
STANDARD-SETTING UPDATE

OFFICE OF THE CHIEF AUDITOR

JUNE 30, 2018

The Public Company Accounting Oversight Board ("PCAOB" or "Board") seeks to establish and maintain high-quality auditing and related professional practice standards for audits of issuers and brokers and dealers in support of the PCAOB's overall mission of protecting investors and furthering the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB's Office of the Chief Auditor—working with other PCAOB offices and divisions—assists the Board in establishing and maintaining PCAOB standards.

The PCAOB takes a priority-based approach to standards-related projects. The process begins with a PCAOB interdivisional team that performs an annual environmental scan to identify current or emerging audit issues and informs the Board regarding matters that potentially warrant changes to PCAOB standards or additional staff guidance. The interdivisional team also continues to monitor current or emerging issues throughout the year, including observations from oversight activities that may merit further consideration. The evaluation of potential issues may result in a project being added to the PCAOB research agenda.

For each project on the PCAOB research agenda, a PCAOB interdivisional research team is formed to perform research, outreach, and economic analysis to assess whether there is a need for changes to PCAOB standards; consider alternative regulatory responses; and, if standard setting is needed, evaluate potential standard-setting scope and approaches. If standard setting is pursued, the project would be added to the standard-setting agenda. If standard setting is not pursued, consideration will be given to whether or not any other action is needed. In addition to the projects on the research agenda, the PCAOB also conducts monitoring activities in other areas that could impact audits or PCAOB standards (e.g., financial reporting fraud, auditor independence, and new accounting standards).

The Board solicits public comment on potential changes to the PCAOB standards before adopting changes. Consideration of changes to PCAOB standards also involves conducting an economic analysis and analyzing potential impacts of changes on audits of emerging growth companies.

The standard-setting update, which includes the standard-setting and research agendas, was prepared by the staff of the Office of the Chief Auditor. Standard-setting and research agendas, staff consultation papers, and staff audit practice alerts are not statements of the Board, nor do they necessarily reflect the views of the Board, individual Board members, or other staff.

Additionally, the PCAOB staff may prepare guidance regarding the application of existing PCAOB standards. For example, PCAOB staff audit practice alerts highlight new, emerging, or noteworthy circumstances that may affect how auditors conduct audits under, or otherwise comply with, the existing requirements of the standards and rules of the PCAOB and relevant laws.

The PCAOB's standard-setting related processes, including identifying current or emerging audit issues, developing the research agenda, and working on standard-setting projects, are informed by a range of activities. These activities include the PCAOB's oversight activities, consultation with the Board's Standing Advisory Group ("SAG"), input from the Board's Investor Advisory Group ("IAG"), discussion with the U.S. Securities and Exchange Commission ("SEC") staff, work of other standard setters (for example, the International Auditing and Assurance Standards Board ("IAASB"), Financial Accounting Standards Board ("FASB"), and International Accounting Standards Board), and other relevant inputs and developments.

Part I below covers the projects on the standard-setting agenda. Part II, beginning on page 4, covers the projects on the research agenda.

The PCAOB will create a new webpage on the PCAOB's website to communicate updates on its standard-setting and research projects. The PCAOB is considering changes to the frequency of updates and the information provided on projects to promote accessibility and transparency, including, for example, by giving website users the ability to sign up to receive regular notices when the page, or any individual project, is updated.

Part I Standard-Setting Agenda

Project	Current Stage
Auditing Accounting Estimates, Including Fair Value Measurements	Developing a recommendation for Board consideration in Q4 2018
The Auditor's Use of the Work of Specialists	Developing a recommendation for Board consideration in Q4 2018
Supervision of Audits Involving Other Auditors	Analyzing comments on supplemental request for comment and determining next steps
Going Concern	Outreach, monitoring, and research

Standard-Setting Project Overviews

- 1. *Auditing Accounting Estimates, Including Fair Value Measurements.*** On June 1, 2017, the Board issued for public comment a proposed single auditing standard to replace the existing standards for auditing accounting estimates and fair value measurements and proposed other related amendments to PCAOB auditing standards to strengthen and enhance the requirements for auditing accounting estimates, including fair value measurements. The proposed single auditing standard also would include a special topics appendix that addresses auditing the fair value of financial instruments, including the use of information from pricing sources. Accounting estimates are becoming more prevalent and significant as financial reporting frameworks evolve and require greater use of estimates, including those based on fair value measurements. Accounting estimates are some of the areas of greatest risk in the audit, requiring additional audit attention and appropriate application of professional skepticism. Auditing accounting estimates has proven challenging for auditors, as indicated by the results of PCAOB inspections. The proposal emphasizes that auditors need to apply professional skepticism and devote greater attention to potential management bias when auditing accounting estimates. This proposal was issued in conjunction with a companion proposal on the auditor's use of the work of specialists. The comment period on both proposals ended on August 30, 2017. The staff has analyzed the comments received and is developing a recommendation for Board consideration in Q4 2018. For further information, see [Rulemaking Docket No. 043](#).
- 2. *The Auditor's Use of the Work of Specialists.*** On June 1, 2017, the Board issued for public comment proposed amendments to PCAOB auditing standards to strengthen the requirements for the auditor's use of the work of specialists. Many companies employ or engage specialists, such as engineers or actuaries, to provide information used in the preparation of financial statements. Auditors often use the work of company specialists as audit evidence. Auditors also employ or engage their own specialists to assist in obtaining and evaluating audit evidence. The proposal calls for auditors to devote more attention to areas of the audit where a specialist's work is used by the auditor. This proposal was issued in conjunction with a companion proposal on auditing accounting estimates, including fair value measurements. The comment period on both proposals ended on August 30, 2017. The staff has analyzed the comments received and is developing a recommendation for Board consideration in Q4 2018. For further information, see [Rulemaking Docket No. 044](#).
- 3. *Supervision of Audits Involving Other Auditors.*** On April 12, 2016, the Board issued for public comment amendments to improve the auditing standards that govern the supervision of audits involving other auditors, and a new auditing standard for situations in which the auditor divides responsibility for the audit with another accounting firm. The roles of other accounting firms and individual accountants in audits (collectively, "other auditors") have taken on greater significance with the increasingly global operations of companies. The lead auditor often involves other auditors at various locations of the company, including in areas of the audit where there is a high risk of material misstatement in the financial statements. After consideration of comments received on the proposal and discussions with the SAG, on September 26, 2017, the Board issued a supplemental request for comment on revisions to the proposed amendments and proposed standard that the Board is considering for

adoption. The comment period on the supplemental request for comment ended on November 15, 2017. The staff is analyzing comments and determining next steps. For further information, see [Rulemaking Docket No. 042](#).

4. **Going Concern.** The auditor's evaluation of a company's ability to continue as a going concern is an important part of an audit under PCAOB standards and federal securities law. The purpose of this project is to evaluate whether there is a need for regulatory action—e.g., changes to the existing PCAOB standard on the auditor's going concern evaluation, staff guidance, or other actions—in light of changes in the relevant accounting requirements¹ and concerns from investors about the effectiveness of auditor going concern reporting. This project is considering, among other things, input from the SAG and IAG, observations from the Board's oversight activities, and relevant research. The staff plans to continue its research and outreach activities, including monitoring the effect on audits of the changes to the relevant accounting standards. In the meantime, AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, and Staff Audit Practice Alert No. 13 continue to provide the applicable requirements and guidance, respectively, for audits under PCAOB standards.

Part II Research Agenda

Project	Current Stage
Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities	Developing recommendations based on research findings for next steps for Board consideration
Changes in the Use of Data and Technology in the Conduct of Audits	Exploring with the SAG task force current practices in data analytics and artificial intelligence; continuing outreach and other research activities
Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures	Developing recommendations based on research findings for Board consideration

¹ On August 27, 2014, FASB issued Accounting Standards Update No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. On September 22, 2014, the PCAOB issued Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern*, to remind auditors to continue to follow existing PCAOB standards when considering a company's ability to continue as a going concern.

Project	Current Stage
Auditor's Consideration of Noncompliance with Laws and Regulations	Developing recommendations based on research findings for Board consideration
Auditor Communications with Audit Committees Concerning Independence	Exploring whether guidance should be issued or whether there is a need for amendments to Rule 3526

Research Project Overviews

1. **Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities.** Deficiencies identified in PCAOB inspections suggest that improvements may be needed in firms' systems of quality control. The staff is exploring whether there is a need for changes to PCAOB quality control standards (e.g., making improvements related to assignment and documentation of firm supervisory responsibilities) that would prompt firms to improve their quality control systems and more proactively identify and address emerging risks and deficiencies, thereby enhancing audit quality.

This project has considered, among other things, observations from the Board's oversight activities, relevant research, input from the SAG and other outreach, and activities of international audit regulators, as well as PCAOB initiatives related to the root cause analysis and audit quality indicators. The staff is also monitoring developments related to the IAASB's project on quality control. The project will also consider impacts of potential standard-setting approaches on large and small domestic and international firms.

The staff has presented its research findings to the Board and is developing recommendations for next steps for Board consideration.

2. **Changes in the Use of Data and Technology in the Conduct of Audits.** Significant advances in technology have occurred in recent years, including increased use by issuers and auditors of data analysis tools and emerging technologies. An increased use of these technology-based tools could have a fundamental impact on the audit process, including the nature and amount of information available to auditors, significant judgments auditors make in critical areas of the audit, and staffing of audit engagements. The staff is exploring whether there is a need for guidance, changes to PCAOB standards, or other regulatory actions in light of increased use of new and emerging technology-based tools. This project is considering, among other things, the new technology-based tools being used in audits and the impact on the audit of new technologies used by issuers, changes to firms' methodologies, academic research, outreach, and the activities of others, including auditing standard setters (e.g., the IAASB's Data Analytics Working Group).

As part of the project's outreach activities, this topic was discussed at the May 2017, November 2017, and June 2018 SAG meetings.

The Board also approved formation of a SAG task force² to assist the staff in obtaining insights into the use of data analytics and certain emerging technologies. The task force held its first meeting in May 2018. It identified data analytics and artificial intelligence as its initial priorities, which will be discussed at its second meeting in fall 2018. The task force will consider additional topics at future meetings.

- 3. Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures.** In recent years, there has been much press attention and regulatory scrutiny about the disclosure of company performance measures, including non-GAAP financial measures and operating measures. These measures are included in a company's annual reports, registration statements, earnings releases, or in other communications, such as calls with analysts and information on the company's website. Company performance measures that are included in an annual report outside the financial statements, for example in management's discussion and analysis of financial condition and results of operations, are considered "other information" and are subject to the requirements of AS 2710, *Other Information in Documents Containing Audited Financial Statements*. Under AS 2710, the auditor has a responsibility to "read and consider" other information in documents containing audited financial statements.³ However, under current PCAOB standards, auditors do not have responsibilities to perform procedures related to information presented in corporate earnings releases, investor presentations, or other communications, such as calls with analysts and information on the company's website.

In August 2013, the Board proposed a new standard that would enhance the auditor's responsibility under AS 2710.⁴ Given the continuing focus on company performance measures by investors and other stakeholders, the Board is reevaluating whether there is a need to revise the standards in this area and, if so, how to change the auditor's existing performance and reporting responsibilities related to other information accompanying audited financial statements. The Board is also considering input it has received regarding the significance to the capital markets of company performance measures that are often reported in documents outside of the scope of AS 2710.

As part of its research activities, the staff has reviewed observations from PCAOB and SEC oversight activities, initiatives of other regulators and standard setters, and the relevant academic literature. The staff has also considered comments received on the other

² See the [Data and Technology Task Force page](#) on the PCAOB's website under the [Standards: Standing Advisory Group page](#) for a roster of task force members and observers.

³ In addition, AS 4105, *Reviews of Interim Financial Information*, includes a similar responsibility for the auditor with respect to other information that accompanies the interim financial information.

⁴ For further information, see [Rulemaking Docket No. 034](#).

information standard proposed in 2013, input from meetings with the IAG and SAG in 2016 and 2017, and additional outreach to various stakeholders on current practice and the potential need to improve the auditor's responsibilities.

The staff is summarizing its research findings and is developing recommendations for next steps for Board consideration.

- 4. Auditor's Consideration of Noncompliance with Laws and Regulations.** AS 2405, *Illegal Acts by Clients*, establishes requirements regarding the auditor's consideration of possible illegal acts by a client in an audit of financial statements. AS 2405 has remained largely unchanged since its issuance in 1988. Since then, regulatory and investor attention to company violations of laws and regulations has increased. The staff has been exploring whether there is a need for improvements to AS 2405 to provide better direction to auditors regarding their responsibilities with respect to illegal acts.

As part of its research activities, the staff has considered auditors' responsibilities related to illegal acts under existing auditing standards and the federal securities laws, as well as the requirements of other standard setters and regulators.

The staff has also considered current practice for auditors' detection, investigation, and reporting of illegal acts by reviewing, among other things, academic literature and other studies, reviewing firm methodologies, and analyzing PCAOB and SEC oversight activities. The staff has also considered input from meetings with the IAG and SAG in 2017 and additional outreach to various stakeholders.

The staff is summarizing its research findings and is developing recommendations for next steps for Board consideration.

- 5. Auditor Communications with Audit Committees Concerning Independence.** PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*, provides, among other things, that a registered public accounting firm must, at least annually with respect to each of its audit clients: (1) describe in writing to the audit committee all relationships between the audit firm and the audit client that, as of the date of the communication, may reasonably be thought to bear on independence; (2) discuss with the audit committee the potential effects of those relationships on the independence of the audit firm; and (3) affirm to the audit committee in writing that, as of the date of the communication, the firm is independent in compliance with PCAOB Rule 3520, *Auditor Independence*. Inspection observations have identified situations that raise questions about how firms are executing against the provisions of PCAOB Rule 3526 in circumstances in which there has been a relationship that caused a firm not to be independent under PCAOB Rule 3520. The staff is exploring, through outreach and other research activities, whether guidance should be issued or whether there is a need for amendments to Rule 3526.