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

Senators re-introduce PCAOB Enforcement Transparency Act

Senators Jack Reed (D-R.I.) and Charles Grassley (R-Iowa) on April 23 re-introduced legislation to make the Public Company Accounting Oversight Board's (PCAOB) disciplinary proceedings public. Reed and Grassley originally introduced the *PCAOB Enforcement Transparency Act* in November 2011, and re-introduced it in April 2013.

"The PCAOB is responsible for ensuring that auditors of public companies meet the highest standards of quality, independence and ethics," Reed said in a statement. "Reliable financial reporting is vital to the health of our economy, and we must take the legislative steps necessary to enhance transparency in the PCAOB's enforcement process. Currently, Congress, investors and others are being denied critical information about an auditor's disciplinary process. Investors and companies alike should be aware when the auditors and accountants they rely on have been charged or sanctioned for violating professional auditing standards."

According to Grassley, "Transparency brings accountability. This legislation levels the playing field between auditors reviewed by the [Securities and Exchange Commission (SEC)] and auditors reviewed by the PCAOB. Currently, PCAOB proceedings are secret while SEC proceedings are not. The secrecy provides incentives to bad actors to extend the proceedings as long as possible so they can continue to do business without notice to businesses about potential problems with a particular auditor. This bill ends the secrecy and brings the kind of transparency that adds accountability to agency proceedings."

Neither the 2011 bill nor the identical 2013 bill received hearings in the Senate Banking Committee. With Republicans now in control of the Committee, the 2015 bill is highly likely to meet the same fate.

PCAOB enters into cooperative agreement with Hungarian audit regulator

The PCAOB on April 16 announced that it had entered into a cooperative agreement with the Auditors' Public Oversight Authority of the Ministry for the National Economy of Hungary (APOA). The agreement provides a framework for joint inspections, data protection, and the exchange of confidential information. There are six registered public accounting firms in Hungary.

According to PCAOB Chairman James Doty, the APOA "put great effort into establishing an independent audit inspection program, and we look forward to working closely together for our mutual benefit. This further strengthens the PCAOB's cooperative arrangements in Europe, which are driven by our shared goals to improve audit quality and protect investors."

SEC

SEC to consider adequacy of management review controls

Brian Croteau, the SEC's deputy chief accountant, on April 24 said the SEC staff would consider whether new guidance on management review controls is needed. The adequacy of such controls is "an ongoing issue with a frequent number of [PCAOB] inspection comments. It's not an area that seems to be improving. So why might that be? Is there something we could do to be more clear?"

The staff study will try to determine the reasons for an apparent disconnect between, on the one hand, how some companies apply the SEC's 2007 guidance on the Management's Report on Internal Control Over Financial Reporting and, on the other, how auditors respond to the requirements in Auditing Standard No. 5 and inspection findings. "There is an initial tendency among some to quickly suggest that PCAOB inspectors are driving auditors to perform work that is unnecessary," Croteau said. "While the inspection findings are, of course, one very visible factor to consider, it's only one of several factors in the equation. The SEC's interpretive guidance and AS5 are aligned in this area, so as a starting point I'd like to better understand examples of the types of facts and circumstances where the differences in views between management and auditors are most significant."

One possible explanation for the disconnect, Croteau suggested, might be that in some instances management may not be fully informed about the nature of the issues behind the most frequent PCAOB inspection deficiencies related to the auditing of management review controls. Another possible explanation might be that "Perhaps some audit engagement teams aren't fully explaining the reasons why such procedures are an important element of the audit when explaining their planned procedures."

Investors ask for scrutiny of climate change risk reporting

A group of institutional investors on April 17 wrote to SEC Chair Mary Jo White to request that the SEC "closely scrutinize oil and gas companies' reporting" on risks related to climate change. "As institutional investors representing over $1.9 trillion in assets under management, we are concerned that oil and gas companies are not disclosing sufficient information about several converging factors that, together, will profoundly affect the economics of the industry," the group wrote. "They include capital expenditures on increasingly high cost, carbon intensive oil and gas exploration projects, government efforts to limit carbon emissions, and the possibility of reduced global demand for oil as early as 2020."

The letter noted that the SEC, in its 2010 interpretive guidance on climate change disclosure, advised companies that "Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants. These developments may create demand for new products or services, or decrease demand for existing products or services." The guidance specifically suggested that companies disclose potential "decreased demand for goods that produce significant greenhouse gas emissions."

The group wrote that they "have found an absence of disclosure in SEC filings regarding these material risks, which constitute 'known trends' under SEC rules, and respectfully ask the Commission to address this issue in comment letters to issuers."

SEC proposes pay-for-performance, cross-border security-based swap rules

SEC on April 29 voted to propose a rule to require public companies to disclose the relationship between executive compensation and the company's financial performance. Under the rule, a company would be required to disclose executive pay and performance information for itself and companies in a peer group in a table and to tag the information using XBRL.

A company would be required to disclose executive compensation actually paid for its principal executive officer using the amount already disclosed in the summary compensation table required in the proxy statement, making adjustments to the amounts included for pensions and equity awards. The amount disclosed for the remaining executive officers would be the average compensation actually paid to those executives. All companies would be required to disclose the information for the last five fiscal years, except for smaller reporting companies, which would only be required to provide disclosure for the last three fiscal years.

The SEC also voted to propose a rule to require a non-U.S. company that uses U.S. personnel to arrange, negotiate, or execute a security-based swap transaction in connection with its dealing activity to include that transaction in determining whether it is required to register as a security-based swap dealer. According to SEC Chair Mary Jo White, "The rules will help ensure that both U.S. and non-U.S. dealers are subject to our registration, reporting, public dissemination and business conduct requirements when they engage in security-based swap activity in the United States, resulting in increased transparency and enhanced stability and oversight."

FASB/IASB

FASB, IASB propose to defer revenue recognition standards' effective date

The Financial Accounting Standards Board (FASB) on April 29 issued the proposed Accounting Standards Update (ASU), *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective*

Date. Under the proposed ASU, public companies would apply the new standard to annual reporting periods beginning after December 15, 2017, and to interim reporting periods within annual reporting periods beginning after December 15, 2017. The deadline for submitting comments is May 29.

The International Accounting Standards Board (IASB) on April 28 also decided to propose the deferral of the effective date of IFRS 15, *Revenue from Contracts with Customers*, until January 1, 2018. The Board said the reason for deferring the effective date was that it plans to issue an Exposure Draft with proposed clarifications to IFRS 15, as well as the desire to keep the effective date of the IASB's and the FASB's new revenue recognition standards aligned. In a discussion paper prepared for the April 28 meeting, the IASB staff recommended that the proposed deferral be released for public comment as a separate narrow-scope Exposure Draft with a 30-day comment period.

FASB issues four new, six proposed ASUs

The FASB issued four new standards in April:

- The objective of ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, is to simplify presentation of debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The ASU does not affect the recognition and measurement guidance for debt issuance costs. For public companies, the ASU is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application is permitted.

- For an entity with a fiscal year-end that does not coincide with a month-end, ASU 2015-04, *Compensation – Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*, permits the entity to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end and apply that practical expedient consistently from year to year. The ASU is effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application is permitted.

- ASU 2015-05, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, provides guidance to customers about whether a cloud computing arrangement includes a software license. If such an arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for it as a service contract. For public business entities, the ASU is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early application is permitted.

- ASU 2015-06, *Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions*, specifies that, for purposes of calculating historical earnings per unit under the two-class method, the earnings (losses) of a transferred business before the date of a drop down transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners (which is typically the earnings per unit measure presented in the financial statements) would not change as a result of the dropdown transaction. Qualitative disclosures about how the rights to the earnings (losses) differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method also are required. The ASU is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted.

In addition to the proposed ASU to defer the revenue recognition standard's effective date, the FASB also proposed ASUs on derivatives and hedging, employee benefit plan accounting, not-for-profit financial statements, and prepaid stored-value cards:

- Proposed ASU, *Derivatives and Hedging (Topic 815): Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts within Nodal Energy Markets*, aims to eliminate diversity in practice resulting from differing opinions on whether certain contracts for the purchase or sale of electricity on a forward basis should be eligible for a scope exception from guidance that requires that a derivative contract be recorded at fair value. The deadline for submitting comments is May 18.

- Proposed ASUs, *Plan Accounting (Topics 960, 962, and 965): (I) Fully Benefit-Responsive Investment Contracts, (II) Plan Investment Disclosures, and (III) Measurement Date Practical Expedient*, are intended to simplify accounting for employee benefit plans. The proposed ASUs would: (1) designate contract value as the only required measure for fully benefit-responsive investment contracts; (2) require that participant-directed and nonparticipant-directed investments of employee benefit plans be grouped only by general type, eliminating the need to disaggregate the investments in multiple ways; and (3) provide a practical expedient allowing employers to measure defined benefit plan assets on a month-end date nearest to the employer's fiscal year end when the fiscal period does not coincide with a month end.

- Proposed ASU, *Presentation of Financial Statements of Not-for-Profit Entities*, aims to improve current net asset classification requirements and information presented in financial statements and notes to financial statements about a not-for-profit organization's liquidity, financial performance, and cash flows. With regard to cash flows, the proposed ASU would make the statement of cash flows more understandable by (a) presenting cash flows provided by operating activities using the direct method of reporting, and (b) classifying cash flows in ways that are more consistent with classifications in the statement of activities. FASB Vice Chairman Jim Kroeker suggested that public companies study the proposal and consider whether the proposed changes around cash flow classifications might have merit for public companies as well. He said discussion of cash flow classification issues for not-for-profits led to a determination that the accounting would be better ultimately if public companies were required to use a direct method of classification cash flows rather than the more common indirect method.

- Proposed ASU, *Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards*, would specify how prepaid stored-value card liabilities within its scope should be derecognized, thereby eliminating current and potential future diversity in practice. The deadline for submitting comments is June 29.

International

IAASB revises standard on auditor's responsibilities relating to other information

The International Auditing and Assurance Standards Board (IAASB) on April 8 released International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*. In revising ISA 120, the IAASB sought to ensure that the standard appropriately reflected the context of today's financial reporting environment, thereby promoting further alignment of users' expectations and auditors' responsibilities. The Board also sought to serve the public interest by ensuring that there is an appropriate auditor response in the event the other information could undermine the credibility of the audited financial statements and the auditor's report.

According to the IAASB's summary of the revised standard, there are three main changes to ISA 720:

- Other information is defined as financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. ISA 720 (Revised) does not apply to preliminary announcements of financial information or securities offering documents, including prospectuses.

- ISA 720 (Revised) requires the auditor to read the other information and consider (1) whether there is a material inconsistency between the other information and the financial statements; and (2) whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit.

- The auditor's report must include: (1) a statement that management is responsible for the other information; (2) identification of the other information obtained prior to the date of the auditor's report. In the case of a listed entity, the auditor is also required to identify any other information expected to be obtained after the date of the auditor's report; (3) a statement that the auditor's opinion does not cover the other information and, accordingly, that the auditor does not express (or will not express) an audit opinion or any form of assurance conclusion thereon; and (4) a description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by ISA 720 (Revised).

ISA 720 (Revised) will be effective for audits of financial statements for periods ending on or after December 15, 2016.

Separately, the IAASB on April 22 published *Auditor Reporting – Illustrative Key Audit Matters*. The publication illustrates how the concept of Key Audit Matters – defined as those matters that, in the auditor's professional judgment, were of most significance in the financial statement audit – may be applied in practice in accordance with ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. The new publication builds on matters highlighted in the January 2015 publication *Auditor Reporting – Key Audit Matters*.

IFIAR agrees on framework for information sharing

The International Forum of Independent Audit Regulators (IFIAR) held its annual meeting on April 21-23. According to a summary of the meeting, members discussed and reached agreement in principle on the text of a Multilateral Memorandum of Understanding (MMOU) that would provide a framework for information sharing among those IFIAR members that decide to sign the MMOU once it is finalized and opened for signature. Other highlights include the following:

- IFIAR addressed how changes in the economic environment and the market for audit services have impacted or may in the future impact the audit industry and audit quality, in particular disclosure of audit quality.

- Members shared insights on developments and changes to the auditor's report and audit committee reporting, focusing on experiences to date with extended reporting in a panel discussion with the IAASB chair and an investor representative.

- Janine van Diggelen of the Netherlands Authority for the Financial Markets was elected chair, replacing PCAOB member Lewis Ferguson as chair. Brian Hunt of the Canadian Public Accountability Board was elected vice chair.

IESBA strengthens auditor independence rules

The International Federation of Accountants' International Ethics Standards Board for Accountants on April 14 released a revised version of the *Code of Ethics for Profession Accountants*. The changes are intended to enhance the *Code*'s independence provisions by no longer permitting auditors to provide certain prohibited non-assurance services to public interest entity (PIE) audit clients in emergency situations. The revised *Code* also ensures that auditors do not assume management responsibility when providing non-assurance services to audit clients.

India requires more stringent audits

The Indian government on April 10 issued Companies (Auditor's Report) Order, 2015 (the English version begins on p. 5). The Order directs auditors to highlight lapses related to internal control, inventories and outstanding dues as part of a more stringent set of rules to curb fraudulent practices. With respect to internal control, the Order specifically stipulates that the auditor's report must mention whether there is an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets, and for the sale of goods and services. The auditor also must report whether the company has failed to correct major internal control weaknesses.

CAQ Updates

CAQ, AAA announce awards for Access to Audit Personnel Program

The Center for Audit Quality (CAQ) and the Auditing Section of the American Accounting Association on April 16 announced awards for the Access to Audit Personnel Program. Now in its third year, the Program facilitates academic scholars' access to audit firm personnel who participate in their research projects. From the 24 proposals submitted, the Review Committee of audit partners and senior academics selected the following four:

- Ann Backof, University of Virginia, *How Does Evidence Specificity in Auditors' Look-Back Analysis Affect Auditors' Planning Judgments?*

- Cassandra Estep, University of Illinois at Urbana-Champaign, *Integrating IT Specialist Input on Audit Engagements: The Joint Effects of IT Specialist Attitude and Team Membership*

- Michael Ricci, University of Georgia, *Using Audit Programs to Improve Audits of Complex Estimates*

- Nicole Wright, Northeastern University, *The Impact of Attraction Effect and Specific Guidance on Auditors' Assessment of Level 3 Fair Value Assumptions*

Approximately 500 audit staff of varying levels from the eight CAQ Governing Board firms will be asked to participate in these research projects.

Nicole Holden joins CAQ Professional Practice team

In April, the CAQ welcomed Nicole Holden as a new Technical Director for Professional Practice. Prior to arriving at the CAQ, Holden served as Senior Manager and Assistant Chief Auditor for the PCAOB, where she focused on identification of higher risk audits and audit areas for closer consideration by the Division of Inspections and Division of Enforcement. In that role, Holden identified and analyzed emerging accounting and operational issues that may present elevated risk of audit failure, and evaluated current trends and developments affecting public companies accounting policies.

Upcoming Events

May 5
FASB Private Company Council Meeting, Norwalk, CT (Link)

May 6
FASB Board Meeting, Norwalk, CT (Link)

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

May 7
Baruch College Annual Financial Reporting Conference, New York, NY (Link)

May 11
FASB Investor Advisory Committee Meeting, Norwalk, CT (Link)

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

May 13-15
AICPA CFO Conference, 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 18-20
IASB Board Meeting, London, UK (Link)

May 21
PCAOB Forum on Auditing in the Small Business Environment, Seattle, WA (Link)

June 3
PCAOB Forum for Auditors of Broker-Dealers, Chicago, IL (Link)

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

June 5
SEC and Financial Reporting Institute Conference, Pasadena, CA (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 24
PCAOB Forum for Auditors of Broker-Dealers, Jersey City, NJ (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)

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

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

October 28
PCAOB Forum for Auditors of Broker-Dealers, West Palm Beach, FL (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 1
PCAOB Forum for Auditors of Broker-Dealers, Las Vegas, NV (Link)

December 2
PCAOB Forum on Auditing in the Small Business Environment, Las Vegas, NV (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.