Introduction

This document provides a summary of the activities of the FASB, PCAOB, and SEC that may be of interest to audit committees, companies, and their stakeholders.

Financial Accounting Standards Board

Transition to equity method accounting simplified

In March 2016, the FASB issued Accounting Standards Update 2016-07, *Simplifying the Transition to the Equity Method of Accounting*, which eliminates the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment. Instead, the equity method of accounting should be applied prospectively from the date significant influence is obtained.

The new standard is effective for interim and annual periods beginning after December 15, 2016. Early adoption is permitted. Refer to our *In brief* for more details.

Share-based payment simplification

In March 2016, the FASB issued Accounting Standards Update (ASU) 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which amends ASC Topic 718, *Compensation – Stock Compensation*. Key provisions include requirements to (1) record all of the tax effects related to share-based payments at settlement (or expiration) through the income statement; (2) record a windfall tax benefit when it arises, subject to normal valuation allowance considerations, and (3) report all tax-related cash flows resulting from share-based payments as operating activities on the statement of cash flows.

In addition, the ASU modifies the minimum statutory tax withholding requirements to allow entities to withhold an amount up to the employees’ maximum individual tax rate in the relevant jurisdiction without triggering liability classification of the award. Additionally, the ASU clarifies that all cash payments made to taxing authorities on employees’ behalf for withheld shares should be presented as financing activities on the statement of cash flows.

Additionally, the new guidance allows a reporting entity to make an accounting policy election related to the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur.

Lastly, there are two provisions that are only available to companies that are not public business entities, as defined in ASC 718: (1) a practical expedient for determining the expected term of certain share-based awards, which would be
adopted prospectively, and (2) a one-time opportunity to change the measurement basis for all liability-classified awards to intrinsic value, which can be elected upon adoption of the ASU.

Refer to our In brief for more details.

**Goodwill impairment**

In May 2016, the FASB proposed eliminating Step 2 of the current goodwill impairment test, which requires a hypothetical purchase price allocation to measure impairment losses identified in Step 1. Under the proposal, a goodwill impairment loss would instead be measured as the amount by which a reporting unit’s carrying amount exceeds its fair value. All other goodwill impairment guidance would remain unchanged.

The proposal would apply to all entities except for private companies that have adopted the Private Company Council goodwill accounting alternative (ASU 2014-02).

The proposed guidance would be applied prospectively to all existing goodwill. The effective date will be determined by the FASB in future redeliberations.

Comments on the proposal are due by July 11, 2016. Refer to our In brief for more details.

**Revenue standard updates**

In April 2016, the FASB issued amendments to certain aspects of the new revenue standard, specifically the guidance on identifying performance obligations and accounting for licenses of intellectual property. Refer to our In brief for more details.

Also in April, the IASB issued its package of proposed amendments to its revenue standard, which include clarifications to the guidance on identifying performance obligations, accounting for licenses of intellectual property, and the principal versus agent assessment (gross versus net revenue presentation). New and amended illustrative examples have been added for each of these areas. The IASB also included additional practical expedients related to transition to the new revenue standard. Refer to our In brief for more details.

In May 2016, the FASB issued additional amendments related to the assessment of collectibility, the definition of completed contracts at transition, and the measurement of the fair value of noncash consideration at contract inception, and added new practical expedients for the presentation of sales taxes collected from customers and the accounting for contract modifications at transition. Additionally, the FASB proposed several technical corrections that primarily impact scoping determinations and provide additional relief from certain disclosure requirements. Refer to In brief (FASB issues narrow-scope improvements to new revenue standard) and In brief (FASB proposes technical corrections to the new revenue standard) for more details.

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**Public Company Accounting Oversight Board**

**PCAOB reproposes changes to enhance the auditor’s report**

In May 2016, the PCAOB reproposed a new auditing standard, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and related amendments that would require additional information in the auditor’s report about the audit and the auditor. The proposed standard includes a requirement for the auditor to identify critical audit matters (CAM), but retains the existing “pass/fail” opinion and the basic elements of the auditor’s report.

The auditor would be required to communicate CAM arising from the audit of the current period’s financial statements. CAM are any matters arising from the audit of the financial statements communicated, or required to be communicated, to the
audit committee that; (1) relate to accounts or disclosures that are material to the financial statements, and (2) involved especially challenging, subjective, or complex auditor judgment. The auditor’s report would (1) identify the CAM; (2) describe the principal considerations that led the auditor to determine the matter is a CAM; (3) describe how it was addressed in the audit; and (4) refer to the relevant financial statement accounts and disclosures.

In light of comments received on the initial 2013 proposal, the PCAOB has made some modifications, including (1) limiting the source of potential CAM to matters communicated, or required to be communicated, to the audit committee; (2) adding a materiality component to the definition of CAM; (3) narrowing the definition to only those matters that involved especially challenging, subjective, or complex auditor judgment; (4) narrowing the related documentation requirement to be consistent with the definition of a CAM; and (5) expanding the communication requirement so the auditor describes how the CAM was addressed in the audit.

Other provisions of the proposed standard would require a statement containing the auditor’s tenure and enhance the auditor’s report, including adding language related to the auditor’s responsibilities for fraud.

Comments on the proposed standard are due by August 15, 2016. Refer to our In brief for further details.

**PCAOB proposes new requirements for audits involving other auditors**

In April 2016, the PCAOB issued a proposal to modify its auditing standards pertaining to a lead auditor’s responsibilities for planning, supervising, and evaluating the work of other auditors (including both those from the same network of firms as the lead auditor and those outside the network). The proposal is intended to strengthen the existing requirements and impose a more uniform approach to the lead auditor’s supervision of the work of other auditors, and enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors.

Changes proposed by the PCAOB include: (1) directing the lead auditor’s supervisory responsibilities to the areas of greatest risk; (2) clarifying that, to act as lead auditor, an audit firm must itself audit a meaningful portion of the financial statements; (3) require the lead auditor to gain an understanding of each other auditor’s knowledge of SEC and PCAOB independence and ethics requirements and their experience in applying them; and (4) prescribing certain procedures to be performed by the lead auditor with respect to the supervision of other auditor’s work, including procedures related to the scope of work, the nature, timing, and extent of audit procedures to be performed, access to work papers, the report, and lead auditor’s communications compliance.

Comments are due by July 29, 2016. Refer to the following materials for further details In brief.

**Staff Inspections Briefs**

In April 2016, the PCAOB published two Staff Inspection Briefs - Preview of Observations from 2015 Inspections of Auditors of Issuers (“Issuer SIB”) and Preview of Observations from 2015 Inspections of Auditors of Brokers and Dealers (“B-D SIB”). These documents provide a preview of observations from PCAOB inspections conducted during the 2015 inspection cycle.

The Issuer SIB indicates that the overall number of inspection findings has decreased. The most frequent inspection findings continue to be in three areas: (1) auditing internal control over financial reporting; (2) assessing and responding to risks of material misstatement, and (3) auditing accounting estimates, including fair value measurements.

Other areas of inspection findings included: (1) the testing of internal controls and substantive tests related to business combinations; (2) the testing of investment portfolios; and (3) assessing the impact of the fluctuation in oil prices, particularly evaluating potential asset impairments.

The B-D SIB notes findings similar in nature to those observed in the past, including in the following areas: (1) auditor
(dependence; (2) testing revenue; (3) evaluating financial statement presentation and disclosures; (4) assessing and responding to risks of material misstatement due to fraud; (5) engagement quality review; and (6) audit documentation.

**Securities and Exchange Commission**

*Commissioner nominations advance to the final stage*

The SEC has been short two commissioners since Dan Gallagher and Luis Aguilar left the Commission at the end of 2015. In May, President Obama’s nominees to fill the open seats, Hester Peirce, a senior research fellow at George Mason University’s Mercatus Center and former Senate Banking Committee senior staffer, and Lisa Fairfax, a law professor at George Washington University, were approved by the Senate Banking Committee. The nominations will now be sent to the full Senate for confirmation, although the timing of a vote is uncertain.

*The SEC’s disclosure effectiveness proposal*

In April, the SEC published a concept release seeking input on whether the business and financial disclosure requirements in Regulation S-K continue to provide important information for investors. These requirements have not been subject to broad public comment in many years.

In addition to seeking input on the usefulness of and potential improvements to existing disclosures (e.g., business information, risk factors, and MD&A), the SEC is also seeking input on other matters, such as the manner of presentation and delivery (e.g., the use of cross references, hyperlinks, and layered disclosure) and the importance of sustainability and public policy matters to investment and voting decisions. Comment are due in late July. Refer to *In brief* for more information.

*SEC staff updates guidance on non-GAAP financial measures*

The use of non-GAAP measures and other key performance indicators (KPIs) continues to increase and in some cases, the difference between certain non-GAAP measures and their GAAP counterparts are growing. In recent speeches, SEC officials have indicated concern with non-GAAP measures that use individually-tailored accounting principles or that exclude normal cash operating expenses. The SEC staff has also been very focused on the prominence of non-GAAP financial information.

In May, the SEC staff updated its interpretive guidance on non-GAAP measures. The updated guidance provides clarifying examples in areas of frequent staff comment, including items which might cause non-GAAP presentations to be considered misleading and presentation methods which might indicate a non-GAAP measure is being presented with greater prominence than the comparable GAAP measure. Refer to *In brief* and *Point of view* for more information regarding non-GAAP measures.