PCAOB Issuer and Auditor Conference Highlights

The Greater Washington Society of CPAs ("GWSCPA") hosted its first annual PCAOB Issuer and Auditor Conference in Washington, D.C., on June 9, 2014. This summary does not capture all of the discussions presented during the conference; rather, the document is intended to highlight hot topics and recurring themes. The selected comments noted below are our interpretation of the speakers’ comments, which do not necessarily represent the opinion of Dixon Hughes Goodman.

Readers should note that presenters issued the disclaimer that the views expressed during their presentations are not necessarily the views of the PCAOB, the SEC, the Center for Audit Quality (CAQ) or their respective boards and staff.

Summary of Selected Topics Presented

- **PCAOB Staff Audit Practice Alert (PA) No. 11** Considerations for Audits of Internal Control over Financial Reporting – continued focus on this Practice Alert and its provisions. Inspections Staff of the PCAOB continue to identify findings consistent with the matters covered in this Practice Alert.

- **Proposed Auditing Standard on Related Parties** (note that the PCAOB subsequently issued Auditing Standard (AS) Number 18 on Related Parties, pending SEC approval) – the PCAOB believes that additional disclosures should accompany the financial statements concerning related party relationships. The proposed AS would include:
  - Evaluating a company’s identification of, accounting for, and disclosure of, relationships and transactions between the company and its related parties.
  - Identifying and evaluating a company’s significant unusual transactions.
  - Obtaining an understanding of a company’s financial relationships and transactions with its executive officers, as part of the auditor’s risk assessment process.
  - Requiring auditors to:
    - Perform specific procedures to obtain an understanding of the company’s relationships and transactions with its related parties;
    - Perform specific procedures for each related party transaction that is either required to be disclosed in the financial statements or determined to be a significant risk;
    - Perform specific procedures if the auditor determines that a related party, or relationship or transaction with a related party, previously undisclosed to the auditor exists;
Evaluate whether the company has properly identified its related parties or relationships or transactions with related parties; and

Communicate to the audit committee the auditor’s evaluation of the company’s identification of, accounting for, and disclosure of its relationships and transactions with related parties.

- In themes shared with PA 11 and AS 18, the PCAOB encouraged further auditing of non-recurring or significant unusual transactions. This includes internal control considerations, along with procedures designed to identify such transactions, documentation and understanding of the business purpose of such transactions and consideration of the disclosures surrounding such transactions.

- Continued discussion of revision to the auditor’s report.
  - The Board’s proposed auditor reporting standard would retain the pass/fail model and the basic elements of the current auditor’s report but would require the auditor to communicate a wider range of information specific to the particular audit.
  - The proposed standard would require:
    - Communication of critical audit matters that would be specific to each audit
    - Addition of new elements to the auditor’s report related to:
      - Auditor independence
      - Auditor tenure
      - Auditor’s responsibility regarding other information that is included in documents containing the audited financial statements and the related auditor’s report
    - Enhancements to existing language in the auditor’s report related to the auditor's responsibility for fraud and notes to the financial statements
  - The proposed auditor’s reporting standard would retain the requirements relating to explanatory language or paragraphs in the auditor’s report (e.g., going concern). Also, the standard would retain the auditor’s ability to emphasize a matter regarding the financial statements.

- Identification of the Engagement Partner and Other Public Accounting Firms or Persons That Are Not Employed by the Auditor but Participate in the Audit
  - On December 4, 2013, the Board re-proposed the amendments that would require disclosure in the auditor’s report of:
    - The name of the engagement partner who led the audit for the most recent period; and
- The names, locations and extent of participation (as a percentage of the total audit hours) of other public accounting firms that took part in the audit, and the locations and extent of participation of other persons (whether an individual or a company) not employed by the auditor who performed procedures on the audit.
  - The public comment period closed in March 2014; summary of comments not yet available.

- **The PCAOB has proposed a re-organization of Auditing Standards. These revisions would include:**
  - Renumber and reorder existing standards without redrafting or making substantive changes.
  - Present standards in a logical order that generally follows the flow of the audit process.
  - Help users navigate the standards more easily.
  - Provide structure for future standard-setting.

- **The CAQ provided an update of their current projects.**
  - Anti-fraud collaboration to promote integrity in financial reporting, which can be found at: AntiFraudCollaboration.org.
  - Discussed the relevance of the CAQ’s March 2013 release, Guide to Internal Control over Financial Reporting.
  - Discussed continued focus on cyber security.

- **PCAOB’s Audit Quality Initiatives (“AQI”) Project**
  - Project proposes two primary questions:
    - Can we develop a portfolio of measures providing new insight into quality?
    - If so, how can we deploy them in a manner that best promotes quality and competition based on quality?
  - Discussion items included support for AQIs, and proposed rationale for identifying and screening AQIs.

- **The conference included a panel discussion composed of the following individuals:**
  - Karen Kubis and Glenn Tempro, Associate Directors, Inspections; Greg Scates, Deputy Chief Auditor; Raphael Larson, Associate Director, Enforcement
  - Topics discussed included:
    - Substantive auditing of revenue.
    - Case studies, including a study of substantive auditing various components of revenue throughout divisions of an operation.
- **Remediation: Satisfactory or Not?**
  - Presented by Karen Kubis, Associate Director of the PCAOB’s Division of Registration and Inspections
  - Discussed the process of remediating firm inspection findings:
    - Stressed the importance of communication with the PCAOB throughout the process.
    - Emphasized the importance of monitoring the ongoing effectiveness of remediation actions.
    - Importance of training.
  - Various case studies were presented and discussed.

- **Auditing of Fair Value Measurements**
  - Remains a major topic throughout the industry, specifically:
    - Failure to obtain an understanding of the methods and evaluate the reasonableness of the significant assumptions used by the issuer’s pricing sources (specialist).
    - Failure to evaluate the appropriateness of the methods and the reasonableness of the significant assumptions used with respect to fair value estimates not involving specialists.
    - Failure to obtain fair values from an independent external source when developing independent fair value estimates.
  - Significant discussion surrounding adherence to AU 328, Auditing Fair Value Measurements and Disclosures and AU 336, Using the Work of a Specialist.
  - Various case studies were presented and discussed.

- **Evaluation of Goodwill for Impairment**
  - Remains a major topic throughout the industry, specifically:
    - Failure to sufficiently test the significant assumptions, underlying data, and methodology used in the estimation of the fair value of a reporting unit.
    - Failure to evaluate whether other relevant information was inconsistent with management’s determination that goodwill was not impaired based on certain qualitative factors.
    - Failure to sufficiently evaluate the identification of operating segments and reporting units.
  - Discussion of AU 342, Auditing Accounting Estimates.
Various case studies were presented and discussed.

- **The SEC’s Division of Corporation Finance Provided an Update for FY2014**
  - Discussion of financial reporting by Smaller Reporting Companies
    - Most frequent Comment Letter matters dealt with MD&A presented by Smaller Reporting Companies. Additional common comment letter matters, in order of prevalence, include:
      - Revenue recognition
      - Income taxes
      - Material misstatements
      - Auditor issues
      - Transactions, specifically ’33 Act filings
      - Goodwill & segment matters
      - Loss contingencies
      - Liability vs. equity determinations
      - Reverse mergers
    - The SEC encouraged Smaller Reporting Companies to focus on the topics covered by its interpretative releases, specifically 33-8350 and 33-6835 (links provided in the slide show presentations, attached to this summary).
    - Additionally, Smaller Reporting Companies are encouraged to pay particular attention to their disclosures, and the quality thereof, concerning results of operations, liquidity and capital resources, trends and uncertainties, critical accounting estimates, and ensuring appropriate disclosure separately quantifiable, material underlying transactions.
    - A comprehensive appendix of key resources for Smaller Reporting Companies was provided by the SEC.
- **Rafael Larson, Associate Director of Enforcement and Investigations, provided an update on enforcement actions by the PCAOB.**
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Michael Gilreath has 12 years of experience serving the financial institution industry, maintaining a focus on banks, investment companies, mortgage companies and broker-dealers. Mike’s banking experience includes assurance and attest engagements, as well as consulting and advisory services, for specialized topics on loans, investments, deposits and regulatory compliance functions. Mike has consulted clients on technical topics including loan securitization transactions, and accounting and financial reporting matters pertaining to variable interest entity consolidation considerations. Mike’s experience also includes accounting for alternative investments, as well as private equity portfolio positions held by investment companies and other-than-temporary impairment considerations under the Financial Accounting Standards Board’s revised accounting. His background includes accounting and financial reporting for multiple bank mergers and acquisitions, including FDIC-assisted transactions to purchase troubled institutions.

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