Provided Courtesy Of
URISH POPECK
accountants and consultants

JANUARY 2014
www.bdo.com

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: SEC

CONTENTS

click a topic for details

SEC YEAR IN REVIEW

SIGNIFICANT 2013 DEVELOPMENTS

Entering 2013, the outlook for the Securities and Exchange Commission's activities was uncertain. It was unclear how long the designated Chair, Elisse Walter, would remain in her position. The fifth seat on the Commission was unfilled, the Commission was split politically with two Democrats and two Republicans and it was deeply divided on certain issues. That changed in April when Mary Jo White became the 31st Chair of the SEC.

Chair White arrived with a strong focus on addressing the backlog of rulemaking required by the Jumpstart Our Business Startups (JOBS) Act of 2012 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This dominated the Commission's agenda in the second half of 2013. In July, the SEC finalized a JOBS Act rule to eliminate the prohibition on general solicitation and general advertising in certain private offerings if all of the participating investors are accredited investors or qualified institutional buyers. At that time the Commission also proposed companion rules that would require issuers to provide additional information about these offerings to better enable the Commission to monitor market practices now that the ban has been lifted. In October, the Commission addressed another JOBS Act requirement by proposing rules to permit crowdfunding, a process designed to facilitate capital raising by exempting issuers raising $1 million per year or less from the standard SEC registration process. In December, the Commission proposed amendments to Regulation A to implement another JOBS Act requirement intended to facilitate capital raising. The proposed amendments would establish a streamlined process

Read more

by which a private company could publicly offer and sell up to $50 million of securities in a twelve-month period if it complies with certain reporting requirements.

The Commission devoted substantial attention to implementing provisions of the Dodd-Frank Act as well. It adopted final rules requiring the registration of municipal advisors and disqualifying felons and other "bad actors" from participating in certain exempt offerings. And in September, the SEC proposed the long-awaited and controversial pay ratio rule, which would require registrants to determine and publicly disclose a ratio comparing the annual compensation of the median employee to the annual compensation of the CEO. Like the conflict minerals and resource extraction issuer rules adopted in 2012, the SEC proposed the pay ratio disclosure rule to comply with a Congressional requirement to use SEC reporting as a tool to accomplish social policy objectives. Effectuating social policy change is seen by many as being outside the scope of the SEC's mission, which is to protect investors, facilitate capital formation and ensure fair and orderly markets. As a result, the Commissioners have been deeply divided in their views about whether the benefits of these rules outweigh their costs. In an October speech, Chair White spoke about this issue, explaining why this approach impairs the SEC's ability to best shape disclosure rules consistent with federal securities laws and asking Congress and the courts to respect the need for the SEC to be independent to accomplish its core mission.

As we noted in our 2012 SEC year in review publication, a group of business associations filed lawsuits to overturn the conflict minerals and resource extraction issuer disclosure rules. In July, a federal judge vacated the resource extraction issuer rule; consequently, issuers need not comply with the rule. As the payments information is required by the Dodd-FrankAct, the SEC plans to rewrite and re-propose the rule. Conversely, a federal judge upheld the conflict minerals rule and issuers should continue with their compliance preparations as the first reports, which cover the 2013 calendar year, are due by May 31, 2014. During 2013, the SEC staff issued interpretive guidance in the form of FAQs to assist registrants with applying the conflict minerals rule.

In 2013, the SEC's Advisory Committee on Small and Emerging Companies continued to provide recommendations to the Commission regarding capital formation by small businesses and small publicly traded companies. Last year, the Advisory Committee made a number of recommendations that Congress subsequently implemented by reflecting them in the JOBS Act. While the SEC has yet to act on any of the recommendations made in 2013, the Commission values the Advisory Committee's advice and renewed its term for another two years.

In addition to providing conflict minerals interpretive guidance, the staff issued other guidance throughout the year to assist registrants and others with interpreting and complying with the SEC's rules and regulations. Specifically, the staff:

- Updated its Compliance and Disclosure Interpretations (C&DIs);
- Updated the Financial Reporting Manual (FRM) four times;
- Issued new Corporation Finance Disclosure Guidance (CF Disclosure Guidance); and
- Issued several small business compliance guides covering new rules adopted to implement the JOBS Act.

Several changes took place among the commissioners and staff during 2013. Chair White was originally appointed to complete the term of her predecessor, which ends in 2014. In August, the Senate extended her appointment for a full five year term that ends in 2019. In addition to Chair White's appointment, two new Commissioners were sworn in during 2013. Kara Stein replaced Commissioner Walter and Michael Piwowar replaced Commissioner Parades. Several open staff leadership positions were filled during the year. Shortly after her appointment in April, Chair White named two new Co-Directors of the Division of Enforcement, George Cannellos (the previous Acting Director) and Andrew Ceresney. In May, Keith Higgins was named Director of the Division of Corporation Finance and in October, Mark Kronforst was named Chief Accountant in the Division of Corporation Finance and Daniel Murdock was named a Deputy Chief Accountant in the Office of the Chief Accountant.

Looking forward to 2014, rulemaking to implement the JOBS Act and Dodd-Frank Act is expected to continue to dominate the Commission's agenda. A related issue the Commission plans to address is possible "information overload" which may result from detailed and lengthy disclosures in SEC filings. In December, the staff completed a study of the disclosure requirements of Regulation S-K that was mandated by the JOBS Act. The purpose of the study was to determine how the offering registration process can be simplified and costs can be reduced for emerging growth companies. Chair White has stated that the study "provides a framework for disclosure reform," and directed the staff to develop recommendations for updating the SEC's disclosure rules in order to improve the disclosure regime for both companies and investors. While higher priorities prevented the Commission from making progress in 2013 on its decision whether, and if so, how and when, to incorporate International Financial Reporting Standards into financial reporting by domestic issuers, the Commission hopes to turn its attention to this issue in 2014 and provide some clarity. With a major new accounting standard on revenue recognition expected to be issued in the first quarter of 2014, the staff is beginning to focus on issues related to implementing the new standard. The staff has begun

▶ Read more

discussing the application of Staff Accounting Bulletin No. 74 (codified in SAB Topic 11-M);[1] Paul Beswick, the SEC's Chief Accountant, has indicated that that the disclosure of the expected effects of applying the new standard should evolve over time and that registrants should disclose their transition method as soon as one is elected. The staff will also need to address issues such as whether registrants that adopt the new standard retrospectively must do so for all periods presented in selected financial data tables.

This publication summarizes 2013 Commission and staff activities that affect financial reporting. We discuss rulemaking to implement legislation first, followed by staff guidance provided during 2013. While not the focus of this publication, we also briefly discuss the new COSO framework for evaluating the effectiveness of internal control over financial reporting and the PCAOB's 2013 standards setting and related activities.

IMPLEMENTING LEGISLATION

PAY RATIO DISCLOSURE

(Release No 33-9452)

In September, the SEC proposed a rule required by Section 953(b) of the Dodd-Frank Act. The proposal would amend Item 402 of Regulation S-K and require issuers to disclose the following:

- The median annual total compensation of all employees except the chief executive officer;
- The annual total compensation of the CEO; and
- The ratio of the median annual total compensation of all employees to the annual total compensation of the CEO.

These disclosures are collectively referred to as the "pay ratio" disclosures.

The pay ratio disclosures would be required in any annual report, proxy, or registration statement that requires disclosure of executive compensation pursuant to Item 402 of Regulation S-K. However, emerging growth companies, smaller reporting companies, foreign private issuers filing on Form 20-F, and Multijurisdictional System filers would be exempt from the requirements. In addition, companies filing initial registration statements would not be required to provide the pay ratio disclosures, and a newly public company would first be required to provide them for the year that commences after the date on which it became subject to Exchange Act reporting.

Under the proposal, a registrant would be required to (1) identify the employee whose annual total compensation level is the median of all of its employees except its CEO, (2) compute the median employee's total compensation, and (3) compute a ratio in which the median employee's total compensation is equal to 1 and the CEO's total compensation is a calculated number. For example, if the of the median employee's total compensation is $45,790 and the CEO's total compensation is $12,260,000, then the pay ratio disclosed would be "1 to 268". The ratio could also be expressed narratively, such as "the CEO's annual total compensation is 268 times that of the median of the annual total compensation of all employees". The median employee is to be identified using the annual total compensation of all persons, including all U.S. and non-U.S. full-time, part-time, seasonal, and temporary workers, employed by the registrant and its subsidiaries as of the last day of the registrant's fiscal year.[2] The individual compensation amounts used to identify the median employee may be annualized for permanent employees who were employed for less than the full fiscal year. Such amounts for seasonal and temporary workers may not be annualized. Similarly, such amounts for part-time workers may not be adjusted to the full time equivalent amount. The proposal allows registrants to identify the median employee in a variety of ways. For example, a registrant is permitted to analyze its entire employee population or use a statistical sampling methodology. Moreover, the median employee can be determined using a consistently applied compensation measure (e.g. amounts derived from the registrant's payroll or tax records), rather than each employee's total compensation. Once the median employee is identified, that person's total compensation pursuant to Item 402(c)(2)(x)[3] must be calculated and disclosed.

In addition to the pay ratio disclosures described above, the proposal would also require disclosure of the methodology and material assumptions and estimates used to identify the median or determine the compensation amounts.

1 SAB 74 addresses disclosure of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period.

2 Independent contractors and leased employees are not included in this population.

3 Total compensation per Item 402(c)(2)(x) includes salary, bonus, the aggregate grant date fair value of options or stock awarded during the period, earnings for services performed under non-equity incentive plans and all earnings on any outstanding awards, certain amounts related to defined benefit and actuarial pension plans, and any other compensation not included in the aforementioned categories.

Read more

The SEC has proposed that an issuer report the pay ratio disclosures for its first fiscal year commencing on or after the effective date of the final rule. For example, if the final requirements were to become effective in 2014, a registrant with a fiscal year ending on December 31 would be first required to include pay ratio information relating to compensation for fiscal year 2015 in its proxy or information statement for its 2016 annual meeting of shareholders and to include or incorporate by reference this information in its 2015 Form 10-K.

The proposing release is available *here* on the SEC's website.

BDO OBSERVATIONS:

The comment period ended on December 2nd and the Commission now needs to analyze the comment letters (including thousands of form letters) that were received. The proposal generated significant interest among some of the nation's largest companies, who question whether the disclosure will provide investors with meaningful and accurate information. The determination of a global median employee could be an arduous task for large multi-national companies and some have questioned whether including non-U.S. employees is appropriate as they may be compensated through non-traditional methods which would not be included in the definition of compensation. Some have also expressed concern that the inability to annualize the compensation of part-time or seasonal workers will artificially skew the ratio, particularly for those companies that depend on such workers near year end.

DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS

In July, a federal judge vacated the resource extraction issuer rule (Exchange Act Rule 13q-1) the SEC had adopted in 2012, which would have required resource extraction issuers to disclose information about certain payments made to the United States government or foreign governments. [4] Reporting was originally required for resource extraction issuers with fiscal years ending after September 30, 2013. The judge ruled that the SEC misread Section 1504 of the Dodd-Frank Act to require public disclosure of such information primarily because the statute does not use the word "public" to describe the disclosure and reporting requirements. He also noted that the SEC's decision to deny any exemptions from the rule was "arbitrary and capricious." In September, the SEC confirmed that it will not appeal the court's decision. Instead, it plans to rewrite and re-propose the rule.

BDO OBSERVATIONS:

The judge's ruling follows a lawsuit filed last October by the American Petroleum Institute, the U.S. Chamber of Commerce and two other business groups seeking to overturn the rule. These groups argued that public disclosure of such information would provide valuable secrets to competitors. The lawsuit also claimed that the SEC exceeded its authority when it adopted the rule and that it ignored companies' suggestions for limiting the rule's cost. Given the focus of the ruling on the public disclosure aspect of the rule, some have speculated that an option for the SEC that would be consistent with the spirit of the Dodd-Frank Act might be to adopt a rule requiring confidential disclosure of payment information to the SEC. The SEC could then aggregate the payment data and disclose the aggregated data publicly.

AMENDMENTS TO REGULATION A

(Release No 33-9497)

In December, the SEC proposed rule amendments required by Title IV of the JOBS Act. The proposed rules are intended to increase access to capital for smaller companies. The SEC proposed amendments to Regulation A to establish a streamlined process by which a private company could offer and sell up to $50 million of securities in a twelve-month period if it complies with certain reporting requirements. Currently, Regulation A permits an exemption from the registration process for public offerings by private companies of up to $5 million of securities in a twelve-month period. The offering document need not include audited financial statements but is subject to SEC staff review, as well as state-level registration and qualification requirements. Very few offerings have been made pursuant to Regulation A. A U.S. Government Accountability Office study identifies the costs and complexity of state law compliance as one of the reasons for this.

4 Refer to the BDO Flash Report *here* for a summary of the rule.

▶ Read more

The proposed amendments to Regulation A would create two tiers of offerings:

- Tier 1 – A revised version of the current Regulation A, Tier 1 would permit offerings of up to $5 million in a twelve-month period.
- Tier 2 – This new tier would permit offerings of up to $50 million in a twelve-month period. Investors in Tier 2 offerings would be limited to purchasing no more than 10% of the greater of their net worth or annual income. State securities law requirements would be preempted for these offerings.

Companies could elect to use Tier 1 or Tier 2 for offerings up to $5 million. Current SEC-reporting companies, certain investment companies, and other companies with no specific business purpose other than to acquire an unidentified company (among others) would not be eligible to use Regulation A. Tier 2 offerings would be subject to additional reporting requirements. For example, the Tier 2 offering documents would need to include audited financial statements. Additionally, after selling securities in a Tier 2 offering, companies would be required to file annual and semiannual reports and current event updates with the SEC, similar to the public company reporting requirements.

The proposal is subject to a 60-day comment period. The proposing release is available *here* on the SEC's website.

STAFF GUIDANCE

Some of the SEC staff guidance discussed below was provided during meetings held in 2013 with the Center for Audit Quality's SEC Regulations Committee. Minutes of those meetings can be found *here* on the CAQ's website.

JOBS ACT

In 2013, the staff provided interpretive guidance regarding certain aspects of the reporting relief made available to emerging growth companies under the JOBS Act. This guidance addresses the following topics:

1) The JOBS Act permits emerging growth companies to elect to defer adopting new or revised accounting standards until the time they are required to be adopted by nonpublic companies. The election to adopt new standards on a deferred basis applies only to standards that are issued after April 5, 2012 and apply to nonpublic companies. If an emerging growth company elects to follow public company adoption dates, that election applies to all new standards and is irrevocable.

   The SEC staff was asked how this aspect of the Act applies when (a) an emerging growth company has elected to adopt new accounting standards on a deferred basis, (b) a new accounting standard has been issued that applies to both public and nonpublic companies and (c) the new standard permits early adoption by nonpublic companies.[5] The staff was asked whether, in this situation, an emerging growth company that adopts the new accounting standard before nonpublic companies are required to adopt it would lose its ability to adopt other new accounting standards on a deferred basis. The staff communicated that as long as the new accounting standard permits early adoption by nonpublic companies, an emerging growth company may adopt the standard early without losing the ability to adopt other new standards using nonpublic company effective dates.

2) An emerging growth company is permitted to submit its IPO registration statement with two years of audited financial statements (in lieu of the three years of audited financial statements usually required). If an emerging growth company elects to present only two years of audited financial statements, FAQ 16 of the staff's frequently asked questions about Title I of the JOBS Act (available *here*) states that the emerging growth company is also permitted to present only two years of audited financial statements for acquired businesses and equity method investees under Rules 3-05 and 3-09 of Regulation S-X, respectively.

   In the March CAQ Regulations Committee meeting, the SEC staff clarified that an emerging growth company can present two years of audited financial statements for an acquired business or equity method investee, even if the emerging growth company voluntarily presents three years of its financial statements in its IPO registration statement.

For further information and implementation guidance on the JOBS Act, refer to our *BDO Knows: SEC 2012 Year in Review* publication available *here*.

5 An example of such a standard is ASU 2013-2, *Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income.*

Read more

CONFLICT MINERALS REPORTING

In May, the SEC staff issued a set of frequently asked questions to assist companies with the application of Exchange Act Rule 13p-1, which requires companies to determine and publicly disclose on an annual basis their use of conflict minerals from the Democratic Republic of the Congo (DRC) or adjoining countries.[6] The FAQs also provide guidance related to reporting under Item 1.01 of Form SD, which was created for the purpose of reporting information required by Rule 13p-1 and the rule requiring disclosure of payments to governments by resource extraction issuers. The FAQs can be accessed *here*.

A number of the FAQs clarify which issuers are subject to the rule, including the following:

- The rule applies to all SEC-reporting companies, including voluntary filers (registered investment companies are excluded).
- Issuers that mine conflict minerals and only engage in activities customarily associated with mining are exempt from the rule.
- An issuer's consolidated subsidiaries are subject to the rule. Accordingly, issuers must determine whether their consolidated subsidiaries manufacture or contract to manufacture products containing conflict minerals.
- Issuers that simply etch their logo onto a generic product manufactured by a third party are not considered to have "contracted to manufacture" the product.
- Issuers must conduct a reasonable country of origin inquiry for conflict minerals contained in the generic components of the products that they manufacture or contract to manufacture (i.e., it does not matter that the issuer did not manufacture or contract to manufacture the generic component of the product).

Other questions assist issuers with the determination of whether reporting is required for conflict minerals contained in the packaging for or equipment/tools used to manufacture the issuer's products:

- Packaging is not considered to be necessary to the functionality of the product. Therefore, if a conflict mineral is only found in the packaging for an issuer's product, the product is not considered to have a conflict mineral necessary to its functionality. However, if an issuer's packaging is also sold independent of the product, the packaging is considered to be a product.
- Issuers that manufacture or contract to manufacture equipment that they will use in providing a service are not required to file Form SD even if the equipment may contain conflict minerals. For example, issuers that operate cruise lines and manufacture or contract to manufacture cruise ships are not required to file Form SD.
- Issuers that manufacture or contract to manufacture tools, machines, or other equipment that are used to manufacture the issuer's products are not required to file Form SD regarding the use of conflict minerals in the tools, machines, or other equipment.

Finally, there are also questions which address certain aspects of an issuer's reporting obligations under the rule:

- If an issuer has manufactured or contracted to manufacture products that "have not been found to be 'DRC conflict free'" or are "DRC conflict undeterminable," it must explicitly state this in the Conflict Minerals Report (CMR) filed with Form SD. The products which fall into one of these two categories must be described in terms commonly understood in the industry (model numbers are not required).
- Issuers that determine the products they manufacture or contract to manufacture contain conflict minerals from the DRC or an adjoining country but are 'DRC conflict free' are still required to file Form SD and obtain an independent audit of the CMR. However, certain disclosures called for by Form SD and the CMR may be omitted.
- Newly public issuers are not required to begin reporting on Form SD until the first calendar reporting year that begins no sooner than eight months after the effective date of an initial public offering registration statement.
- An issuer that fails to timely file Form SD regarding conflict minerals does not lose its eligibility to use Form S-3.

BDO OBSERVATIONS:

In October 2012, the National Association of Manufacturers, the Business Roundtable and the U.S. Chamber of Commerce asked the U.S. District Court for the District of Columbia to modify or set aside in whole or in part the SEC's conflict minerals rule on the basis that the rule is overly burdensome, unworkable, and ineffective. In July 2013, a federal judge rejected the challenge. The case is now pending before the Court of Appeals and the outcome of the appeal is uncertain. Regardless, with the first conflict minerals reports due on May 31, 2014, SEC-reporting companies should continue with their compliance preparations.

6 Refer to the BDO Flash Report *here* for a summary of the rule. The rule is available *here*.

▶ Read more

RULE 3-09 REPORTING MATTERS

Significance of Equity Method Investees – Effect of Retrospectively Applied Change in Accounting Principle

Section 2410 of the FRM provides guidance to registrants measuring the significance of their equity method investees under Rule 3-09. Under Rule 3-09, audited financial statements of an equity method investee are required if the investee is significant at the 20% level under either the investment or pretax income test in Rule 1-02(w) of Regulation S-X.

In October, paragraph 2410.8 was updated to clarify that the effect of a retrospectively applied change in accounting principle should be treated in a similar manner to the effect of a discontinued operation for purposes of calculating significance. If a registrant discontinues an operation or retrospectively applies a change in accounting principle subsequent to the filing of its Form 10K, the significance of an equity method investee in a subsequently filed registration statement should be measured based on the historical financial statements included in Form 10-K (not the financial statements that reflect the retrospective presentation of the discontinued operation or application of the change in accounting principle). However, an investee's significance in prior years will need to be remeasured using the revised prior year financial statements when the next Form 10-K is filed. This could cause a registrant to need to provide audited investee financial statements that it did not previously need to provide and vice versa.

Additionally, the guidance clarifies that Rule 3-09 financial statements are not required in the Form 10-K for the year that an equity method investment is disposed of if the equity method investment is not significant for any of the registrant's fiscal years presented in Form 10K (including the year of disposal), measured using the financial statements that have not been retrospectively adjusted to give effect to the discontinued operation or change in accounting principle.

Presentation of Rule 3-09 Financial Statements for Entities with Different Fiscal Year Ends

Under Rule 3-09 of Regulation S-X, financial statements of an equity method investee are required if the investee is significant at the 20% level under either the investment or pretax income test in Rule 1-02(w) of Regulation S-X. In some cases, an equity method investee may have a different fiscal year end than the registrant. When the fiscal year end of an equity method investee differs from that of the registrant, the registrant may question which fiscal year of the investee represents its most recent fiscal year for purposes of complying with Rule 3-09, particularly when the fiscal year ends differ by six months. In March, the SEC staff clarified that the registrant may present either the investee's financial statements for the fiscal year ending prior to the registrant's year end, or the investee's financial statements for the fiscal year ending after the registrant's year end. For example, for a registrant with a December 31, 2012 year end and an equity method investee with a June 30 year end, financial statements of the equity method investee may be presented as of and for the year ending June 30, 2013 or June 30, 2012. The selected approach should be applied consistently and on an investee by investee basis. Additionally, either approach is acceptable even if the registrant recognizes the equity in earnings on a lag basis.

Rule 3-09 "Grace Period"

In accordance with Rule 3-09, the financial statements of a private equity method investee (that does not meet the definition of a foreign business) should be filed within 90 days of the investee's fiscal year end, but are not required to be filed before the due date of the registrant's Form 10-K. The investee's financial statements may be filed by amendment to the registrant's Form 10-K if they are due subsequent to the due date of the registrant's Form 10-K. The period between the due date of the registrant's Form 10-K and the due date of the investee's financial statements is commonly referred to as the annual report "grace period." In March, the SEC staff clarified that the annual report grace period for filing equity method investee financial statements does not extend to a registration statement (i.e. Form S-1, S-3, S-4, S-11), even if the registration statement incorporates Form 10-K by reference. Therefore, when a registrant is preparing a registration statement during the annual report grace period, it may be required to file the equity method investee financial statements earlier than would otherwise be required. The staff indicated that it is still thinking about how this guidance applies to automatic shelf registration statements and Form S-8.

RULE 3-10 REPORTING MATTERS

Impact of Changes in the Guarantor Structure on Condensed Consolidating Financial Information

Every issuer of a registered security and every guarantor of a registered security must file financial statements required by a registrant pursuant to Rule 3-10 of Regulation S-X. However, if certain conditions are met, Rule 3-10 permits a registrant to present condensed

▶ Read more

consolidating financial information in a footnote to its financial statements in lieu of filing separate financial statements for each subsidiary issuer or guarantor. At the March CAQ SEC Regulations Committee meeting, the SEC staff discussed its views about how to appropriately reflect the following events in the condensed consolidating financial information:

1) ***Transfers of businesses within a consolidated group*** – typically, transfers of businesses within a consolidated group are transactions between entities under common control. Under U.S. GAAP, the transferee reflects the business received retrospectively, but the transferor does not remove the business transferred retrospectively. However, the staff believes that the most meaningful and appropriate approach is to reflect transfers of businesses retrospectively in the transferor and transferee columns in the condensed consolidated financial information. For example, if a subsidiary guarantor transfers a business to a subsidiary non-guarantor in a particular period, the transferred business should be reflected in the non-guarantor column for all periods presented.

2) ***Transfers of assets within a consolidated group*** – transfers of assets are recorded prospectively under U.S. GAAP. Accordingly, transfers of assets within a consolidated group should also be reflected prospectively from the date of the transfer.

3) ***Changes in the composition of guarantors and non-guarantors*** – changes in the subsidiaries designated as guarantors and non-guarantors should generally be reflected retrospectively in the condensed consolidating financial information so that the information reflects the guarantee structure in place as of the most recent balance sheet date.

4) ***Disposals of subsidiary guarantors (released from the guarantee)*** – the staff will accept either of two alternative presentations:
   a. Reflect the disposed subsidiary in the guarantor column through the date of disposal. Subsequent to the disposal, retrospectively reflect the subsidiary in the non-guarantor column (similar to the presentation described in 3 above when there is a change in the composition of the guarantors and non-guarantors).
   b. Reflect the disposed subsidiary in the guarantor column through the date of disposal with no retrospective adjustment in order to preserve the historical results of operations of the guarantors.

Measuring Significance of a Recently Acquired Subsidiary or Issuer Guarantor

Under Rule 3-10(g), a Securities Act registration statement of a parent company must include the financial statements[7] of a recently acquired subsidiary issuer or guarantor if:

- The subsidiary has not been included in the audited consolidated results of the parent company for at least nine months of the most recent fiscal year, and
- The net book value or purchase price (whichever is greater) of the subsidiary is 20% or more of the principal amount of the securities being registered.

As a single registration statement may be used to register multiple series of notes (with different holders, maturity dates, interest rates, etc.), questions arise about how to compute significance when applying the guidance above. In March, the SEC staff clarified that the form of the registration statement does not impact how significance is measured under Rule 3-10(g). Accordingly, significance should be measured based on the principal amount of each series of notes separately.

REPORTING REAL ESTATE ACQUISITIONS

In July, the staff made several updates to Section 2300 of the FRM, which covers real estate acquisitions. Certain updates are noteworthy and summarized below.

2305.3 – Investment in a pre-existing legal entity

Rule 3-05 of Regulation S-X applies to acquisitions of business and requires full GAAP financial statements of businesses acquired if the acquisition is significant at the 20% level under any of the three tests in Rule 1-02(w) of Regulation S-X. Rule 3-14 applies to acquisitions of real estate properties and requires abbreviated income statements and other information if they are significant at the 10% level under an investment test.

7 The financial statements required by Rule 3-10(g)(2) include audited financial statements for the subsidiary's most recent fiscal year preceding the acquisition and the unaudited interim financial statements required by Rules 3-01 and 3-02.

▶ Read more

Previously, when a registrant acquired an equity interest in a pre-existing legal entity that has had no operations other than holding real estate and related debt, the transaction was viewed as subject to Rule 3-05. Full GAAP financial statements called for by Rule 3-05 were required, but a registrant was permitted to file abbreviated Rule 3-14 financial statements instead if it desired to do so. The FRM now states that such events are subject to the significance testing and reporting requirements in Rule 3-14. However, the staff has informally indicated that full financial statements may be provided in lieu of the abbreviated income statements required by Rule 3-14.

The staff added guidance to the FRM that addresses situations where a registrant acquires a business that has both real estate leasing operations (which are covered by Rule 3-14) and other activities, such as property management or development (which are subject to Rule 3-05 and, if they are significant enough, could make the acquisition as a whole subject to Rule 3-05). The guidance states, "If the acquired entity has operations other than leasing, but is significant at less than 20%, S-X 3-14 financial statements are required if the acquisition is significant at 10% or more when the underlying property has a rental history." Although this guidance might be read to say that two tests must be performed when a target has both leasing and other operations, the staff has informally communicated that the intent is for a registrant to evaluate the overall substance of the operations acquired and apply the tests in Rule 3-14 if the substance of the transaction was an acquisition of operating real estate properties.

2310.1 and 2320 – Registration and proxy statement requirements for individually insignificant properties

Previously, the FRM instructed registrants to compute the aggregate significance of individually insignificant property acquisitions during two periods (the most recently completed fiscal year and the period subsequent to the end of the most recently completed fiscal year) and provide Rule 3-14 financial statements in registration and transactional proxy statements for any of these periods in which the aggregate significance of the individually insignificant acquisitions exceeded 10%.

Paragraph 2310.1 and Section 2320 were changed and now indicate that a registrant is not required to provide Rule 3-14 financial statements for individually insignificant properties that were acquired during the most recently completed fiscal year. Rule 3-14 financial statements are required only for acquisitions of individually insignificant properties that are (a) made or to be made subsequent to the end of the most recently completed fiscal year for which the registrant's financial statements have been filed and (b) significant in the aggregate.

2315.4 – Use of pro forma amounts to compute significance

For acquisitions of businesses, Rule 3-05(a)(3) permits a registrant to measure significance using pro forma amounts if it made a significant acquisition subsequent to its latest fiscal year-end and filed a report on Form 8-K which included audited financial statements of such acquired business.

Previously, the FRM stated that registrants were not permitted to determine the significance of property acquisitions subject to Rule 3-14 using pro forma amounts. Paragraph 2315.4 was changed and now states that a registrant may compute the significance of a subsequent Rule 3-14 acquisition using pro forma amounts if it previously made an individually significant acquisition and filed a Form 8-K that included historical audited Rule 3-14 financial statements for that acquisition.

2340 – Financial statements of significant lessees

When a registrant has triple net leased one or more real estate properties to a single lessee and such properties represent a significant portion of the registrant's assets, an investor may need to consider the lessee's financial statements or other financial information in order to evaluate the risk to the registrant from this asset concentration. An asset concentration is generally considered significant if it exceeds 20% of the registrant's assets reflected on its most recent balance sheet.

Paragraph 2340 was revised to explicitly state the staff's previously informal view that in these situations a registrant should generally provide full audited financial statements of the lessee for the periods required by Rules 3-01 and 3-02 of Regulation S-X.

This paragraph was also revised to address and expand the reporting requirements in situations where a property is acquired and triple net leased to a single lessee but does not give rise to a significant asset concentration. This paragraph now states, "If a registrant acquires a property subject to a triple net lease and there is a rental history, the registrant should apply S-X 3-14 in situations where there is not a significant asset concentration."

▶ Read more

ACQUISITIONS OF PRODUCING OIL AND GAS PROPERTIES

Rule 3-05 applies to the acquisition of a business as defined in Rule 11-01(d), which includes the acquisition of a business that represents "less than substantially all of an entity." Section 2065 of the FRM provides reporting guidance for registrants that acquire only selected parts of an entity, which may result in the need to present less than a full set of financial statements under Rule 3-05. When it is impracticable to prepare a full set of financial statements (either legal entity or carve-out financial statements) as required by Regulation S-X, the staff may allow audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses (i.e. abbreviated financial statements) in satisfaction of a Rule 3-05 requirement.

Previously, the FRM stated that all requests to substitute abbreviated financial statements for full financial statements should be directed to the Office of the Chief Accountant in the Division of Corporation Finance (CF-OCA) prior to filing (typically via a pre-clearance letter). In October, the staff added paragraph 2065.11, which now provides relief from this pre-clearance process for acquisitions of certain producing oil and gas properties. When an oil and gas property acquired represents less than substantially all of the selling entity's key operating assets and liabilities, the staff will accept abbreviated financial statements in satisfaction of the Rule 3-05 requirements if the following criteria are met:

- The acquired interest represents only a portion of the seller's assets and is not a segment or division of an entity, or contained in a separate legal entity;
- Separate financial statements of the acquired property have not been previously prepared and the seller has not maintained the distinct and separate accounts to present full carve-out financial statements of the property; and
- It is impracticable to prepare the full financial statements required by S-X.

It should be noted that the accommodation to present abbreviated financial statements for certain acquired oil and gas properties did not change the guidance for calculating the significance of such acquisitions. Accordingly, written requests to CF-OCA must be made if a registrant wishes to adjust its pre-tax earnings used as the denominator for the income test to exclude costs not directly associated with the registrant's revenue producing activity (which may be desired when the numerator excludes such costs).

Paragraph 2065.12 was also added to the FRM and provides additional guidance to those registrants that plan to present abbreviated financial statements based on the circumstances described in paragraph 2065.11. This additional guidance specifies that:

- The statement of assets acquired and liabilities assumed may be omitted if the business acquired consists solely of interest(s) in one or more oil or natural gas properties (e.g. working interests and net profit interests).
- The statement of revenues and direct expenses should include the income statement effects of all derivative contracts related to the property that existed during the historical financial statement periods if the derivative contracts were assumed or acquired by the registrant.
- The supplementary disclosures required by ASC 932-235-50-3 through 50-11 (proved oil and gas reserve quantities) and ASC 932-235-50-29 through 50-36 (standardized measure of discounted future cash flows and changes in the standardized measure) should be provided for each full year of operations presented. Additional guidance is provided for circumstances where prior year reserve studies were not made.

Paragraph 2065.10 provides expanded guidance with respect to the pro forma financial information to be provided when only selected parts of an entity are acquired.

All of the guidance discussed above is consistent with approach the staff has historically communicated in responses to pre-clearance letters.

BDO OBSERVATIONS:

Registrants should not apply the guidance set forth above by analogy to any other fact pattern where abbreviated financial statements might be provided in lieu of the financial statements required by Rule 3-05. The relief from the pre-clearance process applies only to acquisitions of producing oil and gas properties.

▶ Read more

SIGNIFICANCE CALCULATIONS FOR ACQUISITIONS OF RELATED BUSINESSES

In 2012, the SEC staff revised the FRM to clarify the approach registrants should use to assess the significance of acquisitions of related businesses under Regulation S-X Rule 3-05(a)(3). The FRM clarified that for purposes of the income test, the absolute values should be used when some of the related businesses report losses and others report income. In a June 2012 CAQ Regulations Committee meeting, the staff indicated that this guidance was intended to apply to "put-together transactions" and not to businesses that are considered related because they are under common control or management (implying that the combined net income or loss should be used to measure significance).

In 2013, the FRM was updated and clarified that the combined income or loss should be used to measure significance for all related businesses regardless of whether they are under common control or management.

RULE 3-06 UPDATING REQUIREMENTS

In certain circumstances, Rule 3-06 of Regulation S-X permits registrants to present audited financial statements for a nine-month period to otherwise satisfy a requirement to present audited financial statements for a fiscal year. For example, if a registrant acquires a business for which two years of audited financial statements are required under Rule 3-05, the registrant may be permitted to present one audited fiscal year and the subsequent audited nine-month period of the acquired business in satisfaction of the two-year requirement. At the March meeting of the CAQ SEC Regulations Committee, the SEC staff clarified that presenting audited financial statements for a nine-month period in reliance on Rule 3-06 does not affect the updating provisions of Rule 3-12. Accordingly, previously filed nine-month period audited financial statements must be updated when the financial statements become stale pursuant to Rule 3-12. For example, if a registrant acquires a target with a December 31 year end in January and presents audited nine-month period ended September 30 financial statements, the audited financial statements need to be updated to December 31 when the September 30 financial statements become stale under Rule 3-12 (i.e. the updating requirement cannot be satisfied by presenting unaudited interim financial statements for the three months ended December 31).

SMALLER COMPANIES

To facilitate the Commission's consideration of rule changes that would reduce the regulatory burden on small business capital formation, the SEC formed an Advisory Committee on Small and Emerging Companies in late 2011, to operate for a term of two years. The Advisory Committee's key objective is to provide advice and recommendations to the Commission regarding capital formation by small businesses and small publicly traded companies. Last year, the Advisory Committee made a number of recommendations that Congress subsequently implemented by reflecting them in the JOBS Act. In October, the SEC renewed the Advisory Committee's term for another two years.

In February, the Advisory Committee made several recommendations to the SEC. Most notably, these recommendations encourage the SEC to:

- Raise the public float threshold for smaller reporting companies from $75 million to $250 million.
- Extend to smaller reporting companies the benefits available to emerging growth companies under Title I of the JOBS Act (which includes relief from the requirement in Section 404(b) of the Sarbanes-Oxley Act for auditor attestation on internal control over financial reporting).

The comprehensive list of recommendations from the February meeting and other information regarding the Advisory Committee's activities can be found *here* on the SEC's website.

In 2013, the SEC staff posted additional materials to the Commission's website to assist smaller public companies in complying with the SEC's rules. Those materials include the following:

1) The slides and speaker notes used in presentations at PCAOB forums on auditing smaller companies, *SEC CF Staff Review of Common Financial Reporting Issues Facing Smaller Issuers*, which are available *here* on the SEC's website.
2) Small entity compliance guides related to the following topics:
   a. *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements* – available *here*.
   b. *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* – available *here*.

▶ Read more

CF DISCLOSURE GUIDANCE

The staff of the SEC's Division of Corporation Finance issued CF Disclosure Guidance on one new topic in 2013, which addresses the staff's observations regarding disclosures by non-traded real estate investment trusts.

CF Disclosure Guidance is available *here* on the SEC's website.

FINANCIAL REPORTING MANUAL

The SEC staff made substantive updates to its FRM[8] four times in 2013. Topic 10 was added to the FRM and includes guidance for emerging growth companies. The guidance set forth in Topic 10 is intended to be consistent with the previous guidance provided in the series of frequently asked questions about the general applicability of Title I of the JOBS Act available on the SEC's website. Conforming changes were also made to other sections of the FRM to address the applicability of such guidance to emerging growth companies. Other substantive changes to the FRM are discussed above in Staff Guidance.

The staff includes a summary immediately following the FRM cover that describes the nature of the changes and lists the paragraphs that were updated. Additionally, the staff continues to annotate the FRM to communicate the date a paragraph was most recently updated. The FRM is available *here* on the SEC's website.

COMPLIANCE AND DISCLOSURE INTERPRETATIONS

The SEC staff updated its C&DIs during the year. The updates provided guidance on topics related to the 2013 rule changes permitting the use of general solicitation in unregistered offerings and various other legal and miscellaneous matters.

The C&DIs are available *here* on the SEC's website.

OTHER STAFF GUIDANCE

In September, the SEC staff published its slides from a presentation at the 2013 AICPA National Conference on Banks & Savings Institutions. The slides are available *here* on the SEC's website.

COSO FRAMEWORK DEVELOPMENTS

In May, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued an updated Internal Control–Integrated Framework (2013 Framework) and related illustrative documents. The Framework, originally published in 1992, is the most commonly used framework for designing and implementing internal control and assessing its effectiveness. The 2013 Framework is intended to:

- Assist organizations of all sizes design and implement internal control in light of many changes in business and operating environments since the original issuance;
- Broaden the application of internal control by organizations in addressing reporting as well as operational and compliance objectives;
- Clarify the requirements for determining what constitutes effective internal control; and
- For external stakeholders, provide a greater understanding of the requirements of an effective system of internal control and a greater confidence in both the board's oversight of internal controls and the organization's ability to identify, analyze, and respond to risk and changes in the business and operating environments.

COSO has indicated that organizations should transition their existing control evaluations and related tools and documentation to the updated 2013 Framework as soon as is feasible under their particular circumstances. COSO will continue to make available its original Framework during the transition period extending to December 15, 2014, after which time COSO will consider it as superseded by the 2013 Framework.

8 The FRM is an SEC staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues.

Read more

COSO publications are available for purchase in both hard copy and electronic formats on the COSO website: http://www.coso.org/. An Executive Summary can be downloaded here on COSO's website.

BDO OBSERVATIONS:

In a May 2013 speech (available here), the SEC's Chief Accountant, Paul Beswick, referred registrants to public statements made by COSO regarding transition, which state that "users should transition their applications and related documentation to the updated Framework as soon as is feasible under their particular circumstances" and that "the key concepts and principles embedded in the original framework are fundamentally sound and broadly accepted in the marketplace, and accordingly, continued use of the 1992 framework during the transition period (May 14, 2013 to December 15, 2014) is acceptable."

The SEC's rules require an issuer to evaluate the effectiveness of its internal control using "a suitable, recognized control framework." Accordingly, the staff has indicated that the longer issuers continue to use the 1992 framework, the more likely it will become that the staff will question whether they have complied with this requirement. Beswick also indicated that the staff will monitor transition and consider whether future action needs to be taken (i.e., action that prohibits use of the old framework).

At the 2013 AICPA Conference on Current SEC and PCAOB Developments, the SEC staff reminded registrants that they should disclose which framework they used in their reports in their Form 10-Ks.

PCAOB DEVELOPMENTS

ADOPTED AUDITING STANDARD AND AMENDMENTS

In October, the Public Company Accounting Oversight Board adopted Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*, and related amendments to other PCAOB standards. The standard establishes the auditor's responsibilities when engaged to perform audit procedures and report on supplemental information that accompanies the audited financial statements included in SEC filings. An example of such supplemental information is the supporting schedules that brokers and dealers are required to file with the SEC. The standard supersedes the PCAOB's interim auditing standard AU sec. 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*, which describes the auditor's reporting responsibilities regarding supplemental information but does not specify the audit procedures to be applied to test supplemental information. In contrast, Auditing Standard No. 17 includes auditor performance requirements to (1) determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable; (2) test the completeness and accuracy of the supplemental information, to the extent that it was not tested as part of the financial statement audit; and (3) evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any. The standard is pending SEC approval. The standard and amendments, if approved by the SEC, will be effective for reports on supplemental information that accompanies financial statements for fiscal years ending on or after June 1, 2014. The adopted standard and amendments are available here on the PCAOB's website.

PROPOSED AUDITING STANDARDS AND AMENDMENTS

PROPOSED STANDARD ON RELATED PARTIES

In May, the PCAOB reproposed for public comment an auditing standard, *Related Parties*, which would supersede the PCAOB's interim auditing standard AU sec. 334, *Related Parties*. The reproposed standard aims to increase the auditor's focus on the evaluation of a company's identification of, accounting for, and disclosure of related party transactions and relationships. At the same time, the PCAOB also reproposed amendments to its standards to enhance the auditor's identification and evaluation of a company's significant unusual transactions that are outside that the normal course of business or that otherwise appear unusual due to their timing, size, or nature. Additionally, amendments were reproposed to improve the auditor's understanding of a company's financial relationships with its executive officers. The reproposed amendments would amend other auditing standards, including AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, and Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.

Read more

The reproposed standard and amendments include revisions to respond to public comments regarding the Board's initial proposal in February 2012. Those revisions include clarifying how the reproposed standard relates to the Board's risk assessment standards (Auditing Standards Nos. 8-15). Additional revisions include requiring the auditor to evaluate whether the company has properly identified its related parties and relationships and transactions with related parties. The reproposed standard and proposed amendments are available *here* on the PCAOB's website.

BDO OBSERVATIONS:

Our comment letter on the reproposed standard and amendments expressed continued support for the PCAOB's overall objective to strengthen existing audit procedures for identifying, assessing, and responding to the risks of material misstatement associated with a company's related party transactions and the auditor's evaluation of significant unusual transactions, including transactions with executive officers, as part of the risk assessment process. While supportive of the PCAOB's overall objective, BDO suggested certain enhancements to the reproposed standard that we believe would improve clarity and ultimately the effectiveness of the reproposals. For example, we suggested including additional implementation guidance within the proposed standard to assist practitioners in the consistent application of the requirements, specifically as it relates to (1) determining others within the company to whom inquiries should be directed and (2) evaluating intercompany transactions.

Our comment letter is available *here*.

PROPOSED STANDARD ON AUDITOR REPORTING AND PROPOSED STANDARD ON THE AUDITOR'S RESPONSIBILITIES REGARDING OTHER INFORMATION

In August, the PCAOB proposed for public comment two proposed auditing standards, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the proposed auditor reporting standard), and *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the proposed other information standard), as well as related amendments to PCAOB standards, to enhance the way auditors communicate with investors and other financial statement users about the audit.

The proposed auditor reporting standard would retain the pass/fail model in the existing auditor's report, but would require: (1) the communication of critical audit matters as determined by the auditor; (2) new elements in the auditor's report related to auditor independence, auditor tenure, and the auditor's responsibilities for, and results of, the auditor's evaluation of other information outside the financial statements; and (3) greater detail in the auditor's report related the auditor's responsibilities for fraud and notes to the financial statements. This proposed standard would supersede portions of AU sec. 508, *Reports on Audited Financial Statements*.

The proposed other information standard describes the scope of "other information" and procedures the auditor is required to perform, including procedures when the auditor identifies a material inconsistency between the other information and the audited financial statements, a material misstatement of fact, or both. "Other information" in an annual report filed on Form 10-K would include, among other things, selected financial data and management's discussion and analysis. This proposed standard would supersede AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*.

The proposed standards and amendments are available *here* on the PCAOB's website.

BDO OBSERVATIONS:

Our comment letter on the proposed standards and amendments expressed continued support regarding the PCAOB's efforts to explore ways to enhance the usefulness and informational value of the auditor's report and provide transparency about the audit that was performed. We support many of the enhancements to auditor reporting set out in the proposed auditor reporting standard, such as expanding the existing language in the auditor's report related to the auditor's responsibilities for fraud and notes to the financial statements and other information, and communication of audit related matters the auditor considered critical. Our comment letter indicated that while we are supportive of the overall direction of the proposed standards, we have reservations about the approach taken in some important areas, such as identifying critical audit matters and the manner of communicating them, including the extent of documentation required, and the expansion of performance obligations and auditor reporting with respect to other information.

Our comment letter is available *here*.

▶ Read more

PROPOSED AMENDMENTS TO REQUIRE DISCLOSURE OF THE ENGAGEMENT PARTNER AND CERTAIN PARTICIPANTS IN THE AUDIT

In December, the Board reproposed for public comment amendments to PCAOB auditing standards that would require disclosure in the auditor's report of (1) the name of the engagement partner in charge of the audit for the most recent period, and (2) the names, locations, and extent of participation (as a percentage of total audit hours) of other public accounting firms that took part in the audit, and the locations and extent of participation of other persons (whether an individual or a company) not employed by the auditor who performed procedures on the audit if their participation exceeded 5% of the total hours in the audit engagement. Other than the disclosure requirements, the reproposed amendments would not change the auditor's performance obligations when conducting the audit. The reproposed amendments include revisions to respond to public comments regarding the Board's initial proposal in October 2011. The Board is reproposing the amendments to seek further comment on such matters as the usefulness of the information that would be required, the potential costs the reproposed amendments might impose, whether the reproposed amendments would have any effect on competition, and other aspects of the reproposal. The proposed amendments are available *here* on the PCAOB's website. Comments are due February 3, 2014.

PROPOSED FRAMEWORK FOR REORGANIZATION OF PCAOB AUDITING STANDARDS

In March, the PCAOB issued for public comment a proposal for the reorganization of its auditing standards, as well as certain related amendments to its rules and standards. The proposal provides a potential framework for reorganizing the Board's existing interim and PCAOB-issued auditing standards into a topical structure with a single integrated numbering system. The proposed reorganization is intended to present the standards in a logical order that generally follows the flow of the audit process. Under the proposed reorganization, all PCAOB auditing standards would be grouped into the following categories: general auditing standards, audit procedures, auditor reporting, matters relating to filings under federal securities laws, and other matters associated with audits. The proposal is available *here* on the PCAOB's website.

BDO OBSERVATIONS:

Our comment letter on the proposal expressed support for initiatives to enhance the usability of PCAOB standards. However, BDO expressed its belief that the costs associated with the proposed reorganization would be unnecessarily burdensome, particularly to smaller audit firms, unless the PCAOB aligned the organization of its standards as closely as possible with those of the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards of the International Auditing and Assurance Standards Board. BDO did support rescinding those interim auditing standards that are no longer appropriate or outdated. In addition, BDO supported excluding consideration of the Board's other professional practice standards, such as the attestation, quality control, and ethics and independence standards, from the scope of the reorganization project at this time. Also, while we agreed that it is appropriate to exclude non-authoritative guidance form the project to codify the auditing standards, we suggested including references to this other guidance within the codification to assist auditors in considering all available PCAOB guidance.

Our comment letter is available *here*.

GUIDANCE

In October, the PCAOB issued Staff Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting*. The Alert highlights certain PCAOB auditing requirements where significant audit deficiencies have been frequently cited in PCAOB inspections. The timing of this Alert is intended for auditors to take note of the matters discussed in the Alert in planning and performing the upcoming calendar year-end audits. The Alert is available *here* on the PCAOB's website.

BDO OBSERVATIONS:

While the Alert is directed toward auditors, registrants may find the Alert useful in planning and performing their ICFR assessments as well.

▶ Read more

PUBLIC REPORTS

In December, the PCAOB issued a public report, Release No. 2013-001, *Report on 2007-2010 Inspections of Domestic Firms That Audit 100 or Fewer Public Companies*. The report summarizes inspection observations from the PCAOB for firms that must be inspected at least once every three years, and highlights areas where audit firms can focus their attention to enhance audit quality. The report is available *here* on the PCAOB's website.

Also in December, the PCAOB released a report that provides information about firms' implementation and compliance with Auditing Standard No. 7, *Engagement Quality Review*. The report is based on the PCAOB's 2011 inspections, which included the first audits for which firms were required to implement Auditing Standard No. 7. The report notes that in a number of engagements in which the PCAOB Inspection staff identified audit deficiencies, the staff concluded that the audit deficiency should have been identified by the engagement quality reviewer. The report also describes the PCAOB's view of potential root causes of such deficiencies. The report is available *here* on the PCAOB's website.

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 49 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,264 offices in 144 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit *www.bdo.com*.

To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Material discussed in this publication is meant to provide general information and should not be acted on without professional advice tailored to your individual needs

© 2014 BDO USA, LLP. All rights reserved.

CONTACT:

WENDY HAMBLETON
312-616-4657
whambleton@bdo.com

JEFF LENZ
312-616-3944
jlenz@bdo.com

CHRIS SMITH
310-557-8549
chsmith@bdo.com