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A New Year Full of Risks and Opportunities

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Entering a new year usually means reflecting on the completed one and planning for the next. In preparing for this effort, one of my favorite conferences is the AICPA's *Conference on Current SEC and PCAOB Developments*. This annual conference features leaders from the AICPA, SEC, FASB, PCAOB and CAQ, as well as perspectives from auditors, preparers, attorneys and industry advisors. While the conference is targeted for public companies, many of the topics pertain to all entities, such as addressing change and cybersecurity risks. This article captures some of the central themes of the conference held on December 4-6, 2017, in Washington, D.C.

Cybersecurity

Without a doubt, cybersecurity is one of the hottest topics in boardroom and management circles, and rightfully so. This is a top-agenda item for the AICPA and several conference speakers mentioned the AICPA's Cybersecurity Risk Management Framework. The Framework helps organizations of all types define a cybersecurity risk management program. The Framework is flexible and voluntary for communicating the effectiveness of a cybersecurity risk management program to build trust and confidence.

SEC staff spoke about possibly updating their staff guidance issued in 2011, this time perhaps being issued at the Commission level. The guidance is principle-based so no changes are necessary, however a refresh and reissuance could bring more attention to cybersecurity risks. These risks should be addressed through disclosure controls and procedures to ensure that the appropriate stakeholders are informed about risks and cyber incidents on a timely basis. It is also clear that cyber-related disclosures will be more closely monitored by SEC staff in the future. The potential impact of cyber risks is very high and hence the need for investors to be properly informed.

Big-3 New Accounting Standards

Russell Golden, FASB Chair, indicated that 2018 will not bring much change from a US GAAP standpoint. There will be some continuous improvements efforts, but no big changes like we have seen over the last several years. FASB is in a 'stand-ready' mode regarding the big new accounting changes. Several conference speakers mentioned FASB's implementation web-portal, which is geared towards helping organizations realize a smooth transition to new standards, especially the Big-3 of:

1. Revenue from Contracts with Customers (ASC Topic 606)
2. Leases (ASC Topic 842)
3. Financial Instruments - Credit Losses (ASC Topic 326)

In addition to the Big-3, FASB's portal offers implementation guidance for not-for-profit financial reporting, hedge accounting and other standards. It also provides detailed contact information for questions on the FASB Accounting Standards Codification, general accounting or audit matters, auditor independence, SEC rules and regulations, and tax compliance.

SEC staff indicated that they generally will not object if sound judgments are made consistent with reasonable accounting policies. However, entities need to have a strong system of internal control over financial reporting (ICFR) to mitigate the risks of inappropriate accounting policies and inconsistent application. ICFR needs to be designed to respond to a robust risk assessment to reach US GAAP and regulatory compliance objectives. The new accounting standards will undoubtedly impact ICFR, including disclosures.

Of course, there was also conference chatter about proper disclosure of new accounting pronouncements. Similar to the 2016 conference, SEC staff warned attendees that they expect to see customized updates on impacts and implementation status in the spirit of SEC's Staff Accounting Bulletin – Topic 11.M guidance, also known as SAB 74. Generic disclosures can trigger regulatory scrutiny through an SEC Staff comment letter. Understanding and implementing US GAAP and SEC guidance, including ASC 250-10-S99-6 and SAB 74 respectively, helps to ensure adequate disclosures.

No conference is complete without addressing board-level oversight. Several speakers commented on the importance for audit committees to hold management accountable for implementation plans in adopting new accounting standards. This includes ensuring that a proper tone-at-the-top is established by both audit committees and management teams. Without a strong tone and accountability, risk of errors and fraud is high.

And finally, warnings were plentiful at the conference, especially regarding the new lease accounting standard.[1] Specifically, a session on lease accounting ranked the top challenges as:

1. data collection
2. systems
3. resources
4. disclosures
5. controls
6. accounting policies
7. taxes impact

[1] On January 5, 2018, the FASB issued a proposed amendment to the leasing standard to include an option for transition that permits application of the new standard at the implementation date instead of at the earliest comparative period. If elected, the option could dramatically reduce the implementation effort required by the new leasing standard.

The bottom line – don't underestimate the effort the new lease accounting standard implementation will take. Simply identifying all leases, including embedded leases, and digitalizing the lease agreements can take a lot of time and resources.

Tackling Change Head-on

Nearly every conference session addressed change, especially relative to the new accounting standards, US tax reform, the new audit report and fast-moving technology advancements, all of which usher in risks and opportunities.

ICFR and the New Accounting Standards: One speaker, Michal P. Dusza, Professional Accounting Fellow, SEC Office of the Chief Accountant, raised the importance of Principle #9 of the *Internal Control—Integrated Framework* (Framework) from the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Principle #9 requires that *the organization identifies and assesses changes that could significantly impact the system of internal control* (refer to page 7 of the Framework's Executive Summary). In his speech, Mr. Dusza states … *we believe that there are benefits to approaching ICFR as more than just a compliance exercise. In addition to supporting reliable financial reporting, effective ICFR also promotes internal accountability and contributes to better information flows within the company which in turn can translate into greater investment efficiency and improved operating performance*. He states that *Principle #9 of the COSO Framework should help companies appropriately prepare for the adoption of the new standards and support timely informative transition disclosures*. Indeed, COSO's Framework can be a powerful tool to help conquer risks and seize opportunities.

As a side note, registrants are required to disclose material changes in ICFR during their fiscal quarter in the 10-Q (Part 1, Item 4) and in the 10-K (Item 9A). Upon adoption of a new accounting standard, some registrants may be required to make changes in ICFR to comply with the new standard on an on-going basis. If such changes have materially affected or are reasonably likely to materially affect ICFR, such changes are required to be disclosed. In situations where the adoption of a new accounting standard did not result in a material change in ICFR, but had an impact on the financial statements and disclosures, it might be prudent to disclose that changes in ICFR were made while recognizing that they were not material.[2]

US Tax Reform: Although the conference occurred prior to the passage of the Tax Cuts and Jobs Act of 2017 (the Act), income tax changes was on the minds of conference speakers. While this has been brewing for a couple of months, the recent passage of the Act means additional accounting and disclosure efforts now. In response, SEC staff released Staff Accounting Bulletin No. 118 on December 22, 2017. SAB 118 allows for the reporting of provisional amounts for certain income tax effects of the Act in circumstances when the entity does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting under ASC Topic 740. The FASB staff indicated that private companies and

[2] See Ford Motor Co Part 1, Item 4 of the 10-Q for the quarterly period ended March 31, 2017 filed with the SEC on April 27, 2017 and Microsoft Corp Part 1, Item 4 of the 10-Q for the quarterly period ended September 30, 2017 filed with the SEC on November 26, 2017 as examples.

not-for-profit entities should also have the option to apply SAB 118. FASB board members agreed in its January 10, 2018 meeting. Stay tuned for a proposed accounting standard update related to the accounting for certain tax effects triggered by the Act.

New Audit Report: The SEC approved on October 23, 2017, (SEC Release # 34-81916) PCAOB's proposal to overhaul the external audit report. The 49-page SEC order provides a lot of useful information to help guide the auditors with their thinking, including page 25 on addressing control deficiencies. This is the first substantive change for public company audit reports since the 1940's. While there are several changes to the audit report addressing the auditor's tenure, independence disclosure, and report form, the most significant change is the addition of the critical audit matters (CAMs) paragraph.

This requires the auditor to report any CAMs arising from the current period's audit or state that there are no CAMs. CAMs are matters that the auditor determines to be material to the financial statements and involve challenging, subjective or complex auditor judgment. Several conference speakers cautioned that CAMs are not meant to be boiler-plate language but rather specific to the audit. Some speakers also encouraged auditors to discuss potential CAMs with their clients. SEC Chairman, Jay Clayton suggested that audit committees should ask for a 'dry run' of the new report before it becomes mandatory beginning in 2019 or 2020 depending on the filer category.[3] The changes to the audit report could have an investor relations angle to it.

Technology Advancements: This topic magnifies the theme of risks and opportunities perhaps more than any other. I have already covered cybersecurity risk, which no one can escape. However, are organizations considering new technology to gain a competitive advantage or to grow and become more profitable? Technology is transforming the way we work and we better be prepared for it because our competitors likely will.

All types of organizations and industries will be impacted, including the auditing profession. A conference panel entitled *Auditing in the Future* talked about the trends of data storage cost declining and access increasingly getting faster. Terms, such as Artificial Intelligence (AI), machine learning, Robotic Process Automation (RPA) and data analytics are entering the audit-related conversations at an increasing pace. Still, panelists also talked about how judgment and professional skepticism will always be a human component to the audit process.

Another hot topic mentioned by several conference speakers was blockchain. Blockchain is a shared, distributed ledger that facilitates the process of recording transactions and tracking assets in a business network. The changes that this technology will likely usher in are immense. 2017 has been a year of experimentation regarding the blockchain technology triggering lots of proof-of-concepts. One speaker mentioned that while there are no large-scale blockchain productions to date, every industry is looking into it, especially healthcare.

[3] Required changes to the audit report other than CAMs are effective for all audit reports issued after December 15, 2017.

Conclusion

Fasten your seat-belt as 2018 promises to be an interesting year. Be prepared to properly address your objectives, risks, opportunities and controls to make 2018 great. Education, frameworks and controls, led by a strong tone-at-the-top, is the recipe for success.

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