AN OFFERING FROM THE BDO CENTER FOR CORPORATE GOVERNANCE AND FINANCIAL REPORTING

2017 AUDIT COMMITTEE ROUND-UP: FOCAL POINTS, TOOLS & RESOURCES

Matters ranging from anticipated disclosures to heightened responsibilities abound for corporate boards as we round up developments in corporate governance and financial reporting this year. 2018 promises to be a year of "firsts" for adoption of significant accounting and auditing standards; contemplation of new frameworks in the form of COSO and cybersecurity risk management; and U.S. tax reform impacts. The future continues to focus on emerging disruptors and opportunities arising from evolving technologies and analytical capabilities. Rounding our top area of focus for audit committees is increased emphasis on transparency in financial reporting and social responsibility disclosures. Learn how each of these may impact public and private companies and their audit committees for the foreseeable future.

BDO has compiled the following year-end snapshot of issues and select resources that audit committees will find helpful in addressing their oversight responsibilities and communications with management and auditors during the year-end audit cycle and related reporting. While the following is intended as a high-level reference, additional resources are forthcoming and include BDO's Q4 2017 Technical Update webinars and our annual newsletters: BDO Knows: FASB 2017 Accounting Year in Review and 2017 SEC Year in Review, among others – all of which are or will be made available on BDO's Center for Corporate Governance and Financial Reporting.

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U.S. TAX REFORM

As legislators, corporate and individual tax payers, and their advisors seek to better understand the implications of the "2017 Tax Cuts and Jobs Act" (the Act) tax signed by President Trump on December 22, 2017, the following outlines considerations for companies to be discussing with their management teams, auditors, and tax advisors as they wrap up their year-end reporting:

CERTAIN CORPORATE TAX REFORM CHANGES AND TAX ACCOUNTING COMPLEXITIES

- **Reduction of the corporate maximum tax rate from 35% to a flat 21% beginning in 2018 –** Historically, the U.S. rate is among the highest of all developed nations, often driving up effective tax rates for companies with heavy domestic operations as compared to global peers, who through their international operations may enjoy more favorable effective rates. This is especially important for smaller domestic companies who may not have the resources to effect such favorable tax planning strategies. FASB ASC Topic 740 (ASC 740) requires remeasurement of all U.S. deferred income tax assets and liabilities for temporary differences and Net Operating Loss (NOL) carryforwards at the new 21% corporate rate. The cumulative adjustment will be recognized in income tax expense from continuing operations as a discrete item in the period that includes the enactment date.
- **Introduction of annual limitations to NOL and interest expense deductions –** This may be particularly challenging for companies with volatile earnings as the restrictions on the carryback and use of NOLs could present a significant cash flow obstacle. Additionally, a new annual limitation on NOL utilization could result in more complexity and unfavorable valuation allowance consequences under ASC 740. Similarly, a new annual limitation on interest deduction would introduce complexity, judgement, and uncertainty into the determination of interest deducibility.
- **Repeal of the alternative minimum tax –** The AMT tax for corporations will cease.
- **Removal of certain business tax credits –** While several business tax credits will be removed, two important credits remain: the research and development (R&D) credit and the low-income housing tax (LIHT) credit.
- **Introduction of a Territorial Tax System –** This portion of the tax legislation will move the U.S. toward an international system in which income earned in other countries would generally not be subject to U.S. taxation with the exception of certain foreign income subject to U.S. anti-deferral rules and new anti-base erosion rules. However, accumulated foreign earnings of U.S. shareholders of specified foreign corporations would be subject to a one-time transition tax. Amounts held in cash or cash equivalents would be subject to a 15.5% tax; while illiquid assets would be subject to an 8% tax. This transition tax could be paid over a period of 8 years at specified increasing rates or paid in one lump sum. NOL and foreign tax credit (FTC) carryforwards can be used to offset the transition tax liability.

  The repatriation tax on accumulated foreign earnings would cause many U.S. corporations to recognize a U.S. tax on foreign earnings that were previously deemed permanently reinvested outside the US. The repatriation tax would also be recognized in income tax expense from continuing operations in the period of enactment. The tax calculation is complex and involves many variables and considerations (e.g., cash and cash equivalent balances at two particular dates). Foreign withholding tax that would be incurred on cash repatriation and foreign exchange translation effects would also be considered in the measurement of the repatriation tax and reflected in the enactment period accounting. The transition tax can be offset by NOL and FTC carryforwards and therefore would be considered a source of income for valuation allowance accounting purposes. Valuation allowance changes due to the transition tax would also be recognized in the enactment period accounting.
- **Intellectual Property (IP) Provision –** A provision to encourage U.S. export of IP provides a deduction for IP-derived income, likely to be accounted for as a permanent benefit in a company's effective tax rate instead of being reflected in deferred income taxes. All these will have corollary impacts on valuation allowances and uncertain tax benefits (FIN 48 liabilities) and will ultimately impact the effective tax rates.

Note: Tax reform for businesses represent permanent changes; while changes for individuals expire in 2026.

These are just a few of the many considerations corporations will need to consider – others include compensation and benefits; pass-through entities; fixed assets deductions; domestic activities deductions; etc.

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TAX REFORM: INTERNAL CONTROLS AND AUDIT CONSIDERATIONS

The internal control framework and environment within an organization will also be affected by U.S. tax reform. New controls or revisions to existing controls might have to be designed and implemented. Auditors will need to evaluate the design of these controls and when applicable, test the operating effectiveness of such controls. If management intends to use certain permissible estimates within their calculations, it should be clear how the estimates were developed, the contradictory information that was considered, and how management challenged the estimate. If estimates are used for the initial assessment of certain provisions, those estimates will need to be adjusted with actual balances in the subsequent period.

As a reminder, auditing standards require an assessment of the overall risk of material misstatement to plan and perform an effective audit. Tax reform legislation will likely result in additional audit risk considerations for all preparers and their external auditors. Preparers should expect targeted audit procedures to address these additional risks and provide audit evidence necessary to support reported amounts. This will include providing detailed calculations and documentation. Early discussion and sharing of information with external auditors concerning the underlying accounting impact in advance of management's final assessment will help prevent last minute audit surprises.

INCOME TAX DISCLOSURES SHOULD NOT BE OVERLOOKED

- **Financial Statements –** Financial statement tax footnote disclosures for the enactment period would have to provide sufficient information on the cumulative effect of the tax reform enactment. Significant components of income tax expense from continuing operations, including the effect of a tax law and tax rate changes, are required disclosures. These disclosures would also include the effect of valuation allowance due to tax reform enactment. For many public companies, the income tax footnote's effective tax rate disclosure, which reconciles statutory rate to effective rate, would have a reconciling item or items for the cumulative effect of the tax reform enactment. The various balance-sheet related disclosures of the inventory of deferred taxes, NOL and credit carryforwards, and uncertain tax benefit liabilities could also be affected.

- **MD&A -** Registrants will need to consider the impact of tax reform measures within their MD&A, specifically as it relates to liquidity, the results of operations, and critical accounting estimates. A discussion is required of known trends, commitments, events, or uncertainties associated with the Tax Reform that are reasonably likely to result in liquidity increasing or decreasing in any material way, on both a short-term and a long-term basis. A registrant with significant foreign earnings must consider the impact of the one-time transition tax, including any changes to its contractual obligations table if the liability is to be paid in annual installments. Furthermore, the ongoing effects of other changes (e.g., the reduced corporate tax rate, among others) should be discussed.

  A discussion of the impact of the Tax Reform on the results of operations should include (i) a one-time impact of the change in the corporate tax rate on deferred tax assets and liabilities (DTAs and DTLs), (ii) the one-time transition tax if the registrant has material foreign operations, and (iii) the ongoing impact of the reduced corporate tax rate. The first two items above should be consistent with amounts reflected in the effective rate reconciliation in the footnotes to the financial statements.

  A discussion will need to be updated to address the material uncertainties associated with the estimates made within the tax provision, including a discussion surrounding the estimate of the one-time transition tax if the registrant has material foreign operations and there are significant uncertainties around the amount reflected in the financial statements.

- **Other SEC Rules -** Additionally, registrants will need to consider the income tax disclosures required under Regulation S-X, Rule 4-08(h), including disclosure of the amounts of income tax expense (benefit) applicable to United States Federal income taxes, foreign income taxes, and each other major component of income taxes as well as a reconciliation between the amount of reported income tax expense (benefit) and the amount computed by multiplying the income (loss) before tax by the applicable statutory Federal income tax rate including detail of the underlying causes for the difference in the two amounts.

In terms of financial reporting, this sweeping tax reform legislation is considered a known event that (presumably) is reasonably likely to materially affect operating results and liquidity. Therefore, a registrant should discuss the expected effects on future operating results and liquidity.

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A registrant should also consider disclosing (via a footnote to the contractual obligations table) the material change in other long term liabilities that occurred after year-end. In December, the SEC issued certain **interpretative guidance** to help ensure timely public disclosures of the accounting impacts of the Act.

As companies look to assess their tax planning strategies for year-end 2017 and beyond, audit committees and their management teams are invited to remain abreast on breaking developments with respect to income taxes through the following:

RECOMMENDED RESOURCES	RELEASE DATE
BDO Knows Tax Reform Resources Page*	Continually Updated
BDO Regional Events: Planning for Tax Reform**	January & February 2017
BDO Webinar: Planning for Tax Reform***	January 2017
BDO Webinar: Tax Reform and the Board's Role***	January 2017
2017 Year-End Tax Planning for Businesses	December 2017
SEC Staff Provides Regulatory Guidance for Accounting Impacts of the Tax Cuts and Jobs Act	December 2017
SEC SAB 118	December 2017
SEC C&DI 110.02	December 2017

* Timely tax reform resources continue to be added regularly.

** Multiple live events being offered around the U.S. and more to be scheduled.

***Archived recordings will be made available via same page link.

IMPLEMENTATION READINESS OF SIGNIFICANT NEW FASB ACCOUNTING STANDARDS

The new revenue recognition standard becomes effective on December 15, 2017. This is the first of several significant FASB accounting standards - revenue recognition, leases, financial instruments and related credit losses - that have a variety of stakeholders sitting at the ready for what they hope will be robust financial reporting in these areas. Heading into year-end, noted progress or lack thereof on implementation has had many, including regulators, anxious for companies that may have been taking a "wait and see" attitude.

In our **2016 Audit Committee Round-Up**, we emphasized the need for robust SEC SAB Topic 11.M (aka "SAB 74") disclosures. This year, we would like to further remind audit committees to ensure not only that the accounting has been done properly and new disclosures are being provided but that transparency into the process undertaken by management and the resulting financial information is easily understood by analysts and the investing communities. Equally as important is the consideration of the controls that support the accounting and reporting for these new standards.

There are many lessons to be learned from the adoption of ASC 606 (Revenue Recognition) that can and should be applied to the pending ASC 842 (Leases) as well as the credit loss and financial instrument standards under ASC 326 and ASC 825 that will be quickly following within in the next 12 to 24 months. Please refer to BDO's Flash Report: **SEC SAB 74 Disclosures and Controls for New Accounting Standards**.

A continued theme in 2017, culminated by remarks by the SEC and PCAOB staff during the December 2017 AICPA SEC and PCAOB Conference, is that both the SEC Office of the Chief Accountant (OCA) and the PCAOB are "open for business" and are ready and willing to speak to companies about their specific transition questions and expect companies to provide increasingly robust disclosures as standard effective dates near. As part of their overall remarks shared during the 2017 AICPA SEC and PCAOB Conference, the SEC reminds audit committees that they can "contribute to an effective implementation [of new standards] by setting a tone at the top, establishing expectations for implementation dialogue, and understanding management's response to any auditor concerns."

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The following summarizes effective dates of the new standards along with related resources for audit committees to consider:

STANDARD	EFFECTIVE DATES - FOR PUBLIC COMPANIES	RECOMMENDED RESOURCES
FASB ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, as amended	Effective for annual periods beginning after 12/15/17, including interim periods therein. Entities may adopt using a retrospective approach or a cumulative effect approach. Early adoption is permitted only as of annual reporting periods beginning after 12/15/16, including interim periods within that year.	▶ FASB Standards Implementation Portal ▶ BDO Revenue Recognition Resource Center ▶ BDO Archived Webinars – 2017 ▶ Topic 606, Revenue from Contracts with Customers ▶ Topic 606, Adoption Timetable ▶ Topic 606, Exploring Transition Methods ▶ Topic 606, Presentation and Disclosure ▶ Topic 606, Income Tax Implications ▶ Topic 606, Tax Implementation Roadmap ▶ SEC Updates (SAB 116) to Reflect New Revenue Recognition Standard ▶ Delayed Adoption of ASC 606 and 842 Permitted by SEC for Certain Entities ▶ PCAOB Staff Audit Practice Alert on Auditing the New Accounting Standard for Revenue ▶ CAQ Tool: Preparing for the New Revenue Recognition Standard ▶ BDO Accounting and Reporting Advisory Services
FASB ASU 2016-02, *Leases (Topic 842)*	Effective for fiscal years beginning after 12/15/18, including interim periods within those fiscal years. Early adoption is permitted. Specific transition requirements apply.	▶ BDO Knowledge Webinar: The New Lease Accounting Standard ▶ BDO Newsletter: Topic 842, Leases ▶ BDO Lease Accounting Services
FASB ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*	For public business entities that are SEC filers, amendments are effective for fiscal years beginning after 12/15/19, including interim periods within those fiscal years. For all other public business entities, amendments are effective for fiscal years beginning after 12/15/20, including interim periods within those fiscal years.	▶ BDO Knowledge Webinar: Financial Instruments Update – Credit Losses and Recognition & Measurement ▶ BDO Flash Report: FASB Issues ASU on Credit Losses on Financial Instruments

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STANDARD	EFFECTIVE DATES - FOR PUBLIC COMPANIES	RECOMMENDED RESOURCES
FASB ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*	Effective for fiscal years, and interim periods within those fiscal years, beginning after 12/15/17. Certain provisions of the ASU are eligible for early adoption.	▶ BDO Knowledge Webinar: **Financial Instruments Update – Credit Losses and Recognition & Measurement** ▶ BDO Flash Report: **FASB Issues Targeted Amendments to the Recognition and Measurement Guidance for Financial Instruments**
FASB ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*	Effective for fiscal years, and interim periods within those fiscal years, beginning after 12/15/18, with early application permitted.	▶ BDO Flash Report: **FASB Issues Targeted Improvements to Hedge Accounting**

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THE NEW AUDITOR REPORTING MODEL HAS ARRIVED

In October 2017, the SEC approved the new PCAOB auditing standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which is the first significant change to the U.S. auditor's report in over 70 years and follows recent international reporting initiatives to provide transparency into the audit. The changes to the auditor's report are primarily intended to clarify the auditor's role and responsibilities related to the audit of the financial statements, provide additional information about the auditor, and make the auditor's report easier to read. Staggered effective dates for significant elements of AS 3101 are summarized below.

WHAT DOES THIS MEAN FOR THE CURRENT AUDIT CYCLE?

Effective December 15, 2017:

- **Form of the Auditor's Report –** Requires the opinion to be first, immediately followed by the basis for opinion,with non-specific sequencing of remaining sections.
- **Addressed to Shareholders and Board of Directors (or Equivalents) –** Allows auditor to voluntarily include additional addressees.
- **Auditor Independence Statement –** Acknowledges the auditor is a public accounting firm registered with the PCAOB and is required to be independent with respect to the company in accordance with U.S. federal securities laws and applicable rules and regulations of the SEC and the PCAOB.
- **Auditor Tenure Statement –** Indicates the year the auditor began serving consecutively as the company's auditor.
- **Explanatory and Emphasis Paragraphs – I**ncludes when an audit of ICFR is *not* performed within the list of circumstances requiring audit report explanatory language.
- **Information about Certain Audit Participants –** Permits the auditor to voluntarily include information required to be reported by the auditor on PCAOB Form AP.

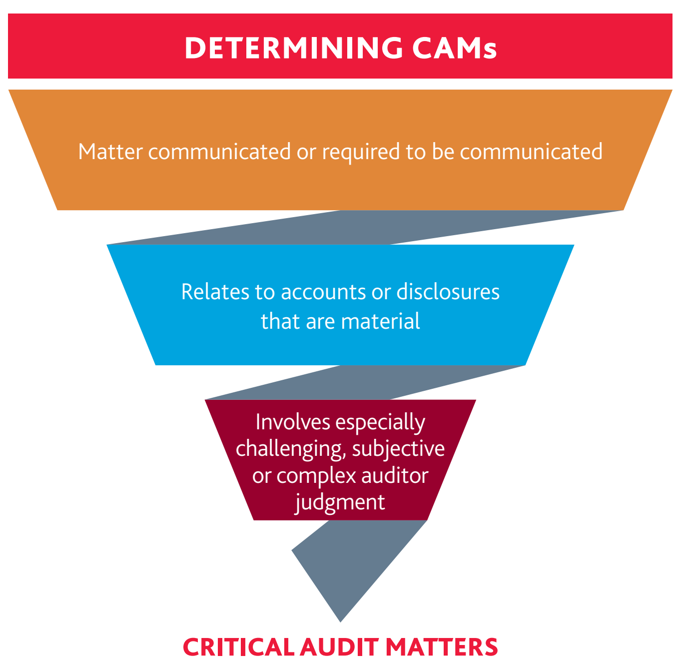
WHAT DOES THIS MEAN FOR FUTURE AUDIT CYCLES?

Effective June 30, 2019 (Large Accelerated Filers) and December 15, 2020 (All Other Filers*):

- **Critical Audit Matters (CAMs) –** Communication in the auditor's report regarding matters arising from the audit of the financial statements that have been communicated or were required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. CAMs may be included voluntarily before the effective date or for entities for which the requirements do not apply.

**Note:* *The communication of CAMs is not required for audits of emerging growth companies; brokers and dealers; investment companies other than business development companies; and employee stock purchase, savings, and similar plans.*

With the introduction of CAMs, the audit report will provide information that had not previously been provided to investors and its form and content remains the responsibility of the auditor. While the new standard requires the auditor to discuss the report, which would include the treatment of any sensitive information, with the audit committee prior to release, it is anticipated that communication with the audit committee regarding potential CAMs will occur throughout the audit.



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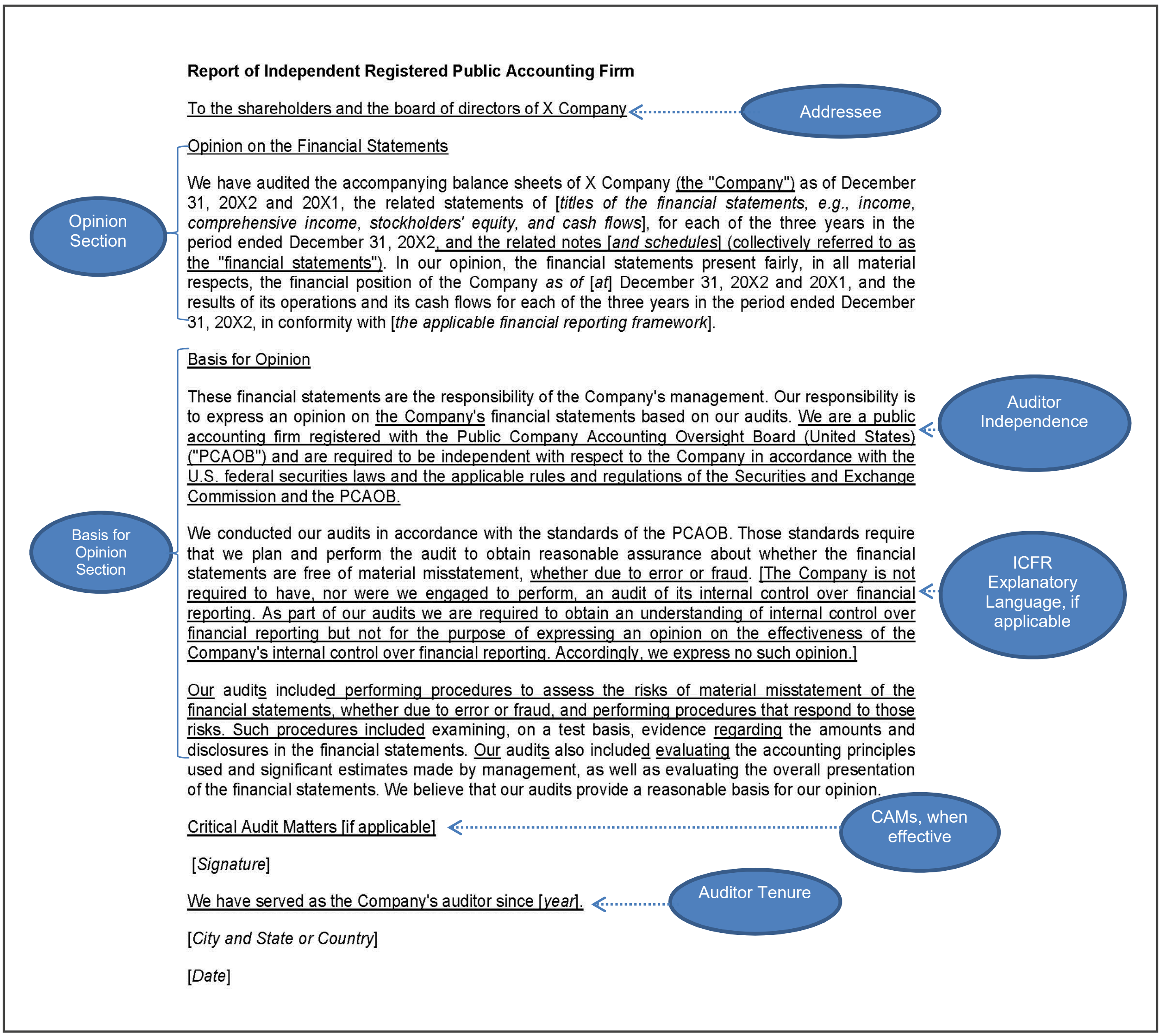
While audit committees in 2018 won't be significantly impacted with respect to the auditor's reorganization of the report and newer disclosures regarding tenure and independence, we do urge them to get up to speed quickly during transition on CAMs, the more significant change in practice impacting most public companies beginning in 2019. SEC Chief Accountant Bricker has offered several on-going communication points that audit committees should be expecting from their auditors during transition including:

- What would the critical audit matters be this year?
- What would be the close calls?
- When could those matters have been raised, and which ones could have been identified at the start of the audit cycle?
- What does the auditor expect to say about those matters?
- When would we expect to see a draft report or at least a draft of the critical audit matters?

HOW WILL THE NEW AUDITOR'S REPORT LOOK?



Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of [*titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows*], for each of the three years in the period ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company *as of* [*at*] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with [*the applicable financial reporting framework*].

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. [The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.]

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters [if applicable]

[*Signature*]

We have served as the Company's auditor since [*year*].

[*City and State or Country*]

[*Date*]

Source: PCAOB Staff Guidance – December 2017

NEXT STEPS?

In December, the PCAOB released **Staff Guidance on "Changes to the Auditor's Report,"** which sets forth the staff's views on issues related to the implementation of the rules and standards of the PCAOB, including practicalities of determining auditor tenure. It indicates the PCAOB intends to monitor implementation of the new requirements and issue additional guidance, as needed. SEC Chairman Clayton's **statement of approval** of the standard and subsequent **commentary** provided by SEC Chief Accountant Wes Bricker also indicate the SEC's intention to closely monitor the timely post implementation review (PIR) of this new standard by the PCAOB, which should include the use of economic analysis tools and an evaluation of unintended consequences that may prompt changes to the new standard.

Following on the heels of the initial PCAOB staff guidance, the Center for Audit Quality (CAQ) introduced a new tool: **The Auditor's Report: Considerations for Audit Committees**. The tool provides a timeline for implementation deadlines. It also lists key questions for audit committees to consider, including a set of questions that the National Association of Corporate Directors has gleaned from audit committee members about the new auditor's report.

BDO has summarized a few **insights** on the new requirements for audit committees and will continue to provide thought leadership and learning opportunities to audit committees and management in the near term to be made available within our **BDO Center for Corporate Governance and Financial Reporting**.

RECOMMENDED RESOURCES	RELEASE DATE
PCAOB Webinar: New Auditor's Report – Overview of Changes Effective in 2017	January 2017
PCAOB Staff Guidance on "Changes to the Auditor's Report"	December 2017
CAQ Tool: The Auditor's Report: Considerations for Audit Committees	December 2017
BDO: The Future of Audit Reporting is Here	December 2017
PCAOB AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*	July 2017

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CYBERSECURITY PREPAREDNESS

In recent years, perhaps no area of board responsibility has grown faster than the oversight of an organization's cybersecurity, often being absorbed into the audit committee's already full agenda. BDO's 2017 Cyber Governance Survey of over 140 public company board of directors offered some interesting results.

ON THE POSITIVE SIDE:

More than three-quarters (79%) of public company directors report their board is more involved with cybersecurity than it was 12 months ago. A similar percentage (78%) say they have increased company investments during the past year to defend against cyber-attacks, with an average budget expansion of 19%. This is the fourth consecutive year that board members have reported increases in time and dollars devoted to cybersecurity.

PUBLIC COMPANY BOARDS MAINTAIN POSITIVE TRENDS ON CYBERSECURITY

	2014	2015	2016	2017
Increased Board Involvement	59%	69%	74%	79%
Increased Cybersecurity Investments	55%	70%	80%	78%
Incident Response Plan in Place	NA	45%	63%	61%
Cyber-Breach in Past 2 Years	NA	22%	22%	18%

WHERE THERE APPEARS TO BE SOME WORK TO BE DONE:

A majority (61%) of corporate directors say their company has a cyber-breach/incident response plan in place, compared to less than a fifth (16%) who do not have a plan, and close to one-quarter (23%) who are not sure whether they have such a plan. Those with plans represent approximately the same percentage as a year ago (63%), but reflect a major improvement from 2015, when less than half (45%) of directors reported having one.

With regard to how frequently boards are being briefed on cybersecurity matters, the trend from 2014 is positive with the vast majority (91%) being briefed at least once per year and 34% being briefed quarterly or more often; however 9% indicated they are not briefed at all.

For more on BDO's Survey results, tune into our recently archived webinar *What's on the Minds of Boards* and our Cyber Governance Survey here.

FREQUENCY OF CYBERSECURITY BRIEFINGS FOR PUBLIC COMPANY BOARDS

	2014	2015	2016	2017
Once a Year	30%	37%	37%	36%
Twice a Year	16%	17%	9%	21%
Quarterly or More Often	25%	33%	42%	34%
Not at All	29%	13%	12%	9%

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In April 2017, the AICPA introduced a Cybersecurity Risk Management Framework—also known as “SOC (System and Organization Controls) for Cybersecurity”—that provides companies with a proactive approach for designing a risk management program and communicating about its effectiveness to their senior management teams, boards of directors, and external stakeholders. When asked about this initiative, just four in ten directors are familiar with it. However, of those aware, 68% indicate that their company is likely to utilize at least one of the related services to independently assess the effectiveness of their efforts. Audit committees are urged to refer to BDO’s **SOC for Cyber** resources to learn more about attestation serves with respect to management programs.

Cybersecurity is also very much on the minds of regulators. SEC Chairman Clayton, facing disclosure of a significant breach of the SEC’s own Edgar reporting database, issued a public **statement** in September 2017. Among other things, the statement outlines the promotion of timely public company disclosures. In 2011, the SEC had issued **CF Disclosure Guidance Topic No. 2 – Cybersecurity** that discusses considerations relevant to a company’s risk factors, management’s discussion and analysis of financial condition and results of operations (“MD&A”), description of business, discussion of legal proceedings, financial statements, and disclosure controls and procedures. The guidance is principles-based and, while issued in 2011, remains relevant today. Accordingly, Chairman Clayton indicated “issuers should consider whether their publicly filed reports adequately disclose information about their risk management governance and cybersecurity risks, in light of developments in their operations and the nature of current and evolving cyber threats. The Commission also will continue to evaluate this guidance in light of the cybersecurity environment and its impacts on issuers and the capital markets generally.” So audit committees should stay tuned in the coming months. Refer to the SEC’s site: **Cybersecurity, the SEC and You** to learn more.

Here are recent tools/materials for use by audit committees in this area:

RECOMMENDED RESOURCES	RELEASE DATE
BDO Archived Webinar: What's on the Minds of Boards?	November 2017
Are You Cyber Aware?: 10 Cybersecurity Questions for Senior Executives	October 2017
Cyber Risk Management: What You Need to Know Now	October 2017
2017 BDO Cyber Governance Survey	September 2017
Breaking Down the Equifax Data Breach	September 2017
BDO Knows Cybersecurity: Petya Cyber Attack	June 2017
BDO Highlights Important DHS - FBI Cyber Alert on North Korea - Hidden Cobra	June 2017
Introducing SOC for Cybersecurity: Translating Cyber Risk For Every Stakeholder	June 2017
The CPA's Role in Addressing Cybersecurity Risk	May 2017
A Cybersecurity Attach of Unprecedented Scale (WannaCry)	May 2017
Cybersecurity Officially Reaches the Board: 12 Questions Every Board Should Ask	April 2017
BDO Knows: Cybersecurity - NY Department of Financial Services Final Cybersecurity Regulation	February 2017

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RECENT REGULATORY APPOINTMENTS

As President Trump's administration got down to work, several significant regulatory appointments were made in 2017. With respect to financial reporting oversight, Jay Clayton was appointed as the new SEC Chairman in May 2017. Late in December, the two open SEC commissioner spots were **confirmed** with the appointment of Hester Peirce (R) and Robert Jackson (D), who will join Chairman Clayton (R), Kara Stein (D), and Michael Piwowar (R) to bring the SEC back to full operation under five commissioners. No more than three of the five commissioners can be from the same political party. For more information on areas of SEC focus refer to BDO's **SEC 2017 Year in Review**.

On December 12, 2017, the SEC **announced** an overhaul of leadership at the PCAOB. William Duhnke III, current Staff Director and General Counsel to the U.S. Senate Committee on Rules and Administration, has been appointed Chairman of the PCAOB, replacing James Doty. Additionally, four new PCAOB board members were appointed: J. Robert Brown, Kathleen Hamm, James Kaiser, and Duane DesParte. They replace the three current board members: Steve Harris, Lew Ferguson and Jeanette Franzel. The fourth PCAOB board seat had been vacated by Jay Hanson since December 2016.

AUDIT COMMITTEE RESPONSIBILITIES TO MAIN STREET INVESTORS

In 2017, leadership within the SEC focused heavily on the protection of "Main Street" investors and "Mr. and Mrs. 401K" which is supported through the audit committee oversight to drive financial reporting integrity. In July, during his first public speech, Chairman Jay Clayton outlined eight guiding principles offering a look into his views on SEC policy-making and its effects on the U.S. economy. He further highlighted several areas where principles are to be put into practice, particularly in areas that affect capital market investors. Refer to BDO's Alert **here**.

Earlier this year, Wes Bricker, the SEC's Chief Accountant, **addressed** the audit committee's "critical role in contributing to financial statement credibility through its oversight and resulting impact on the integrity of a company's culture and internal controls over financial reporting, the quality of financial reporting, and the quality of audits performed on behalf of investors."

His comments spoke to the ways in which the audit committee can promote high quality financial reporting and covered the following key areas:

- Understanding the organization's business operating environment
- Ensuring diversity in the audit committee's composition
- Balancing the audit committee's workload
- Regularly assessing the tone, culture, and strength of the internal control environment
- Emphasizing continuing education
- Overseeing policies, processes, and controls over Non-GAAP and key operational metrics
- Promoting auditor independence and alignment of auditor's interests with those of investors
- Enhancing voluntary audit committee reporting

We will explore certain of these in other sections below. Here are recommended resources:

RECOMMENDED RESOURCES	RELEASE DATE
CAQ and Audit Analytics 2017 Audit Committee Barometer	November 2017
New SEC Chairman Sets Tone for the SEC's Agenda	July 2017
SEC Chief Accountant Speech: Advancing the Role and Effectiveness of Audit Committees	May 2017
CAQ External Auditor Assessment Tool	April 2017
BDO Audit Committee Requirements Practice Aid	January 2017
CAQ Questions on Non-GAAP Measures – A Tool for Audit Committees	June 2016

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RISK MANAGEMENT, DISRUPTORS, AND DISCLOSURES

There are many factors that keep audit committees awake at night as oversight responsibilities continue to broaden. How top-of-mind areas for 2017 including risks, disruptors, and disclosures are being managed within the organization is under close scrutiny. Let's focus on a few:

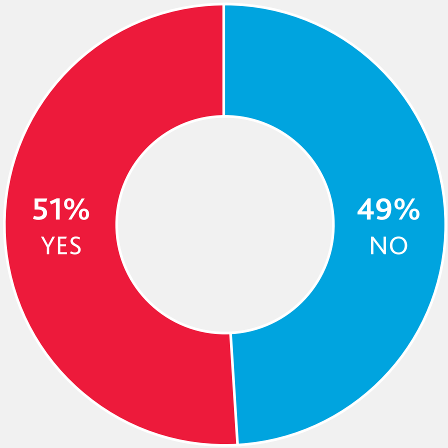
WHISTLE-BLOWING AND ENFORCEMENT TRENDS

The number of whistle-blower tips received by the SEC continues to rise – over 4,484 tips were received in fiscal year 2017; while enforcement actions remain high at 754. Penalties and disgorgements totaled $3.79 billion. When BDO asked corporate directors in 2017 whether the SEC's widely publicized whistleblower bounties have undercut their internal whistleblower/compliance program, only a third (32%) agreed. This is a major shift from BDO's 2012 survey when a slight majority (51%) indicated the SEC's bounty program enacted in 2011 could undermine internal anti-fraud and compliance programs. Attitudes of corporate directors reflect the confidence in compliance programs implemented in recent years and appear to view compliance failures as exceptions that can be used to further educate and reinforce adherence to programs.

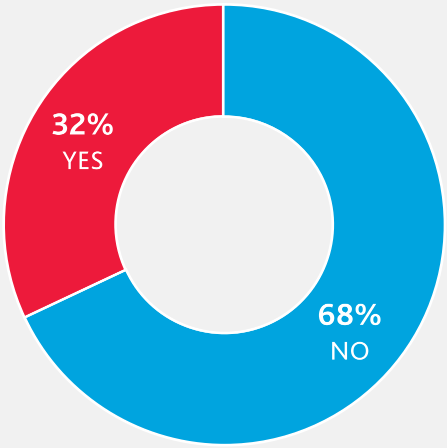
Organizations and capital markets are best served by directors who reinforce their corporate cultures by setting no tolerance expectations for ethical breaches and who demonstrate commitment to such through continual engagement with management and communication to all levels of employees.

However, even organizations with the most robust anti-fraud compliance policies and procedures remain susceptible to fraud. The SEC has encouraged directors, in particular audit committees, to not only support internal whistleblowers and take all claims seriously but also consider the favorability that could result from a company's self-reporting of suspected fraud that is brought to its attention.

2012 Do you feel the "whistle-blower" bounties, enacted by the SEC last year [2011], undermine internal anti-fraud and compliance programs?



2017 Do you feel the SEC's widely publicized whistleblower bounties have undermined internal whistleblower/compliance programs?



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ACHIEVING ENTERPRISE RISK MANAGEMENT

In 2017, COSO released its updated ***Enterprise Risk Management – Integrating with Strategy and Performance Framework***, highlighting the importance of considering risk in both the strategy-setting process and in driving performance. Within the framework are considerations for boards in defining and addressing their risk oversight responsibilities with respect to: governance and culture; strategy, risk appetite and business objective-setting; performance; information; communications and reporting; as well as review and revision of practices to enhance entity performance. This publication is intended to complement the widely used COSO *Internal Control-Integrated Framework* and further help companies in the longer term enhance "enterprise resilience" in the ability to anticipate and respond to change.

EVOLUTION OF VOLUNTARY AUDIT COMMITTEE DISCLOSURES

SEC Chairman Clayton has remarked that "the independent audit committee has emerged as one of the most significant and efficient drivers of value to Main Street investors." As evidenced in the fourth annual ***Audit Committee Transparency Barometer*** produced by the CAQ and Audit Analytics, public companies – small through large – continue to promote encouraging trends with respect to voluntary, enhanced disclosure around external audit oversight.

COMPARISON	LARGE-CAP		MID-CAP		SMALL-CAP	
	2017	2014	2017	2014	2017	2014
Enhanced discussion of AC considerations in recommending the appointment of the audit firm	37%	13%	24%	10%	17%	8%
Disclosure of criteria considered when evaluating the audit firm	38%	8%	28%	7%	27%	15%

Excerpted highlights from the CAQ and Audit Analytics 2017 Audit Committee Transparency Barometer

In 2017, new Chairman of the SEC Jay Clayton **emphasized** his desire to spur capital formation and review the accessibility and meaningfulness of increasing disclosure requirements of public companies. Many have suggested that the public company audit, designed to provide investor confidence that management is accurately portraying the financial reporting for their organizations, remains somewhat of a mystery. Furthermore, with the recent SEC **approval** of the PCAOB's new auditing standard to significantly enhance the auditor's report (see above discussion), audit committees are pondering whether and how this may impact company disclosures in the public filings – particularly those disclosed by the audit committee.

Given complexities in transactions, increasing access to information, rapid pace of change – technology, economic, information, etc. - public demand for more transparency and understanding continues to rise. Regulators, while potentially trying to reduce an already overwhelming disclosure burden, remain focused on the balance for meaningful investor information and consideration of whether such should be mandated.

Those charged with governance can get ahead of the curve now and voluntarily incorporate more insightful disclosures in their public filings. This is a significant opportunity to provide timely and relevant information about the audit process and the related decision-making around this particular area of oversight. It further represents a means for a company to perhaps further differentiate itself from its peers and demonstrate focus on driving audit quality. The increasing illustrations highlighted in the Transparency Barometers may be a good starting point in determining where your organization currently may be positioned and how to further strengthen disclosures in this area.

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NON-GAAP, KEY OPERATING METRICS, AND FORECAST DISCLOSURES

Non-GAAP represented a significant issue in our 2016 Round-Up based on the SEC's activities (e.g., issuance of **Compliance & Disclosures Interpretations (C&DIs)**) aimed at companies the Staff felt were not properly presenting and disclosing information with respect to performance metrics and indicators not subject to the same audit and accounting rigors as financial statement measures that fall under GAAP and GAAS. In a review by Audit Analytics of the **top SEC comment letter issued in the first half of 2017**, non-GAAP financial measures (e.g., EBIT, EBITDA, etc.) received the highest number of letters impacting over 300 registrants.

SEC Chief Accountant Bricker further **reminded** financial reporting professionals that companies should proactively and thoughtfully address risks to their corporate reporting beyond financial statements. In addition to non-GAAP financial metrics, key operating metrics and forecasts may be "distorted via bias - for example, painting a potentially misleading picture – error, or fraud, all of which undermine the credibility of the reporting."

Companies, inclusive of the audit committee, need to:

- Understand the other information being reported , including how metrics are defined;
- Have adequate disclosure controls and procedures in place to report such metrics; and
- Determine whether it would be beneficial to obtain insight into their other reporting processes from outside the finance and investor relations functions.

During the December 2017 AICPA Conference, sentiments expressed by SEC Staff indicated that the SEC was seeing improvement in this area but urged companies not to take their foot off the gas. Similarly, in their own remarks, the PCAOB Staff indicated that they are receiving encouragement from the PCAOB Investor Advisory Group (IAG) and the Standing Advisory Group (SAG) to move forward with making the auditor's responsibilities for non-GAAP measures more rigorous than the current requirements.

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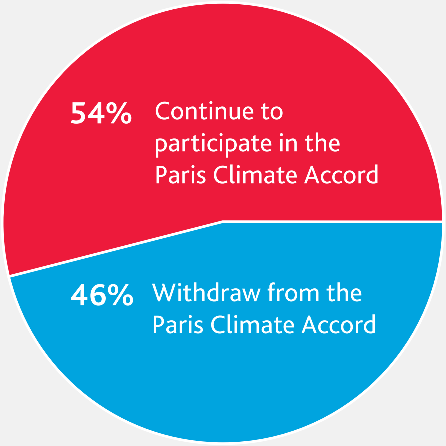
SUSTAINABILITY REPORTING

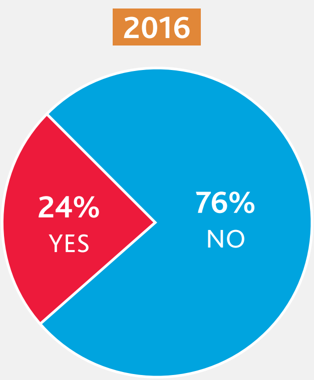
Environmental, social, and governance ("ESG" or "Sustainability") reporting is gaining international favor, particularly as **Directive 2014/95/EU** becomes law of the land as mandatory reporting for certain companies in Europe. ESG is broadly encompassing and extends beyond the "go green" campaigns that many are already familiar with. This initiative got center stage earlier this year when President Trump announced that the U.S. would withdraw from the Paris Climate Accord on climate change mitigation due to the unfavorable competitive positioning the current accord would result in for many of our U.S. companies that transact globally. However, BDO's recent **2017 Board Survey** found that a majority of directors (54%) were opposed to President Trump's position. Many companies are seeing the value in such initiatives in recognition of the corporate responsibilities that shareholders and other stakeholders are holding them accountable to.

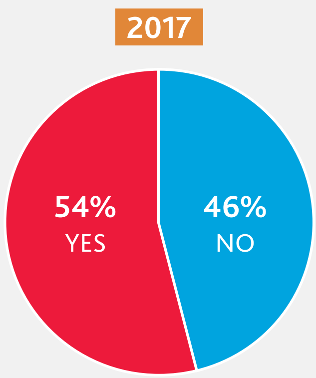
Corporate directors indicated that disclosures regarding sustainability matters (e.g., climate change, corporate social responsibility, etc.) are important to understanding a company's business and helping investors make informed investment and voting decisions. More and more larger, global companies are issuing voluntary disclosures as to how their organizations are promoting good policies and practices that benefit society. The **Global Reporting Initiative (GRI)** has been a significant driver and has now issued uniform **standards** (superseding previous G4 guidelines) as a framework for companies to consider in issuing standardized disclosures regarding their critical impacts on the environment, society, and the economy.

Earlier this year, numerous businesses were critical of President Trump's decision to leave the Paris Climate Accord. From your perspective, what should the U.S. have done?



Do you believe disclosures regarding sustainability matters (e.g. climate change, corporate social responsibility, etc.) are important to understanding a company's business and helping investors make informed investment and voting decisions?





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AUDIT QUALITY AND THE AUDIT AND AUDIT COMMITTEE OF THE FUTURE

AUDIT OF THE FUTURE

Prior sections have addressed many of the current audit standard-setting activities of the PCAOB and oversight of the SEC in promoting audit quality. Many regulators are making forward-looking statements about the evolution of the audit and the need for standard-setting to keep pace with advances in technologies, methodologies, and auditing procedures. The "Audit of the Future" is being shaped by many factors. One of which pertains to the increased use by audit firms of data analytical approaches to auditing. Audit firms, including **BDO**, are actively developing emerging technologies with applications to enhance the audit process and risk assessment procedures to account for evolving technologies including distributed ledgers or blockchain, artificial intelligence, and machine learning, among others. The PCAOB's SAG has **announced** the formation of a task force with the purpose of helping the PCAOB "stay at the front end of these emerging developments."

AUDIT COMMITTEE OF THE FUTURE

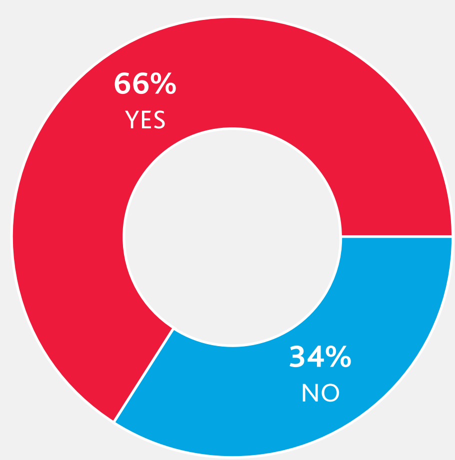
In addressing market demands for high quality audits and governance oversight of the integrity of financial reporting, how should the audit committee continue to improve? In 2016, the CAQ and the University of Delaware's John L. Weinberg Center for Corporate Governance convened an expert panel to **explore** the composition of the audit committee of the future. Key discussions focused on:

- Expertise and knowledge of financial accounting and reporting – ensuring the audit committee truly has one or more financial experts that not only ask good questions but have the ability to assess and respond to responses of management, the auditors and others.
- Enhancing voluntary audit committee disclosures (see discussion above) – improving communications around audit committee composition, expertise, and attributes may be an important impetus in addressing potential gaps in knowledge and experience needed.
- Fostering robust communication and engagement – encouraging functional and healthy internal communication channels exist to drive audit committee engagement.
- Prioritizing continuing education – growing complexities necessitate continuing education for all board of directors, particularly audit committees.
- Addressing the "kitchen sink" challenge – maintain the focus of the audit committee on financial reporting. Leverage and annually assess audit committee charters and needs for special committees of the board, where necessary. Balance this with "**overboarding**" risk and monitor the number of other board obligations audit committee members may be carrying.

Performing robust board assessments and evaluations in conjunction with highlighting organizational risks and opportunities identified are strongly encouraged of audit committees to ensure that existing skills and attributes of current audit committee members can be aligned with strategy and any gaps identified from this process can be timely addressed. Equally important is analyzing the engagement and interactions of the directors themselves. Succession planning and **driving diversity in thought of directors** can be critical for organizations to strike the right balance in the boardroom.

The 2017 BDO Board Survey indicated that there likely remains room for improvement for boards to proactively address the issue of board diversity:

Do you believe your board is proactively addressing the issue of board diversity?



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PCAOB AUDITOR INSPECTIONS

Late in 2017, the PCAOB issued a **Staff Inspection Brief** previewing the results of the 2016 public company audit inspections. Several recurring areas of audit deficiencies were highlighted including:

- Auditor's assessment and response to risks of material misstatement – e.g., where the auditor failed to perform a test of details specifically responsive to fraud and other significant risks
- Internal control over financial reporting (ICFR) - most frequently noted were insufficient testing of the design and operating effectiveness of selected controls, particularly those with a review element.
- Accounting estimates, including fair value measurements – e.g., instances where auditors did not fully understand how management developed certain estimates or did not sufficiently evaluate management assumptions. These were frequently noted with respect to goodwill impairment analysis and valuations of assets and liabilities acquired in business combinations.

In **comments** delivered during the recent AICPA SEC and PCAOB Conference, PCAOB Chief Auditor Martin Bauman indicated that "auditing accounting estimates has proven challenging for auditors… the proposed standard [see discussion below] should prompt auditors to be more diligent and skeptical as they face those challenges, which can improve audit quality…"

In August, the PCAOB had provided a forward-looking **Staff Inspection Brief** on its ongoing 2017 inspections outlining key areas of focus including:

- Audit areas where inspectors have identified deficiencies in the past, such as assessing and responding to risks of material misstatement
- Audit areas affected by recent economic developments, including the high rate of merger and acquisition activity and fluctuations in oil and natural gas prices
- Financial reporting areas that require significant judgment, including going concern considerations and income tax disclosures
- An audit firm's compliance with new transparency rules (Form AP)
- Preparation for new accounting standards for revenue recognition and lease accounting
- Work by other auditors on multinational audits
- The auditor's use of information technology, particularly software audit tools
- The audit firm's system of quality control, including emphasis on audit quality, professional skepticism, risk management, training and workload balance, as well as inspection remediation

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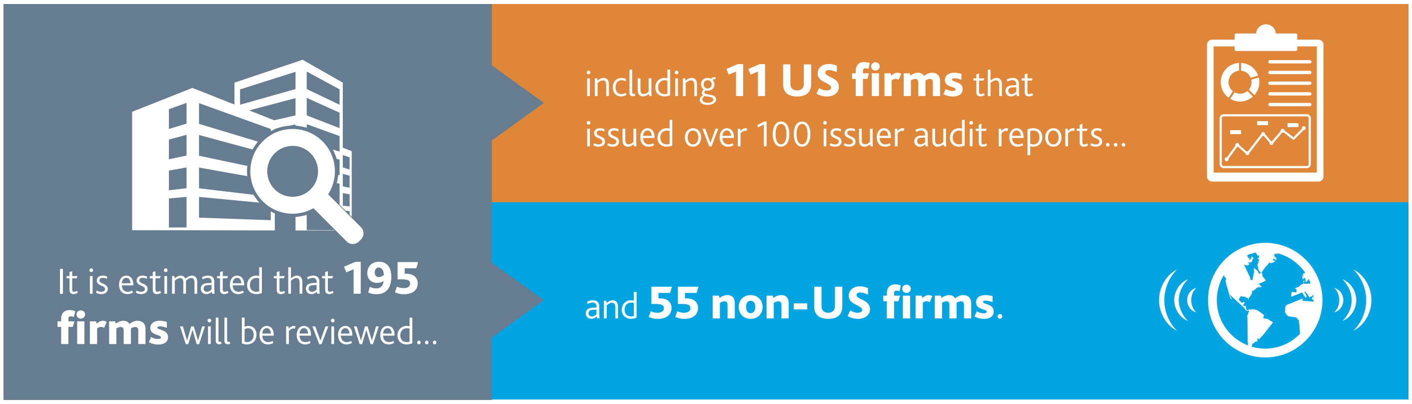

Additional areas that are likely to be emphasized by the PCAOB in the coming audit inspection cycles will be the adoption of new accounting and auditing standard requirements. For 2018, these include FASB ASC 606 on revenue recognition and changes to the auditor's report under PCAOB AS 3101, as amended. The PCAOB will likely also be inquiring as to what auditing firms are doing to prepare for reporting on CAMs beginning in 2019. Further, under the PCAOB's awaited auditing guidance on the auditors use of specialists, the PCAOB will be similarly interested in auditor oversight enhancements to related processes and policies with respect to supervising others engaged in the audit. Refer to discussions elsewhere in this document.

On the technology front, as cyber-attacks continue to grow in frequency and scale, the PCAOB will likely be increasing interest in what audit firms are doing to protect confidential and sensitive client information from cyber risk. Furthermore, within various in speeches and announcements, the PCAOB is designing activities and making investments to remain abreast of the rapid pace of digital change affecting the use of data and technology in audits. Understanding how audit firms' development efforts and design and deployment of new audit tools and technologies will be increasingly important to inform the PCAOB as to relevant adjustments and enhancements that may be needed to current standard setting and guidance to address risk and opportunity.

Other significant areas of PCAOB attention during 2018 inspections will include: quality control systems of audit firms; impact of economic trends, natural disasters, and policy changes; and multinational audits. For further insight, refer to various December 2017 speeches by current PCAOB Board members and Staff available **here**. Each of the areas outlined above should remain important topics of conversation among auditors, management, and the audit committee as they plan and execute the audit.

BDO encourages audit committees to have continuing dialogue with their auditors about the PCAOB inspection process and whether audit deficiency observations by the PCAOB inspections staff have the potential to manifest themselves within the organization's system of internal controls.

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OTHER NEW AND PENDING PCAOB AUDITING STANDARDS

FORM AP RULES

Effective in 2017 were new PCAOB rules requiring registered audit firms to submit a new Form AP, *Auditor Reporting of Certain Audit Participants*, to disclose the names of engagement partners and other accounting firms that participated in audits of public companies. The PCAOB has indicated that over 13,000 Forms AP have been filed through November 2017 and these are being made available within the ***Auditor Search Database*** accessible from the PCAOB's website. Information provided can be used by companies and investors to determine certain data points about audit firms, including what types of audits an engagement partner is involved in – number of engagements, size, industry, etc. Additionally, the breadth of participation in certain audit engagements by other firms may inform users of such information about the extent of oversight responsibilities for the lead auditor. See related discussion on the pending PCAOB standard on supervision.

PCAOB PROPOSED AUDITING STANDARDS

Promotion of audit quality remains a constant theme for activities being undertaken by the PCAOB. Two proposals issued in June 2017 are being developed in tandem: **auditing accounting estimates** and the **auditor's use of the work of specialists**. These projects largely stem from the rise in frequency and significance of the use of fair value measurements and other accounting estimates and the increased for expertise in this areas. This combined with the continued identification of significant deficiencies during PCAOB audit inspections has increased attention by the PCAOB in each of these related areas.

AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements, and Related Amendments*

The proposed single standard would strengthen existing requirements by prompting a risk-based and skeptical approach to auditing management accounting estimates while addressing potential management bias and promoting skepticism. The proposed standard can be accessed **here** and a fact sheet that summarizes the main provisions of the proposed standard can be accessed **here**. The comment period for this standard is closed.

AS 1210, *Using the Work of an Auditor-Engaged Specialist*

The proposed standard and related amendments to existing standards are intended to further investor protection by calling for auditors to devote more attention to areas of the audit where a specialist's work is used. It is intentionally aligned with the PCAOB's risk assessment standards through a risk-based approach to supervising and evaluating the work of both auditor-employed and auditor-engaged specialists.

The proposed changes may improve the auditor's ability to detect material misstatements in the financial statements and promote an improved, uniform approach to the supervision of an auditor's specialists. The proposed amendments can be accessed **here** and a fact sheet that summarizes the main provisions of the proposed amendments can be accessed **here**. The comment period for this standard is closed.

In commentary offered during the December 2017 AICPA SEC and PCAOB Conference, PCAOB board members and leaders indicated that the PCAOB was close to issuing final standards on both of these proposals in 2018.

For more information and educational opportunities on these and other topics related to audit committee oversight, please visit **BDO's Center for Corporate Governance and Financial Reporting**.

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