

Heads Up

In This Issue:

- [Broker-Dealer Audit Considerations](#)
- [FASB Projects and Potential Impact on Auditors](#)
- [Subsequent Events](#)
- [The Auditor's Reporting Model](#)
- [Communications With Audit Committees](#)

A Summary of the July 15 Meeting of the PCAOB's Standing Advisory Group

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At its July 15, 2010, meeting, the PCAOB's Standing Advisory Group (SAG) discussed the following: broker-dealer audit considerations, FASB projects and their potential impact on auditors, and the auditor's consideration of subsequent events. In addition, the PCAOB staff summarized comments it has received on its proposed audit committee communications standard and gave an update on its plans to undertake a project on the auditor's reporting model.

The next SAG meeting is expected to be held on October 13–14, 2010.

Broker-Dealer Audit Considerations

Congress recently passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which gives the PCAOB the authority to oversee audits of nonpublic broker-dealers. Under SEC rules, broker-dealers are required to have auditors perform certain procedures with respect to the stock record (in addition to the audit of the financial statements). In anticipation of the passage of the new legislation, the PCAOB sought the SAG's views on certain aspects of audit procedures performed on broker-dealer engagements. The [briefing paper](#) on this topic cites the following questions (reprinted in their entirety), which were discussed at the meeting:

1. Because of existing SEC requirements, would the PCAOB need to establish specific auditing, attestation or professional practice standards for broker-dealer audits, and if so, what would they be?
2. What other matters would the PCAOB need to consider in developing standards for the audits of broker-dealers?

SAG members urged the PCAOB to work closely with the SEC, the Financial Industry Regulatory Authority, the Securities Investor Protection Corporation, and others to assess the issues and determine the appropriate next steps. Those SAG members who are also auditors explained that existing standards and practice aids will be a useful guide to the PCAOB. It was also acknowledged that the PCAOB should use its new authority as an opportunity to stand back (in concert with other regulators) and determine the intended objectives of the procedures to be performed by the auditors and how best to meet those objectives.

FASB Projects and Potential Impact on Auditors

This session of the SAG meeting started with a panel presentation by Larry Smith, a member of the FASB; Jamie Miller, vice president, controller, and chief accounting officer of the General Electric Company; and Mike Gallagher, assurance partner and a U.S. National Office leader at PricewaterhouseCoopers. The panel discussed current FASB projects, focusing on the FASB's and IASB's activities to converge U.S. GAAP with IFRSs.

The panel presentation was followed by the SAG's open discussion of the following topics (reprinted from the PCAOB's [briefing paper](#)):

- Potential challenges for auditors in auditing under the new accounting standards (i.e. changes in firm methodology, training of personnel, consistent application of accounting standards)
- Possible need for additional PCAOB guidance or updates to PCAOB auditing and related professional practice standards

There was considerable debate and discussion regarding the proposed timeline for the completion of current and upcoming FASB projects, with many voicing concerns about the potential for compromising quality in standards if the current timeline were to be strictly followed. In addition, many SAG members expressed concern about (1) resources and the ability to respond within compressed time frames and (2) capacity constraints that could cause diversions from financial reporting needs, potentially affecting the quality of financial reporting. Further, several SAG members pointed out that it would be difficult for stakeholders to provide thoughtful input when so many significant changes are being considered at the same time.

As a result of these concerns, some suggested that the PCAOB and FASB coordinate to create working groups associated with each FASB project; these working groups could focus on and discuss potential operational and implementation issues (including the auditability of proposed standards) and help the FASB and PCAOB address these issues during the course of the various projects. Some SAG members also were concerned that once standards are finalized, the ability to implement so many standards all at once will put considerable pressure on the financial reporting and auditing process. One member suggested that the PCAOB consider the various changes in accounting principles that were under way and the resulting impact on audits as a systemic audit risk issue, and on the basis of that assumption, contemplate how such a systemic risk would or should be addressed in the audit process.

SAG members also discussed the increase in judgment that will be needed as a result of the FASB's move to more principles-based accounting standards. These same individuals encouraged the PCAOB and the SEC to implement the recommendation of the SEC's Advisory Committee on Improvements to Financial Reporting and develop a judgment framework for both issuers and auditors to help them arrive at well-reasoned judgments.

Editor's Note: The final report of the SEC's Advisory Committee on Improvements to Financial Reporting contained the following recommendation to the SEC and PCAOB:

Recommendation 3.5: The SEC should issue a statement of policy articulating how it evaluates the reasonableness of accounting judgments and include factors that it considers when making this evaluation. The PCAOB should also adopt a similar approach with respect to auditing judgments.

The [final report](#) is available on the SEC's Web site.

Subsequent Events

The discussion regarding subsequent events centered on whether the PCAOB should amend or replace AU Section 560, *Subsequent Events*. The [briefing paper](#) provided background information and the following discussion questions (reprinted in their entirety):

1. Should any of the existing audit procedures for identifying subsequent events be strengthened? Should the standard require any additional audit procedures?
2. Should the auditor be required to perform additional procedures similar to those in AU sec. 560 to identify and evaluate subsequent events to cover the period from report date through issuance, or should any additional procedures during this period be limited to inquiries regarding material adverse effects?
3. What effect would adding requirements during this period have on when auditors would date their report or on the offering process?

SAG members indicated that the identification of subsequent events does not seem to be an issue in practice. As a result, several members questioned whether this topic should be on the PCAOB's standard-setting priority list.

The Auditor's Reporting Model

Following up on the SAG's discussion of the auditor's reporting model at the April 7–8 SAG meeting (see Deloitte's [April 26, 2010, Heads Up](#)), the PCAOB staff presented its plans for a project to consider changes to the current form and content of the auditor's report. The PCAOB staff is considering recommending to the Board a two-phase project as follows:

Phase 1: Making limited changes to the auditor's report to clarify certain aspects. The changes being considered are:

- Adding the words "whether caused by error or fraud" to the sentence in the report that explains that the audit is intended to provide reasonable assurance that the financial statements are free of material misstatement.
- Adding the concept that reasonable assurance is a high level of assurance but is not absolute assurance.
- Adding wording to the body of the report that the auditor is independent, as required by applicable rules and regulations.
- Adding a requirement that the auditor's report be addressed to both the board of directors and shareholders.

Phase 2: Assessing the form and content of the auditor's report and identifying additional user needs. Phase 2 steps being considered are:

- *Part A* — Conducting research on potential changes to the auditor's reporting model.

Editor's Note: As part of this research, the PCAOB would monitor the developments of other standard setters and regulators studying this topic. For instance, the IAASB and AICPA commissioned four research studies on user perceptions of the standard unqualified auditor's report, which have recently been completed. The results of these studies were discussed at the December 2009 IAASB meeting. [Information](#) about these studies and about the IAASB's project history is available on the IFAC's Web site.

- *Part B* — Holding roundtables to discuss information obtained during the research phase and seeking additional feedback.
- *Part C* — Assessing feedback received and determining next steps.

Generally, SAG members supported the PCAOB's undertaking a project to reconsider the form and content of the auditor's report and to evaluate how the auditor's report could be more informative to investors. However, some recommended that, rather than do the project in two phases, the PCAOB make all changes at once to avoid confusing investors and potentially needing to change language adopted in phase 1 as a result of research in phase 2. If the PCAOB staff follows a two-phase approach, phase 1 changes would be proposed during 2010 and phase 2 changes would be considered in 2011.

Communications With Audit Committees

Acting Chairman Dan Goelzer and the PCAOB staff shared with the SAG some of the feedback the PCAOB has received on its proposed standard on audit committee communications. Several commenters suggested that the PCAOB engage in additional outreach to learn more about what information audit committees are most interested in. As a result of this feedback, the PCAOB has decided to hold a roundtable and reopen the comment period to receive further input. It is expected that this roundtable will be held in September. The PCAOB plans to reach out to the National Association of Corporate

Directors, issuers, auditors, and others to identify participants for the roundtable. Other comments the PCAOB has received on the proposed standard have suggested that the Board:

- Clarify how auditors would evaluate two-way communication with the audit committee.
- Consider management's communications with the audit committee.
- Clarify which consultations outside the engagement team would be communicated.

Commenters' views have been mixed regarding whether:

- All communications should be in writing.
- The auditor should communicate all corrected misstatements, including those detected and corrected by management, to the audit committee.
- Too many communication requirements were proposed.

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