

International Symposium on Audit Research 2011

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Discussion Topics

- Registration and Inspections
- Update for Broker-Dealer Auditors
- Standard-Setting Projects
- Keeping Current with PCAOB Standards

Caveat

The views I express are my own and do not necessarily reflect the views of the Board, individual Board members, or other members of the Board's staff.

Registration and Inspections

Registration Update

- 2,443 firms registered with PCAOB as of May 26, 2011
- 906 foreign firms representing 83 countries-Australia, Canada, China, India, and UK have the most registered firms
- 558 firms auditing broker-dealers registered since 2009

Inspections Overview

- Inspections process designed to promote broad improvement in audit quality
- Process includes:
 - Assessing the firm's quality control systems (tone at the top, partner management, monitoring functions, independence, client acceptance/retention, supervision of work by foreign affiliates)
 - Audit engagement reviews (risk-biased selection method)
 - Issuance of inspection report
 - Remediation of quality control inspection findings (as applicable)

2010 Inspection Findings – Annual firms

□ Fair Value Measurements and Disclosures

■ Financial Instruments

- Use of pricing services
- Testing difficult to value or illiquid securities
- Auditing fair value hierarchy disclosures

■ Non-Financial Assets

- Goodwill impairment assessments

□ Estimates and Assumptions

□ Internal Controls

- Failure to test controls for all relevant assertions for significant accounts
- Insufficient testing of issuer review controls, including entity-level controls
- Unwarranted reliance on information system controls
- Identifying and evaluating control deficiencies

2010 Inspection Findings – Triennial firms

- Significant or frequent auditing or quality-control deficiencies were observed in -
 - Revenue
 - Related-Party Transactions
 - Equity Transactions
 - Business Combinations and Impairment of Assets
 - Going-Concern Considerations
 - Loans and Accounts Receivable (including allowance accounts)
 - Service Organizations
 - Use of Other Auditors
 - Use of the Work of Specialists
 - Independence
 - Concurring Partner Review

Inspection Reports

- Inspection reports contain both public and nonpublic portions
 - Inspection reports **do not** identify an issuer by name
 - The public portions of inspection reports are posted on the PCAOB's web site, including the public part of firm responses*
 - Nonpublic portions address quality control issues and may discuss criticisms of, and potential defects in, the firm's quality control systems
- Final inspection report triggers 12-month remediation cycle for quality control deficiencies
 - These criticisms or potential defects are made public only if they are not satisfactorily addressed by the firm before the 12-month period deadline

*See www.pcaobus.org/Inspections/Public_Reports/index.aspx

Possible Consequences of an Inspection Report

- The entire inspection report is provided to the firm, the SEC and appropriate state regulators
- Firms may be required to perform follow-up procedures on the audit deficiencies included in the report (subject to AU 390/561)
 - May result in restatement of an issuer's financial statements if material misstatement is detected
- Possible violations of securities laws, independence rules, GAAP violations or illegal acts are referred to the appropriate authorities through a Rule 4004 report

Countries where Inspections have been Conducted

- Argentina
- Australia (joint inspection)
- Belize
- Bermuda
- Bolivia
- Brazil (regulator observes)
- Canada (joint inspection)
- Cayman Islands
- Chile
- Colombia
- Greece
- Hong Kong
- India
- Indonesia
- Ireland
- Israel (regulator observes)
- Japan
- Kazakhstan

Countries where Inspections have been Conducted (cont'd)

- Republic of Korea (joint inspection)
- Malaysia
- Mexico
- New Zealand
- Norway (joint inspection)
- Panama
- Papua New Guinea
- Peru
- Philippines
- Russian Federation
- Singapore (joint inspection)
- South Africa (joint inspection)
- Switzerland (joint inspection)
- Taiwan
- Thailand (regulator observes)
- Ukraine
- United Arab Emirates-Dubai
- United Kingdom (joint inspection)

Update for Broker- Dealer Auditors

Pre-Dodd-Frank

- ❑ Sarbanes-Oxley Act provided that auditors of BDs would be required to register with the PCAOB
- ❑ SEC provided an exemption from this oversight until December 2008
- ❑ For fiscal years ending after 12/31/08, BD's financial statements were required to be audited by a PCAOB-registered firm
- ❑ Dodd-Frank extended PCAOB's authority to include oversight of auditors of BDs

Dodd-Frank--Inspections

- ❑ Dodd-Frank expanded the PCAOBs inspection authority to include audits of registered securities brokers and dealers.
- ❑ Gave PCAOB the authority to:
 - Differentiate among different classes of BDs
 - Consider whether different inspection schedules would be appropriate with respect to auditors that issue audit reports only for brokers or dealers that do not receive, handle, or hold customer securities or cash or are not members of the Securities Investor Protection Corporation (section 104(a)(2)(B))
 - Exempt any public accounting firm from such an inspection program; the firm would not be required to register with the Board (section 104(a)(2)(D))

Proposed Temporary Inspection Rules

- Establish an interim program to assist in making fully informed judgments on permanent rules
- The interim program will focus on assessing compliance with the rules and standards that applied to the inspected work at the time the audit work was done.
 - Pursuant to SEC statement, audits will continue under GAAS as promulgated by the ASB
- Applicable rules and standards may change during this interim program if and when the SEC amends Rule 17a-5

Standard-Setting Projects

Standard-Setting Projects

- Auditor's Reporting Model*
- Auditor Independence*
- Audits of Broker-Dealers*
- Pricing Sources Task Force*
- Audit Transparency
 - Signing the Auditor's Report
 - Disclosure of Firms in the Auditor's Report
- Communications with Audit Committees
- Part of Audit Performed by Other Auditors (Principal Auditor)
- Application of Sarbanes-Oxley Act's Provision on "Failure to Supervise"
- Confirmation
- Specialists

* *Described in more detail on separate slide*

Standard-Setting Projects (cont'd)

- Going Concern
- Related Parties
- Quality Control Standards, including SEC Practice Section Requirements
- Subsequent Events
- Codification of the Board's Standards

Auditor's Reporting Model Standard-Setting Project

- PCAOB staff outreach to investors, issuers/preparers, audit committee members, auditors, regulators to solicit their views; staff discussed outreach results with the Board at an open meeting on March 22
- IAG task force discussed feedback from investor survey on the topic on March 16
- In addition to pass/fail model, investors have expressed strong interest in:
 - More information about the audit – risk, procedures, results
 - More information about the company's financial statements – management estimates and judgments, policies
 - Scope of the auditor's work – audit of MD&A (or parts thereof)
- Recommendations may potentially require SEC rulemaking
- Proposed Timing
 - Q2 2011 – Issue concept release
 - Q3 2011 – Hold roundtable discussion
 - Q1 2012 – Issue proposed standard

Auditor Independence

- Board plans to issue a concept release in the near future.

Audits of Broker-Dealers Standard-Setting Project

- We are considering potential changes to PCAOB standards that might be necessary in light of changes that the SEC is considering making to its rules for audits of brokers and dealers.
- In the event that the SEC requires auditors of brokers and dealers to comply with PCAOB standards, we also are considering potential guidance for auditors of brokers and dealers who would be transitioning from AICPA standards to PCAOB standards.

Pricing Sources Task Force

- ❑ In the Board's 4010 Report last year on "Observations of Audits during the Economic Crisis," there were numerous comments pertaining to auditing fair values and using specialists where our inspectors noted audit deficiencies.
- ❑ A task force of the Board's Standing Advisory Group convened in May to study issues pertaining to auditing fair values and the use of third-party sources.
- ❑ The task force informed the Board's standard-setting project on fair values and specialists as well as other auditing guidance.
- ❑ The task force consists of
 - Auditors, issuers, pricing services, brokers, and investors
 - Observers from the SEC and the FASB.

FASB/IASB Joint Projects: Potential Audit Implications

- Significant proposed changes to accounting framework
 - More principles-based and more fair values, estimates, judgments, and disclosures
 - Volume of new and amended accounting standards
 - Rapid pace of change
- Discussions at previous SAG meetings (July 2010, Oct. 2010, and March 2011)
 - Many members expressed concerns, including questions about auditability of new standards.
 - Audit implications from FASB's proposed implementation of new standards, including proposed effective dates and transition methods include
 - Audit firms' quality controls – massive and rapid changes in accounting standards
 - Impact on audit firms from FASB's decision on implementation method – retrospective implementation is more challenging for issuers/auditors
 - PCAOB standards and inspections activities.

Keeping Current with PCAOB Standards

Keeping Current with PCAOB Standards

- Our Web site:

- <http://www.pcaobus.org/Standards/Pages/default.aspx>

- PCAOB standards and related rules, including interim standards
 - PCAOB proposed standards
 - Staff Questions and Answers
 - Staff Audit Practice Alerts
 - Standing Advisory Group

- Contact us at info@pcaobus.org

- Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our Web site at:

- <http://pcaobus.org/About/Pages/Subscribe.aspx>