



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

Highlights from the PCAOB's November 12-13 SAG meeting

The Public Company Accounting Board's (PCAOB or Board) Standing Advisory Group (SAG) met on November 12-13. The [agenda](#) included discussions of audit quality indicators (AQIs); emerging issues that could affect audits, auditors, or the PCAOB; and the auditor's use of the work of specialists. PCAOB Chairman James Doty and Chief Auditor Martin Baumann updated the SAG on Board developments and the standard-setting agenda.

1. *Audit Quality Indicators*

Greg Jonas, Director of the PCAOB's Office of Research and Analysis, introduced the topic with a [summary](#) of the feedback received on the Board's [Concept Release on Audit Quality Indicators](#). Jonas identified five broad areas of agreement among comment letter respondents:

- A majority of respondents believe the discussion of AQIs should continue;
- The purpose of AQIs is to inform discussion and raise questions to facilitate a discussion with auditors;
- AQIs are not scorecards;
- Audit committees are key users; and
- Large accounting firms would benefit more than small firms from the use of AQIs.

He also identified four broad areas of controversy:

- The relevance of individual AQIs identified in the Concept Release and considerations surrounding how much testing and empirical evidence would be needed to demonstrate their usefulness.
- Many commenters had mixed views whether or not investors should be viewed as consumers of AQI information.
- Many commenters identified factors giving rise to unintended consequences. The controversy centered on recommended actions to be taken to prevent such issues.
- Views expressed in the comment letters were mixed on mandatory AQI implementation and reporting, and on the role of the PCAOB in the context of the AQI project. Some respondents advocated against regulatory involvement, requesting more experimentation time; others said the regulator plays a key role in standardizing vocabulary and calculation methodologies for AQIs. Many commenters offered encouragement for further development of AQIs, and offered insight from their own regulatory or pilot testing experience, but did not explicitly express support or opposition for the mandated approach.

For the breakout session, SAG members were asked to work in three groups focused on the topics: AQIs and Their Content; Auditor Discussion of AQIs with Audit Committees; and Use of AQIs by Investors. Highlights of the discussion include the following:

- The PCAOB should proceed with development of a principles-based framework, outlining broad categories of AQIs and providing common definition and calculation methodologies for AQIs to promote comparability.
- Various groups of AQI users will have different levels of context available to them, and will place a different degree of relevance on various individual AQIs. The audit committee should be in a position to choose, as well as add or tailor, those AQIs most relevant to them.
- The number of AQIs should be reduced from 28 indicators to focus on those most relevant, but it is too early to determine exactly how many AQIs should be used. One breakout group identified four AQIs as perhaps the most useful; however, there was no consensus among the rest of the SAG members in this regard.
- The use of AQIs should not be mandated at this time. Allowing the audit committee and auditor to focus on AQIs most relevant to them on a voluntary basis and without public reporting would allow AQIs to develop naturally and the market to determine which AQIs are most relevant.
- Engagement-level AQIs were deemed most useful for audit committee members, and firm-level AQIs should be used to provide context.

- With respect to the use of AQIs in firms' audit quality (a.k.a. transparency) reports, firms should disclose how they calculated the AQIs that they chose to disclose.

2. Emerging Issues that Could Affect Audits, Auditors, or the PCAOB

Individual SAG members [presented each “emerging issues” topic](#) and asked the breakout groups to consider the impact these issues could have on audits, auditors, or the PCAOB. Highlights of the discussion included the following:

Whistleblower Activity

- Investigations of illegal acts have grown substantially over the past few years since new whistleblower rules went into effect in late 2011. It is more important than ever for auditors, audit committees, and management to exercise good judgment in balancing an appropriately thorough investigation with timely completion relative to the circumstances. Some law firms are entering this area without the appropriate knowledge and experience in completing a proper investigation that can put the auditor in challenging situations.
- Several SAG members stressed the importance of reminding auditors of best practices when reviewing whistleblower activity within the audit, which could include, for example, reminding auditors of their responsibilities under 10A of the Securities Exchange Act, to focus more on independent evaluation of the facts and circumstances the more risky or severe the complaint, and lastly to communicate the risks around internal control over financial reporting (ICFR) to the audit committee.

Economic Developments

- The impact of falling oil prices and continued low interest rates on financial reporting, accounting, and auditing should be considered part of the auditor's risk assessment procedures. Both matters may impact future estimated cash flows, which, in turn, will impact the auditor's evaluation of significant estimates.
- Two additional areas of emerging risks are currency risks (especially in Venezuela) and mergers and acquisitions. The group suggested the PCAOB issue practice alerts, have staff explicitly identify these issues during public speeches, or conduct webcasts focused on these topics to re-emphasize their importance.

Use of Data and Data Auditing

- The use of data analytics in areas such as risk assessment procedures and audit performance has the potential to improve audit quality. There also are opportunities to automate certain audit procedures allowing more time for the auditor to exercise professional judgment. There are a number of implications for the profession, for instance: potential changes in firms' staffing models; training and education of junior auditors; student education; and the evolution of auditing standards and firms' policies and methodologies.
- The use of data analytics in an audit is in the early stages of development and it is not yet clear how to take advantage of opportunities arising from the technological advances.
- SAG members noted that standard setters and regulators are at risk of not incorporating technological advances in standard setting activities in a timely fashion. However, the PCAOB should be cautious: technological changes move more quickly than the standard setting-process, which could render any

standards useless by the time they were adopted. It may be necessary to remove some auditing standards that might prohibit the use of data auditing.

Auditor's Role in Evaluating Non-GAAP Measures

- While the investor community's reliance on non-GAAP measures is growing, the auditor's responsibilities with respect to such measures have not changed. SAG members were asked to consider whether the level of independent audit assurance regarding compliance with the regulations and rules under the SEC's "Conditions for Use of Non-GAAP Financial Measures" should be elevated.

Impact of FASB Materiality Proposals

- The Financial Accounting Standards Board's (FASB) [proposed definition of materiality](#) could reduce the number of disclosures in the notes to the financial statements. Omission of immaterial disclosures is not an error and does not need to be communicated to the audit committee. In the opinion of one observer, however, AS 16 provisions will continue to require auditors to report omitted disclosures to the audit committees.

Revenue Recognition Transition

- Implementation guidance, particularly for industry groups, is about 12 months away from completion. Thus far, in practice generic training has not proved as useful as the industry guidance is expected to be.
- The new revenue recognition standard requires many more estimates, which will have an impact on auditors. Some SAG members suggested that any accounting and auditing standards, as well as related guidance, should be issued concurrently.
- SAG members also recommended that the PCAOB consider providing additional guidance for predecessor vs. successor auditors in relation to the retrospective application of the new standard and the implications for the successor auditor.

3. Auditor's Use of the Work of Specialists

PCAOB Deputy Chief Auditor Greg Scates provided an update on the staff's progress on this project. The staff has decided to align and release the next stage of both the Auditing Accounting Estimates and Fair Value Measurements project, and the Auditors Use of the Work of Specialists project, on the same day in the 2016.

- *Auditor's Specialist.* The staff is considering implementing a requirement similar to ISA 620.12, which includes requirements for the auditor to evaluate the adequacy of the auditor's expert's work for the auditor's purpose. Many SAG members agreed with this course, with some noting the importance of the application guidance that accompanies this paragraph.
- *Company's Specialist.* The staff is considering implementing a requirement similar to ISA 500.08, which includes the requirements of the auditor when it uses information prepared by management's specialist as audit evidence. SAG members agreed with incorporating this into the PCAOB standards and noted that, when determining whether to use the information prepared by management's specialist as audit evidence, the auditor performs an assessment of objectivity, knowledge and skills, and uses that assessment to determine the nature and extent of procedures that he or she performs over that information obtained from management's specialist.

4. Update on PCAOB Developments

Chairman James Doty spoke generally about current developments and the focus of PCAOB oversight activities. He also provided a status update on the [Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on New PCAOB Form](#) (“Supplemental Request”), which he expects will be submitted for the Board’s approval in December.

- Early results from the 2015 inspection cycle show a general decline in deficiencies in some areas for many inspected firms compared to prior year. ICFR continues to be a significant area of inspection findings and a focal point of discussions among the regulators, auditors, and preparer community.
- Inspections of brokers and dealers in 2015 continue to raise concerns over auditor independence, particularly among the firms that do not audit issuer clients. A permanent broker and dealer inspection program will be implemented in 2016 and will be open to public comment and review by the SEC.
- A SAG member suggested that the PCAOB could make the SAG a more effective advisory body if there were a mechanism to for members to communicate with one another outside of formal meetings or to form “collective views.”

5. Update on Standard-Setting Agenda

Chief Auditor Martin Baumann provided an update on projects included on the PCAOB’s standard-setting agenda.

- *Supervision of Other Auditors and Multi-location Audit Engagements.* He expects to submit a proposed standard for the Board’s approval in the first part of 2016. The proposed standard will not impact the provisions of Auditing Standard 10, *Supervision of the Audit Engagement*, but will expand on the responsibilities of the lead auditor that are currently defined in AU 543, *Part of Audit Performed by Other Independent Auditors*.
- *Auditor’s Reporting Model (ARM).* The re-proposed standard on ARM should be released by March 31, 2016. The re-proposal will provide some modifications to the previously proposed definition of critical audit matters (CAMs) based on the responses received from the commenters.
- *Going Concern.* A Staff Consultation Paper is expected to be issued in the early part of 2016 as additional research, economic analysis, and outreach to various stakeholders is still needed.
- *Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities.* Baumann expects to issue a concept release at the end of 2016, at the earliest. His staff is working closely with the Division of Inspections on identifying root causes of audit deficiencies, which would be considered in connection with the issuance of the consultation paper.

PCAOB approves 2016 budget and 2015-2019 strategic plan

The PCAOB on November 24 [approved](#) its 2016 fiscal-year budget of approximately \$257.7 million and its 2015-2019 strategic plan. The 2016 budget, which is subject to SEC approval, is about three percent more than the 2015 budget. The budget assumes that the PCAOB will reach a 2016 year-end projected total of 876 staff, with the Division of Registration and Inspections accounting for 530 of this total. The total accounting support fee for 2016 is \$253.3 million, with approximately \$220.9 million allocated to public companies and \$32.4 million to broker-dealers.

A summary of the 2016 budget and strategic plan will be available on the PCAOB website once the budget is submitted to the SEC.

SEC

Schnurr to recommend supplemental use of IFRS

SEC Chief Accountant James Schnurr on November 17 [told reporters](#) he will recommend to Chair Mary Jo White that U.S. companies be allowed to use IFRS to provide supplemental information, in addition to filing their financials in accordance with U.S. GAAP. Schnurr said the recommendation was going through the rule-making process, but that he had no timetable as to when or whether the SEC would propose any new regulations based on it.

Aguilar announces departure date

Commissioner Luis Aguilar on November 16 [announced](#) that his last day at the SEC would be at the end of December, or at such earlier time as a successor is confirmed. Aguilar's term officially ended on June 5.

On October 20, President Barack Obama nominated Lisa Fairfax, a professor at the George Washington University Law School, to succeed Aguilar. The president also nominated Hester Peirce, a senior research fellow at George Mason University's Mercatus Center, to fill the seat previously held by Daniel Gallagher. The Senate Banking Committee has yet to schedule a confirmation hearing.

FASB/IASB

FASB votes to proceed with final standards on leases, financial instruments

The FASB on November 11 [voted to proceed](#) with three new Accounting Standards Updates (ASUs):

- *Leases.* The FASB expects to publish the final lease accounting standard in the first quarter of 2016. The ASU will require companies and other organizations to include lease obligations on their balance sheets. For public companies, the ASU will be effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2018. For private companies, the standard will be effective for annual periods beginning after December 15, 2019. Early adoption will be permitted.
- *Financial Instruments – Recognition and Measurement.* The Board also voted to proceed with a final ASU intended to improve and simplify the recognition and measurement of financial instruments. The FASB expects to issue the ASU possibly before the end of the year. For public companies, the ASU will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For non-public companies, the standard becomes effective for fiscal years beginning after December 15, 2018, and for interim periods within fiscal years beginning after December 15, 2019. Early adoption will be permitted.
- *Financial Instruments – Credit Losses.* Thirdly, the Board voted to set the effective date of its planned ASU on measuring credit losses. The FASB expects to publish the final ASU on credit losses in early 2016. Public companies that meet the definition of an SEC filer will be required to apply the guidance for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Other public companies will be required to apply the guidance for fiscal years beginning after

December 15, 2019, including interim periods within those fiscal years. Non-public business organizations will be required to apply the guidance for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application of the guidance will be permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

FASB issues new, proposed ASUs

The FASB issued one new ASU in November:

- [ASU 2015-17](#), *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, is part of the FASB's Simplification Initiative, the objective of which is to identify, evaluate, and improve areas of U.S. GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users. The ASU simplifies the presentation of deferred income taxes under U.S. GAAP by requiring that all deferred tax assets and liabilities be classified as non-current. For public companies, the amendments are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period.

The FASB also issued two proposed ASUs:

- [Proposed ASU](#), *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*, would require an entity to provide users with more information about the entity's existing government assistance agreements to help users better assess the nature of the government assistance and the significant terms and conditions of the agreement. Specifically, it would require disclosures about (1) the types of arrangements, (2) the accounting for government assistance, and (3) their effect on the business organization's financial statements. The deadline for submitting comments on the proposed ASU is February 10, 2016.
- [Proposed ASU](#), *Business Combinations (Topic 805): Clarifying the Definition of a Business*, would assist reporting organizations with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses by providing a more robust framework to determine when a set of assets and activities is a business. The deadline for submitting comments on the proposed ASU is January 22, 2016.

International

IOSCO publishes report on audit firm transparency

The International Organization of Securities Commissions (IOSCO) on November 6 published a [report on transparency of firms that audit public companies](#). The report considers “the practices employed by audit firms to be transparent in their own reporting to investors and other stakeholders about the firm itself, notably, with respect to firm governance and elements of their system of quality control for their financial statement audits.”

According to the report, “Transparency reporting can foster internal introspection and discipline within audit firms and may encourage audit firms to sharpen their focus on audit quality, which would also be of

benefit to investors and other stakeholders. In addition, in comparing audit firms competing for an audit engagement, audit firm transparency reporting can aid those responsible for selecting a public company's auditor in their decision making process by providing information on a firm's audit quality.”

The report includes an IOSCO Statement on, as well as a Guide for, audit firm transparency reporting. The Guide is intended to serve as a frame of reference for promoting good practice and contributing to high quality audit firm transparency reports.

CAQ Point of View:

In August 2013, the CAQ released a [Resource on Audit Quality Reporting](#) to highlight some important elements of audit quality that firms could consider in refining or developing their own reporting regarding their public company audit practice. “Audit quality reporting can foster greater confidence in the public company audit process by assisting financial statement users, audit committee members, and other stakeholders in understanding how an audit firm’s management and operations support the performance of high quality audits,” Executive Director Cindy Fornelli said in a [statement](#). “As regulators and standard-setters explore ways to increase auditor transparency and update the reporting model, this is an example of the profession’s efforts to improve communication with key stakeholders regarding firm activities aimed at enhancing audit quality.”

CAQ Updates

CAQ comments on effectiveness of Reg S-X financial disclosure requirements

The Center for Audit Quality (CAQ) on November 25 submitted a [comment letter](#) on the SEC’s *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant*. The September 25 [Request for Comment](#) focused on the requirements in Regulation S-X (S-X) for the form and content of financial disclosures that companies must file with the SEC about acquired businesses, affiliated entities, and guarantors and issuers of guaranteed securities.

The CAQ’s comment letter offers recommendations on the following topics:

- Significance tests (S-X Rule 1-02(w))
- Financial statements of acquired or to-be-acquired businesses and real estate operations (S-X Rules 3-05 and 3-14, respectively)
- Pro forma financial information requirements for acquisitions and dispositions (S-X Article 11)
- Financial information of equity method investees (S-X Rules 3-09 and 4-08(g))
- Financial statements of guarantors or issuers of guaranteed securities registered or being registered (S-X Rule 3-10)
- Financial statements of affiliates that collateralize registered securities (S-X Rule 3-16)
- Consideration of XBRL tagging in other entity financial statements

CAQ submits framework for auditing accounting estimates, fair value to PCAOB

The CAQ on December 1 submitted to the PCAOB an addendum to its comment letters on Staff Consultation Papers regarding auditing accounting estimates, including fair value measurements, and using the work of specialists. [Auditing Accounting Estimates and Fair Value Measurements: A Framework](#) offers suggestions for auditing accounting estimates that build upon the overarching principles described in the

CAQ's comment letters. Those principles state that any enhancements to existing auditing standards should:

- Recognize the relationship between the auditor's risk assessment and the audit procedures designed to sufficiently and appropriately respond to that risk;
- Consider the range of accounts (and elements of accounts) that involve varying levels of estimation uncertainty and the varying levels of complexity in measurement and risk associated with different accounting estimates;
- Recognize that accounting estimates may be subject to a significant degree of measurement uncertainty, and such inherent uncertainty will exist irrespective of the level of effort involved in auditing the accounting estimate (e.g., not imply that a level of precision exists in an inherently imprecise measurement exclusively as a result of an audit of that measurement); and
- Continue to recognize that auditors may use the work of a specialist when situations arise that require specialized knowledge and subject matter expertise in a field other than accounting or auditing.

In developing the Framework, the CAQ considered the views in each of the Staff Consultations Papers, as well as discussions with PCAOB staff as part of its outreach efforts regarding auditing estimates and fair value measurements, as well as the use of specialists. The Framework also reflects input received from CAQ member firm representatives that have participated in recent PCAOB SAG discussions on this topic.

CAQ releases new 'Profession in Focus' video

The CAQ in November released one new episode of its online video series, *Profession in Focus*:

- In [episode 11](#), Joseph Ucuzoglu, Chairman and Chief Executive Officer of Deloitte & Touche LLP, discusses the impact of regulation on public company auditors, top issues facing the profession, and his career advice.

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

Upcoming Events

December 3

Baruch College Annual Audit Conference, New York, NY ([Link](#))

December 3-4

PLI Annual SEC Reporting and FASB Forum, New York, NY ([Link](#))

December 4

FASB Private Company Council Meeting, Norwalk, CT ([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 15-17

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

2016**January 14**

NACD Chapter Event, “Audit Committee Agendas 2016: Emerging Issues and Best Practices,” Chicago, IL ([Link](#))

January 18-22

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

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 8-11

CFA Institute Annual Conference, Montreal, Canada ([Link](#))

May 10-12

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

June 27-29

ICGN Annual Conference, San Francisco, CA ([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.