

Audit Committee *Brief*



A voice at the table:
Becoming more
involved in the financial
reporting regulatory process

Regulators and standard setters such as the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB), Public Company Accounting Oversight Board (PCAOB), and International Accounting Standards Board (IASB) frequently encourage audit committees and other stakeholders to be more involved in regulatory and standard-setting activities that affect their companies and industries. Among the most effective means for audit committees to enhance their involvement is through becoming familiar with domestic and global standard-setting processes, as well as audit quality and financial reporting initiatives. This knowledge can help audit committees identify issues about which they may want to engage in the regulatory arena.

Audit committee members can strengthen their understanding of these rapidly evolving issues through engaging in discussions with management, auditors, and other stakeholders about current and potential standards and rule proposals, emerging topics and trends, frequent areas of focus in SEC reviews, and the results of PCAOB inspections of their companies' external auditors. Participation in the standard-setting and rulemaking process allows audit committees to have a substantive voice in the architecture of the financial reporting regulatory system, which affects the operations of the capital markets, and thus the prosperity of the economy.

Involvement in standard-setting and rulemaking activities

There are numerous ways in which audit committees can get involved in the standard-setting and rulemaking process. Formal comment letters and direct discussions with regulators and standard setters, as well as less formal discussions with other stakeholders, such as the external auditor, industry groups, and professional organizations like the Center for Audit Quality and the National Association of Corporate Directors, can help shape the dialogue around regulations that affect the committee's oversight responsibilities. Audit committees can provide feedback as a body or as individual members on issues relevant to the companies they serve.

Regulators and standard setters have emphasized the importance of hearing perspectives from audit committees, in their capacity as representatives of the interests of investors, on financial reporting and audit quality issues. For example, the PCAOB has set as a priority for 2013 "enhancing outreach to and interaction with audit committees to constructively engage in areas of common interest, including auditor independence and audit quality."

The following sections summarize the typical rulemaking and standard-setting processes for the SEC, FASB, PCAOB, and IASB. Though the specific timeline and number of iterations of individual steps can vary significantly based on the topic and the feedback received, the general sequence of activities is consistent.



"Investing in the standard setting and regulatory arena is something that I feel, as professionals, should be an obligation – the ability of professionals to take their knowledge and shape the future of the regulatory environment to the betterment of our capital markets."

Jim Kroeker

Former SEC Chief
Accountant and Partner,
Deloitte & Touche LLP

How to comment

There is no single standardized format to use when submitting comments to regulators and standard setters. Some commenters choose to express their views in a narrative format, while others structure their response around questions posed in the document on which they are commenting.

Comment letters can be submitted through a variety of methods, including postal mail, email, electronic forms, and fax. Each regulator and standard setter has specific instructions on commenting available on its website, and the option to comment is typically linked to the specific draft for which feedback is being sought. Comment letters are typically posted on the regulator's or standard setter's website; reviewing the letters submitted by others can provide insight into common approaches to the structure and content of the comments on a particular proposal.

Further information on how to submit comments and on topics open for comment can be found at the following links: [SEC](#); [FASB](#); [PCAOB](#); and [IASB](#).



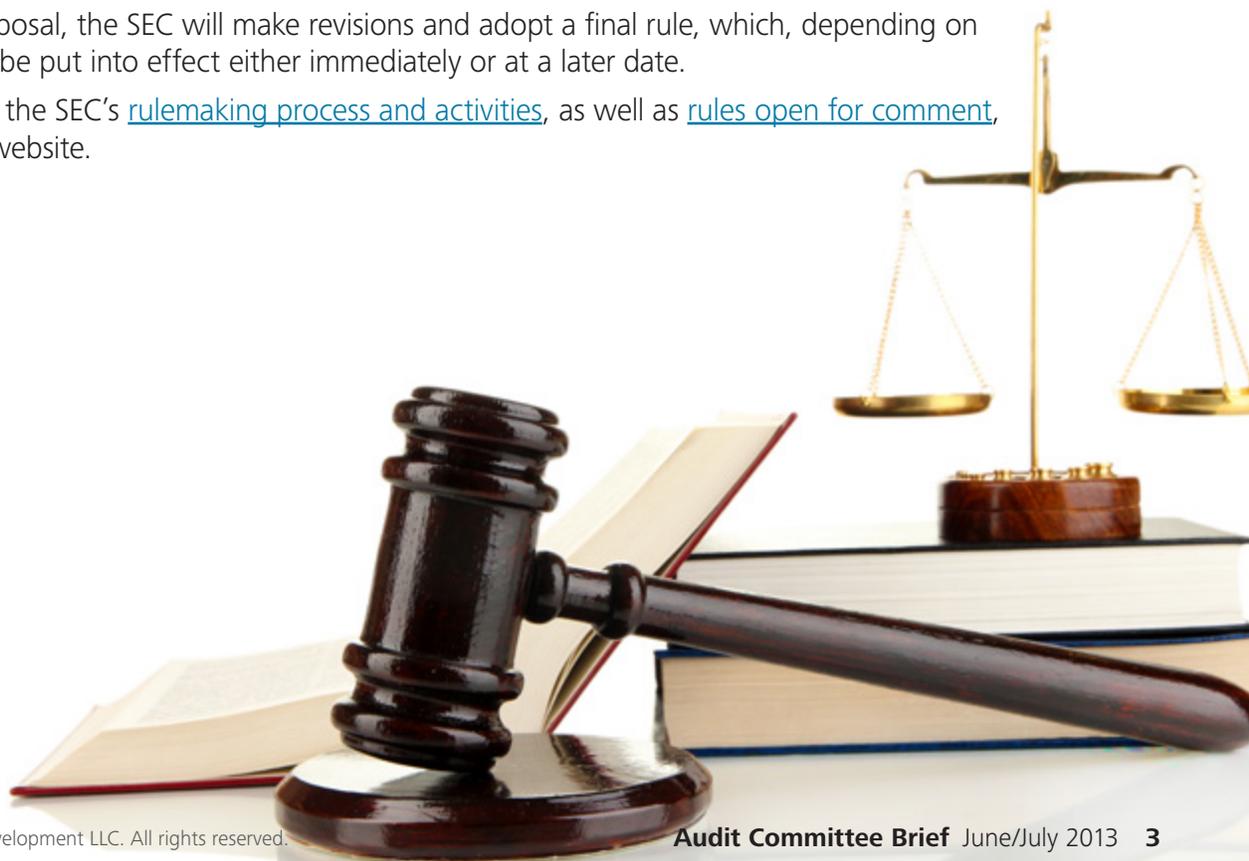
SEC rulemaking process

The mission of the SEC is “to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital information.” The SEC derives its rulemaking authority from federal securities laws, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940, as well as through newer laws, such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

While not all of the SEC’s activities directly affect the audit committee, certain issues, particularly those raised by the Division of Corporation Finance regarding public company disclosures, have a significant impact on the audit committee’s oversight responsibilities. The following provides a brief summary of the SEC’s rulemaking process:

- Generally, the public portion of the SEC’s rulemaking process commences with a rule proposal, or, if the issue is particularly novel or complex, a concept release on which it requests public comment. The SEC also may seek public comment on particular issues prior to a formal rule proposal or concept release through SEC advisory groups, roundtables, or other venues.
- A rule proposal or concept release will usually include a discussion of the intent and reasons behind the proposal, potential alternatives, and a series of questions for consideration. In the case of a proposed rule, the SEC will provide draft rule text, as well as a narrative description of the proposed rule.
- Typically, proposals from the SEC are released for public comment for 60 to 90 days, although the length of comment periods can vary depending on circumstances, such as statutory deadlines. The SEC may also seek feedback by means other than formal comment letters, including roundtables on proposed rules and meetings with interested stakeholders.
- All public comments on a concept release are reviewed, and if, upon considering the comments, the SEC decides to proceed with the rulemaking, it will issue an official rule proposal for public comment.
- A rule proposal is more specific than a concept release and includes proposed text for the rule. The SEC notes in its rulemaking guidelines that comments are “vital to the formulation of a final rule.” Based on feedback on the rulemaking proposal, the SEC will make revisions and adopt a final rule, which, depending on circumstances, can be put into effect either immediately or at a later date.

More information on the SEC’s [rulemaking process and activities](#), as well as [rules open for comment](#), can be found on its website.



FASB standard-setting process

FASB standards are highly relevant to audit committees since they are considered generally accepted accounting principles (GAAP) in the United States, and U.S. public companies are required to follow them in preparing their financial statements. The FASB's stated mission is "to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports. That mission is accomplished through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholder views, and is subject to oversight by the Financial Accounting Foundation's Board of Trustees."

Public input is a fundamental part of the FASB's standard-setting process, and the FASB seeks strong participation from a range of stakeholders. The audit committee should be aware of the FASB's process, since new standards directly affect their role in overseeing financial reporting. The following is a brief summary of the FASB's standard-setting activities:

- The FASB identifies an issue, often based on recommendations from stakeholders.
- The FASB's chairman consults with FASB members and others to determine if a topic should be added to the technical agenda.
- The FASB holds public meetings deliberating the identified issues.
- The FASB will then issue an exposure draft of a standard, or, in some cases, an initial discussion draft, and seek feedback; in certain cases, public roundtables are held. The comment period usually lasts at least 60 days.
- FASB members analyze all feedback received through comment letters, roundtables, and other efforts, and conduct a final deliberation on the standard's provisions and revisions through one or more public meetings.
- The FASB issues a final Accounting Standards Update that amends the Accounting Standards Codification to add the new or revised standard.

More information on the FASB's [standard-setting process](#), as well a list of [exposure drafts open for comment](#), can be found on its website.

PCAOB standard-setting process

The Sarbanes-Oxley Act mandated the creation of the PCAOB and called for the PCAOB to adopt auditing standards to which accounting firms must adhere when conducting audits of U.S. public companies.¹ The mission of the PCAOB is “to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.” The PCAOB’s Office of the Chief Auditor is responsible for formulating these standards, which must be approved by the PCAOB before being issued for public comment. Audit standards should be of interest to audit committees because they delineate the requirements with which their auditors need to comply and articulate why specific audit procedures are in place.

Stakeholders such as investors, financial statement preparers, auditors, and other standard setters and regulators have the chance to weigh in on standards as they are formulated:

- In most cases, the PCAOB’s Standing Advisory Group, which includes public company board members and executives, auditors, investors, academics, and others, provides input on various topics, including potential audit standards.
- In addition, the PCAOB may consider feedback from roundtables, task forces, and focus groups, as well as data from inspections.
- In some cases, the PCAOB will issue a concept release and ask for public comment before issuing a proposed standard. The comment period typically lasts from 30 to 90 days.
- After the PCAOB examines the feedback on a concept release, it may then develop a proposed standard. The PCAOB then seeks public comment on the proposed standard and reviews the comments to decide whether to issue a final standard.
- If a standard is adopted by the PCAOB, it is sent to the SEC for consideration and approval. The SEC also solicits public comment as part of its consideration process, although the best chance to provide input on PCAOB standards is typically while it is being considered by the PCAOB.

More information on the PCAOB’s [standard-setting and rulemaking process and activities](#), as well as [dockets open for public comment](#), are available through its website.



¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act gave the PCAOB added authority over all broker-dealers (public and non-public), including the authority to establish standards for the audits of broker-dealers.

IASB standard-setting process

While there are a number of international standard-setting bodies, the IASB, which sets International Financial Reporting Standards (IFRS), is relevant for many U.S. companies. In 2002, the IASB established a joint convergence project with the FASB, with the goal of converging the standards associated with certain topics in U.S. GAAP and IFRS. The IASB's objective is to "develop a single set of high quality, understandable, enforceable, and globally accepted financial reporting standards based upon clearly articulated principles." It can be beneficial for audit committee members to stay apprised of international standard developments and to understand their effects on current operations and future opportunities for investment.



The IASB standard-setting process is similar to the FASB process, and provides for international input. There are typically six stages:

- The IASB sets its agenda by evaluating the issues that are relevant to investors or have been raised in light of comments from other standard setters and interested parties.
- Once its agenda is set, the IASB plans a project, which includes the consideration of whether the project should be conducted by the IASB alone or jointly with another standard setter, and a plan is drafted.
- In certain cases, the IASB publishes a discussion paper to explain the topic and seek comments from the public. This typically includes an overview of the topic, possible approaches, and preliminary views of the IASB.
- The IASB develops and publishes an exposure draft for comment. The draft summarizes the issues, any comments received if a discussion paper is published, and any suggestions from the IFRS Advisory Council.
- If any issues arise from the exposure draft, they are resolved, and the IASB considers whether it should revise the proposal for a second exposure draft. If re-exposure is not necessary and all outstanding issues are resolved, the IASB members vote on the standard and it is issued upon approval.
- Once the standard is issued, the IASB holds meetings to better understand any issues associated with the implementation or effects of the proposal.

The IASB's website contains further details on its [standard-setting process](#), as well as information on [documents open for comment](#).

International Financial Reporting Standards

The SEC's [final report](#) on its IFRS work plan, issued in July 2012, did not provide any binding judgments regarding whether international standards would or should be adopted in the United States, but summarized the progress made and feedback received thus far. Among the issues highlighted was the importance of recognizing the uniqueness of the U.S. capital markets, differences in readiness for conversion among companies of various sizes and industries, and the consistent application and enforcement of standards.

While discussions continue about whether IFRS reporting will be fully integrated into the U.S. context, a number of individual FASB/IASB convergence projects related to revenue recognition, leasing, and financial instruments have made substantial progress. Regardless of the ultimate outcome of the IFRS debate, global convergence efforts are likely to continue. The [May 2013](#) issue of the *Audit Committee Brief* explores these efforts in more detail.

As the preceding regulatory and standard-setting process summaries demonstrate, there are typically several junctures at which an audit committee can provide feedback to regulators or standard-setters. An audit committee's participation in the process will likely be most effective if the audit committee members familiarize themselves with the process and issues under consideration for a particular topic at an early stage, while standards or rules are in the concept or proposal phase. This may help audit committee members better understand the impact on the business, industry, and overall regulatory environment and to determine whether they would like to weigh in.

PCAOB inspections and the audit committee's interaction with the auditor

There are other aspects of the regulatory process that audit committees should be aware of and engaged in, as appropriate. For example, there has recently been increased interest among various stakeholders regarding the results of the PCAOB's inspections of auditors of public companies. In August 2012, the PCAOB issued [Information for Audit Committees About the PCAOB Inspection Process](#); this document is intended to assist the audit committee in its oversight role and to enhance its understanding of how the auditor has performed on specific audits and in high-risk areas across audits. Deloitte's [August 30, 2012, Heads Up](#) contains further information on the release.

As part of its inspection program, the PCAOB chooses specific engagements of audit firms for review, in addition to reviewing the firms' overall quality control systems. If a company's audit engagement is chosen for inspection, the audit committee chair will likely be aware and may be interviewed by the PCAOB inspection team, typically regarding discussions between the chair and the auditor, and about communication from the auditor to the audit committee² on accounting judgments and estimates, findings and adjustments, and other similar matters.

Even if a company's audit engagement is not selected for review, it is still important for audit committees to understand the nature of the PCAOB's findings. Sample questions for committee members to ask the auditor regarding the audit and inspection process are provided in the [PCAOB's release](#).

The ultimate effect of the increased focus on inspection results is an enhanced focus on quality—a goal the audit committee shares with the external auditor and the PCAOB. The PCAOB will likely continue its focus on the role of the audit committee as part of its efforts to promote continuous improvement in audit quality.

² Auditing Standard 16, *Communications with Audit Committees*, approved by the SEC in December 2012, is intended to standardize and enhance the information provided to audit committees by auditors. See Deloitte's [January 4, 2013, Heads Up](#) for additional details on the standard.

Conclusion

Typically, only a relatively small percentage of feedback on proposed financial reporting and audit regulations and standards comes from audit committees, although it is a constituency from which regulators and standard setters are generally eager to hear. Regulators such as the PCAOB are increasingly seeking out audit committees to leverage industry- and company-specific knowledge and experience, including in the context of inspections. Taking the time to engage in formal or informal communication with regulators, industry groups, or the external auditor on these topics can substantively affect the development of standards and rules.

Additional resources



[May 2013 Audit Committee Brief:
The Road to Convergence](#)



[Information for Audit Committees
About the PCAOB Inspection Process](#)



[SEC Approves PCAOB Auditing Standard
on Communications With Audit Committees](#)

Questions for audit committees to consider

What types of investments has the company made with respect to the standard-setting and regulatory arena?

What steps does management take to identify financial reporting developments that are likely to have a material impact on the company?

Does management discuss with the audit committee the potential impact of proposed accounting standards on the company?

When commenting to standard-setting or regulatory agencies, are there any real-world examples you can provide to further support the argument?

Have management and the auditors discussed what types of inspection comments are most relevant to the audit committee?

To what extent does the audit committee probe the auditor about inspection results and the remediation steps being taken to address comments received?



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In other news: spotlight on enterprise compliance

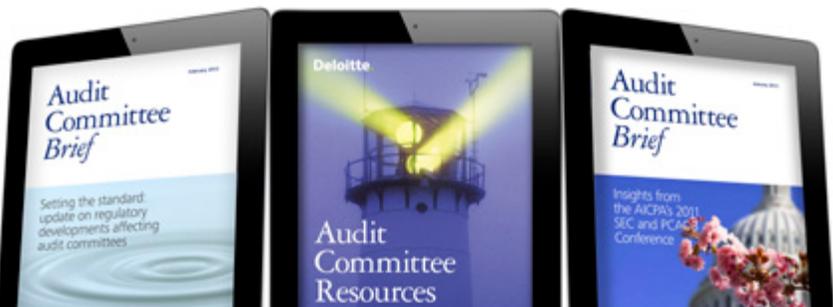
Whether your organization is highly regulated, unregulated, public, or private, compliance is likely a core business issue on your immediate agenda. As government regulation continues to evolve around the world, its importance is only growing. While there has been plenty of discussion about the role of an enterprise compliance approach in managing these risks, the details have always been a little fuzzy—until now.

Deloitte’s new guidebook, [*Enterprise Compliance: The Risk Intelligent Approach*](#), explains the key components of enterprise compliance and highlights the tough questions senior executives and board members should be asking about their compliance efforts.



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