CENTER FOR AUDIT QUALITY

Serving Investors, Public Company Auditors & the Markets

Affiliated with the American Institute of CPAs

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.

In This Issue:

PCAOB

SEC approves PCAOB's 2015 budget

The Securities and Exchange Commission (SEC) on February 4 approved the Public Company Accounting Oversight Board's (PCAOB) 2015 budget and the related annual accounting support fee. The PCAOB budget totals $250.9 million and will be funded primarily by the collection of an accounting support fee totaling $226.6 million and from the under-spending in 2014 that will be available to fund the 2015 budget.

"The PCAOB's work to oversee auditors of public companies and SEC registered broker-dealers is critical to investor protection and our markets," SEC Chairman Mary Jo White said. "The PCAOB in 2015 will expand its inspection program of broker dealer audits, conduct inspections of issuer audits around the world and work to advance a number of important standard-setting initiatives. It is the responsibility of the Commission to make sure that the PCAOB has the necessary funds to fulfill all aspects of its important mission and that it responsibly and optimally uses those funds."

PCAOB Chairman James Doty, in presenting the budget, noted that it includes funds for a review of the Board's standard-setting agenda, "with a view to identifying ways to advance standard-setting initiatives more efficiently.” Doty said he had been meeting with SEC Chief Accountant James Schnurr to explore “potential ways to make the standard setting process more efficient. It is a rulemaking process. There are a lot of perspectives, interests and effects that have to be considered. But I agree that the process can be improved.”

However, SEC officials continued to press Doty on the PCAOB’s standard-setting priorities. SEC Commissioner Daniel Gallagher said he is “a bit concerned the PCAOB’s limited standard-setting resources have been focused too heavily on disclosure projects…[T]o the extent that this focus on disclosure comes at the expense of making meaningful progress on core audit performance standards, which would drive improved auditor performance, those priorities need to be reexamined.”

In addition to Commissioner Gallagher, Commissioners Luis Aguilar, Kara Stein and Michael Piwowar also weighed in with statements.

Aguilar and Stein emphasized the importance of the PCAOB’s inspection program. “While the PCAOB’s inspections program continues to mature,” Stein said she, “like many others, remain concerned about the high percentage and reoccurrence of audit deficiencies at the firms…Audit firms should be asking questions to find out what happened, why it happened, and how to prevent it from happening again. The continued number and rate of audit deficiencies may be symptomatic of a need to address deeper issues.”

Aguilar acknowledged that the PCAOB “has continued to make progress in negotiating with foreign authorities to gain access to relevant audit documents and/or to conduct required inspections. However, that the PCAOB “continues to face challenges in certain member countries of the European Union and in China” raises unnecessary risks for American investors, who cannot be assured that companies with foreign operations in these countries will be subject to audits that meet the requisite independence and high quality professional standards.” Bilateral cooperative arrangements in the remaining EU countries, and a viable cooperative agreement for cross-border inspections with China, “are long overdue.”

Piwowar said he looks forward “to observing the further development and integration of economists, including those in the Center for Economic Analysis, into all facets of the Board’s operations…As the Board’s [Staff Guidance on Economic Analysis in PCAOB Standard Setting] observes, economic analysis ‘can play a crucial role in defining critical policy questions and in developing and evaluating different approaches to addressing identified problems.’ Thus, “economists should be fully integrated into, and be members of, project teams.’”

SEC

SEC reaches settlement with Chinese affiliates

The Securities and Exchange Commission (SEC) on February 6 announced sanctions against four Chinese public accounting firms that had refused to turn over documents related to investigations of potential fraud at nine audit clients. The four firms – Deloitte Touche Tohmatsu Certified Public Accountants Limited, Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), and PricewaterhouseCoopers Zhong Tian CPAs Limited Company – are registered with the Public Company Accounting Oversight Board (PCAOB).

As part of the settlement, the firms are required to perform specific steps to satisfy SEC requests for similar materials over the next four years. The firms also each agreed to pay $500,000 and admit that they did not produce documents before the proceedings were instituted against them in 2012. If future document productions fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms, including, as appropriate, an automatic six month bar on performing certain audit work, a new proceeding against a firm, or resumption of the current proceeding against all four firms.

SEC proposes rules for disclosing hedging policies

The SEC on February 9 proposed a rule to enhance corporate disclosure of company hedging policies for directors, officers, and employees, as mandated by Section 955 of the Dodd-Frank Act. The proposed rule would add new Section 14(j) to the Securities Exchange Act of 1934.

Section 14(j) would require issuers to disclose whether directors, officers, and other employees are permitted to hedge or offset any decrease in the market value of equity securities granted by the company as compensation or held, directly or indirectly, by employees or directors. To implement Section 14(j), the proposal would add new paragraph (i) to Item 407 (corporate governance disclosure requirements) of Regulation S-K.

The deadline for submitting comments is April 20.

FASB/IASB

FASB updates consolidation guidance

The Financial Accounting Standards Board (FASB) on February 18 issued Accounting Standards Update (ASU) No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. An overview of the new standard is also available.

The ASU is intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The ASU "simplifies consolidation accounting by reducing the number of consolidation models, providing incremental benefits to stakeholders, FASB Chairman Russell Golden said. "For example, specialized guidance for legal entities will be eliminated by removing the indefinite deferral for certain investment funds, and certain money market funds will no longer have to apply the guidance."

In addition to reducing the number of consolidation models from four to two, the new standard will improve U.S. GAAP by:

- Placing more emphasis on risk of loss when determining a controlling financial interest. A reporting organization may no longer have to consolidate a legal entity in certain circumstances based solely on its fee arrangement, when certain criteria are met;
- Reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE); and
- Changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs.

The ASU will be effective for periods beginning after December 15, 2015, for public companies. For private companies and not-for-profit organizations, the ASU will be effective for annual periods beginning after December 15, 2016; and for interim periods, beginning after December 15, 2017. Early adoption is permitted.

FASB proposes update to disclosures about bifurcated embedded derivatives

The FASB on February 24 proposed the Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815): Disclosures about Hybrid Financial Instruments with Bifurcated Embedded Derivatives*. Under current U.S. GAAP, Topic 815 does not require an entity to provide information that explicitly links bifurcated embedded derivatives (that are measured at fair value) with their related host contracts (that may be measured at amortized cost, fair value, or another measurement attribute depending on applicable accounting literature).

The proposed ASU would require that an entity disclose (in both interim and annual reporting periods) the carrying amount, measurement attribute, and line item within the balance sheet and the income statement in which each bifurcated embedded derivative and its related host contract are presented. The FASB will determine the effective date after considering stakeholders' feedback.

The deadline for submitting comments on the proposed ASU is April 30.

IASB proposal clarifies classification of liabilities

The International Accounting Standards Board (IASB) on February 10 published for public comment the Exposure Draft, *Classification of Liabilities* (Proposed amendments to IAS 1), which would amend the classification of liabilities element of IAS 1, *Presentation of Financial Statements.* The proposed amendments are designed to improve presentation in financial statements by clarifying the criteria for the classification of a liability as either current or non-current.

In particular, they clarify: (1) that the classification of a liability as either current or non-current is based on the entity's rights at the end of the reporting period; and (2) the link between the settlement of the liability and the outflow of resources from the entity.

The deadline for submitting comments is June 10.

CAQ Updates

Harvey Goldschmid: An appreciation

Harvey Goldschmid passed away on February 12. Goldschmid was the Security and Exchange Commission's (SEC) general counsel in 1998-99, a special senior adviser to SEC Chairman Arthur Levitt in 2000, and a commissioner from 2002 to 2005. He was sworn in as a commissioner the day after President George W. Bush signed the Sarbanes-Oxley Act and helped with many aspects of its implementation, including the creation of the Public Company Accounting Oversight Board.

Goldschmid joined the Columbia Law School faculty in 1970 and was named Dwight Professor of Law in 1984. He was a member of the Systemic Risk Council, a private-sector group of former government officials and financial and legal experts formed after the 2008 financial crisis to monitor and encourage reform of the U.S. financial system. He was also a member of the Center for Audit Quality's (CAQ) Governing Board and a trustee of the International Financial Reporting Standards Foundation.

According to Levitt, Goldschmid "will go down in history as one of the giants of the SEC." Joel Seligman, president of the University of Rochester and an expert on securities law, described Goldschmid as the most influential SEC commissioner in history who never rose to become chairman. "Harvey was in a class by himself in terms of understanding the securities laws," Seligman said. "He did everything one could have done as a leading figure in securities regulation despite having not been appointed chair."

CAQ Executive Director Cindy Fornelli called the range of Goldschmid's professional accomplishments "astonishing." In a tribute to Goldschmid, Fornelli said of his contribution to the CAQ, "From the outset, it was clear that given the breadth of his knowledge and experience, Harvey would make a great member of the CAQ Governing Board…He brought a perspective that was key to establishing the CAQ as a policy organization not only dedicated to enhancing the quality of the audit, but also, more broadly, to building investor confidence and public trust in the global capital markets. Throughout his tenure, Harvey kept the CAQ continuously focused on the important voices of the investor and the regulator."

Upcoming Events

March 4
FASB Board Meeting, Norwalk, CT (Link)

March 4
SEC Advisory Committee on Small and Emerging Companies, Washington, DC (Link)

March 9-11
IIA General Audit Management Conference, Las Vegas, NV (Link)

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

March 19-20
AICPA Fair Value Measurements Workshop, New York, NY (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 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.

