CENTER FOR AUDIT QUALITY

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CAQ Public Policy Monitor

MARCH 2015

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 approves reorganization of auditing standards
- PCAOB publishes progress report on broker-dealer interim inspections program
- The SEC Speaks in 2015 conference
- SEC adopts 2015 GAAP Financial Reporting Taxonomy
- FASB, IASB to propose additional changes to revenue recognition standard
- IASB outlines practical effects of proposed leases standard
- IFRS Foundation publishes 2015 IFRS Taxonomy
- IFIAR issues survey of inspection findings
- FRC encouraged by first year of extended auditor's report requirements
- Senate, House committees approve cyber threat sharing bills
- U.S. Chamber issues 2015 FAR Agenda
- CAQ, IIA report identifies steps to improve audit, risk management
- Upcoming Events

PCAOB

PCAOB approves reorganization of auditing standards

The Public Company Accounting Oversight Board (PCAOB) on March 31 unanimously approved the reorganization of its audit standards into a topical, integrated numbering system that integrates the existing interim and PCAOB-issued auditing standards. The PCAOB believes this reorganization will facilitate better compliance with auditing standards, by improving searchability, usability, and ordering in a more logical way, following the flow of the audit process. Under the reorganization, the individual standards will be grouped into the following topical categories:

- *General Auditing Standards*: standards on broad auditing principles, concepts, activities, and communications.

- *Audit Procedures*: standards for planning and performing audit procedures and for obtaining audit evidence.

- *Auditor Reporting*: standards for auditors' reports.

- *Matters Relating to Filings Under Federal Securities Laws*: standards on certain auditor responsibilities relating to Securities and Exchange Commission (SEC) filings for securities offerings and reviews of interim financial information.

- *Other Matters Associated with Audits*: standards for other work performed in conjunction with an audit.

These amendments remove references to superseded standards and inoperative language and references. They do not impose new requirements on auditors or change the substance of the requirements for performing and reporting on audits under PCAOB standards. The amendments will be effective, subject to SEC approval, as of December 31, 2016. Going forward, new auditing standards adopted by the Board would be issued as new or replacement sections and paragraphs within the new structure.

PCAOB publishes progress report on broker-dealer interim inspections program

The PCAOB on March 18 published a review of its broker-dealer inspection program. The Board's Office of Internal Oversight and Performance Assurance (IOPA) undertook the review to determine the Division of Registration and Inspections' (DRI) progress in building an interim inspections program for auditors of brokers and dealers.

The IOPA concludes that the DRI has made significant progress in building an interim inspections program that would (1) assist the Board in making informed judgments about the scope of a permanent program and (2) prepare the infrastructure to execute that program once adopted. The report also notes a number of areas that will require sustained attention as the PCAOB prepares to transition to a permanent inspections program. Specifically, the DRI will need to:

- Continue to build a well-qualified staff with expertise related to brokers and dealers, as well as train and retain staff once on board.

- Provide the Board with thoroughly developed and analyzed alternative solutions, which will require continued efforts to collect and analyze non-public data on brokers and dealers, evaluate inspection results, and incorporate economic analysis into the proposed solutions.

- Prepare for the addition of firm-specific report writing and remediation under the permanent program.

- Establish a formal timeline with the Board pertaining to steps in the rule proposal program.

SEC

The SEC Speaks in 2015 conference

The Practising Law Institute held its "The SEC Speaks in 2015" conference on February 20 and 21. Securities and Exchange Commission (SEC) Chair Mary Jo White, Commissioners Luis Aguilar, Daniel Gallagher, Kara Stein, and Michael Piwowar, and SEC Investor Advocate Rick Fleming addressed the conference.

Chair White summarized key accomplishments off 2014, including record enforcement activity. She also highlighted three core initiatives for 2015:

- Enhancing market structure, including increasing transparency and accountability, and mitigating market stability concerns.

- Strengthening asset managers to address risks that could have a systemic impact on the capital markets.

- Facilitating capital formation for smaller issuers by looking for ways SEC rules can be used to help these companies thrive.

White added that the SEC will continue to implement the remaining Dodd-Frank Act requirements, among a number of other initiatives – for example, evaluating fiduciary duties and financial responsibility rules for broker-dealers, disclosure effectiveness, and updating rules for transfer agents.

Commissioner Stein and Investor Advocate Fleming promoted the benefits of XBRL. According to Stein, the SEC's "goal should be leveraging data to enhance disclosure and provide greater transparency." Although technology has advanced since the SEC launched the EDGAR system in 1995, EDGAR has not kept pace. "Going forward," she said, "we should be thinking broadly about new and creative ways to make the information contained in the filings more accessible to investors. In short, modernizing this critical disclosure portal should be a top priority to provide benefits to both companies who file and investors who get their information from the filings." Stein added that, "fundamentally, we should be moving toward data protocols that allow data to be submitted more easily by companies, and analyzed and compared more easily by investors. This would reduce the burden to filers by improving the capture of structured data while at the same time providing all market participants with greater ability to use and share the data."

Fleming said that, "if the SEC wants issuers to provide effective disclosure to the 21st Century investor, the data needs to be both layered and structured…[S]tructured data could assist the analyst or intermediary who wants to search data dynamically and compare multiple companies by slicing and dicing the data. Millions of investors in pension plans and other pooled investment vehicles could greatly benefit from these enhanced analytical tools, and smaller reporting companies may find greater trading volume in their shares as analysts are able to use data more effectively and cover more companies."

In addition to the above speakers, David Glockner, director of the SEC's Chicago Regional Office, told the conference that, although cybersecurity is an area where the SEC has not brought a significant number of cases, it "is high on our radar screen." He said the SEC is looking at two areas in particular: the cybersecurity controls companies have in place to protect market integrity, and the adequacy of companies' disclosures of "material" cyber events.

SEC adopts 2015 GAAP Financial Reporting Taxonomy

The SEC on March 9 announced that the EDGAR system has been upgraded to Release 15.0.3 and now supports the 2015 GAAP Financial Reporting Taxonomy (Taxonomy). The 2015 Taxonomy reflects the same taxonomy that the Financial Accounting Standards Board (FASB) made available on December 18, 2014.

While the SEC does not anticipate removing the 2013 Taxonomy before June 2015, the staff is encouraging companies to use the 2015 Taxonomy for their XBRL exhibits to take advantage of the most up-to-date tags related to new accounting standards and other improvements. The staff suggests that filers consider transitioning to the 2015 taxonomies for the earliest reporting period that ends after March 9, 2015.

The FASB will host a live webcast on April 2 to discuss changes in the 2015 Taxonomy and how to use the Taxonomy Implementation Guides to support more efficient and effective XBRL document creation. SEC staff also will discuss current XBRL filing issues.

FASB/IASB

FASB, IASB to propose additional changes to revenue recognition standard

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) on March 18 agreed to propose additional changes to the converged revenue recognition standard to address financial statement preparers' implementation concerns.

- To address preparer concerns that the frequency and extent of contract modifications may make an evaluation of each of those modifications during transition complex and costly, the boards agreed to propose a "use of hindsight" expedient. The IASB also will propose a practical expedient to permit an entity electing the full retrospective approach to apply the new revenue standard retrospectively only to contracts that are not completed as of the beginning of the earliest period presented. The FASB voted not to propose this expedient.

- The FASB agreed to add a project to its technical agenda to propose revisions to the standard that would permit a practical expedient for presentation of sales taxes. It would allow an election for net reporting for all in-scope sales taxes with disclosure of the policy. The IASB voted not to propose this revision.

- The FASB will propose clarifying the guidance for determining the measurement date for noncash consideration, explaining that noncash consideration is measured at contract inception. The FASB also voted to propose applying the constraint on variable consideration only to transactions in which the fair value of noncash consideration might vary for reasons other than the form of the consideration. The IASB voted not to propose clarifying this guidance.

- To address preparer concerns about applying the standard in situations when they sign a contract to provide goods or services with a customer with low credit quality, or a customer whose credit quality deteriorates after the contract is signed, FASB voted to improve the articulation of the guidance. The IASB will make decisions at a future meeting about whether and how to clarify the collectability guidance.

The FASB directed the staff to draft a proposed Accounting Standards Update (ASU). The proposed ASU will have a 45-day comment period.

Also during the March 18 meeting, the FASB directed the staff to draft two additional ASUs:

- One proposed ASU would be designed to simplify the equity method of accounting. Specifically, it would eliminate the requirement that entities retroactively adopt the equity method of accounting if an investment that was previously accounted for on other than the equity method becomes qualified for use of the equity method by an increase in the level of ownership interest. The proposed ASU will have a 60-day comment period.

- The second would apply to accounting for measurement period adjustments in a business combination. Under the proposed ASU, an acquirer would recognize adjustments of provisional amounts in the reporting period in which the adjustment amount is determined. The acquirer would record, in that period, the cumulative effect on earnings of changes in depreciation, amortization, or other income effects, as a result of the change to the provisional amount. The proposed ASU will have a 45-day comment period.

IASB outlines practical effects of proposed leases standard

The IASB on March 16 published an outline of the likely practical effects of its proposed leases standard. The IASB expects to issue the final standard later this year.

While the IASB and FASB have reached the same decisions in many areas – such as requiring leases to be shown on the balance sheet, how to define a lease, and how lease liabilities should be measured – a number of differences remain. The document provides an overview of the likely practical effects of these differences.

The document also examines other potential implications of the leases accounting model, such as the possible impact on the cost of borrowing. It clarifies that the new standard will provide more transparent information about a company's financial commitments, but does not change those commitments. The document explains that, should the standard affect the cost of borrowing for a company, it would be because the improved reporting provides lenders with new information that is relevant and important to their decision-making.

IFRS Foundation publishes 2015 IFRS Taxonomy

The IFRS Foundation on March 11 published the IFRS Taxonomy 2015. The IFRS Taxonomy is the XBRL representation of the IFRSs, including International Accounting Standards (IASs), Interpretations, and the IFRS for SMEs (Small and Medium-sized Entities), as issued by the IASB. The IFRS Taxonomy 2015 is consistent with IFRS as issued by the IASB as of January 1, 2015, including standards published but not yet effective at that date.

International

IFIAR issues survey of inspection findings

The International Forum of Independent Audit Regulators (IFIAR) on March 3 released its *2014 Survey of Inspection Findings* (Survey). The Survey covers findings identified by IFIAR members in inspections of significant audit firms in their respective jurisdictions.

Overall, the Survey found deficiencies in close to half of the 948 public company audits inspected. The topics with the highest numbers of findings overall were internal control testing (24 percent), fair value measurement (20 percent), and revenue recognition (14 percent).

Lewis Ferguson, IFIAR chair and Public Company Accounting Oversight Board member, said, "We continue to see high levels of inspection deficiencies in vital areas of public company audits. This is a problem for investors and stakeholders around the world." However, Ferguson said during a news conference, "There are some very interesting things going on in this profession right now. It's quite exciting to watch what's happening. I'm actually reasonably optimistic that we will see some significant improvements."

Janine van Diggelen, IFIA vice-chair and head of the Audit and Reporting Quality Division at the Netherlands Authority for the Financial Markets, added that root cause analysis "is absolutely necessary" to improve audit quality. "A well performed in-depth root cause analysis will provide the firms with a thorough understanding of the factors that underlie [the Survey's] findings, which includes the cultural and behavioral influences relevant to the deficiencies. Only with this understanding can audit firms develop the appropriate remedial actions."

CAQ Point of View:

Public company auditing is a dynamic field that responds to the evolving demands of a global economy, CAQ Executive Director Cindy Fornelli said in a statement. "The profession is strongly committed to an ongoing cycle of improvement, which means continuously evaluating approaches and methodologies, responding to issues that stem from the inspection process, and remaining focused on the core tenets of independence, objectivity, and skepticism."

FRC encouraged by first year of extended auditor's report requirements

The U.K. Financial Reporting Council (FRC) on March 2 published a report on the implementation of its June 2013 revised auditing standard for the independent auditor's report on financial statements. The revised standard requires the auditor to explain in the auditor's report more about the work performed. In particular, the auditor must:

- Provide an overview of the scope of the audit, showing how this addressed the risk and materiality considerations.
- Describe the risks that had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.
- Provide an explanation of how they applied the concept of materiality in planning and performing the audit.

The revised standard also encourages auditors to provide explanations that relate directly to the specific circumstances of the audited entity rather than generic or abstract explanations expressed in standardized language.

The FRC analyzed 153 extended auditor's reports that had been published as of September 2014. Overall, the FRC found that auditors not only have met the new requirements, in many cases they have made further – sometimes radical – changes to auditor's reports going beyond the changes required by the FRC. The report notes in particular that audit firms have adopted different approaches to the extended auditor's report and have been innovative in different ways. Significant areas of innovation include:

- Reporting of detailed audit findings with respect to identified risks.
- Experimentation with detailed broader explanation of the audit scoping process.
- Improved presentation of auditor's reports through the use of diagrams and graphs.
- Addressing going concern disclosures in auditor's reports.

The FRC also identified three areas in which further improvements could be made:

- Increasing the granularity of risk reporting.
- Improving the discussion of the auditor's application of materiality and why a particular benchmark or level was chosen and addressing other aspects of materiality.
- Making a clearer linkage between the discussions of risks and materiality and the description of how these influenced the audit's scope.

U.S. Congress

Senate, House committees approve cyber threat sharing bills

The Senate Intelligence Committee on March 12 approved S. 754, the *Cybersecurity Information Sharing Act* (CISA), by a vote of 14 to 1. The bill provides additional incentives to the private sector to increase sharing of cybersecurity threat information, including liability protections. In particular, CISA would:

- Direct increased sharing of classified and unclassified information about cyber threats with the private sector, including declassification of intelligence as appropriate.
- Authorize private entities to monitor their networks or those of their consenting customers for cybersecurity purposes. Companies are authorized to share cyber threat indicators or defensive measures with each other or the government.
- Require the establishment of a "portal" at the Department of Homeland Security (DHS) as the primary government capability to quickly accept cyber threat indicators and defensive measures through electronic means.
- Require reports on implementation and privacy impacts by agency heads, Inspectors General, and the Privacy Civil Liberties Oversight Board to ensure that cyber threat information is properly received, handled, and shared by the government.

One concern that has dogged previous versions of the legislation is that they included inadequate provisions for safeguarding consumer privacy and civil liberties. To address that concern, S. 754 would require that personally identifiable information be removed prior to sharing cyber threat indicators. It also would narrowly define the term "cyber threat indicator" to limit the amount of information that may be shared and limit the use of cyber threat indicators to specific purposes, including the prevention of cybersecurity threats and serious crimes. Sharing would be strictly voluntary.

The House Intelligence Committee on March 26 approved its own cybersecurity threat information sharing legislation. Similar to the Senate Intelligence Committee's bill, H.R. 1560, the *Protecting Cyber Networks Act*, would enable private companies to voluntarily share cyber threat indicators with one another and to voluntarily share these indicators with any federal agency, except the National Security Agency or Department of Defense.

To protect consumer privacy, H.R. 1560 would require companies to remove personally identifiable information before they share cyber threat indicators with a federal agency. The federal agency receiving the information would be required to perform a second check to remove personally identifiable information before sharing the indicators with other relevant federal agencies. The bill also would permit individuals to sue the federal government for intentional privacy violations in federal court.

Other Policy Developments

U.S. Chamber issues 2015 FAR Agenda

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) released its annual *Fix.Add.Replace. (FAR) Agenda*. The *FAR Agenda* outlines and prioritizes improvements to the U.S. financial regulatory structure.

The *FAR Agenda* for 2015 calls for ending regulation through enforcement by creating a dialogue with the Public Company Accounting Oversight Board (PCAOB) to ensure that audited financial statements provide investors and businesses with decision useful information. It also recommends that the PCAOB establish a definition of "audit failure" predicated on materiality and how that applies to the restatement of financial reports.

The recommendations for 2015 also include:

- The PCAOB and Financial Accounting Standards Board (FASB) should be required to conduct cost-benefit analyses and follow the transparency requirements of the Administrative Procedures Act and Federal Advisory Committee Act when developing standards.
- The FASB's and International Accounting Standards Board's (IASB) final lease accounting standard should accurately reflect economic activity and provide useful information to investors.
- The Securities and Exchange Commission (SEC) should develop a disclosure framework that addresses "information overload" and ensures that investors are provided with the information they need to make informed investment and voting decisions. Such a framework should ensure that the materiality standard remains the guiding principle for determining what is disclosed in SEC filings.
- A financial reporting forum made up of regulators, standard-setters, investors, and businesses to proactively identify problems within the financial reporting system and suggest solutions should be created.
- The SEC and Commodities Futures Trading Commission should be consolidated to create a streamlined and rational regulatory structure.

CAQ Updates

CAQ, IIA report identifies steps to improve audit, risk management

A research paper published on March 10 by the Center for Audit Quality (CAQ) and Institute of Internal Auditors (IIA) found that stronger communications and cooperation among three key players in the financial statement auditing process – external auditor, internal auditor, and audit committee – could help avoid potential tensions and result in improved risk management. The paper is based on three roundtable discussions held in the Fall of 2014, which drew representatives from each stakeholder group.

"Successful organizations will recognize the importance of building and sustaining effective relationships among the audit committee, those responsible for the internal audit function, and the external auditor," the paper, *Intersecting Roles: Fostering Effective Working Relationships Among External Audit, Internal Audit, and the Audit Committee Intersecting Roles: Fostering Effective Working Relationships Among External Audit, Internal Audit, and the Audit Committee*, says. "There are efficiencies and enhancements that can be realized in risk assessment, risk management, and in the performance of the external audit, while respecting each stakeholder's roles and responsibilities in accordance with professional standards. Both formal and informal channels of communication are critical. Because they are charged with over-sight of both the internal and external audit functions, audit committees are instrumental in determining the amount of support and resources that each group receives."

The paper shares practitioners' best practices and strategies for coping with challenges in three areas:

- Creating a more productive and efficient external audit process within the constructs of PCAOB requirements. One major topic of discussion during the roundtables was the impact of *Staff Audit Practice Alert No. 11*, which discusses, among other matters, what external auditors require in order to use the work of internal audit, and when it is not appropriate to use that work.

- Audit committees fostering better communication between internal and external auditors to build more effective working relationships. Roundtable participants discussed several specific tactics that audit committees may want to consider to help improve audit efficiency, including: (1) coordinating walk-throughs between internal audit and external audit to be sure they are not done twice; (2) to the extent possible, having internal audit use the same templates as external audit, so external audit does not have to spend as much time reformatting; and (3) discussing the allocation of work to be performed by the internal auditor for use in the external audit – and what the external audit team will do on its own – early in the process to avoid having internal audit perform work that will have to be duplicated by the external auditor because of the associated level of risk or a PCAOB requirement.

- Introducing enterprise risk management (ERM) to an organization. "The status of ERM in an organization naturally affects how key stakeholders work together, as well as the frequency and nature of their communications," the paper says. "Risk management may be strong in many departments, groups, and locations, but still remains inadequate at the entity level. Much of the effort will therefore focus on taking existing risk management strengths and leveraging them into an ERM structure."

Upcoming Events

April 2
FASB Webcast, "2015 GAAP Financial Reporting Taxonomy Changes and Beyond, Taxonomy Implementation Guides, and SEC Update" (Link)

April 9
SEC Investor Advisory Committee, Washington, DC (Link)

April 16
SEC Historical Society Broadcast, "COSO at Thirty Years" (Link)

April 23
PCAOB Forum on Auditing in the Small Business Environment, Houston, TX (Link)

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

April 27-30
IASB Board Meeting, London, UK (Link)

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

May 6-8
ICI General Membership Meeting, Washington, DC (Link)

May 13
AICPA Cyber Security for CPAs Workshop, Denver, CO (Link)

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

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

May 21
PCAOB Forum on Auditing in the Small Business Environment, Seattle, WA (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 5-8
IIA International Conference, Vancouver, Canada (Link)

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

July 16
PCAOB Forum on Auditing in the Small Business Environment, New York, NY (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 27-30
ICI Tax and Accounting Conference, Orlando, FL (Link)

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

October 6
U.S. Chamber of Commerce Cybersecurity Summit, Washington, DC (Link)

October 6
PCAOB Forum on Auditing in the Small Business Environment, Pittsburgh, PA (Link)

Oct 22-23
PCAOB Conference on Auditing and Capital Markets, Washington, DC (Link)

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

October 29
PCAOB Forum on Auditing in the Small Business Environment, West Palm Beach, FL (Link)

November 5
ICI Cybersecurity Forum, Washington, DC (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.