CENTER FOR AUDIT QUALITY

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CAQ Public Policy Monitor

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As part of the Center for Audit Quality's ongoing effort to keep members informed on critical public policy matters with the potential to impact the public company audit profession, we are pleased to offer the Public Policy Monitor. Each month, the CAQ Public Policy Monitor highlights and examines the policies and broader political events shaping the public debate on public company auditing, as well as financial reporting and related regulatory and legislative issues.

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PCAOB

PCAOB finds deficiencies in broker-dealer audits

The Public Company Accounting Oversight Board (PCAOB) on January 28 released a summary inspection report covering five broker-dealer audit and attestation engagements conducted by five auditors in 2014. The Board found deficiencies (defined as "failures by firms to perform, or perform sufficiently, certain required audit or attestation procedures") in five audit and four attestation engagements related to compliance with PCAOB standards.

The deficiencies included deficiencies with respect to the audit and attestation reports, procedures performed on the audit and attestation engagements (e.g., revenue recognition, risks of material restatement due to fraud, and financial statement presentation and disclosures), and engagement quality reviews. According to the Board, the findings suggest that other auditors similarly may not be sufficiently familiar with the application of PCAOB standards.

In 2015, the PCAOB plans to inspect approximately 75 firms and portions of approximately 115 audit and attestation engagements.

PCAOB plans active first six months

The PCAOB on January 9 released an updated standard-setting agenda. During the first six months of 2015, the Board plans to finalize only one new auditing standard: *Proposed Framework for Reorganizing of PCAOB Auditing Standards and Related Amendments to PCAOB Auditing Standards and Rules* (Docket 040). However, the Board plans to take action on a further five projects:

Project	Planned Action
Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits (Docket 029)	Supplemental request for comment
Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments (Docket 034)	Re-proposal
Supervision of Other Auditors and Multilocation Audit Engagements	Proposal
Use of Specialists	Staff Consultation Paper
Going Concern	Staff Consultation Paper

SEC

CorpFin updates Financial Reporting Manual

The Securities and Exchange Commission's Division of Corporation Finance (CorpFin) on January 12 issued an update to the Financial Reporting Manual (FRM). CorpFin made changes to the following FRM sections:

2070.4, 2070.6, 7410	Revisions to conform to issuance of Accounting Standards Update No. 2014-17, *Business Combinations (Topic 805): Pushdown Accounting, a consensus of the FASB Emerging Issues Task Force* and rescission of SAB Topic 5.J

FASB/IASB

New FASB standard eliminates extraordinary items

The Financial Accounting Standards Board (FASB) on January 9 issued Accounting Standards Update (ASU) No. 2015-01, *Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. The ASU eliminates the concept of "extraordinary items" from U.S. General Accepted Accounting Principles (U.S. GAAP). It also aligns U.S. GAAP more closely with International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, which prohibits the presentation and disclosure of extraordinary items.

According to the FASB, stakeholders said the concept of extraordinary items caused uncertainty because it was unclear when an item should be considered both unusual and infrequent. Additionally, some stakeholders said that, although users found information about unusual or infrequent events and transactions useful, they did not find the extraordinary item classification and presentation necessary to identify those events and transactions. Other stakeholders noted that it was extremely rare in current practice for a transaction or event to meet the requirements to be presented as an extraordinary item.

ASU 2015-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

FASB proposes updates to income tax accounting

The FASB on January 22 proposed two ASUs to update the accounting for income taxes.

- Proposed ASU, *Income Taxes (Topic 740): Intra-Entity Asset Transfers*, would eliminate the exception in U.S. GAAP that prohibits recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset or assets have been sold to an outside party. Entities would be required to recognize the current and deferred income tax consequences of an intra-entity asset transfer when the transfer occurs.

- Proposed ASU, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, would amend the current requirement that an entity separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Under the proposed ASU, deferred tax liabilities and assets would be classified as noncurrent in a classified statement of financial position.

The deadline for submitting comments on the proposed ASUs is May 29.

International

IAASB issues new and revised auditor reporting standards

The International Auditing and Assurance Standards Board (IAASB) on January 15 released *Reporting on Audited Financial Statements – New and Revised Auditor Reporting Standards and Related Conforming Amendments*. The new and revised standards are intended to provide investors and other users of audited financial statements with more informative and relevant auditor's reports.

The standards include new International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. ISA 701's objective is to assist financial statement users in understanding those matters that, in the auditor's professional judgment, were most significant in the financial statement audit. The standards also include five revised ISAs:

- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, includes a requirement that the engagement partner's name be disclosed in the auditor's report "unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat";

- ISA 570 (Revised), *Going Concern*, includes new guidance to support the auditor's evaluation of disclosures when a material uncertainty exists, and a new requirement for the auditor to evaluate the adequacy of disclosures in "close call" situations;

- ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, establishes three types of modified opinions: qualified opinion, adverse opinion, and disclaimer of opinion;

- ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, provides guidance for when the auditor considers it necessary to draw attention to (1) a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, or (2) a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report; and

- ISA 260 (Revised), *Communication with Those Charged with Governance*: provides a framework for the auditor's communication with those charged with governance, and identifies some specific matters to be communicated with them.

Reporting on Audited Financial Statements will be effective for audits of financial statements for periods ending on or after December 15, 2016.

U.S. Congress

House passes bill easing financial reporting rules

Republicans in the House of Representatives started the 114th Congress with a clear signal that they intend to continue efforts both to roll back key provisions of the Dodd-Frank Act and to ease financial reporting requirements for smaller public companies. On January 6, Rep. Michael Fitzpatrick (R-Pa.) introduced H.R. 37, the *Promoting Job Creation and Reducing Small Business Burdens Act*. The full House passed the bill on January 14, on a 271-154 vote. Twenty-nine Democrats voted for the bill; only one Republican voted against passage.

H.R. 37's most controversial provision is Title VIII (Sec. 801), which would delay restrictions on bank ownership of collateralized loan obligations (CLOs) until 2019. The Federal Reserve in April 2014 gave banks until July 2017 to sell off their holdings of CLOs, which are mainly backed by commercial loans to higher-risk companies. That delay followed a previous one-year extension by the Federal Reserve, to July 2015.

But the bill also contains three provisions that would ease financial reporting requirements for smaller public companies, especially emerging growth companies (EGCs).

- *Title VI – Improving Access to Capital for Emerging Growth Companies Act*. The measure would exempt EGCs from various Sarbanes-Oxley and Dodd-Frank requirements for five years, or until they lose their EGC status.

- *Title VII – Small Company Disclosure Simplification Act*. EGCs and issuers with total annual gross revenues of less than $250 million would be exempted for up to five years from using eXtensible Business Reporting Language (XBRL) for financial statements and other periodic reporting required to be filed with the Securities and Exchange Commission (SEC). The measure also would require the SEC to undertake: (1) a cost-benefit analysis; (2) an assessment of the benefits to the SEC in terms of improved ability to monitor securities markets, assess the potential outcomes of regulatory alternatives, enhance investor participation in corporate governance, and promote capital formation; and (3) an assessment of the effectiveness of standards in the United States for interactive filing data relative to the standards of international counterparts. The measure was approved by the full House during the 113th Congress.

- *Title X – Disclosure Modernization and Simplification Act*. The measure would require the SEC to: (1) issue regulations permitting issuers to submit a summary page on annual and transition report Form 10-K if each item on that page cross-references the material contained in Form 10-K; (2) revise Regulation S-K to reduce the burden on smaller issuers, including EGCs, accelerated filers, and smaller reporting companies; and (3) eliminate duplicative, overlapping, out-dated, or unnecessary provisions in Regulation S-K. It would also require the SEC to study ways to: (1) modernize and simplify the requirements in Regulation S-K; (2) improve the readability and navigability of disclosure documents; and (3) discourage repetition and disclosure of immaterial information. The measure was approved by the full House during the 113th Congress.

Sen. Richard Shelby (R-Ala.), the new chairman of the Senate Banking Committee, has yet to signal what action – if any – he intends to take on H.R. 37 or its component provisions. However, even should the bill win the Senate's approval, President Barack Obama has vowed to veto it.

CAQ Update

CAQ comments on OECD's review of corporate governance principles

The Organization for Economic Cooperation and Development (OECD) in November 2014 released proposed revisions to its Principles of Corporate Governance. The Principles, which the OECD last revised in 2004, are intended to assist governments and regulators in their efforts to evaluate and improve the legal, regulatory and institutional framework for corporate governance. They also provide guidance for stock exchanges, investors, corporations, and others with a role in the process of developing good corporate governance.

Section V of the Principles addresses disclosure and transparency matters, including auditor independence and enhanced audit committee transparency. The Center for Audit Quality (CAQ), in its comment letter on the proposed revisions, remarks that "auditor independence and increased transparency around the oversight responsibilities of audit committees are essential to the quality of financial information provided by companies, and further contribute to audit quality and increased investor confidence."

In particular, the CAQ supports:

- The proposed change to expand on the importance of auditor independence by stating, "The independence of auditors and their accountability to shareholders *should be required*." However, the CAQ encourages the OECD take a more principles-based approach and delete the list of specific examples of "other provisions to underpin auditor independence," because it includes measures that may not work consistently across different legal and regulatory environments.

- Clarifying within the Principles that "it is good practice for external auditors to be *recommended by an independent audit committee* of the board or an equivalent body and to be appointed either by that committee/body or by shareholders directly." The CAQ believes a similar requirement in the U.S., where all members of the audit committee of a public company must be "independent" of the company, directors, and controlling shareholders, greatly adds to their ability to oversee the financial reporting processes of a company and the external auditor in an objective manner and free from undue pressure from management.

- Enhanced language calling for the required disclosure of fees for non-audit services, as such disclosure contributes to the transparency of services provided by auditors that may impact their independence.

The final version of the revised Principles is scheduled to be completed by the end of 2015.

Highlights of International Practices Task Force meeting now available

The CAQ has made available an overview of the International Practices Task Force's (IPTF) November 18 meeting. The IPTF is a task force of the CAQ's SEC Regulations Committee.

During the meeting, Securities and Exchange Commission (SEC) staff said they have seen instances of joint ventures that were 50 percent owned by a U.S. company and 50 percent owned by non-U.S. investors reported as "foreign businesses." In these cases, the non-U.S. investors had not consolidate the joint ventures but followed equity method accounting to represent the non-U.S. ownership interest. The staff noted that such entities do not qualify as foreign businesses because they do not meet the "majority owned by persons who are not citizens or residents of the United States" criteria of Regulation S-X.

Among the other issues discussed during the meeting were:

- Venezuela currency issues;
- Monitoring inflation in certain countries, including Belarus, Iran, Venezuela, Sudan, South Sudan, and Malawi;
- Status update of the SEC staff's Disclosure Effectiveness Initiative; and
- SEC staff observations regarding the use of the IFRS XBRL taxonomy.

The IPTF's next meeting is scheduled for May 19.

Upcoming Events

February 16-20
IASB Board Meeting, London, UK (Link)

March 25
Center for Capital Markets Competitiveness Annual Capital Markets Summit, Washington, DC (Link)

March 30-April 1
CII Spring Conference, Washington, DC (Link)

April 26-29
CFA Institute Annual Conference, Frankfurt, Germany (Link)

April 28
FASB Private Company Accounting Issues Town Hall Meeting, Dallas, TX (Link)

May 17-19
FEI 2015 Summit Leadership Conference, Boca Raton, FL (Link)

May 18-20
AICPA Employee Benefit Plans Conference, National Harbor, MD (Link)

June 3-5
ICGN Annual Conference, London, UK (Link)

June 15-19
IAASB Board Meeting, New York, NY (Link)

June 17-18
PCAOB Standing Advisory Group Meeting, Washington, DC (Link)

July 13-14
AICPA National Advanced Accounting and Auditing Technical Symposium, Baltimore, MD (Link)

September 16-18
AICPA National Conference on Banks & Savings Institutions, Washington, DC (Link)

September 21-25
IAASB Board Meeting, New York, NY (Link)

September 27-29
NACD Global Board Leaders' Summit, Washington, DC (Link)

September 30-October 2
CII Fall Conference, Boston, MA (Link)

October 25-28
NASBA Annual Meeting, Dana Point, CA (Link)

November 12-13
PCAOB Standing Advisory Group Meeting, Washington, DC (Link)

November 16-17
PLI Annual SEC Reporting and FASB Forum, Dallas, TX (Link)

December 3-4
PLI Annual SEC Reporting and FASB Forum, New York, NY (Link)

December 7-8
AICPA Employee Benefit Plans Accounting, Auditing and Regulatory Update, Washington, DC (Link)

December 7-11
IAASB Board Meeting, New York, NY (Link)

December 9-11
AICPA Conference on Current SEC and PCAOB Developments, Washington, DC (Link)

December 14-15
PLI Annual SEC Reporting and FASB Forum, San Francisco, CA (Link)

The Center for Audit Quality is an autonomous, nonpartisan, nonprofit organization dedicated to enhancing investor confidence and public trust in the global capital markets by fostering high-quality public company audits; collaborating with other stakeholders to advance the discussion of critical issues; and advocating policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of CPAs. For more information, visit www.thecaq.org.

The CAQ Public Policy Monitor represents the observations of the CAQ, but not necessarily the views of particular member firms, Governing Board members or individuals associated with the CAQ. Questions and comments about the CAQ Public Policy Monitor can be addressed to: ppm@thecaq.org.

