International Impacts on State Boards

(IFRS, EC Directive, MRAs, etc.)

NASBA 2012 Regional Meetings

June 15th – Philadelphia

W. Michael Fritz · Gaylen R. Hansen

June 28th – Anchorage

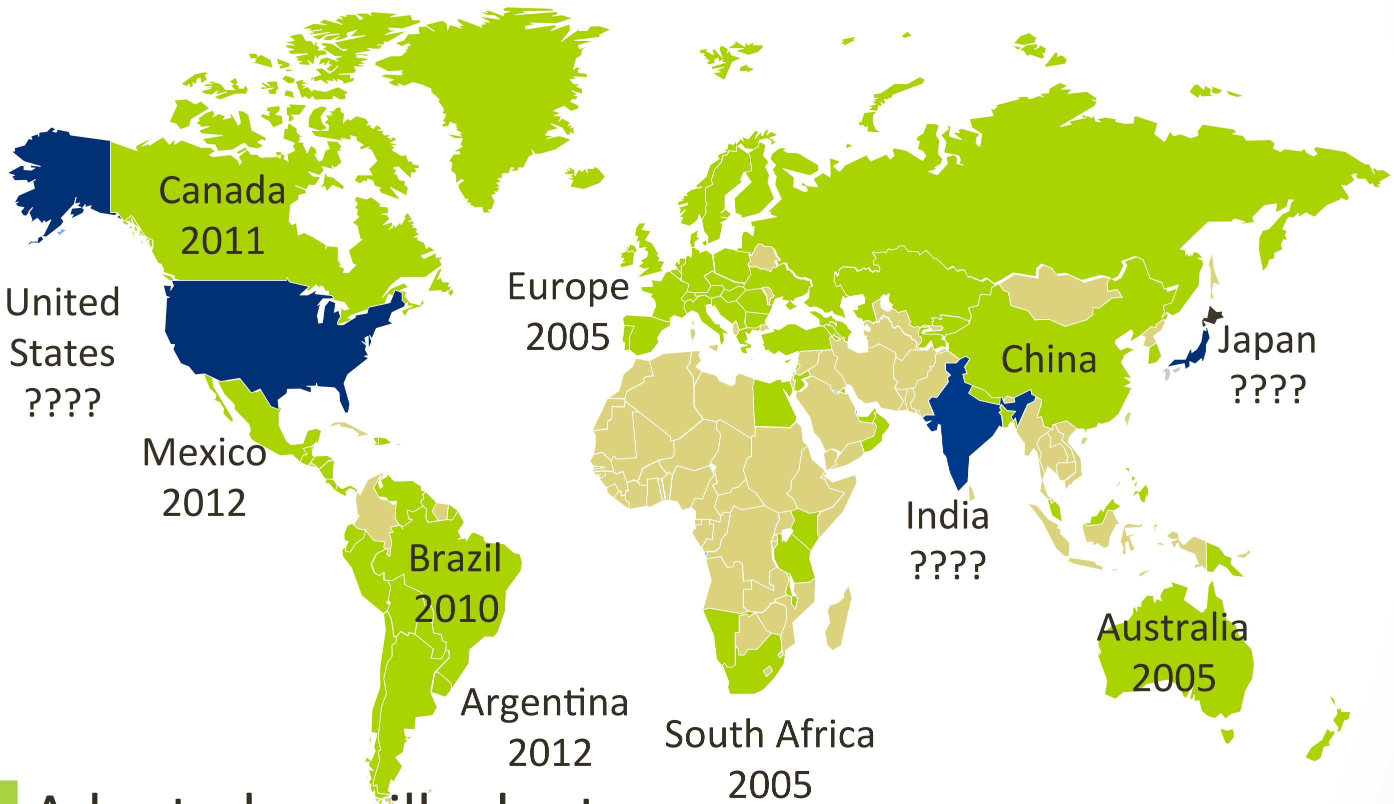
Ruben A. Davila · Gaylen R. Hansen

International Financial Reporting Standards

IFRS

Current Landscape: Use of IFRS

- IFRSs are used to some extent in over 100 countries



Adopted or will adopt
Developing plans to adopt or converge
No plans or unknown

Current Landscape: IFRS in the U.S.

- SEC issued a formal Statement in February 2010
  - Supportive of a single set of global accounting standards
  - IFRS is best positioned
  - Initiated a “Work Plan” and committed to regular reports
- A number of staff papers issued over the last 2 years
  - Explaining a possible approach for IFRS incorporation
  - Observations of IFRS in practice
  - Differences between IFRS and US GAAP
- Final staff report expected in the next few weeks
- Staff recommendation to follow the final staff report
- Commission action uncertain at this time

Updated IASB Work plan

Project	Exposure Draft	Final Standard
General hedge accounting	Q2 2012	Q4 2012
Macro hedge accounting	Q4 2012	2015
Impairment	Q4 2012	2013
Amendments to IFRS 9:Classification & Measurement	Q4 2012	2013
Insurance contracts	Q4 2012	2013/2014
Leases	Q4 2012	2013/2014
Revenue recognition	Q4 2011	2013
Consolidation - investment entities	Q3 2011	Q4 2012

IFRS Developments

- Revenue Recognition
  - New model based on transfer of control to the customer
  - Comment period ended on 13 March 2012
  - Approximately 350 comment letters received
  - Redeliberations will commence in July
- Leases
  - New lessee and lessor models developed
    - Operating leases would be eliminated
    - Receivable and residual approach for lessors
  - Boards discussing pattern of expense recognition for lessees
  - Boards may reopen lessor accounting

IFRS Developments

- Financial Instruments - project is in 4 phases: classification and measurement, impairment, offsetting and hedge accounting
  - Classification and measurement – IASB and FASB discussing ways to converge
  - Impairment – an expected loss model based on a three-bucket approach
  - Offsetting – final amendments issued last year that clarified IAS 32 and added additional disclosure requirements
  - General hedge accounting – staff draft expected to be posted shortly to IASB website for comments
  - Macro hedge accounting – discussions recently began on hedging portfolios

IFRS Developments

- Insurance
  - Progress has been made but areas of non-convergence exist
  - Boards will likely go their own ways
- Consolidation – Investment Entities
  - Comment period on exposure draft ended on 5 January 2012
  - Controlled investments held by "investment entities" measured at fair value rather than consolidated
  - Areas of non-convergence exist
    - The IASB would not extend the exemption from consolidation to a parent entity that is not itself an investment entity

EC Proposed Regulation & Directive on Auditing

Timeline

- Oct 2010 – EC issues a "Green Paper"
  Audit Policy: Lessons from the Crisis
- Feb 2011 – Brussels Conference
  Financial reporting and auditing. A time for change?
- May 2011 – "White Paper" Report to Parliament
- Nov 2011 – Draft Legislation
  - Regulation for PIEs (required)
  - Directive for non PIEs (some member state discretion allowed)
- Q4 2012? – Discussion & Finalization

Overview of Draft Legislation

- Rules for statutory audits
  - Directive
- Stricter audits of Public Interest Entities (PIEs)
  - Regulation
  - PIEs = listed companies, financial institutions, insurers

Statutory Audits (Not PIEs)
Main Measures

- Liberalize firm ownership rules
- IFAC audit standards required (ISAs)
- Prohibit “Big 4 only clauses”
- “Simplified audits” of Small/Medium Size Entities (SMEs)
  - Not a “Statutory Audit”
  - *Application of auditing standards proportionate to scale and complexity of the business of SMEs*

PIE Audits
Main Measures

- Non-audit services largely prohibited
- Pure audit-only firms
- Audit report
- Additional report to audit committee
- Communication with regulators of PIEs
- Audit committees
- Audit firm rotation
- Contingency planning

PIE Audits
Categories of Non-Audit Services

1. White List - Related financial audit services
   - Always allowed
   - Audits or reviews of interim F/S, assurance on corporate governance
   - Fees limited to 10% of total fees paid by the client

2. Black List – Prohibited services
   - Prevent “conflicts of interest”

3. Grey List - Services permitted with regulatory or audit committee approval

PIEs: Non-Audit Services
Black List

- Expert services unrelated to the audit
- Bookkeeping/preparing accounting records or F/S
- Design/implementing internal control/risk mgmt
- Valuation, fairness, contribution in-kind reports
- Actuarial services, including resolution of litigation
- Internal audit services
- Broker or dealer, investment adviser or banking

Note: these prohibitions are generally consistent with SEC rules and the AICPA Code of Professional Conduct

PIEs: Non-Audit Services
Grey List

Services after approval by Audit Committee

- Human resources services, recruiting senior management
- Comfort letters for investors in the issuance of securities

Services after approval by "competent authority" (regulator)

- Design/implement financial information technology systems
- Due diligence services to the vendor or buy side on M&A transactions and providing assurance on the audited entity to other parties

Note: these positions above are generally consistent with SEC rules and the AICPA Code of Professional Conduct with the following exceptions:
• SEC rules prohibit HR services and systems design/implementation services

PIEs: Pure Audit-Only Firms

Two cumulative geographic requirements

1. National criterion: > 1/3 of annual audit revenues from Large PIEs
2. European criterion: Belonging to a network whose members have combined annual audit revenues > €1.5B within EU (from PIEs and non-PIEs)

Large PIE

- The 10 largest issuers of shares in each member state by market cap
- All issuers of shares with an average market cap of more than €1B

Note: these proposals are clearly aimed at the large firms in an attempt to reduce firm concentration.

PIEs: Pure Audit-Only Firms
Consequences

- Firm can't belong to a network providing non-audit services in the EU
- Any entity providing non-audit services can't have > 5% of capital or voting rights in the audit-only firm
- Audit-only firm can't have > 5% of capital or voting rights in an entity providing non-attest services

PIEs: Audit Report Content

1. Audit methodology
   - Portion of B/S directly verified
   - Portion based on system vs. compliance testing
2. Level of substantive and compliance testing compared to prior year
3. Details about materiality
4. Key areas of risk of material misstatement
   - Critical accounting estimates
   - Areas of measurement uncertainty

PIEs: Audit Report Content *(continued)*

5. Statement on "situation" of audited entity, especially ability to continue as a going concern
6. Internal control assessment
7. Extent audit designed to detect irregularities, including fraud
8. Violations of accounting rules, laws, articles of incorporation
9. Audit opinion
10. Emphasis of a matter

PIEs:
Additional Report to Audit Committee

Internal report with possibility to provide it to management

- *Additional information, such as*
  1. Appointment procedure
  2. Judgments about material uncertainty in going concern assessment
  3. Details on bookkeeping, accounting, audited documents
  4. Non-compliance involving non-material occurrences
  5. Details of guarantees, comfort letters, undertakings relied upon in going concern assessment
  6. Whether all requested explanations and documents were provided by the client

PIEs:
Additional Report to Audit Committee

Report promptly any fact or decision regarding

1. Material breach of rules governing a PIE
2. Impairment of going concern conclusion
3. Auditor's refusal to certify F/S or expression of reservations

PIEs: Audit Committees

- *All members non-executives, at least one with competence in auditing and another in accounting and/or auditing*
- *Majority of members independent*
- *New Tasks*
  1. Supervise completeness and integrity of drafts of audit reports
  2. Selection procedures of the auditor and recommendation
  3. Authorize non-attest services on the Grey List

PIEs: Audit Firm Rotation

- 2 year minimum duration of statutory audit
  - Renewable only once
- Maximum duration of the combined 2 engagements: 6 years
  - 9 years if a joint audit
- Exceptional circumstances subject to regulator approval: extend duration to 8 years
- Cooling off period 4 years
- Partner rotation every 7 years with a 3 year cooling off period

PIEs: Contingency Planning

- Identify measures to avoid disruption
- Indicate level of liability of each partner
  - Extent to which legal liability can spread to other firms in same network
- Identify measures to prepare an orderly failure of the firm

Mutual Recognition Agreements

Agreements Developed by the NASBA/AICPA International Qualifications Appraisal Board

What is a Mutual Recognition Agreement (MRA)?

A reciprocal agreement between governments or non-governmental professional bodies that indicates acceptance of the equivalence, compatibility or acceptability of the other jurisdiction's regulatory standards for a particular group of licensees.

What MRAs are in place?

U.S. IQAB has effected MRAs with the following:

Under GATS:

- The Institute of Chartered Accountants in Australia
- The Institute of Chartered Accountants in Ireland
- The New Zealand Institute of Chartered Accountants
- Hong Kong Institute of Certified Public Accountants

Under NAFTA:

- The Canadian Institute of Chartered Accountants
- The Instituto Mexicano de Contadores Publicos

Appraisals are in progress or have been considered from several other countries including the United Kingdom, the Philippines, South Africa, and India.

U.S. International Qualifications Standards

The laws of many states authorize the granting of a reciprocal certificate or license to an accountant of another jurisdiction provided *“that the standards under which the applicant was certified or otherwise authorized to practice public accountancy were at least as high as the standards of this state at the time that authority was granted.”*

U.S. IQAB, acting on behalf of the state boards, has established a process for conducting appraisals using criteria comparable to those which U.S. CPAs must meet to become certified.

U.S. International Qualifications Standards – *con't*.

U.S. IQAB uses the "three Es" to appraise the standards of a foreign jurisdiction's accountancy body against those that U.S. CPA candidate must satisfy:

- Education:
  - Baccalaureate or graduate degree, or its equivalent
  - At least 150 semester hours of quarter-hours equivalents in Board-recognized courses
- Examination: Pass the Uniform CPA Examination
- Experience: Meet the work experience requirement

Why Recognition Is Important

In a global economy, international reciprocity in professional licensure facilitates the flow of professional services across international borders.

How can Recognition be Granted?

- Unilaterally - recognition of criteria-standards and regulations is not reciprocal but becomes equivalent to the jurisdiction's own

- Bilaterally - between two jurisdictions whereby each recognizes the regularity jurisdiction of the other for the profession in question

- Plurilaterally - between two or more economies (rare), involving the same process but for several jurisdictions

Who enters into MRAs?

- GOVERNMENTS

  National Level – in a unitary system

  State/Provincial level – in a federal system

- INDUSTRY or TRADE ASSOCIATIONS

Benefits of Recognition

- Increases market access for professional service providers
- Facilitates mutual learning
- Elevates professional standards
- Helps economies to exchange regulatory experiences
- Improves quality and uniformity of domestic regulatory measures

The GATS Article vii: Recognition

Neither encourages nor promotes, but allows a WTO member to recognize “education or experience obtained, requirements met, or licenses or certification granted”

Says nothing about the substance of recognition itself – provides procedural framework

The GATS Article VII: Recognition

CONSTRAINTS

Requires a WTO member entering into an MRA to give other interested members the opportunity to negotiate their accession to such an agreement.

Stipulates that a WTO member may not discriminate between countries or restrict trade in applying its standards or criteria for authorization of licensees or certifications.

What was the International Qualifications Examination (IQEX)?

- Was an examination that evaluated the professional competence, from a U.S. perspective, of accountants from foreign jurisdictions determined by U.S. IQAB to have education, examination, and experience standards substantially equivalent to those of U.S. CPAs

- IQEX beginning in November 2012, will be replaced by the REG section of the Uniform CPA Examination. IQEX candidates will be able to take the section in the second month of each testing window.