US GAAP Today

Views on, analysis of, and news about US GAAP and corporate reporting:
A Canadian perspective

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Our people are ready to help you understand US GAAP. If you have questions or want to discuss the developments in this publication or other developments, our people in the US GAAP Reporting Group will be happy to answer your questions and have a discussion with you.

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PwC's ***US GAAP Today*** provides updates and insights on financial and corporate reporting for Canadian companies using US GAAP as their accounting framework. Each quarter, we publish views on, analysis of, and news about relevant financial accounting, internal control for financial reporting, corporate reporting, and auditing developments that have occurred during the most recently completed calendar quarter.

US GAAP Today provides guidance primarily by summarizing, interpreting, and supplementing the discussion papers and proposals; exposure drafts; final standards, rules and regulations; reports; and summaries of meetings and conferences of the following organizations and their respective committees:

- Financial Accounting Standards Board (FASB),
- Public Company Accounting Oversight Board (PCAOB),
- American Institute of Certified Public Accountants (AICPA),
- The Securities and Exchange Commission (SEC), and
- The Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Consistency and comparability across companies is a continuing challenge in a principles-based set of standards, rules, regulations and policies. We support consistent application through our work with companies, with the standard setters, with regulators, and with other stakeholders.

Financial and corporate reporting requires professional accountants and preparers to make judgments when applying the standards, rules and regulations. Sound judgment derives from experience. We share our practical knowledge with those charged with preparing, auditing, enforcing, and perhaps most importantly using the corporate reporting published by companies.

PwC guides

PwC also publishes a series of Guides to help our professionals, clients, and others to understand US GAAP accounting for various types of transactions and events. Our engagement teams can provide information on Guides available.

New or updated Guides published during the most recently completed quarter include:

- *Bankruptcies and liquidations* (October 2019)
- *Business combinations and noncontrolling interests, global edition* (October 2019)
- *Derivatives and hedging* (November 2019)
- *Fair value measurements* (October 2019)
- *Financial statement presentation* (November 2019)
- *IFRS and US GAAP: similarities and differences* (October 2019)
- *Leases* (December 2019)
- *Loans and investments* (November 2019)
- *Pensions and employee benefits* (December 2019)
- *Property, plant and equipment* (November 2019)
- *Stock-based compensation* (October 2019)

PwC Guides are available (1) through *Inform* if you are a subscriber; (2) in eBook format for downloading to your iPad by using this *CFOdirect* link https://www.pwc.com/us/en/cfodirect/publications/accounting-guides.html; or (3) in printed format by contacting your local PwC representative.

SEC speaks: Collaborating to achieve transparency

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"High-quality financial reporting is the bedrock of the US financial system." Jay Clayton, Chair of the SEC, made this statement at the *2019 Conference on Current SEC and PCAOB Developments* to set the bar for financial reporting for public companies. The 2019 Conference, hosted by the American Institute of Certified Public Accountants (AICPA) provides a forum for standard setters, regulatory agencies, auditors, preparers, and others to review significant accounting, auditing, and regulatory issues and developments. A key theme at the Conference was the need for collaboration among all parties to achieve transparent, high-quality financial reporting.

Some of the key issues covered at the Conference included:

- Implementation of new accounting standards;
- Evolving issues such a reference rate (LIBOR) reform, digital assets, and cybersecurity;
- Non-GAAP financial measures;
- Reporting of critical audit matters (CAMs) in the auditor's report; and
- Auditors and audit committees.

Implementation of new accounting standards

During 2018 and 2019, companies have implemented the new standards on revenue recognition and leases. Soon, these companies will be working on the implementation of the new credit losses standards. The FASB and SEC Staff have commended standard setters, preparers, auditors, and others for their efforts in successfully implementing these new standards.

The success has been attributed to active and early planning and timely identification of complex and unique issues allowing for timely consultations with advisors, standard setters, auditors, and SEC Staff. The SEC Staff emphasized at the Conference that they have consistently accepted well-reasoned judgments applied by registrants when they have consulted on the application of the new standards.

Revenue recognition

While most SEC registrants have implemented the new revenue recognition standards issued by the FASB and IASB, the new guidance continues to be the top area for consultations with the SEC. Revenue recognition was also the number one topic for comment letters issued by the SEC.

Two matters that have been an area of focus were discussed at the Conference:

- Determining whether an entity is acting as principal or agent, and
- Identification of performance obligations.

The SEC Staff illustrated certain issues on these two topics by referring to consultations between registrants and the SEC Staff. While the SEC Staff's comments were based on US GAAP, these comments can also apply to IFRSs because the revenue recognition standards for US GAAP and IFRS are highly similar.

Principal versus agent considerations

Some revenue contracts may involve more than one party providing goods and services to a customer, requiring the contracting entity to determine whether it is the principal or an agent for the other provider. The SEC Staff emphasized these situations involve significant judgment and require careful consideration of the specific facts and circumstances and contractual terms, as well as any changes over time. The critical point to the evaluation is to identify the entity that can control the particular services before transferring them to a customer.

The SEC Staff referred to a consultation in which a registrant had a contract to provide services but could not legally provide some of the services promised in the contract. The registrant had to rely on another entity to provide those restricted services. The other service provider had discretion in how it would fulfill its performance obligations. The SEC Staff did not object to the registrant concluding it was the principal because (1) the other service provider could not contractually deny the services, (2) the registrant could contract with other service providers, and (3) the registrant could define the scope of the services to be performed on the registrant's behalf.

Identification of performance obligations

A performance obligation may be an individual item or a combined unit for which multiple items are inputs. Identification of the performance obligation requires significant judgment considering the nature of the promise, within the context of the contract. The SEC Staff is not persuaded that promises are a single performance obligation simply because they are sold as a "solution".

The basis of any identification of performance obligations requires a well-reasoned analysis of the revenue recognition guidance beyond referring to how the goods and services are sold to the customer. The SEC Staff suggested registrants should consider the FASB's discussion in the Background and Basis of Conclusions to the standard and address whether the customer received a combined output that is greater than or substantively different from the sum of the parts.

The SEC Staff illustrated the principles based on a consultation with a registrant. The registrant provided software and updates to customers to build and continually deploy the customer's applications on third-party platforms. The software updates were integral to the customer's ability to benefit from the software over the term of the contract. The SEC Staff did not object to the conclusion that software and software updates were a combined performance obligation.

Sale-leaseback transactions

The lease accounting standards permit sales treatment in a sale-leaseback transaction if counterparty obtains control over the asset transferred. The sale and purchase of an asset in a sale-leaseback require consideration of the guidance in the revenue recognition standards. The SEC concluded that arrangements, which allow the seller-lessee to regain control over the transferred assets, would not meet the criteria for transfer of control.

The SEC Staff considered a situation in which the registrant transferred its fixed assets to a variable interest entity in exchange for 100% interest in the VIE. The VIE leased the assets to a third party and entered into a substantive fixed price purchase option with the third party for the assets at the end of the lease term. Subsequently, the third party leased a physically distinct portion of the assets to the registrant. The registrant concluded that since the third party obtained a controlling interest in the VIE, the transaction qualified as a sale of the assets. The SEC Staff objected because the registrant could regain control over the assets if the third party did not exercise the purchase option.

Leases

During 2019, registrants began implementing the new lease standards issued by the FASB and the IASB. Annual financial statements for the 2019 year-ends will be the first sets of financial statements reflecting the new lease standards.

A significant challenge in implementing the new lease standards for some registrants has been the identification of all leases, included embedded contracts, within their worldwide organization. Registrants also faced issues in identifying and accounting for reassessments and impairment of the right-of-use assets.

As registrants prepare their annual financial statements, the SEC Staff reminded them to consider the new disclosures requirements in the new standard, to avoid boilerplate disclosures which simply parrot the requirements of the standards, and to tailor disclosures to the registrant's facts and circumstances.

US GAAP requires lessors to assess whether the collection of lease payments and any amount to satisfy a residual value guarantee is probable at the inception of the lease before recognizing a sale in a sales-type lease. If collectability is not probable, the leased asset remains on the lessor's books, and any income or loss is deferred. In a consultation, the SEC Staff objected to the registrant's assessment that the collections of lease payments were probable. The registrant historically had a high rate of payment defaults resulting in the termination of the contracts and repossession of the equipment. Also, there was an expectation of significant continuing defaults and leases were structured using high implicit rates and residual value guarantees. The SEC Staff emphasized that it is essential to consider all factors in the analysis of collectability issues.

Credit losses

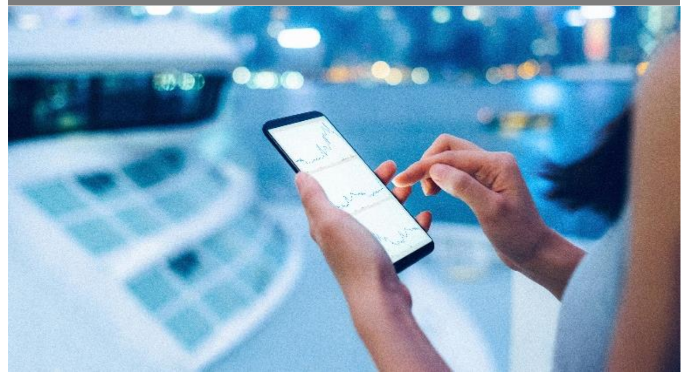
FASB's new standard on credit losses will start to become effective in 2020 and after that. While both the FASB and the IASB issued new guidance on dealing with credit losses, there are significant differences between US GAAP and IFRS models. For larger public companies, the remaining time for implementation is short. Also, the new credit loss disclosures may prove challenging for some and should be addressed early in the implementation process. Registrants were also reminded to describe their implementation processes, including progress to date and work yet to be completed, in their disclosures for the current year-ends.

In November 2019, the SEC Staff issued Staff Accounting Bulletin 119 to update the SEC Staff's guidance on appropriate documentation customarily expected to prepare, maintain, and support estimates for credit losses. SAB 119 aligns with the new credit losses standard issued by the FASB. Many of the concepts in the previous guidance on loan losses in SAB 102 have been carried forward in SAB 119. SAB 119 covers the interpretative guidance on (1) measuring current expected credit losses; (2) developing methodologies, policies, procedures, and internal controls for determining credit losses; (3) documenting the methodologies; and (4) the continuing assessment of the methodologies, policies, procedures, and internal controls.

The SEC Staff is engaged in consultations with registrants. The results of one query illustrated at the Conference, considered whether the estimate of expected credit losses should include potential future advances to the borrower to cover costs such as property taxes, fees, and insurance premiums. The SEC Staff did not object to such future advances not being included in the measurement of expected credit losses when using the discounted cash flow method because the advances were not unconditional obligations of the lender. Further, the standard does not specify which specific cash flows must be included in the present value calculation. Finally, the particular costs do not meet the definition of costs to sell and are not part of the amortized cost basis of the loan.

Evolving issues

The SEC Staff are monitoring several evolving issues and often focuses on these issues in their reviews of disclosures by registrants. The SEC Staff and others mentioned some of these issues at the Conference. Registrants will want to review the Staff's comments to understand how they may be addressed in the upcoming annual disclosures.



Reference rate reform

The phasing out of LIBOR and similar benchmark interest rates could have a significant impact on the financial markets and financial reporting. The SEC Chair raised the issue of transitioning to new reference rates in his speech and stated the "complexity is greatly underestimated. The earlier addressed, the better." The SEC Chief Accountant, Sagar Teotia, encouraged registrants to assess the risks associated with the transition away from LIBOR as soon as possible.

The SEC is actively monitoring activities to address financial reporting and disclosure issues. Both the FASB and IASB have projects considering how to facilitate and address the change over in financial statements. The SEC encourages an ongoing discussion and analysis of the issues related to the changes in reference rates.

The SEC is expecting to see more disclosures about the transition from LIBOR and similar rates in filings. While registrants in the financial sector have included more disclosures, companies in the non-financial industries are lagging, even though many companies have substantial debt with LIBOR rate or exposure to derivatives linked to LIBOR.

In consultations, the SEC Staff did not object to registrants' conclusions that:

- an entity could continue to use the qualitative approach in considering whether a hedged forecasted transaction (i.e., cash flow hedge of LIBOR-based interest payments) was probable of occurring, even though some of the forecasted payments were expected to be made after LIBOR is no longer quoted;
- an amendment to equity-classified preferred stock instruments (with periodic dividend payments based in part on LIBOR) to replace the reference rates for dividend payments to another rate was a modification and not an extinguishment because the changes were not significant; and

- there was no accounting effect for the modification of the preferred stock instrument noted above because there was no change in the fair value.

Digital assets

Emerging technologies, such as blockchain and digital assets, are having an impact on capital markets, financial reporting, and securities regulation. Digital assets or crypto-assets remain an area of focus for the SEC Staff, including initial coin offerings.

Digital assets are represented by a quantity of cryptographic tokens that can be transferred between pseudonymous accounts on a blockchain. Digital assets may include Bitcoins, Ethereum tokens, securities tokens, initial coin offers, and similar items.

The SEC Staff noted that accounting for digital assets is not clear. The AICPA has established a Digital Assets Working Group to develop nonauthoritative guidance on accounting for and auditing digital assets. The project is expected to address initial measurement, subsequent measurement, and derecognition of digital assets. Specific accounting considerations for investment companies and broker-dealers will also be discussed. The IASB is also considering what action to take to address accounting for digital assets.

Other issues

SEC continues to monitor disclosures about Brexit, cybersecurity, environmental risks, risks resulting from social and political unrest, the effects of trade barriers and tariffs, and other world events. If these risks are material, the SEC Staff expects registrants to consider the following disclosures:

- How management assesses these risks;
- How management is mitigating and managing these risks; and
- What role the board of directors have in overseeing risk management.

The impact of these risks and events may evolve, and companies will need to monitor and adapt their disclosures as necessary. When a company cannot reasonably estimate the impact of a material risk, disclosures are required to inform investors about the potential risk. The disclosure would include the fact that management cannot reasonably estimate the impact of the risk and what steps, if any, management needs to take to address the risk.

The SEC Staff also recommended companies look to their communications about these risks with their boards to inform the timing and content of disclosures for investors.

Non-GAAP financial measures

Non-GAAP financial measures are a perennial topic at the Conference. The SEC continues to support the use of non-GAAP financial measures as a supplement to GAAP measures to assist investors in understanding a registrant's performance.

Chairman Clayton encouraged "responsible" non-GAAP reporting by:

- Making sure non-GAAP measures are comparable and consistent from period to period;
- Cleary explaining adjustments made to develop non-GAAP metrics;
- Making non-GAAP measures more meaningful by presenting metrics used by management to run the business rather than measures created solely for investors, which Clayton referred to as "window dressing"; and
- Having well-developed and robust internal controls and procedures over non-GAAP financial measures.

The SEC Staff commented that adjustments to present results using superseded accounting standards are inappropriate because they are considered to have been prepared using individually tailored accounting principles, which causes the measures to be misleading. While transitional provisions for some standards allowed the presentation of amounts using the superseded standard, continued use is not considered appropriate. The Staff also cautioned registrants that it would not be appropriate to present non-GAAP financial measures that excluded the effects of the new credit losses standard or the complete provision for loan losses.

The SEC Division of Enforcement discussed some actions taken against registrants and individuals for intentionally misstating non-GAAP financial measures and key performance indicators and manipulating those measures over multiple periods by using "cookie jar" reserves. Also, action was taken against a company for disclosing a non-GAAP financial measure more prominently than the corresponding GAAP measure.

The SEC Staff also reminded registrants that contribution margins are non-GAAP financial measures, which should be compared to "fully loaded" gross margin. Registrants were cautioned that excluding costs necessary to generate revenues could result in a misleading non-GAAP financial measure.

The IASB is also considering guidance on non-GAAP financial measures, which may require issuers to reconcile, in a note to the financial statements, such measures to the most comparable profit subtotal.

Information disclosed should be tailored to the specific facts and circumstances of the audit and be consistent with the specific audit procedures performed to respond to those considerations. Each year, the auditor should take a fresh look at its reporting of CAMs.

Reporting critical audit matters

Audit reports of certain registrants are now reporting critical audit matters. Several commentators at the Conference acknowledged the efforts by auditors, the PCAOB, and others in implementing the new reporting requirements. These efforts included collaboration among audit firms and regulators in preparing audit committees, management, and investors for the new requirements, including implementing dry runs before the effective date and providing guidance and resources for all participants.

The PCAOB is actively monitoring the reporting of CAMs. The PCAOB conducted a review of some of the initial audit reports containing CAMs and published those findings in its publication, ***Critical Audit Matters Spotlight***. These PCAOB's observations are outlined in the ***AC Insights*** section *Auditing update*.

The SEC Staff observed that there is not necessarily a direct correlation between critical accounting estimates to be disclosed in the MD&A and CAMs. Some CAMs are consistent with critical accounting estimates, while others do not involve critical accounting estimates.

Auditors were encouraged by the SEC Staff to provide meaningful descriptions of CAMs that reflect why the matters were identified as CAMs in the particular audit.

Users were encouraged by Conference panelists to focus on the principal considerations unique to each audit rather than merely comparing the number and nature of CAMs year over year or by industry.

The SEC noted some of their expectations about reporting CAMs. SEC expects auditors will report at least one CAM for each operating company. SEC does not expect CAMs to be consistent within industries as CAMs depend on the facts and circumstances of each audit. Comment letters may be sent to registrants if information in the filing does not reflect the importance of the issue described in the auditor's report.

Auditors and audit committees

High-level comments made by Chair Clayton and Chief Accountant Teotia highlight the importance of audit committees. Clayton strongly believes that independent audit committees have a crucial role in protecting investors and can have a positive effect on audit quality. Further, audit committees must have highly qualified members who interact actively and directly with the auditors. Mr. Clayton also noted that the SEC would continue to advocate for high-quality audits in foreign jurisdictions.

The SEC leadership promoted a more direct interaction between the audit committee and the auditors, rather than indirect interaction through management. Further, the audit committee should be informed of issues and the audit committee's views obtained before consultations with the SEC Staff.

The SEC Chair stressed that auditor independence is fundamental, and audit committees are responsible for making sure that auditors comply with the Commission's independence rules. The SEC Staff indicated that by working together, auditors, management, and the audit committee could help prevent independence violations from occurring. The SEC Division of Enforcement emphasized the importance of auditor independence by reference to actions taken against auditors for violations of the independence requirements and other improper conduct.

Tips for working with SEC Staff

A panel discussed SEC comment letter trends. In that panel discussion, the SEC Staff provided some tips for responding to comment letters:

- Clearly and directly address the questions and issues raised in the comments;
- The Staff assumes that any policies and transactions disclosed in the financial statements are material. If the items raised are considered immaterial, share these views with Staff early in the process so they can be dealt with efficiently;
- Before providing the Staff with courtesy paper copies, ask the Staff if they are needed or will be used;
- Do not assume that the SEC has accepted an item because it was reported similarly in another registrant's filing. The SEC may not have reviewed some filings or sections of filings of other registrants, or the particular item may not have been material to the other registrant;
- When asking for interpretations of procedural guidance, do not assume the Staff has all the relevant facts. Providing sufficient background and analysis based on the pertinent authoritative literature will assist the Staff in understanding the issue;
- Describe the objectives or business purpose of a novel or complex transaction upfront;
- Call the Staff to discuss or obtain clarifications on a Staff comment or request an extension of time to respond to comments; and
- Provide the Staff with e-mail addresses for the company's and its outside counsel's contacts.

Other matters of note

Accounting issues

The SEC Staff raised a couple of other accounting issues that have arisen during the year.

Equity method of accounting

The SEC Staff discussed the application of the equity method of accounting to limited partnerships (LPs) and limited liability companies (LLCs). For an LP or LLC, SEC Staff's position has been that the equity method should be applied to account for interests in an LP or LLC unless the investor's interest is so minor that the limited partner has virtually no influence over the partnership's operating and financing policies. Practice views investments of more than three to five percent of the interests to be more than minor. This threshold is significantly different from the 20% or more of the voting common stock used for corporate investments.

Consolidation of variable interest entities

The primary beneficiary (PB) of a variable interest entity (VIE) consolidates the VIE. Identifying the PB of a VIE is based on whether the PB has the power to direct the activities that most significantly affect the economic performance of the VIE. Significant judgment is required to make the assessment and involves an evaluation of the significant activities and the risks that cause variability based on the VIE's purpose and design.

The SEC Staff emphasized this principle by reference to two consultations:

- A registrant concluded it was not the PB in a newly formed VIE, even though the registrant was involved in establishing investment guidelines for the VIE and had the contractual right to modify certain aspects of those guidelines. The registrant concluded that the most significant activities of the VIE were the day-to-day investment decisions, which were made by the general manager of the VIE, and the registrant was not able to significantly limit the general partner's discretion over current and future investment decisions. The SEC did not object to the registrant's conclusion.

- A VIE was designed as a single asset LLC to (1) lease the asset to the registrant for substantially all of the asset's economic life, and (2) provide a return to investors from the lease payments and the sale of the property at the end of the lease. The registrant was obligated to operate and maintain the asset, and the VIE had the right to sell the asset at the end of the lease term. The registrant concluded it did not have power over the activities that significantly impacted the VIE's economic performance. The SEC Staff objected to this conclusion on the basis that the most significant activities subject to risk were the residual value of the asset and the operation and maintenance of the asset, of which the latter most significantly affected the VIE's economic performance.

MD&A

During the Conference, the SEC Staff highlighted some areas for which MD&A disclosures could be improved.

Agent's incentives

Certain entities that provide platforms to connect users with suppliers use incentives to attract users to the platforms. These arrangements often involve multiple parties and judgment is applied to assess whether the entity is the principal or agent. When entities concluded they are agents, incentive payments are classified as expenses on the basis the payments are not to customers. These payments are recorded as marketing expenses and may be significant. The SEC Staff noted that these incentives should be disclosed and quantified in the MD&A, so investors understand the effect on the operating performance.

Structured payables

Some registrants used structured payables arrangements (also referred to as supplier finance programs, reverse factoring, vendor payable programs, supply chain financing) to extend the payment of trade payables and improve cash flows. The Staff observed that some registrants had not disclosed these arrangements as a strategy to strengthen their liquidity. Registrants were reminded that, if material, MD&A disclosures should include (1) the material terms of the program, (2) the general benefits and risks of the programs, (3) any guarantees provided, (4) plans to further extend terms to suppliers, (5) any factors that may limit continued use of similar programs to improve cash flows, and (6) trends and uncertainties related to extending payment terms. In recent comment letters from the SEC, the SEC Staff has requested analysis to support the classification of these programs.

Compensation Discussion and Analysis

Stock buybacks may be perceived as a way for management to unfairly increase executive compensation tied to stock prices or EPS targets. Compensation committees often consider the effect of stock buybacks and adjust targets. The SEC Staff have observed that compensation discussion and analysis may not explain adequately how the compensation committee dealt with targets and asked registrants to improve these disclosures.

Further, the SEC Staff noted that compensation levels might be tied to non-GAAP financial measures. Registrants were reminded that when these non-GAAP measures are included in the compensation discussion and analysis, the measures should be cross-referenced to disclosures about the non-GAAP financial measures included elsewhere in the filings.

Financial statements for offering documents

The SEC also discussed the financial statements that might be included in offering documents. Advice was provided on financial statements required for:

- Registrants using the FASB's new stratified effective date approach. The new approach provides two additional years for these registrants to apply new accounting standards.

- Filing documents when a special-purpose acquisition company is used in conjunction with a transaction;

- The predecessor company in IPO transactions.

The SEC Staff also reminded registrants that the definition of a business for regulatory purposes has not changed, and the changes to the FASB definition generally will not affect the requirements for financial statements of a business under the SEC rules.

For foreign entities, the SEC Staff have allowed exceptions to the rules for financial statements including exemptions from including a complete set of financial statements; use of abbreviated financial statements for businesses acquired; and audit qualifications for exclusion of comparative periods (which is not permitted under IFRS) or the opening balance in carve-out financial statements.

The Conference provides an opportunity for the SEC and PCAOB to review current trends and key issues. Registrants will want to take into account the information shared in their next round of annual filings with the SEC.

Accounting standards updates

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At the end of the standard setting process, the FASB issues an Accounting Standards Update (Update or ASU) that replaces or amends an existing standard in the Accounting Standards Codification (ASC). Each ASU sets out the specific changes to the ASC, explains the nature of and reasons for the changes, the effective dates, and the transition method. This section summarizes the Updates finalized and issued during the most recently completed quarter. For specific details of the changes, you should consult the ASC or the ASU.

Simplifications for income tax accounting

ASC Topic 740: *Incomes Taxes*

ASU 2019-12: *Simplifications to accounting for income taxes*

On December 18, 2019, as part of the FASB's Simplification Initiative, the FASB issued ASU 2019-12. The ASU provides improvements to reduce the cost and complexity of accounting for income taxes, based on issues submitted by stakeholders.

Removal of exceptions to general principles
The ASU removes certain exceptions previously made to address specific issues in accounting for income taxes as follows:

- The requirement for intraperiod allocation of income taxes within the financial statements when there is a loss from continuing operations. Now, when there is a loss from continuing operations, the income tax expense benefit allocated to continuing operations is based solely on the loss and not on other items not included in continuing operations. In some cases, the income tax benefit for the loss from continuing operations may be reduced by a valuation allowance if the amount of the loss is not more likely than not to be recoverable. These changes can be applied on a prospective basis.
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- The exception to freeze deferred taxes on the outside basis differences when there is a change in the ownership levels of investments has been eliminated. Now, when an entity's investment in a foreign entity changes from a subsidiary to an equity investment, the ASU requires deferred income taxes to be recorded on the outside basis temporary difference (the difference between the tax basis and the carrying amount of the investment) when the change in status occurs. Also, when an entity's investment in a foreign entity changes from an equity-accounted investment to an investment in a subsidiary, an entity will reverse any deferred tax liabilities previously recorded if the entity asserts the indefinite reinvestment of earnings in the subsidiary at the time of the change in ownership. These changes are to be applied on a modified retrospective basis with a cumulative-effect adjustment recorded in retained earnings as of the beginning of the period of adoption.

- The limitation of the year-to-date income tax benefit recognized in an interim period to the amount of the actual year-to-date ordinary losses when the actual losses exceed the expected ordinary losses used in calculating the annual effective tax rate (AETR). This change is to be applied prospectively.

Other simplifications made include:

- For interim periods, the ASU clarifies that the calculation of the AETR should be revised as of the beginning of an interim period in which tax rates or legislation is changed. This change is applied on a prospective basis.

- For taxes applied partially on income and partly on another basis, such as the capital of a company, the applicable income tax rate is used to calculate current and deferred income taxes, ignoring any reversal of temporary differences that may result from future non-income taxes. The change is applied on a full retrospective basis or a modified retrospective basis with a cumulative-effect adjustment to opening retained earnings.

- The tax basis of goodwill may increase for various reasons. If the increase relates to the original business combination, deferred taxes are only recognized to the extent that the tax basis of goodwill exceeds the book basis of goodwill. If the goodwill arises from other transactions, deferred taxes are recognized for the temporary difference between the tax basis and book basis of the goodwill. The ASU provides several factors to consider in determining whether the step-up results from a separate transaction. Judgment will be required to make the determination. This change is applied on a prospective basis.

- The ASU clarifies that income taxes will not need to be allocated in the separate financial statements of members of a consolidated tax filing group that are non-taxable entities. However, such members of a group can elect to allocate income tax expense to their separate financial statements if they are not subject to tax and are disregarded by the tax authority. An entity can choose to allocate income tax expenses to non-taxable entities on an individual basis; however, income tax expense cannot be allocated to partnerships or pass-through entities that are not wholly-owned. Disclosure of the election is required in the respective member's financial statements. The new guidance will be applied on a retroactive basis.

The ASU also deals with the income statement presentation of tax benefits of tax-deductible dividends on allocated and unallocated shares in an employee stock ownership plan. Also, a correction was made to an illustration of accounting for future tax benefits when an affordable housing investment accounted for under the equity method is impaired.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2020, and interim periods of those years. The effective date for all other entities is for fiscal years beginning after December 15, 2021, and for interim periods beginning in fiscal years after December 15, 2022. Early adoption is permitted.

Addressing issues related to credit losses

ASC Topic: 326: *Financial Instruments – Credit Losses*

ASU 2019-11: *Codification improvements to Topic 326, Financial instruments – Credit losses*

In 2016, the FASB issued ASU 2016-13: *Measurement of Credit Losses on Financial Instruments*, which introduced the current expected credit loss model for impairment of financial assets accounted for using the amortized cost model. ASU 2016-13 is not yet effective, but some companies may have adopted the provisions of the new model. Clarifications or amendments in this ASU are addressing specific issues identified during the implementation process.

Negative allowances

The standard allows a negative allowance, which represents the amount of the amortized cost basis an entity expects to recover after it has written off the amortized cost when it was deemed uncollectible. The FASB clarified the guidance to indicate that recoveries should be considered when estimating the allowance for credit losses on an individual or a pool of PCD assets.

The allowance for credit losses for PCD assets should include expected recoveries of amounts previously written off and expected to be written off by the entity and should not exceed the aggregate amount of the amortized cost previously written off or expected to be written off.

When a method other than discounted cash flows is used to estimate expected credit losses, expected recoveries should not include any amounts that result in the acceleration of a non-credit discount. An entity may include expected cash flows after the acquisition. These provisions would allow a negative allowance to be recorded, reflecting the expected recovery.

Troubled debt restructurings (TDRs) on transition

An accounting election is available to adjust the effective interest rates of TDRs using prepayment assumptions on the adoption of the new standard rather than prepayment assumptions in effect immediately before the restructuring.

Disclosures about accrued interest receivables

The practical expedient previously granted to disclose the total amount of accrued interest included in the amortized cost basis of financial instruments as a single balance is extended to other disclosures about accrued interest receivable balances.

Financial assets secured by collateral maintenance provisions

The standard provides a practical expedient allowing the estimated expected credit losses to be measured by comparing the amortized cost basis of a financial asset to the fair value of the collateral supporting the financial asset at the reporting date. An entity should assess whether it reasonably expects the borrower will be able to replenish collateral securing the financial asset continually. An entity may determine that the expectation of nonpayment for the amortized cost basis equal to the fair value of the collateral is zero.

Effective date

The amendments are effective on the same basis as ASU 2016-13. For entities that have already adopted ASU 2016-13, the changes are effective for fiscal years beginning after December 15, 2019, using a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the date ASU 2016-13 was adopted.

Extending effective dates

ASC Topic 326: *Financial instruments – Credit Losses*
ASC Topic 815: *Derivatives and hedging*
ASC Topic 842: *Leases*
ASC Topic 944: *Financial services - Insurance*

ASU 2019-10: *Credit losses, hedging, and leases – Effective dates for private companies, non-for-profit organizations and small public companies*
ASU 2019-09: *Effective date (Insurance)*

The FASB had received feedback from various constituents about the challenges in applying the new standards on credit losses, derivatives and hedging, leases, and insurance. A new effective date policy has been developed to allow for staggered implementation dates based on the following buckets:

- **Bucket 1:** Larger public entities consisting of public business entities that are SEC filers, excluding entities eligible to be smaller reporting companies (SRCs) under the SEC definition. ASUs would also apply to interim periods within the annual period.
- **Bucket 2:** All other entities, including eligible SRCs, other public business entities, and non-public business entities (private companies, not-for-profit entities, and employee benefit plans). ASUs would apply to interim periods in the annual period after the initial annual period.

This new policy has been applied to new standards currently being implemented as outlined in the following table.

Effective dates for ASU

ASU	Bucket 1	Bucket 2
2016-13: *Measurement of credit losses on financial instruments*	December 15, 2019	December 15, 2022
2017-12: *Targeted improvement to accounting for hedging activities*	Already effective	December 15, 2020 (except for public business entities for which the ASU is already effective)
2016-02: *Leases*	Already effective	December 15, 2020 (except public business entities for which the ASU is already effective)
2018-12: *Targeted improvement to the accounting for long duration contracts*	December 15, 2021	December 15, 2023

Share-based payments granted to customers

ASC Topic 718: *Compensation – Stock compensation*
ASC Topic 606: *Revenue from contracts with customers*

ASU 2019-08: *Codification Improvements – Share-Based Consideration Payable to a Customer*

In transactions to sell goods or services to customers, entities may grant share-based payments to customers. While ASC Topic 606, *Revenue from Contracts with Customers*, provides guidance on the presentation of costs associated with share-based payments to customers, the Topic does not provide guidance on measuring these share-based payments.

ASU 2019-08: *Codification Improvements – Share-Based Consideration Payable to a Customer* was issued in November 2019 to provide guidance on the measurement and classification of these share-based payments. ASU 2019-08 follows the principles of ASC Topic 718 requiring the payments to be recorded as a reduction of the transaction price to be measured at the grant-date fair value. The grant date is the date the vendor and the customer reach a mutual understanding of the key terms and conditions of the share-based payment. The subsequent classification and measurement should also follow the guidance in Topic 718 unless the share-based payment is modified, and the grantee is no longer a customer.

These amendments are effective for all entities for fiscal years beginning after December 15, 2019, with non-public business entities having an additional year to apply the new guidance to interim periods. The amendments will be implemented using a cumulative-effect adjustment to opening retained earnings when the entity (1) adopts ASU 2018-07; or (2) adopted ASU 2018-07 or ASU 2019-08.

FASB projects in progress

3

FASB projects in progress provides information on projects within the FASB's and EITF's agendas, covering developments during the standard-setting process including pre-agenda research; agenda decisions; initial deliberations and tentative decisions made by the FASB and EITF; exposure drafts of proposed ASUs; feedback from comment letters, hearings and roundtables; and redeliberations based on stakeholders' feedback. This section includes all projects that were in development at the end of the most recently completed quarter.

We have identified topics for which there were significant developments in the most recently completed quarter by shading the ASC Topic.

Recognition and measurement projects

Broad projects

Distinguishing liabilities from equity

ASC Topic 470: *Debt*
ASC Topic 815: *Derivatives and hedging*

Objective:

Improve the understandability and reduce the complexity for accounting for instruments with the characteristics of liabilities and equity (including convertible debt).

Exposure draft:

Accounting for convertible instruments and contracts in an entity's own equity issued on July 31, 2019, with comments due by October 14, 2019.

Status:

Redeliberations in progress.

This Q's developments

The FASB discussed feedback from comment letters and began deliberating the tentative conclusions. There was general support for several of the proposals, except for the proposal to add a remote threshold to the derivatives scope exception assessment. The Board reaffirmed some of its conclusions in December 2019. FASB Staff are conducting further research on fair value disclosures of equity-classified instruments, and certain EPS questions.

Key proposals

- All guidance on convertible debt and convertible preferred shares will be consolidated into Topics 470: *Debt* and 505: *Equity*, respectively.
- Convertible debt and convertible preferred shares that do not contain an embedded derivative would be accounted for using traditional convertible models, with cash or beneficial conversion options no longer accounted for separately.
- The equity classification conditions for contracts in an entity's own equity set out in the *Derivatives and hedging* standard will be relaxed to: (a) apply only to freestanding instruments and not embedded features; (b) allow contracts to qualify as equity if only a remote likelihood existed that potential contingent event will occur causing net cash settlement; and (c) to eliminate classification conditions related to settlement in unregistered shares, priority of counterparty rights, penalty payments for failure to make timely filings with the SEC, and collateral requirements were eliminated. Reassessment of a contract's classification would only be required when a triggering event occurs.

- Earnings per share would be calculated for all convertible instruments using the if-converted method. Entities will not be able to overcome the share settlement provisions for a contract that may be settled in either cash or shares. When calculating the diluted earnings per share denominated for contracts with variable pricing or number of shares, the average share price should be used.

- Disclosures for convertible instruments will be amended to disclose events or changes in conditions or circumstances that occurred and significantly affected the conversion conditions, identify which party controls the right and privileges of various convertible securities outstanding, and the fair value and carrying amount of convertible instruments at the individual instrument level. Improvements will also be made by requiring certain formatting and aligning disclosure requirements for contingent and other convertible instruments.

- Disclosures for derivatives will add a disclosure objective for the instruments, clarify the disclosures required only for freestanding instruments, and require disclosure of triggering events that cause a reclassification. The fair value of equity-classified instruments will no longer be required.

- Transition will be either on a modified or full retrospective basis, with a practical expedient to assess at the date of adoption whether the adjustment or settlement features are remote.

Identifiable intangible assets and subsequent accounting for goodwill

ASC Topic 350: *Intangibles – Goodwill and other*

Objective:

Revisit the subsequent accounting for goodwill and identifiable intangible assets for all entities.

Status:

Initial deliberations.

Formal input is being obtained from stakeholders through in *Invitation to Comment* on the subsequent accounting of goodwill, the accounting for certain intangible assets, and the scope of the project. The *Invitation to Comment* was issued on July 9, 2019 with comments due by October 7, 2019.

This Q's developments

There were no further developments during the most recently completed quarter.

Narrow-scope projects

Accounting for asset acquisitions and business combinations

ASC Topic: This project may affect multiple topics within the ASC.

Objective:

Improve the accounting for asset acquisitions and business combinations by aligning the accounting for the recognition and derecognition of assets and businesses.

Status:

Initial deliberations. Staff is conducting further research.

This Q's developments

There were no further developments on this project during the most recently completed quarter.

Key proposals

The Board decided to focus on specific areas such as the accounting for transaction costs, in process research and development, and contingent consideration.

Improvements to equity method accounting

ASC Topic 321: *Investments – Equity Securities*
ASC Topic 323: *Investments – Equity Method and Joint Ventures*
ASC Topic 815: *Derivatives and hedging*

Objective:

Address issues related to (a) accounting for equity securities under the measurement alternative upon the application and discontinuation of the equity accounting method; (b) recognizing investee losses when an investor has other equity investments in the investee; and (c) scope considerations for certain forward contracts and purchased call options on equity securities.

Exposure draft:

Clarifying the interactions between Topic 321, Topic 323, and Topic 815 issued on July 30, 2019, with comments due on August 29, 2019.

Status:

Consensus reached by EITF, which was ratified by the FASB. ASU to be issued in Q1, 2020.

This Q's developments

EITF reached a final consensus on the issues and the Board ratified that consensus. FASB Staff is performing additional research to assess whether the equity method of accounting can be simplified.

Key proposals

- Immediately before applying or discontinuing the equity method of accounting, an entity should consider observable and orderly transactions under the measurement alternative and make the necessary adjustments.
- Equities securities underlying a forward contract or purchased option would not be considered, individually or with existing investments, for the application of the equity method until the settlement of the forward contract or exercise of the purchased option.
- Recurring fair value disclosures would not be required for equity method investments or equity securities accounted for under the measurement alternative.
- The amendments would be applied prospectively for years ending after December 15, 2020 for public business entities and December 15, 2021 for non-public business entities.

Nonmonetary assets contributed to a joint venture by investors

ASC Topic: 323: *Investments – Equity Method and Joint Ventures*

Objective:

Address issues the accounting for nonmonetary assets, including businesses, contributed to a joint venture in the financial statements of the joint venture.

Status:

The project was added to the FASB's agenda in September 2019. No deliberations have been conducted.

This Q's developments

There were no further developments on this project during the most recently completed quarter.

Modifications of equity classified freestanding call options

ASC Topic 505: *Equity*

Objective:

Reduce diversity in accounting for modifications of equity classified warrants (that is, equity classified freestanding call options) that are not compensation or derivatives.

Status:

The EITF has not yet considered this issue.

This Q's developments

There were no further developments on this project during the most recently completed quarter.

Modifications of licenses of intellectual property

ASC Topic 606: *Revenue from contracts with customers*

Objective:

Reduce diversity in accounting for revenue recognition for contract modifications of licenses of intellectual property.

Status:

Initial deliberations.

This Q's developments

The EITF was not able to reach a consensus during the quarter and asked FASB Staff to perform additional research.

Improvements for measuring share-based payment for private companies

ASC Topic 718: *Compensation – Stock compensation*

Objective:

Develop a practical expedient for private companies for measuring equity-classified share-based payment awards.

Status:

Initial deliberations by Private Company Council.

This Q's developments

There were no further developments during the most recently completed quarter.

Key proposals

Private companies would be allowed to use the exercise price of the underlying stock as its current price for determining the grant-date fair value of equity-classified awards provided the awards that are not issued in-the-money.

Consolidation reorganization and targeted improvements

ASC Topic 810: *Consolidation*

Objective:

Reorganize the guidance in ASC 810 to assist in its application and provide clarifications on certain terms and concepts.

Exposure draft:

Reorganization was issued on September 20, 2017 and comments were due December 4, 2017.

Status:

Exposure draft redeliberations.

This Q's developments

There were no developments during the most recently completed quarter.

Key proposals

The Board has decided to:

- Reorganize the current guidance into a new ASC Topic with separate subtopics for VIEs and voting interest entities.
- Add language on the application of "expected" in the VIE guidance, as well as nonauthoritative education materials.

Clarifications about use of "prepayable" and cash flow hedges

ASC Topic 815: *Derivatives and hedging*

Objective:

Clarify (a) the use of the word "prepayable" under the short-cut method guidance; (b) FASB's intent related to the change in hedged risk guidance for cash flow hedges; and (c) alignment of the recognition and presentation of hedging relationships in which a foreign-currency-denominated debt instrument that is designated as the hedging instrument in a net investment hedge and the hedged item in a fair value hedge of interest rate risk (a dual hedge) to previous guidance.

Status:

Initial deliberations. Stakeholder feedback received on tentative decisions.

This Q's developments

The Board did not discuss this project during the most recently completed quarter.

Key proposals

- The scope of the change in hedged risk guidance will exclude hedges of foreign exchange risk and hedges of credit risk.

- When hindsight is applied to identify hedged relationships with a revised hedged risk that would not have achieved a highly effective hedging relationship, amounts deferred in AOCI would continue to be deferred until the associated forecasted transaction affects earnings. Amounts reclassified from AOCI to earnings would be recognized in the same income statement line items as the earning effect of the hedged forecasted transaction. The change in hedged risk would not count as a missed forecast.

- The best estimate of the hedged risk would be used to assess hedge effectiveness. This best estimate should be made at the individual transaction level.

- Entities would be required to first identify hedged transactions that occur during the hedge period before identifying hedged transactions that occur during the two-months after the hedge period.

- Entities are required to document its method of identifying hedged transactions using hindsight at hedge inception.

- An agreement in which a contractually specified component may be evidenced will require the component to be explicitly referenced in the agreement.

- The clearly and closely related underlying portion of the normal purchases and normal sales scope exception is the only portion of the exception that would need to be applied for an entity to designate variability in a contractually specified component as the hedged risk in a nonfinancial purchase or sale agreement that qualified for hedge accounting.

- For dual hedging relationships in which a debt instrument is both a hedging instrument in a net investment hedge in a foreign entity and a hedged item in a fair value hedge of interest rate, the entity would exclude the foreign currency denominated debt's fair value hedge basis adjustment from the effectiveness assessment of the net investment hedge.

- To convey the FASB's intent, the terms "prepayable" or "prepayment" and "prepaid" under the short-cut method guidance will be replaced with "early settlement" and "settled early", respectively.

- The guidance would be applied at the same time as the improvements made to hedging accounting in ASU 2017-12. For entities that have already adopted ASU 2017-12, varying transition guidance has been provided for the various issues.

- The amendments would be effective for public business entities fiscal years beginning after December 15, 2020 and for all other entities for fiscal years beginning after December 15, 2021.

Hedging issues – Last-of-layer method

ASC Topic 815: *Derivatives and hedging*

Objective:

Address issues related to accounting for basis adjustments and multiple-layer strategies within the last-of-layer method.

Status:

Initial deliberations. A proposed ASU is being drafted and will be circulated for an external review.

This Q's developments

The Board discussed several topics and made several tentative decisions.

Key proposals

- A new multiple layer model is proposed for situations when an entity designates more than one hedging relationship associated with a closed portfolio of prepayable financial assets or one or more beneficial interest securities by a portfolio of prepayable financial instruments. An entity would be required to dedesignate the entirety of one or more hedging relationships affected by an actual breach. Partial dedesignations would be allowed for anticipated breaches. A dedesignation sequence can be documented at inception of the hedge. If there is no documented sequence, all hedging relationships associated with the closed portfolio would have to be dedesignated. All hedging relationships associated with a closed portfolio must be supported by all the assets in the closed portfolio.

- For single-layer, last-of-layer and multiple layer models, entities would not be allowed to allocate the fair value hedge basis adjustment to the assets of a closed portfolio during an outstanding last-of-layer hedge. The last-of-layer fair value hedge adjustment on an outstanding hedge cannot be considered in determining an allowance under the credit losses model. In addition, the last-of-layer fair value basis adjustment will be subject to certain presentation and disclosure requirements.

Facilitating the effects of the Interbank Offered Rate transitions on financial reporting

ASC Topic 848: *Reference rate reform*

Objective:

Facilitate the effects on financial reporting of the market-wide migration from Interbank Offered Rates (IBORs) to alternative rates.

Exposure draft:

Facilitation of the effects of reference rate reform on financial reporting was issued on September 5, 2019 and comments were due October 7, 2019.

Status:

The Board completed its redeliberations. FASB Staff is drafting a final ASU.

This Q's developments

The FASB completed its initial deliberations and issued the Exposure Draft.

Key proposals

- The guidance would apply only to contracts and hedging relationships that reference LIBOR or another reference rate expected to be discontinued due to reference rate reform, provided the related contracts are entered into or evaluated on or before December 31, 2022.
- Provides optional expedients, to be consistently applied to similar contracts, for the accounting for contract modifications that replace a reference rate affected by reference rate reform as follows:
  - Modification to receivables and debt can be accounted for prospectively by adjusting the effective interest rate;
  - Modifications to leases can be accounted as a continuation of the existing lease without reassessments or remeasurements;
  - Modifications to contracts with embedded derivatives can continue to account for the embedded derivative as previously determined; and
  - Modification to other contracts can be accounted for as a continuation of those contracts without any reassessments of previous determinations.
- Provides certain exceptions to derivatives accounting guidance for changes to critical terms of an existing hedging relationship due to reference rate reform. Certain criteria must be met.
- Provides option expedients for existing fair value hedging relationships for which the derivative designated as the hedging instrument is affected by reference rate reform.
- Provides optional expedients for cash flows hedges to address changes in the designated hedge risk affected by reference rate reform, the effective assessment method when perfect hedge effectiveness is assumed, mismatches in variable interest rate indexes between the designated hedging instrument and the hedger item, new cash flow hedges of portfolios of forecasted transactions, and application methods to assess whether cash flow hedging accounting may be applied.

Presentation and disclosure projects

Incorporating SEC disclosure requirements

ASC Topics: Various

Objective:

Determine whether and how SEC disclosure requirements referred to FASB as part of SEC's Disclosure Update and Simplification initiative should be incorporated in the ASC.

Exposure draft:

Disclosure improvements – Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative issued May 6, 2019, with comment due by June 28, 2019.

Status:

Board will consider comments and redeliberate the conclusions in the Exposure Draft.

This Q's developments

There were no further discussions on this project during Q4, 2019.

Key proposals

The Board tentatively decided to incorporate the following SEC disclosures in the ASC:

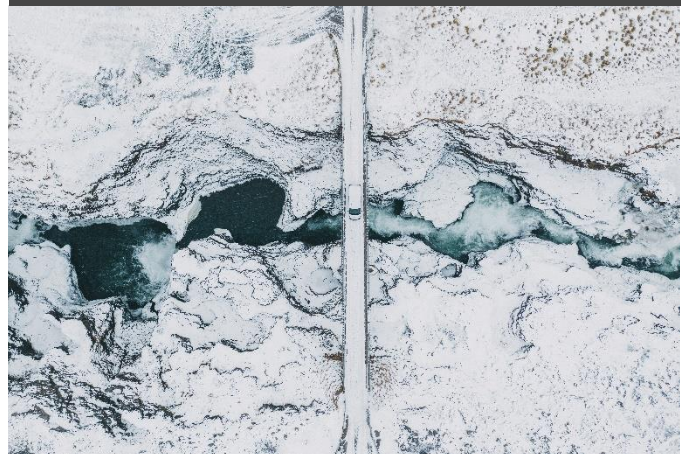
- Presentation of financial statements and foreign currency – amends guidance to include situations when a reporting entity uses a reporting currency other than its function currency.

- Accounting changes and error corrections – disclosures of any retroactive prior-period adjustments are required in interim financial statements.

- Earnings per share – disclosure of methods used for diluted EPS computation are required in financial statements including interim financial statements.

- Segment reporting – remove the impracticability exception to the requirement to disclosure revenues for each product and service or each group of similar products and services.

- Commitments – add disclosure of assets mortgaged, pledged or otherwise subject to lien and obligations collateralized.



- Debt – add disclosure of amounts and terms of unused line-of-credit and unfunded commitments and the weighted average interest rate on outstanding short-term borrowings.

- Equity – amend requirement to present preference on involuntary liquidation parenthetically in the equity section of the balance sheet if the liquidation preference is other than par or stated value.

- Business combinations – add disclosure of separate results of combined entities before a combination between entities under common control in interim financial statements.

- Consolidation – add disclosure of the name of any legal entity newly included in or excluded from the consolidated financial statements if the entity has a material effect on the financial statements.

- Derivatives and hedging – add disclosure where derivative instruments and their related gains and losses are reported in the statement of cash flows.

- Related party disclosures – add disclosures of profits or losses resulting from transactions with other entities in the consolidated or combined financial statements and the effects of those transactions in separate financial statements of public business entities.

- Transfers and servicing – secured borrowing and collateral
  - Clarifies that accrued interest should be included in disclosure of liabilities incurred in securities borrowing or repurchase or resale transactions.

- Adds requirement to present separately the carrying amount of reverse repurchase agreements on the face of the balance sheet if the amount exceeds ten percent of total assets.
- Add disclosures of (a) the effective interest rates of repurchase liabilities; (b) amounts at risk with an individual counterparty if that amount exceeds more than ten percent of stockholders' equity; and (c) whether there are any provisions in a reverse repurchase agreement to ensure that the market value of the underlying assets remains sufficient to protect against counterparty default, and, if so, the nature of those provisions.

- Extractive activities – oil and gas – clarify that guidance is applicable for all periods presented in the financial statements.
- Investment companies – clarifies that investment companies are to disclose the components of capital on the balance sheet.
- Real estate investment trusts – add disclosure of tax status of distributions per unit for a REIT.

Classification of debt

ASC Topic 210: *Balance sheet*

Objective:

Provide guidance to reduce the cost and complexity of determining current versus noncurrent balance sheet classification of debt.

Exposure draft:

Simplifying the classification of debt in a classified balance sheet (Current versus noncurrent) (originally issued on January 10, 2017) revised on September 12, 2019, with comments due on October 28, 2019.

Status:

Board will consider comment letters and begin redeliberations of the revised Exposure Draft in 2020.

This Q's developments

There were no further Board developments during the most recently completed quarter.

Key proposals

The project establishes a principle for determining the classification of a debt or other instrument as current or noncurrent at the balance sheet date.

Guidance applies to all debt arrangements, including convertible debt, liabilities classified mandatorily redeemable financial instruments, and lease liabilities.

An instrument will be classified as noncurrent, based on facts and circumstances at the reporting date, if either:

- The liability is contractually due to be settled more than one year (or the operating cycle, if longer) after the balance sheet; or
- The entity has a contractual right to defer settlement of the liability for at least one year (or the operating cycle, if longer) after the balance sheet date.

In applying the principle, subjective acceleration clauses will affect the classification only when triggered.

Subsequent refinancing of a debt, either by another debt or by equity, would not be considered in determining the classification. In addition, an unused long-term financing arrangement in place at the balance sheet date would not affect the classification of outstanding debt.

The issuance of equity instruments will not be a settlement when considering the classification of the liability.

An exception to the principles is provided if a waiver of debt covenant violations is received after the reporting date, but before the date the financial statements are issued. This exception will apply to all waivers except those that result in a troubled debt restructuring or extinguishment. An entity will have to assess whether the violations of any other covenants not covered by the waiver is probable within the 12 months following the reporting date. If such violations were probable, the debt would be classified as current. Any debt classified as noncurrent because of a waiver would be presented separately in the balance sheet.

Disclosures will be required about events of default, triggers of a subjective acceleration clause, and grace periods.

These provisions would be applied prospectively to all debt that exists at the effective date.

The changes would be effective for public companies for years after December 15, 2020 and other entities after December 15, 2021. Early adoption will be permitted.

Financial performance reporting — Disaggregation of performance information

ASC Topic 225: *Income statement*

Objective:

Improve decision-usefulness of the income statements through the disaggregation of performance information.

Status:

The project has been put on pause pending further development in the segment reporting project.

This Q's developments

The feedback from the preparer outreach was discussed and possible alternative approaches, as well as the interaction with segment reporting.

Interim reporting disclosures

ASC Topic 270: *Interim reporting*

Objective:

Evaluate and improve existing disclosure requirements for interim reporting through the consideration of the concepts in the Board's decision process and promote the use of discretion by the entity.

Status:

Initial deliberations. FASB Staff conducting outreach on the high-level principle.

This Q's developments

There were no further Board developments in Q4, 2019.

Key proposals

The FASB has decided that interim reports should update disclosures about matters required in annual financial statements if there is a significant event or transaction that has a material effect on an entity.

Segment reporting

ASC Topic 280: *Segment reporting*

Objective:

Improve the segment aggregation criteria and disclosure requirements.

Status:

Initial deliberations. FASB Staff are conducting investor outreach.

This Q's developments

The FASB considered preparer feedback and decided to conduct investor feedback. The FASB Staff were directed to consider an approach for greater reporting of total assets by reportable segment for public entities.

Vintage disclosures

ASC Topic: 326: *Financial Instruments – Credit Losses*

Objective:

Address issues arising from the implementation of ASU 2016-13: *Measurement of Credit Losses on Financial Instruments* dealing with disclosures of gross write-offs and gross recoveries in vintage disclosures.

Status:

Initial deliberations.

This Q's developments

There were no developments during the most recently complete quarter.

Inventory disclosures

ASC Topic 330: *Inventory*

Objective:

Evaluate and improve existing disclosure requirements for inventory through the consideration of the concepts in the Board's decision process and promote the use of discretion by the entity.

Exposure draft:

Changes to Disclosure Requirements for Inventory was issued on January 10, 2017 and comments were due March 13, 2017.

Status:

Exposure draft redeliberations continue.

This Q's developments

The FASB has not discussed this project since mid-2017.

Key proposals

The proposals include an objective for the disclosures and a statement that individual disclosures need not be provided if immaterial. Any changes would be applied prospectively.

Tentative proposals for disclosure changes

Disclosures added:
Inventory disaggregated by component (raw materials, work-in-process, finished goods, and supplies).
Inventory disaggregated by measurement basis.
Changes to inventory balances that are not specifically related to the purchase, manufacture, or sale of inventory in the ordinary course of business (for example, atypical losses, reclassifications, business combinations, divestitures, and unrealized gains and losses on inventories recorded above cost or at selling prices).
A qualitative description of costs capitalized into inventory.
The effect of LIFO liquidations on income.
The replacement cost of LIFO inventory.
Critical assumptions, qualitative and quantitative, used in the calculation of the cost of inventory under the retail method.
Facts and circumstances leading to impairment losses.
Public business entities only: Inventory by reportable segment or by component for each reportable segment if the information is regularly provided to the chief operating decision maker. This information would be required in both annual and interim periods.
Disclosures eliminated:
Measurement basis of inventories when inventories are stated above cost or at sale prices.
Relationship between costs under a recognized measurement method and standard costs.

Income taxes disclosures

ASC Topic 740: *Income taxes*

Objective:

Evaluate and improve existing disclosure requirements for income taxes through the consideration of the concepts in the Board's decision process and promote the use of discretion by the entity.

Exposure draft:

Disclosure Framework – Changes to the Disclosure Requirement for Income Taxes (revised) issued March 25, 2019 with comments due May 31, 2019.

Disclosure Framework – Changes to the Disclosure Requirements for Income Taxes was issued in July 2016 and comments were due September 30, 2016.

Status:

Exposure draft redeliberations will continue after receipt of comments on the revised exposure draft.

This Q's developments

There were no further developments during the most recently completed quarter.

Key proposals

The proposals include an objective for the disclosures and a statement that individual disclosures need not be provided if immaterial. Any changes would be applied prospectively.

The proposals add several new disclosures, modify some disclosures, and eliminate a couple of disclosures as set out in the table below.

Tentative proposals for disclosure changes

Disclosures added:
Balance sheet related disclosures
Public business entities only: Amount of deferred tax assets for federal, state, and foreign carryforwards (tax affected) before the valuation allowance, in total and disaggregated by time period of expiration for first five years and total for remaining years.
Public business entities only: Valuation allowance associated with the tax-affected amounts of federal, state and foreign carryforwards.
Public business entities only: Total amount of unrecognized tax benefits that offset the deferred tax assets attributable to carryforwards.
Public business entities only: The amount and expiration of the valuation allowance recognized or released during the period.
Public business entities only: Line items and related amounts in which unrecognized tax benefits are presented, with separate disclosure of amounts not presented in the balance sheet.

Income statement related disclosures
Pre-tax income or loss from continuing operations before intracompany eliminations disaggregated between domestic and foreign.
Income tax expense or benefit from continuing operations disaggregated by federal or national, state and foreign amounts.
Cash flow related disclosures
Income taxes paid disaggregated by domestic and foreign.
Interim tax paid when interim financial statements are prepared.

Disclosures modified:
Income statement related disclosures
Public business entities only: Tax rate reconciliation between the amounts computed at the applicable federal statutory rate and the total amount of income tax expense or benefit from continuing operations with individual reconciling items equal to or greater than five percent of the computed amount being reported. When the rate used is other than the US federal corporate income tax rate, the rate used, and the basis of the rate. An explanation of year-to-year changes in reconciling items.
Non-public business entities: Non-tax effected amounts of carryforwards should be separately disclosed for loss carryforwards and credit carryforwards.

Disclosures eliminated:
Balance sheet related disclosures
The amounts and expiration dates of operating loss and tax credit carryforwards for tax purposes.
The cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures.
Income statement related disclosures
Disclosure of government grants included in income tax expense or benefit.
Reasonably possible increase or decrease in unrecognized tax benefits within 12 months of the reporting date, including nature of uncertainty, the nature of the event that would cause the change and the estimate of the reasonable possible change.

Disclosures by business entities about government assistance

ASC Topic 832: *Government assistance*

Objective:

Develop disclosure requirements about government assistance that improves the content, quality, and comparability of financial information and financial statements and is responsive to the emerging issues in the changing financial and economic environment in which reporting entities operate.

Exposure draft:

Disclosures by Business Entities about Government Assistance was issued on November 12, 2015 with comments due February 10, 2016.

Status:

Exposure draft redeliberations continue.

This Q's developments

There were no further discussions on this project in Q4, 2019.

Key proposals

The disclosures would apply to grants of assets, tax assistance, low-interest-rate loans, loan guarantees, and forgiveness of liabilities.

The objectives of the disclosures would be to enable a user to assess the nature of the assistance, the accounting policies of accounting for government assistance, the effect of government assistance on the entity's financial statements, and significant terms and conditions of legally enforceable agreements. Various disclosure requirements are included to meet these objectives.

The disclosures would be effective for fiscal years ending after December 15, 2020 for public business entities and after December 15, 2021 for non-public business entities. Early adoption is permitted. The disclosures would be provided on a prospective basis for agreements existing at the effective date or entered into after the effective date.

Conceptual framework projects

Elements

Objective:

Develop concepts related to the elements of financial statements, which include assets, liabilities, equity, revenues, expenses, gains, losses, investments by owners, distributions to owners, and comprehensive income.

Status:

Initial deliberations.

This Q's developments

The Board discussed certain concepts and made some decisions.

Key proposals

The Board has reviewed the definitions of revenue and expenses and made some minor tweaks to the definitions.

A definition of an asset should consider the identifiable and separability notions to help assess whether an intangible asset meets the definition of an asset. Further, the term "control" should not be included in the definition of an asset.

A working definition of a liability was presented as follows: "A liability is a present obligation of an entity to transfer an economic benefit." The Board agreed the term "present obligation" adequately distinguishes business risks and liabilities; the present description of constructive obligations is adequate; and there are present obligations with uncertain outcomes.

All present obligations to transfer assets or obligations to deliver shares sufficient in number to satisfy a determinable or defined obligation would meet the definition of a liability.

Measurement

Objective:

Develop concepts related to measurement, including the meanings of key terms; appropriate types of measurements; and which measurements to use in specific circumstances.

Status:

Initial deliberations completed. An *Invitation to Comment* is being drafted.

This Q's developments

The Board discussed the project and made some more tentative decisions.

Key proposals

The Board has made the following tentative decisions on initial measurement:

- There are three categories of initial measurement: (1) entry price; (2) exit price; and (3) estimated future cash flows.
- Exit price is appropriate as an initial carrying amount of an asset when the subsequent measurement of the asset will be at exit price. When the consideration for a transaction is other than cash, the exit price for the asset transferred may be used as the initial measure of an asset.
- Costs to be included in the initial carrying amount of an asset at entry price should capture the costs incurred to bring the asset to the condition necessary for it to be capable of operations. The types of costs that should be included are government-imposed charges, costs of services related to the acquisition of the asset and readying the asset for use, and costs to participate in the market for the asset. Gains and losses on cash flow hedges are neither part of the entry price of assets nor a cost to be included in the initial carrying amount of assets.
- There would be no change to the definitions of equity and comprehensive income. The term "owner" has been defined as the holder of an instrument that creates no obligation of the entity other than on liquidation.

Presentation

Objective:

Develop concepts on how information should be grouped into reasonably homogeneous groups and the association between changes in assets, liabilities, and equity instruments.

Exposure draft:

Concepts Statement No. 8: Conceptual Framework for Financial Reporting – Chapter 7: Presentation was issued in August 2016 with comments due November 9, 2016.

Status:

Exposure draft redeliberations.

This Q's developments

There were no discussions on this topic during the most recently completed quarter.

Key proposals

Chapter 7 will address the presentation of information in the primary financial statements, as a means of communicating financial information with users of financial statements.

The FASB describes presentation as "the display of line items, totals, and subtotals in the financial statements", excluding notes to the financial statements. Subtotals represent broad classes of often-heterogeneous items, while line items reflect classes of more homogeneous items. A critical aspect of creating line items is to include classes that are as nearly homogeneous as possible. Classification of items in lines would consider:

– The cause of, the activity associated with, and the frequency of the item to be recognized – a transaction, a change in circumstances or conditions, an accounting adjustment, or an accounting change;

– The time expected to pass before realization or settlement of an asset or liability;

– The expected form of realization or settlement of an asset, liability or equity instrument – cash, financial instruments or equity instruments;

– The response to changes in economic conditions and other factors affecting an existing asset or liability, or future revenues, expenses and gains or losses; and

– The measurement method used for the item.

Although the proposal addresses how the Board would consider financial statement presentation when setting future standards, authoritative guidance on financial statement presentation would come from a standard's level project. The FASB has a project on financial performance reporting on its research agenda. The topic is also included in the Board's recently released *Invitation to Comment* on the Board's future agenda.

Research projects

Research projects consider current issues and provide the background to the FASB for a decision as to whether the project should be developed further as a standard development project. The table below lists the research projects on the FASB research agenda.

ASC Topic	Project	Description
220	**Financial performance reporting**	Consider whether to require and how to define a measure of operations.
230	**Targeted improvements to statement of cash flows**	Reduce existing diversity in practice for presentation of cash receipt and cash payments in the statement of cash flows.
330	**Inventory and cost of sales**	Improve accounting for inventory and cost of sales including inventory-costing methods, impairment models and other areas that need guidance.
350	**Intangible assets' disclosures**	Review of current disclosure requirements to improve the financial information in notes to the financial statements.
740	**Income taxes – Backwards tracing**	Consider whether backwards tracing should be allowed or whether there are other alternatives to backwards tracing.
805	**Measurement of acquired revenue contracts in a business combination**	Consider how to measure an assumed contract liability for a revenue contract with a customer acquired in business combinations.
810	**Variable interest entity related party guidance**	Determine frequency for which VIE related party guidance is applied to arrangements where related parties are under common control.
815	**Hedge accounting – Phase 2**	Consider further aspect of hedge accounting to align the accounting with risk management activities.

Implementation notes

4

Implementation notes provide information to support the implementation of the new major accounting standards. In this section, for the new major standards not yet implemented, we include news on recent FASB developments, matters discussed at the various standard setting bodies and regulators, and resources available from the FASB, AICPA and PwC.

Implementation notes are provided for those standards that are effective for the current and future years. PwC resources listed are limited to those issued within the last two years of this edition of ***US GAAP Today***. Specific resources from other organizations are limited to those issued in the most recently completed quarter.

Time to effective date for each new standard is based on time from most recently completed calendar quarter end to the effective date for public companies. Effective dates are set out for SEC filers (which excludes smaller reporting companies) and other entities (which includes SEC filers that are smaller reporting companies, public business entities that are not SEC filers, and private companies).

Leases

ASC Topic	**842**
Effective	**NOW**
	Years beginning on or after
Public business entities	December 15, 2018
Other entities	December 15, 2020

ASUs	
Primary	2016-02
Supplemental	2017-13: *Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments* 2018-01: *Land Easement Practical Expedient for Transition to Topic 842* 2018-10: *Codification Improvements to Topic 842, Leases* 2018-11: *Targeted Improvements* 2018-20: *Lessor Narrow Scope Amendments* 2019-01: *Codification improvements to leases* 2019-10: *Effective dates for private companies, not-for-profit organizations and small public companies*

Effective date deferral

The FASB has extended the effective date for implementation of the leases standard for entities that are not public business entities for one year.

SEC views on implementation

At the 2019 AICPA Conference on *Current SEC and PCAOB Developments*, the SEC expressed several views and offered tips and other guidance on the implementation of the new leases standard. We covered the Conference in our article *SEC speaks: Collaborating to achieve transparency* in Section 1 of this edition of ***US GAAP Today***.

FASB implementation resources

Inquiries
The FASB has a technical inquiry service through which the FASB Staff assist people in understanding the FASB standards. Questions may be submitted to the FASB to obtain clarifications on FASB standards. For more information on these services, visit www.fasb.org under the tab *Projects / Technical Inquiry Service*.

The FASB did not strike a Transition Resource Group for the leases standard.

Educational resources
The FASB has provided various educational resources on the leases standard beyond the ASUs and their ***FASB in Focus*** publication as listed below. These resources are available through the FASB website at www.fasb.org under the tab *Standards / Implementing New Standards / Leases / Educational Resources*.

AICPA implementation guidance

The AICPA has established a section on *Accounting for Leases* on their website at www.aicpa.org under the tab *Topics / Financial Reporting / Accounting and Financial Reporting / Leases*.

The section provides information on the new leases standard including AICPA TV discussing the implications of the new standard, links to news and views from various AICPA magazines and publications, access to AICPA resources, and links to AICPA webcasts and courses. Some of these resources are free, while others are available for a fee.

PwC resources to help you

PwC has prepared several resources to assist you with your implementation of the new leases standard. These resources include printed publications, podcasts, and webcasts.

PwC general resources
The following table lists general resources released on or after January 1, 2017 that are currently available.

You can access these materials through http://www.pwc.com/us/en/cfodirect/issues/lease-accounting.html.

Legend
e-Book
Podcast
Print
Video or webcast
Website

Title	Description	Format
Leases – 2019 edition (2016 – Updated to November 2019)	PwC Guide on lease accounting covering the scope of the leases standard, classification and accounting for leases, accounting for modifications, unique leasing transactions, presentation of leases in the financial statements, and transitional guidance.	e-Book, Print
2019 lease accounting survey results	Findings of PwC's 2019 lease accounting survey of more than 900 finance executives on key challenges and lessons learned from implementing the new standard.	Website, Print
Ongoing lease accounting: 5 things you need to know	Discussion of frequently asked questions around the ongoing accounting for operating leases.	Podcast
Lease remeasurements: 5 things you need to know	Discussion of key day 2 accounting issues related to remeasurements required under the leases standard.	Podcast

Title	Description	Format
In depth: Lessors: the impact of operating lease receivable collectability (July 2019)	Discussion how the new leases model should be applied to a lessor's operating lease receivables.	PDF
In depth: FAQ: Lessee accounting for right-of-use assets in operating leases (June 2019)	Responses to frequently asked questions on the subsequent measurement of right-of-use assets in operating leases, including impairment testing, abandonment, subleases, lease components, and acquired right-of-use assets.	PDF
Lease accounting implementation: Lessons learned from Halliburton and Sysco (May 2019)	Discussion of lessons learned and perspectives on remaining challenges by two industry leaders, covering top accounting issues, systems and processes challenges, approach to gathering lease data, managing controls and tax impact.	
Lease accounting implementation and post-compliance insights (April 2019)	Implementation insights for companies still approaching their leases effective date, as well as considerations for companies that have moved past their compliance deadline.	
Leased assets: Ongoing impairment considerations (April 2019)	Guidance on measuring an asset group that includes leases, revisiting useful life and other ongoing lease impairment considerations.	
Lessee financial statement disclosures (April 2019)	Discussion of key disclosure considerations for lessees.	
Lessee's right-of-use assets: 5 things you need to know (April 2019)	Discussion of day 2 lease accounting considerations, including impairment testing.	
Can prior impairments or lease costs accruals impact lease transition?	Addresses the additional impairment related considerations that are relevant after transition to the new standard.	PDF
In brief: New proposal to simplify new leases standard for certain lessors	Provide overview of changes to leases standard that will impact financial institutions, captive finance companies, and entities in the scope of financial services depository and lending guidance.	PDF
Leasing – Reminders as you prepare for adoption (November 2018)	Discussion of overall readiness, transition elections and practical expedients, and implementation challenges and best practices.	
In brief: More changes to ease lessor adoption of the new leases standard (November 2018)	Outline of narrow-scope amendments for lessors.	PDF
Leasing – Lessor practical expedient (September 2018)	Covers the practical expedient that allows lessors to avoid separating lease and non-lease components in a contract.	
Leasing – How lessees should account for finance leases (August 2018)	Covers the basic mechanics of how a lessee should account for a finance lease, including journal entries and related calculations.	
Leasing – How lessees should account for operating leases (August 2018)	Covers how to calculate the initial lease liability and right-of-use asset and the subsequent accounting for an operating lease.	
Lease accounting transition: Index or rate for measuring operating lease liability (August 2018)	Outlines SEC views on use of the current index or rate for operating leases on transition.	PDF

Title	Description	Format
Lease accounting implementation insights (August 2018)	Covers lessons learned to date from companies that have made substantial progress with their implementation.	PDF
Adopting the new leases standard just got easier (July 2018)	Covers the additional transition method provided by the FASB and the new lessor expedient for components.	PDF
Leases: What you need to know as you prepare to adopt the new guidance (June 2018)	PwC lease specialists highlight important decisions lessees and lessors need to make before the effective date and discuss how those decisions may affect the transition plan and financial statements.	
Leasing – Accounting for variable lease payments (June 2018)	Covers which variable payments are included when measuring and classifying a lease and how to account for changes in variable payments.	
Leasing – Discount rate for the lease liability (June 2018)	Covers key factors when determining the discount rate, including the definition of incremental borrowing rate (IBR), what can be used as collateral in determining the IBR, and the term used for the IBR.	
Leasing – Identifying embedded leases under the new standard (May 2018)	Covers how to identify an embedded lease and what to do when you do.	
Leasing – Determining the lease term (May 2018)	Covers factors in identifying the lease term.	
Leasing – Practical expedients (April 2018)	Covers transitional options available and how companies might benefit from the practical expedient.	
Assessing land easements under the new leases standard (April 2018)	Explanation of how lease accounting may affect the accounting for land easements.	PDF
Lease accounting implementation insights from Bridgestone and Verizon (April 2018)	Hear lessons learned and suggestions for the way forward from finance executives who have advanced their implementation and insights from PwC specialists.	
Next up: The new leasing standard (April 2018)	Summary of the recent and proposed amendments to the leasing standard.	PDF
Leasing – Transition (April 2018)	Discussion of the modified retrospective transition approach and the practical expedients designed to make it easier.	
CFOdirect podcast series: Leasing – Recent proposals, impairment and subleases (Episode 33 – February 2018)	Covers the new FASB proposals related to transition as well as accounting for impairments and subleases.	

PwC industry resources

Supplementing the general resources, a few industry specific supplements have been published, which include examples and further insights into ways entities within the industry are likely to be affected by the new leases standard. The supplements released on or after January 1, 2017 are available from http://www.pwc.com/us/en/cfodirect/issues/lease-accounting.html.

Industry	Publication date
Banking and capital markets	November 2017
Chemicals	November 2017
Higher education	January 2017
Industrial products	September 2017
Telecommunications	March 2017

Derivatives and hedging

ASC Topic	815
Effective	NOW
	Years beginning on or after
Public business entities	December 15, 2018
Other entities	December 15, 2020
ASUs	
Primary	2017-12
Supplemental	2019-10: *Effective dates for private companies, not-for-profit organizations and small public companies* 2019-04: *Codification Improvements – Financial Instruments*

Effective date deferral

The FASB has extended the effective date for private entities by one year.

FASB implementation resources

Inquiries
The FASB has a technical inquiry service through which the FASB Staff assist people in understanding the FASB standards. Questions may be submitted to the FASB to obtain clarifications on FASB standards. For more information on these services, visit www.fasb.org under the tab *Projects / Technical Inquiry Service*.

The FASB did not strike a Transition Resource Group for the hedge accounting amendments.

Proposed amendments
The FASB has addressed several implementation issues resulting from the amendments to the derivatives and hedging standard.

The FASB has decided to issue two additional proposed ASUs covering issues where additional clarifications or guidance are needed. See our articles in the Section 3:

FASB projects in progress under the titles of:

– ***Clarifications about use of "prepayable" and cash flow hedges***; and

– ***Hedging issues – Last-of-layer method***.

Educational resources
The FASB has provided some educational resources on the hedging amendments beyond the ASUs and their ***FASB in Focus*** publication as listed below. These resources are available through the FASB website at www.fasb.org under the tab *Standards / Implementing New Standards / Hedge Accounting / Educational Resources*.

PwC resources to help you

PwC has prepared several resources to assist you with your implementation of the changes to the derivatives and hedging standard. These resources include printed publications, podcasts, and webcasts.

These PwC resources can be accessed through https://www.pwc.com/us/en/cfodirect/issues/derivatives-hedge-accounting.html.

Legend
e-Book
Podcast
Print
Video or webcast

Title	Description	Format
Derivatives and hedging guide (Updated October 2019)	PwC Guide focuses on accounting and financial reporting considerations for derivative instruments and hedging activities based on the most recent amendments made by the FASB.	Print, e-Book

Title	Description	Format
In depth: Recent amendments to the hedging standard (May 2019)	Addresses the FASB's amendments to the hedging standard, which clarify provisions and provide additional guidance in response to stakeholder questions.	PDF
Hedge accounting: 5 things to know when implementing the new standard (February 2019)	Discussion of things to consider when implementing the new hedging standard.	Podcast
Hedging – Implementation considerations (January 2019)	Insights on implementation considerations when adopting the new hedged accounting guidance, including modification to excluded component for net investment hedges, qualitative assessments of effectiveness, and revised presentation and disclosure requirements.	Video
Hedging – Benchmark rate component (October 2018)	Covers concepts of the election to include only the benchmark rate component of the contractual coupon cash flows of the hedged item when calculating the change in the hedged item's fair value.	Video
Hedging – Accounting for excluded components (September 2018)	Covers what components are eligible for exclusion from the assessment of effectiveness and how to recognize those components in the financial statements.	Video
What you need to know about the new hedging standard (May 2018)	Highlights some of the bigger changes from the amendments.	Podcast
FASB revisits certain provisions in recently-issued hedging guidance (April 2018)	Covers proposed codification improvements to the recently issued amendments.	PDF
Hedging – Are you early adopting the FASB's new guidance (February 2018)	Discusses certain considerations for early adopters.	Video
In brief: FASB clarifies certain provisions within recently issued hedging guidance (February 2018)	Summarizes the FASB review of implementation issues.	PDF

Current expected credit losses

ASC Topic	326
Effective	**In three months**
	Years beginning on or after
SEC public entities (excluding smaller reporting companies)	December 15, 2019
Other entities	December 15, 2022

ASUs	
Primary	2016-13
Supplemental	2019-11: *Codification improvements* 2019-10: *Effective dates for private companies, not-for-profit organizations and small public companies* 2019-05: *Targeted Transition Relief* 2019-04: *Codification improvements* 2018-19: *Codification improvements*

Effective date deferral

The FASB has deferred the effective date for public business entities that are SEC smaller reporting companies, public business entities that are not SEC filers, and all non-public business entities by two years.

FASB implementation resources

Inquiries

The FASB has a technical inquiry service through which the FASB Staff assist people in understanding the FASB standards. Questions may be submitted to the FASB to obtain clarifications on FASB standards. For more information on these services, visit www.fasb.org under the tab *Projects / Technical Inquiry Service*.

Transition Resource Group

The FASB has formed a Transition Resource Group for Credit Losses (TRG) to solicit, analyse and discuss issues arising from the implementation of the new standard; to inform the FASB about issues that may need to be addressed by the FASB; and provide a forum for stakeholders to learn about the new guidance.

The TRG met in November 2018 and made several recommendations to the FASB for clarifications. No additional meetings are currently scheduled.

Memos covering matters considered by the TRG are available on the FASB website at www.fasb.org under the tab *Standards / Implementing New Standards / Credit Losses / Implementation Issues Memos*.

Public roundtables on issues

On January 28, 2019, the FASB held a public roundtable meeting on credit losses to obtain views on an alternative approach to presenting expected credit losses in the income statement. In addition, the roundtable group considered whether gross write-offs and recoveries should be presented in credit quality disclosures. A summary of the roundtable meeting is available on the FASB website at www.fasb.org under the tab *Standards / Implementing New Standards / Credit Losses / Implementation Issues Memos*.

Proposed amendments

Based on implementation activities, the FASB has one project on its agenda to address issues where additional clarifications or guidance is needed. See our article in Section 3: *FASB projects in progress* under the title of:

– ***Vintage disclosures***

CECL Workshops

During the last quarter of 2019, the FASB has held some workshops in conjunction with various organizations.

Educational resources

The FASB has provided certain educational resources on the measurement of credit losses on financial instruments beyond the ASUs and their ***FASB in Focus*** publication.

The FASB has issued the following video and podcast on credit losses:

– ***Why a New Credit Losses Standard?***

– ***FASB Investor Podcast: Credit Losses***

These resources are available through the FASB website at www.fasb.org under the tab *Standards / Implementing New Standards / Credit Losses / Educational Resources*.

AICPA implementation guidance

The AICPA has established a section on accounting for credit losses on its website at www.aicpa.org under the tab *Topics / Financial Reporting / Accounting and Financial Reporting / Credit Losses*.

The AICPA has formed the Depository Institutions and Insurance Experts Panel to discuss implementation issues and provide guidance, which may be incorporated into the AICPA *Audit and Accounting Guide for Depository and Lending Institutions*. The Panel has identified 44 issues. Most of the issues have been resolved at the FASB TRG meetings or by completed or pending FASB amendments to the ASC. Some of the issues have been addressed by AICPA issues papers and some will be addressed in the AICPA *Accounting and Auditing Guide on Credit Losses*. Six issue papers are out for comment. The topics under consideration and the exposure drafts can be accessed through the AICPA link above.

Resources provided by the AICPA include:

– ***Current Expected Credit Loss (CECL) Accounting Standard: An introduction for Bank CEOs and their Board*** (by American Bankers Association)

– ***CECL Implementation: Practical implementation and operational considerations of the CECL model for credit unions***

– ***FASB's Current Expected Credit Loss (CECL) Model: Interpretative issues***. These issues include those identified by the Experts Panel.

The AICPA section on credit losses also provides links to articles from AICPA magazines and journals. Online self-study programs about the new FASB requirements and the IFRS requirements are also available through the same link.

PwC resources to help you

PwC has prepared several resources to assist you with your implementation of the new credit losses standard. The resources including printed publications and webcasts released on or after January 1, 2017 are available from www.pwc.com/us/en/cfodirect/issues/financial-instruments.html.

Legend
e-Book
Podcast
Print
Video or webcast
Website

Title	Description	Format
Loans and investment guide (Updated October 2019)	PwC Guide discusses the accounting for debt and equity investments. Chapter 4, *Accounting for loans,* covers credit losses.	Print, e-Book
If you haven't been tuning into CECL, there's still time to binge (December 2019)	Reproduction of column on five areas to focus on for starting the implementation process for the new standard.	Website
Implement the CECL standard: 5 things you need to know (November 2019)	Discussion of hot topics and areas generating the most questions.	Podcast
In depth: Further FAQs on the FASB's new credit losses standard (September 2019)	FAQs to help evaluate how the new standard affects your company.	Print
The CECL standard – 5 things you need to know (May 2019)	Points to know for your implementation of the new CECL standard.	Podcast
In depth: FASB's amendments to the new credit losses standard (May 2019)	Addresses FASB's amendments to the new credit losses standard to clarify implementation issues raised by stakeholders, eliminate certain inconsistencies in the guidance, and provide additional guidance to preparers on certain topics.	Print
PwC Response to FASB's proposed improvements to CECL (March 2019)	PwC's response letter to FASB's proposal to make targeted improvements to the CECL standard.	Print
In brief: FASB proposes targeted relief upon adoption of the new credit loss standard (February 2019)	Outlines FASB proposal to allow the election of the fair value option upon adoption of the credit losses standard.	Print
PwC Response to GASB's proposed improvement to financial instruments (January 2019)	Includes response to proposed amendment to clarify and correct areas in ASU 2016-13: *Financial instruments – Credit losses.*	Print
In depth: Update from the TRG for Credit Losses (November 2018)	Discusses developments at the November 2018 TRG meeting.	Print

Title	Description	Format
CECL – Accounting impacts to guarantees (August 2018)	Discusses requirements for guarantees under the new standard and how it will require an additional credit loss estimate for guarantees.	
In brief: Recent developments related to the new credit loss standard (August 2018)	Outlines FASB proposal to give private companies more time to adopt the CECL standard and provide FASB and SEC insights on the interaction of subsequent events and CECL.	PDF
In depth: Transition Resource Group for credit losses (June 2018)	Covers the topics discussed at the June 2018 meeting.	PDF
How the credit impairment standard impacts non-financial services companies (June 2018)	Summarizes how the new impairment standard affects trade receivables, loans, debt securities, lease receivables and financial guarantees held by non-financial services companies.	PDF

Long-duration insurance contracts

ASC Topic	944
Effective	**In TWO years**
	Years beginning on or after
SEC filers (excluding smaller reporting companies)	December 15, 2021
Other entities	December 15, 2023
ASUs	
Primary	2018-12
Supplemental	2019-09: *Effective date*
Resources	
PwC	www.pwc.com/us/en/cfodirect/issues/insurance-contracts.html
FASB	www.fasb.org under *Standards / Implementing New Standards / Insurance: Long-Duration Contracts*
More information	Consult PwC insurance team

Effective date deferral

The FASB has deferred the effective dates for SEC filers by one year and other entities, including SEC smaller reporting companies, by two years.

SEC developments

5

SEC developments provides news and analysis of financial reporting requirements of the SEC, including final rules, findings of SEC reviews, and SEC comments on financial issues. Financial reporting covers accounting, internal control over financial reporting, and financial and other corporate reporting disclosures in SEC filings.

SEC regulations and rules

Modernizing auditor independence rules

The current SEC auditor independence framework has been in place since 2000. There were some revisions in 2003. In December 2019, the SEC announced it would be updating the rules for auditor independence to reflect matters dealt with in staff consultations and to take into account capital markets developments over the past two decades.

The objective of the update is to more effectively structure the rules so that relationships with and services of the auditor do not impair the auditor's objectivity and permit an impartial analysis of the auditor's independence by avoiding non-substantive rules breaches.

The proposals would amend Rule 2-01, *Qualification of accountants*. The changes would amend certain rules that do not impact audit firm objectivity and impartiality by:

- Amending definitions of affiliate of the audit client to address certain affiliate relationships, including entities under common control.
- Amending the definition of the audit and professional engagement period to shorten the look-back period, for domestic first-time filers in assessing the compliance with independence rules.
- Amending the independence-impairing lending relationships to exclude certain student loans and de minimis consumer loans.
- Amending the business relationship rule by replacing the reference to "substantial stockholders" to the concept of beneficial owners with significant influence.
- Introducing a new transition framework to address inadvertent independence violations that only arise as a result of merger and acquisition transactions (replacing the existing guidance).
- Making certain other miscellaneous changes.

It is expected these changes would remove some restrictions permitting firms to conduct audits of clients they may not have been previously able to do and to focus more clearly on relationships that could impair the auditor's objectivity and impartiality.

Resource extraction payments proposed again

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the SEC is required to establish rules for the disclosure of payments made to foreign governments or the US federal government for the commercial development of oil, natural gas and minerals. Rules adopted in 2012 were vacated by a US court. New rules were adopted by the SEC in 2016 but were disapproved by the US Congress.

In December 2019, the SEC proposed another version of rules to comply with the Dodd-Frank Act. Under the proposed rule, resource extraction issuers would be required to annually furnish a Form SD disclosing resource extraction payments made by the issuer, its subsidiaries and entities controlled by the issuer. These disclosures would not be "filed", and Exchange Act liability would not apply to the disclosures.

The proposed rules would apply to Resource Extraction Issuers that file annual reports on Forms 10-K, 20-F and 40-F and engage in the commercial development of oil, gas, and minerals. However, smaller reporting companies and emerging growth companies would be exempt from providing the disclosures. Disclosures would also not be required when the disclosure is prohibited by foreign law or pre-existing contracts. Transitional relief is also available for recently acquired companies and issuers that recently conducted an initial public offering.

Commercial development of oil, gas, and minerals would cover the exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for such activities. Companies that provide product or services to support those activities would not be included.

Disclosures would be based on a project level based on three factors:

- The major subnational political jurisdiction where the development is occurring. For example, for a Canadian company, the provinces would be a major subnational jurisdiction.
- Type of resource by oil, natural gas, and the specified type of mineral (for example, gold, copper, coal, sand, gravel, or some other generic mineral class).
- The methods of extraction based on use of a well, open pit, or underground mining.

For example, a project may be classified as Canada / Alberta / Coal / Underground mining. If multiple resource types or extraction methods are located in the same subnational political jurisdiction (for example oil and gas drilling), they would not need to be split by oil and gas.

Monetary and in-kind payments subject to disclosure would include:

- Taxes, excluding value added taxes, personal income taxes, and sales taxes;
- Royalties based on units, value and profits;
- Fees, such as license fees, rental fees, entry fees, and concession fees;
- Production entitlements;
- Bonuses such as signature, discovery and production bonuses;
- Dividends, except for dividends paid on common or ordinary shares to the issuer if paid on same terms as to shareholders;
- Payments for infrastructure, such as building roads or railways;
- Community and social responsibility payments required by law or contract.

Disclosures of payments would not be required if the aggregate payments for an individual project are below US$750,000. The payments to be disclosed when the threshold is exceeded would be a single payment or a series of payments to each foreign government in a host country or the US Federal Government that equal or exceed US$150,000.

An exemption is included for disclosure of payments related to exploratory activities in the year of payment to the subsequent year.

Alternative forms of reporting may be allowed based on reporting in other jurisdictions. Applications to file these alternative forms will have to be made to the SEC.

Public comments are being sought for the proposals. The comment period is 60 days.

Protecting capital markets

The SEC Division of Enforcement publishes a yearly report of its accomplishments. The Report highlights some enforcement actions and other initiatives to enforce the securities laws of the United States. The 2019 Report was issued in November 2019.

During 2019, the Division of Enforcement addressed a wide range of misconduct, many related to asset management, securities offerings, and issuer reporting and accounting issues. Two key priority areas of focus were retail investor protection and combating cyber threats.

Enforcement actions

In 2019, the SEC brought 862 enforcement actions (2018 – 821), of which 526 (2018 – 490) were standalone enforcement actions brought in a federal court or as an administrative proceeding. Other actions were either follow-on administrative proceedings from other proceedings and proceedings to de-register companies that were delinquent in their filings. The SEC obtained significant monetary remedies during the year amounting to about $3.2 billion in disgorgement of ill-gotten gains and $1.1 billion in penalties. In addition to financial penalties, the SEC seeks to protect investors through other remedies such as:

- Undertakings to conduct activities to come into and stay in compliance with the orders (for example, further internal investigations or assessments of related issues or conditions, training to make employees aware of and responsive to the issues or conditions, and review of entity's practices and procedures);

- Bars and suspensions of individuals from serving as officers and directors of public companies, dealing in penny stocks, associating with registered entities (dealer-brokers or investment advisors), or practicing before the SEC (accountants or attorneys). In 2019, 595 bars and suspensions were imposed.

- Suspension of trading of stock for up to ten days. In 2019, securities of 271 issuers were suspended from trading.

- Court-ordered asset freezes to prevent alleged wrongdoers from hiding assets or moving them offshore, so they are not available for restitution to harmed investors. In 2019, 31 asset freezes were ordered.

Noteworthy actions

The Report highlights several noteworthy actions taken by the Division of Enforcement. Several cases involve financial institutions' roles in the securities markets as dealer-brokers, investment advisors, traders, trading platforms, and fund managers; insider trading; and fraud involving illegal sales of securities, Ponzi schemes, and similar actions.

The SEC brought actions against public companies for fraud, deficient disclosure controls, misleading risk disclosures, and misleading non-GAAP metrics. Some examples of financial and corporate reporting cases included in the Report involved:

- Failure to disclose in the risk factor disclosures the potential events that created the risk that had occurred;

- Failure to timely accrue for and disclose the potential liability arising from government regulatory actions and to make disclosures about the risk of the government actions;

- Inflated reporting of product sales by paying dealers to report fake sales and by maintaining a reserve of actual unreported sales to cover short-falls in sales in later months;

- Omission from disclosures of material amounts to be paid to a CEO on retirement;

- Material misstatement of pre-tax income resulting from accounting errors in several business units over multiple reporting periods;

- Inflating income for two years from failure to record proper expense accruals and misclassification of certain income;

- Fraudulent manipulation of non-GAAP metrics relied upon by analysts and investors;

- Use of non-monetary transactions to improperly increase its revenue; and

- Deceptive claims about the environmental impact of certain of the company's products while raising financing.

The Report indicates 61 entities and 83 individuals were held to account for these types of misconduct. Most companies were ordered to pay penalties ranging from US$3 million to US$100 million. In cases where companies have cooperated extensively with the investigation, no monetary sanctions were ordered. In some cases, remedies have been sought from officers and directors involved, including monetary penalties, orders to reimburse companies for profits received from stock awards or incentive compensation, and limitations on executive and board positions with public companies.

Eighteen Foreign Corrupt Practices Act actions were brought against 15 entities and five individuals. Monetary relief of approximately US$515 million was levied against these parties. The actions resulted from bribery schemes and inappropriate business dealings in foreign countries. These parties violated the FCPA's anti-bribery, internal accounting controls, and recordkeeping provisions.

One of the most effective enforcement tools used by the SEC is holding individuals accountable. In 2019, 69% of the standalone actions involved charges against one or more individuals. The charges were against top corporate executives such as CEOs, COOs, CFOs, and gatekeepers such as accountants, auditors and attorneys.

Protecting retail investors
The Division of Enforcement continued to protect investors through outreach, data analysis, and providing restitution to victims through recouping ill-gotten gains from wrongdoers.

In one of the initiatives to protect retail investors, investment advisors were ordered to return about US$135 million to retail investors. These fees had been received for placing the investors in fee-paying share classes of mutual funds when lower fee or no cost share classes were available. In addition, disclosures and share class selection practices have been improved to inform investors of their choices.

Technology-related actions
The Division of Enforcement, along with other divisions of the SEC, continue to educate market participants about potential cyber-related risks and have taken action to combat cyber-related threats.

The SEC has used a two-prong approach in dealing with distributed ledger technologies and digital assets. Distributed ledger technology is a digital system in which transactions or contracts are maintained in a decentralized form across different locations and participants. Digital assets are assets or contracts in a digital, rather than physical form, which facilitate peer-to-peer financial transactions on a decentralized system. Examples of digital assets are cryptocurrencies and tokenized assets.

In addition to dealing with fraudulent activities in digital assets, the SEC has investigated issuers with initial coin

offerings (ICOs) for violation of the registration requirements for these offerings. Some of these actions were resolved by registering the tokens with the SEC, allowing investors to claim restitution, and payment of penalties. The SEC also brought actions against third parties (dealers, promoters, and trading platforms) for their participation in the offer, sale, or promotion of digital asset securities.

To raise the awareness of cybersecurity threats against companies and regulated entities, the SEC has pursued actions when it determined there were insufficient or ineffective controls to prevent the threats. Two examples were:

- The Options Clearing Corporation (OCC), which is the sole clearing agency for exchange-listed options contracts on equities in the US, was required to pay a penalty of US$15 million and undertake other remedies because the OCC had failed to establish and enforce policies and procedures for financial risk management, operational requirements, and information systems security.

- Business email frauds, which resulted in several companies making payments to bad actors that had spoofed or manipulated the respective companies' email systems. While no action was taken against the companies, the SEC published a report to make companies aware of the need for heightened controls in managing such risks.

The actions brought by the SEC reflect the importance placed by the SEC on maintaining the integrity of financial statements and completeness and accuracy of registrants' disclosures.

More information
The full report can be obtained from www.sec.gov under the tab *News / Press Releases / 2019-233*.

Auditing developments

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Auditing developments provides news and analysis about auditing requirements and guidance relevant to SEC registrants as issued by the SEC, the PCAOB, the Center for Audit Quality, and other agencies. Auditing developments includes guidance relevant to audit committees in carrying out their oversight responsibilities for auditors and audits of financial statements and internal control over financial reporting.

PCAOB

Critical audit matters in action

Under PCAOB auditing standards, auditors began reporting critical audit matters (CAMs) in audit reports during the latter half of 2019. The PCAOB has reviewed the implementation by auditors of 12 audits of SEC large accelerated filers. In December 2019, the PCAOB provided their observations from these reviews as well as their outreach and data analytics in their publication, *Critical Audit Matters Spotlight*.

As of November 30, 2019, 189 audit reports have included CAMs, with one to four CAMs being reported. The most frequent CAMs disclosed related to goodwill and other intangible assets, revenue recognition, taxes, and business combinations.

The PCAOB observed that:

- Audit firms had made significant investments in developing methodologies, tools, training, and support mechanisms for audit teams to implement the new requirements.

- Early starts in determining and describing CAMs provided ample time to draft CAMs disclosures and discuss CAMs with management and the audit committee.

- The evaluation of CAMs is an ongoing process reflecting the facts and circumstances of the current year's audit, including audit procedures performed and documented in the auditor's working papers.

- The use of subject matter specialists, including experts in tax, information technology, and other areas, early and throughout the process of determining and drafting disclosures about CAMs was beneficial in providing appropriate descriptions of CAMs.

- Practice runs during the year of implementation, and regular dialogue among the audit team, management, and the audit committee built a common understanding of the purpose of CAM disclosures and implementing the requirements.

The PCAOB plans to continue to monitor the implementation of the CAMs requirements to evaluate the audit firms' response to the new requirements, how investors are using the CAM disclosures and the experiences of issuers' management and audit committees. This initial analysis may indicate whether the PCAOB needs to take any action to facilitate better reporting.

Copies of the report are available at https://pcaobus.org/Documents/CAMs-Spotlight.pdf.

PCAOB listens to audit committee chairs

The PCAOB has ongoing discussions with the audit committee chairs of almost all of the US issuers whose audits are inspected by the PCAOB. In 2019, the PCAOB estimates it has spoken to nearly 400 audit committee chairs. The summary of those conversations was provided by the PCAOB in their document *Conversations with Audit Committee Chair: What We Heard & FAQs* published in December 2019.

In addition to the summary of conversations, the publication outlines the process for PCAOB inspections.

Audit quality
Audit quality was mostly evaluated based on the performance of the engagement team rather than the audit firm as a whole. While the majority of the audit committee chairs were not familiar with the term audit quality indicators, many were familiar with metrics commonly used as AQIs. There were no significant concerns expressed over the use of audit service centers used to conduct some of the audit work, provided that the lead engagement partner is to be responsible for the quality and service of the audit.

Actions that worked well evaluating audit quality were the consideration of (1) the audit firm's annual audit quality report (or similar report), (2) how the auditor addressed the PCAOB's inspections report, (3) review of other PCAOB inspection reports to understand common issues, (4) AQIs for the auditor's evaluations, and (5) controls and audits of shared service centers used by the auditor.

Relationship and communication with the auditor
There was a high level of satisfaction expressed with the relationships with auditors, their services, and level of skepticism and judgment. Communications with the auditors were very good and thorough with the appropriate level of frequency. Conversations before or during meetings were helpful in understanding key issues and areas of focus.

Actions that worked well for communications were (1) pre-meeting discussions between the audit committee chair and the engagement partner to refine the agenda and meeting materials, (2) annual assessment of the engagement team and the audit, (3) discussion of matters that arose during a PCAOB inspection, (4) visits to component locations in a multi-location audit by the audit committee chair, and (5) completing deep dive discussion of specific topic, such as cybersecurity, at some meeting, including obtaining the auditor's feedback on best practices and trends.

New auditing and accounting standards
Significant time was spent on discussing new accounting and auditing standards. While there was some concern the overlapping timing for implementation of some standards might stretch auditors' resources and time, most felt auditors were proactive and timely in addressing the new standards. Most chairs were pleased with the preparations for the new requirements to report critical audit matters; although some hoped the conversations would eventually focus on what the CAMs mean and how they affect the audit process.

Actions that worked well for implementation of new standards were (1) early discussions about the new standards, (2) developing an implementation timeline, and (3) using outside consultants or experts to educate the audit committee on complex issues.

Technology driven changes
Some audit committees were aware of the use of data analytics and other tools and technologies used in audits. There was a mix of views on whether technology will improve the quality of the audit. The majority of the chairs indicated that the audit committee was responsible for cybersecurity and significant resources are being committed to this issue.

Actions that worked well to address technology driven changes were (1) tracking the status of the audit plan using project management software or website, (2) discussing software tools used by the auditor, and (3) completing deep dive discussion of emerging technologies.

More information
A copy of the report is available through the PCAOB at https://pcaobus.org/Documents/Conversations-with-Audit-Committee-Chairs.pdf.

Audit focus on estimates and specialists

Financial statements contain many accounting estimates, some of which may be significant in measuring and disclosing the financial condition and financial performance of a company. Accounting estimates involve subjective assumptions, measurement uncertainty, complex processes and methods, and significant management judgment. Often, specialists are used to preparing or evaluating these estimates. Some of these accounting estimates are areas of significant risk in an audit.

In response to the increasing use of significant estimates in financial statements, the International Auditing and Assurance Standards Board, the Canadian Auditing and Assurance Standards Board, and the PCAOB issued new standards to strengthen the auditing requirements for auditing accounting estimates. The relevant standards are:

- International Standard on Auditing 540 (Revised): *Auditing Accounting Estimates and Related Disclosures* effective for audits of financial statements for periods beginning on or after December 15, 2019;

- Canadian Auditing Standard 540: *Auditing Accounting Estimates and Related Disclosures* effective for audits of financial statements for periods beginning on or after December 15, 2019*;* and

- PCAOB Auditing Standard 2501: *Auditing Accounting Estimates* effective for audits of financial statements for periods ending on or after December 15, 2020.

The implementation of these standards is expected to impact the work audit teams must perform. In addition to understanding the incremental effort that may be required in audits of financial statements, management and the audit committee will want to consider their internal controls over accounting estimates and the use of company specialists.

Accounting estimates

The new auditing standards develop a more consistent risk-based approach to auditing accounting estimates, including estimates of fair value. The enhanced audit requirements require the auditor to focus on estimates with a higher risk of material misstatement in significant accounts and disclosures.

An accounting estimate is the amount for an account, disclosure, or transaction that involves subjective assumptions and measurement uncertainty. There may be a range of measurement outcomes. Management needs to exercise judgment in developing accounting estimates. The three main inputs into developing accounting estimates are:

- Methods and models, which may be prescribed by standards, internally developed, or widely accepted in industry. The methods may be complex and involve a degree of subjectivity.

- Assumptions, which are often significant, complex, and subjective.

- Data, which is derived from different sources (internal and external).

Key changes to auditing estimates

Significant revisions were made to all of the standards. Some of the main changes are:

- Enhanced risk assessment procedures to focus on accounting estimates with a higher risk of material misstatement based on the degree of measurement uncertainty, complexity, and subjectivity involved in determining the estimates and internal controls over accounting estimates.

- More comprehensive understanding of management's process for developing accounting estimates.

- Heightened and more granular audit effort directed to main components of the estimate that are important to the recognition or measurement of the accounting estimates as well as controls related to accounting estimates.

- Enhanced “stand back” requirement to evaluate the audit evidence obtained to support the conclusions about the accounting estimates.

- More emphasis on the exercise of professional judgment to consider the potential for management bias by challenging, questioning, and reconsidering management’s assertions.

- Increased focus on procedures to support external information sources used in accounting estimates.

- Enhanced procedures to assess whether disclosures are reasonable.

The impact of the standards on individual audits may vary based on several factors, such as the nature, complexity, subjectivity, and degree of uncertainty of the accounting estimates.

The IAASB and CAASB did not make any changes to their respective standards on the use of experts.

Under AS 1210, a specialist is a person or firm possessing special skill or knowledge in a particular field other than accounting or auditing, except for those persons or firms with specialized expertise or knowledge in information technology or income taxes. Lawyers engaged by the company to interpret contracts or provide legal opinions are also specialists. However, the requirements for specialists do not apply to information provided by company lawyers concerning litigation, claims, or assessments that are used by the auditor.

Company's response to changes in auditing accounting estimates

These new requirements may require auditors to place more emphasis on auditing accounting estimates. Management can be expected to be increasingly challenged on how they develop accounting estimates. Further, companies can expect auditors to make more focused requests for information about methods, assumptions, and data used to derive accounting estimates.

Companies will likely want to consider re-assessing their controls over accounting estimates. Effective controls should address the selection process when there are multiple methods available or a range of potential assumptions to make an accounting estimate. Management should also have controls in place to prevent or detect bias in the selection of their methods and assumptions. If management uses pricing data provided by third parties, consideration should be given to the reliability and relevance of the data provided by third parties, including understanding the valuation techniques, assumptions, and other inputs used by third parties to determine fair values.

Use of specialists

In 2019, the PCAOB issued a new standard, Auditing Standard 1210: *Using the Work of an Auditor-Engaged Specialists* and amended AS 1105: *Audit Evidence* and AS 1201: *Supervision of the Audit Engagement* to address how auditors may use the work of specialists in their audits. This new guidance is effective for audits of financial statements for periods ending on or after December 15, 2020.

Key changes to use of specialists

The amendments require the auditor to design a risk-based approach to determine the extent of evaluation of the work of a specialist. The approach considers the risk of a material misstatement related to work, the significance of the work to the auditor's conclusions, the knowledge, skill, and ability of the specialist, and the susceptibility of the specialist to the company's influence.

Company specialists

Specialists may include a person or firm employed or engaged by the company (a company specialist). When the auditor decides to use the work of a company specialist, the auditor will now be required to:

- assess the competence of and the client's relationship with the specialist and the specialist's employer; and

- test and evaluate the specialist's work by testing company produced data provided to the specialist, assessing the relevance and reliability of data from external sources, evaluating the reasonableness of significant assumptions used, and determining whether the method is appropriate under the circumstances.

Companies should maintain effective controls over the assessment of the professional qualifications of their specialists and the specialists' employers and the relationship between the company and the specialists. Also, as part of a company's system of internal control, the company may need to obtain additional information and documentation from their specialist to support their evaluation of the specialist's methods, significant assumptions, and external data sources. This information will also be needed by the auditor to support their audit procedures.

Auditor-employed specialists

The amendments broadly align the requirements for auditor-employed specialists with those required for the supervision of audit engagement team members. Auditor-employed specialists are to be independent as required by the SEC and the PCAOB.

Auditor-engaged specialists

The requirements to assess the knowledge, skill, ability, and objectivity of an auditor-engaged specialist are now extended to the entity that employs the specialist. This assessment along with the risk of material misstatement will determine the extent of the review and evaluation of the specialist's work required.

The use of accounting estimates has become more prevalent in accounting and the new standards address the increased risks with accounting estimates. These changes may have a significant impact on the audits of more complex and subjective accounting estimates. New guidance is expected so Management and the audit committee should understand how these new standards affect the auditor's audit plan and work for future audits.

CAQ

Barometer on oversight of auditor

The CAQ published its *2019 Audit Committee Transparency Barometer* in November 2019. The *Barometer* gauges how US public companies approach their disclosures about their oversight of external auditors. The information is based on a review of proxy circulars by the companies in the S&P Composite 1500 index. The requirements and disclosures are based on US securities laws and may differ in several respects from requirements in Canada. The research was conducted by the Center for Audit Quality in the United States and Audit Analytics, an independent research provider.

The *Barometer* observed some positive developments as follows:

- Most audit committee disclosures are robust. The majority of the disclosures included information about non-audit services and the impact on independence, the length of time the auditor has been engaged, criteria considered to evaluate the auditor, and involvement in audit partner selection.
- Cybersecurity is a hot topic, with disclosures about the responsibility for oversight of cybersecurity and whether the board has a cybersecurity expert.

Some areas of concern emanating from the research include:

- Many disclosures about the audit committee have remained at the same level year-over-year.
- Some areas of interest (as noted in the next paragraph) are poorly addressed.

The *Barometer* includes areas of disclosure that could be enhanced to increase the transparency of the work of the audit committee. These include:

- The audit committee's perspective on significant areas of discussion during the audit. This type of disclosure could be integrated with the reporting of critical audit matters by the auditor.
- Disclosures about how the audit committee evaluated the audit firm and the audit committee's involvement in the audit partner selection upon rotation. Disclosure may include how often the auditor is evaluated, what mechanism is used to assess the auditor, who is involved in the evaluation, what are the critical considerations in the assessment, what is the process for selecting the audit partner, and who is included in the audit partner selection.
- Disclosure about auditor compensation, including how the fees are negotiated and how it relates to audit quality, explanation of changes in fees, and the audit committee's responsibility for fee negotiation.

The *Barometer* includes details of the data collected for the survey and examples of useful disclosure on different topics. A copy of the *Barometer* is available at https://www.thecaq.org/ under the tab *Resources*. The publication is also accompanied by a video: *Profession in Focus: Audit Committee Transparency*.

Common abbreviations

Abbreviations	
AICPA	American Institute of Certified Public Accountants
ASC	Accounting Standards Codification
ASU	Accountings Standards Update
CAMs	Critical auditing matters
CAQ	Center for Audit Quality of AICPA
CECL	Current expected credit losses
COSO	The Committee of Sponsoring Organizations of the Treadway Commission
CSA	Canadian Securities Administrators
ED	Exposure Draft or Proposed Accounting Standards Update
EITF	Emerging Issues Task Force of the Financial Accounting Standards Board
FAF	Financial Accounting Foundation
FASAC	Financial Accounting Standards Advisory Committee
FASB	The Financial Accounting Standards Board
FinREC	The Financial Reporting Executive Committee of the American Institute of Certified Public Accountants
GAAP	Generally accepted accounting principles
IASB	The International Accounting Standards Board
ICFR	Internal control over financial reporting
IFRS	International Financial Reporting Standards
MD&A	Management's discussion and analysis
NGM	Non-GAAP financial measure
Q	Quarter
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
SEC	Securities and Exchange Commission
TRG	Transition Resource Group
VIE	Variable interest entity

At PwC, our purpose is to build trust in society and solve important problems. PwC Canada is a member firm of PricewaterhouseCoopers network of firms in 158 countries with over 250,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more and tell us what matters to you by visiting us at www.pwc.com/ca.

PwC has a strong network of people in Canada and worldwide who can advise on the developments in US GAAP and SEC reporting. If you would like to discuss any of the issues or matters raised in this publication, please contact your engagement team or local office.

For other PwC publications please refer to http://www.pwc.com/ca/en/research-insights.html