PCAOB
Public Company Accounting Oversight Board

1666 K Street, NW
Washington, D.C. 20006
Telephone: (202) 207-9100
Facsimile: (202)862-8430
www.pcaobus.org

STANDING ADVISORY GROUP MEETING

POTENTIAL AUDIT IMPLICATIONS OF FASB-IASB JOINT PROJECTS AND RELATED EFFECTIVE DATES AND TRANSITION METHODS

MARCH 24, 2011

Introduction

At the March 24, 2011 meeting of the Standing Advisory Group ("SAG"), a Board member from the Financial Accounting Standards Board ("FASB") will provide an overview of the:

- Updated FASB standard-setting agenda, including re-prioritization of key projects;

- Implications to the volume and pace of proposed FASB standards as a result of FASB's project re-prioritization, including feedback that the FASB received on the transition and effective dates of its proposed standards; and

- Key audit and operational issues raised in comment letters and at recent FASB roundtables held on revenue recognition, leases, and financial instruments.

The joint projects of the FASB and International Accounting Standards Board ("IASB") expected to be completed during 2011 ("joint projects") may result in significant changes for preparers and users. The joint projects may also require preparations by audit firms necessary for the adoption of the joint projects. Further, the effective dates and transition methods that the FASB and IASB specify for the joint projects may have additional implications for auditors.

After the FASB Board member overview, SAG members will have an opportunity to provide feedback regarding the audit implications of FASB's revised timeline and project re-prioritization. To facilitate the discussion among SAG members of the potential audit implications of the joint projects, this briefing paper:

- Provides an overview of the FASB's discussion paper, *Effective Dates and Transition Methods* ("FASB's Discussion Paper"),[1/]

- Describes potential audit implications raised in comment letters to the FASB on its joint projects and on its upcoming decision on effective dates and transition methods,[2/] and

- Describes how decisions regarding effective dates and transition methods might have implications for the PCAOB.

Background

At the July 15, 2010 SAG meeting, a panel discussed the joint projects and their potential impact on auditors.[3/] The purpose of that discussion was to help inform OCA staff of the SAG's views on the auditing challenges of, and the potential need for new or

---

[1/] See FASB Discussion Paper, *Effective Dates and Transition Methods*, available at: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175821547400&blobheader=application%2Fpdf. The IASB simultaneously issued its *Request for Views on Effective Dates and Transition Methods*, available at: http://www.ifrs.org/NR/rdonlyres/00843740-4E15-40A8-A7EF-8B634F904B46/0/RequestViewsNFDOct10.pdf.

[2/] This SAG discussion is not intended to address potential audit implications associated with the decision by the Securities and Exchange Commission ("SEC") whether or how to incorporate IFRS into the U.S. financial reporting system (e.g., the auditability and enforceability of IFRS; audit regulation and standard setting, and auditor capacity) as discussed in *Commission Statement in Support of Convergence and Global Accounting Standards* (February 24, 2010), available at: http://www.sec.gov/rules/other/2010/33-9109.pdf. The SEC staff has indicated that it will consider such auditing implications as part of its Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System.

[3/] See July 15, 2010 SAG Briefing Paper and related FASB presentation slides, available at: http://pcaobus.org/News/Events/Pages/07152010_SAGMeeting.aspx.

revised auditing standards or staff guidance. The panel discussion took place in response to the potential upcoming changes to U.S. generally accepted accounting principles ("GAAP") and International Financial Reporting Standards ("IFRS") that might occur as a result of certain FASB/IASB joint projects.

At the October 13-14, 2010 meeting, the SAG continued its discussion of the potential challenges to auditors arising from certain proposed FASB/IASB joint projects and other FASB standard-setting activities. The SAG discussion focused primarily on the following proposed FASB accounting standards updates ("ASU"):[4/]

- FASB Proposed ASU, *Revenue from Contracts with Customers*,[5/]
- FASB Proposed ASU, *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*,[6/]
- FASB Proposed ASU, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities,*[7/] and
- FASB Proposed ASU, *Disclosure of Certain Loss Contingencies*.[8/]

[4/] See October 14, 2010 SAG Briefing paper available at: http://pcaobus.org/News/Events/Documents/10132010_SAGMeeting/Briefing_Paper-FASB_Projects.pdf.

[5/] The proposed ASU is available at: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf.

[6/] The proposed ASU is available at: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820873224&blobheader=application%2Fpdf.

[7/] The proposed ASU is available at: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820761372&blobheader=application%2Fpdf.

[8/] The proposed ASU is available at: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175821001041&blobheader=application%2Fpdf.

The SAG discussed certain potential audit-related challenges that may arise from these proposed FASB ASUs including the increased use of fair values, estimates and judgments; increased emphasis on disclosure objectives and related disclosure principles; and changes in accounting disclosure requirements for contingencies.

Overview of the FASB's Discussion Paper

The FASB's Discussion Paper solicited information about the expected time and effort involved in properly adapting to the new accounting requirements, and the implementation timetable and sequence of adoption that facilitates cost-effective management of the changes.[9/]

Effective Dates

The FASB's Discussion Paper described two broad implementation approaches for the effective dates[10/] relating to the requirements of the joint projects, including:

- A single-date approach – All of the requirements of the joint projects would become effective as of the same date, following an appropriate implementation period ("the big-bang approach")[11/], or

---

9/ See paragraph 8 of the FASB's Discussion Paper. Additionally, paragraph 12 of the FASB's Discussion Paper notes that in order that comment letters be prepared consistently, the FASB asked respondents to provide feedback without regard to the possibility of IFRS being incorporated into the U.S. reporting system. The level of convergence achieved with IFRS and the timing of any transition to IFRS could be significant factors in the cost of adopting the requirements of the joint projects. The FASB's Discussion Paper noted that the FASB may need to reconsider the effective dates and transition methods once the SEC has made its determination regarding the incorporation of IFRS into the U.S. financial reporting system.

10/ New accounting standards often provide for an effective date of 12-18 months after the date the standard is issued. See FASB/IASB *Progress Report on Commitment to Convergence of Accounting Standards and a Single Set of High Quality Global Standards* (November 29, 2010), available at: http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176157955243.

11/ A single-date approach was used for the adoption of IFRS in the European Union. Public companies were required to prepare financial statements for

- A sequential approach – Each new ASU or an appropriate group of new ASUs would become effective as of different dates spanning a number of years ("the sequential approach").[12/]

Requiring the same effective date for comparable IFRS and U.S. GAAP requirements would further enhance comparability.[13/] Such a requirement also may affect implementation costs. For example, a common effective date might simplify implementation for multinational entities and make it easier for investors and other users to make comparisons between U.S. and international entities.[14/]

The FASB's Discussion Paper also sought comment as to whether the FASB should permit early adoption of the requirements of the joint projects.[15/] Permitting early adoption can allow earlier reporting of improved information while reducing implementation costs by timing the adoption of new standards to coincide with other business changes.[16/] However, the primary disadvantage of early adoption is that it reduces comparability across companies.[17/]

Transition Methods

The FASB's Discussion Paper outlined three possible transition methods for the joint projects:

---

years beginning on or after January 1, 2005 using IFRS. See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002R1606:EN:HTML.

12/ See paragraph 22 of the FASB's Discussion Paper.

13/ See paragraph 25 of the FASB's Discussion Paper.

14/ Ibid.

15/ See paragraph 24 of the FASB's Discussion Paper.

16/ Ibid.

17/ Ibid.

- Retrospective application, which applies the new accounting principle to one or more previously issued financial statements as if that principle had always been used,[18/]

- Limited retrospective application, which would limit the extent to which companies need to revise previously issued financial information for practicability reasons,[19/] and

- Prospective application, which would apply the new accounting principle to transactions, other events and conditions occurring after the date on which the accounting principle is adopted.[20/]

The FASB and IASB generally utilize a retrospective application of new accounting principles unless it is impracticable to do so. However, as indicated below, each new accounting standard might require a specific transition method.[21/] The transition method used would directly affect the time, effort, and cost of adopting the requirements of the joint projects. For example, a full retrospective transition requires more effort than a prospective transition.

Users of financial statements often prefer that companies apply requirements of new accounting standards retrospectively to all periods presented to facilitate comparison of results.[22/] However, many preparers of financial statements note that retrospective application can sometimes be costly and, in some cases, impracticable (such as when the information needed for prior periods is not available).[23/]

18/ See e.g., FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.

19/ See paragraph 17 of the FASB's Discussion Paper.

20/ See FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Correction*, and International Accounting Standard No. 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

21/ Ibid.

22/ See paragraph 16 of the FASB's Discussion Paper.

23/ Ibid.

The FASB's Discussion Paper also noted that application of the retrospective method might be facilitated by delaying the effective date to allow issuers to cost effectively accumulate the data needed to produce comparative information.[24/] Additionally, the FASB's Discussion Paper identified the FASB's tentative decisions regarding the transition methods for the FASB/IASB joint projects as follows:[25/]

Project	**Transition Method**
Accounting for financial instruments	Retrospective
Other comprehensive income	Retrospective
Fair value measurement	Limited retrospective
Revenue recognition	Retrospective
Leases	Limited retrospective
Netting financial instruments	To be decided
Consolidation: investment companies	Prospective
Financial statement presentation	Retrospective
Financial instruments with characteristics of equity	To be decided
Accounting for insurance contracts	To be decided

24/ See paragraph 20 of the FASB's Discussion Paper.

25/ See paragraph 18 of the FASB's Discussion Paper.

At the joint FASB/IASB meeting on March 2, 2011, the FASB and IASB staff presented a summary of the comment letters and constituent feedback received.[26/] Among other things, the FASB and IASB staff analysis of the comment letters noted:

- IASB stakeholders had a strong preference toward the single-date approach, while approximately equal numbers of FASB stakeholders supported the sequential and single-date approach.

- Many FASB respondents expressed support for prospective application of the joint projects, while the majority of IASB respondents tended to agree with the proposed transition methods specified in the joint projects.

The FASB and IASB have not reach any decisions, and intend to discuss the effective dates and transition methods at a future meeting.[27/] The FASB and IASB directed their staff to obtain additional input from investors and other users about what transitional disclosures might be needed to help users understand the effect of the new requirements and develop recommendations for consideration at a future meeting.[28/]

Potential Audit Implications Raised in Comment Letters to FASB on Joint Projects, Effective dates, and Transition Methods

This section summarizes certain potential audit implications raised in comment letters to FASB on joint projects, effective dates, and transition methods.

[26/] A summary of the meeting is available at: http://www.fasb.org/cs/ContentServer?site=FASB&c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FActionAlertPage&cid=1176158285204 and http://media.iasb.org/IASBupdate1and2march2011.html#1. Meeting handouts included a comment letter summary prepared by the FASB and IASB staff and are available at: http://www.ifrs.org/Meetings/IASB+FASB+2+March+2011.htm.

[27/] Ibid.

[28/] Ibid.

Potential Audit Implications Associated with the Joint Projects

Some of the comment letters from accounting firms noted that, among other things, accounting firms anticipate undertaking the following activities in response to the joint projects:[29/]

- Develop internal training on the requirements of the joint projects,
- Develop audit approaches and update firm audit methodologies, including the creation of new audit programs and audit tools,
- Train auditors to understand and apply the requirements of the joint projects and to audit financial statements prepared using the requirements of the joint projects, and
- Monitor implementation issues and emerging industry practices.

Some of these comments letters also suggested that training auditors to audit financial statements prepared using the requirements of the joint projects could require significant effort and investments by accounting firms. In addition, that effort may also require lead time before the commencement of the effective dates to allow accounting firms adequate time to be prepared.[30/]

[29/] See e.g., comment letters from KPMG IFRG Limited, BDO IFR Advisory, PricewaterhouseCoopers LLP, McGladrey & Pullen LLP, Deloitte & Touche LLP, Ernst & Young LLP, Crowe Horwath LLP, Grant Thornton LLP available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

[30/] See e.g., comment letter from Ernst & Young LLP noting "[w]e expect to need approximately 18 months from the time a final standard is issued to develop our interpretive guidance and training materials and train our professionals" available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

In addition, comment letters from accounting firms also identified procedures that individual audit engagement teams would need to perform following issuers' adoption of the requirements of the joint projects, including:[31/]

- Understanding the client's interpretation and application of the requirements of the joint projects (e.g., modifications and renegotiations to existing revenue contracts)
- Considering industry applications and emerging industry issues
- Understanding relevant guidance issued by regulatory bodies (e.g., banking regulators and the Internal Revenue Service)
- Understanding and evaluating the information systems developed by issuers to capture information necessary to apply the new standards and changes to internal control over financial reporting

Potential Audit Implications Associated with Decisions Regarding Effective Dates of the Joint Projects

Accounting firms also commented that the potential impact to accounting firms resulting from the effective dates of the joint projects to be selected by the FASB, includes the following:[32/]

- A decision to require a sequential application of the requirements of the joint projects could allow accounting firms more time to develop accounting and auditing interpretations and update their quality control systems.

[31/] See e.g., comment letters from KPMG IFRG Limited, BDO IFR Advisory, PricewaterhouseCoopers LLP, McGladrey & Pullen LLP, Deloitte & Touche LLP, Ernst & Young LLP, Crowe Horwath LLP, Grant Thornton LLP available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

[32/] See e.g., comment letters from Ernst & Young LLP, KPMG IFRG LLP, BDO IFR Advisory, PricewaterhouseCoopers LLP and Grant Thornton LLP available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

- While permitting early adoption might reduce the comparability of financial reporting for users, it could also allow issuers to identify implementation issues earlier. The earlier implementation issues are identified, the faster they can be resolved and diversity in practice can be reduced.[33/]

- A decision to allow the early adoption of the requirements of the joint projects might also require issuers to early adopt certain standards simultaneously due to their interrelationships. For example, *Revenue from Contracts with Customers* and *Leases,* may need to be adopted together because contracts have both lease and revenue components and are therefore interrelated.

Potential Audit Implications Associated with Decisions Regarding Transition Methods of the Joint Projects

Accounting firms also commented on the potential impact to accounting firms resulting from the transition method for the joint projects to be selected by the FASB, including:[34/]

33/ Although auditing firms generally indicated that time was needed to prepare for audits of financial statement prepared using the requirements in the joint projects, there was less agreement as to whether early adoption should be permitted. Among other things, comment letters noted "[w]e generally believe that early adoption should not be permitted for significant standards" (Ernst & Young LLP); "[w]e believe all entities should be permitted to early adopt any of the future proposed standards" (Deloitte & Touche LLP); "[g]enerally, we do not think the Board should allow early adoption of the new standards" (Grant Thornton LLP); "[w]e do not believe that early adoption of these standards should be permitted for public companies, although it may be acceptable for private companies" (McGladrey & Pullen LLP); and "[w]e believe there should be an option to early adopt all standards with no restrictions around applying standards in groups" (PricewaterhouseCoopers LLP). Comment letters are available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

34/ See e.g., comment letters from Grant Thornton LLP, PricewaterhouseCoopers LLP, Ernst & Young LLP, and BDO IFR Advisory available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100.

- A full retrospective application could challenge an auditor's ability to obtain sufficient appropriate audit evidence for financial statements and the related disclosures.[35/] For example, availability of sufficient appropriate audit evidence could be limited under a retrospective approach (e.g., increasing the potential for the inappropriate use of hindsight).

- A limited retrospective or prospective approach could also alleviate some of the concerns associated with a full retrospective application.

Potential Audit Implications For Smaller Accounting Firms

The concerns raised in the comment letters might have added significance for smaller accounting firms.[36/] For example, smaller accounting firms: might not be able to make the necessary changes if the FASB were to permit early adoption of the joint projects; might face problems from the anticipated increase in audit procedures and the potential for increased fees; and might face additional risks of misstatement as smaller issuers may face challenges with training staff and making changes to controls.

Potential Implications for the PCAOB

The completion of the FASB/IASB joint projects during 2011, including a decision on the effective dates and transition methods, could impact the need for revised or additional audit guidance and alter the timing of the PCAOB's current standard-setting agenda.[37/] However, potential audit-related challenges resulting from the joint projects may not be able to be resolved through changes to auditing standards. Further, while it is likely that the joint projects will have an impact on PCAOB's inspections, it is difficult

---

35/ PCAOB auditing standards require auditors to obtain sufficient appropriate audit evidence. See paragraph 4 of Auditing Standard No. 15, *Audit Evidence*.

36/ Smaller accounting firms may not typically provide comment addressing the auditing implications of proposed accounting standards. OCA staff would like to obtain feedback from the SAG on smaller accounting firm considerations.

37/ As noted in the FASB Staff's *Comment Letter and Constituent Feedback Summary*, available at: http://www.ifrs.org/Meetings/IASB+FASB+2+March+2011.htm, the "majority of respondents representing the auditing profession do not believe the new standards will give rise to a need for changes in the auditing standards. However, those respondents do believe that the principal challenge from an auditing perspective will be auditing areas where the new standards require management to make new estimates."

to anticipate what the ultimate impact will be (e.g., modify or expand risk analysis models, adjust inspection methodology, or augment the expertise of staff).

Discussion Topics

SAG members will have an opportunity to provide feedback regarding the FASB's revised timeline and the re-prioritization of the joint projects. After that discussion, the SAG members will have an opportunity to provide feedback regarding the following matters:

- Potential audit implications resulting from the joint projects, including:

  - Accounting firm preparation and changes that may be necessary to quality control systems to prepare for adoption of the joint projects by issuers (e.g., steps necessary for audit quality in light of a potential increased workload resulting from fundamental changes to U.S. GAAP).

  - Whether auditors will be able to address the risks of material misstatement due to the new requirements of the joint projects, including whether those risks of material misstatement are greater for smaller issuers.

  - Implications of the FASB and IASB decisions regarding effective dates and transition methods of the joint projects on audit firm preparations (e.g., single-date or sequential approach).

- Potential challenges to the timely issuance and implementation of new or revised PCAOB auditing standards or guidance and challenges to PCAOB inspection activities.

* * * * *

The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.