



CAQ Alert #2008-04 – January 17, 2008

**DEAR CENTER MEMBERS**

**Applicability of Appendix K – Quality Control Standards Involving Foreign Associated Firms that Audit SEC Registrants**

Late last year, the SEC adopted a [rule](#) to accept, from foreign private issuers in their filings, financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) without reconciliation to U.S. generally accepted accounting principles (GAAP). As a result of this new SEC rule, questions have arisen regarding the application of the PCAOB's Interim Quality Control standard [Appendix K – SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants](#).

The PCAOB adopted certain AICPA SEC Practice Section's membership requirements, in existence as of April 16, 2003, to the extent not superseded or amended by the PCAOB, as part of their Interim Quality Control Standards. Part of the standards that the PCAOB adopted included [Appendix K](#) to SECPS section 1000.08(n) which applies to U.S. registered public accounting firms that were members of the former AICPA SEC Practice Section, and that are members of, correspondents with, or similarly associated with international firms or international associations of firms. Such firms are to seek adoption of policies and procedures by the international organization or individual foreign associated firms that are consistent with the objectives set forth in Appendix K.

In a recent [speech](#) at the AICPA National Conference on SEC and PCAOB Developments on December 10, 2007, Thomas Ray, PCAOB's Chief Auditor and Director of Professional Standards, discussed the continued applicability of Appendix K with respect to an SEC filing that includes financial statements prepared in accordance with IFRS as issued by the IASB, and for which the U.S. GAAP reconciliation is neither required by, nor filed with, the SEC. The text of Mr. Ray's speech with respect to Appendix K is reproduced below.

“As I mentioned earlier, the SEC will now permit foreign private issuers to file with the Commission financial statements prepared in accordance with the English language version of IFRS, as published by the IASB, without reconciliation to U.S. GAAP. The SEC rule changes raise some questions about certain PCAOB professional standards.

Today I will address the effect of the recent SEC action on one of the Board's interim quality control standards, known as Appendix K<sup>1</sup>.

U.S. registered public accounting firms that were members of the former AICPA SEC Practice Section, that are members of, correspondents with, or similarly associated with international firms or international associations of firms are to seek adoption of policies and procedures by the international organization or individual foreign associated firms that are consistent with the objectives set forth in Appendix K.

Appendix K seeks to enhance the quality of SEC filings by SEC registrants whose financial statements are audited by foreign associated firms. It does this by setting out procedures to be performed by persons knowledgeable in U.S. accounting, auditing, and independence requirements on certain SEC filings – the "filing review" – and annually in connection with internal inspection programs.

With respect to an SEC filing that includes financial statements prepared in accordance with the English language version of IFRS, as issued by the IASB, and for which the U.S. GAAP reconciliation is neither required by, nor filed with, the SEC, there are several provisions within Appendix K that are affected. I will discuss each of those provisions.

Among other things, the filing reviewer is directed to discuss with the partner-in-charge of the engagement the engagement team's familiarity with and understanding of U.S. accounting and financial reporting standards and the significant differences between the accounting and financial reporting standards used in the filing and those applicable in the U.S.<sup>2</sup> These provisions, which are specific to U.S. GAAP, are not applicable to a filing that contains no U.S. GAAP or U.S. GAAP reconciliation.

Other filing review procedures address reading the document to be filed with the SEC<sup>3</sup>; discussing with the partner-in-charge of the engagement the engagement team's familiarity with and understanding of applicable U.S. auditing and independence standards and requirements, and significant differences between these applicable U.S. standards and requirements and the auditing and independence standards of the foreign associated firm's domicile country<sup>4</sup>; and discussing with the partner-in-charge of the engagement significant auditing, accounting, financial reporting, and independence matters that come to the attention of the filing reviewer when performing the filing review procedures<sup>5</sup>. These

filing review procedures are still applicable to filings that do not contain any U.S. GAAP.

The Appendix K inspections procedures direct "inspection reviewers" knowledgeable in U.S. accounting, auditing, and independence requirements to review a sample of audit engagements performed by foreign associated firms for SEC registrants. Based on the procedures performed, the inspection reviewers should determine, among other things, whether anything came to their attention to cause them to believe that the financial statements were not presented in all material respects in conformity with accounting principles generally accepted in the U.S. or, if applicable, the footnote reconciliation of the financial statements to U.S. GAAP did not include appropriate treatment of the material reconciling items<sup>6</sup>. This determination with respect to U.S. GAAP compliance required by Appendix K would not be applicable to filings that contain no U.S. GAAP. The other inspections procedures remain applicable<sup>7</sup>.

Finally, the documentation and resolution of differences provisions remain applicable.<sup>8</sup>

The PCAOB staff is evaluating whether changes should be made to Appendix K, including whether it should be replaced with something else or eliminated, and other possible changes to the Board's standards and rules that may be necessary to clarify how PCAOB standards apply when financial statements are prepared according to IFRS.“

**NOTE:** Please refer to [CAQ Alert #2008-03](#) for important information regarding the SEC's final rule eliminating the U.S. GAAP reconciliation requirement.

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<sup>1</sup> See Interim Quality Control Standards, SEC Practice Section (SECPS) – Requirements of Membership, Section 1000.08(n) – Audit Firm Obligations with Respect to the Policies and Procedures of Correspondent Firms and of Other Members of International Firms or International Associations of Firms. The PCAOB interim standards may be found at [www.pcaob.org/standards/interim\\_standards/index.aspx](http://www.pcaob.org/standards/interim_standards/index.aspx).

<sup>2</sup> See Appendix K, secs. .01 a. (2) (i) and (ii)(a).

<sup>3</sup> See Appendix K, sec. .01 a. (1).

<sup>4</sup> See Appendix K, sec. .01 a. (2) (i) and (ii)(b).

<sup>5</sup> See Appendix K, sec. .01 a. (2) (iii).

<sup>6</sup> See Appendix K, sec. .01 b. (1).

<sup>7</sup> See Appendix K, secs. .01 b. (2) – (5).

<sup>8</sup> See Appendix K, secs. .01 a. (3) and c.