



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.

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PCAOB

PCAOB's Munter highlights challenges in ICFR audits

Helen Munter, Director of the Public Company Accounting Oversight Board's (PCAOB or the Board) Division of Registration and Inspections, on September 9 [spoke](#) to the PCAOB Investor Advisory Group about the challenges the inspections staff continues to find in audits of internal control over financial reporting (ICFR). She highlighted three areas where the staff most commonly identifies problems:

- *Understanding a company's flow of transactions.* "This is a critical first step in planning an effective audit," Munter said. "Without this understanding, engagement teams may not identify all of the risks that exist and select the appropriate controls to test. Further, the controls that are selected for testing may not be responsive to the risk of material misstatement (including fraud risk) that the engagement team has identified." Inspectors have "observed this scenario commonly when auditors were testing revenue."

- *Testing of management review controls.* “In order to rely on management review controls, the auditor needs to understand the control and test it to see if it is operating or operating at a precise enough level to detect material misstatements...If the auditor only looks to see that management performed the review and does not understand what management looked for in the review, what matters were investigated, and how they were resolved, the auditor has failed to obtain evidence that the review could in fact prevent or detect a material misstatement.”
- *Testing of system-generated data or reports.* “If a control selected for testing uses system-generated data or reports, the effectiveness of the control depends in part on the controls over the accuracy and completeness of the system-generated data or reports. For example, if the control relies on sales prices coming from a price list, the auditor needs to understand where the price list is coming from and identify and test the controls over the accuracy and completeness of the price list.”

The answer to these challenges is not more work, but “smart work,” Munter concluded. “Smart work involves taking the time and effort for careful planning in advance. This involves having a good understanding of the audit client’s business and flow of transactions to identify the risks, making a thoughtful selection of controls that address those risks, and calibrating the testing of controls along with obtaining sufficient audit evidence based on the associated risks. Applying a mechanical approach to the audit, for example, just checking that management performed a review, without proper planning can lead to ineffective testing of controls and other problems.”

SEC approves reorganization of PCAOB auditing standards

The Securities and Exchange Commission (SEC or Commission) on September 17 [approved](#) the PCAOB’s proposed reorganization of its auditing standards into a topical, integrated numbering system that integrates the existing interim and PCAOB-issued auditing standards. The Board unanimously approved the reorganization in March.

Under the reorganization, the individual standards will be grouped into the following topical categories:

- *General Auditing Standards (AS 1000s):* standards on broad auditing principles, concepts, activities, and communications.
- *Audit Procedures (AS 2000s):* standards for planning and performing audit procedures and for obtaining audit evidence.
- *Auditor Reporting (AS 3000s):* standards for auditors’ reports.
- *Matters Relating to Filings Under Federal Securities Laws (AS 4000s):* standards on certain auditor responsibilities relating to SEC filings for securities offerings and reviews of interim financial information.
- *Other Matters Associated with Audits (AS 6000s):* standards for other work performed in conjunction with an audit.

The amendments also 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 new rules are effective as of December 15, 2016. However, auditors and others are allowed to use and reference the reorganized standards before the effective date. Going forward, new auditing standards

adopted by the Board will be issued as new or replacement sections and paragraphs within the new structure.

PCAOB launches series of staff inspection briefs, podcasts

The PCAOB on September 1 issued the first in a series of staff inspection briefs that will provide additional detail about the PCAOB inspections process, from scope documents to results and summaries of inspection findings. According to Helen Munter, the PCAOB has “added these briefs to our outreach to auditors to inform them of areas of concern and inspection focus. Inspections staff believes that publicly discussing our areas of current inspections focus is important to understanding audit risks and encourages auditors to improve audit quality.”

The [first edition](#) details the objectives, focus, and scope of the PCAOB’s ongoing inspections of auditors of brokers and dealers. During the 2015 inspection cycle, the PCAOB plans to inspect 75 firms that audit brokers and dealers covering portions of 115 audit and attestation engagements of broker and dealers – a 14 percent increase from the number of firms inspected in 2014. The inspections staff is evaluating how firms performed on audit and attestation engagements and focusing on:

- The examination of compliance reports and the review of exemption reports under newly applicable PCAOB standards;
- Financial statement audit areas that had deficiencies identified in past inspections, including revenue recognition and use of information produced or used by brokers and dealers;
- Audit procedures on the supplemental schedules to the financial statements;
- The engagement quality review; and
- Auditor independence.

On September 17, the PCAOB launched its [PCAOB Dialogues Podcast](#) series. Each episode will feature Board members and staff speaking with audit committee members, investors, and others about auditing, investor protection, and capital markets. In Episode 1, the PCAOB’s Greg Jonas talks with audit committee chairman Mike Cook about Audit Quality Indicators (AQIs). Jonas answers questions ranging from the history and purpose of the PCAOB’s AQI project to specific examples of potential indicators. Cook draws on his experience in piloting AQIs from his seat on an audit committee to provide insights into how audit committees can hone in on indicators that may help them do their jobs.

SEC

SEC seeks comments on Regulation S-X disclosure requirements

The SEC on September 25 issued a [request for comment](#) to seek public input regarding the financial disclosure requirements in Regulation S-X for certain entities other than a registrant. The SEC is specifically interested in comments on the following rules:

- Rule 3-05, Financial Statements of Businesses Acquired or to be Acquired;
- Rule 3-09, Separate Financial Statements of Subsidiaries not Consolidated and 50 Percent or Less Owned Persons;
- Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered; and
- Rule 3-16, Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered.

The SEC is seeking to better understand how well these requirements are informing investors and on how investors use the disclosures to make investment and voting decisions. The Commission is also interested in learning about any challenges that registrants face in preparing and providing the required disclosures. Finally, it is interested in potential changes to these requirements that could enhance the information provided to investors and promote efficiency, competition, and capital formation.

The deadline for submitting comments is November 30.

FASB/IASB

FASB simplifies accounting for measurement-period adjustments

The Financial Accounting Standards Board (FASB or Board) issued one new Accounting Standards Update (ASU) in September. [ASU 2015-16, Business Combinations \(Topic 805\): Simplifying the Accounting for Measurement-Period Adjustments](#), requires:

- That an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined;
- That the acquirer 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; and
- That an entity present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

For public companies, the amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the ASU's effective date, with earlier application permitted for financial statements that have not yet been issued.

FASB proposes improvements to materiality, revenue recognition

The FASB on September 24 issued for public comment the [proposed ASU, Notes to Financial Statements \(Topic 235\): Assessing Whether Disclosures Are Material](#), which is intended to promote the appropriate use of discretion by organizations when deciding which disclosures should be considered material in their particular circumstances. Specifically, the proposed amendments would:

- State that materiality is applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole; therefore, some, all, or none of the requirements in a disclosure Section may be material;
- Identify materiality as a legal concept; and
- State specifically that an omission of immaterial information is not an accounting error.

The FASB also [proposed amendments](#) to Concepts Statement No. 8, *Conceptual Framework for Financial Reporting – Chapter 3: Qualitative Characteristics of Useful Financial Information*. The main pro-

posed amendment would modify the current definition of materiality to add a statement that materiality is a legal concept. Another amendment would add a brief summary to Chapter 3 of the U.S. Supreme Court’s definition of materiality because that is the definition currently observed by the Board.

The deadline for submitting comments on both proposals is December 8.

On September 30, the FASB issued an additional [proposed ASU](#), *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which is intended to improve the guidance on collectability, non-cash consideration, and completed contracts at transition in the new revenue recognition standard. Additionally, the amendments would provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The deadline for submitting comments is November 16, 2015.

Other Policy Developments

Highlights of the IAASB’s September meeting

The International Auditing and Assurance Standards Board (IAASB) on September 30 posted on its website a podcast with [highlights](#) of its September 21-25 meeting. Chairman Arnold Schilder, Deputy Chair Chuck Landes, and IAASB members Annette Köhler, Rich Sharko, and Megan Zietsman discuss the following topics:

- Enhancing Audit Quality – Draft Invitation to Comment, *Group Audits and Quality Control*;
- Financial Institutions, including ISA 540 and IFRS 9;
- Professional Skepticism;
- Approval of ISA 800 (Revised) and ISA 805 (Revised); and
- Innovation, Integrated Reporting, and Data Analytics.

CAQ Updates

CAQ’s annual investor survey finds continued confidence in U.S. capital markets

The Center for Audit Quality (CAQ) on September 17 released its [2015 Main Street Investor Survey](#). The annual survey measures retail investor confidence in U.S. capital markets, global capital markets, and audited financial information, as well as confidence in investing in publicly traded companies. The survey also asks respondents about their confidence in key players in the capital markets when it comes to effectiveness in looking out for investor interests.

This year’s survey found:

- 73 percent of retail investors have confidence in U.S capital markets, holding steady from 2014 levels and up from the low of 61 percent recorded in 2011. However, confidence levels remain below the confidence measure of 84 percent recorded in 2007, the year the CAQ began the survey.
- By contrast, confidence in non-U.S. capital markets – at 38 percent – decreased from 2014, and edged closer to the 35 percent recorded in 2012. Confidence in non-U.S. capital markets has dropped 27 percent since 2007.

- 78 percent of investors have confidence in investing in U.S. publicly traded companies, statistically consistent with last year’s finding, which was an all-time high in the survey.
- Investors expressed strong levels of confidence regarding key players in the financial system, including external auditors (76 percent), financial advisers and brokers (73 percent), stock exchanges (73 percent), and independent audit committees (71 percent). Independent auditors topped the list for the fourth consecutive year.

The 2015 survey also highlighted attitudes among millennial investors – those between the ages of 18 and 34. In many respects, their views mirrored those of previous generations when it comes to confidence in U.S. capital markets, publicly held companies, and the role of key players in corporate governance, financial reporting, and investment advice. However, millennial investors’ viewpoints diverged from others in notable and statistically significant ways. For example, they said that paying off debt was a higher priority for them than investing or saving. They also are more attuned to emerging risks such as cybersecurity threats.

CAQ comments on possible revisions to audit committee disclosures, AQIs

The CAQ on September 8 submitted a [comment letter](#) on the [SEC concept release, Possible Revisions to Audit Committee Disclosures](#). The SEC invited comments on whether improvements could be made to the information audit committees provide to investors about their responsibilities and activities. In particular, the SEC sought comments on whether disclosure requirements should be refined to provide more insight into the information audit committees use and the factors they consider in overseeing independent auditors.

The “best route to promote informative and relevant audit committee disclosures is through the encouragement of a voluntary, market-driven approach rather than by mandating additional prescriptive disclosures,” the CAQ wrote. “If the SEC does pursue rulemaking...it should be a principles-based framework that allows audit committees the flexibility to adapt disclosures to their individual circumstances. However,” the letter continued, “audit committees already are enhancing their disclosures beyond what is currently required, and we have not seen evidence of market demand for mandated, prescriptive disclosures. Continued enhanced, voluntary disclosure practices could be supported by the SEC through speeches and staff pronouncements that encourage the development of best practices and offer recommendations for informative, stakeholder-centric disclosures.”

On September 28, the CAQ submitted a [comment letter](#) on the PCAOB’s [Concept Release on Audit Quality Indicators](#) (AQIs). The PCAOB identified 28 potential AQIs and invited comments on their content and potential value to audit committees, audit firms, investors, and regulators.

“Due to the dynamic nature, inherent complexity, and variability of public companies and their audits, AQIs alone (whether input or output measures) without context cannot adequately communicate factors relative to the audit of any particular engagement or firm,” the CAQ wrote. “However, the right AQIs as determined by the audit committee could provide perspective on factors that may contribute to or detract from audit quality.” More specifically, the CAQ argued:

- AQIs should be used and reported voluntarily. This is particularly appropriate given that the development of AQIs is in the early stages. Furthermore, there is insufficient evidence of the correlation between any one set of AQIs and audit quality outcomes.
- Mandatory public reporting of AQIs is not appropriate due to the early-stage nature of AQI concepts and the necessity of the contextual discussion to interpreting AQIs. Focusing efforts on providing the

audit committee with additional information about the audit is a prudent step with respect to any AQI effort to (1) allow the audit committee to determine what information is relevant to their oversight of the audit, (2) take into account the audit's particular facts and circumstances, and (3) allow for the two-way dialogue that is necessary to put the AQIs into context.

CAQ releases three new 'Profession in Focus' videos

The CAQ in September released three new episodes of its online video series, *Profession in Focus*:

- In [episode six](#), Lynne M. Doughtie, U.S. Chairman and CEO at KPMG LLP, shares reflections on her priorities, on moving into her present role at KPMG, and why the public company auditing profession is an exciting career choice.
- In [episode seven](#), PCAOB Board Member Lewis H. Ferguson discusses the Board's concept release on audit quality indicators, including the release's history, implications, and global context.
- In [episode eight](#), James L. Powers, CEO of Crowe Horwath LLP, discusses his priorities for Crowe, the core values that define public company auditing, and his advice for those just joining the profession.

The video series is [archived](#) on the CAQ website.

Upcoming Events

October 5

FASB Board Meeting, Norwalk, CT ([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 7

FASB Board Meeting, Norwalk, CT ([Link](#))

October 15

SEC Investor Advisory Committee, Washington, DC ([Link](#))

October 19-23

IASB Board Meeting, London, UK ([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 28-30

PLI Annual Securities Regulation Institute, New York, NY (+ Webcast) ([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](#))

November 16-20

IASB Board Meeting, London, UK ([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](#))

December 14-18

IASB Board Meeting, London, UK ([Link](#))

2016**March 16**

Center for Capital Markets Competitiveness Annual Capital Markets Summit, Washington, DC ([Link](#))

March 21-23

CII 2016 Spring Conference, Washington, DC ([Link](#))

May 10-12

AICPA Employee Benefit Plans Conference, Las Vegas, NV ([Link](#))

July 21-22

AICPA National Advanced Accounting and Auditing Technical Symposium, Salt Lake, UT ([Link](#))

September 28-29

CII 2016 Fall Conference, Chicago, IL ([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.