



CAQ Alert #2008-91 – December 29, 2008

## DEAR CENTER MEMBERS

### PCAOB Issues Staff Audit Practice Alert No. 3, Audit Considerations in the Current Economic Environment

On December 5, 2008, the [Public Company Accounting Oversight Board](#) (PCAOB or the Board) issued [Staff Audit Practice Alert No. 3, Audit Considerations in the Current Economic Environment](#) (Practice Alert). The Practice Alert is intended to assist auditors in identifying matters related to the current economic environment that may affect audit risk and require additional emphasis in audits of financial statements and audits of internal control over financial reporting.

#### *CAQ Summary of the Practice Alert*

Please refer to the [PCAOB's Staff Audit Practice Alert No. 3](#) in its entirety as the following only represents a very high level summary of its contents.

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#### Overview

The Practice Alert is organized into the following sections:

- **Overall Audit Considerations;**
- **Auditing Fair Value Measurements;**
- **Auditing Accounting Estimates;**
- **Auditing the Adequacy of Disclosures;**
- **Auditor's Consideration of a Company's Ability to Continue as a Going Concern;**
- **Additional Audit Considerations for Selected Financial Reporting Areas.**

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#### Overall Audit Considerations

This section of the Practice Alert describes areas of audit consideration that may be affected by recent events in the financial markets and current economic conditions. Additionally, the following guidance for auditors was referenced in the respective sections of the Practice Alert.

## Planning Considerations

- [AU Section 311](#), *Planning and Supervision*
- [PCAOB Auditing Standard No. 5](#), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
- [AU Section 312](#), *Audit Risk and Materiality in Conducting an Audit*

## Fraud Risk Considerations

- [AU Section 316](#), *Consideration of Fraud in a Financial Statement Audit*
- [AU Section 110](#), *Responsibilities and Functions of the Independent Auditor*

## Internal Control Considerations

- [AU Section 316](#), *Consideration of Fraud in a Financial Statement Audit*
- [PCAOB Auditing Standard No. 5](#), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

## Effect on Substantive Procedures

- [AU Section 319](#), *Consideration of Internal Control in a Financial Statement Audit*

## Communications with Audit Committees

- [AU Section 380](#), *Communication with Audit Committees*

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## Auditing Fair Value Measurements

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This section of the Practice Alert describes how the current conditions of the financial market have created difficulties in the valuation of certain investments. As a result, difficulties surrounding the measurement of fair value and the adequacy of related disclosures have come under increased focus this year. The following guidance has been referenced in the Practice Alert as a resource for auditors in audits of fair value:

- [Statement of Financial Accounting Standards No. 157](#), *Fair Value Measurements*
- [Clarifications on Fair Value Accounting](#), (SEC & FASB joint press release)
- [FASB Staff Position No. 157-3](#), *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*
- [PCAOB Staff Audit Practice Alert No. 2](#), *Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists*

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## Auditing Accounting Estimates

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This section of the Practice Alert describes how the auditor should consider the company's historical experience in making past estimates as well as the auditors experience in the industry when auditing accounting estimates. Auditors should also consider whether recent changes in the economy and financial markets may make certain facts, circumstances, or a company's procedures more significant to the estimate. The following guidance was referenced in the Practice Alert in regards to auditing accounting estimates:

- [AU Section 342](#), *Auditing Accounting Estimates*
- [AU Section 316](#), *Consideration of Fraud in a Financial Statement Audit*

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## Auditing the Adequacy of Disclosures

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This section of the Practice Alert describes how the current economic environment may require additional disclosures surrounding a company's risks and uncertainties. The following guidance was provided in the Practice Alert as a reference for auditors when auditing the adequacy of disclosures:

- American Institute of Certified Public Accountants' Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*
- [AU Section 431](#), *Adequacy of Disclosure in Financial Statements*
- [AU Section 550](#), *Other Information in Documents Containing Audited Financial Statements*
- [SEC Regulation S-K, Item 303](#), *Management's Discussion and Analysis of Financial Condition and Results of Operations*
- [SEC Regulation S-K, Item 308 and 308T](#), *Internal Control Over Financial Reporting*

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## Auditor's Consideration of A Company's Ability to Continue as a Going Concern

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This section of the Practice Alert describes how some companies may face challenges in their ability to continue operating as a going concern in the current environment due to conditions such as decreased liquidity, limited access to the commercial paper markets, customer payment delays, or reduced collateral valuation. The Practice Alert includes the guidance below that auditors may utilize when evaluating a company's ability to continue as a going concern.

- [AU Section 341](#), *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

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## Additional Audit Considerations for Selected Financial Reporting Areas

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This section of the Practice Alert indicates that auditors should consider whether the current economic environment could impact risks associated with the following financial reporting areas. Additionally, auditors should be aware that other financial reporting areas may also be impacted that are not listed herein. The Practice Alert includes the following guidance that may be used by auditors when auditing the respective areas below.

### Consolidation

- [FASB Interpretation No. 46\(R\)](#), *Consolidation of Variable Interest Entities – an interpretation of ARB No. 51*
- [FSP FAS 140-4 and FIN 46\(R\)-8](#), *Disclosures by Public Entities about Transfers of Financial Assets and Interests in Variable Interest Entities*

### Contingencies and Guarantees

- [AU Section 337](#), *Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments*

### Credit Derivatives

- [FSP No. FAS 133-1 and FIN 45-4](#), *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*
- [AU Section 332](#), *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

### Debt Obligations

### Deferred Tax Assets

- [Statement of Financial Accounting Standards No. 109](#), *Accounting for Income Taxes*
- [FIN 48](#), *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109.*

### Derivatives (Other than Credit Derivatives)

- [Statement of Financial Accounting Standards No. 133](#), *Accounting for Derivative Instruments and Hedging Activities*

- [FASB Staff Implementation Guidance: Guidance to Implementation of Statement No. 133 on Accounting for Derivative Instruments and Hedging Activities](#), *Issue G10 Cash Flow Hedges: Need to Consider Possibility of Default by the Counterparty to the Hedging Derivative*
- [AU Section 332](#), *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

### **Goodwill, Intangible Assets and Other Long-lived Assets**

- [Statement of Financial Accounting Standards No. 144](#), *Accounting for the Impairment or Disposal of Long-Lived Assets*
- [Statement of Financial Accounting Standards No. 142](#), *Goodwill and Other Intangible Assets*

### **Inventory**

- Accounting Research Bulletin ("ARB") No. 43, *Inventory Pricing* (Chapter 4)

### **Other-than-Temporary Impairment**

- [Statement of Financial Accounting Standards No. 115](#), *Accounting for Certain Investments in Debt and Equity Securities*
- [SEC Staff Accounting Bulletin \(SAB\) No. 59](#), *Accounting for Noncurrent Marketable Equity Securities* (SEC Codification of SAB's – Topic 5.M)
- [FASB Emerging Issues Task Force No. 99-20](#), *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*

NOTE: On December 19, 2008, the FASB proposed [FSP 99-20-a](#), *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue 99-20* for public comment. The FSP amends the implementation guidance in EITF 99-20 (referenced above) and is intended to reduce complexity and achieve more consistent determinations as to whether other-than-temporary impairments of available-for-sale and held-to-maturity debt securities have occurred. See [CAQ Alert#2008-89](#) issued December 22, 2008 regarding this topic.

### **Pension and Other Postretirement Benefits (OPEB)**

- [Statement of Financial Accounting Standards No. 87](#), *Employers' Accounting for Pensions*
- [Statement of Financial Accounting Standards No. 106](#), *Employers' Accounting for Postretirement Benefits Other Than Pensions*
- [Statement of Financial Accounting Standards No. 158](#), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of SFAS No. 87, 88, 106, and 132(R)*

## Receivables

- [Statement of Financial Accounting Standards No. 114](#) (SFAS 114), *Accounting by Creditors for Impairment of a Loan – an amendment of SFAS 5 and 15*

NOTE: On December 23, 2008, the Center for Audit Quality issued a white paper entitled the *Application of SFAS 114 to Modifications of Residential Mortgage Loans that Qualify as Troubled Debt Restructurings*. See [CAQ Alert #2008-90](#).

## Restructuring

- [Statement of Financial Accounting Standards No. 146](#), *Accounting for Costs Associated with Exit or Disposal Activities*

## Revenue Recognition

- [AU Section 316](#), *Consideration of Fraud in a Financial Statement Audit*

## Share-based Payments

- [PCAOB Staff Questions and Answers, Auditing the Fair Value of Share Options Granted to Employees](#)
- [Statement of Financial Accounting Standards 123\(R\)](#), *Share-Based Payment*
- [AU Section 316](#), *Consideration of Fraud in a Financial Statement Audit*
- [AU Section 328](#), *Auditing Fair Value Measurements and Disclosures*
- [AU Section 336](#), *Using the Work of a Specialist*
- [AU Section 342](#), *Auditing Accounting Estimates*

The [PCAOB Practice Alert No. 3](#) in its entirety can be accessed at the respective link.

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## Stay Informed

As a member of the Center, your firm will receive periodic updates on important developments related to the PCAOB and the SEC, as well as the activities of the Center, particularly with respect to the submission of comment letters on PCAOB and SEC proposals. To stay abreast of these and other relevant events in public company audit practice, please visit the Center Web site at [theCAQ.aicpa.org](http://theCAQ.aicpa.org). Also, we welcome any suggestions or questions - please send them by email to [center@theCAQ.org](mailto:center@theCAQ.org).

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