Discussion Items

SEC Developments

PCAOB Developments

The Role of the Audit Committee (SEC and PCAOB recent area of focus)
SEC Developments
SEC organization and structure

Commissioner
Robert Jackson, Jr. (Term expires 2019)
Commissioner
Hester Peirce (Term expires 2020)
Chairman
Jay Clayton (Term expires 2021)
Commissioner
Elad Roisman (Term expires 2023)

- Economic and Risk Analysis
- Corporation Finance Director – William Hinman
- Investment Management
- Trading and Markets
- Enforcement
- Office of Chief Accountant
  - Chief Accountant – Wes Bricker
- Corp Fin – Office of the Chief Accountant
  - Chief Accountant – Kyle Moffatt
- Industry Assistant Director (AD) Group (11)

*Kara Stein (D), who held one of the five commissioner seats, completed her term on January 2, 2019. Allison Lee expected to be nominated by the President, subject to Senate confirmation.
SEC Developments

Overview

Overall SEC Priorities
On October 11, 2018, the SEC released their final strategic plan for fiscal years 2018-2022. The strategic plan outlines their planned initiatives to support three overall goals:

- Focus on the long-term interests of Main Street investors
- Recognize significant developments and trends in evolving capital markets and adjust efforts to ensure they are effectively allocating resources
- Elevate the SEC’s performance by enhancing analytical capabilities and human capital development

Current Priorities for Public Companies

- Facilitating capital formation
- Assessing the potential impact of Brexit
- Implementation of new Accounting Standards
- Cybersecurity
- Disclosure Effectiveness
- Non-GAAP Disclosures
SEC Developments
Current Priorities for Public Companies

Efforts to encourage new capital formation and US Market competitiveness include:

- Scaled disclosure framework for smaller reporting companies
- Adoption of the amendments to Simplify and Update Disclosure requirements
- Staff guidance facilitating the IPO process
- Current review of Section 404(b) thresholds
- Nonpublic Review of Draft Registration Statements
- Disclosures Relating to Acquisitions and Dispositions of Businesses

Cybersecurity Interpretive Guidance

- On October 16, 2018, the SEC issued an investigative report that focuses on the internal accounting controls of nine issuers that were victims of various schemes involving spoofed or compromised electronic communications from persons purporting to be company executives or vendors, commonly referred to as business email compromise scams.
- On February 21, 2018, the SEC issued interpretive guidance on public company disclosure obligations under existing law with respect to matters involving cybersecurity risk and incidents
SEC Developments
Current Priorities for Public Companies

Implementation of New Accounting Standards - The SEC staff suggested the companies focus on the following points related to implementation of the GAAP standards:

- ICFR
- Transition disclosures (SAB 74)
- New disclosure requirements
- Reasonable judgment
- Audit committee involvement

Disclosure Effectiveness Initiative – Actions that the SEC has taken recently that are connected to its Disclosure Effectiveness Initiative, include:

- Amended Regulations S-K and S-X to address certain repetitive, immaterial, or outdated disclosure requirements
- Amended the “smaller reporting” company definition
  - Amend definitions of “accelerated filer” and “large accelerated filer”
- Adopted rule on use of inline XBRL and tagged data
- Requested comment on its interim reporting requirements
- Proposed changes to Regulations S-X related to requirements for financial statements for entities other then the issuer
**SEC Developments**
Current Priorities for Public Companies

**SEC’s Enforcement Division Areas of Focus:**
- Cybersecurity – identifying and managing cybersecurity risks
- Financial reporting – focus on areas include revenue recognition, income taxes, balance sheet issues, and disclosures
- Enforcement of Foreign Corrupt Practices Act (FCPA)

**SEC’s Whistleblower Program:**
- The SEC has investigated numerous cases related to issuer reporting and disclosure, offering frauds and Ponzi schemes, and FCPA violation that were brought to its attention by whistleblowers
- In the last few years the SEC has made significant awards to whistleblowers recognizing that they provide critical information at all phases of the investigatory processes
- On June 28, 2018, the SEC proposed amendments to the Commission’s Whistleblower Program that would provide the Commission with additional flexibility when making awards, increase efficiencies of the claims review process, and clarify the anti-retaliation protection requirements
SEC Developments
Non-GAAP measures and KPIs

Where are we now?

Overall level of comments on non-GAAP measures has declined
Continued focus on Disclosure Controls and Procedures
Comments continue regarding:
• Prominence
• Transparent labeling
• Individually tailored accounting
Adjustments for impact of:
• Tax reform
• New guidance on recognizing and measuring financial instruments (ASU 2016-01)

Disclosure Controls and Procedures (DCPs): When non-GAAP measures are disclosed in earnings releases or in Forms 10-K and 10-Q (outside of financial statements), companies may consider designing their DCPs over non-GAAP financial measures to ensure that procedures are in place regarding:

<table>
<thead>
<tr>
<th>Design DCPs so that controls and procedures cover:</th>
</tr>
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<tbody>
<tr>
<td>Compliance</td>
</tr>
<tr>
<td>Non-GAAP measures presented in compliance with rules, regulations and guidance</td>
</tr>
<tr>
<td>Consistency</td>
</tr>
<tr>
<td>Adjustments evaluated and presented in an appropriate and consistent manner each period</td>
</tr>
<tr>
<td>Data quality</td>
</tr>
<tr>
<td>Calculated based on reliable inputs</td>
</tr>
<tr>
<td>Accuracy</td>
</tr>
<tr>
<td>Calculation is arithmetically accurate</td>
</tr>
<tr>
<td>Transparent disclosure</td>
</tr>
<tr>
<td>Descriptions of adjustments and required disclosures are clear and not confusing</td>
</tr>
<tr>
<td>Review</td>
</tr>
<tr>
<td>Reviewed by the appropriate levels of management</td>
</tr>
<tr>
<td>Monitoring</td>
</tr>
<tr>
<td>Internal audit, disclosure committee or audit committee reviews the controls or is involved in the oversight</td>
</tr>
</tbody>
</table>
SEC review process

- All issuers reviewed at least once every 3 years
- Focus on registrants that comprise a large portion of the market cap
- Percentage of issuers reviewed in 2018: 57%
- Not all reviews result in comment letters
- Comments are posted to EDGAR 20 days after completion of review

Reminders:
- Staff is listening to analyst/earnings calls, reviewing press releases, websites
- May call registrants to address time-sensitive matters or resolve open comments
PCAOB Developments
PCAOB — Leadership

Chairman and members of the board:

Duane DesParte
Board Member

J. Robert Brown
Board Member

William Duhnke
Chairman

Kathleen Hamm
Board Member

James Kaiser
Board Member

The PCAOB organization also includes Office of Secretary that oversees the scheduling of the Board’s open and closed meetings and preparing and maintaining records of Board actions.
PCAOB Standard Setting
Requirement for auditors to report critical audit matters (CAMs)

The PCAOB approved several changes to the auditor’s report – the most significant of which relates to the auditor reporting of critical audit matters (CAMs) in a new section of the auditor’s report.

| What is a CAM? | Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee AND that: |
|               | • Relates to accounts or disclosures that are material to the financial statements AND |
|               | • Involved especially challenging, subjective, or complex auditor judgment. |

| How will CAMs be described in the auditor’s report? | The PCAOB standard requires the auditor to: |
|                                                    | • Identify the CAM. |
|                                                    | • Describe the principal considerations that led to the auditor’s determination that the matter is a CAM. |
|                                                    | • Describe how the CAM was addressed in the audit. |
|                                                    | • Refer to the relevant financial statement accounts or disclosures that relate to the CAM (or both). |

| Effective Date | • Audits of large accelerated filers: fiscal years ending on or after June 30, 2019. |
|               | • Audits of all other companies to which CAMs apply: fiscal years ending on or after December 15, 2020. |
PCAOB Standard Setting

**PCAOB Staff Provides Guidance in Advance of CAM Effective Dates:**

- Implementation of CAMs – The Basics
- Implementation of CAMs – Staff Observations from Review of Audit Methodologies
- Implementation of CAMs - A Deeper Dive on the Determination of CAMs
Public Company Accounting Oversight Board (PCAOB) Strategic Plan (approved November 15, 2018)

Strategic Plan Background

- For the 2018-2022 plan, the PCAOB elected to take a different approach than prior years by engaging in both internal and external stakeholder outreach.
- As a result of this outreach, and their own internal assessment, the PCAOB identified three key factors directing their strategic planning efforts:
  - Further improvement in the quality of audit services
  - Disruptive change in technology
  - Stakeholder engagement and communications
- In addition to seeking input during the planning process, for the first time, the PCAOB invited public comment on its strategic goals.

2018-2022 Strategic Goals

1. Drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation.
2. Anticipate and respond to the changing environment, including emerging technologies and related risks and opportunities.
3. Enhance transparency and accessibility through proactive stakeholder engagement.
4. Pursue operational excellence through efficient and effective use of our resources, information, and technology.
5. Develop, empower, and reward our people to achieve our shared goals.
# PCAOB Standard Setting Agenda

## Standard Setting Agenda

<table>
<thead>
<tr>
<th>Project</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board Actions</strong></td>
<td></td>
</tr>
<tr>
<td>Auditing Accounting Estimates, Including Fair Value Measurements</td>
<td>On December 20, 2018, the PCAOB adopted a new standard, AS 2501, Auditing Accounting Estimates, Including Fair Value Measurements, and related amendments. The new standard and related amendments are subject to approval by the SEC, which is pending.</td>
</tr>
<tr>
<td>The Auditor’s Use of the Work of Specialists</td>
<td>On December 20, 2018, the PCAOB adopted amendments to the auditing standards regarding the requirements that apply when auditors use the work of specialists in an audit. The amendments are subject to approval by the SEC, which is pending.</td>
</tr>
<tr>
<td>Supervision of Audits Involving Other Auditors</td>
<td>Supplemental request for comment issued on September 26, 2017; comment period ended November 15, 2017. Analyzing comments received and determining next steps.</td>
</tr>
<tr>
<td>Going Concern*</td>
<td>Monitoring the effect on audits of the changes in relevant accounting standards.</td>
</tr>
</tbody>
</table>

**Note:**
- Listing of projects above does not represent a priority order.
- The PCAOB also has a project focused on audit quality indicators (AQIs) which is led by the PCAOB Office of Research and Analysis, and as a result does not appear in the PCAOB standard-setting agenda.

* On August 2, 2014, FASB issued Accounting Standards Update No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*. On September 22, 2014, the PCAOB issued Staff Audit Practice Alert No. 13 to remind auditors to continue to follow existing PCAOB standards when considering a company’s ability to continue as a going concern.
# PCAOB Standard Setting Agenda

## Planned Research Agenda

<table>
<thead>
<tr>
<th>Project</th>
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</tr>
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<tbody>
<tr>
<td>Quality control (QC) standards, including assignment and documentation of firm supervisory responsibilities</td>
<td>Explore the need for changes to PCAOB QC standards in order to enhance audit quality. Potential changes include prompting firms to improve their QC systems and to more proactively identify and address emerging risks and deficiencies. The staff has presented its research findings to the Board and is developing recommendations for next steps for Board considerations.</td>
</tr>
<tr>
<td>Changes in the use of data and technology in the conduct of audits</td>
<td>Explore need for guidance, changes to PCAOB standards, or other regulatory actions to address increased use of new and emerging technology-based tools. In conjunction with SAG task force, the staff is researching whether impediments exist in PCAOB audit standards.</td>
</tr>
<tr>
<td>Auditor’s role regarding other information and company performance measures, including non-GAAP measures</td>
<td>Evaluate the auditor’s role in relation to other information and company performance measures, including non-GAAP measures, and explore whether there’s a need for guidance, changes to PCAOB standards, or other regulatory action. The staff is summarizing its research findings and developing recommendations for next steps for Board consideration.</td>
</tr>
<tr>
<td>Auditor’s consideration of noncompliance with laws and regulations</td>
<td>Explore need for improvements to PCAOB standards to provide better direction to auditors regarding their responsibilities with respect to illegal acts. The staff is summarizing its research findings and developing recommendations based on research findings for Board consideration.</td>
</tr>
<tr>
<td>Auditor Communication with audit committees concerning independence</td>
<td>The staff is planning to issue guidance in Q2 of 2019.</td>
</tr>
</tbody>
</table>
The Role of the Audit Committee
The Role of the Audit Committee
SEC and PCAOB Recent Areas of Focus

• In speeches, the SEC staff has emphasized the integral role that audit committees play in capital markets as gatekeepers and suggest that audit committee members consider the following:
  — Cybersecurity
  — Readiness to adopt new accounting standards
  — Balanced agenda
  — Candid discussions to help promote audit quality
• The SEC issued concept release in 2015 seeking public comment on current audit committee disclosure requirements, especially regarding oversight of the independent auditor.
  — Studies, including by Deloitte, show continued increase in voluntary audit committee disclosures in the last several years.
  — While the SEC has not taken any further action on the concept release, it has indicated that it is watching voluntary developments in this area.
• Additionally, as part of its new strategic plan, the PCAOB is expected to continue to enhance their engagement with external stakeholders, particularly with Audit Committees.
  — PCAOB has announced that its inspection teams will be directly communicating with audit committees of all issuers selected for inspection