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

PCAOB issues Audit Committee Dialogue

The Public Company Accounting Oversight Board (PCAOB) on May 7 issued the first in a series of communications intended to provide insights from inspections of public company auditors that may be helpful to audit committee members in their oversight of the auditor. The *Audit Committee Dialogue* highlights key areas of recurring concern in PCAOB inspections of large audit firms as well as certain emerging risks to the audit. The *Dialogue* also provides targeted questions that audit committee members could ask their auditors on each topic.

The key recurring areas of concern include: auditing internal control over financial reporting; assessing and responding to risks of material misstatement; auditing accounting estimates, including fair value measurements; and deficiencies in work performed by other audit firms and used by the signing audit firm. The emerging risks include: increase in mergers and acquisitions; falling oil prices; undistributed foreign earnings; and maintaining audit quality when growing other business lines.

SAG meeting to focus on use of specialists, accounting estimates

The PCAOB on May 28 announced that the June 18 Standing Advisory Group (SAG) meeting will focus on two ongoing standard-setting projects: the auditor's use of the work of specialists, and auditing accounting estimates, including fair value measurements.

In connection with the discussion of the use of specialists, the PCAOB also released for public comment a staff consultation paper that seeks input on potential changes to the standards for the auditor's use of the work of specialists, specifically the objectivity and oversight of specialists and the use of their work in audits. Staff Consultation Paper No. 2015-01, *The Auditor's Use of the Work of Specialists*, discusses the increase in the use and importance of specialists in recent years due, in part, to the increasing complexity of business transactions reported in a company's financial statements. The paper raises questions about whether PCAOB standards adequately address the auditor's use of the work of specialists, and whether more rigorous standards and specific procedures are needed in this regard to help the auditor respond to the risks of material misstatement in financial statements. The deadline for submitting comments is July 31.

The meeting agenda also includes an update on the staff's work in developing a new standard on auditing accounting estimates, along with a discussion of three areas where the staff is seeking SAG member views: emphasizing professional skepticism, addressing significant measurement uncertainty, and using third parties. In August 2014, the PCAOB issued a staff consultation paper on auditing accounting estimates and fair value measurements, including how a potential new standard might address the varying circumstances when auditors obtain information from third parties, including specialists. The staff anticipates that some of the comments submitted on the specialists consultation paper will be relevant to the estimates and fair value project.

> CAQ Point of View:
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> In a comment letter on the PCAOB's August 2014 staff consultation paper, the CAQ wrote that, "Given the wide range of issues associated with many accounting estimates, including fair value measurements, there may not be a 'one-size-fits-all' solution to these auditing challenges. It is important to continue to analyze the root cause of these issues, particularly as it relates to the inspection deficiencies observed by the PCAOB and other global standard-setters." A potential new standard, the CAQ added, should "acknowledge that all accounting estimates, including fair value measurements, are not the same, and allow for the continued application of the auditor's risk assessment process."

Hanson: What the PCAOB is hearing from audit committees, preparers

PCAOB member Jay Hanson, in a May 1 speech, said some audit committee members have told the Board "they are hearing concerns from management about an uptick in auditors' demands on financial reporting staff or about audit work that they don't believe adds value to the audit…The chief concern tends to be about increasing audit costs, both in terms of the fee paid to the auditor and the time spent by management responding to information requests from auditors."

Furthermore, Hanson said, some preparers believe PCAOB "actions are causing their auditors to spend more time than necessary on 'busy work' or 'check-the-box' compliance activities without adding much value to the audit process. Others believe that we are bringing back the more burdensome 'Auditing Standard No. 2' in audits of internal controls...We also hear that some auditors may not be performing effective risk assessments, but rather are treating all areas as high risk, doing extensive audit work even in low risk areas, in order to avoid PCAOB inspection findings."

The PCAOB takes "seriously concerns about inefficiencies and adverse consequences on companies," Hanson continued, "and we will continue to work toward the right balance between regulations intended to enhance investor protection and unnecessary burdens on auditors and issuers. For that reason, the PCAOB staff and Board take great care to ensure that inspection reports reflect only deficiencies based on existing risk based audit requirements, adopted by the Board after extensive consideration and public input. It is not our intention to impose new requirements through inspections."

On the inspections themselves, Hanson said that, "Early on during our inspection process, our inspectors were finding deficiencies in a wide variety of audit areas, including in what I call basic 'blocking and tackling' procedures. Today, the findings are narrower and more likely to occur in especially complex and subjective auditing areas, including internal controls, revenue recognition, accounting estimates and fair value. And even within these areas, findings have become more nuanced, such as in the area of internal controls, where we are seeing better compliance overall with applicable standards but finding deficiencies when we look deeper at whether auditors fully understand and appropriately test certain types of controls. So while a lot of work remains to be done, I am encouraged by the progress many auditors are making."

U.S. Chamber seeks dialogue on ICFR, inspection process

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) on May 29 wrote to the PCAOB and Securities and Exchange Commission (SEC) that "developments over the past several years have raised concerns that the unintended consequences of the PCAOB inspection process and corresponding changes to internal control processes are eroding judgment, as well as increasing costs and burdens for work that may in some instances not lead to more effective audits or controls. While accelerated filers are feeling the direct impacts, even non-accelerated filers are being affected."

According to the CCMC, the unintended consequences are "the result of a lack of a dialogue between the business community and the PCAOB." To rectify this, the CCMC requested "a meeting of stakeholders, the PCAOB and SEC to discuss these issues, explore ways to address them, and create such a dialogue on a continuous basis in order to promote effective controls and an appropriate exercise of judgment to enhance investor protection, capital formation, and competition. In our view, such a meeting should focus on three areas: management review controls, a 'checklist' or 'one-size-fits-all' approach, and materiality."

"Companies are passionate about supporting the goal of high quality financial reporting and recognize the contributions of effective systems of ICFR to achieving this goal," the letter added. "However, balance is essential and it is reasonable to expect that companies understand why certain audit activities take place…[F]rom a company perspective, principles-based guidance, such as the SEC's guidance for management and COSO, has not been able to withstand the authoritative weight of new interpretations of AS 5 for auditors from PCAOB inspections and the goal of both audit firms and individual auditors to reduce the risk of inspection findings."

SEC

Schnurr: Little support for mandating IFRS

SEC Chief Accountant James Schnurr, speaking on May 7, reported on discussions he and his staff have had with preparers, investors, auditors, regulators, and standard setters about what action, if any, the SEC should take regarding the further incorporation of International Financial Reporting Standards (IFRS) into U.S. capital markets. According to Schnurr, there is continued support for the objective of a single set of high-quality, globally accepted accounting standards. However, there is virtually no support for having the SEC mandate IFRS for all registrants, and there is little support for an option allowing domestic companies to prepare their financial statements under IFRS. Schnurr added that he plans to deliver a recommendation to SEC Chair Mary Jo White "in the near term."

Following his speech, Schnurr told reporters that there are "real impediments" to either the mandatory or voluntary use of IFRS by U.S. companies. "Given the outreach that we had with respect to various constituents, people indicated that there was actually no interest in those two alternatives. So I think those would probably not be my recommendations." He added that his recommendation could include the use of some IFRS information, such as for credit losses, as supplemental, non-GAAP measurements, which investors and regulators might find useful.

Commissioner Gallagher to resign

Commissioner Daniel Gallagher has notified the White House that he plans to leave the SEC as soon as the Senate confirms his successor, according to media reports. His term does not officially expire until November 2016.

The SEC also will be losing Commissioner Luis Aguilar, whose term ends in July. Aguilar reportedly would like to remain at the SEC long enough to help complete executive compensation disclosure rules.

Business groups recommend EDGAR improvements

Four business policy organizations – the Business Roundtable, Center for Audit Quality (CAQ), Financial Executives International, and the U.S. Chamber's CCMC – on May 29 submitted a comment letter to the SEC with recommendations on the EDGAR Modernization initiative. The letter outlines recommendations that could incrementally improve EDGAR filing information on the SEC's website in the near-term, prior to implementation of other enhancements and without the need for SEC rulemaking. The recommendations focus on consolidating and updating current EDGAR search features by improving their visibility and organization, along with additional enhancements to EDGAR, including improvements to the company search page, filings detail screen, and output functionality.

FASB/IASB

FASB to launch consultation on 'big ticket' issues

The Financial Accounting Standards Board (FASB) plans to publish a discussion paper looking for input on what comprehensive accounting standard revisions the board should add to its technical agenda. According to FASB Chairman Russell Golden, writing in the latest issue of *FASB Outlook*, "Now that some of our major projects are winding down – and good progress is being made on our narrow-focus simplification projects – the FASB is determining whether there are additional 'big ticket' issues we should tackle – and if so, when we should address them." By "big ticket" issues, Golden said he means issues that impact multiple industries and affect both public and private companies and not-for-profit organizations, such as revenue recognition, leases, and financial instruments.

The FASB will begin seeking stakeholder input in June, when the Financial Accounting Standards Advisory Committee (FASAC) begins its periodic survey on FASB agenda priorities. FASAC will survey members of the FASB's Investor Advisory Committee (IAC), Not-for-Profit Advisory Committee (NAC), Small Business Advisory Committee (SBAC), Emerging Issues Task Force (EITF), and Private Company Council (PCC). Survey results will be discussed at the September 29 FASAC meeting.

FASB issues three new, two proposed ASUs

The FASB issued three new Accounting Standards Updates (ASUs) in May:

- ASU No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. It also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The ASU is effective for public companies for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years.

- ASU No. 2015-08, *Business Combinations (Topic 805): Pushdown Accounting – Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115*, amends various SEC paragraphs pursuant to the release of Staff Accounting Bulletin (SAB) No. 115. The SEC issued SAB 115 on November 18, 2014 to facilitate the transition to ASU 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*, which provides that an acquired entity may elect to apply pushdown accounting in its separate financial statements upon a change-in-control event in which an acquirer obtains control of the acquired entity.

- ASU No. 2015-09, *Financial Services—Insurance (Topic 944): Disclosures About Short-Duration Contracts*, requires insurance companies to provide additional information to help financial statement users understand the nature, amount, timing, and uncertainty of future cash flows related to insurance liabilities, as well as the effect of those cash flows on the statement of comprehensive income. The ASU will take effect for public companies for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.

The Board also issued two proposed ASUs:

- Proposed ASU, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. The proposed ASU clarifies the guidance on performance obligations and licensing contained in the new revenue recognition standard in order to proactively address areas in which diversity in practice potentially could arise, as well as to reduce the cost and complexity of applying certain aspects of the guidance both at implementation and on an ongoing basis. The deadline for submitting comments on the proposed ASU is June 30.

- Proposed ASU, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*, would require the acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer also would record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The deadline for submitting comments on the proposed ASU is July 6.

FAF: Statement 160 achieving its purpose

The Financial Accounting Foundation (FAF) on May 20 published the Post-Implementation Review (PIR) of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which amends Accounting Research Bulletin (ARB) No. 51 (Statement 160). Statement 160 establishes accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated organization that should be reported as equity in the consolidated financial statements.

"The PIR report on Statement 160 tells us that, overall, the standard on noncontrolling interests is useful to investors," FASB Chairman Russell Golden said. "That said, the report did identify areas of improvement – most notably in the allocation of net income or loss between a parent company and the noncontrolling interest." He added that the Board "plans to conduct outreach with stakeholders to understand if there are any cost-effective solutions that also reduce complexity without significantly reducing the usefulness of the information."

IASB issues proposal to defer revenue recognition standard's effective date

The International Accounting Standards Board (IASB) on May 19 issued for public comment a proposal to defer the effective date of IFRS 15, *Revenue from Contracts with Customers*, by one year to January 1, 2018. The deadline for submitting comments is July 3. According to the IASB, the main reason for the proposed deferral of the effective date is that the IASB is planning to propose targeted amendments to IFRS 15, which will include clarifying some of the standard's requirements and adding illustrative examples to aid implementation.

On April 29, the FASB issued its proposal to defer the effective date of ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, by one year to annual reporting periods beginning after December 15, 2017 and to interim reporting periods beginning after December 15, 2017. The deadline for submitting comments on the proposal was May 29.

IASB proposes enhancements to Conceptual Framework

The IASB on May 28 issued proposals to improve the *Conceptual Framework for Financial Reporting*. The deadline for submitting comments is October 26.

The proposed enhancements include:

- A new chapter on measurement that describes appropriate measurement bases (historical cost and current value, including fair value), and the factors to consider when selecting a measurement basis;

- Confirming that the statement of profit or loss is the primary source of information about a company's performance, and adding guidance on when income and expenses could be reported outside the statement of profit or loss, in "Other Comprehensive Income"; and

- Refining the definitions of the basic building blocks of financial statements – assets, liabilities, equity, income and expenses.

"A solid *Conceptual Framework* is essential because it shapes the decisions the IASB takes when developing Standards," IASB Chair Hans Hoogervorst said in a statement. "Two particularly important areas of the proposals published [on May 28] are the clarification of the key role of profit or loss as an indicator of a company's financial performance, and the chapter that describes the information provided by historical cost and current value measurements."

U.S. Congress

House committee approves bills to promote small business capital formation

The House Financial Services Committee on May 20 approved 13 bills intended to give small companies and startups greater access to capital. Committee Chairman Jeb Hensarling (R-Texas) said in his opening statement that "regrettably a lot of the regulatory scheme has been made for larger financial companies and put an undue burden on smaller startups and our smaller companies. We must remember that the SEC, part of their three-part mission is capital formation. We should not as a United States Congress totally outsource that vital function of our economy to the SEC because regrettably they have occasionally dragged their feet on this…So to some extent, I think I would view a number of these bills as simply helping level the playing field between our larger companies and our smaller companies."

The Committee Memorandum includes summaries of all 13 bills. The following three bills are of particular relevance to public company auditors:

- H.R. 1525, the *Disclosure Modernization and Simplification Act*, would require the SEC to simplify its disclosure regime for issuers and investors by permitting issuers to submit a summary page on Form 10-K with cross-references to the content of the report. The bill also would require the SEC to revise Regulation S-K to scale disclosure rules for emerging growth companies (EGCs) and smaller issuers, and to eliminate duplicative, outdated, or unnecessary Regulation S-K disclosure requirements for all issuers. The bill was approved by a vote of 60-0.

- H.R. 1965, the *Small Company Disclosure Simplification Act*, would provide a voluntary exemption for all EGCs and other issuers with annual gross revenues under $250 million from the SEC's requirements to file their financial statements in XBRL. The vote was 44-11.

- H.R. 2354, the *Streamlining Excessive and Costly Regulations Review Act*, would require the SEC to review significant regulations it has previously issued. The bill would require that within the first five years after enactment, and every ten years thereafter, the SEC must engage in a retrospective review of all significant SEC rules and regulations to determine if they are necessary to the public interest or if they should be amended or rescinded. The bill defines "significant regulations" as those the Office of Management and Budget finds to have resulted in, or are likely to result in: (1) an annual economic impact of $100 million or more as defined by the Office of Management and Budget; or (2) a major increase in costs or prices for consumers, individual industries, federal, state, or local governments, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S. enterprises to compete against their foreign counterparts. The vote was 41-16.

CAQ Updates

Educational video promotes Call to Action

The Audit Committee Collaboration, of which the CAQ is a member, on April 29 released a video that succinctly explains the key elements of the Collaboration resource, *Enhancing the Audit Committee Report: A Call to Action*. As the video explains, the *Call to Action* examines leading disclosure practices of audit committees and encourages public company audit committees to voluntarily and proactively improve their public disclosures to more effectively convey to investors and others the critical aspects of the important work they currently perform, including oversight of the external auditor.

CAQ launches new online video series

The CAQ on May 27 launched an online video series that will highlight critical issues facing the public company auditing profession and the markets. Hosted by CAQ Executive Director Cindy Fornelli, *Profession in Focus* will feature interviews with an array of thought leaders from the auditing profession, corporate governance world, investor community, regulatory arena, academia, and other important stake-holders in the financial reporting process.

The inaugural episode features Cathy Engelbert, CEO of Deloitte LLP. Engelbert, the first female chief executive of a large, global accounting and advisory firm, shares her views on leadership.

Stacie Morales joins the CAQ as Senior Director of Strategy

On May 4, Stacie Morales joined the CAQ as Senior Director of Strategy. In this role, Morales will focus on helping the CAQ better understand, coordinate, and strategically align the profession's U.S. policy positions with those in other jurisdictions.

Prior to joining the CAQ, Morales served as KPMG's Executive Director of International Government. In that capacity, she worked with firm leadership to develop global positions on public policy matters impacting the profession and to convey those positions throughout KPMG's global network of member firms. Previously, she was an economist for the U.S. Senate Committee on Banking, Housing, and Urban Affairs. In that role, she worked on financial reporting and insurance matters, including development and passage of the Sarbanes-Oxley Act and the Federal Terrorism Risk Insurance Act.

Upcoming Events

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

June 3
SEC Advisory Committee on Small and Emerging Companies Meeting, Washington, DC (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 18
PCAOB Standing Advisory Group Meeting, Washington, DC (Link)

June 22-26
IASB Board Meeting, London, UK (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)

Oct 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.

