



Presentation to the North Atlanta Chapter

PCAOB – Past, Present and Future

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Overview of PCAOB

- **Overview of PCAOB – Past, present and future**
- **Questions & Answers**



Caveat

Although much of the information that will be provided to you has been made public by the PCAOB via Releases and the like, there also will be views expressed that are those of the speaker alone, and do not necessarily reflect the views of the Board, its members or staff. Therefore, unless it is clear that the Board has authorized the statement, you should not attribute it to the Board or staff.



PCAOB Mission

- **The Board’s mandate is to “*protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports*” of public companies.**
- **The Board has a unique regulatory structure**
 - Created as part of Sarbanes-Oxley Act
 - Operates as a private, non-profit corporation – NOT a governmental organization
 - SEC has oversight authority over the Board



Core Areas of Responsibility

- Registration
- Inspection
- Investigation and Enforcement
- Standard Setting



Registration Statistics*

- **Total registered — 1,738.**
- **U.S. registered firms — 986 (57%).**
- **Foreign registered firms — 752 (43%).**
- **Countries of registration — 82.**
- **Firms with 5 or fewer public company clients — 1,513 (976 – no issuer clients).**

*As of 31 December 2006, according to the PCAOB
2006 Annual Report



Inspections

- **Inspections assess a firm's compliance with the Act, the Board's and the SEC's rules and with professional standards, including the firm's system of quality control.**
- **Regular inspections must take place annually for firms that audit more than 100 U.S. public companies.**
- **All other firms must be inspected once every 3 years.**



Inspections

- **In 2003, the Board conducted limited inspections of the largest four accounting firms.**
- **In 2004, regular inspections commenced:**
 - U.S. firms with more than 100 or more U.S. public company clients – 9 firms
 - Approximately 90 small firms
- **In 2005, the PCAOB inspected 281 registered accounting firms, including 16 non-U.S. firms.**
- **In 2006, the PCAOB inspected 172 firms; 14 non-U.S. firms.**
- **Unlike peer review, there is no comprehensive report or status of the firm at the end of the inspection – only comments and a report.**
- **Inspection reports (public and some non-public*) are available on the Board's website at www.pcaobus.org**



Quality Control Assessment

- Tone at the top
- Independence
- Quality control (internal programs and peer review results)
- Concurring partner reviews
- Client acceptance and retention
- Training
- Audit methodology
- Work of other auditors
- Alternative practice structure



Engagement Reviews

- Meet with engagement partner
- Review of audit workpapers
- Comment forms issued, reviewed by the firm, and responded to



Issues Identified in All Types of Issuers

- The Big 3 - Derivatives, leases and taxes
- Audit of fair values
- Related party issues
- Prohibited loans
- Revenue recognition
- Auditing of expenses
- Independence
- Going concern/development stage designation
- Control of issuer use of reports
- Understanding of contractual arrangements/substance of transactions
- Principal auditor



Investigation and Enforcement

- **The Board may investigate possible violations of the Sarbanes-Oxley Act, the Board's rules, the securities laws related to audit reports and professional standards.**
- **In practice, a Board investigation may include a look at both the auditor's conduct and the accuracy of the client's financial statements.**
- **Discovery of potential violations by issuers may lead to Board referral to other law enforcement with appropriate jurisdiction.**
 - The SEC
 - U.S. Attorney General or other state's attorneys general
 - Federal functional regulators (OCC, FDIC, OTC)
 - State regulatory bodies



Standard Setting

- **The Sarbanes-Oxley Act directs the Board to establish:**
 - *Auditing and related attestation standards.*
 - *Quality control standards.*
 - *Ethical standards.*
- **The Board may also establish independence standards relating to the preparation of audit reports, including prohibiting new categories of non-audit services.**
- **Board uses an open process**
 - *Standing Advisory Group (“SAG”)*
 - *Ad Hoc Task Forces*
 - *Roundtables on selected issues*



Standard Setting

Some new/revised standards are mandated, or clearly implied, by the Act:

- *Internal Control*
- *Audit Documentation*
- *Second Partner Review (Engagement Quality)*
- *Quality Control*
- *Independence*
- *Audit Committee Communication*



Standard Setting

- **The Board has issued five auditing standards:**
 - PCAOB Auditing Standard No. 1 – Reference to the Board’s Standards in Audit Reports.
 - PCAOB Auditing Standard No. 2 – Audit of Internal Control (superseded).
 - PCAOB Auditing Standard No. 3 – Audit Documentation.
 - PCAOB Auditing Standard No. 4 – Reporting on Whether a Previously Reported Material Weakness Continues to Exist
 - PCAOB Auditing Standard No.5 – Audit of Internal Control
- **The Board has issued several interpretative rules, including Rule 3101 – also known as the “presumption rule”**
- **The Board has issued several independence rules**
- **An ED has been issued concerning the evaluation of consistency of financial statements in response to FAS 154.**



Rule 3101 – Certain Terms used in Auditing and Related Professional Standards

- Rule 3101 formalizes the concept that certain words in the professional standards have specific meaning.
- If the following words appear in a professional standard, whether PCAOB or pre-PCAOB, then the following guidance applies:
 - *“Must”, “shall” and “is required” – creates an unconditional responsibility for the auditor to perform and document these procedures*
 - *“Should” – presumptively mandatory. If not performed, the auditor must document why a “should” procedure was not performed*
 - *“May”, “might” and “could” – creates a responsibility for the auditor to consider performing these procedures*



Future Standard Setting

- Engagement Quality Control Review*
- Risk assessment process, including fraud risk assessment*
- Auditing fair values measurements and disclosures*
- Convergence of global auditing standards*
- Responsibility for fraud detection
- Auditing related party transactions
- The meaning of “to present fairly in accordance with US GAAP”
- Communications with audit committees
- Confirmation process
- Quality control



Other matters – My views

- Continued assessment of the interim standards
- More firms will have their non-public reports released to the public
- Small firm inspection process will continue to evolve to better reflect our model
- More “large” firms will evolve shifting more resources from smaller firms
- Mark-to-market will continue to be a major focus of regulators, including the PCAOB, especially with FAS 157 becoming effective next year



Questions



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