October 2012

A&A Update

The Technical Standards Update of Crowe Horwath International

From the Standards Setters

Scope of appropriate content, structure in auditor's report under debate

The IAASB is seeking feedback from investors, auditors and other interested parties on an Invitation to Comment (ITC) it issued in June on the auditor's report. Depending on where you are in the world, the changes to the IAASB standard auditor report will be viewed as ranging from marginal to radical, but it is increasingly apparent that change to the auditor's report is coming.

The question of the appropriate content and structure for the auditor's report was the subject of an IAASB round-table meeting in New York on 10 September. Participants in the roundtable expressed numerous concerns about, and objections to, some of the ITC's more controversial proposals, e.g. the requirement for an "auditor commentary." Another commonly held view by participants is that much of the information that would be required in the new standard auditor report should more appropriately come from management.

The ITC proposes that additional information in the auditor's report should be provided as "auditor commentary" to highlight matters that the auditor believes are likely to be most important to users' understanding of the audited financial statements or the audit. Auditor commentary would be required for entities, which at a minimum include listed entities, and could be provided at the auditor's discretion for other entities.

Hans Hoogervorst delivers speech entitled *The Concept of Prudence: dead or alive?*

Hans Hoogervorst, Chairman of the IASB, recently delivered a speech entitled *The Concept of Prudence: dead or alive?* at the Federation of European Accountants (FEE) Conference on Corporate Reporting of the Future in Brussels. Speaking about the removal of the concept of "prudence" from the IASB's Conceptual Framework in 2010, Mr Hoogervorst maintained that, despite its removal, the basic tenets of the concept remain intact and visible throughout IFRS.

The speech makes for interesting reading. To access the speech, click here

COSO seeks comment on internal control proposals

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is seeking public comment on a proposed document that explains how to apply its guidance to internal control over external financial reporting.

On September 18, COSO released an exposure draft of its Internal Control Over External Financial Reporting (ICEFR): Compendium of Approaches and Examples document. The proposed Compendium describes how the

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principles set forth in COSO's proposed Internal Control – Integrated Framework can be used to design, implement and conduct internal control over external financial reporting.

A revised version of COSO's updated Internal Control – Integrated Framework also was released along with an invitation for further comments.

These drafts incorporate input received earlier this year during a comment period that saw more than 200 organizations and professionals write to COSO.

The documents can be downloaded by clicking here.

Is convergence dead?

The FASB and IASB spent a decade working to converge U.S. GAAP and IFRS. The two sets of accounting literature have gotten much closer to each other, but important differences remain, and the leadership at both standard-setters no longer sees any value in aggressive efforts to come up with shared accounting principles if it means trampling on the interests of important constituents.

In August 2012, FASB Chairman Leslie Seidman told IASB Chairman Hans Hoogervorst that the model they'd developed together for marking down financial assets wouldn't work for U.S. banks. Three years of working side-by-side on the standard-setters' most important response to the 2008 financial crisis appeared to be falling apart. Hoogervorst, who had complained about the pressures pulling the boards in different directions, called the revelation "deeply embarrassing."

By the end of 2011, the chairmen of both the FASB and IASB said publicly that the almost monthly trips between Connecticut and London to set standards together were no longer viable.

Seidman and Hoogervorst are committed to wrapping up the remaining joint projects, but finishing the four projects—financial instruments, insurance contracts, lease accounting and revenue recognition will be no simple feat. The boards will have to accommodate different constituencies and address many complex issues.

From the Regulators

SEC adopts its long-awaited conflict minerals rule — 4 September 2012.

This matter was discussed in the September newsletter, but is repeated this month because of its expected wide-ranging impact. Readers should take care not to ignore this rule based on thinking that it will not impact your clients.

Although the reporting requirements are limited to SEC registrants, the information that will have to be gathered by SEC registrants, to determine (a) whether disclosures are required, and (b) what to disclose, will have to be gathered from the vendors in the SEC registrants' supply chain. Of course, the vast majority of such vendors will not be SEC registrants, and perhaps not listed companies at all, but they will be expected by their SEC registrant customers to provide the needed data.

To recap very briefly, the issue is the final rule adopted by the SEC to implement the "conflict minerals" provision set forth in Section 1502 of the Dodd-Frank Act. This Act requires annual disclosures by SEC-reporting companies if conflict minerals are necessary to the functionality or production of products they manufacture or contract to manufacture. Such companies (which are expected to be approximately half of all SEC registrants) are required to disclose annually in a special report whether any of those conflict minerals originated in the Democratic Republic of the Congo or an adjoining country. The report is due 31 May each year (regardless of the fiscal year of the SEC registrant) based on the previous calendar year activity. The rule is effective for years beginning 1 January 2013, and so the first reports are due 31 May 2014.

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If the conflict minerals originated in any of those countries, the companies will have to include in their report a description of the measures they took to exercise due diligence on the source and chain of custody of the conflict minerals. To implement these requirements, the SEC adopted new Exchange Act Rule 13p-1 and a new Form SD for the "specialized disclosure report" required by the new rule. Click here for more detail.

The rule is complex and will require significant analytical efforts to determine its full effects.

One provision of the rule worthy of further comment here is the requirement for an independent private sector audit (II E 3 in the rule). These audits may be attestation engagements performed by CPAs, or "performance audits" which may be performed by CPAs or others permitted to do so.

SEC seeks comments on PCAOB's Audit Committee Communications Standard – AS 16

The PCAOB release of AS-16 was discussed in this newsletter last month. In that report we noted that SEC approval of AS-16 is required before its provisions become effective, and that SEC approval is expected. However, as part of its process, the SEC has to solicit public comments on the PCAOB's proposed AS 16 before the SEC can approve it. On 10 September, the SEC issued its formal request for comment with a 21-day response time after the request for comment (Release No. 34-67807) appears in the Federal Register, a process that normally takes a few days following a rule's publication on the SEC's website. The SEC said it expects to make its decision on approving the rule in the next three months. This would be just in time to accommodate the PCAOB expectation that the standard would effective for audits that start after 15 December 2012.

PCAOB makes tentative progress on Chinese audit firm inspections

The PCAOB reached a tentative agreement to begin observing Chinese regulatory authorities during inspections of auditing firms in China as a kind of "trust-building exercise." This will not allow the PCAOB to begin inspections in China, but is viewed as a step in the right direction.

To learn more click here.

Headlines from around the world

Government exempts UK SMEs from statutory audit

Small UK businesses will be exempt from having a mandatory statutory audit as the government relaxes auditing and reporting requirements. The Department for Innovation Business and Skills (BIS) made recommendations that will allow more companies to make a commercial decision about whether or not to have a statutory audit.

The new regulations will align mandatory audit thresholds with accounting thresholds, meaning Small-and-Medium sized Enterprises (SME) will be able to obtain an exemption if they meet two out of three criteria relating to balance sheet total, turnover and number of employees. This change will allow approximately 36,000 companies to choose not to have an audit.

The government will also exempt most subsidiary companies from mandatory audit, as long as their parent company guarantees their liabilities, thus a further 83,000 subsidiary companies will benefit, while a further 67,000 dormant subsidiaries will no longer need to prepare and file annual accounts, provided they receive a similar guarantee.

Following consultation by the Financial Reporting Council on changes to UK GAAP, the government has also decided to allow companies that prepare their accounts under IFRS to move to UK GAAP to take advantage of reduced disclosures.

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JURI scraps mandatory firm rotation and audit-only firm proposals

Audit-only firms and mandatory rotation of audit firms, two of the significant proposals contained in the "Green Paper," have been scrapped by the European Parliament's Committee on Legal Affairs (JURI) in its latest revision to draft regulation.

On another significant point, JURI suggests that a Public Interest Entity (PIE) should be allowed to keep its auditor for a maximum of 25 years before mandatory re-tendering is required, a period of time much longer than the original proposal.

The JURI recommendations are presented to the Economic and Monetary Affairs Committee (ECON) which is then expected to give its opinion in November. A final text will then go to EU Parliament for debate possibly by the end of this year.

Lawmakers call for joint audits for listed companies

On 18 September, EU lawmakers proposed that listed companies should have two auditors, beefing up proposals to boost competition and standards in the audit market. The idea represents a significant addition to a draft EU law designed to improve the performance of auditors.

The legislation is also intended to end the dominance of the Big Four, but some there are those that doubt the plan as drafted will be supported by enough EU member states to be enacted, and believe a likelier outcome is a system of shared audits where the junior partner audits some subsidiaries.

Mid-tier company audit exemption dropped

The European Parliament rejected an amendment to the Accounting Directives which would have seen medium-sized companies no longer having to comply with the statutory audit requirement. The Legal Affairs Committee rejected the amendment, which was proposed by the UK government.

Not a headline per se, but interesting reading – Are checklists killing our profession?

"The accounting profession is rife with checklists. While this makes sense for a highly technical industry, there are drawbacks to using generic checklists because they can lead to shallow thinking."

Click here to read the article

Useful Links

- International Accounting Standards Board (IASB) www.iasb.org
- IASB Exposure Drafts open for comment www.iasb.org/Open+to+Comment/International+Accounting+Standards+Board+-+Open+to+Comment.htm
- International Auditing and Assurance Standards Board (IAASB) www.ifac.org/iaasb
- International Federation of Accountants (IFAC) www.ifac.org
- IFRS Interpretations Committee (IFRIC) www.iasb.org/Updates/IFRIC+Updates/IFRIC+Updates.htm
- Financial Accounting Standards Board (FASB) www.fasb.org
- Public Company Accounting Oversight Board (PCAOB) www.pcaob.org

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- American Institute of CPAs Auditing Standards Board (AICPA ASB) www.aicpa.org/InterestAreas/AccountingAndAuditing/Pages/AccountingandAuditing.aspx
- United States Securities and Exchange Commission (SEC) www.sec.gov
- European Commission (EC) ec.europa.eu/internal market/index_en.htm
- Forum of Firms (FoF) www.ifac.org/Forum_of_Firms
- Transnational Auditors Committee (TAC) www.ifac.org/TransnationalAuditors
- TAC Guidance Statement No. 1, Definition of Transnational Audit - web.ifac.org/download/TAC_Guidance_Statement_1.pdf
- UK Financial Reporting Council www.frc.org.uk

Published by Crowe Horwath International

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