

# Forum on Auditing in the Small Business Environment

September 18, 2018

Fairfax, VA

# Welcome

Greg Scates, Director

Office of Outreach and Small Business  
Liaison

# Caveat

One of the benefits of today's session is that you will hear firsthand from numerous PCAOB staff members. You should keep in mind, though, that when we share our views they are those of the speaker alone, and do not necessarily reflect the views of the Board, its members or staff.

# Learning Objective and Course Description

## Learning Objective

To discuss important information concerning PCAOB activities with registered accounting firms that audit public companies operating in the small business community. The forum also provides an opportunity for Board members and PCAOB staff to hear comments, concerns and questions from auditors. More specifically, the forum features a panel discussion on revenue recognition under ASC 606, Revenue from Contracts with Customers. A case study will be presented and facilitated by PCAOB staff from the Division of Registration and Inspections and the Office of the Chief Auditor, and will focus on auditing revenue under ASC 606. Other discussion topics include: key inspection findings, an update on the auditor's report, remediation, auditor independence, a standard setting update, and an enforcement update. In addition, staff from the Securities and Exchange Commission's (SEC) Office of the Chief Accountant will join us to provide an update on SEC activities.

## Course Description

The PCAOB Forum on Auditing in the Small Business Environment is a one-day session that will offer attendees the opportunity to interact with the PCAOB and learn more about its programs and activities, primarily with respect to triennially inspected registered firms.

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/OOSBSBFVA2018>

# Stay Connected

- ❑ Stay up-to-date on current PCAOB activities (including announcements about future forums!) by signing up for our email list.

<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>

# CPE Credit

Name of Participant	
Firm	

**LEGIBLE** name and firm name

**MARK** sessions attended

**Add/Divide** Minutes

**SIGN** and **DATE**

<u>Session Title</u>	<u>Auditing Minutes</u>
Board Member Perspective	20
Panel: Revenue Recognition	65
Case Study: Auditing Revenue	40
SEC Update	60
Inspections Overview	20
New Auditor's Report	40
Remediation	45
Standards Update	20
Auditor Independence	25
Enforcement Update	45
Q&A	20
<b>Total Minutes (400)</b>	400
<b>Total Minutes Divided by 50</b>	8

Signature \_\_\_\_\_ Date \_\_\_\_\_

# Polling and Messaging

- ❑ Use the following URL in your internet browser:

<https://web.meetoo.com/m#/144749648>

**OR**

- ❑ Download the Meetoo app (iOS and Android) and enter meeting ID  
**144-749-648**



# The audit report has undergone significant change where?

- 1 U.S. only
- 2 U.S. and U.K.
- 3 Globally

# The audit report has undergone significant change where?

1. U.S. only
2. U.S. and U.K.
3. **Globally**

# Board Member Perspective

Duane DesParte  
Board Member

# Panel Discussion: The New Revenue Standard, ASC 606

Greg Scates, Moderator

Emily Fitts, SEC

Sarah Esquivel, SEC

Alan Skinner, PCAOB - Inspections

Brian Degano, PCAOB – Standards

Carol Der Garry, PCAOB – Enforcement

# What is your level of experience with ASC 606?

- 1 Participated in one or more audits in which the audit client adopted ASC 606 in 2017
- 2 Participated in one or more audits in which the audit client adopted ASC 606 in 2018
- 3 Both 1 and 2
- 4 Assisted non-audit clients with the implementation of ASC 606
- 5 Attended training, but no experience yet

# Overview of ASC 605 'Legacy GAAP'

## Core Principle

- ❑ Revenue should not be recognized until it is realized or realizable and earned. Revenue generally is realized or realizable and earned when all of the following criteria are met:
  - ❑ Persuasive evidence of an arrangement exists
  - ❑ Delivery has occurred or services have been rendered
  - ❑ The seller's price to the buyer is fixed or determinable
  - ❑ Collectability is reasonably assured

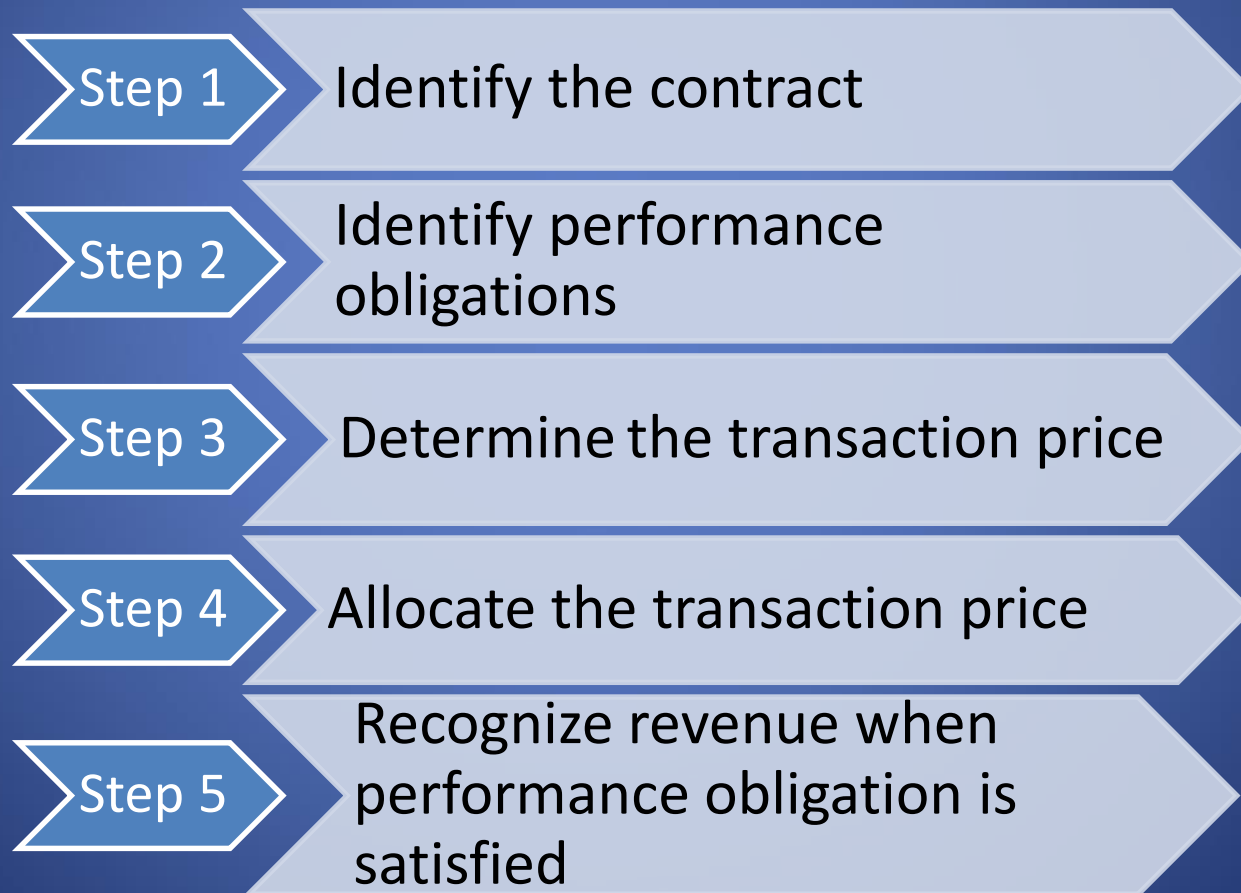
# Overview of ASC 606

## Core Principle

“An entity shall recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.”

# Overview of ASC 606 (cont'd)

## Five-Step Process





# Panel Discussion: The New Revenue Standard, ASC 606

# When did your firm audit or plan to audit the ASC 606 transition adjustments of your audit clients?

- 1 During the audit of the SAB 74 disclosures prepared by the Company in connection with prior year's financial statements
- 2 During the firm's review of a company's interim financial information for the first quarter of 2018
- 3 While planning the 2018 annual audit and performing the risk assessment
- 4 While performing interim and year-end audit procedures during the 2018 annual audit

# Panel Discussion: The New Revenue Standard, ASC 606

# What element of ASC 606 do you anticipate will be the most difficult to audit?

- 1 Transition adjustments
- 2 Determining the transaction price
- 3 Allocating the transaction price to each performance obligation
- 4 New disclosures
- 5 Other

# Panel Discussion: The New Revenue Standard, ASC 606

**BREAK (15 minutes)**

# Auditing Revenue under ASC 606

Alan Skinner, Deputy Director  
Division of Registration and Inspections

Brian Degano, Associate Chief Auditor  
Office of the Chief Auditor

# Auditing Revenue under ASC 606

## Case Study – We Build Trailers, Inc.



# Case Study

## *Background*

Your firm has been engaged to audit the financial statements of We Build Trailers, Inc. (the “Company”) for the year ended December 31, 2018, and to review the Company’s interim financial information to be included in its quarterly filings in 2018. The Company, the largest audit client of your firm, manufactures concession trailers to a variety of customers in the U.S. The Company has been a client of your firm for a number of years.

The following relates to the Company’s operations for 2018:

- ❑ The Company adopted ASC 606, *Revenue from Contracts with Customers*, as of January 1, 2018, using the modified retrospective method
- ❑ The Company sells its concession trailers for prices in the range of \$45,000 to \$75,000.

# Case Study

## *Background (cont'd)*

- ❑ Title to a concession trailer is transferred to the customer at the Company's manufacturing plant upon pick-up.
- ❑ Payment terms are as follows: (1) generally 30% of the price of the trailer is due at the date the trailer is placed into production and (2) the remainder is due upon delivery of the trailer. Each trailer takes approximately 30 days to manufacture.
- ❑ The Company provides price concessions for those customers ordering more than five trailers in a twelve-month period. (i.e. upon the sixth purchase, the discount would be applied to all purchases during that twelve-month period, including being retroactively applied to the first five purchases).

# Case Study

## *Background (cont'd)*

- ❑ The Company also offers an optional service for an additional fee in the range of \$3,000 to \$5,000, whereby the Company provides initial set-up and training for operation of the trailer to the customer's employees at the customer site ("Set-up Service"), which is provided within 30 days of customer receiving the trailer.
- ❑ Set-up Service is typically purchased by first-time customers, which represented approximately 42 percent of all trailer sales in 2017. Payment is due upon delivery of service, and price concessions do not apply.

# Case Study

## *Background (cont'd)*

- ❑ The audit partner and other members of the 2018 engagement team have not worked on an audit engagement that included the initial adoption of ASC 606.
- ❑ An audit of internal control over financial reporting is not required.
- ❑ Your firm has completed its interim reviews for the Company's first and second quarters.
- ❑ You, the audit partner, have asked the audit manager to provide you with their assessment of risks related to auditing revenue of the Company.

# Case Study – Scenario 1

## *Question #1*

- ❑ With the Company adopting ASC 606 using the modified retrospective method, what challenges do you think the Company will face in implementing the provisions of ASC 606?

# Case Study – Scenario 1

## *Question #1 Debrief*

Challenges for the Company in Implementing ASC 606:

- Determining the opening balance sheet effect of modified retrospective adoption of ASC 606
- Estimating the future obligation of the Company's twelve-month volume price concession program upon adoption of ASC 606 and for post-adoption transactions
- Determining standalone selling price of the Set-up Service
- Disclosure of remaining performance obligations (i.e., backlog)

# Case Study – Scenario 1

## *Question #1 Debrief (cont'd)*

Accounting for volume-based discounts or rebates under ASC 605 (Legacy GAAP): ASC 605-50-25-7 states, in part:

A vendor may offer a customer a rebate or refund of a specified amount of cash consideration that is redeemable only if the customer completes a specified cumulative level of revenue transactions or remains a customer for a specified time period. The vendor shall recognize the rebate or refund obligation as **a reduction of revenue based on a systematic and rational allocation** of the cost of honoring rebates or refunds earned and claimed to each of the underlying revenue transactions that result in progress by the customer toward earning the rebate or refund. Measurement of the total rebate or refund obligation shall be based on the estimated number of customers that ultimately will earn and claim rebates or refunds under the offer (that is, breakage should be considered if it can be reasonably estimated). However, **if the amount of future rebates or refunds cannot be reasonably estimated**, a liability shall be recognized for the maximum potential amount of the refund or rebate (that is, no reduction for breakage shall be made).

# Case Study – Scenario 1

## *Question #1 Debrief (cont'd)*

Accounting for volume-based discounts or rebates under ASC 606 (new GAAP): ASC 606-10-32-8 states, in part:

An entity shall estimate an amount of variable consideration by using either of the **following methods**, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- a. The expected value
- b. The most likely amount

The constraint – ASC 606-10-32-11 states:

An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 606-10-32-8 **only to the extent** that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.



# Case Study – Scenario 1

## *Question #1 Debrief (cont'd)*

Determining the standalone selling price – ASC 606-10-32-34 states:

Suitable methods for estimating the standalone selling price of a good or service include, but are not limited to, the following:

- a. Adjusted market assessment approach** – An entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach also might include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- b. Expected cost plus a margin approach** – An entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

*(continued on next slide)*

# Case Study – Scenario 1

## *Question #1 Debrief (cont'd)*

Determining the standalone selling price – ASC 606-10-32-34 states:

**c. Residual approach** – An entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 606-10-32-33, the standalone selling price of a good or service only if one of the following criteria is met:

1. The entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (that is, the selling price is highly variable because a representative standalone selling price is not discernible from past transactions or other observable evidence).
2. The entity has not yet established a price for that good or service, and the good or service has not previously been sold on a standalone basis (that is, the selling price is uncertain).

# Case Study – Scenario 1

## *Background*

- The audit manager recommended using a similar risk assessment that was used for the 2017 audit, as there haven't been any significant changes to the Company's operations over the past year, and none are expected in 2018. That risk assessment is as follows:

	Inherent Risk	Control Risk	Risk of Material Misstatement	Fraud Risk or Other Significant Risk?
Existence or Occurrence (EO)	High	Low	High	✓
Completeness (CO)	Low	Low	Low	
Valuation or Allocation (VA)	Low	Low	Low	
Rights and Obligations (RO)	Low	High	Low	
Presentation & Disclosure (PD)	Low	High	Low	

# Case Study – Scenario 1

## *Background (cont'd)*

- ❑ Consistent with the prior year, the audit manager indicated there was a fraud risk related to the occurrence of revenue. This was due principally to the fact that the CFO indicated in the Q1 earnings call that the Company anticipated 10 percent revenue growth in 2018.
- ❑ The audit manager also indicated that using a risk assessment similar to last year seemed appropriate given the following:
  - ❑ There have been no significant changes in the Company's operations during 2018.
  - ❑ The CFO indicated that the adoption of ASC 606 had, thus far, had little impact on the Company's revenue recognition during 2018.

# Case Study – Scenario 1

## Question #2

What are your thoughts on the risk assessment?

	Inherent Risk	Control Risk	Risk of Material Misstatement	Fraud Risk or Other Significant Risk?
Existence or Occurrence (EO)	High	Low	High	✓
Completeness (CO)	Low	Low	Low	
Valuation or Allocation (VA)	Low	Low	Low	
Rights and Obligations (RO)	Low	High	Low	
Presentation & Disclosure (PD)	Low	High	Low	

# What assertions do you believe should be significant risks?

- 1 EO and VA
- 2 EO, CO, and VA
- 3 EO, VA, and PD
- 4 All assertions, based on the presumed fraud risk for revenue

# What assertions do you believe should be significant risks?

1. EO and VA
2. EO, CO, and VA
- 3. EO, VA, and PD**
4. All assertions, based on the presumed fraud risk for revenue

# Case Study – Scenario 1

## *Question #2 Debrief*

- ❑ Risk assessment and planning the audit
  - ❑ Assessment of systems that provide information to allow for measurement of the estimated price concessions (e.g. when customers purchase more than five trailers in a twelve-month period)
  - ❑ Assessment of systems that allow for the bifurcation of revenue when a customer purchases the Set-up Service as well (and allocate revenue based on relative standalone selling prices of each performance obligation)
- ❑ Auditing the transition adjustment
- ❑ Audit committee communications



# Relevant Auditing Standards

## *Risk Assessment*

AS 2110, *Identifying and Assessing Risks of Material Misstatement*, paragraphs .68 and .70 state, in part:

The auditor should presume that there is a **fraud risk** involving improper revenue recognition and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks.

To determine whether an identified and assessed risk is a **significant risk**, the auditor should evaluate whether the risk requires **special audit consideration** because of the nature of the risk or the likelihood and potential magnitude of misstatement related to the risk.

Note: The determination of whether a risk of material misstatement is a significant risk is based on **inherent risk**, without regard to the effect of controls.

# Relevant Auditing Standards

## *Risk Assessment (cont'd)*

AS 2110, paragraph .71 states:

Factors that should be evaluated in determining which risks are significant risks include:

- a. The effect of the quantitative and qualitative risk factors discussed in paragraph .60 on the likelihood and potential magnitude of misstatements;
- b. Whether the risk is a fraud risk; (Note: A **fraud risk** is a **significant risk**)
- c. Whether the risk is related to **recent significant economic, accounting, or other developments**;
- d. The complexity of transactions;
- e. Whether the risk involves significant transactions with related parties;
- f. The degree of **complexity or judgment** in the recognition or measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- 42 g. Whether the risk involves significant unusual transactions.

# Relevant Auditing Standards

## *Risk Assessment (cont'd)*

AS 2110, paragraph .67 states, in part:

The auditor's evaluation of fraud risk factors in accordance with paragraph .65 should include evaluation of how fraud could be perpetrated or concealed by **presenting incomplete or inaccurate disclosures or by omitting disclosures** that are necessary for the financial statements to be presented fairly in conformity with the applicable financial reporting framework.

# Case Study – Scenario 2

## *Background*

- ❑ You, the audit partner, discussed the risk assessment with the audit manager. You both agreed that the risk assessment for inherent risk and fraud risk or other significant risk related to revenue should be:

	Inherent Risk	Fraud Risk or Other Significant Risk?
Existence or Occurrence (EO)	High	✓
Completeness (CO)	Low	
Valuation or Allocation (VA)	High	✓
Rights and Obligations (RO)	Low	
Presentation & Disclosure (PD)	High	✓

- ❑ You've now asked the audit manager to provide you with a suggested set of audit procedures with respect to substantive testing of revenue. Here's what the audit manager came up with...

# Case Study – Scenario 2

## *Background (cont'd)*

### Proposed Audit Approach

Obtain the Company's schedule of sales contracts executed during the year. Select all high-dollar contracts and a sample of the remaining contracts and perform the following procedures for each contract:

- (1) examine the sales contract and the P.O. for each trailer and, if applicable, Set-up Service;
- (2) agree the prices from the P.O. to the sales contract and to the sales invoice;
- (3) agree the initial deposit and the final payment to the Company's bank statements;
- (4) examine evidence of customer acceptance of trailer upon pick-up and, if applicable, customer acknowledgement of Set-up Service;
- (5) agree price concessions or any discounts to supporting documentation; and
- (6) recalculate the revenue amount.

Perform testing of credit memos and debit memos issued throughout the year and subsequent to year end related to any adjustments to revenue.

Perform substantive analytical procedures.

# Relevant Auditing Standards

## *Responding to Risks*

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraphs .05d and .11 state, in part:

The auditor should evaluate whether the company's selection and **application of significant accounting principles**, particularly those related to subjective measurements and complex transactions, are indicative of bias that could lead to material misstatement of the financial statements.

**For significant risks**, the auditor should perform substantive procedures, including tests of details, that are **specifically responsive** to the assessed risks.

# Relevant Auditing Standards

## *Auditing Estimates*

AS 2501, *Auditing Accounting Estimates*, paragraph .09 states, in part:

In evaluating the **reasonableness of an estimate**, the auditor normally concentrates on key factors and assumptions that are —

- a. Significant to the accounting estimate.
- b. Sensitive to variations.
- c. Deviations from historical patterns.
- d. Subjective and susceptible to misstatement and bias.

The auditor normally should consider the **historical experience** of the entity in making past estimates as well as the auditor's experience in the industry. However, changes in facts, circumstances, or entity's procedures may cause factors different from those considered in the past to become significant to the accounting estimate.

# Relevant Auditing Standards

## *Auditing Disclosures*

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .36 states:

The auditor should perform substantive procedures for each relevant assertion of each significant account **and disclosure**, regardless of the assessed level of control risk.

AS 2810, *Evaluating Audit Results*, paragraph .31 states, in part:

As part of the evaluation of the presentation of the financial statements, the auditor should **evaluate whether** the financial statements **contain the information** essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.



# Case Study – Scenario 2

## *Discussion Question*

What are your thoughts on the proposed audit approach to audit revenue?

# Case Study – Scenario 2

## *Debrief*

### Pricing Concessions

- ❑ The Company's sales contracts with its customers may include pricing concessions, requiring management judgment
- ❑ Under ASC 606, variable consideration, such as this, should be determined using either the “expected value” method or the “most likely amount” method, whichever one is a better indicator of the expected amount.
  - ❑ The Company had previously accounted for these pricing concessions under ASC 605-50-25-7
  - ❑ Did the auditor evaluate this change in accounting estimate in the Company's transition adjustment as of January 1, 2018?
- ❑ Did the auditor evaluate the Company's consideration of a constraint related to the pricing concessions?

# Case Study – Scenario 2

## *Debrief (cont'd)*

### Set-up Service

- ❑ If a customer purchases the Set-up Service (for an additional fee), the transaction would now have two performance obligations – manufactured trailer and set-up service
  - ❑ Under ASC 605, this Set-up Service would not be recognized as revenue until it is realized or realizable and earned
- ❑ Did the auditor evaluate this change in accounting from ASC 605 to ASC 606 in the Company's transition adjustment as of January 1, 2018?

# Case Study – Scenario 2

## *Debrief (cont'd)*

- ❑ Did the auditor obtain an understanding of the processes and controls related to:
  - ❑ Pricing concessions
  - ❑ Allocation of the transaction price between the manufactured trailer and the Set-up Service
- ❑ Note: Even if not an ICFR audit, the auditor should comply with AS 2110.18
- ❑ Were tests of details performed to address all of the significant/fraud risks identified? What did the auditor do to address this? And what about the other assertions? Is there any cut-off or completeness testing being performed?

# Case Study – Scenario 2

## *Debrief (cont'd)*

- ❑ New revenue disclosures for quarterly and annual financial statements – Auditor should review the new revenue disclosures in the Company's Form 10-Qs filed in 2018 and audit the new revenue disclosures in the Company's Form 10-K, as required pursuant to ASC 606.
- ❑ What did the substantive analytical procedures entail? Were they in compliance with AS 2305?
- ❑ Did the engagement quality reviewer review the risk assessment and the proposed audit approach?

# Relevant Auditing Standards

## *Review of Interim Financial Information*

AS 4105, *Reviews of Interim Financial Information*, paragraph .22 states:

*Extension of interim review procedures.* If, in performing a review of interim financial information, the accountant becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles in all material respects, the accountant should make additional inquiries or perform other procedures that the accountant considers appropriate to provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information. **For example, if the accountant's interim review procedures lead him or her to question whether a significant sales transaction is recorded in conformity with generally accepted accounting principles, the accountant should perform additional procedures, such as discussing the terms of the transaction with senior marketing and accounting personnel, reading the sales contract, or both, to resolve his or her questions.**

# Other Resources

- ❑ Staff Audit Practice Alert No. 12, *Matters Related to Auditing Revenue in an Audit of Financial Statements*
- ❑ Staff Audit Practice Alert No. 15, *Matters Related to Auditing Revenue From Contracts with Customers*
  - ❑ Auditing Management's Transition Disclosures in the Notes to the Financial Statements
  - ❑ Auditing Transition Adjustments
  - ❑ Considering Internal Control Over Financial Reporting
  - ❑ Identifying and Assessing Fraud Risks
  - ❑ Evaluating Whether Revenue is Recognized in Conformity with the Applicable Financial Reporting Framework
  - ❑ Evaluating Whether the Financial Statements Include the Required Disclosures Regarding Revenue

# Questions





What is the highest number of other accounting firms reported so far on Form AP for one audit?

1 28

2 44

3 65

4 87

What is the highest number of other accounting firms reported so far on Form AP for one audit?

1. 28

2. 44

3. **65**

4. 87



# Forum on Auditing in the Small Business Environment: Update from the SEC

September 18, 2018

Sarah Esquivel, Associate Chief Accountant – Accounting  
Emily Fitts, Professional Accounting Fellow – Professional Practice  
Office of the Chief Accountant  
U.S. Securities and Exchange Commission

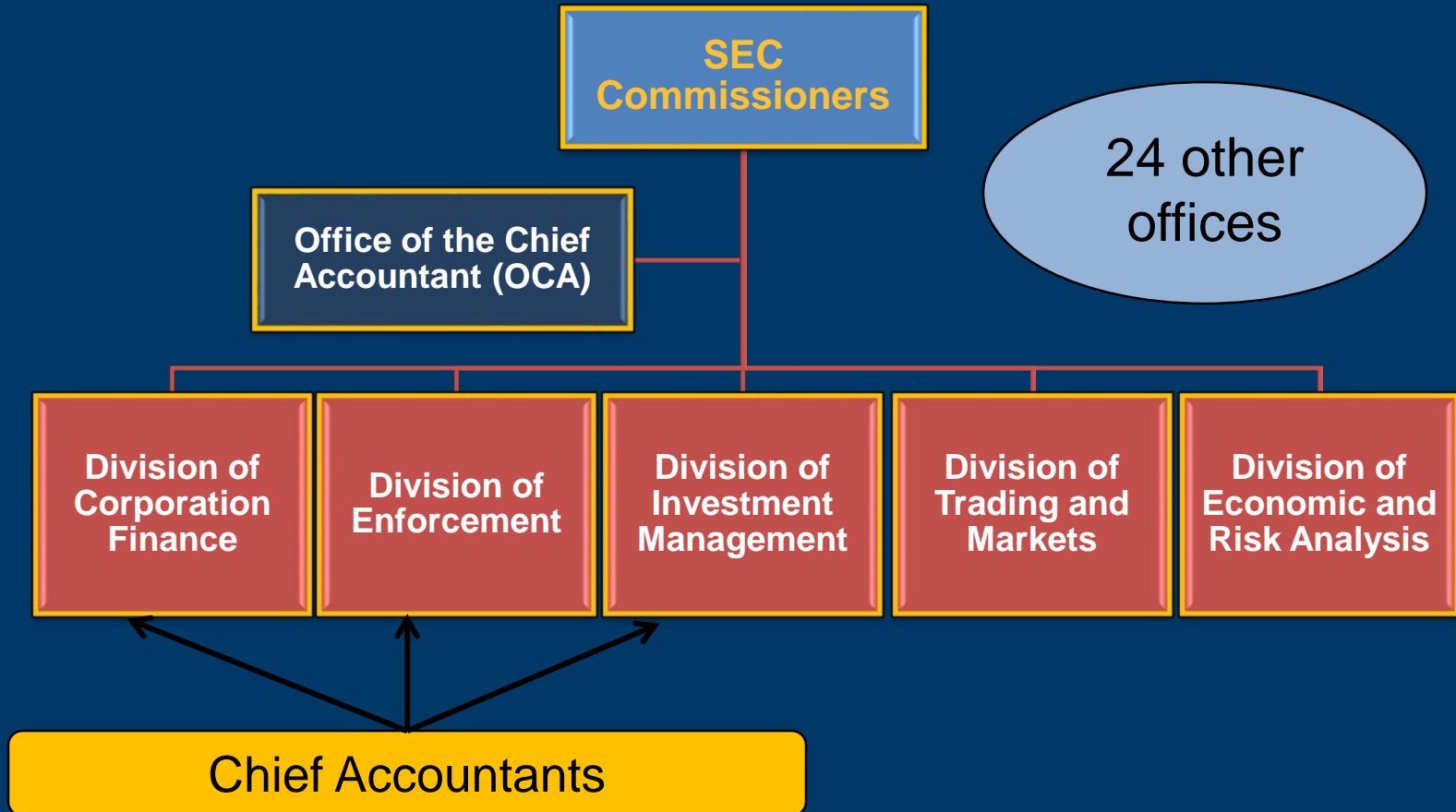
## Disclaimer

The Securities and Exchange Commission (“SEC” or “Commission”) disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. The views expressed herein are those of the speaker and do not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

# Agenda

- Office of the Chief Accountant (OCA) – Overview
- OCA – Accounting update
- OCA – Professional Practice update

# OCA – Overview: SEC structure



# OCA – Overview: Responsibilities

- Principal adviser to the Commission on accounting and auditing matters
- Rulemaking, interpretive guidance, and reports
- Oversight and monitoring of standard setting
- Consultations

# OCA – Overview: Main groups

- Accounting
- Professional Practice
- International
- Office Chief Counsel and Enforcement Liaison



# OCA - Accounting

# Accounting: Workstreams

- Operations (including rulemaking support)
- Consultations
- Oversight/monitoring of accounting standards:
  - Financial Accounting Standards Board (FASB)
  - International Accounting Standards Board (IASB)
- New U.S. GAAP standards – transition

# Accounting: New standard implementation

- Revenue standard (2018)
- Leases standard (2019)
- Credit losses standard (2020)

# Accounting: New revenue standard

- Thank you
- OCA's role in implementation
  - Monitoring implementation groups (TRG and AICPA task forces)
  - Participating in meetings with preparers, industry groups, and accounting firms to understand application issues
  - Providing staff views through the consultation process
  - Delivering over 20 OCA staff speeches in 3 years
- Disclosures – continue monitoring
- OCA staff will continue to respect well-reasoned, practical judgments when grounded in the principles of the new standard

# Accounting: New leases standard

- Impacts any registrant with leasing activities
- FASB objective was to increase transparency and comparability
  - Standard addresses primary objective of the 2005 SEC staff report on off-balance sheet arrangements
  - Limits the costs of implementation by leveraging existing lease classification for expense attribution
  - Improved disclosures will aid in understanding amount, timing and uncertainty in cash flows
- OCA staff engaging in dialogue with various constituents on implementation questions

## Accounting: New leases standard (cont.)

- Lessor costs
- Combination/separation of lease/non-lease components
- Consultations
- Disclosures
- OCA staff is available for consultation!

# Accounting: New credit losses standard

- Moving from an incurred loss model to an expected loss model
- Support transition resource group discussions
  - Registrants should escalate key implementation issues
- Many of the concepts from FRR 28 and SAB 102 will be relevant as companies implement the standard
  - Development, documentation and application of a systematic methodology (procedural discipline)
  - Data reliability
  - Documentation of adjustments

# OCA – Accounting: Recent matters



# Accounting: Recent matters

## Staff Accounting Bulletin No. 118

- Staff Accounting Bulletin No. 118 (SAB 118) was issued in response to concerns expressed by preparers and other constituents regarding scope of changes of Tax Cuts and Jobs Act (TCJA) and requirement under ASC 740 to recognize tax effects in period of enactment
- Permits use of a measurement period approach when the accounting for certain tax effects of the TCJA is incomplete
- Provisional amounts may be recorded for specific tax effects that are incomplete where a reasonable estimate can be made

# Accounting: Recent matters

## Staff Accounting Bulletin No. 118 (cont.)

- Provisional amounts should be updated and recorded as current period adjustments during the measurement period as additional information is obtained, prepared or analyzed
- Measurement periods begins on the enactment date (December 22, 2017) and ends when the accounting for the specific tax effects is completed, not to exceed one year from the enactment date
- Various disclosures are required where material if provisional amounts are recorded under SAB 118

# Accounting: Recent matters

## Trends in accounting restatements

- Three accounting areas most commonly identified in a restatement:
  - Debt/equity accounting
  - Income tax accounting
  - Statement of cash flows classification
- Continuing assessment of resources
  - Sufficient training and competence
  - Accounting policy function
  - Qualified service provider

# Accounting: Recent matters

## Trends in accounting consultations

- Most frequently consulted topics in 2017:
  - Revenue Recognition
  - Business Combinations
  - Financial Assets
  - Financial Statement Presentation
  - Consolidations

# Accounting: Recent matters

## New revenue standard consultations

- Identification of performance obligations and measure of progress
  - Application of the entire standard
  - Examples should supplement the analysis
- Principal/agent considerations – gross vs. net presentation
- Scoping considerations of cost guidance

# Accounting: Recent matters

## New revenue standard consultations (cont.)

- Contract existence/combination considerations
  - Enforceable rights and obligations
  - Economic or regulatory compulsion does not determine when to combine
  - Linked contracts between two customers - not related parties
- Registration statement includes post-adoption interim financials
  - Full retrospective adoption requires an additional restated year
  - Impracticability exception

# **OCA – Professional Practice: Update**

# Professional Practice: Topics

- Responsibilities
- Internal control over financial reporting (ICFR)
- Auditor's reporting model
- Auditor independence



# Professional Practice: Responsibilities

- Assist in Commission oversight of the PCAOB
- ICFR
- Audit committee disclosure and communications
- Auditor independence
- Other activities:
  - Enforcement assistance
  - Rulemaking support

# Professional Practice: ICFR

- Importance of ICFR to:
  - Investors
  - Management
  - Audit committees
- Working together – audit committees, auditors, and management
- New GAAP standards
- Identification of material weaknesses

# Professional Practice: Auditor's Reporting Model

- Commission approved on October 23, 2017
- Implementation considerations:
  - Changes effective for audits of fiscal years ending on or after December 15, 2017, except for the requirements related to critical audit matters
  - Critical audit matters

# Professional Practice: Auditor independence – Rule 2-01

- Consider Rule 2-01 of Regulation S-X when evaluating a relationship or provision of service that:
  - Creates a mutual or conflicting interest between the accountant and the audit client
  - Places the accountant in the position of auditing his or her own work
  - Results in the accountant acting as management or an employee of the audit client
  - Places the accountant in a position of being an advocate for the audit client

# Professional Practice: Auditor independence – Rule 2-01 (cont.)

- Rule 2-01(c) specifically addresses financial relationships, non-audit services, contingent fees, partner rotation, and audit committee administration of the engagement
- Prohibited non-audit services include:
  - Bookkeeping or other services related to the accounting records or financial statements of the audit client
  - Financial information systems design and implementation
  - Appraisal and valuation services, fairness opinions, or contribution-in-kind reports
  - Actuarial services
  - Internal audit outsourcing services
  - Management functions
  - Human resources
  - Broker-dealer, investment adviser, or investment banking services
  - Legal services
  - Expert services unrelated to the audit

# Professional Practice: Auditor independence – Areas of focus

- Partner rotation
- Bookkeeping/financial statement preparation
- Not subject to audit exception
- OCA staff is available to discuss and consult on any matter

# Inspections Overview

Alan Skinner, Deputy Director  
Division of Registration and Inspections

In which circumstance(s), would a Form AP be required? There may be more than one correct response. Audit reports issued for:

- 1 Attestation engagements
- 2 Audits of issuers
- 3 Interim reviews
- 4 Audits of non-issuers under SEC rules such as Regulation Crowdfunding and Regulation A



In which circumstance(s), would a Form AP be required? There may be more than one correct response. Audit reports issued for:

1. Attestation engagements
2. **Audits of issuers**
3. Interim reviews
4. Audits of non-issuers under SEC rules such as Regulation Crowdfunding and Regulation A

# The Inspection Process

- Planning and preparation
- Inspection fieldwork
- Issuance of comment forms
- Evaluating responses to comment forms and drafting inspection report

# The Inspection Process

- Review of inspection report and inspection files
- Issuance of draft inspection report
- Evaluating response to draft inspection report
- Board approval of inspection report
- Remediation submission

# Categories of Inspection Findings

- Risk assessment and responses
- Substantive testing
- Controls testing, including ICFR testing
- Quality control findings

# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports

## 10. AS 2310, *The Confirmation Process*

- failure to maintain control of the confirmation process (AS 2310.28)
- failure to appropriately address exceptions identified in confirmation responses (AS 2310.33)

## 9. AS 2110, *Identifying and Assessing Risks of Material Misstatement*

- failure to assess risk at the financial statement level and the assertion level (AS 2110.59)

## 8. AS 2315, *Audit Sampling*

- failures related to determining an appropriate sample size (AS 2315.19, .23, and .23A)

# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports (cont'd)

## 7. AS 2305, *Substantive Analytical Procedures*

- failure to develop expectations at a sufficient level of precision (AS 2305.17)
- failure to obtain corroboration of the explanations provided by management for significant unexpected differences (AS 2305.21)
- failure to test the controls over, or otherwise test, the completeness and accuracy of underlying data (AS 2305.16)

## 6. AS 1105, *Audit Evidence*

- failure to test the accuracy and completeness of data produced by the company and used in the auditor's substantive testing (AS 1105.10)
- testing specific items (e.g., selecting all items over a certain dollar amount) and inappropriately using the results of that testing to form a conclusion related to the entire population (AS 1105.27)

# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports (cont'd)

## 5. *AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

- failure to identify appropriate controls to test (AS 2201.39)
- failure to perform sufficient procedures for testing the design and operating effectiveness of controls (AS 2201.42 and .44)
- relying on results of substantive testing for evidence of control effectiveness, instead of testing the actual controls (AS 2201.B9)

# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports (cont'd)

## 4. AS 2501, *Auditing Accounting Estimates*

- failure to evaluate the assumptions or inputs used to develop an estimate (AS 2501.09 and .11)
- failure to test the accuracy and completeness of the data underlying the assumptions (AS 2501.11)

## 3. AS 2502, *Auditing Fair Value Measurements and Disclosures*

- failure to understand and evaluate the assumptions used in fair value measurements (AS 2502.26 and .28)
- failure to test the accuracy and completeness of the data underlying the assumptions (AS 2502.39)



# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports (cont'd)

## 2. AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*

- failure to design and perform procedures to address an assertion or assertions for a significant account (AS 2301.08)
- failure to perform sufficient substantive testing in response to a significant risk or a fraud risk (AS 2301.11 and .13)
- relying on controls to reduce substantive testing, but failing to adequately test those controls (AS 2301.16)

# Most Frequently Cited Auditing Standards for Findings in Part I of Inspection Reports (cont'd)

## 1. AS 2810, *Evaluating Audit Results*

- failure to adequately evaluate whether the financial statements are presented in accordance with GAAP (AS 2810.30)
- failure to adequately evaluate the appropriateness of disclosures (AS 2810.31)
- failure to sufficiently consider contrary or inconsistent audit evidence (AS 2810.03)

# Questions?



LUNCH (70 minutes)

# New Auditor's Report

Jessica Watts, Associate Chief Auditor  
Office of the Chief Auditor

# Overview of the New Auditor's Report

- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ Retains pass/fail opinion but makes significant changes to the auditor's report:
  - ❑ Critical audit matters
  - ❑ Additional improvements

# New Auditor's Report – Overview of Key Changes Effective December 15, 2017



- ❑ Basic Elements and Form of Auditor's Report
  - ❑ Required order of the "Opinion on the Financial Statements" and "Basis for Opinion" sections
  - ❑ Section titles
  - ❑ Required addressee
  - ❑ Indication that the notes are part of the financial statements
  - ❑ Statement on auditor independence
  - ❑ New phrase "whether due to error or fraud"
  - ❑ New language about the nature of the audit that aligns with the risk assessment standards
  - ❑ Auditor tenure
- ❑ Management Reports on ICFR with no Auditor Reporting

**These key changes apply to audits  
conducted under PCAOB standards**

# New Auditor's Report – Auditor Tenure

The auditor's report must include a statement containing the year the auditor began serving consecutively as the company's auditor.

## Determining Auditor Tenure

- Reflect the entire relationship between the company and the auditor
  - The auditor's relationship with the company is not affected by the company's status as a public company
- Calculate taking into account firm or company mergers, acquisitions, or changes in ownership structure





# Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in January 2013 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  1. 2010
  2. 2011
  3. 2012
  4. 2013

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1 2010

2 2011

3 2012

4 2013

# Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in January 2013 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  1. 2010
  2. 2011
  3. 2012
  - 4. 2013**

# Auditor Tenure – Example B

- ❑ The auditor has been the auditor of Company X since 1990. Company X undergoes an IPO in 2018 and includes the auditor's report on the company's financial statements for the years ending December 31, 2015, 2016, and 2017.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  1. 1990
  2. 2015
  3. 2017
  4. 2018

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1 1990

2 2015

3 2017

4 2018

# Auditor Tenure – Example B

- ❑ The auditor has been the auditor of Company X since 1990. Company X undergoes an IPO in 2018 and includes the auditor's report on the company's financial statements for the years ending December 31, 2015, 2016, and 2017.
- ❑ The auditor would state in the auditor's report \_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1. 1990

2. 2015

3. 2017

4. 2018

# Auditor Tenure – Example C

- ❑ Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- ❑ Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  1. 1997
  2. 2002
  3. 2017
  4. 2018

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

- 1 1997
- 2 2002
- 3 2017
- 4 2018



# Auditor Tenure – Example C

- ❑ Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- ❑ Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- ❑ The auditor would state in the auditor's report \_\_\_\_ as the year the auditor began serving consecutively as the company's auditor

1. 1997

2. 2002

3. 2017

4. 2018

# New Auditor's Report – Auditor Tenure

- ❑ Reporting of Tenure
  - ❑ Auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.
  - ❑ No required location is specified within the auditor's report.
  - ❑ If there is uncertainty as to the year the auditor began serving as the company's auditor, state that the auditor is uncertain as to the year and provide the earliest year of which the auditor has knowledge.
  - ❑ Auditors can provide additional information in the auditor's report about tenure, if the information would provide context or otherwise assist the reader's understanding of the relationship between the auditor and the company.

# Management Reports on ICFR with no Auditor Reporting

- ❑ In some circumstances, management is required to report on the company's ICFR but such report is not required to be audited, and the auditor is not engaged to perform an audit of management's assessment of the effectiveness of ICFR.
- ❑ In such cases, the auditor is required to include the following explanatory language in the Basis for Opinion section:

The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

# Explanatory Paragraphs

- ❑ The standard includes a list of circumstances with references to other PCAOB standards in which the auditor is required to include explanatory paragraph (or explanatory language) in the auditor's report. Those include, among others:
  - Going concern (AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*);
  - Other auditors (AS 1205, *Part of the Audit Performed by Other Independent Auditors*);
  - Change between periods in accounting principles or in the method of their application (AS 2820, *Evaluating Consistency of Financial Statements*); and
  - A material misstatement in previously issued financial statements has been corrected (AS 2820).
- ❑ Some PCAOB standards specify the location of required explanatory paragraphs within the auditor's report and may also have a requirement for an appropriate section title.
- ❑ If the auditor is required to include an explanatory paragraph but the location is not specified, the paragraph may be placed where the auditor considers appropriate.

# Explanatory Paragraph Example

## Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

### Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of *[titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows]*, for each of the three years in the period ended December 31, 20X2, and the related notes *[and schedules]* (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of *[at]* December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with *[the applicable financial reporting framework]*.

### Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### Basis for Opinion

\*\*\*

# Emphasis Paragraphs

- ❑ Although not required, the standard includes the ability for the auditor to emphasize a matter regarding the financial statements (“emphasis paragraph”).
- ❑ Emphasis paragraph may be placed where the auditor considers appropriate.
- ❑ If the auditor includes an emphasis paragraph in the auditor's report, the auditor is required to use an appropriate section title.

# What does CAM stand for?

- 1 Critical Accounting Matter
- 2 Critical Audit Matter
- 3 Current Audit Matter
- 4 Certified Audit Magician

# What does CAM stand for?

1. Critical Accounting Matter
- 2. Critical Audit Matter**
3. Current Audit Matter
4. Certified Audit Magician



# Critical Audit Matters

Phased in effective date for audits of:

- Large accelerated filers – for fiscal years ending on or after June 30, 2019; and
- All other companies to which the requirements apply – for fiscal years ending on or after December 15, 2020.

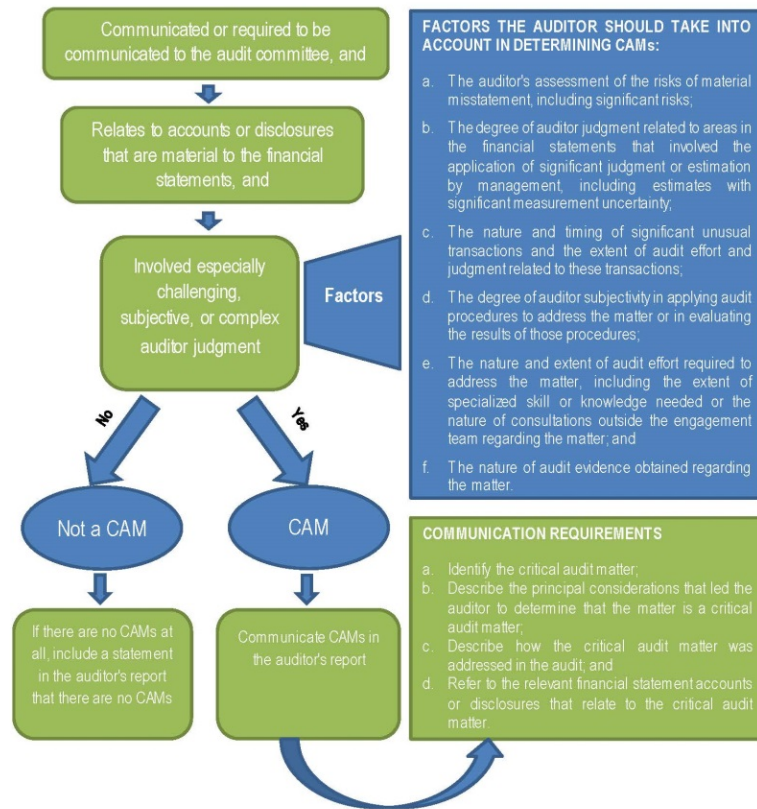
CAM requirements do not apply to audits of:

- Brokers and dealers;
- Investment companies, other than business development companies;
- Employee benefit plans; and
- Emerging growth companies

Auditors of these entities may choose to include CAMs voluntarily.

# Critical Audit Matters

## Determining and Communicating Critical Audit Matters ("CAMs")



# Critical Audit Matters

Definition: A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that:

- (1) Relates to accounts or disclosures that are material to the financial statements, and
- (2) Involved especially challenging, subjective, or complex auditor judgment.

# CAMs are required to be communicated for what period?

- 1 Current period only
- 2 Current and prior periods
- 3 All periods presented in the F/S

# CAMs are required to be communicated for what period?

1. **Current period only**
2. Current and prior periods
3. All periods presented in the F/S

# Critical Audit Matters

## *Audit Period Covered by CAMs:*

- ❑ CAMs are required to be communicated for the audit of the current period financial statements only.
- ❑ The auditor may communicate CAMs relating to a prior period when: (1) the prior period's financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor's report on the prior period's financial statements because the previously issued auditor's report could no longer be relied upon.

# Critical Audit Matters

Communication requirements: The communication of each critical audit matter in the auditor's report includes:

- a. Identification of the critical audit matter;
- b. Description of the principal considerations that led the auditor to determine that the matter was a critical audit matter;
- c. Description of how the critical audit matter was addressed in the audit; and
- d. Reference to the relevant financial statement accounts or disclosures.

# Critical Audit Matters

## Communication requirement:

Description of how the critical audit matter was addressed in the audit

The standard includes four examples of potential approaches: (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the procedures performed; (3) an indication of the outcome of the auditor's procedures; and (4) key observations with respect to the matter, or some combination of these elements.



# Critical Audit Matters

## Ability to Communicate No Critical Audit Matters

- ❑ The Board expects that, in most audits, the auditor will determine that at least one matter involved especially challenging, subjective, or complex auditor judgment. There may be CAMs even in an audit of a company with limited operations or activities.
- ❑ However, there may be circumstances in which the auditor determines there are no matters that meet the definition of a CAM and, in those circumstances, the auditor will communicate that there were no CAMs.

# Critical Audit Matters

## Documentation Requirement

- ❑ For each matter arising from the audit of the financial statements that:
  - ❑ Was communicated or required to be communicated to the audit committee; and
  - ❑ Relates to accounts or disclosures that are material to the financial statements;
- ❑ the auditor must document whether or not the matter was determined to be a critical audit matter (i.e., involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination.

# How is Your Firm Getting Ready for CAMs?



# Resources



- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments To PCAOB Standards* (June 1, 2017)
- ❑ SEC, *Order Granting Approval of Proposed Rules on the Auditor's Report*, Exchange Act Release No. 34-81916 (Oct. 23, 2017).
- ❑ Staff guidance, *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or after December 15, 2017* (updated Aug. 23, 2018)
- ❑ Questions pertaining to ARM may be directed to the staff in the PCAOB's Office of the Chief Auditor via the standards' help line at (202) 591-4395 or may be submitted through a web form at <https://pcaobus.org/About/Pages/ContactUsWebForm.aspx?contact=Standard-related%20Inquiries>

# Questions?



When an audit report has been issued and is subsequently dual-dated, does the dual-dating require a new Form AP?

- 1 Yes
- 2 No, the original Form AP is amended.
- 3 No, there is no requirement to file a Form AP.
- 4 None of the above.

When an audit report has been issued and is subsequently dual-dated, does the dual-dating require a new Form AP?

1. Yes

2. No, the original Form AP is amended.
3. No, there is no requirement to file a Form AP.
4. None of the above.

# Remediation

Karen Kubis, Regional Associate Director  
Division of Registration and Inspections



# Topics

- ❑ Remediation Timeline
- ❑ Unsatisfactory recommendations
  - ❑ Common quality control criticisms
  - ❑ Common remedial steps
  - ❑ Examples

# Does your firm perform a root cause analysis?

- 1 Yes - After receipt of the comment form during inspection fieldwork.
- 2 Yes - After receipt of the draft inspection report.
- 3 Yes - After receipt of the final inspection report.
- 4 Yes – On an annual basis when considering both internal and external findings that indicate improvements are needed.
- 5 Yes – On a different basis than those suggested above.
- 6 No - We do not perform a root cause analysis.

# Remediation Timeline



- ❑ Firms have 12 months from the inspection report date to address the quality control criticisms included in Part II, if any, to the Board’s satisfaction
- ❑ Firms should submit electronic responses to the Remediation mailbox ([Remediation@pcaobus.org](mailto:Remediation@pcaobus.org))
- ❑ A standard reminder letter is sent to the firm if a response has not been received within six months, and again 60 days prior to the expiration of the 12-month period.

For your firm's most recent PCAOB inspection, when did your firm submit a draft response and initiate a request to engage in a dialogue with the PCAOB remediation staff?

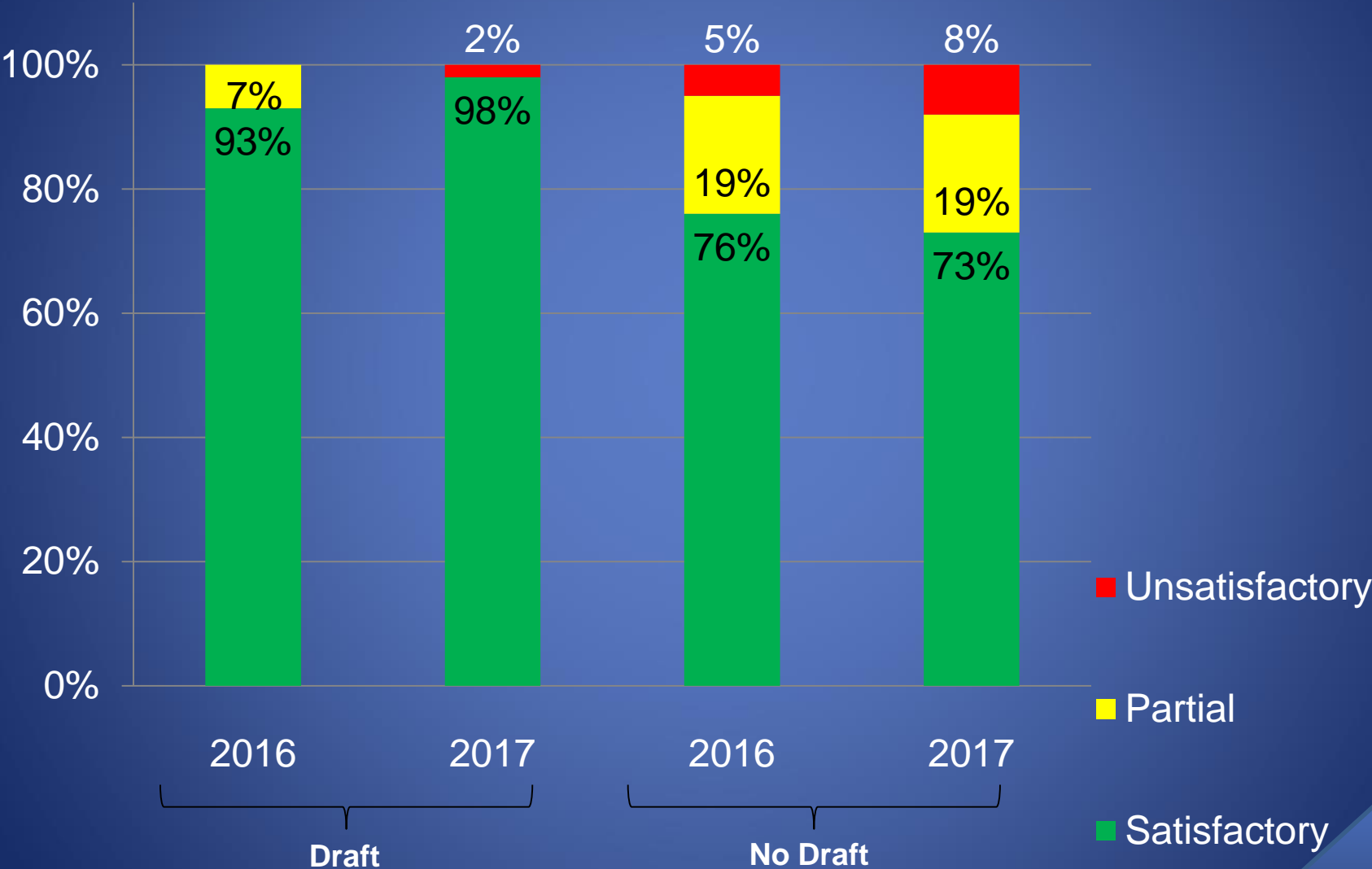
- 1 Within three months of the beginning of the remediation period.
- 2 Within six months of the beginning of the remediation period.
- 3 Within two to six months of the close of the remediation period.
- 4 Within a month or less of the close of the remediation period.
- 5 We did not submit a draft response.

# Phone. Phone!

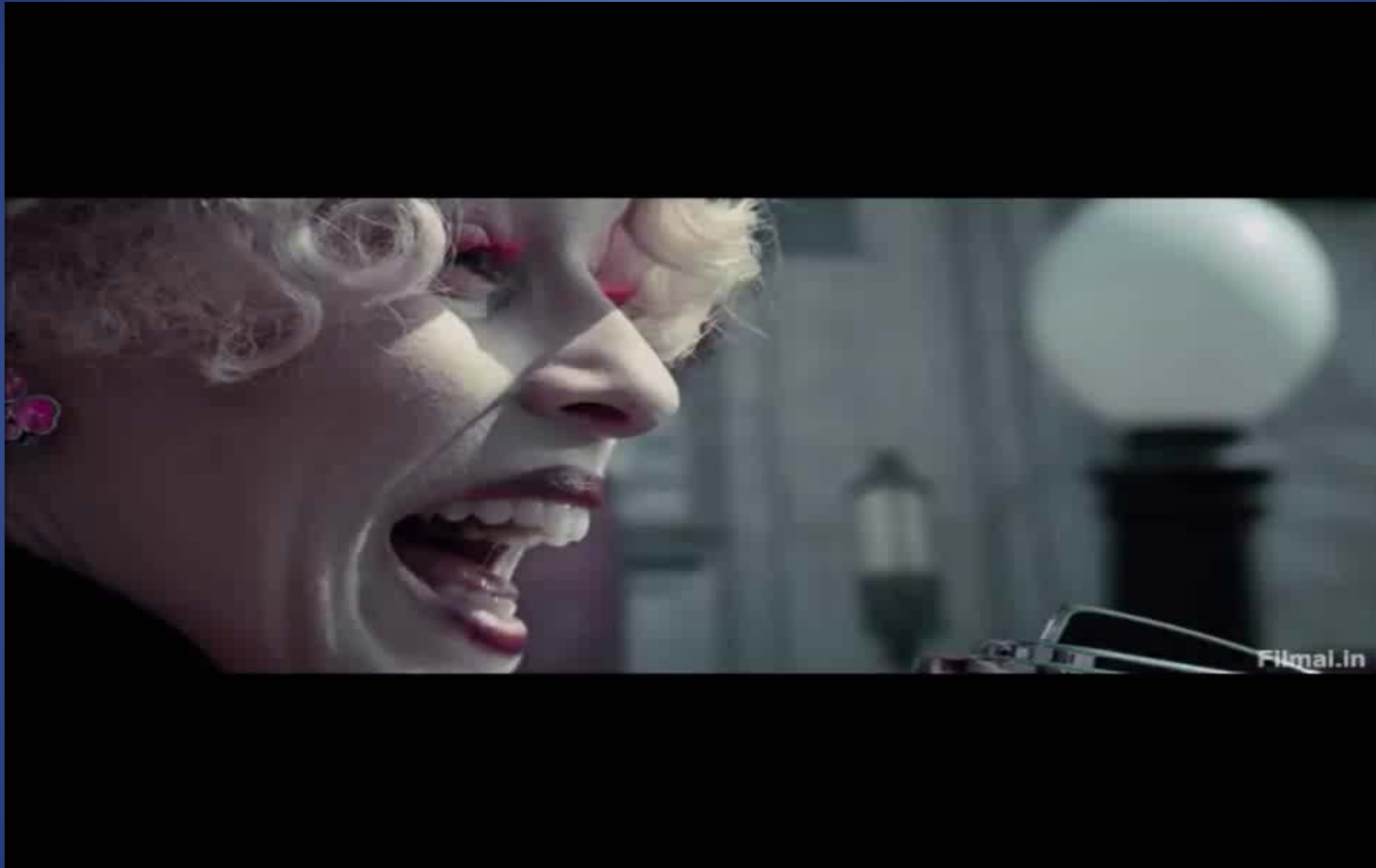


MOVIECLIPS.COM

# Remediation Results Based on Whether Firm Submits a Draft Remediation Submission



May the odds be ever in your favor



Video source:

Movie: Hunger Games

YouTube (smilecloseup): [https://www.youtube.com/watch?v=\\_s7qgNMqDJl](https://www.youtube.com/watch?v=_s7qgNMqDJl)

# Unsatisfactory Recommendations: Common Quality Control Criticisms

- ❑ Testing appropriate to the audit
  - ❑ Business combinations
  - ❑ Revenue
  - ❑ Goodwill/intangible assets
  - ❑ Other various areas
  
- ❑ Application of due professional care, including professional skepticism
  
- ❑ Engagement quality review



# Unsatisfactory Recommendations: Common Remedial Steps

- Training
- New or revised policies
- New or revised guidance or practice aids



# Unsatisfactory Recommendations: Common Remedial Steps (cont'd)

## Staff Guidance on Training

- Change from previous trainings?
- Relevant?
- Tailored to appropriate targeted audience?
- Attendance tracked and monitored?
- Retention of course materials tested?
- Professionals' execution of audit procedures based on new training monitored?

# We have a problem!



Video source:

Movie: Apollo 13

YouTube (Aksim Omanenko): [https://www.youtube.com/watch?v=Je76KRTLl\\_A](https://www.youtube.com/watch?v=Je76KRTLl_A)

# Unsatisfactory Recommendations: Examples



No evidence beyond the firm's assertion



Not a change to the firm's system of quality control



Not relevant



Not designed effectively or implemented before close of remediation period



Evidence of ineffectiveness in subsequent audits

# No Evidence Beyond the Firm's Assertion

- ❑ No favorable weight is assigned to steps where the firm fails to provide evidence
- ❑ Mere assertion that remedial step occurred is not sufficient



# Examples of Evidence

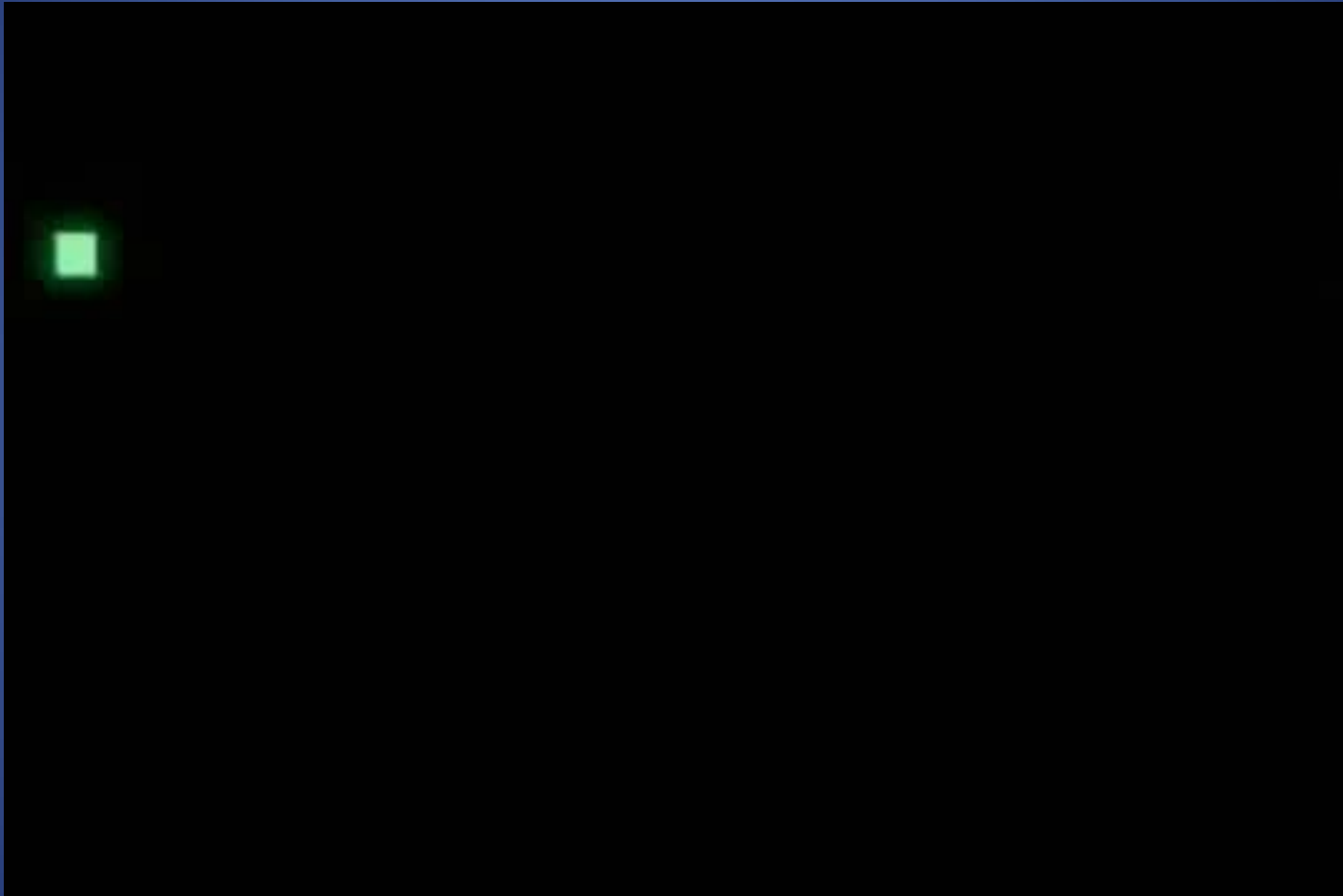
## Policy, Guidance, and Practice Aids

- Excerpt from quality control manual or audit guidance
- Blank practice aid (e.g., form, template)
- Documentation of how step was communicated to firm
- Documentation of how step will be monitored to ensure compliance
- Documentation of the firm's monitoring of the effectiveness of the remedial step

## Trainings

- Presentation materials (e.g., slide deck, leader's guide or notes) to reinforce new practice aids or policies
- Attendance records (e.g., sign-in sheet, certificates of completion)
- Agenda

# Afraid of change?



Video source:

Movie: The Matrix

YouTube (thenihilist0):

[https://www.youtube.com/results?search\\_query=matrix+i+know](https://www.youtube.com/results?search_query=matrix+i+know)

# Unsatisfactory Recommendations: Examples



No evidence beyond the firm's assertion



Not a change to the firm's system of quality control



Not relevant



Not designed effectively or implemented before close of remediation period



Evidence of ineffectiveness in subsequent audits



# Example #1 – Made No Change

## IIB. – Testing appropriate to the audit – revenue

- ❑ Failure to sufficiently test the allocation of revenue

## Remedial step and evidence provided

- ❑ Remedial step: Purchased practice aids from a widely-recognized audit methodology provider.
- ❑ Evidence provided: Purchase invoice and revenue audit program.

# Example #1 – Made No Change

## Reason for unsatisfactory recommendation

- ❑ No significant, relevant audit procedures are included in the audit program that were not already part of the practice aids completed by the firm in the audit that gave rise to the criticism.

# Example #2 – Made No Change

## IIB. – Testing appropriate to the audit – revenue

- Failure to sufficiently test the allocation of revenue

## Other specifics

- A session on auditing revenue was included in the firm's annual training.
- Remedial step and evidence provided

## Remedial step: Training on testing the allocation of revenue.

- Evidence provided: Training agenda, presentation materials, and attendance records.

# Example #2 – Made No Change

## Reason for unsatisfactory recommendation

- ❑ The design and content of the training was not significantly different from the annual training programs that the firm had provided to its personnel before the performance of the audits that gave rise to the criticism.

# Stay on target...



Video source:

Movie: Star Wars

YouTube (AMCCAustralia): <https://www.youtube.com/watch?v=X9Svm8xc1z8>

# Unsatisfactory Recommendations: Examples



No evidence beyond the firm's assertion



Not a change to the firm's system of quality control



Not relevant



Not designed effectively or implemented before close of remediation period



Evidence of ineffectiveness in subsequent audits

# Example #3 – Not Relevant

## IIB. – Application of due professional care, including professional skepticism

- ❑ Concern that professionals will not exercise due professional care, including professional skepticism, in the performance of issuer audits.
- ❑ Based on several audit performance deficiencies

## Remedial steps and evidence provided

- ❑ Remedial step #1: Training on underlying areas of the audit performance deficiencies
- ❑ Evidence provided: Presentation materials and attendance records
- ❑ Remedial step #2: Training on general auditing matters and inspection findings
- ❑ Evidence provided: Agenda and attendance records

# Example #3 – Not Relevant

## Reasons for unsatisfactory recommendation

Remedial step #1: Training on underlying areas of the audit performance deficiencies

- ❑ Training did not include any significant content on the exercise of due care, including professional skepticism.

Remedial step #2: Training on general auditing matters and inspection findings

- ❑ The agenda included line items for due professional care and professional skepticism, but did not provide any context as to the level of detail these matters were covered in the training sessions.



# Build it...



# Unsatisfactory Recommendations: Examples



No evidence beyond the firm's assertion



Not a change to the firm's system of quality control



Not relevant



Not designed effectively or implemented before close of remediation period



Evidence of ineffectiveness in subsequent audits

# Example #4 – Poor Design

## IIB. – Engagement quality review

- Failure of the EQR partner to detect the audit deficiencies identified by the inspection team

## Remedial step and evidence provided

- Remedial step #1: Training on AS 1220 conducted for senior associates
- Evidence provided: Presentation materials and attendance records

## Reason for unsatisfactory recommendation

- The training was not provided to the appropriate levels of professionals within the firm who would be expected to perform or review the audit procedures that resulted in the deficiencies.

# Example #5 – Late

## IIB. – Testing appropriate to the audit – valuation of goodwill and intangible assets

- ❑ Failure to apply due professional care, including professional skepticism, when auditing the valuation of goodwill and intangible assets

## Remedial step and evidence provided

- ❑ Remedial step #1: Plan to develop a new audit program for auditing goodwill and intangible assets and conduct training on how to implement this new audit program.
- ❑ Evidence provided: Draft outline of training topics.

## Reason for unsatisfactory recommendation

- 164
- ❑ New audit program was not fully developed and training was not conducted before the remediation deadline.

# Unsatisfactory Recommendations: Examples



No evidence beyond the firm's assertion



Not a change to the firm's system of quality control



Not relevant



Not designed effectively or implemented before close of remediation period



Evidence of ineffectiveness in subsequent audits

# Example #6 – Subsequent Audits

## IIB. – Testing appropriate to the audit – business combinations

- Failure to apply due professional care, including professional skepticism, when auditing the business combinations

## Remedial step and evidence provided

- Remedial step: Implemented new audit programs and checklists
- Evidence provided: New and previous audit programs and checklists

# Example #6 – Subsequent Audits

## Reason for unsatisfactory recommendation

- ❑ Documentation from a subsequent audit indicated the firm omitted the relevant guidance and new procedures and did not complete certain steps included on the new checklist.

# Questions?



Video source:

Movie: Ferris Bueller's Day Off

YouTube (Gareth Stearns): <https://www.youtube.com/watch?v=xRcUFvbcWCw>



# Resources

- ❑ [http://pcaobus.org/Inspections/Pages/Remediation\\_Process.aspx](http://pcaobus.org/Inspections/Pages/Remediation_Process.aspx)
- ❑ The firm's remediation contact from the report transmittal letter and reminder letters.



# Standard-Setting Update

Jessica Watts

Associate Chief Auditor

# Agenda

- Recently Adopted Standards
- Ongoing Standard-Setting Projects
- Research Projects
- Resources
- Keeping current with PCAOB standards

# Recently Adopted Standards

- ❑ Standards that Improve the Relevance and Transparency of Audits:
- ❑ New Audit Report
- ❑ Disclosure of Engagement Partners and Other Accounting Firms Participating in Audits

# Ongoing Standard-Setting Projects (as of June 30, 2018)

- Auditing accounting estimates, including fair value measurements
- Auditor's use of the work of specialists
- Auditor's use of other auditors
- Going concern

# Research Projects (as of June 30, 2018)

- ❑ Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities
- ❑ Changes in the Use of Data and Technology in the Conduct of Audits
- ❑ The Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures
- ❑ Auditor's Consideration of Noncompliance with Laws and Regulations
- ❑ Auditor Communications with Audit Committees Concerning Independence

# Resources

Standards   Registration & Reporting   Inspections   Enforcement   International   Economic & Risk Analysis   Careers

Home > Standards > Auditing Standards

## Auditing Standards

### General Auditing Standards

#### 1000 General Principles and Responsibilities

- AS 1001: Responsibilities and Functions of the Independent Auditor
- AS 1005: Independence
- AS 1010: Training and Proficiency of the Independent Auditor
- AS 1015: Due Professional Care in the Performance of Work

#### 1100 General Concepts

- AS 1101: Audit Risk
- AS 1105: Audit Evidence
- AS 1110: Relationship of Auditing Standards to Quality Control Standards

#### 1200 General Activities

- AS 1201: Supervision of the Audit Engagement
- AS 1205: Part of the Audit Performed by Other Independent Auditors
- AS 1210: Using the Work of a Specialist
- AS 1215: Audit Documentation

#### Resources

- Downloadable PCAOB Auditing Standards
- Current and Recent Standard-Setting Activities

#### Reference Tools

- Identifying ASB and IAASB Analogous Standards
- Reorganized and Pre-Reorganized Numbering for PCAOB Auditing Standards

- Downloadable PDF of all current PCAOB auditing standards

# Resources (cont'd)

## ❑ Auditing Standards in Effect: Final Rules, Amending Releases, and Related SEC Approval Orders

Standards | Registration & Reporting | Inspections | Enforcement | International | Economic & Risk Analysis | Careers

Home > Standards > Auditing Standards

General Auditing Standards

- 1000 General Principles and Responsibilities
- 1100 General Concepts
- 1200 General Activities
- AS 1201: Supervision of the Audit Engagement

### AS 1215: Audit Documentation

**Adopting Release:** [PCAOB Release No. 2004-006](#)

**Effective Date of Standard:** For audits of financial statements, which may include an audit of internal control over financial reporting, with respect to fiscal years ending on or after Nov. 15, 2004. For other engagements conducted pursuant to the standards of the PCAOB, including reviews of interim financial information, this standard takes effect beginning with the first quarter ending after the first financial statement audit covered by this standard.

**Amendments:** [Amending releases and related SEC approval orders](#)

**Guidance on AS 1215:** [Staff Guidance for Auditors of SEC-Registered Brokers and Dealers](#)

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## Auditing Standards in Effect: Final Rules, Amending Releases, and Related SEC Approval Orders

The following table lists the PCAOB auditing standards in effect, the standard's final rule, the release(s) that amended the respective standard since it was adopted by the Board, and the related SEC approval order(s).

The organizational structure and numbering of the auditing standards were amended on December 31, 2016. A reference table with the reorganized and pre-reorganized numbering can be found [here](#).

AUDITING STANDARD	PCAOB RELEASE	SEC APPROVAL ORDER
AS 1001, <i>Responsibilities and Functions of the Independent Auditor</i>	<a href="#">PCAOB Release No. 2015-002</a>	<a href="#">SEC Release No. 34-75935 (Sept. 17, 2015)</a>
	<a href="#">PCAOB Release No. 2010-004</a>	<a href="#">SEC Release No. 34-63606 (Dec. 23, 2010)</a>
	<a href="#">PCAOB Release No. 2003-006</a>	<a href="#">SEC Release No. 34-47745 (Apr. 25, 2003)</a>
AS 1005, <i>Independence</i>	<a href="#">PCAOB Release No. 2015-002</a>	<a href="#">SEC Release No. 34-75935 (Sept. 17, 2015)</a>



# Resources (cont'd)


- ❑ PCAOB Auditing Standards as of December 14, 2017

**Standards**   Registration & Reporting   Inspections   Enforcement   International & I

[Home](#) > [Standards](#) > [Archived Standards and Guidance](#)


## Archived Standards and Guidance

This archive consists of standards and guidance that are no longer in effect.

[Summary Table of Contents](#) 

### Auditing Standards

Below are past versions of PCAOB auditing standards. [View the current version of the auditing standards.](#)

- [PCAOB Auditing Standards as of December 14, 2017](#)   
(reflecting amendments effective January 31 and June 30, 2017)
- [PCAOB Auditing Standards before December 31, 2016](#)

# Keeping Current with PCAOB Standards

- ❑ PCAOB Standards website –  
<http://www.pcaobus.org/Standards/Pages/default.aspx>
  - ❑ PCAOB standards and rules
  - ❑ Guidance
  - ❑ Standard-related activities
  - ❑ Standing Advisory Group
- ❑ Contact the Standards Inquiry Line via the web form or at (202) 591-4395
- ❑ Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our website at:  
<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>

# Questions?



**BREAK (15 minutes)**

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/OOSBSBFVA2018>

# Auditor Independence

Greg Scates, Director  
Office of Outreach

# Agenda

- ❑ Overview of Independence Rules and Guidance
  - ❑ SEC Independence Rules and Interpretive Guidance
  - ❑ PCAOB Independence Rules
  
- ❑ Prohibited Non-Audit Services
  
- ❑ Audit Client and Affiliate of an Audit Client

# SEC Independence Rules and Guidance

- ❑ Title II of the Sarbanes-Oxley Act, as Codified in Section 10A(g) through (l) of the Securities Exchange Act of 1934
- ❑ SEC Exchange Act Rule 10A-2
- ❑ SEC Rule 2-01 of Regulation S-X (17 C.F.R. § 210.2-01)
  - ❑ Adopting Release No. 33-8183 –Strengthening the Commission's Requirements Regarding Auditor Independence [2003]
  - ❑ Adopting Release No. 33-7919 - Revision of the Commission's Auditor Independence Requirements [2000]
- ❑ Frequently Asked Questions – SEC Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence  
Note: Auditors of brokers and dealers are not subject to the requirements for partner rotation; compensation; audit committee pre-approval; or cooling-off period for employment. These requirements only reference issuers.



# PCAOB Independence Rules and Guidance

<b>Overall Framework and Definitions</b>	Rules 3500T, 3501, and 3520
<b>Contingent Fees</b>	Rule 3521
<b>Tax Transactions</b>	Rule 3522
<b>Tax Services for Persons in Financial Reporting Oversight Roles</b>	Rule 3523*
<b>Audit Committee Pre-approval of Certain Tax Services</b>	Rule 3524*
<b>Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting</b>	Rule 3525*
<b>Communications with Audit Committees Concerning Independence</b>	Rule 3526

\* Rule applies only to audits of issuers.

# PCAOB Independence Rules and Guidance (cont'd.)

<b>Rule 3500T - Interim Ethics and Independence Standards</b>	
<b>Independence</b>	ET 101
<b>Integrity and Objectivity</b>	ET 102
<b>Ethics Rulings on Independence, Integrity and Objectivity</b>	ET 191
<b>Certain Independence Implications of Audits of Mutual Funds and Related Entities</b>	ISB No. 2
<b>Employment with Audit Clients</b>	ISB No. 3
<b>Impact on Auditor Independence of Assisting Clients in Implementation of FAS 133 (Derivatives)</b>	ISB Interpretation 99-1
<b>Interim Quality Control Standards Related to Independence (from Rule 3400T)</b>	
<b>System of Quality Control for a CPA Firm's Accounting and Auditing Practice – Independence, Integrity and Objectivity</b>	QC Section 20.9 & 20.10
<b>Independence Quality Controls – SEC Practice Section Member Firms</b>	SEC Practice Section – Section 1000.08(O) .46 Appendix L

# Prohibited Non-Audit Services

## Rule 2-01(c)(4)

“An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:”

Prohibited Non-Audit Services	
Bookkeeping or other services related to the accounting records or financial statements of the audit client	Management functions
Financial information systems design and implementation	Human resources
Appraisal or valuation services, fairness opinions, or contribution-in-kind reports	Broker-dealer, investment adviser, or investment banking services
Actuarial services	Legal services
Internal audit outsourcing services	Expert services unrelated to the audit

# Prohibited Non-Audit Services

With respect to the following 5 prohibited non-audit services, the rules state that the service may not be provided "unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements."

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services

In considering potential independence violations when performing non-audit services, materiality should be considered as a basis for determining potential impairments.

- 1 True
- 2 False

In considering potential independence violations when performing non-audit services, materiality should be considered as a basis for determining potential impairments.

1. True

2. **False**

# SEC FAQ – Non-Audit Services

## Question 4 (issued August 13, 2003)

**Q:** For five of the prohibited services (bookkeeping, internal audit outsourcing, valuation services, actuarial services, information system design and implementation), the rules contain the modifier that allows the audit firm to provide these services to an audit client when "it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements." The release text discussion indicates that there is a presumption that the services will be subject to audit procedures. Is materiality a basis for determining that it is reasonable to conclude that the services will not be subject to audit procedures (e.g., could the audit firm provide bookkeeping services for a subsidiary that is immaterial to the consolidated financial statements)?

**A:** No. There is a rebuttable presumption that the prohibited services will be subject to audit procedures. Determining whether a subsidiary, division, or other unit of the consolidated entity is material is a matter of audit judgment. Thus, the determination of whether to apply detailed audit procedures to a unit of the consolidated entity is, in and of itself, an audit procedure. Therefore, materiality is not an appropriate basis upon which to overcome the presumption in making a determination that it is reasonable to conclude that the results of the services will not be subject to audit procedures.

# What Does 'Audit Client' Mean?

Rule 2-01(f)(6) defines 'audit client' as follows:

*Audit client* means the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client, other than, for purposes of paragraph (c)(1)(i) of this Rule 2-01, entities that are affiliates of the audit client only by virtue of paragraph (f)(4)(ii) or (f)(4)(iii) of this Rule 2-01.



# What is an 'Affiliate of the Audit Client?'

Rule 2-01(f)(4) defines 'affiliate of the audit client' as follows:

*Affiliate of the audit client* means:

- (i) An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;
- (ii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
- (iii) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and
- (iv) Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

# Affiliate of the Audit Client

- Example

# Questions?



Which audit participant is excluded from disclosure on Form AP and the computation of total audit hours?

- 1 Auditor's employed specialist
- 2 Tax partner
- 3 Information technology senior
- 4 Nonaccounting firm participant
- 5 None of the above are excluded from disclosure.

Which audit participant is excluded from disclosure on Form AP and the computation of total audit hours?

1. Auditor's employed specialist
2. Tax partner
3. Information technology senior
4. Nonaccounting firm participant
- 5. None of the above are excluded from disclosure.**

# Division of Enforcement and Investigations Update

Carol Der Garry, Associate Director  
Division of Enforcement and Investigations

# Division of Enforcement & Investigations

What do we do.....



Investor Protection

# Agenda

- ❑ Today we would like to discuss:
  - ❑ Range of sanctions and effects of bars/suspensions
  - ❑ Association with a registered firm
  - ❑ Enforcement Program statistics and outlook
    - ❑ 2017 Settled enforcement actions and adjudicated actions made public
    - ❑ Certain types of enforcement actions and their consequences
    - ❑ Recent matters involving audit standards violations
  - ❑ Extraordinary cooperation credit
  - ❑ Termination of bars



# Range of Possible Sanctions

- ❑ In a disciplinary proceeding, the Board may:
  - ❑ suspend or permanently bar an individual from association with a registered public accounting firm
  - ❑ temporarily or permanently revoke a firm's registration
  - ❑ appoint an independent monitor
  - ❑ impose a civil monetary penalty
  - ❑ temporarily or permanently limit the activities, functions, or operations of a firm or person
  - ❑ require undertakings, such as additional professional education or training, changes to policies
  - ❑ impose a censure, and/or any other sanction per Board rules

# Effect of Suspensions and Bars From Being An Associated Person

- ❑ It is unlawful for any person that is suspended or barred to become or remain associated with any registered firm or with any issuer, broker, or dealer in an accountancy or a financial management capacity
  - ❑ See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301
  
- ❑ It is unlawful for any registered firm, issuer, broker, or dealer that knew, or, in the exercise of reasonable care should have known, that a person is suspended or barred from association to permit such association
  - ❑ See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301

# Association with a Registered Firm

- ❑ An individual associates with a registered firm if he or she, in connection with the preparation or issuance of any audit report:
  - ❑ Shares in the profits of, or receives compensation in any other form from, that firm; or
  - ❑ Participates as agent or otherwise on behalf of such accounting firm in any activity of that firm
  
- ❑ See Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301; Rules on Investigations and Adjudications, PCAOB Release No. 2003-015 (Sept. 29 2003), at A2-80-81

# Disclaimers

- ❑ Unless otherwise noted, in settled disciplinary proceedings, the firms and the associated persons neither admitted nor denied the Board's findings, except as to the Board's jurisdiction over them and the subject matter of the proceedings.
- ❑ The data and charts in this slide deck are intended to assist the public understanding the PCAOB enforcement program. It is possible inaccuracies or other errors were introduced into the data sets during the process of extracting the data and compiling the data sets. The data and charts presented are not a substitute for reading, analyzing and understanding each litigated and settled order.

# Program Statistics for 2017

- ❑ The Board has imposed sanctions on auditors ranging from censures to monetary penalties and bars on association with registered firms in settled or public adjudicated disciplinary orders
- ❑ The Board issued **54** settled disciplinary orders
  - ❑ Sanctioning **42** registered firms and **45** associated persons in those proceedings, imposing a total more than **\$4.8 million** in monetary penalties
- ❑ Three orders were adjudicated during 2017
  - ❑ Sanctioning **three** associated persons and imposing **\$75,000** in monetary penalties

# Program Statistics for 2017

- ❑ The Board imposed sanctions in its first settled orders involving violations of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*
  - ❑ Fulvio & Associates, LLP., et al.
  - ❑ PricewaterhouseCoopers LLP

# 2017 Settled Enforcement Actions

- ❑ **More than one-half** of these matters resulted from referrals from the Division of Inspection
  - ❑ The remainder resulted from the Division's public sources analyses and tips or referrals from sources outside the Board (e.g., SEC, FINRA)
- ❑ **About two-thirds** of the respondents were from the U.S. and the balance based outside of the U.S.
- ❑ **About one-quarter** of the respondents were from the global network firms and the balance from non-affiliated firms
- ❑ Highest penalty was **\$1.5 million**

# Program Outlook

- ❑ The DEI continues to prioritize:
  - ❑ Investigations involving significant audit violations, including a lack of due professional care and professional skepticism
  - ❑ Audit matters relating to the independence and integrity of the audit
  - ❑ Matters threatening or eroding the integrity of the Board's regulatory oversight process
  - ❑ Investigations focusing on the risks associated with cross border audits



# Coordination with the SEC

- ❑ PCAOB may share information with the SEC, DOJ, and other agencies enumerated in the Act
  
- ❑ Coordination with SEC Enforcement is standard practice
  - ❑ Parallel investigations: PCAOB investigates auditor conduct; SEC investigates public company, its management, and others
  
- ❑ PCAOB may defer its investigation of auditor to the SEC or vice versa
  
- ❑ PCAOB seeks to avoid duplication of effort

# Information about Enforcement Matters in Certain Areas

*Data inception to Dec. 31, 2017, unless otherwise indicated*

# Staff Practice Alert No. 14, *Improper Alteration of Audit Documentation*

- ❑ Issued in April, 2016
- ❑ Improper alteration of audit documentation in connection with an inspection or investigation can result in disciplinary actions with severe consequences (violation of duty to cooperate)
- ❑ Issues in recent oversight activities have heightened concerns about this at a range of firms, including global network affiliates
- ❑ Consequences of improper alteration, in many cases, are more severe than from the underlying perceived audit deficiency

# Matters involving Interference in Board Processes

- ❑ Violations of PCAOB Rules 4006 and 5110, which govern registered firms and associated person's conduct with respect to a Board inspection or investigation
  - ❑ ZERO tolerance for failing to provide information or interference with these processes
- ❑ These matters primarily involve providing improperly altered audit documentation to the Board in its inspections or enforcement processes
- ❑ These matters can be pursued in isolation, or in conjunction with other audit standards violations
- ❑ The Board has settled or finalized adjudication in **over 60** non-cooperation matters, involving **around 25 firms** and **more than 60** associated persons

# Matters involving Interference in Board Processes (cont'd)

- ❑ **About two-thirds** of the respondents were U.S. based firms and persons
- ❑ **About one-third** of the firms and persons involved in these matters were affiliated with the global network firms
- ❑ **Nearly one-half** of the respondents received a 5 year or permanent bar or revocation
  - ❑ **About one-third** also involved other violations of auditing standards in the associated audits

# Deloitte Touche Tohmatsu Auditores Independentes – December 5, 2016

- ❑ Firm is a Brazilian affiliate firm of Deloitte Touche Tohmatsu Limited
- ❑ Firm admitted to conduct
- ❑ Matter involved:
  - ❑ 14 now former partners and other audit personnel
  - ❑ Violations of AS 3, Rule 4006 and 5110, SEC Rule 10(b)(5) Failure to obtain sufficient evidence prior to issuance of the Firm's audit opinion or issuance of false audit report

# Deloitte Touche Tohmatsu Auditores Independentes – December 5, 2016 (cont'd)

- ❑ Sanctions imposed
  - ❑ Firm: censure, limitation of activities, independent monitor, adoption of certain QC policies and procedures, \$8 million monetary penalty
  - ❑ Associated Persons: censures, range of \$20,000 monetary penalties, bar with right to reapply after 5 years, permanent bars

# KAP Purwantono, Sungkoro & Surja – February 9, 2017

- ❑ KAP Purwantono, Sungkoro & Surja is an Indonesian affiliate firm of Ernst & Young Global Limited
- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence prior to issuance of the Firm's audit opinion
  - ❑ Violations of AS 3, PCAOB Rules 4006 and 5110
- ❑ As a result
  - ❑ Firm received censure and \$1 million penalty
  - ❑ Engagement Partner received censure, \$20,000 penalty, bar with right to reapply after 5 years
  - ❑ Asia-Pacific Area Prof. Practice Director (a U.S. seconded partner) received censure, \$10,000 monetary penalty, 1 year limitation on activities



# Matters involving audit violations around illegal acts

- ❑ Section 10A(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) requires firms to include procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts
- ❑ Section 10A(b) of the Exchange Act requires firms to take certain steps after becoming aware that an illegal act has taken place, and PCAOB standards, under AS 2405, *Illegal Acts by Clients*, require auditors to take certain steps in response to possible illegal acts

# Matters involving audit violations around illegal acts (cont'd)

- ❑ The Board has settled more than **10** matters involving audit violations around illegal acts
- ❑ **About three-quarters** of the respondents were U.S. based and substantially all were associated with non-affiliated firms

# Canuswa Accounting and Jun Zhang, CPA – March 20, 2017

- ❑ *In the matter of Canuswa Accounting & Tax Services Inc. and Jun Zhang, CPA* involves:
  - ❑ Failure to take certain actions required by Section 10A(b) and AU § 317, Illegal Acts by Clients, in response to becoming aware of information about possible illegal acts
    - ❑ After learning a former client included an audit report purported issued by the firm in a Form 10-K for an audit it had not completed, the firm did not take the required steps
  - ❑ Also violations of AS 7, AS 9 and AS 11 through 15 for audits completed in previous years

# Canuswa Accounting and Jun Zhang, CPA – March 20, 2017 (cont'd)

- ❑ As a result
  - ❑ Firm received censure, revocation with a right to reapply after three years and \$20,000 penalty
  - ❑ Engagement Partner received censure and a bar with a right to reapply after three years

# Independence Matters

- ❑ A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period
  - ❑ To be recognized independent, an auditor must be free from any obligation to or interest in the audit client, its management or its owners
  
- ❑ The Board has found independence violations in several areas—one significant area is violations associated with maintaining the financial records or preparing financial statements for issuers and broker/dealers

# Independence Matters (cont'd)

- ❑ Since December 2014, the Board has entered into settled orders with certain associated persons for violations associated with maintaining the financial records or preparing financial statements of:
  - ❑ Broker-dealer audit clients – *about 25 orders*
  - ❑ Issuer audit clients – *about 10 orders*
- ❑ Sanctions included:
  - ❑ Firms: censures, monetary penalties of \$2,500 - \$20,000, remedial measures, one year prohibitions on new clients
  - ❑ Associated Persons: censures, monetary penalties of \$2,500- \$15,000, bars with a right to reapply of typically one or two years

# Independence Matters – Sanctionable Conduct

- For one or more of its audit clients, members of the audit firm
  - Prepared and filed Focus reports
  - Prepared all or a portion of the financial statements, including notes
  - Prepared draft statements with placeholders for dollar amounts
  - Obtained drafts, but made extensive changes
  - Directed or supervised professionals from another firm to prepare all or a portion of the financial statements that were the subject of the firm's audit opinion
  - Maintained and prepared accounting records, including journal entries
  - Prepared the tax provision
  - Provided valuation services

# Independence Matters – Factors in Severity of Sanctions

- ❑ Range of Conduct
  - ❑ Audits of multiple issuers or broker-dealers over multiple years resulted in more severe sanctions
- ❑ Context of Conduct
  - ❑ More severe sanctions resulted from:
    - ❑ Specific awareness of independence rules
    - ❑ Continued conduct after specific notice of previous violations
  - ❑ Less severe sanctions when firms or associated person made changes with the intent to comply, but efforts fell short



# Engagement Quality Review Matters

- ❑ Engagement quality reviews are required for issuer audits and interim reviews, broker-dealer audits, and examinations/ reviews of broker-dealer compliance/exemption reports
- ❑ EQR violations were also present in 2017 settlements where other audit standard or regulation violations were also present
- ❑ The Board settled disciplinary orders in 2017 against more than **15** firms and **20** associated persons for conduct substantially relating to violations of EQR requirements

# Engagement Quality Review Matters – 2017 Settlements

- ❑ Of the 2017 settlements substantially related to EQR –
  - ❑ No concurring approval of an EQR was obtained prior to granting permission to the client to use the firm’s report in about one-half
  - ❑ Engagement Quality Reviewer violated the mandatory two year “cooling off” period in about one-third
  - ❑ Each registered firm and associated person was censured
    - ❑ Monetary penalties ranged from \$5,000 to \$40,000 (in some matters there were no monetary penalties)
    - ❑ Where misconduct was more severe, a bar or revocation with right to reapply after one to five years

# Engagement Quality Review Matters – Weaver and Tidwell, L.L.P.

- ❑ On October 26, 2017, Board sanctioned the firm for failing to comply with the mandatory two year “cooling off” period for engagement partners serving as EQ Reviewer’s on their former clients on four broker-dealer financial statement audits
  - ❑ The firm had been previously sanctioned for similar conduct with respect to an issuer audit
- ❑ Firm was censured, received a \$30,000 monetary penalty and required to undertake certain remedial measures
- ❑ Remedial measures (undertakings) include establishment of policies and procedures to
  - ❑ provide reasonable assurance of compliance with AS 1220, *Engagement Quality Review*
  - ❑ Ensure training at least annually on AS 1220

# Engagement Quality Review Matters – Brace & Associates, PLLC, et al.

- ❑ On November 26, 2017, Board sanctioned the firm and its sole owner for repeated failures to obtain EQRs for 19 broker-dealer audit clients
- ❑ Firm was censured, had its registration revoked with a right to reapply after three years and received a \$10,000 monetary penalty
- ❑ Sole owner was censured, and was barred with a right to reapply after three years

# Certain Recent Matters involving Audit Standards Violations

- ❑ In the Matter of PricewaterhouseCoopers LLP – Aug. 2, 2017
- ❑ In the Matter of Seale & Beers CPAs – Sep. 14, 2017
- ❑ In the Matter of Grant Thornton – Dec. 20, 2017

# Matter of PricewaterhouseCoopers LLP – August 2, 2017

- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence regarding Merrill Lynch’s compliance with the SEC’s Customer Protection Rule prior to issuance of the Firm’s examination and audit opinion
  - ❑ Included violations of AT 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, and AS No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*
- ❑ As a result
  - ❑ Firm received censure and \$1 million penalty

# In the Matter of Seale & Beers CPAs, et al. – Sep. 14, 2017

- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence, particularly with respect to related party transactions of an issuer audit
  - ❑ Firm violated quality control standards with respect to that issuer audit, as well as others
- ❑ As a result
  - ❑ Firm received censure, bar with right to reapply after one year, and \$20,000 penalty
  - ❑ Managing Partner received censure, one year suspension, one year limitation on activities, and a \$10,000 penalty

# In the Matter of Grant Thornton LLP, et al. – Dec. 20, 2017

- ❑ Matter involves:
  - ❑ Violation of PCAOB quality control standards in assigning of two partners with known audit quality issues to audits without sufficient support or monitoring; violation of auditing standards relating to allowance for loan and lease losses
- ❑ As a result
  - ❑ Firm received censure, \$1.5 million penalty and remedial sanctions (undertakings)
  - ❑ Engagement Partner received censure, \$15,000 penalty, bar with right to reapply after one year, one year limitation on activities
- ❑ First Quality Control matter against a domestic Global Network firm



# Extraordinary Cooperation Credit

- ❑ Extraordinary cooperation is voluntary and timely action, *beyond compliance with legal or regulatory obligations*, that contributes to the mission of the Board
- ❑ Three types:
  - ❑ self-reporting
  - ❑ remedial or corrective action
  - ❑ substantial assistance to the Board's investigative processes or to other law enforcement authorities

# Extraordinary Cooperation Credit (cont'd)

- ❑ The Board has previously announced that two unnamed broker-dealer audit firms had prepared financial statements, but would not be sanctioned
  - ❑ The Board awarded credit for extraordinary cooperation based on the firms':
    - ❑ Timely and voluntary self-reporting to the PCAOB Tip Line
    - ❑ Timely, voluntary, and meaningful remedial actions, including, in one matter, communicating the violation to the client and discussing the conduct and violation at an annual firm training session

# Extraordinary Cooperation Credit – 2017 Settlement

- ❑ In Schild, et al., sanctions credit was given for the substantial assistance it provided the Division through timely and voluntarily providing information on independence and EQR violations
  - ❑ Disclosure that financial statements for an issuer had been prepared by Respondents
  - ❑ Disclosure that the Firm did not obtain concurring approval from engagement quality reviewer of issuance of an audit report before granting permission to use it

# Extraordinary Cooperation Credit – 2017 Settlement

- ❑ *In the Matter of DRT Bagimsiz Denetim ve Serbest Muhasebeci Mali Musavirlik A.Ş. ("Deloitte Turkey")*, credit was given for providing substantial assistance –
  - ❑ Deloitte Turkey, a Turkish affiliate firm of Deloitte Touche Tohmatsu Limited
    - ❑ Self-reporting alleged misconduct relating to non-cooperation with a Board inspection
    - ❑ Conducting its own investigation and sharing the factual results with the Board Staff
    - ❑ Implementing enhancements to its quality control policies and procedures in relevant areas and separating from the firm the personnel responsible for the misconduct identified
  - ❑ Certain Partners for providing detailed information concerning the improper conduct

# Extraordinary Cooperation Credit – 2018 Settlement

- ❑ *In the Matter of Baum & Company, P.A., et al.*, sanctions credit was given for providing substantial assistance by
  - ❑ Self-reporting, at the start of the inspection, the improper adding and backdating of audit documentation in anticipation of the inspection
  - ❑ Providing a list identifying remembered added or altered documents and describing such changes in general terms

# Terminations of Bars

- ❑ PCAOB Rule 5302(b) governs petitions to terminate a bar
  - ❑ Specific items outlined in the PCAOB Rules 5302(b)(2), 5302(b)(3), and 5302(b)(4) must be addressed for the Board to consider a petitioner's request
  
- ❑ To date, six individuals have successfully terminated their bars
  - ❑ One each in 2009, 2010, 2016 and 2017
  - ❑ Two in 2018

# PCAOB Center for Enforcement Tips, Complaints and Other Information

Website: <http://pcaobus.org/Enforcement/Tips/Pages/default.aspx>  
E-mail: [TIPS@pcaobus.org](mailto:TIPS@pcaobus.org)  
Post: PCAOB Tip & Referral Center  
1666 K Street, NW  
Washington, DC 20006  
Fax: 202-862-0757  
Telephone: 800-741-3158

# Questions





In 2018, how many universities received a \$10,000 scholarship from the PCAOB to award to a student at the university?

1 100

2 123

3 167

4 332

In 2018, how many universities received a \$10,000 scholarship from the PCAOB to award to a student at the university?

1. 100

2. 123

3. 167

**4. 332**

# Q&A and Closing Remarks

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/OOSBSBFVA2018>