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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70843; File No. PCAOB-2013-02)

November 8, 2013

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), notice is hereby given that on October 30, 2013, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rules described in items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On October 10, 2013, the Board adopted Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements* and related amendments to its interim auditing standards (collectively, the "proposed rules"). The text of the proposed rules is set out below.

Auditing Standard No. 17

Auditing Supplemental Information Accompanying Audited Financial Statements

Introduction

1. This standard sets forth the auditor's responsibilities when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental

information<sup>1</sup> that accompanies financial statements<sup>2</sup> audited pursuant to Public Company Accounting Oversight Board ("PCAOB") standards.

### Objective

2. The objective of the auditor of the financial statements, when engaged to perform audit procedures and report on supplemental information that accompanies audited financial statements, is to obtain sufficient appropriate audit evidence to express an opinion on whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole.

### Performing Audit Procedures on Supplemental Information Accompanying Audited Financial Statements

3. The auditor should perform audit procedures to obtain appropriate audit evidence that is sufficient to support the auditor's opinion regarding whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole. The nature, timing, and extent of audit procedures necessary to obtain sufficient appropriate audit evidence and to report on the supplemental information depends on, among other things:

- a. The risk of material misstatement of the supplemental information;
- b. The materiality considerations relevant to the information presented;

Note: When planning and performing the audit procedures to report on supplemental information, the auditor generally should

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<sup>1</sup> Terms defined in Appendix A, Definitions, are set in boldface type the first time they appear.

<sup>2</sup> For purposes of this standard, supplemental information "accompanies financial statements" when it is (1) presented in the same document as the audited financial statements, (2) presented in a document in which the audited financial statements are incorporated by reference, or (3) incorporated by reference in a document containing the audited financial statements.

use the same materiality considerations as those used in planning and performing the audit of the financial statements.<sup>3</sup> However, if applicable regulatory requirements specify a lower materiality level to be applied to certain supplemental information, the auditor should use those prescribed threshold requirements in planning and performing audit procedures for the supplemental information.

- c. The evidence obtained from the audit of the financial statements and, if applicable, other engagements by the auditor or affiliates of the firm,<sup>4</sup> for the period presented; and

Note: The procedures performed regarding the supplemental information should be planned and performed in conjunction with the audit of the financial statements. For audits of brokers and dealers, the procedures should be coordinated with the attestation engagements related to compliance or exemption reports required by the U.S. Securities and Exchange Commission ("SEC").<sup>5</sup> The auditor should take into account relevant evidence from the audit of the financial statements and, for audits of brokers or dealers, the

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<sup>3</sup> Auditing Standard No. 11, Consideration of Materiality in Planning and Performing an Audit, establishes requirements regarding the auditor's consideration of materiality in planning and performing an audit.

<sup>4</sup> The term "affiliates of the firm" as used in this standard has the same meaning as the term "affiliates of the accounting firm" as defined in PCAOB Rule 3501.

<sup>5</sup> See Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, and Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers.

attestation engagements, in planning and performing audit procedures related to the supplemental information and in evaluating the results of the audit procedures to form the opinion on the supplemental information.

- d. Whether a qualified opinion, an adverse opinion, or a disclaimer of opinion was issued on the financial statements.
4. In performing the audit procedures on supplemental information, the auditor should:
- a. Obtain an understanding of the purpose of the supplemental information and the criteria management used to prepare the supplemental information, including relevant regulatory requirements;
  - b. Obtain an understanding of the methods of preparing the supplemental information, evaluate the appropriateness of those methods, and determine whether those methods have changed from the methods used in the prior period and, if the methods have changed, determine the reasons for and evaluate the appropriateness of such changes;
  - c. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplemental information;
  - d. Determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable;
  - e. Perform procedures to test the completeness and accuracy of the information presented in the supplemental information to the extent that it was not tested as part of the audit of financial statements; and

- f. Evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any.

### Management Representations

5. The auditor should obtain written representations from management, including:
  - a. A statement that management acknowledges its responsibility for the fair presentation of the supplemental information and, if applicable, the form and content of that supplemental information, in conformity with relevant regulatory requirements or other applicable criteria;
  - b. A statement that management believes the supplemental information, including its form and content, is fairly stated, in all material respects;
  - c. A statement that the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement or presentation have changed, the reasons for such changes and why those changes are appropriate;
  - d. If the form and content of the supplemental information is prescribed by regulatory requirements or other applicable criteria, a statement that the supplemental information complies, in all material respects, with the regulatory requirements or other applicable criteria, and identification of those requirements or other applicable criteria; and
  - e. A description of any significant assumptions or interpretations underlying the measurement or presentation of the supplemental information, and a statement that management believes that such assumptions or interpretations are appropriate.

## Evaluation of Audit Results

6. To form an opinion on the supplemental information, the auditor should evaluate whether the supplemental information, including its form and content, is fairly stated, in all material respects, in relation to the financial statements as a whole, including whether the supplemental information is presented in conformity, in all material respects, with the relevant regulatory requirements or other applicable criteria.

7. The auditor should accumulate misstatements regarding the supplemental information identified during performance of audit procedures on the supplemental information and in the audit of the financial statements.<sup>6</sup> The auditor should communicate accumulated misstatements regarding the supplemental information to management on a timely basis to provide management with an opportunity to correct them.

8. The auditor should evaluate whether uncorrected misstatements related to the supplemental information are material, either individually or in combination with other misstatements, taking into account relevant quantitative and qualitative factors.

Note: The auditor should evaluate the effect of uncorrected misstatements related to the supplemental information in evaluating the results of the financial statement audit.<sup>7</sup>

9. The auditor should evaluate the effect of any modifications to the audit report on the financial statements when forming an opinion on the supplemental information:

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<sup>6</sup> See paragraph 10 of Auditing Standard No. 14, Evaluating Audit Results, which discusses the auditor's responsibilities regarding the accumulation of misstatements in an audit of financial statements.

<sup>7</sup> See paragraph 17 of Auditing Standard No. 14, which discusses evaluation of uncorrected misstatements in the financial statement audit.

- a. When the auditor expresses a qualified opinion on the financial statements and the basis for the qualification also applies to the supplemental information, the auditor should describe the effects of the qualification on the supplemental information in the report on supplemental information and should express a qualified opinion on the supplemental information.
- b. When the auditor expresses an adverse opinion, or disclaims an opinion on the financial statements, the auditor should express an adverse opinion, or disclaim an opinion, on the supplemental information, whichever is appropriate.

### Reporting

10. The auditor's report on supplemental information accompanying audited financial statements should include the following:

- a. Identification of the supplemental information.

Note: Identification may be by descriptive title of the supplemental information or reference to the page number and document where the supplemental information is located.
- b. A statement that the supplemental information is the responsibility of management.
- c. A statement that the supplemental information has been subjected to audit procedures performed in conjunction with the audit of the financial statements.

Note: If the financial statements are presented in a separate document from the supplemental information or otherwise are not readily identifiable to the user of the supplemental information, the

auditor's report on supplemental information should identify the document containing the company's financial statements.

- d. A statement that the audit procedures performed included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information.
  - e. A statement that in forming the auditor's opinion, the auditor evaluated whether supplemental information, including its form and content, complies, in all material respects, with the specified regulatory requirements or other criteria, if applicable.
  - f. A statement, if applicable, that the supplemental information is presented on a basis that differs from the financial statements and is not prescribed by regulatory requirements. When such a statement is made, the report should describe the basis for the supplemental information presentation.
  - g. An opinion on whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole, or a disclaimer of opinion.
11. Unless prescribed by regulatory requirements, the auditor may either include the auditor's report on the supplemental information in the auditor's report on the financial statements or issue a separate report on the supplemental information. If the auditor issues a separate report on the supplemental information, that report should identify the auditor's report on the financial statements.

12. The date of the auditor's report on the supplemental information in relation to the financial statements as a whole should not be earlier than:
- a. The date of the auditor's report on the financial statements from which the supplemental information was derived, and
  - b. The date on which the auditor obtained sufficient appropriate audit evidence to support the auditor's opinion on the supplemental information in relation to the financial statements as a whole.<sup>8</sup>

13. The following is an example of an auditor's report on supplemental information when included in the auditor's report on the financial statements:

The [identify supplemental information] has been subjected to audit procedures performed in conjunction with the audit of [Company's] financial statements. The [supplemental information] is the responsibility of the Company's management. Our audit procedures included determining whether the [supplemental information] reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the [supplemental information]. In forming our opinion on the [supplemental information], we evaluated whether the [supplemental information], including its form and content, is presented in conformity with [specify the relevant regulatory requirement or

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<sup>8</sup> AU sec. 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report, sets forth procedures to be followed by the auditor who, subsequent to the date of the report upon audited financial statements becomes aware that facts may have existed at that date that might have affected the report had he or she then been aware of such facts. AU sec. 561 applies to situations in which the auditor identifies a material misstatement of the financial statements while performing audit procedures on supplemental information after the date of the auditor's report on the financial statements.

other criteria, if any]. In our opinion, the [identify supplemental information] is fairly stated, in all material respects, in relation to the financial statements as a whole.

14. If the auditor determines that the supplemental information is materially misstated in relation to the financial statements as a whole, the auditor should describe the material misstatement in the auditor's report on the supplemental information and express a qualified or adverse opinion on the supplemental information.

15. If the auditor is unable to obtain sufficient appropriate audit evidence to support an opinion on the supplemental information, the auditor should disclaim an opinion on the supplemental information. In those situations, the auditor's report on the supplemental information should describe the reason for the disclaimer and state that the auditor is unable to and does not express an opinion on the supplemental information.

Note: If the supplemental information consists of two or more schedules, and the auditor is able to obtain sufficient appropriate audit evidence to support an opinion on some but not all schedules, the auditor may express an opinion on only those schedules for which he or she obtained sufficient appropriate evidence but should disclaim an opinion on the other schedules.

#### APPENDIX A - Definitions

A1. For purposes of this standard, the term listed below is defined as follows:

A2. Supplemental Information – Refers to the following information when it accompanies audited financial statements:

- a. Supporting schedules that brokers and dealers are required to file pursuant to Rule 17a-5 under the Securities Exchange Act of 1934;<sup>9</sup>
- b. Supplemental information (i) required to be presented pursuant to the rules and regulations of a regulatory authority and (ii) covered by an independent public accountant's report on that information in relation to financial statements that are audited in accordance with PCAOB standards; or
- c. Information that is (i) ancillary to the audited financial statements, (ii) derived from the company's accounting books and records, and (iii) covered by an independent public accountant's report on that information in relation to the financial statements that are audited in accordance with PCAOB standards.

#### Amendments to PCAOB Standards

##### Auditing Standard No. 16, "Communications with Audit Committees"

Auditing Standard No. 16, Communications with Audit Committees, is amended as follows:

- a. The second sentence of footnote 27 to paragraph 14 is replaced with:

In addition to AU sec. 550, discussion of the auditor's consideration of other information is included in Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, AU sec. 558, Required Supplementary Information, and AU sec. 711, Filings Under Federal Securities Statutes.

##### AU sec. 9342, "Auditing Accounting Estimates: Auditing Interpretations of Section 342"

AU sec. 9342, "Auditing Accounting Estimates: Auditing Interpretations of Section 342," as amended, is amended as follows:

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<sup>9</sup> See 17 CFR § 240.17a-5 (d)(2).

- a. The second sentence of paragraph .07 is replaced with:

When the audited disclosures do not constitute a complete balance sheet presentation and are included in a supplemental schedule or exhibit, the auditor should look to the requirements in Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements.

- b. The second sentence of paragraph .08 is replaced with:

If the unaudited voluntary disclosures are located on the face of the financial statements or in the footnotes, the voluntary disclosures should be labeled "unaudited." If the unaudited information is presented in a supplemental schedule, the voluntary disclosures should be labeled "unaudited" and the auditor should disclaim an opinion on the unaudited information.

- c. In the second flowchart in paragraph .10, "Auditing Guidance for Fair Value Information, Required and Voluntary Information," the box text that states:

The voluntary disclosures should be labeled "unaudited" and the auditor should disclaim an opinion on the unaudited information as discussed in section 551.13.

is replaced with:

The voluntary disclosures should be labeled "unaudited" and the auditor should disclaim an opinion on the unaudited information.

- d. In the second flowchart in paragraph .10, "Auditing Guidance for Fair Value Information, Required and Voluntary Information," the box text that states:

The auditor should add an additional paragraph to the report as discussed in section 551.12

is replaced with:

The auditor should add an additional paragraph to the report. See paragraph 10 of Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements.

AU sec. 530, "Dating of the Independent Auditor's Report"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 530, "Dating of the Independent Auditor's Report" (AU sec. 530, "Dating of the Independent Auditor's Report"), as amended, is amended as follows:

Within paragraph .06 at the end of the paragraph, the sentence, "(See Section 551.)" is deleted.

AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"

SAS No. 8, "Other Information in Documents Containing Audited Financial Statements" (AU sec. 550, "Other Information in Documents Containing Audited Financial Statements"), as amended, is amended as follows:

a. Within paragraph .03

- At the end of the paragraph, the sentence "(see sections 551\* and 623\*\*)" is replaced with:

(See Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, and AU sec. 623\*\*).

- Footnote \* to paragraph .03 is deleted.

b. Paragraph .07 is deleted.

AU sec. 551, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents"

SAS No. 29, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents" (AU sec. 551, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents") as amended, is superseded.

AU sec. 552, "Reporting on Condensed Financial Statements and Selected Financial Data"

SAS No. 42, "Reporting on Condensed Financial Statements and Selected Financial Data" (AU sec. 552, "Reporting on Condensed Financial Statements and Selected Financial Data"), as amended, is amended as follows:

The second sentence in paragraph .01 is replaced with:

Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, sets forth the auditor's responsibilities when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies financial statements audited pursuant to Public Company Accounting Oversight Board standards.

AU sec. 558, "Required Supplementary Information"

SAS No. 52, "Required Supplementary Information" (AU sec. 558, "Required Supplementary Information"), as amended, is amended as follows:

- a. Footnote 3 to paragraph .03 is deleted.
- b. The second sentence of paragraph .05 is replaced with:

Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, sets forth the auditor's responsibilities when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies financial statements audited pursuant to Public Company Accounting Oversight Board standards.

- c. Footnote 7 to paragraph .08 is replaced with:

Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, sets forth the auditor's responsibilities when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies financial statements audited pursuant to Public Company Accounting Oversight Board standards.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, for application to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"). The Board's request is set forth in section D.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Section 103 of the Sarbanes-Oxley Act directs the Board, by rule, to establish, among other things, "auditing and related attestation standards . . . to be used by registered public accounting firm in the preparation and issuance of audit reports, as required by th[e] [Sarbanes-Oxley] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." Auditing Standard No. 17 requires auditors to perform certain audit procedures when engaged to audit and report on supplemental information accompanying financial statements. Supplemental information is required by regulators, including the SEC,<sup>10</sup> who have determined the information is important in carrying out their regulatory oversight. The standard includes auditor performance requirements to (1) determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable; (2) test the completeness and accuracy of the supplemental information, to the extent that it was not tested as part of the audit of the financial statements; and (3) evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any. The standard has been designed to promote coordination between the work performed on the

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<sup>10</sup> Rule 17a-5 under the Securities Exchange Act of 1934 ("Exchange Act") requires brokers and dealers registered with the SEC to submit financial reports to the SEC that include audited financial statements as well as certain required supporting schedules ("SEC Rule 17a-5"). See 17 CFR § 240.17a-5. On July 30, 2013, the SEC adopted amendments to SEC Rule 17a-5 to strengthen and clarify broker and dealer financial reporting requirements and also require that broker and dealer audits be conducted in accordance with PCAOB standards. See SEC Exchange Act Release No. 34-70073, Broker-Dealer Reports (July 30, 2013), 78 Federal Register 51910 (August 21, 2013) ("SEC Release").

supplemental information and the work performed on the financial statement audit. This approach should enhance audit effectiveness as well as avoid duplication of audit procedures.

In the Board's view, Auditing Standard No. 17 should provide regulators with greater confidence in the quality and consistency of supplemental information accompanying audited financial statements of brokers<sup>11</sup>, dealers<sup>12</sup>, and others.<sup>13</sup> Supplemental information is often required by regulators for their oversight purposes. For example, the supplemental information brokers and dealers are required to include in their annual reports relates to their compliance with certain SEC rules regarding maintaining minimum net capital and reserves,<sup>14</sup> specifically those governing the safeguarding of customer securities and funds in their filings with the Commission. Also, supplemental information includes schedules included in annual reports filed by employee stock purchase, savings, and similar plans on Form 11-K ("11-K filers"), For Annual Reports Of Employee Stock Purchase, Savings and Similar Plans Pursuant To Section

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<sup>11</sup> According to PCAOB Rule 1001(b)(iii), the term "broker" means a broker (as defined in Section 3(a)(4) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that Act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

<sup>12</sup> According to PCAOB Rule 1001(d)(iii), the term "dealer" means a dealer (as defined in Section 3(a)(5) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that Act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

<sup>13</sup> For example, certain employee benefit plans that are subject to the Employee Retirement Income Security Act of 1974 ("ERISA") file an annual report with the Commission on Form 11-K, which includes the plan's financial statements and schedules prepared in accordance with the financial reporting requirements of ERISA. See 17 CFR § 240.15d-21, 17 CFR § 249.311 and item 4 of the "Required Information" section of SEC Form 11-K "For Annual Reports Of Employee Stock Purchase, Savings And Similar Plans Pursuant To Section 15(D) Of The Securities Exchange Act Of 1934."

<sup>14</sup> See paragraph (d)(2) of SEC Rule 17a-5.

15(D) Of The Securities Exchange Act Of 1934,<sup>15</sup> when those entities elect to file plan financial statements and schedules prepared in accordance with the financial reporting requirements of ERISA.<sup>16</sup>

As discussed more fully in Exhibit 3, a number of developments led the Board to re-examine its requirements regarding supplemental information. Primarily, Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>17</sup> (the "Dodd-Frank Act") gave the Board oversight of audits of brokers and dealers registered with the SEC. Under SEC Rule 17a-5, brokers and dealers are required to submit to the SEC financial reports containing certain schedules, including supporting schedules regarding (i) the computation of net capital; (ii) the computation for determination of reserve requirements; and (iii) information related to the broker's or dealer's possession or control of its clients' assets.<sup>18</sup> These schedules provide important information that can support and assist the Commission and other broker or dealer "designated examining authorities"<sup>19</sup> in their oversight of financial responsibility practices of brokers and dealers. In addition, as described in the SEC's release, one of the SEC's motivations for its amendments to SEC Rule 17a-5 to require that audits of brokers and dealers – including

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<sup>15</sup> See 29 CFR § 2520.103-1.

<sup>16</sup> See 17 CFR § 240.15d-21, 17 CFR § 249.311, and item 4 of the "Required Information" section of SEC Form 11-K "For Annual Reports Of Employee Stock Purchase, Savings And Similar Plans Pursuant To Section 15(D) Of The Securities Exchange Act Of 1934."

<sup>17</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

<sup>18</sup> See paragraph (d)(2) of SEC Rule 17a-5.

<sup>19</sup> Under SEC Rule 17d-1, Examination for Compliance with Applicable Financial Responsibility Rules, a registered broker or dealer that is a member of more than one securities self-regulatory organization may be assigned a "designated examining authority" or "DEA" that is responsible for examining the broker or dealer for compliance with SEC financial responsibility rules. An example of a securities self-regulatory organization that is a DEA is the Financial Industry Regulatory Authority.

the examination of the financial statements and supplemental schedules in the financial report – be conducted in accordance with PCAOB standards was to "better ensure alignment between broker-dealer audits and the regulatory policy objectives reflected in the Commission's financial responsibility rules."<sup>20</sup>

On July 30, 2013, the Commission adopted amendments to SEC Rule 17a-5 to require, among other things, that an auditor engaged by the broker or dealer provide an audit report based on an auditor's examination of the broker's or dealer's financial report, which consists of the financial statements and supporting schedules, in accordance with the standards of the PCAOB.<sup>21</sup> However, the PCAOB's existing audit standards do not contemplate the SEC's requirements for an auditor's report on the examination of the financial statements and supporting schedules of a broker or dealer. As noted earlier, the Board's existing standard, AU sec. 551, describes the auditor's reporting responsibilities regarding supplemental information accompanying audited financial statements in terms of auditor-submitted documents and, additionally, does not specify audit procedures to be applied to test the supplemental information that is provided to the regulator. Accordingly, the Board decided to adopt Auditing Standard No. 17 and align its standard for performing auditing procedures and reporting on supplemental information with the SEC's requirements. Due to the importance of the required supplemental information for regulatory purposes, the Board also determined to include audit procedures designed to support the auditor's reporting requirements, including procedures for testing the supplemental information accompanying the financial statements.

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<sup>20</sup> See the SEC Release at 208.

<sup>21</sup> See paragraphs (f)(1) and (g)(1) of SEC Rule 17a-5. See also paragraph (d)(1)(i)(C) of SEC Rule 17a-5, which requires that the auditor's report on the examination of the financial report of the broker or dealer be filed with the Commission.

Additionally, the amendments to SEC Rule 17a-5 also require certain brokers and dealers to include in their annual reports a compliance report that addresses, among other things, the broker's or dealer's compliance with the SEC rules requiring a broker or dealer to maintain a minimum level of net capital and a reserve of funds or qualified securities in an amount at least equal to the value of the amount of net funds owed to customers of the respective broker or dealer.<sup>22</sup> In conjunction with these recent amendments, the Board also is adopting new standards for attestation engagements (the "attestation standards") that relate to brokers' and dealers' compliance reports required in SEC Rule 17a-5.<sup>23</sup> The requirements in the attestation standards are closely related to the audit requirements in this standard regarding supporting schedules for brokers and dealers. Among other things, the attestation standards emphasize the importance of coordinating the work in the compliance attestation engagement with the audit of the financial statements and audit procedures performed on the schedules required under SEC Rule 17a-5.<sup>24</sup>

In addition to the schedules required by SEC Rule 17a-5, Auditing Standard No. 17 covers supplemental information required to be presented pursuant to the rules and regulations of a regulatory authority when that information is reported on in relation to financial statements that are audited in accordance with PCAOB standards. For example, Auditing Standard No. 17 covers the schedules in Form 11-K of an 11-K filer that elects to file plan financial statements and

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<sup>22</sup> See paragraphs (f)(1), (g)(2)(i) and (ii) of SEC Rule 17a-5. The net capital rule is 17 CFR § 240.15c3-1, and the reserve requirements rule is paragraph (e) of 17 CFR § 240.15c3-3.

<sup>23</sup> See Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards, PCAOB Release No. 2013-007 (October 10, 2013).

<sup>24</sup> Id.

schedules prepared in accordance with the financial reporting requirements of ERISA ("covered 11-K filer").<sup>25</sup>

In the Board's view, Auditing Standard No. 17 promotes investor protection because of the importance of supplemental information in meeting regulatory objectives regarding audits of financial statements of brokers, dealers, and others. Because such information is often critical to the effectiveness of regulatory oversight, Auditing Standard No. 17 requires the performance of audit procedures to test the supplemental information to support the auditor's report on the supplemental information. The standard also requires the auditor to evaluate whether the supplemental information complies with applicable regulatory requirements, which should help facilitate consistent compliance with regulatory requirements and give regulators greater confidence about the reliability of the supplemental information provided for regulatory oversight activities that are important to investor protection.

For example, in the context of oversight of brokers and dealers, the requirements in the standard for testing and evaluating supplemental information could improve the quality of the supporting schedules that regulators rely on when considering whether the broker or dealer maintains adequate safeguards over customer funds and securities. Also, strengthening and clarifying the auditing requirements for applying procedures and reporting on supplemental information could facilitate consistent compliance with SEC Rule 17a-5.

For 11-K filers, the requirements in the standard for testing and evaluating supplemental information may increase the quality of information available to investors, especially the plans' participants.

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<sup>25</sup> The new standard would not apply to 11-K filers that do not make that election because the SEC-required schedules for those 11-K filers are part of the audited financial statements.

Auditing Standard No. 17 also requires the auditor to coordinate the auditor's work with the financial statement audit. To the extent that the supplemental information relates to information in the financial statements, the enhanced audit attention to the supplemental information could enhance the confidence of regulators and other users in the reliability of the financial statements and supplemental information.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Sarbanes-Oxley Act.

B. Board's Statement on Burden on Competition

Not Applicable.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2013-008 (October 10, 2013). The Board received eleven written comment letters. The Board has carefully considered all comments received. The Board's response to the comments it received and the changes made to the rules in response to the comments received are discussed below.

Applicability of the Standard and Definition of Supplemental Information (Appendix A – Definitions)

Auditing Standard No. 17 applies when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies financial statements audited pursuant to PCAOB standards.

The SEC and other regulators may require regulated entities, such as brokers and dealers, to file supplemental information with their annual financial reports for regulatory purposes.<sup>26</sup> In

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<sup>26</sup> Rule 17a-5 under the Securities Exchange Act of 1934 ("Exchange Act") requires brokers and dealers registered with the SEC to submit financial reports to the SEC that include audited financial statements as well as certain required supporting schedules ("SEC Rule 17a-5").

other cases, companies may voluntarily provide supplemental information that is derived from, or ancillary to, the company's financial statements audited pursuant to PCAOB standards.

The proposed standard included a definition of the types of supplemental information to which this standard would apply. In response to questions in the proposing release, several commenters stated that the proposed definition was appropriate, while other commenters expressed concern that, as the proposed definition was expressly tailored to supplemental information included in certain SEC filings by brokers and dealers, the definition did not describe all types of supplemental information that auditors of issuers, brokers, and dealers might be engaged to report on.

In particular, several commenters expressed concern that the proposed definition would exclude certain types of supplemental information because that information is not included in SEC filings. One commenter noted that information that is ancillary to financial statements and not otherwise required to be presented pursuant to the rules and regulations of the SEC or another relevant regulatory body, may also be reported on, but not included in an SEC filing. Another commenter gave examples of situations when issuers engage auditors to report on supplemental information that would be excluded under the proposed standard's definition of supplemental information, including subsidiary-specific data or information used to calculate financial ratios related to a loan covenant or other contractual provision.

After consideration of these comments, the definition of supplemental information has been revised to remove the references to SEC filings. Auditing Standard No. 17 covers the following types of supplemental information:

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See 17 CFR § 240.17a-5. Paragraph (d)(2) of SEC Rule 17a-5 specifically addresses the supporting schedules. See also SEC Exchange Act Release No. 34-70073, Broker-Dealer Reports (July 30, 2013), 78 Federal Register 51910 (August 21, 2013) ("SEC Release").

- a. Supporting schedules that brokers and dealers are required to file pursuant to SEC Rule 17a-5;<sup>27</sup>
- b. Supplemental information (i) required to be presented pursuant to the rules and regulations of a regulatory authority and (ii) covered by an independent public accountant's report on that information in relation to financial statements that are audited in accordance with PCAOB standards; or
- c. Information that is (i) ancillary to the audited financial statements, (ii) derived from the company's accounting books and records, and (iii) covered by an independent public accountant's report on that information in relation to the financial statements that are audited in accordance with PCAOB standards.

As mentioned previously, the standard covers supplemental information required by regulatory authorities and supplemental information that is voluntarily provided, when the auditor is engaged to report on that information in relation to the financial statements as a whole and the financial statements are audited in accordance with PCAOB standards. However, the standard itself does not impose an obligation to audit such supplemental information.

By its terms, the standard would not apply to unaudited supplemental information. For example, the standard would not apply to the information required by the accounting standards or Item 302 of SEC Regulation S-K, 17 CFR § 229.302. Similarly, auditors should continue to look to the requirements of AU sec. 558, Required Supplementary Information, regarding unaudited information about oil and gas producing activities required by Item 302(b) of Regulation S-K 17 CFR § 229.302(b) and Financial Accounting Standards Board's Accounting Standards Codification, Topic 932, Extractive Industries – Oil and Gas, section 932-50-2.

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<sup>27</sup> See paragraph (d)(2) of SEC Rule 17a-5.

Likewise, auditors should continue to look to the requirements of AU sec. 722, Interim Financial Information, regarding selected quarterly financial data required by Item 302(a) of Regulation S-K. Additionally, auditors should continue to look to AU sec. 550, Other Information in Documents Containing Audited Financial Statements, including Management's Discussion and Analysis of Financial Condition and Results of Operations, unless the auditor is engaged to examine and report on that information.

Further, the standard does not apply if the auditor who is engaged to audit and report on supplemental information did not audit the financial statements. In those situations, the auditor would not have the knowledge of the company's financial statements or the evidence regarding the accounts and disclosures in the financial statements necessary to express an opinion regarding whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole. Accordingly, in those instances, the auditor of the supplemental information should look to the requirements in AU sec. 623, Special Reports.

Some commenters suggested that the standard would not apply to supplemental information prepared after the financial statement audit because of the requirement in the proposed standard, and related statement in the auditor's report, that the audit procedures on the supplemental information be performed in conjunction with the audit of the financial statements. Auditing Standard No. 17 applies when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies audited financial statements, regardless of the timing of the preparation of the supplemental information.

To address issues regarding timing, a footnote was added to paragraph 1 of the standard to clarify that supplemental information "accompanies financial statements" when it is (1)

presented in the same document as the audited financial statements, (2) presented in a document in which the audited financial statements are incorporated by reference, or (3) incorporated by reference in a document containing the audited financial statements.

Additionally, the note to paragraph 3.c. of the standard includes the phrase "in conjunction with." That phrase is meant to indicate that the auditor of the financial statements is in a position to take into account other information available as a result of the financial statement audit, but Auditing Standard No. 17 does not require that the two engagements be performed simultaneously. The note to paragraph 3.c. explains the auditor's responsibilities for performing audit procedures on the supplemental information "in conjunction with" the audit of the financial statements. That note states that the auditor should take into account relevant evidence from the audit of the financial statements and the attestation engagements<sup>28</sup> in planning and performing audit procedures related to the supplemental information and in evaluating the results of the audit procedures to form the opinion on the supplemental information. As such, the language in the standard was retained largely as proposed.

#### Exclusion of Schedules Required by SEC Regulation S-X

Some commenters expressed concern with the definition of supplemental information because of the discussion in the proposing release,<sup>29</sup> which stated that the standard would not

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<sup>28</sup> See Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards, PCAOB Release No. 2013-007 (October 10, 2013).

<sup>29</sup> See Section I.A.1 of Proposed Auditing Standard, Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards, PCAOB Release No. 2011-005 (July 12, 2011).

apply to schedules prepared pursuant to SEC Regulation S-X.<sup>30</sup> One commenter noted that diversity in practice suggests that these schedules may be considered supplementary and not part of the basic financial statements covered by the standard auditor's opinion. The views of these commenters are not consistent with SEC requirements. Section 1-01(b) of SEC Regulation S-X<sup>31</sup> states "the term financial statements as used...shall be deemed to include all notes to the statements and all related schedules". Thus, it is clear that the schedules required by SEC Regulation S-X are part of the financial statements. As such, no changes were made to the standard.<sup>32</sup>

"In Relation to" the Financial Statements as a Whole (Paragraphs 1 and 2)

As stated in the proposing release, the auditor's report on supplemental information in the standard includes an expression of an opinion on whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole. In order to express an opinion on the supplemental information the auditor performs the procedures set forth in the standard, to the extent not performed in the course of the audit. The concept of expressing an opinion on the supplemental information "in relation to" the financial statements as a whole carries over from the Board's existing standard for supplemental information, AU sec. 551.

The proposing release requested comment regarding whether to change from the AU sec. 551 "in relation to" approach to reporting on supplemental information to a stand-alone reporting approach. Overall, commenters supported the decision to retain the "in relation to" approach.

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<sup>30</sup> See Section 1-01(b) of SEC Regulation S-X, 17 CFR § 210.1-01(b).

<sup>31</sup> See e.g., Rules 5-04, 6-10, 6A-05, 7-05, and Article 12 of Regulation S-X, 17 CFR § 210.5-04, 6-10, 6A-05, 7-05, and 12.

<sup>32</sup> The schedules required by SEC Regulation S-X should be referred to in the introductory paragraph and in the opinion of the standard auditor's report set forth in AU sec. 508, Reports on Audited Financial Statements.

One commenter stated that it was an appropriate degree of responsibility for supplemental information. Another commenter stated that the level of assurance provided by this type of engagement meets the needs of users in a cost-effective manner.

After consideration of the comments received, the Board determined that the "in relation to" approach remains appropriate for reporting on supplemental information accompanying audited financial statements. Nothing in the comments received indicates that an "in relation to" opinion on supplemental information is inadequate for financial statement users or that the additional cost for stand-alone assurance is warranted for all engagements involving supplemental information. The Board also considered that existing standards, specifically AU sec. 623, establish requirements in those limited situations in which auditors are engaged to audit supplemental information on a stand-alone basis.

Some commenters expressed concern that use of the word "audit" in the introduction and objective paragraphs of the proposed standard implied that the standard requires the auditor to issue a stand-alone audit opinion on supplemental information and that the reference to audit goes beyond the meaning of "in relation to."

The standard does not require the auditor to issue a stand-alone audit opinion on the supplemental information. However, the standard emphasizes that the auditor should perform procedures to obtain sufficient appropriate audit evidence to support his or her opinion that the supplemental information is fairly stated, in all material respects, "in relation to" the financial statements as a whole. To avoid misperceptions, the wording in paragraphs 1 and 2 of the standard has been revised to state, ". . . when the auditor of the company's financial statements is engaged to perform audit procedures and report on supplemental information . . . ." Further, several of the amendments to PCAOB standards were revised to reflect this wording.

### Materiality (Paragraph 3)

The proposed standard included a requirement for the auditor, in the performance of audit procedures on supplemental information, to use the same materiality considerations as those used in planning and performing the audit of the financial statements. Auditing Standard No. 11, Consideration of Materiality in Planning and Performing an Audit, describes the auditor's responsibilities for considering materiality in planning and performing an audit of the financial statements. Commenters generally supported using the same materiality considerations for supplemental information as those used in the financial statement audit. In general, auditors that are engaged to express an opinion on supplemental information "in relation to" the financial statements as a whole use the same materiality considerations for the audit of the supplemental information as those used in planning and performing the audit of the financial statements.

One commenter recommended that the standard acknowledge instances in which regulatory requirements may prescribe a materiality level for audit procedures over supplemental information that differs from the materiality level used in the audit of the financial statements. As auditors might encounter instances in which this occurs, a note has been added to paragraph 3.b. of the standard stating that "if applicable regulatory requirements specify a lower materiality level to be applied to certain supplemental information, the auditor should use those prescribed threshold requirements in planning and performing audit procedures for the supplemental information." For example, if the supplemental information consisted of a list of transactions over a threshold specified by a regulatory agency, the auditor should use that prescribed threshold in planning and performing the audit procedures to be applied to the supplemental information. This is consistent with the requirement in Auditing Standard No. 11 to use a lower materiality level for accounts and disclosures for which there is a substantial likelihood that

misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor.<sup>33</sup>

Another commenter expressed concern that paragraph 3 of the proposed standard, which requires the auditor to base the nature, timing, and extent of audit procedures on, among other things, the materiality of the information presented, implied that the auditor will undertake a second audit, separate from the audit of the financial statements. Paragraph 3 of the standard does not require the auditor to perform a second audit. The note to paragraph 3.b. specifically provides that the auditor should use the same materiality considerations for the supplemental information as that for the audit of the financial statements. In general, the objective of using the same materiality considerations from the financial statement audit is consistent with the principle of reporting on the supplemental information in relation to the financial statements as a whole. As such, paragraph 3 was retained substantially as proposed. If the auditor is engaged to audit and report on a stand-alone basis (i.e., not "in relation to"), separate and apart from the audit of the financial statement, the auditor should look to the requirements in AU sec. 623. A stand-alone audit of supplemental information under AU sec. 623 is usually more extensive than applying audit procedures and reporting on supplemental information in relation to the financial statements taken as a whole.<sup>34</sup>

Performing Audit Procedures on Supplemental Information Accompanying Audited Financial Statements (Paragraphs 3 and 4)

Similar to AU sec. 551, the standard auditor's report on supplemental information pursuant to Auditing Standard No. 17 includes an opinion on whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a

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<sup>33</sup> See paragraph 7 of Auditing Standard No. 11.

<sup>34</sup> See AU sec. 623.13.

whole. As with any audit opinion, it is necessary for the auditor to obtain reasonable assurance so the auditor has a reasonable basis for that opinion.<sup>35</sup> Accordingly, Auditing Standard No. 17 includes a requirement for the auditor to perform audit procedures to obtain appropriate audit evidence that is sufficient to support the auditor's opinion on the supplemental information in relation to the financial statements as a whole.

At the same time, Auditing Standard No. 17 recognizes that the circumstances in which the auditor expresses an opinion on supplemental information differ from those of a stand-alone audit. That is, the opinion under Auditing Standard No. 17 is expressed in relation to the financial statements as a whole, and the auditor's procedures on the financial statements ordinarily provide substantial evidence that is relevant to the supplemental information. Thus, the standard provides that the nature, timing, and extent of audit procedures necessary to obtain sufficient appropriate audit evidence and to report on the supplemental information depend on, among other things:

- The risk of material misstatement of the supplemental information;
- The materiality considerations relevant to the information presented;
- The evidence obtained from the audit of the financial statements and, if applicable, other engagements by the auditor or affiliates of the accounting firm for the period presented; and
- Whether a qualified opinion, an adverse opinion, or a disclaimer of opinion was issued on the financial statements.

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<sup>35</sup> This also is consistent with the requirements of SEC Rule 17a-5, which requires the auditor to perform an examination of the broker's or dealer's financial report, which consists of the financial statements and supplemental schedules. See paragraph (g) of SEC Rule 17a-5. See also the SEC Release at 74, which discusses the SEC's intention that the auditor obtain reasonable assurance regarding the financial statements and supporting schedules of brokers and dealers.

Further, the standard states that the procedures performed regarding the supplemental information should be planned and performed in conjunction with the audit of the financial statements and, for audits of brokers and dealers, the procedures should be coordinated with the attestation engagements related to compliance or exemption reports required by the SEC.<sup>36</sup> One commenter stated that this requirement implies that the auditor would be required to separately consider and document audit planning considerations relative to supplemental information.

While the standard requires the auditor to assess the risk of material misstatement of the supplemental information as part of determining the nature, timing, and extent of audit procedures, the standard allows this assessment to be performed with, and informed by, the planning and performance of procedures relating to the financial statement audit. The auditor's knowledge obtained from the audit of financial statements and any related engagements (such as an attestation engagement) should generally provide necessary knowledge for the auditor to assess the risk of material misstatement regarding the supplemental information.

For example, evidence regarding the completeness and accuracy of the supplemental information that brokers and dealers are required to file pursuant to SEC Rule 17a-5 may be obtained from procedures performed during an attestation engagement regarding compliance for a broker or dealer and include procedures regarding safeguarding securities or compliance with certain SEC rules.

In addition, paragraph 4 of the standard includes requirements for the auditor to perform the following procedures on supplemental information:

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<sup>36</sup> For example, a compliance examination performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, includes compliance tests relating to the schedules the broker or dealer used to determine compliance with the SEC's net capital rule, 17 CFR § 240.15c3-1, and the reserve requirements rule, paragraph (e) of 17 CFR § 240.15c3-3.

- a. Obtain an understanding of the purpose of the supplemental information and the criteria management used to prepare the supplemental information, including relevant regulatory requirements;
- b. Obtain an understanding of the methods of preparing the supplemental information, evaluate the appropriateness of those methods, and determine whether those methods have changed from the methods used in the prior period and, if the methods have changed, determine the reasons for and evaluate the appropriateness of such changes;
- c. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplemental information;
- d. Determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable;
- e. Perform procedures to test the completeness and accuracy of information presented in the supplemental information to the extent that it was not tested as part of the audit of financial statements; and
- f. Evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any.

Some commenters stated that certain of the required procedures in the proposed standard exceeded those procedures necessary to support an auditor's "in relation to" opinion on supplemental information. Commenters stated that the required procedures in paragraph 4.d. and 4.e. expand the scope of the auditor's responsibility as compared to the existing requirements in AU sec. 551 with respect to information that was not derived from the underlying accounting records. One commenter further stated that information not derived from the underlying

accounting records, by its nature, is not subject to internal control over financial reporting and likely would not have been subjected to the auditor's procedures in the audit of the financial statements.

In many instances, supplemental information reported on under PCAOB standards is required by regulators that have determined that the information required is important to carrying out their regulatory authority, and users of that information can reasonably expect that an auditor's report on supplemental information means that the supplemental information has been subjected to audit procedures. This is consistent with AU sec. 551.07, which states that the auditor may "choose to modify or redirect certain of the procedures to be applied in the audit of the basic financial statements so that [the auditor] may express an opinion on the accompanying information" under that standard. If, as some commenters suggested, the auditor's procedures are limited to solely those procedures performed in the financial statement audit, it is possible that few or no audit procedures might be applied directly to the supplemental information in some engagements, and the auditor would have little or no basis for his or her opinion.

One commenter suggested a revision to the proposed requirement regarding the auditor's responsibility for understanding and evaluating the methods used by management to prepare the supplemental information. The commenter recommended that the auditor should evaluate the appropriateness of the methods used by management to prepare the supplemental information, as well as any changes to those methods. Such a suggestion can be viewed as a necessary step in evaluating whether the supplemental information is fairly stated, so the standard has been revised to specifically include that procedure.

One commenter suggested that consultation with legal counsel or other experts may be necessary. The standard does not prohibit such consultations. Other commenters suggested that

additional procedures be included in the standard, such as a requirement for the auditor to consider the complexity of the methodology used to prepare supplemental information, particularly in those situations in which complex analytical or sampling techniques have been employed in the preparation of underlying data. These suggestions did not warrant changes to the standard because the suggested examples are factors that affect the risk of material misstatement of the supplemental information, which the standard already addresses in paragraph 3.

#### Management Representations (Paragraph 5)

The proposed standard included a requirement for the auditor to obtain written representations from management. Commenters generally supported the language as proposed. One commenter recommended that the standard include an additional requirement for auditors to obtain a representation that management acknowledge its responsibility for the fair presentation of the supplemental information, including its form and content, in accordance with regulatory requirements or other applicable criteria. This additional requirement has been incorporated into the standard.

One commenter suggested that the standard specifically address management representations with respect to supplemental information arising after the auditor has been engaged to perform the financial statement audit. As discussed previously, the auditor's and management's responsibilities relating to supplemental information are not affected by timing considerations, such as whether or not the audit procedures required for the supplemental information were considered when the auditor was first engaged to audit the financial statements; therefore, no changes were made to the standard to address such circumstances. Further, the standard does not prohibit auditors from obtaining additional representations from management

in the case in which the auditor believes additional management representations would be appropriate under the circumstances.

#### Evaluation of Audit Results (Paragraphs 6 – 9)

The proposed standard included a requirement for the auditor to evaluate whether the supplemental information, including its form and content, is fairly stated, in all material respects, in relation to the financial statements as a whole, including whether the supplemental information is presented in conformity, in all material respects, with the relevant regulatory requirements or other applicable criteria. The evaluation should encompass, among other things, whether the information: is complete and accurate, is consistent with the audited financial statements, and complies with relevant regulatory requirements, if applicable.

Commenters generally agreed that the auditor's evaluation of form and content is important to the auditor's evaluation as to whether the supplemental information is fairly stated. One commenter suggested that modification be made to paragraph 6 so that the evaluation of audit results is in the context of the auditor's responsibility to form an opinion on the supplemental information. This recommendation has been reflected in the standard because it provides additional context that helps to clarify the auditor's responsibilities in this area.

Paragraph 9 of the proposed standard included a requirement for the auditor to consider the effect of any modifications to the audit report on the financial statements when evaluating whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole. One commenter stated that the auditor should be prohibited from expressing an "in relation to" opinion on the supplemental information when an adverse or disclaimer of opinion has been issued. Other commenters suggested that additional guidance would be necessary regarding the effect of modification of the auditor's report on the financial

statements on the auditor's report on supplemental information. Some commenters suggested that the standard be revised to follow the requirements in the existing standard more closely regarding when the auditor has issued an adverse opinion or disclaims an opinion on the financial statements.

After consideration of the comments received, the standard was revised to include updated and expanded direction on reporting in these situations. Specifically, paragraph 9 of the standard has been revised to state that the auditor should evaluate the effect of any modifications to the audit report on the financial statements when forming an opinion on supplemental information. The standard provides that:

- a. When the auditor expresses a qualified opinion on the financial statements and the basis for the qualification also applies to the supplemental information, the auditor should describe the effects of the qualification on the supplemental information in the report on supplemental information and should express a qualified opinion on the supplemental information.
- b. When the auditor expresses an adverse opinion, or disclaims an opinion on the financial statements, the auditor should express an adverse opinion, or disclaim an opinion, on the supplemental information, whichever is appropriate.

#### Reporting (Paragraphs 10 – 15)

The proposed standard included requirements regarding reporting on supplemental information that described the auditor's responsibilities when reporting on the types of supplemental information covered by the proposed standard.

The standard does not retain from AU sec. 551 the statement that the supplemental information "is presented for purposes of additional analysis and is not a required part of the

basic financial statements." One commenter supported retaining this wording in the standard. However, such a statement could be misunderstood by users as indicating that the supplemental information is supplied on a voluntary basis even when governed by rules regarding content or presentation. In fact, supplemental information presented by brokers, dealers, and others often is presented in conjunction with audited financial statements to comply with rules of regulatory agencies that generally specify the form and content of the information to be provided.

Further, the standard does not retain from AU sec. 551 the statement that "the audit has been performed for the purpose of forming an opinion on the basic financial statements taken as a whole." One commenter supported including this wording in the standard. However, such a statement could confuse users regarding the relationship between the audit of financial statements and the auditor's "in relation to" opinion on supplemental information given that audit procedures have been performed on the supplemental information that serve to support the auditor's "in relation to" opinion.

The reporting language in the standard is intended to clearly communicate the auditor's responsibilities regarding evaluating the supplemental information. For example, the standard requires the auditor's report to state that the supplemental information has been subjected to audit procedures performed in conjunction with the audit of the financial statements. Also, the standard includes a requirement for the auditor to describe the audit procedures on the supplemental information. This approach differs from the report language provided in AU sec. 551, which provides that the auditor's report should state that the supplemental information has been subjected to the auditing procedures that were applied in the audit of the basic financial statements.

Consistent with AU sec. 551, paragraph 11 of the standard states that, unless prescribed by regulatory requirements,<sup>37</sup> the auditor may either include the auditor's report on the supplemental information in the auditor's report on the financial statements or issue a separate report on the supplemental information. If the auditor issues a separate report on the supplemental information, the standard provides that the auditor's report on the supplemental information should identify the auditor's report on the financial statements.

The standard also includes an example of the auditor's report on supplemental information when included with the auditor's report on the financial statements.

One commenter suggested that the reporting elements include a statement that the supplemental information is the responsibility of management and that such a revision would serve to clarify the auditor's responsibility in this area. This recommendation has been incorporated into the list of required elements in the auditor's report on supplemental information. Some commenters expressed concern that report language in paragraph 13 of the proposed standard, ". . . and accordingly, its form and content comply, in all material respects, with the relevant regulatory requirements," could be viewed as a separate opinion regarding compliance or as conveying more responsibility for form and content than appropriate.

Because the intention of the proposed standard was not to require a stand-alone opinion on the supplemental information or on compliance, the standard includes revised report elements intended to emphasize that the auditor's evaluation of form and content is part of determining whether the supplemental information is fairly stated, in all material respects, in relation to the audited financial statements rather than a separate opinion on compliance. The revisions are also

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<sup>37</sup> For example, paragraph (g)(1) of SEC Rule 17a-5 requires the auditor to prepare an auditor's report on the broker's or dealer's financial report, which covers both the financial statements and supporting schedules.

responsive to commenters who were generally supportive that evaluating form and content is important to the auditor's determination of whether supplemental information is fairly stated in relation to the audited financial statements.

The standard states that if the auditor is unable to obtain sufficient appropriate audit evidence to support an opinion on the supplemental information, the auditor should disclaim an opinion on the supplemental information. In those situations, the auditor's report on the supplemental information should describe the reason for the disclaimer and state that the auditor is unable to and does not express an opinion on the supplemental information.

If the supplemental information consists of two or more schedules and the auditor is able to obtain sufficient appropriate audit evidence to support an opinion on some but not all schedules, the auditor may express an opinion on only those schedules for which he or she obtained sufficient appropriate evidence but should disclaim an opinion on the other schedules. The standard provides the elements that should be included in the auditor's report on supplemental information, many of which are the same as those included in the proposed standard.

Other commenters expressed concern that the reporting requirements in the proposed standard would require a registered public accounting firm to make a legal determination regarding a company's compliance with relevant regulatory rules. The auditor's report issued pursuant to the standard does not provide, or purport to provide, a legal determination of a broker's or dealer's compliance with the net capital rule or the reserve requirements rule or any other legal determination. However, such a report may be useful to legal counsel or others in making such determinations.

One commenter suggested including a reference to AU sec. 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report, in the proposed standard. The commenter suggested that this standard might be applicable in situations in which the date of the auditor's report on supplemental information is subsequent to the date of the auditor's report on the financial statements. Such a revision would serve to remind auditors of their responsibilities under AU sec. 561. A footnote to paragraph 12.b. was added to address this topic.

Comparison of the Requirements of Auditing Standard No. 17 with the Analogous Standard of the Auditing Standards Board of the American Institute of Certified Public Accountants

The release accompanying the proposed standard discussed certain noteworthy differences between requirements of Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, and the analogous standard of the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA"). The analogous standard of the AICPA is Statement on Auditing Standards, Supplementary Information in Relation to the Financial Statements as a Whole ("AU-C Section 725").<sup>38</sup> This comparison does not cover the application and explanatory material in the ASB standard.<sup>39</sup> The International Auditing and Assurance Standards Board does not have an analogous standard.

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<sup>38</sup> These AU-C Sections are contained in Statement on Auditing Standards No. 122, Statement on Auditing Standards: Clarification and Recodification ("SAS No. 122"). In October 2011, the ASB adopted SAS No. 122, which contains 39 clarified SASs with "AU-C" section numbers for each clarified SAS. The "AU-C" is a temporary identifier to avoid confusion with references to existing "AU" sections in AICPA Professional Standards.

<sup>39</sup> Paragraph A64 of the AU-C 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards, states that although such guidance "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

This discussion is provided for informational purposes only. It is not a summary of or substitute for Auditing Standard No. 17 itself. This comparison may not represent the views of the ASB regarding its standard.

### Conditions in Order to Opine on Supplemental Information

#### PCAOB

Auditing Standard No. 17 does not include conditions in order to opine on supplemental information. Such conditions are not considered necessary in the standard because the supplemental information covered by Auditing Standard No. 17 is generally required by the SEC or other regulatory bodies.

#### ASB

AU-C Section 725 states that, in order to opine on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should determine that: (a) the supplementary information was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements; (b) the supplementary information relates to the same period as the financial statements; and (c) the auditor issued an audit report on the financial statements that contained neither an adverse opinion nor a disclaimer of opinion. Although Auditing Standard No. 17 does not contain such explicit conditions, the scope of Auditing Standard No. 17 is similar to AU-C Section 725 in that both standards apply only when the auditor of the financial statements is engaged to perform audit procedures and report on supplemental information accompanying audited financial statements.

AU-C Section 725 also states that the auditor should determine that the supplementary information will accompany the entity's audited financial statements or that such audited

financial statements will be made readily available by the entity. Auditing Standard No. 17 does not require that the supplementary information accompany the entity's audited financial statements, or that such audited financial statements will be made readily available by the entity. Rather, rules of the SEC and other regulatory agencies specify the requirements for filing or furnishing supplemental information, and whether that supplemental information is to be made publically available.

### Performing Audit Procedures on Supplemental Information Accompanying Audited Financial Statements

#### PCAOB

Paragraph 4 of Auditing Standard No. 17 requires that the auditor perform the following procedures:

- Obtain an understanding of the purpose of the supplemental information and the criteria management used to prepare the supplemental information, including relevant regulatory requirements;
- Obtain an understanding of the methods of preparing the supplemental information, evaluate the appropriateness of those methods, and determine whether those methods have changed from the methods used in the prior period and, if the methods have changed, determine the reasons for and evaluate the appropriateness of such changes;
- Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplemental information;
- Determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable;

- Perform procedures to test the completeness and accuracy of the information presented in the supplemental information to the extent that it was not tested as part of the audit of financial statements; and
- Evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any.

Additionally, a note to paragraph 3.b. of Auditing Standard No. 17 includes a requirement that when planning and performing the audit procedures to report on supplemental information, the auditor generally should use the same materiality considerations as those used in planning and performing the audit of the financial statements. Additionally, that note further states that if applicable regulatory requirements specify a lower materiality level to be applied to certain supplemental information, the auditor should use those prescribed threshold requirements in planning and performing audit procedures for the supplemental information.

#### ASB

AU-C Section 725 requires that, in addition to the procedures performed during the audit of the financial statements, in order to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should perform certain procedures using the same materiality level used in the audit of the financial statements.

AU-C Section 725 specifically requires the auditor to inquire of management about the purpose of the supplementary information and the criteria used by management to prepare the supplementary information, such as an applicable financial reporting framework, criteria established by a regulator, a contractual agreement, or other requirements, and to determine

whether the form and content of the supplementary information complies with the applicable criteria.

Paragraph 4.a. of Auditing Standard No. 17 includes a requirement for the auditor to obtain an understanding of the purpose of the supplemental information and the criteria management used to prepare the supplemental information, including relevant regulatory requirements.

AU-C Section 725 requires the auditor to obtain an understanding about the methods of preparing the supplementary information and to determine whether the methods of preparing the supplementary information have changed from those used in the prior period and, if the methods have changed, the reasons for such changes.

Paragraph 4.b. of Auditing Standard No. 17 includes requirements that the auditor obtain an understanding of the methods of preparing the supplemental information, evaluate the appropriateness of those methods, and determine whether those methods have changed from the methods used in the prior period, and, if the methods have changed, determine the reasons for and evaluate the appropriateness of such changes. This last requirement can be important in determining whether the form and content of the information complies with relevant regulatory requirements.

AU-C Section 725 requires the auditor to compare and reconcile the supplementary information to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves. Paragraph 4.d. of Auditing Standard No. 17 includes a requirement for the auditor to determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements rather than only to those records used in preparing the financial statements. Certain schedules may be required by

the SEC or other regulators that are prepared from information not directly used to prepare financial statements.

### Management's Representations

#### PCAOB

Paragraph 5 of Auditing Standard No. 17 includes a requirement for the auditor to obtain from management certain written representations regarding the supplemental information.

#### ASB

AU-C Section 725 requires the auditor to obtain similar representations from management.

AU-C Section 725 states that the auditor should obtain from management representations that when the supplementary information is not presented with the audited financial statements, management will make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance by the entity of the supplementary information and the auditor's report thereon. Auditing Standard No. 17 does not require the auditor to obtain that representation because rules of the SEC and other regulatory agencies specify the requirements for furnishing supplemental information. Further, Auditing Standard No. 17 does not include a requirement that the auditor's report on the supplemental information be included in any document that contains supplemental information for the same reason, so a similar requirement in Auditing Standard No. 17 is not appropriate.

### Evaluation of Audit Results

#### PCAOB

Paragraph 6 of Auditing Standard No. 17 includes a requirement that to form an opinion on the supplemental information, the auditor should evaluate whether the supplemental

information, including its form and content, is fairly stated, in all material respects, in relation to the financial statements as a whole, including whether the supplemental information is presented in conformity, in all material respects with the relevant regulatory requirements or other applicable criteria.

Paragraph 7 of Auditing Standard No. 17 includes a requirement for the auditor to accumulate misstatements regarding supplemental information identified during performance of audit procedures on the supplemental information and in the audit of the financial statements and to communicate the accumulated misstatements regarding the supplemental information to management on a timely basis to provide management with an opportunity to correct them.

Paragraph 8 of Auditing Standard No. 17 includes a requirement for the auditor to evaluate whether uncorrected misstatements related to the supplemental information are material, either individually or in combination with other misstatements, taking into account relevant quantitative and qualitative factors.

### ASB

AU-C Section 725 requires the auditor to evaluate the appropriateness and completeness of the supplementary information, considering the results of the procedures performed and other knowledge obtained during the audit of the financial statements.

### Reporting

### PCAOB

Paragraph 10 of Auditing Standard No. 17 includes a requirement for the auditor to include certain elements in the auditor's report, including identification of the supplemental information, a statement that the supplemental information is the responsibility of management, a statement that the supplemental information has been subjected to audit procedures performed in

conjunction with the audit of the financial statements, and a description of certain audit procedures performed.

Paragraph 10 of Auditing Standard No. 17 also includes a requirement that, if the form and content of the supplemental information are prescribed by regulatory requirements or other applicable criteria, the auditor's report should include a statement that, in forming the auditor's opinion on whether the supplemental information was fairly stated, the auditor evaluated whether supplemental information, including its form and content, complies, in all material respects, with the specified regulatory requirements or other criteria.

Additionally, paragraph 10 of Auditing Standard No. 17 includes a requirement that if the supplemental information is presented on a basis that differs from the financial statements and that basis is not prescribed by regulatory requirements, the report should state that and describe the basis for the presentation.

#### ASB

AU-C Section 725 requires the auditor to include in an explanatory paragraph or separate report on supplementary information a statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole.

Auditing Standard No. 17 does not include similar language.

#### D. Request to Apply Auditing Standard No. 17 to Audits of Emerging Growth Companies

In developing Auditing Standard No. 17, the Board sought to develop a new auditing standard that takes into account the SEC's requirements for supplemental information in SEC Rule 17a-5. As part of its process, the Board also considered the SEC's economic analysis for its amendments to SEC Rule 17a-5, which included considerations relating to efficiency, competition, and capital formation. Notably, the SEC's analysis considers the economic effects,

including the costs and benefits, of the required use of PCAOB standards, and discusses the impact of such change on audits of financial statements and supporting schedules that are required by the SEC to be filed by registered brokers and dealers pursuant to SEC Rule 17a-5.<sup>40</sup>

In addition to considering the SEC's requirements and economic analysis, the Board also took into account other related economic considerations, including comments received on the proposed standard, as discussed further below.<sup>41</sup>

### Economic Baseline

Regulators such as the SEC make the determination regarding whether an entity must file supplemental information and whether auditors are required to report on that information.

To the Board's knowledge, the only entities that are required to file supplemental information to which the standard would apply are (1) brokers and dealers pursuant to SEC Rule 17a-5<sup>42</sup> and (2) covered 11-K filers.

Accordingly, the Board's consideration of the economic consequences of Auditing Standard No. 17 takes into account how the new standard differs from the pre-existing auditing

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<sup>40</sup> See the SEC Release at 220-226. Notably, after analysis of the views of commenters on the costs of the SEC's proposal to replace GAAS with PCAOB standards with respect to audits of brokers and dealers, the SEC concluded that the Commission "does not expect that a requirement that an audit of financial statements and supporting schedules be conducted in accordance with the standards of the PCAOB instead of with GAAS will result in substantial changes for broker-dealer audit programs and therefore the Commission does not anticipate that this change will result in significant costs to broker-dealers in the form of increased audit fees."

<sup>41</sup> The Board did not specifically request comments that attempted to quantify costs related to the auditing standard, but the Board did request comment on the appropriateness of the standard and received comments that pertained to audit effort and related costs that it considered. The discussion in this section reflects the Board's qualitative assessment of the standard.

<sup>42</sup> See paragraphs (d)(1)(i)(A) and (d)(2) of SEC Rule 17a-5.

standards applicable to supplemental information required in audits of brokers and dealers and covered 11-K filers.

For brokers and dealers, as discussed previously, the SEC's amendments to Rule 17a-5 require audits of brokers and dealers to be conducted in accordance with PCAOB standards. This includes the examination of the financial report, which consists of the financial statements and supporting schedules. Before the SEC's amendments to Rule 17a-5, audits of brokers and dealers were performed under generally accepted auditing standards ("GAAS"), established by the American Institute of Certified Public Accountants ("AICPA"). Specifically, AU-C Section 725-C, Supplementary Information in Relation to the Financial Statements as a Whole, addressed the auditor's responsibilities when auditors were engaged to report on supplemental information in relation to audited financial statements.

For covered 11-K filers, auditors generally use the reporting language in AU sec. 551 in preparing their auditor's reports on the supplemental information under PCAOB standards.

Both GAAS and AU sec. 551 use an "in relation to" approach to reporting. That is, the auditor's report on the supplemental information generally presents an opinion on whether the supplemental information is fairly stated in all material respects "in relation to" the audited financial statements taken as a whole. When reporting using the "in relation to" approach, the materiality considerations generally are the same as those used in forming an opinion on the basic financial statements taken as a whole.<sup>43</sup> However, GAAS includes requirements for audit procedures to be applied to the supplemental information, whereas AU sec. 551 generally does not specify audit procedures.

#### Consideration of Alternatives of Audit Approach

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<sup>43</sup> See e.g., AU sec. 551.08, which provides that the "measurement of materiality" under that standard is the same as that used in forming an opinion on the financial statements.

In developing Auditing Standard No. 17, the PCAOB sought to adopt a standard that is tailored to the circumstances under which supplemental information is required in SEC filings of brokers and dealers and covered 11-K filers.

Two principal alternatives were considered in developing the new standard<sup>44</sup> –

- A stand-alone audit of the supplemental information
- An "in relation to" approach

As adopted, Auditing Standard No. 17 builds on existing auditing standards by retaining the "in relation to" approach for reporting on supplemental information "in relation to" the financial statements as a whole. The PCAOB assessed the alternative, which would have required the supplemental information to be audited on a stand-alone basis. In the Board's view, the stand-alone alternative could require substantial additional audit effort because the materiality considerations would be substantially lower than in an "in relation to" approach.<sup>45</sup> The Board does not believe that this additional audit effort would enhance the quality of supplemental information significantly over properly performed testing and evaluation under the "in relation to" approach. In the Board's view, the use of the "in relation to" approach – together with the required coordination with the work on the financial statement audit – can accomplish the objectives of the financial statement audit and audit procedures on the supplemental information with more efficient use of resources than the alternative stand-alone approach.

Commenters on the proposed standard generally supported the use of the "in relation to" approach and generally observed that the "in relation to" audit opinion meets the needs of users

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<sup>44</sup> The preceding section discusses the Board's decision to adopt a new standard rather than retain AU sec. 551.

<sup>45</sup> In a stand-alone audit, the auditor would apply materiality considerations for the supplemental information by itself, which typically would be substantially lower than the materiality level for the financial statements as a whole. See e.g., paragraph .13 of AU sec 623.

in a cost-effective manner. Nothing in the comments received indicates that an "in relation to" opinion on supplemental information is inadequate for users of that information.

#### Additional Considerations

Auditing Standard No. 17 differs from AU sec. 551 in the following key respects:

- Auditing Standard No. 17 specifies audit procedures to be applied to test supplemental information, while AU sec. 551 generally does not specify audit procedures. Furthermore, those audit procedures include consideration of the regulatory requirements for supplemental information, for example, requirements to evaluate whether the supplemental information complies with the applicable regulatory requirements.
- The new audit procedures are risk-based so that the required level of testing of the supplemental information is commensurate with the risks of material misstatement.
- Auditing Standard No. 17 requires that the audit procedures on the supplemental information be "planned and performed" "in conjunction with" the auditor's work on the financial statement audit and, if applicable, other engagements.

In developing Auditing Standard No. 17, the Board has taken note of observations from its oversight activities regarding the inconsistencies and deficiencies in auditing practices regarding the application of auditing procedures to supplemental information. For example, a 2013 PCAOB inspection report on audits of brokers and dealers, which were performed under GAAS, indicated that PCAOB inspections staff in their inspections of broker and dealer audits identified auditing deficiencies in 57 of 60 audits and that deficiencies in auditing procedures

regarding supporting schedules were among the most frequently noted deficiencies in compliance with audit requirements.<sup>46</sup>

The Board believes that strengthening and clarifying the requirements for supplemental information – and tailoring the required procedures for the supplemental information required by regulatory authorities – will promote consistent auditor performance to support audit reports on supplemental information. Similarly, the risk-based approach set forth in the standard should direct auditors to devote more audit attention to the areas of greatest risk to material misstatement of the supplemental information. The auditor's enhanced focus on the supplemental information should help give regulators greater confidence about the reliability of the supplemental information used in their regulatory oversight, which is important to investor protection. For example, as noted previously, in the context of oversight of brokers and dealers, the audit performance requirements in the standard could improve the quality of supplemental information that regulators rely on when considering whether the broker or dealer maintains adequate safeguards over customer funds and securities.

The Board also has taken into account cost considerations in developing Auditing Standard No. 17. As discussed previously, the use of the "in relation to" approach can accomplish the objectives of the financial statement audit and audit procedures on the supplemental information with more efficient use of resources than the alternative stand-alone

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<sup>46</sup> See Second Report on the Progress of the Interim Inspection Program Related to Audits of Brokers and Dealers, PCAOB Release No. 2013-006 (August 19, 2013), which reports that PCAOB inspection staff identified auditing deficiencies in 57 of the 60 audits of brokers and dealers selected for inspection and that deficiencies in compliance with audit requirements for brokers and dealers under the Exchange Act that were among the most frequently noted by PCAOB inspection staff included deficiencies in audit procedures related to net capital and customer reserve supporting schedules, compliance with the conditions of the exemption claimed by the broker or dealer, and the accountant's supplemental report on material inadequacies. See PCAOB Release 2013-006, Executive Summary, at ii.

approach. Also, the risk-based approach helps avoid unnecessary procedures by focusing audit attention on areas of higher risk. Furthermore, the required coordination of the audit procedures on the supplemental information with the audit of the financial statements – and other engagements, when applicable – helps avoid unnecessary duplication of audit procedures. These measures can facilitate the transition to the new standard and help lessen the effects of the associated costs.

Auditing Standard No. 17 has some commonalities with GAAS, for example, the "in relation to" approach and the requirement to apply audit procedures to the supplemental information. This should help facilitate the transition from GAAS to Auditing Standard No. 17 generally and lessen the associated costs for 11-K filers that are audited under both GAAS and PCAOB standards.

The PCAOB acknowledges that the new standard will create some additional compliance costs for affected market participants. These costs include the one-time implementation costs for registered firms to update their audit methodologies to reflect the new standard and train their personnel. However, because, as mentioned above, the new standard builds on concepts in existing standards and has commonalities with GAAS, the PCAOB does not anticipate that changes associated with initial implementation will result in significant costs to auditors (or to brokers and dealers or covered 11-K filers in the form of increased audit fees).

Further compliance costs, which are associated with audit effort, may depend on auditors' existing auditing practices under pre-existing auditing standards and the size and complexity of the entity being audited.

The Board has taken note of the views of commenters on the proposed standard in assessing economic considerations. Some auditors who commented on the Board's proposal

indicated that the procedures required by the proposed auditing standard were similar to their current practices. Comments from other auditors suggested that they did not perform specific procedures to test supplemental information. To the extent that auditors already are testing supplemental information, the PCAOB does not anticipate significant incremental costs associated with compliance with Auditing Standard No. 17. Those incremental costs might be somewhat higher for auditors that have not been performing specific tests of supplemental information.<sup>47</sup>

Auditing Standard No. 17 is designed to be scalable based on an entity's size and complexity. Specifically, the audit effort under the standard likely will be greater for entities that have more supplemental information or more complex supplemental information. For example, audit effort generally would be greater for larger, more complex brokers or dealers that carry securities for customers than for smaller, less complex brokers that neither carry nor clear securities. Similarly, audit effort generally would be greater for larger, more complex covered 11-K filers that have more investments and reportable transactions subject to regulatory reporting requirements.

#### Applicability to Audits of Emerging Growth Companies

The Board is adopting Auditing Standard No. 17 pursuant to its authority under the Sarbanes-Oxley Act.<sup>48</sup>

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<sup>47</sup> The auditors whose comments suggested that they did not perform specific procedures on supplemental information did not address in their letters their current practices for complying with GAAS, which requires audit procedures for supplemental information. To the extent that those auditors apply audit procedures to supplemental information in audits under GAAS, the Board anticipates that the costs of transitioning to Auditing Standard No. 17 would not be significant.

<sup>48</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002). Under Section 101 of the Sarbanes-Oxley Act, the mission of the PCAOB is to oversee the audit of companies that are subject to the

Before rules adopted by the Board can take effect, they must be approved by the SEC. Pursuant to Section 107(b)(3) of the Sarbanes-Oxley Act, the SEC shall approve a proposed rule if it finds that the rule is "consistent with the requirements of [the Sarbanes-Oxley] Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors."

Additionally, Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act")<sup>49</sup> amended the Sarbanes-Oxley Act to provide that any additional rules adopted by the PCAOB after April 5, 2012 do not apply to audits of emerging growth companies ("EGCs")<sup>50</sup> unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."<sup>51</sup>

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securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. Section 103 of the Sarbanes-Oxley Act authorizes the Board to adopt auditing standards for use by registered public accounting firms in the preparation and issuance of audit reports "as required by [the] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors."

<sup>49</sup> Pub. L. No. 112-106, 126 Stat. 306 (2012).

<sup>50</sup> Section 3(a)(80) of the Exchange Act defines the term "emerging growth company." An issuer generally qualifies as an EGC if it has total annual gross revenue of less than \$1 billion during its most recently completed fiscal year (and its first sale of common equity securities pursuant to an effective Securities Act registration statement did not occur on or before December 8, 2011.) See JOBS Act Section 101(a), (b), and (d). Once an issuer is an EGC, it retains its EGC status until the earliest of: (i) the first year after it has total annual gross revenue of \$1 billion or more (as indexed for inflation every five years by the SEC); (ii) the end of the fiscal year after the fifth anniversary of its first sale of common equity securities under an effective Securities Act registration statement; (iii) the date on which the company issues more than \$1 billion in non-convertible debt during the prior three-year period; or (iv) the date on which it is deemed to be a "large accelerated filer" under the Exchange Act (generally, an entity that has been public for at least one year and has an equity float of at least \$700 million).

<sup>51</sup> See Section 103(a)(3)(C) of Sarbanes-Oxley (15 U.S.C. §7213(a)(3)), as added by Section 104 of the JOBS Act, Pub. L. No. 112-106 (April 5, 2012).

The following discussion is intended to provide information that may assist the SEC in any determination it may make regarding whether to apply the new standard to audits of EGCs.

As noted above, Auditing Standard No. 17:

- Strengthens and clarifies the audit requirements regarding supplemental information to promote consistent audit performance and compliance with regulatory requirements, which can enhance the quality of information that is used in regulatory oversight for investor protection and, with respect to covered 11-K filers, increase the quality of information available to investors;
- Helps lessen the effects of the costs associated with the new auditing standard by retaining the "in relation to" approach, setting forth a risk-based approach for the required audit procedures, and requiring coordination with the financial statement audit to avoid redundancy in testing; and
- Is designed to be scalable based on the size and complexity of the entity.

The PCAOB has begun monitoring implementation of the JOBS Act to better understand the characteristics of EGCs and inform the Board's considerations regarding whether it should recommend to the SEC that it apply the new standard and related amendments to audits of EGCs. Based on the PCAOB's research of self-identified EGCs, a substantial majority of EGCs are smaller reporting companies that began reporting under the Exchange Act in 2012 or later.<sup>52</sup>

Currently, the PCAOB is not aware of EGCs for which auditors would be required to apply this standard. PCAOB staff has performed research on filings of self-identified EGCs. Text

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<sup>52</sup> See Appendix 7 of The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, Reports on Audited Financial Statements, and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report, and Related Amendments to PCAOB Standards, PCAOB Release No. 2013-005 (August 13, 2013).

searches were used to identify any issuers with audit reports that opine on supplemental information required by Rule 17a-5, and PCAOB staff read the most recent filings of those companies. For those companies for which audited financial statements were available and based on information included in the most recent audited financial statements filed as of May 15, 2013, PCAOB staff has observed that none of the EGCs is a broker or dealer or an 11-K filer. The staff observed one SEC filing containing supplemental information for which an auditor expressed an opinion. Based on the nature of the supplemental information filed, it appears that the issuer included the supplemental information voluntarily rather than pursuant to a requirement specified by rule.

As noted previously, to the Board's knowledge, the only entities that are required to file supplemental information to which Auditing Standard No. 17 will apply are (1) brokers and dealers pursuant to SEC Rule 17a-5 and (2) covered 11-K filers. PCAOB staff has discussed the applicability of the JOBS Act to this rulemaking with the SEC staff. The reporting regimes for registered brokers and dealers under SEC Rule 17a-5 and the reporting regime for employee benefit plans that must comply with financial reporting requirements under both ERISA and the SEC are separate and distinct from those for companies subject to reporting requirements pursuant to Section 13 and 15 of the Exchange Act or for a Securities Act registration statement. The Board defers to the SEC on the applicability of the JOBS Act to this rulemaking for these entities and stands ready to assist the SEC with any additional analysis that may become necessary.

In the event that the standard would be applied to an EGC, the Board has no reason to believe that the economic effects on those EGCs would be different from those described previously for brokers, dealers, and covered 11-K filers. Accordingly, and pursuant to the

foregoing discussions, the PCAOB requests that the Commission, to the extent necessary, determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply these amendments to audits of EGCs.

### III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Pursuant to Section 19(b)(2)(A)(ii) of the Exchange Act, and based on its determination that an extension of the period set forth in Section 19(b)(2)(A)(i) of the Exchange Act is appropriate in light of the PCAOB's request that the Commission, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, determine that the proposed rules apply to audits of emerging growth companies, as defined in Section 3(a)(80) of the Exchange Act, the Commission has determined to extend to [insert date 90 days from the date of publication in the Federal Register] the date by which the Commission should take action on the proposed rules.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Sarbanes-Oxley Act. Comments may be submitted by any of the following methods:

#### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/pcaob.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number PCAOB-2013-02 on the subject line.

#### Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2013-02. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/pcaob.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without charge; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. PCAOB-2013-02 and should be submitted on or before [insert 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill  
Deputy Secretary

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