- The method(s) that management used to determine the fair value of the company's shares and the nature of the material assumptions involved.
- The extent to which the estimates are considered highly complex and subjective.
- A statement indicating that the estimates will not be necessary to determine the fair value of new awards once the underlying shares begin trading.

In making these disclosures, companies may cross-reference to information provided elsewhere in the prospectus.

Accordingly, a comprehensive history of awards or details sufficient to allow re-computation of compensation expense is not needed. While the staff may issue comments asking companies to explain the reasons for valuations that appear unusual, paragraph 9520.2 makes it clear the comments should not be interpreted as requests for additional disclosures. Rather, the comments are intended to elicit information for the staff to address whether the accounting for share-based compensation was appropriate.

The FRM was also updated in October. Most of the October updates reflect minor, non-substantive wording changes. Most of the other changes simply conform the wording in the FRM with current practice or previously communicated guidance from SEC Regulations Committee meeting discussions or informal discussions with the SEC staff. Notable changes are referenced in the sections above.

The FRM is available [here](#) on the SEC's website.

COMPLIANCE AND DISCLOSURE INTERPRETATIONS

The SEC staff updated its C&DIs during the year. The updates provided guidance on various legal topics including those related to beneficial ownership, unbundling of separate matters submitted to a shareholder vote, the definition of an accredited investor and offerings pursuant to Rule 506(c) of Regulation D, among others.

The C&DIs are available [here](#) on the SEC's website.

► STAFF ACTIVITIES

During 2014, the staff has devoted substantial attention to several initiatives which have not yet resulted in formal staff guidance. Two of these initiatives are discussed below. Furthermore, many staff speeches in 2014 have highlighted the staff's refreshed focus on segment reporting and internal controls over financial reporting. Additional information regarding these topics and other staff focus areas will be available in our report on the AICPA Conference on SEC and PCAOB Developments held in December.

IMPLEMENTING THE NEW REVENUE STANDARD

The FASB issued ASU 2014-09, *Revenue Recognition*, in May. The standard is scheduled to take effect in 2017 for public entities and establishes a comprehensive revenue recognition standard for virtually all industries. Consequently, the SEC staff is beginning to focus on issues related to implementing the new standard. Thus far, the SEC staff has indicated that:

- The disclosure of the expected effects of applying the new standard in accordance with SAB Topic 11.M⁵ should evolve over time and registrants should disclose their transition method as soon as one is elected.
- The staff will not object if companies that select a full retrospective approach to adopt the new revenue standard do not recast the earliest two years in their selected financial data disclosures. That is, a company would be required to reflect the accounting change in selected financial data only for the three years for which it presents full financial statements elsewhere in the filing. Companies will be required to include clear disclosures about the lack of comparability.
- Pursuant to the JOBS Act of 2012, emerging growth companies will be permitted to adopt the new revenue standard using nonpublic company adoption dates (i.e., annual reporting periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018). Under the JOBS Act, emerging growth companies are permitted to adopt new accounting standards using the nonpublic company adoption dates. Delayed adoption is permitted only for those that haven't elected to use public company adoption dates for new accounting standards (as such election is irrevocable). Further guidance is anticipated to address presentation of the quarterly data required by Item 302 of Regulation S-K 302 in the 2018 Form 10-K and the 2018 comparative financial statements in the 2019 Form 10-Qs of emerging growth companies that take advantage of the delayed adoption. The staff will also need to consider whether there are any other types of Public Business Entities for which delayed adoption should be permitted (e.g., a business acquired by an emerging growth company whose financial statements are provided in the emerging growth company's IPO registration statement).

BDO OBSERVATIONS:

SEC staff activities related to implementation and reporting issues associated with the new revenue standard are expected to continue as the adoption date approaches. The staff will need to address whether portions or all of its legacy revenue recognition guidance in SAB Topic 13 should be rescinded. Additionally, the staff is considering whether the current effective date of the standard provides sufficient time for registrants to adequately assess and prepare for the standard's adoption and is closely watching the FASB as it considers the need to defer the effective date.

DISCLOSURE EFFECTIVENESS PROJECT

In December 2013, the staff completed a [study](#) of the disclosure requirements of Regulation S-K that was mandated by the JOBS Act. The purpose of the study was to determine how the offering registration process can be simplified and costs can be reduced for emerging growth companies. However, Chair White indicated that the study provided a "framework for disclosure reform" and directed the staff to develop recommendations for updating the SEC's disclosure rules in order to improve the disclosure regime for both companies and investors. Consequently, the staff began its work on the "Disclosure Effectiveness Project." In April, the Director of the Division of Corporation of Finance gave a [speech](#) about the staff's approach to the project. The staff is initially focused on the business and financial disclosures required by periodic and current reports such as Forms 10-K, 10-Q, and 8-K. The Division's Office of Chief Accountant is specifically focused on a review of rules in Regulation S-X which require financial statements of others to be filed (e.g., acquired businesses, equity method investees, and guarantors) and other staff are focused on a review of the disclosure requirements in Regulation S-K. The staff has indicated that it is gathering input from a wide array of stakeholders and that the next step in the process will be the issuance of a concept release to solicit formal feedback. Comments on the project and additional information can be found [here](#) on the SEC's website.

⁵ SAB Topic 11.M addresses disclosure of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period.

MONITORING COSO FRAMEWORK IMPLEMENTATION

In May 2013, the Committee of Sponsoring Organizations of the Treadway Commission issued an updated Internal Control–Integrated Framework (2013 Framework) and related illustrative documents. The Framework, originally published in 1992, has been the most commonly used framework for designing and implementing internal control and assessing its effectiveness. Effective December 15, 2014, COSO considers the 1992 Framework to be superseded by the 2013 Framework.

The SEC staff has been monitoring registrants' transition from the original framework to the updated framework. The staff has informally indicated that it will not comment (i.e., object) to a registrant's use of the original framework in 2014. Thereafter, the staff will be more likely to question whether a registrant that has not transitioned to the updated framework is meeting the requirement to use a suitable, recognized control framework.

The staff has also reminded registrants that they should disclose which framework they used in their internal control reports and that if using the 2013 Framework prompts them to make material changes to their internal controls, those changes should be disclosed as required by Item 308(c) of Regulation S-K.

► PCAOB DEVELOPMENTS

FINAL AUDITING STANDARD AND AMENDMENTS

AUDITING STANDARD NO. 18

In October, the SEC approved the PCAOB's Proposed Rules on Auditing Standard No. 18, *Related Parties, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Amendments to PCAOB Auditing Standards* (AS No. 18 and the related amendments), as previously adopted by the PCAOB in June 2014. The new auditing standard and amendments are meant to strengthen auditor performance in three critical areas that were considered to have been, and continue to be, contributing factors in numerous financial reporting frauds. These areas are:

- (1) relationships and transactions with related parties;
- (2) significant unusual transactions outside the ordinary course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature; and
- (3) a company's financial relationships and transactions with its executive officers.

The standard also requires enhanced communications to audit committees related to both related party transactions and significant and unusual transactions. Those communications include discussing the business purpose for the transactions where it isn't evident from other information the auditor has obtained.

Auditing Standard No. 18 and the related amendments are effective for audits of financial statements for fiscal years beginning on or after December 15, 2014, including reviews of interim financial information within these fiscal years.

The final standard and amendments are available [here](#) on the PCAOB's website.

OTHER STANDARD-SETTING ACTIVITIES

PROPOSED STANDARD ON AUDITOR REPORTING AND PROPOSED STANDARD ON THE AUDITOR'S RESPONSIBILITIES REGARDING OTHER INFORMATION

In August 2013, the PCAOB proposed for public comment two proposed auditing standards, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the proposed auditor reporting standard), and *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the proposed other information standard), as well as related amendments to PCAOB standards, to enhance the way auditors communicate with investors and other financial statement users about the audit.

The proposed auditor reporting standard would retain the pass/fail model in the existing auditor's report, but would require: (1) the communication of critical audit matters as determined by the auditor; (2) new elements in the auditor's report related to auditor independence, auditor tenure, and the auditor's responsibilities for, and results of, the auditor's evaluation of other information outside the financial statements; and (3) greater detail in the auditor's report related to the auditor's responsibilities for fraud and notes to the financial statements. This proposed standard would supersede portions of AU sec. 508, *Reports on Audited Financial Statements*.

The original proposed standards and amendments are available [here](#) on the PCAOB's website. In April 2014, the Board held a public meeting to discuss the proposed standards and comments received. The staff is analyzing the comments received on the proposal and at the public meeting, and is currently drafting a reproposal of both standards for the Board's consideration. In drafting the reproposal of the auditor reporting standard, the PCAOB staff will consider the requirements of the International Auditing and Assurance Standards Board's recently adopted standard regarding auditor reporting (ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*), which includes a requirement for the auditor to communicate key audit matters in the audit report for listed companies. Additionally, according to commentary at the PCAOB's Standing Advisory Group meeting in November 2014, the reproposal of the auditor reporting standard is expected to, among other things, clarify that matters deemed to be critical audit matters would likely be matters that are material to the financial statements, and would be the same audit matters that are required to be reported to the audit committee. The PCAOB's reproposal of both standards is expected to be issued in the first quarter of 2015.

PROPOSED AMENDMENTS ON DISCLOSURE OF ENGAGEMENT PARTNER AND CERTAIN OTHER PARTICIPANTS IN AUDITS

In December 2013, the Board issued for public comment repropoed amendments to its auditing standards that would improve transparency of audits by requiring disclosure in the auditor's report of (1) the name of the engagement partner and (2) the names, locations, and extent of participation of certain other participants in the audit. The repropoed amendments are available [here](#) on the PCAOB's website. The staff is currently drafting for the Board's consideration a supplemental request for comment that takes into account comments received on the repropoal, including comments related to personal liability and to incremental costs that would be incurred by firms in implementing such amendments. The supplemental request for comment is also expected to include a proposal for an alternative location for such disclosure outside of the audit report, for example, as a separate form on the PCAOB's website. The supplemental request for comment was recently reviewed with the SEC staff, and is expected to be issued by the first quarter of 2015.

STAFF CONSULTATION PAPER

In August, the PCAOB issued a Staff Consultation Paper on standard-setting activities related to auditing accounting estimates and fair value measurements. In recent years, the PCAOB has observed significant audit deficiencies in this area. In the Consultation Paper, the PCAOB staff requests commenters to provide their views on (1) the potential need for changes to the PCAOB's existing standards to better address changes in the financial reporting frameworks related to accounting estimates and fair value measurements and (2) current audit practices to address issues relating to accounting estimates and fair value measurements. The Consultation Paper also asks commenters for their views on possible approaches to revising existing standards, as well as the requirements of a new standard. Furthermore, the Consultation Paper requests commenters to provide relevant economic data about potential economic impacts of standard-setting in this area. The comment period closed in November.

BDO OBSERVATIONS:

Our comment letter on the repropoed standard and amendments expressed support for developing a single standard regarding auditing accounting estimates and fair value measurements that is aligned with the PCAOB's risk assessment standards. We encouraged the staff to consider aligning the potential new standard with International Standard on Auditing 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* (ISA 540). We also made certain suggestions for auditor requirements of a potential new standard regarding (1) performing audit procedures when management uses the work of a specialist, (2) developing an independent accounting estimate as a range, (3) identifying significant assumptions, and (4) using third party pricing sources. Further, we expressed our view that there may be an opportunity to provide incremental guidance relating to more specific narrow topics in a separate interpretive practice aid.

Our comment letter is available [here](#).

GUIDANCE

STAFF AUDIT PRACTICE ALERT NO. 12

In September, the PCAOB issued Staff Audit Practice Alert No. 12, *Matters Related to Auditing Revenue in an Audit of Financial Statements*. The Alert highlights certain PCAOB auditing requirements related to revenue where significant audit deficiencies have been frequently cited in PCAOB inspections.

The timing of this Alert is intended for auditors to take note of the matters discussed in the Alert in planning and performing the upcoming calendar year-end audits. The Alert is available [here](#) on the PCAOB's website. While the alert is aimed at auditors, companies should also consider whether their accounting policies and controls around the areas noted in the alert are complete and clearly documented.

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