

Heads Up

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A Summary of the November 12–13 Meeting of the PCAOB’s Standing Advisory Group

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Introduction

At the November 12–13, 2015, PCAOB Standing Advisory Group (SAG) meeting, the PCAOB gave an update on recent developments, including an overview of its current and future standard-setting activities. In addition, SAG members participated in separate breakout sessions on audit quality indicators (AQIs) and emerging issues that could affect audits, auditors, or the PCAOB. The PCAOB staff also discussed the status of the Board’s project on using the work of specialists, and the SAG responded to a series of questions posed by PCAOB staff.

Recent PCAOB Developments

Chairman James Doty summarized the following recent PCAOB activities:

- *Standard setting* — The PCAOB continues to explore ways to improve the efficiency of its standard-setting process and is working closely with the SEC in this effort. Chairman Doty indicated that 2016 will be an active year for standard setting and that actions are expected in projects on auditor reporting, supervision of other auditors, accounting estimates, and specialists. He also indicated that in December 2015, a final rule related to the PCAOB’s transparency project is expected to be submitted for the Board’s approval. The rule will require the names of the audit partner and other participants in an audit of an issuer to be included in a form filed with the PCAOB.¹
- *Inspections and enforcement* — The PCAOB is nearing the end of its field work for the 2015 inspection cycle. Early indicators point to a slight decrease in the overall number of findings relative to 2014; however, not all firms improved, and some of the same findings recur year over year. Internal control over financial reporting continues to be a source of significant inspection findings and the subject of much discussion by auditors, preparers, and the regulatory community. In October 2015, the Board issued a general report² summarizing observations related to implementation of its risk assessment standards for the 2012, 2013, and 2014 inspection cycles.

The PCAOB is also continuing its focus on broker-dealers and its 2015 inspections under the interim inspection program. The Board plans to use the information it gathers from interim inspections to develop a permanent inspection program for public comment and review by the SEC. In August 2015, the PCAOB issued a staff inspection brief³ that summarizes observations from its 2015 inspections. The brief is intended to help auditors, audit committees, investors, and preparers further their understanding of the inspection process and its results. Inspectors

¹ See Deloitte’s July 15, 2015, *Heads Up* for information about the PCAOB’s reproposal to disclose certain audit participants.

² *Inspection Observations Related to PCAOB “Risk Assessment” Auditing Standards (No. 8 through No.15)*.

³ PCAOB Staff Inspection Brief, *Information About 2015 Inspections of Auditors of Brokers and Dealers*.

of audits of broker-dealers continue to identify many independence-related deficiencies, particularly among registered firms that do not also perform audits of issuers.

Chairman Doty noted that the PCAOB continues to build and strengthen its relationships with non-U.S. regulators and that many of its inspections are conducted in cooperation with such regulators. New agreements have been reached with Greece, Luxembourg, and Hungary, and the PCAOB is making progress with others. The Board is also continuing its efforts to reach agreements related to conducting inspections in China, although this process has proved more difficult than originally anticipated.

Several enforcement matters are approaching the final stages. Enforcement activity related to non-U.S. registered firms has stepped up, and such acceleration is expected to continue. The PCAOB also continues to coordinate closely with the SEC’s Division of Enforcement.

- *Economic analysis* — The PCAOB’s Center for Economic Analysis continues to be a critical component of the Board’s standard-setting and inspection processes. The Board is also increasing its use of data and economic analysis to improve the efficiency of the standard-setting process as well as its post-implementation analysis of new standards (e.g., this worked well in the Board’s review of Auditing Standard No. 7, *Engagement Quality Review*). Chairman Doty also discussed the Economic Research Fellowship program and indicated that five working papers have been prepared and are currently in academic peer review.
- *Outreach to audit committees and small firms* — The PCAOB continues to reach out to audit committees and their members regarding its work.

Standard-Setting Agenda

Chief Auditor and Director of Professional Standards Martin Baumann provided an update on the PCAOB’s standard-setting activities outlined in the following table:

| Recent Development | |
|--|--|
| Project | Action |
| Reorganization of PCAOB Auditing Standards | Adopted by the PCAOB and approved by the SEC; effective as of December 31, 2016, with early adoption permitted. ⁴ |
| October 2015 to March 2016 | |
| Project | Planned Action Under Consideration |
| Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits | Adoption. ⁵ The PCAOB staff is proceeding to finalize the adopting release for the final rule and hopes to present it to the Board for approval in December 2015. |
| Supervision of Other Auditors and Multi-Location Audit Engagements | Proposal, ⁶ which will consist of one standard rather than the current approach, under which both PCAOB Auditing Standard No. 10, <i>Supervision of the Audit Engagement</i> , and AU Section 543, <i>Part of Audit Performed by Other Independent Auditors</i> , apply. |
| Going Concern | Planned Staff Consultation Paper to obtain input on possible changes to PCAOB AU Section 341, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i> , in light of FASB Accounting Standards Update No. 2014-15, <i>Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern</i> . |
| Auditor’s Reporting Model | Reproposal. ⁷ |

⁴ The PCAOB’s standards can now be accessed under either the old or the new organization on the PCAOB’s Web site.

⁵ Mr. Baumann indicated that 48 comment letters were received on the most recent reproposal and that commenters largely supported it. The staff is resolving some practical issues, including considering the effective date and various matters related to how the information about the name of the audit partner and other participants would be filed with the PCAOB (e.g., possibly via batch reporting). The PCAOB is also investigating the possibility of requiring unique identifiers for individual engagement partners to facilitate its ability to distinguish between individuals with the same name, those who might change their names, or those who might have moved from one firm to another.

⁶ Mr. Baumann indicated that the staff hopes to present a proposed standard to the Board in the first part of 2016.

⁷ Mr. Baumann indicated that the original proposal included a section that addressed the auditor’s responsibilities for other information outside the financial statements and that this aspect of the proposal would not be included in the reproposal, which would deal with other changes to the auditor’s report.

| Other Projects | |
|--|---|
| Project | Project Direction |
| The Auditor's Use of the Work of Specialists | Proposal. See discussion below in Using the Work of Specialists . |
| Auditing Accounting Estimates, Including Fair Value Measurements and Related Disclosures | Proposal. ⁸ |
| Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities | Staff Consultation Paper. |
| Confirmation | Reproposal. |

Mr. Baumann discussed the Board's proposal *Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits* and noted that disclosing the audit partner's name adds clarity about who is performing the audit. The proposal would also result in increased transparency about how much work was performed by the lead audit team as well as others involved in the audit over a certain threshold. For example, portions of the audits might have been performed in countries where the PCAOB could not inspect work papers. He indicated that the Board will be encouraged to adopt this proposal because of the large amount of support it has received for it. Mr. Baumann then discussed the proposal *Supervision of Other Auditors and Multi-Location Audit Engagements* and stated that there needs to be further direction of the supervision of the lead audit firm over a supporting audit firm.

Mr. Baumann also discussed the audit reporting model. He referred to the public meeting in 2014 at which there was discussion of the thoughts and framework related to including in the auditor's report additional information about the audit, including the most significant risks of material misstatement and how the auditor has responded to such risks. This already takes place in the United Kingdom, where it has received much public support.

Audit Quality Indicators

Director Gregory Jonas, Deputy Director George Wilfert, and Senior Advisor Stephen Kroll of the PCAOB's Office of Research and Analysis introduced the topic of AQIs and provided an update of the PCAOB's accomplishments related to AQIs since the last SAG meeting.⁹

Editor's Note: The PCAOB held an open meeting on June 30, 2015, at which it approved a concept release on AQIs (see Deloitte's July 1, 2015, [Heads Up](#) for more information). SAG meeting attendees were reminded that the concept release's comment period ended on September 29, 2015, and that the concept release had proposed 28 potential AQIs.

The PCAOB staff informed SAG members about the general themes of the 47 comment letters it received. Commenters generally agreed that:

- AQIs are useful and that the Board should therefore continue its work.
- AQIs are meant to inform discussion and raise questions to facilitate discussion about audit quality; they should not be used as scorecards or benchmarks.
- Audit committees are thought to be the key users of AQIs and would benefit most from AQIs at the engagement-team level.
- Large accounting firms would benefit more than small firms from the use of AQIs.

⁸ Mr. Baumann indicated the staff continues to analyze the comments on its consultation paper and other input. The issues related to this project are closely related to the issues relevant to the Board's project on the use of the work of specialists, and the PCAOB intends to keep the projects closely aligned.

⁹ See Deloitte's July 1, 2015, [Heads Up](#) on the June 18, 2015, SAG meeting.

Examples of divergent or controversial views expressed by commenters include the following:

- The relevance of some of the 28 AQIs was questioned, and concerns were raised related to how much testing and empirical evidence would be needed to demonstrate their usefulness and scalability as well as implications for smaller firms and issuers. The need was emphasized for additional qualitative considerations to give context to quantitative measures.
- Mixed views were expressed about whether investors would find AQIs useful and would be able to understand them given the likely lack of additional qualitative context to supplement the quantitative information.
- Possible unintended consequences resulting from an AQI, especially without sufficient context to support the need for the AQI.

Mixed views were expressed about (1) whether AQI implementation and reporting should be mandated and (2) the role of the PCAOB. Some commenters recommended that practice be allowed to continue to evolve without intervention; others believed that regulators would play an important role in standardizing AQIs and the related methods for determining them.

In three separate breakout sessions, SAG members were asked to discuss all of the following topics with a view toward giving the PCAOB advice on how to proceed: (1) AQIs and their content, (2) audit committee use of AQIs, and (3) investors' use of AQIs.

The PCAOB staff provided the following overview of the breakout session discussions:

- Two groups gave the PCAOB similar feedback, generally agreeing that the Board should continue to take action and move its AQI project forward rather than continue to debate the need for AQIs and their relevance. They noted that AQIs were useful in the discussion about audit quality and that the AQIs considered the most relevant would most likely depend on who the end user of information would be (e.g., audit committees might be interested in different indicators than investors). They also believed that 28 AQIs was too many but that, depending on the circumstances, there could be other AQIs that would be more relevant. SAG members therefore recommended that the PCAOB consider developing a principles-based framework for the determination of AQIs rather than establishing an overly prescriptive formula for which and how many AQIs should be determined and discussed or reported. It was noted, for example, that this approach would give audit committees the flexibility necessary to decide which AQIs they would find most helpful. Some members suggested that PCAOB guidance on how to calculate AQIs would drive consistency in how individual AQIs would be determined. Although these members generally favored communication of AQIs with audit committees as opposed to requiring public reporting, some investor representatives expressed support for a phased approach toward ultimately requiring public reporting of certain AQIs, noting that investors would find the data informative. Some audit committee representatives who had experience discussing AQIs with their auditors indicated that engagement-team level AQIs were generally more useful and informative than firm-level AQIs. It was also noted that the value of AQIs alone was limited, and that they became most useful and informative when they were part of a broader discussion.
- The third group generally believed that the PCAOB should move forward with mandating public reporting of a subset of AQIs, suggesting that the following AQIs might be most useful: (1) staffing leverage, (2) persons with specialized skills and knowledge, (3) experience of audit personnel, and (4) industry expertise of audit personnel. The group recommended that the PCAOB mandate some and eventually make them public for investors to consider and that it implement them over a period of time rather than requiring them all at once. However, the group did not agree about which AQIs should be mandatory.

After each breakout session's overview was completed, views were sought from all the SAG members and observers about how the PCAOB should proceed. Although differing perspectives were expressed, in particular about whether the PCAOB should move forward with mandatory public reporting of some number of AQIs, there was general support from the SAG for the PCAOB to continue to advance the

project. Many noted that audit committees are the right audience for AQIs and that even if the PCAOB does not ultimately mandate public reporting, the Board nevertheless has an important role to play in encouraging discussions about audit quality between audit committees and auditors. SAG members also expressed support for the ongoing work being done by the PCAOB to explore relationships between the results of PCAOB inspections and selected AQI information.

Emerging Issues That Could Affect Audits, Auditors, or the PCAOB

The PCAOB asked various SAG members to identify emerging issues for discussion with the SAG. After participating in a panel discussion during which an overview of the topics identified was presented, SAG members discussed certain issues in more detail in breakout sessions. Panelists then provided feedback to the SAG about the breakout sessions, including suggestions for possible actions for the PCAOB to consider. The following topics were discussed:

- *Whistleblower activity* — The SAG noted increased levels of whistleblower activity and reflected on the importance of auditors’ being aware of their responsibilities under Section 10A of the Securities Exchange Act of 1934 with respect to illegal acts and investigations. It was also observed that auditors should engage in appropriate discussions with audit committees about the importance of robust investigations and in particular should highlight the benefits of independent investigations conducted by suitably experienced legal counsel. SAG members supported a recommendation for the PCAOB to consider developing staff guidance that would highlight the current increasing trend of whistleblower activity, discuss the implications of such activity for preparers and audit committees, and remind auditors of their responsibilities.
- *Economic developments* — SAG members were asked to reflect on the accounting and auditing implications of falling oil prices and continued low interest rates. The SAG discussion focused on how important it is for auditors to address these matters during their risk assessment procedures and in particular when auditing significant management estimates. Additional emerging risks raised during the breakout sessions included currency risks (especially related to Venezuela) and merger and acquisition activity. SAG members noted that in 2011, the PCAOB issued a staff alert that contained useful information for auditors about assessing and responding to risk in the current environment. Although the nature of the current economic issues would be somewhat different from those in 2011, SAG members were of the view that the guidance in this alert may nevertheless be useful to auditors in assessing and responding to risks related to the current economic environment. SAG members encouraged the PCAOB to highlight current issues and remind auditors about the staff guidance in upcoming speeches.
- *Use of data/data auditing* — The SAG discussion highlighted various matters related to the use of data and data auditing, including the potential for increased audit quality through the application of data analytics and increased automation of routine processes. SAG members expressed interest in this topic but also noted that the use of data analytics is still in the early stages and is continuing to evolve. They advised the PCAOB to be cautious about standard-setting action, noting that while current standards do not directly address all the various data analytics and innovative techniques being explored today, updates should make the standards “fit for purpose” as technological advances continue.
- *Auditor’s role — non-GAAP measures* — Investors are increasingly relying on non-GAAP measures; however, the auditor’s responsibility for such information is currently limited.¹⁰ Some SAG members indicated that they would like to see the auditor’s role and responsibilities expanded to include providing assurance on non-GAAP information, but they acknowledged that a cost-benefit analysis would need to be performed.
- *Impact of FASB materiality proposals* — It was observed that as a result of the FASB’s materiality proposals,¹¹ the number of disclosures in the notes to the financial statements could be reduced. The proposals would also clarify that the omission of an immaterial disclosure is

¹⁰ The auditor’s responsibilities for such information are contained in PCAOB AU Section 550, *Other Information in Documents Containing Audited Financial Statements*, and include reading such information and considering whether it is materially inconsistent with the financial statements or whether there are any apparent material misstatements of fact.

¹¹ See Deloitte’s September 28, 2015, *Heads Up* for information about the FASB’s proposed ASU, *Notes to the Financial Statements (Topic 235) — Assessing Whether Disclosures Are Material*.

not considered an error and, therefore, auditors would not be obligated to accumulate such omissions and communicate them to the audit committee.¹² Some investor representatives expressed concerns that financial statements could become less informative and that audit committees might not receive relevant information about significant judgments being made regarding omitted disclosures. SAG members encouraged the PCAOB to continue to monitor this project and assess whether any amendments were necessary to the PCAOB's auditing standards (in particular, PCAOB Auditing Standard No. 16, *Communications With Audit Committees*).

- *Revenue recognition transition* — The discussion focused on issues related to the implementation of FASB Accounting Standards Codification Topic 606, *Revenue From Contracts With Customers*. Matters highlighted included challenges associated with the significant increase in the number of accounting estimates that will be involved, implications for internal control over financial reporting, and a number of industry-specific implementation issues. SAG members also highlighted possible challenges regarding retrospective adoption, particularly when predecessor auditors are involved, and encouraged the PCAOB to consider developing additional guidance to address these challenges.¹³ SAG members also encouraged the PCAOB to consider using the *Audit Committee Dialogue* newsletters to highlight the issues and challenges with audit committees and to encourage audit committees to discuss implementation efforts with management and the auditor. As part of continuing to monitor implementation progress and assessing the need for additional auditing guidance, the PCAOB was also encouraged to liaise with the AICPA's Financial Reporting Executive Committee, which is overseeing task forces that are developing industry-specific implementation guidance.

Other issues that were discussed briefly included:

- Cybersecurity.
- Audit considerations resulting from mandatory audit firm rotation in the European Union.
- Auditing forward-looking assumptions.
- Disruptive technology changes.

Using the Work of Specialists

Deputy Chief Auditor Greg Scates discussed the use of the work of specialists, which was also a topic at the June 2015 SAG meeting. The Board received 44 comment letters in response its staff consultation paper, *The Auditor's Use of the Work of Specialists*. Mr. Scates noted that the majority of responders generally supported this project and indicated that it needs to be carefully aligned with PCAOB's project on management estimates, including fair value measurements. Respondents also generally supported the approach of starting with the requirements and guidance in International Standards on Auditing (ISAs) 620, *Using the Work of an Auditor's Expert*, and 500, *Audit Evidence*.

Editor's Note: In the ISAs, the guidance on the auditor's use of a specialist is separated from the guidance on the auditor's consideration of management's use of a specialist.

SAG members then discussed certain requirements in ISA 620 related to evaluating an auditor's specialist's work (including requirements for the auditor to evaluate the adequacy of the specialist's work for the auditor's purposes) and expressed general agreement with the guidance. Similarly, SAG members discussed and expressed general support for the requirements in ISA 500 related to evaluating work performed by a company's specialist, which include assessing the competence, capabilities, and objectivity of the management specialist and using that assessment together with an understanding of the nature of the work and its appropriateness to inform the necessary audit procedures.

¹² Paragraph 18 of PCAOB Auditing Standard No. 16, *Communications With Audit Committees*, requires auditors to communicate uncorrected and corrected misstatements by attest clients to the audit committee.

¹³ SAG members noted that additional guidance could potentially build on the PCAOB staff guidance *Adjustments to Prior-Period Financial Statements Audited by a Predecessor Auditor*, which was issued in 2006.

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