

PKF PERSPECTIVES

PCAOB Proposes New Auditing Standard: COMMUNICATIONS WITH AUDIT COMMITTEES

The Public Company Accounting Oversight Board (PCAOB or “the Board”) has issued PCAOB Release No. 2010-001 which proposes an auditing standard superceding interim standard AU sec. 380, *Communication with Auditing Committees*, and AU sec. 310, *Appointment of the Independent Auditor*. The proposed standard would carry forward all the required communications in AU sec. 380.

The comment period ends May 28, 2010 and thereafter the proposed standard and amendments will be submitted to the Securities and Exchange Commission (SEC).

The Sarbanes-Oxley Act of 2002 mandated that audit committee requirements be complied with by issuers, including:

- independence of audit committee members;
- audit committee’s responsibility to select and oversee the issuer’s independent accountant;
- authority of the audit committee to engage advisors; and,
- funding for the independent auditor and any outside advisors engaged by the audit committee.

The term “audit committee” as used by the PCAOB refers to:

a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and

audits of the financial statements of the company; if no such committee exists with respect to the company, the term refers to the entire board of directors of the company.

The audit committee plays an important role in protecting the interests of investors: it assists the board of directors in fulfilling its responsibility to shareholders and others in overseeing the integrity of the financial statements and financial reporting process.

Thus, the more well-informed an audit committee is about accounting and disclosure matters the better able it may be to carry out its role. Effective **two-way** communication between the auditor and the audit committee on the auditor’s evaluations of matters that are significant to the financial statements might also benefit the auditor.

PCAOB Acting Chairman Daniel L. Goelzer said:

The proposed standard on audit committee communications is intended to enhance the relevance and effectiveness of the communications between an auditor and audit committee throughout the course of an engagement.

The Board’s primary objectives in proposing the new standard are to:

- (1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee; and,
- (2) emphasize the importance of effective, two-way communications between the

auditor and the audit committee to better achieve the objectives of the audit.

Factors influencing the development of the new standard include:

- increased use of risk-based audit methodologies;
- emphasis on judgments and estimates in financial reporting; and,
- improvement of communications by the auditor to the audit committee in the areas of disclosures and critical accounting estimates.

Addressing these factors, the PCAOB drafted the proposed standard encompassing the following:

- Setting forth requirements regarding the auditor's overall communication responsibilities with the audit committee that are applicable to all audits conducted in accordance with PCAOB standards.
- Including an appendix identifying other PCAOB standards and rules that require auditor communication with the audit committee about specific matters.
- Requiring the auditor to communicate to the audit committee the significant risks identified giving the committee an opportunity to understand the auditor's view of the most important risks of material misstatements.
- Affording the audit committee the opportunity to communicate to the auditor its views relating to those risks based on the committee's knowledge of the company.
- Understanding of the audit committee's view of the company risks could assist the auditor in the development of an audit strategy, possibly resulting in an improvement in audit quality.
- Requiring the auditor to communicate to the audit committee the evaluation of the quality of

the company's accounting policies, practices and estimates underlying the financial results.

- Requiring the auditor to communicate their evaluation of the company's ability to continue as a going concern.
- Providing the audit committee timely communications from the auditor in order to give the committee the opportunity to make informed decisions and take action.

In summary, the main focus of this proposed standard is to enhance the two-way communication between the auditor and the audit committee.

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Over the years, PKF has endeavored to communicate with its client audit committees on the level proposed by this PCAOB standard and will continue to do so.

We will let you know when the proposed audit standard is approved by the SEC. In the meantime, please do not hesitate to contact us.

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