



CENTER FOR AUDIT QUALITY

Serving Investors, Public Company Auditors & the Markets
Affiliated with the American Institute of CPAs

CAQ Public Policy Monitor

JULY 2015

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 posts updated standard-setting agenda
- Highlights from the PCAOB’s June 18 SAG meeting
- SEC seeks public input on audit committee disclosures
- SEC proposes requiring companies to adopt clawback policies
- FASB, IASB to delay revenue recognition standard’s effective date
- FASB releases ASU to simplify subsequent measurement of inventory
- New ASU aims to simplify employee benefit plan accounting
- IASB proposes clarifications to revenue recognition standards
- CAQ releases two ‘Profession in Focus’ videos
- Anti-Fraud Collaboration releases third case study
- Mary Schapiro joins CAQ Governing Board
- Upcoming Events

PCAOB

PCAOB posts updated standard-setting agenda

The Public Company Accounting Oversight Board (PCAOB or Board) on July 2 posted to its website an updated [standard-setting agenda](#). The PCAOB plans to take action on three projects during the second half of 2015:

Project	Planned Action
1. Going Concern	Staff Consultation Paper
2. Supervision of Other Auditors and Multilocation Audit Engagements (Docket 031)	Proposal
3. Auditor’s Report and the Auditor’s Responsibilities Regarding Other Information and Related Amendments (Docket 034)	Re-proposal

1. The staff currently is evaluating potential revisions to the existing PCAOB standard on the auditor's going concern evaluation in light of changes in the relevant accounting requirements, input from the SAG and Investor Advisory Group, and academic research. The staff anticipates that the PCAOB will issue the staff consultation paper in the third quarter of 2015.
2. The PCAOB in August 2010 issued a [concept release](#) on the application of the "failure to supervise" provision of the Sarbanes-Oxley Act. The staff currently is drafting a proposed standard on the planning, supervision, and performance of audits involving other auditors and multi-location audit engagements, and anticipates recommending that the Board propose the standard for public comment in the third quarter of 2015.
3. In August 2013, the PCAOB issued for public comment [proposed auditing standards](#) and related amendments on the auditor's report and the auditor's responsibilities regarding other information. Subsequently, the Board held a public meeting in April 2014 to discuss the proposed standards and comments received. The staff has analyzed the comments received on the proposal and at the public meeting and is drafting a re-proposal for the Board's consideration. The staff anticipates recommending that the PCAOB re-propose the auditor's reporting standard for public comment in the fourth quarter of 2015. The staff also is evaluating potential revisions to the proposed other information standard and anticipates recommending that the Board issue a separate re-proposal for the standard at a later date.

Highlights from the PCAOB's June 18 SAG meeting

The PCAOB's Standing Advisory Group (SAG) on June 18 held its [first meeting of 2015](#). The meeting focused on two topics: the auditor's use of the work of specialists; and auditing accounting estimates, including fair value measurements. PCAOB Chairman James Doty and Chief Auditor Martin Baumann updated the SAG on Board developments and standard-setting agenda.

Using the Work of Specialists

The SAG heard from two panels on the auditor's use of the work of specialists. One panel discussed the auditor's use of the work of an auditor's specialist, while the other focused on the auditor's use of the work of a company's specialist. The panels were comprised of various public company auditing profession representatives, specialists of different areas of expertise, and preparers. Panelists described how their companies and firms make use of, provide, or supervise specialists.

- Several SAG members noted that a certification or credentialing process for the valuation industry could be helpful for auditors and eliminate the need to re-perform the specialists' valuations.
- Several SAG members cautioned the PCAOB against rescinding AU 336 and forcing auditors to take full responsibility for everything a specialist does, citing cost concerns without commensurate benefit. Specifically, many SAG members noted that the requirement to recalculate the work performed by management's specialist would be overly burdensome. Several SAG members proposed retaining the principles of AU 336 with some enhancements – for example, requiring written communications between the auditor and specialist.
- Chief Auditor Martin Baumann reiterated that the auditor is responsible for the specialist's work and needs to include documentation that supports the work done by the specialist as well as the work done by the auditor to review the specialist's work. He confirmed that the standards require auditors to have sufficient skill to be able to direct the work of specialists, including an understanding of the relevant industry, but noted that there is still a need to explore whether more specificity is needed.

Several SAG members acknowledged the expectation gap between the auditor's and specialist's responsibilities and how those roles communicate.

Auditing Accounting Estimates and Fair Value Measurements

- In August 2014, the PCAOB released the [Staff Consultation Paper](#), *Auditing Accounting Estimates and Fair Value Measurements*. During the June 18 SAG meeting, Associate Chief Auditor Barbara Vanich provided a [status update](#) and led a discussion on the project's general direction. She noted that the staff has completed a detailed analysis of the comment letters received on the Staff Consultation Paper and conducted additional research (specifically related to measurement uncertainty and the use of third parties).
- The staff's anticipated direction in a proposal to the Board includes: (1) moving forward with the proposal for a single standard; (2) aligning a potential new standard with the PCAOB's risk assessment standards; and (3) retaining the three substantive testing approaches available to the auditor.
- Based on its analysis and research, the staff is seeking additional information on two areas in order to develop a proposed standard for the Board to consider: emphasizing professional skepticism and addressing significant measurement uncertainty.
- Vanich added that the staff is considering certain enhancements with respect to the Use of Third Parties, including recognizing the auditor's ability to group certain homogenous securities with similar risks together for testing and including additional guidance in certain areas in a potential appendix to the standard (for example, special risk considerations related to financial instruments and impairment of financial instruments). Several SAG members agreed that there should be a uniform approach to the review of the pricing sources in the form of a SOC1 report that would be available to all. PCAOB staff questioned their authority to execute this and welcomed additional dialogue. A SAG observer noted that the SEC also lacks the authority to mandate such a report.

Update on PCAOB Developments

- Chairman James Doty spoke generally about the standard-setting process, indicating that the PCAOB is exploring ways to be more efficient and to include economic analysis in the review of a project's effectiveness.
- Doty updated the SAG on the PCAOB's 2014 inspection activities. He also noted that the PCAOB continues to conduct inspections in the European Union, and is working toward renewing the European Commission Adequacy Decision (which allows the PCAOB to conduct inspections in the European Union) in 2016. He added that the PCAOB is getting close to an agreement to allow the PCAOB to perform inspections on Chinese companies registered in the United States. The PCAOB will resume inspections in Hong Kong this year.
- Doty indicated that the PCAOB consulted with audit committee members to develop the information in the May 2015 [Audit Committee Dialogue](#). The PCAOB plans to follow up with additional dialogues at least twice a year. SAG Members generally shared positive feedback on the content of the Dialogue.

Update on Standard-Setting Agenda

- *Auditors Reporting Model (ARM)*. Chief Auditor Martin Baumann provided background on the ARM project, which includes a proposal on the communication of critical audit matters (CAMs) in the

auditor's report as well as an increased threshold for the auditor's review of other information (OI). Several SAG members expressed their support for expanded auditor reporting through the communication of CAMs. However, SAG members expressed mixed feedback on the need to elevate auditor performance requirements with respect to OI.

- *Going Concern.* A SAG observer expressed concerns about the conflict between the Financial Accounting Standards Board's (FASB) guidance for preparers' going concern disclosures ([ASU 2014-15](#)) and current auditing standards, specifically related to the FASB definition of "substantial doubt" and the timeframe for evaluation of a going concern. The observer suggested that the PCAOB re-word its standards so as to clarify that the auditor's responsibility should not go beyond an evaluation of whether management's disclosures are "in accordance with GAAP."
- *Supervision of Other Auditors and Multi-location Audit Engagements.* Baumann shared the goal of having one simplified approach that strengthens the lead audit firm's oversight over the work of other audit firms involved with the audit engagement. He expects the Board to approve the proposal by the fall.

SEC

SEC seeks public input on audit committee disclosures

The Securities and Exchange Commission (SEC or Commission) on July 1 issued a [concept release](#) on current audit committee disclosure requirements, focusing on the audit committee's oversight of independent auditors. In addition to seeking stakeholder views about audit committee disclosures, the SEC invites comments on whether SEC disclosure requirements should be refined to provide more insight into the information the audit committee used and the factors it considered in overseeing the independent auditor.

"While current audit committee reporting requirements provide information about the role of the audit committee with respect to its oversight of the auditor, these disclosures do not describe how the audit committee executes its responsibilities," the concept release says. "Providing additional disclosure about the audit committee's oversight of the independent auditor could further inform investors about the oversight process and provide them with useful context for audit committee decisions. It may also enable investors to differentiate between companies based on the quality of audit committee oversight, and determine whether such differences in quality of oversight may contribute to differences in performance or quality of financial reporting among companies."

The concept release asks, for instance:

- Should the Commission update the existing disclosure requirements to include all communications required by SEC rules and PCAOB standards rather than only those required by AS 16, *Communications with Audit Committees*?
- Should there be disclosure about the audit committee's consideration beyond a statement that they have received and discussed the matters communicated by the auditor as required by PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*?
- Audit committees currently are only required to disclose whether the required communications occurred. Should there be disclosures regarding the nature or substance of the required communications between the auditor and the audit committee?

- Would disclosure about the audit committee’s review and discussion of the audit firm’s internal quality-control review and most recent PCAOB inspection report be useful to investors? Should the SEC require disclosure about how the audit committee considered the results described in PCAOB inspection reports in its oversight of the auditor?
- Would disclosures about whether, and if so how, the audit committee assesses, promotes, and reinforces the auditor’s objectivity and professional skepticism be useful to investors?
- What types of disclosures could be made regarding the process the audit committee undertook to evaluate the external audit and performance and qualifications of the auditor, including the rationale for selecting or retaining the auditor?
- Would disclosure of the name of the engagement partner be useful to investors? Would disclosure of any additional members of the engagement team be useful and, if so, which?
- Should the audit committee’s report include information about the length of the audit relationship?
- Should current audit committee disclosure requirements be changed for smaller reporting companies or emerging growth companies?

The deadline for submitting comments on the concept release is September 8.

CAQ Point of View:

“Given the audit committee’s responsibilities for broadly overseeing the financial statement process, including the work of the external and internal auditors, it is vital for investors and others with a stake in our financial markets to understand and have confidence in the audit committee’s important role,” CAQ Executive Director Cindy Fornelli said of the SEC concept release. “Alongside its partners in the Audit Committee Collaboration, the CAQ has worked extensively and proactively on the topic of audit committee disclosure since 2012. We look forward to reviewing the SEC’s concept release and to providing analysis and views from the public company auditing profession.”

SEC proposes requiring companies to adopt clawback policies

The SEC on July 1 [proposed rules](#) directing national securities exchanges and associations to establish listing standards requiring companies to adopt policies that require executive officers to pay back incentive-based compensation that later is shown to have been awarded in error. In particular:

- Recovery would be required from current and former executive officers who received incentive-based compensation during the three fiscal years preceding the date on which the company was required to prepare an accounting restatement to correct a material error. Recovery would be required without regard to whether any misconduct occurred or an executive officer’s responsibility for the erroneous financial statements.
- Companies would be required to recover the amount of incentive-based compensation received by an executive officer that exceeds the amount the officer would have received had the incentive-based compensation been determined based on the accounting restatement. For incentive-based compensation based on stock price or total shareholder return, companies could use a reasonable estimate of the effect of the restatement on the applicable measure to determine the amount to be recovered.

- A company would be subject to delisting if it failed to adopt a compensation recovery policy that complied with the applicable listing standard, disclose the policy in accordance with SEC rules, or comply with the policy's recovery provisions.

The deadline for submitting comments on the proposed rules is September 14.

FASB/IASB

FASB, IASB to delay revenue recognition standard's effective date

The FASB on July 9 [voted](#) to delay the effective date of the new revenue recognition standard by one year, with early adoption permitted as of the original effective date. The FASB expects to issue the final Accounting Standards Update (ASU) formally amending the effective date by the end of the third quarter of 2015.

For annual reporting, public business entities, certain not-for-profit entities, and certain employee benefit plans will apply the new revenue recognition standard in annual reporting periods beginning after December 15, 2017. All other entities will apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2019 – that is, all other entities will not be required to apply the guidance in the new revenue standard in interim periods within the year of adoption.

For interim reporting, public business entities, certain not-for-profit entities, and certain employee benefit plans will apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2017 (that is, beginning in the first interim period within the year of adoption). All other entities will apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2019 (that is, all other entities will not be required to apply the guidance in the new revenue standard in interim periods within the year of adoption).

The International Accounting Standards Board (IASB) on July 22 also [confirmed](#) a one-year deferral of the effective date of IFRS 15, *Revenue from Contracts with Customers*, to January 1, 2018. The IASB expects to issue the formal amendment to the standard, specifying the new effective date, in September.

FASB releases ASU to simplify subsequent measurement of inventory

The FASB on July 22 released [Accounting Standards Update \(ASU\) No. 2015-11](#), *Inventory (Topic 330), Simplifying the Measurement of Inventory*. The ASU does not apply to inventory measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost.

Under the ASU, an entity should measure inventory within the scope of this Update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method.

The ASU is effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the ASU takes effect for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The new guidance should be applied prospectively, and earlier application is permitted as of the beginning of an interim or annual reporting period.

New ASU aims to simplify employee benefit plan accounting

The FASB on July 31 issued [ASU 2015-12](#), *Plan Accounting (Topics 960, 962, and 965) – (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient*.

- Under the amendments in Part I, fully benefit-responsive investment contracts are measured, presented, and disclosed only at contract value. A plan will continue to provide disclosures that help users understand the nature and risks of fully benefit-responsive investment contracts. The amendments are effective for fiscal years beginning after December 15, 2015. Earlier application is permitted. An entity should apply the amendments retrospectively for all financial statements presented.
- Part II eliminates the requirements for participant-directed investments and nonparticipant-directed investments to disclose: (1) individual investments that represent 5 percent or more of net assets available for benefits, and (2) the net appreciation or depreciation for investments by general type. The amendments are effective for fiscal years beginning after December 15, 2015. Earlier application is permitted. An entity should apply the amendments retrospectively for all financial statements presented.
- The amendments in Part III provide a practical expedient to permit plans to measure investments and investment-related accounts (for example, a liability for a pending trade with a broker) as of a month-end date that is closest to the plan's fiscal year-end, when the fiscal period does not coincide with a month-end. The amendments are effective for fiscal years beginning after December 15, 2015. Earlier application is permitted. An entity should apply the amendments prospectively.

IASB proposes clarifications to revenue recognition standards

The IASB on July 30 [proposed](#) clarifications to and transition reliefs for IFRS 15, *Revenue from Contracts with Customers*. The Exposure Draft proposes to clarify:

- How to identify the performance obligations in a contract;
- How to determine whether a party involved in a transaction is the principal (responsible for providing the goods or services) or the agent (responsible for arranging for the goods or services to be provided to the customer); and
- How to determine whether a license provides the customer with a right to access or a right to use the entity's intellectual property.

The IASB also proposed two reliefs to aid the transition to the new revenue recognition standard. The deadline for submitting comments on the proposals is October 28. The Board said that it expects to complete its discussions on these issues by the end of 2015, after which the final amendments to IFRS 15 will be issued.

CAQ Updates

CAQ releases two 'Profession in Focus' videos

The Center for Audit Quality (CAQ) on July 8 released the [third episode](#) of its online video series, *Profession in Focus*. In this episode, CAQ Governing Board member Lynn Paine, the John G. McLean

Professor of Business Administration and Senior Associate Dean at the Harvard Business School, discusses the importance of robust and independent academic research to the public company auditing profession.

In the [fourth episode](#), which the CAQ released on July 28, Governing Board member Michele J. Hooper – President and CEO, The Directors’ Council, and co-chair of the Anti-Fraud Collaboration’s Steering Committee – discusses the work of the Anti-Fraud Collaboration, including its innovative series of case studies. “These case studies are a useful addition to the arsenal of fraud tools that we have brought to the marketplace,” she says.

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

Anti-Fraud Collaboration releases third case study

The Anti-Fraud Collaboration – a joint effort of the Center for Audit Quality, Financial Executives International, Institute of Internal Auditors, and National Association of Corporate Directors – on July 28 released the latest installment of its [series of case studies](#) examining how to identify and stop accounting fraud in an organization. The [Kendallville Bank Case Study](#) explores potential material fraud at a fictitious regional bank. With a plot revolving around the questionable accounting decisions of a star executive, the hypothetical scenario is designed to foster a greater understanding of the importance of exercising skepticism as a participant in the financial reporting process at publicly traded companies.

The Collaboration has also created a [short video](#) that introduces the case study and brings it to life in cinematic fashion.

Kendallville Bank is the Collaboration’s third case study. The first, Hollate Manufacturing, focused on understanding the conditions that can generate and perpetuate fraud and misrepresentation in financial reporting. The second, Carolina Wilderness Outfitters, is intended to facilitate a discussion about how to conduct an internal investigation when fraud is suspected in an organization. The series of case studies is designed for all members of the financial reporting supply chain.

Mary Schapiro joins CAQ Governing Board

Former SEC Chairman Mary Schapiro has joined the CAQ’s Governing Board as one of three independent members, the CAQ [announced](#) on July 9. During her four years as chairman, from January 2009 to December 2012, the SEC pursued one of the busiest rulemaking agendas in its history, while bringing a record number of enforcement actions. The agency also executed a comprehensive restructuring program to improve protections for investors.

Prior to becoming SEC chairman, Schapiro served as CEO of the Financial Industry Regulatory Authority (FINRA), the largest nongovernmental regulator of securities firms. Earlier, she was Commodity Futures Trading Commission (CFTC) chairman and a commissioner of the SEC. She began her career at the CFTC, serving first as a trial attorney and later as counsel and executive assistant to the chairman. She was the first woman to serve as SEC chairman, and the only person to have served as chairman of both the SEC and the CFTC.

“The public company auditing profession plays a critical role in protecting investors in our capital markets, and the CAQ plays a key role in focusing on continuous improvements to audit quality,” Schapiro said. “Following in the footsteps of my good friend, the late Harvey Goldschmid, I look forward to working alongside my fellow Governing Board members to help the CAQ carry out its important mission.”

Upcoming Events

August 5

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

August 5

SEC Open Meeting, Washington, DC ([Link](#))

August 7-12

American Accounting Association Annual Meeting, Chicago, IL ([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 26-29

NACD Global Board Leaders' Summit, Washington, DC ([Link](#))

September 27-30

ICI Tax and Accounting Conference, Orlando, FL ([Link](#))

September 30

ICGN Boston Event, Boston, MA ([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.