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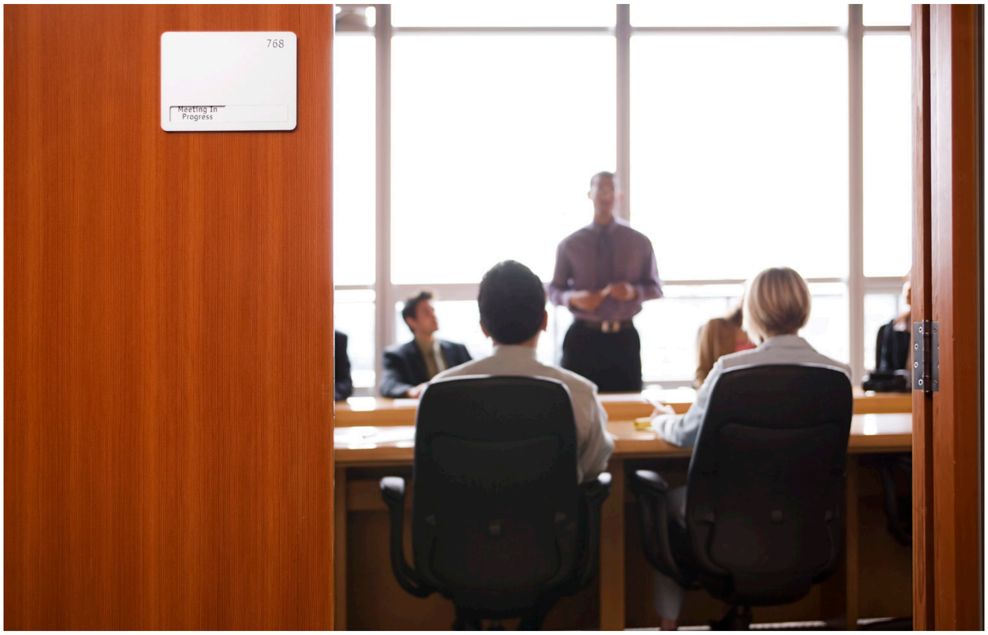

PCAOB AUDIT COMMITTEE DIALOGUE AND OTHER RESOURCES

As part of its focus to engage stakeholders in improving the quality of corporate governance and in response to requests from public company audit committees, the Public Company Accounting Oversight Board (PCAOB) is finding new ways to share insights from its oversight activities.

In May 2015, the PCAOB introduced a new digital outreach communication vehicle to audit committees - the "*Audit Committee Dialogue*." This first communication, in what is expected to be a series, highlights insights from PCAOB inspections of public company auditing firms, specifically discussing recurring areas of concern and emerging risks related to merger & acquisition activity, falling [fluctuating] oil prices, and undistributed foreign earnings. For each of these areas, the PCAOB has included several targeted questions audit committees may want to consider asking their auditors. Additionally, these targeted questions may also be helpful in discussions with company management, in particular as they relate to emerging risk areas.

BDO INSIGHT:

While the PCAOB's guidance is primarily focused on questions to be posed to external auditors, audit committees may consider customizing such questions to be posed, as appropriate, to both management and the internal auditors to enhance the audit committees' understanding of their company's financial reporting processes, controls and related risks prior to directing such questions to the external auditors.

The following is a summary of the areas identified by the PCAOB and the related questions audit committees may ask their auditors. Refer to the PCAOB *Dialogue* for the complete communication.

BDO USA CORPORATE GOVERNANCE PRACTICE

BDO USA's Corporate Governance Practice was developed to provide guidance to corporate boards. The firm works with a wide variety of clients, ranging from entrepreneurial businesses to multinational Fortune 500 corporations, on a myriad of accounting, tax, risk management and forensic investigation issues.

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KEY RECURRING AREAS OF CONCERN

	Questions Audit Committee May Pose to Auditors
Auditing internal controls over financial reporting (ICFR)	▶ What are the points within the company's critical systems processes where material misstatements could occur? How has the audit plan addressed the risks of material misstatement at those points? How will your auditor determine whether controls over those points operate at a level of precision that would prevent or detect and correct a potential material misstatement? ▶ What is your auditor's approach to evaluating the company's controls over financial reporting for significant unusual transactions or events, such as the acquisition of assets and assumption of liabilities in a business combination, divestitures, and major litigation claims? ▶ If the company enters into a significant unusual transaction during the year, how will your auditor adjust the audit plan, including the plan for testing ICFR related to the transaction? For example, how would the company's acquisition of a significant enterprise during the third quarter affect the audit plan for the year? How might your auditor's materiality assumptions change? Would the audit plan focus on different systems and controls than originally planned? How would your auditor test controls over the systems used to generate information for recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree? How would the ICFR of the acquired company be considered? Asking about the effectiveness of controls before such transactions and events occur will signal to your auditor that preparedness is a priority, as well as asking similar questions about new systems and processes. ▶ If the company or your auditor has identified a potential material weakness or significant deficiency in internal control, what has been done to probe the accuracy of its description? Could the identified control deficiency be broader than initially described? Could it be an indication of a deficiency in another component of internal control?
Assessing and responding to risks of material misstatement (RMM)	▶ Which audit areas are designated by your auditor as having significant risks of material misstatement and what audit procedures are planned to address those risks? ▶ In your auditor's view, how have the areas of significant RMM changed since the prior year? What new risks has your auditor identified? What is your auditor's process to make sure that it identifies new or changing RMM and tailors the audit plan appropriately? How is the engagement partner involved? ▶ How does your auditor's audit plan address the varied risks in a multi-location environment? If your auditor assumes that controls are uniform across multiple locations, how does your auditor support that assumption? ▶ If the company has operations in countries that are experiencing political instability, how has your auditor identified and addressed the specific risks that might result from such a circumstance? Or, if some of the company's products are approaching technological obsolescence due to competitive new products, you might ask how your auditor plans to address the risks of inventory obsolescence.
Auditing accounting estimates, including fair value measurements and disclosures	▶ What does your auditor do to obtain a thorough understanding of the assumptions and methods the company used to develop critical estimates, including fair value measurements? ▶ What is your auditor's approach to auditing critical accounting estimates, such as allowances for loan losses, inventory reserves, and tax-related estimates? ▶ How has your auditor assessed whether management has identified all separable intangible assets that, while not included in the financial statements, must nevertheless be valued in connection with assessing goodwill for possible impairment (e.g., customer-related intangibles and in-process research and development)? Has your auditor considered contrary information that suggests the existence of such assets that management has not identified? ▶ Will your engagement team use its firm's in-house valuation specialists? If so, how are the specialists integrated into the engagement team? How are specialists supervised, and how are significant issues they identify resolved? If the firm does not have in-house valuation specialists, does the firm engage external specialists to assist the auditor with their audit of complex estimates?
Referred work in cross- border audits	▶ How does the engagement partner assess the quality of the audit work performed in other jurisdictions? Were the firms that participate in the audit recently inspected by the PCAOB? If yes, what does the engagement partner know about the results? ▶ How does your auditor review the work? Does your auditor visit other countries to review the audit work done there? What steps does your auditor take to make sure that the work is performed by persons who understand PCAOB standards and U.S. GAAP and financial reporting requirements? ▶ As part of planning the audit, does your auditor consider performing additional steps if the referred work is in an area that has recently been the subject of a significant number of PCAOB inspection findings on your auditor?

NEW RISKS THE PCAOB IS MONITORING

	Questions Audit Committees May to Pose to Auditors
Increase in mergers and acquisitions (M&A)	▶ Does your auditor have the expertise necessary to address the audit issues that may arise from the reporting requirements related to business combinations as well as other effects of a business combination that may bear on financial reporting, such as the effects on segment reporting? If not, how will your auditor obtain or develop that expertise?
Falling [fluctuating] oil prices	▶ Have declining oil prices been identified as a risk factor and changed your auditor's approach to testing related accounting estimates? Will your auditor require different evidence to support any assumptions and estimation methods used by the company that may depend on a certain level of oil prices? ▶ How might the estimated effects of falling oil prices be factored into estimates of the company's future undiscounted net cash inflows used in the assessments of possible impairments of long-lived assets? How might those effects affect the possible need for recording or adjusting a deferred tax valuation account? ▶ Does the decline in oil prices create a need to disclose certain significant risks and uncertainties in the financial statements? Do oil price movements subsequent to year-end represent a subsequent event that requires disclosure in the company's financial statements?
Undistributed foreign earnings	▶ What is the nature and extent of audit evidence gathered by your auditor related to management's assertions about indefinite reinvestment? Is there contrary evidence? If so, how did your auditor consider the contrary evidence? ▶ Has your auditor considered whether the company's MD&A disclosure, including disclosure regarding liquidity and capital resources, is consistent with, or contradicts, management's indefinite reinvestment assertion?
Maintaining audit quality while growing other business	▶ Has your engagement team been affected by any changes in the firm's business model? Has the engagement team lost key auditors or specialists to other lines of business? How are you ensuring that the quality of the audit team will remain high over time?

The *Audit Committee Dialogue* is one of several tools issued in recent years by the PCAOB in recognition that the audit committee plays a significant role in ensuring audit quality and as a means to enhance constructive engagement with audit committees in areas of common interest, including independence, objectivity, professional skepticism, and audit quality. Other information aimed at assisting audit committees with their oversight of the audit and financial reporting processes are listed below and a full list of resources is available from the PCAOB's Information for Audit Committees website.

- ▶ Audit Quality Indicators – presentation, discussion, and briefing paper
- ▶ Information for Audit Committees About the PCAOB Inspection Process
- ▶ Observations Related to the Implementation of the Auditing Standard on Engagement Quality Review
- ▶ The Quality Control Remediation Process
- ▶ Staff Audit Practice Alerts (e.g., 10, 11, 12, and 13)
- ▶ Auditing Standard No. 16, Communications with Audit Committees

The important role of the audit committee in overseeing the integrity of an organization's financial statement reporting process continues to evolve. We encourage you to explore the resources cited in this practice aid as you carry out your duties on behalf of the boards and companies that you serve. For additional audit committee tools and resources, visit BDO's Board Governance page at: www.bdo.com/services/assurance/board-governance/overview.