PUBLIC OVERSIGHT BOARD STAFF

STATUS REPORT:

THE RECOMMENDATIONS OF

THE PANEL ON AUDIT EFFECTIVENESS,

AS OF FEBRUARY 15, 2002

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The August 31, 2000 report of the Panel on Audit Effectiveness contained recommendations directed at 14 groups of stakeholders in the financial reporting process. Many of the recommendations are addressed to more than one group. This Status Report summarizes the extent to which those stakeholders have responded to the most significant of the Panel's recommendations.

Objective and Methodology

The Panel expressed its confidence that the Public Oversight Board (POB) "will monitor the progress toward implementing the recommendations in [its August 31, 2000] report." The POB accepted that responsibility, and immediately instituted a program for tracking the status of the Panel's recommendations.

The POB staff reported to the Board on the status of the Panel's recommendations on a regular basis. Information about the status of many recommendations came from the staff's monitoring and oversight activities, for example, its oversight of the Auditing Standards Board (ASB) to whom many of the Panel's recommendations were addressed. In preparation for this Status Report, the staff compiled a list of all of the Panel's recommendations and, to the extent it had first-hand knowledge, determined the actions taken. If the staff did not have first-hand knowledge of the status of a particular recommendation, it requested and received information from the organization or body to whom the Panel addressed the recommendation. (The staff had no way to determine, however, the extent to which some stakeholder groups, such as audit committees, were responsive to the Panel's recommendations.) The Board reviewed the Status Report and suggested amendments to it. The evaluations included in this Report represent the judgments of the POB staff, after considering the views of the Board and those to whom many of the Panel's recommendations were addressed.

An Overview of the Panel's Report

While the primary purpose of this Status Report is to summarize how the various stakeholders have responded to the Panel's report, the reader also should focus on the Panel's thought processes as it considered the environment in which audits take place and formulated its recommendations. The logic underlying the Panel's report is helpful in understanding how the Panel's recommendations continue to be relevant in today's environment.

For example, the Panel observed that "audits improve the reliability of financial statements, make them more credible and increase shareholders' confidence in them. . . Accordingly, a fundamental assumption underlying the Panel's study and recommendations is its belief that, for many reasons, the value of audits and the public's need for effective audits remain undiminished and in fact may be greater than ever before."

The Panel noted "the dramatic increases in 'new economy' service- and technology-based businesses with predominantly intangible assets; large increases in the number of individuals who directly or indirectly own equity securities." It also recognized the "extreme pressures on management to achieve earnings, revenue or other targets," and how the technology explosion "has contributed significantly to the enormous growth in large audit firms' consulting practices," leading the Panel to the conclusion that "examining the efficacy of the audit process alone is not the answer to assessing audit effectiveness."

The Panel also described the importance of a strong, unified self-regulatory framework for the profession, noting that an effective regulatory body should have a majority of public members, be independent of both the profession and regulators, develop an atmosphere of mutual respect and confidence with regulators, and report periodically to the public regarding its activities. Those criteria for effective regulation of the profession are no less relevant in the context of the current proposals for a successor body to the POB than they were in the Panel's context of revisions to the system of governance centered around a strengthened POB.

While the Panel's proposals to enhance the auditor's ability to detect fraud – such as through introducing a "forensic-type" phase in every audit – are described later in this report, it is important to note that the Panel explicitly accepted the premise that "a GAAS audit is not, and should not become, a fraud audit." The Panel also recognized that "the primary responsibility for the prevention and detection of fraud rests with management, boards of directors and audit committees," not with the auditor. Accordingly, the Panel suggested that management needs to create a culture that deters fraud and "should set and communicate clear corporate policies against improper conduct. Directors and audit committees should oversee management's activities and demonstrate a strong commitment and involvement when problems arise." Recent events have demonstrated the wisdom of these observations.

A final example of the Panel's understanding of the environment in which audits take place and how that environment affects the financial reporting process is its awareness that "a substantial portion of litigation against audit firms . . . involves revenue recognition issues" and that "financial statements generally are replete with accounting judgments and estimates." That awareness led the Panel to recommend significant enhancements to auditing standards to help auditors in auditing revenues and accounting estimates. But it also led the Panel to believe that it is not auditors alone, but accounting standard-setters and audit committees as well, who have a role to play in evaluating and making more transparent the judgments and estimates that enter into the reporting process, thereby generating recommendations to the FASB and audit committees as well as to the ASB.

The Panel's overall conclusions can be briefly summarized as follows:

- The risk-based approach to audits of financial statements is appropriate, but it needs to be enhanced, updated, and implemented more consistently.
- Auditors should perform "forensic-type" procedures on every audit to enhance the prospects of detecting material financial statement fraud.
- The governance of the auditing profession should be enhanced through a strengthened POB that would oversee the processes of setting auditing standards, monitoring auditor performance, and disciplining auditors for substandard performance, as well as conduct special reviews as appropriate.

While this Status Report indicates that many of the Panel's recommendations have been addressed by the various stakeholders in the financial reporting process, no conclusions should be drawn about the extent to which the actions taken to date have enhanced audit effectiveness. The Panel's report was published less than two years ago, and none of the stakeholders has completed the process of responding to the Panel's recommendations. In many cases, new standards or other forms of guidance or audit policy are at the draft or Exposure Draft stage; in some cases, new standards, guidance, or policies have been promulgated but are not yet effective; and in most cases audits have not yet been performed under those standards, guidance, or policies. In addition, the Board's decision to terminate its existence by March 31, 2002, which is discussed below, forestalls the ability to evaluate the extent to which the public interest has benefited from the POB's new Charter that was adopted in response to the Panel's recommendations for enhancing the profession's governance.[1]

Increasing the Auditor's Responsibilities

The Panel's recommendations in chapters 2, "Improving the Conduct of Audits," and 3, "Earnings Management and Fraud," were aimed directly at enhancing the effectiveness of audits of the financial statements of public companies. Those recommendations reflected three major themes:

- Definitive auditing standards establish the starting point for promoting quality audits. Based on this belief, the Panel's recommendations to the ASB suggested the need to examine existing auditing standards critically, with the objective of revising or replacing some or all of them with more specific and definitive guidance containing imperatives to guide auditors in formulating their judgments and carrying out their work.
- Audit firms need comprehensive and vigorous audit methodologies, based on auditing standards, to drive the behavior of their auditors to a higher plane. Accordingly, the Panel recommended that audit firms reexamine their methodologies and other guidance in specific areas to make them more comprehensive and vigorous, that they enhance the training of audit personnel in those methodologies, and that they convey a culture of high professionalism as the principal message to their auditors, with corresponding incentives, rewards, and penalties.
- The peer review process is a critical element in "closing the loop" to assure the public that audit performance measures up to high standards and continues to improve. Thus, the Panel made numerous recommendations aimed at enhancing the effectiveness of peer reviews by making them more frequent and more rigorous.

Recommendations to the Auditing Standards Board

The Panel's principal recommendation in the area of the conduct of audits is that the ASB develop stronger and more definitive auditing standards to improve the likelihood that auditors will detect fraudulent financial reporting. These new standards also could serve as deterrents to fraud by posing a greater threat to its successful concealment.

The Panel envisioned new fieldwork requirements beyond those now contemplated by an audit performed in accordance with generally accepted auditing standards (GAAS). Key to implementation of the recommendation would be the ASB's creating a "forensic-type" phase on

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[1] The Board's decision to terminate its existence, conveyed in a January 21, 2002 letter to the chairman of the SEC, was the result of the chairman's announcement at a news conference on January 17, 2002 outlining the structure and role of a successor oversight body that did not include the POB.

all audits – not converting GAAS audits into "fraud" audits, but adding or integrating a phase into GAAS audits during which auditors would approach their procedures with heightened skepticism and a specific focus on the potential for earnings management and fraud.

The incremental procedures envisioned by this recommendation would be based on the possibility of dishonesty and collusion, management override of controls, and falsification of documents. This would modify the neutral concept of professional skepticism heretofore required in a GAAS audit. (In a GAAS audit, professional skepticism includes a questioning mind and a critical assessment of audit evidence, but the auditor neither assumes that management is dishonest nor assumes unquestioned honesty.)

The Panel's recommendation specifies that auditors should:

- in planning and supervising the audit, discuss with engagement team members the vulnerability of the entity to fraud
- perform tests directed at the possibility of fraud
- examine non-standard journal entries
- analyze certain opening financial statement balances to assess, with the benefit of hindsight, how certain accounting estimates, judgments, and other matters identified in the prior year's audit were resolved
- consider incorporating an element of surprise or unpredictability in their tests
- apply procedures in interim periods using a forensic-type approach equivalent to that developed for annual audits

The ASB immediately formed a task force to consider the need to revise existing standards in response to the Panel's recommendation, and in February 2002, the ASB voted to expose a draft of a new Statement on Auditing Standards (SAS).

The Exposure Draft does not call for a "forensic-type" phase, but it incorporates many of the Panel's specific recommendations. The proposal includes requirements and guidance about:

- engagement personnel discussing the risks of material misstatements due to fraud
- expanding inquiries of entity personnel regarding the risk of fraud
- identifying risks that may result in a material misstatement due to fraud
- evaluating the entity's programs and controls that address the identified risks
- planning and performing procedures that respond to the identified risks

- planning and performing procedures that further address the risk of management override of controls, as noted below

- evaluating audit test results

- communicating conclusions about fraud to management, the audit committee, and others

- documenting the auditor's consideration of fraud

The proposal increases the focus on professional skepticism. Audit team members should set aside any prior beliefs they may have about management's honesty and integrity when considering the possibility of fraud, and should not be satisfied with audit evidence that is less than persuasive because of a belief that management is honest.

Revenue recognition ordinarily would be considered an “identified” risk of material misstatement due to fraud. Thus, in almost all audits of public companies, auditors would be required to plan and perform procedures that respond to that risk.

The proposed SAS specifies selected substantive procedures that would be applied in the audit of every public company. The specified procedures respond in part to the risk of management override that cannot be readily addressed through reliance on controls. The tests proposed to further address this risk include:

- examining journal entries and other adjustments

- reviewing accounting estimates for bias, including a retrospective analysis

- evaluating the business rationale for significant unusual transactions

In a related effort, the AICPA, in conjunction with other organizations, is developing additional guidance on programs that corporate managements can use to combat and help prevent fraudulent financial reporting. This guidance would be directed to several audiences, including auditors and audit committees, as well as management. Its publication would be timed to coincide with the planned issuance of the SAS on fraud in late 2002.

The exposure draft of the SAS states that, "by its nature, management override of controls can occur in unpredictable ways." In recognition of that unpredictability, The Panel believed that fraud would more likely be prevented and detected if auditors were required in all audits to direct auditing procedures specifically toward fraud detection, in what it referred to as a “forensic-type” phase. The intent was for auditors to be creative in considering how fraud could occur and each year devise tests oriented to that possibility. In addition to areas identified as high risk, the Panel’s recommendations would have encouraged auditors to consider accounts and locations otherwise thought to be “low or moderate risk.” This would have recognized that, as the exposure draft states, “by its nature, management override of controls can occur in unpredictable ways.”

The ASB has significantly expanded its existing guidance and believes that it substantially complies with the Panel's recommendation. While the POB staff would have preferred implementation of the Panel's "forensic-style" phase, the staff hopes that the ASB's approach achieves the objective of an increased likelihood of detection of fraud.

The ASB has responded to other Panel recommendations that it:

- Give priority to completing the work of its technology task force, formed to consider how auditing standards should reflect the use and impact of information technology. (The ASB issued SAS No. 94, *The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit*, in May 2001.)
- Specify appropriate minimum documentation requirements generally, as well as in one specific area, namely, analytical procedures. (SAS No. 96, *Audit Documentation*, issued in January 2002, specifies those requirements. In addition, all future task forces will be instructed to consider documentation requirements in conjunction with revisions or additions to auditing guidance.)
- Complete its proposed audit guide on revenue recognition, require cutoff tests of revenue transactions in certain circumstances, and clarify the standard on the confirmation process to require confirmation of the terms of significant, high risk revenue transactions. (The ASB issued an audit guide, *Auditing Revenue in Certain Industries*, in June 2001 that provides guidance on those procedures, among others. However, the ASB has not specifically required cutoff tests or clarified the confirmation standard.)
- Provide more specific guidance on the use of analytical procedures as substantive tests. (An audit guide, *Analytical Procedures*, was issued in September 2001. That guide did not address the linkage of analytical procedures to other auditing procedures. As discussed below, the ASB's Risk Assessments Task Force is expected to address the linkage issue generally.)
- Provide additional guidance to assist auditors in determining whether identified misstatements are material. (The ASB issued four Interpretations in October 2000. Materiality also was addressed in the revised audit guide, *Audit Sampling*, issued in July 2001.)
- Create a GAAS "hierarchy" to specify the authoritative and quasi-authoritative guidance auditors should follow. (SAS No. 95, *Generally Accepted Auditing Standards*, issued in December 2001 established such a hierarchy. As part of that project, the ASB catalogued documents of varying levels of authority in the auditing standards literature. A listing of these documents will be included in an appendix to the codification of the SASs.)
- Revise SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* to establish more definitive and specific criteria and requirements for testing the work performed by internal auditors. (The ASB's Audit Issues Task Force concluded that the discussion in the Panel report did not support the recommendation and decided not to revise the SAS. However, the AICPA's Audit and Attest Standards staff has been directed to update and revise prior guidance in an existing AICPA Auditing Practice Study.)

- Establish a protocol with the Financial Accounting Standards Board (FASB) to assess the auditability of proposed accounting standards before they are issued, and formalize the existing liaison with the FASB. (Although no formal protocol has been established, the ASB issued a comment letter on auditability issues related to the FASB's proposed standards on accounting for business combinations and goodwill. The ASB and its Audit Issues Task Force worked with the FASB staff on implementation issues that arose following the issuance in September 2000 of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities.* The ASB and FASB will continue periodic liaison meetings to discuss matters of common interest, but they will not be an official part of the structure of either body.)
- Initiate a formal collaborative effort with the International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC) to harmonize auditing standards internationally and achieve their global acceptance.[2] (The ASB and the IAPC have initiated several joint activities and attend each other's meetings. Among the joint activities is a project to improve the audit risk assessment process and the linkage of the auditor's risk assessments to the related audit procedures.)

Several ASB projects that would respond to Panel recommendations are in process. Among the Panel's recommendations that fall into this category are several that the Risk Assessments Task Force – a joint task force of the ASB and the IAPC – is in the process of addressing and has brought to the full Board for further guidance. The ASB and the Task Force are preparing a new standard that would expand and make more specific the auditor's responsibilities to assess risk, and link the understanding of those risks to assertions at the account balance and class of transactions level and to the nature, timing, and extent of substantive tests. The eventual SAS is expected to address the auditor's consideration of materiality in planning the audit and designing audit tests, and how materiality and risk assessments are related. The ASB also plans to consider related documentation requirements. In addition, the Risk Assessments Task Force will consider the Panel's recommendation that analysts' reports and forecasts be incorporated into the auditor's risk assessment process.

Additional guidance on auditing accounting judgments and estimates is in process. Also, various ASB task forces are reviewing the standards of fieldwork not addressed by other specific Panel recommendations to ensure that they are sufficiently specific and definitive to guide auditors in formulating their judgments and performing their work. A joint task force of the ASB, the Peer Review Committee (PRC), the Quality Control Inquiry Committee (QCIC), and the Accounting and Review Services Committee is performing a similar review of the Statements on Quality Control Standards. When that task is completed, those bodies should be in a position to implement the Panel's recommendation to establish a mechanism for ongoing monitoring of the quality control standards to keep them current.

The ASB has not yet added a project to address recommendations that it develop more specific and definitive guidance for multi-location audits. However, the IAPC has such a project

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[2] IFAC has approved an extended role for the IAPC and suggested that its name be changed to the International Auditing and Assurance Services Board. It is anticipated that the new board will be in place in April 2002.

underway and an ASB observer attends the task force meetings. The ASB will monitor the activities of the IAPC to determine what action it should take on multi-location audit guidance.

Two of the Panel's recommendations to the ASB – both of which involve accounting standards – have not been acted on because the ASB believes that the issues involved are not solely within its purview. The Panel recommended that the ASB specify, in cooperation with the FASB if necessary, that there be only one method of handling prior periods' uncorrected misstatements when determining whether proposed adjustments are material. The ASB considered the issue, but suspended the project until the accounting issues have been resolved. The Panel also recommended that the ASB provide expanded guidance and specific examples of the auditing procedures to be performed and the audit evidence to be obtained when considering management's plans for mitigating the adverse effects of conditions and events that raised substantial doubt on the part of the auditor about the entity's ability to continue as a going concern. The ASB would like to undertake a project to revise SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, but believes that it would be more effective after the FASB has addressed the Panel's accounting recommendations in this area. (See the discussion of the status of recommendations to the FASB below.)

Recommendations to Audit Firms

The Panel's principal recommendations to audit firms are that they should put more emphasis on the performance of high quality audits and that senior management should communicate this message to the firms' professionals.

The Panel recommended that, in their "corporate cultures," each firm should:

- Emphasize a strong commitment to high quality audits.
- Reestablish the importance of the role of independent auditors within their organization.
- Ensure that performing high quality audits is recognized as the highest priority in performance evaluations and in compensation and promotion decisions for all audit personnel.
- Embed intolerance for audit failures into the firm's culture.

In certain areas, the firms should increase and improve their guidance materials to ensure that they are specific and definitive and they should improve their training materials. The Panel also recommended that the firms encourage increased consultation among professionals and take strong actions with respect to auditors who do not consult when appropriate.

In determining firms' progress in implementing the Panel's recommendations, the POB requested a status report from the 13 largest accounting firms in the United States. The eight largest firms and two others responded to the POB's request. This report summarizes those responses; it is based solely on the firms' representations to the POB, which made no attempt to verify their accuracy.

The firms' responses generally were extensive and provided significant details about their activities in implementing the Panel's recommendations. Overall, the firms appear to have been responsive to the recommendations or believe they had already implemented their substance.

With respect to implementing the Panel's recommendations relating to firm culture, the firms believe that auditing is an important part of their practice and that the concept of "zero tolerance" for audit deficiencies is a part of their culture. Additionally, most firms report increasing internal consultation requirements and are emphasizing its importance to engagement partners and managers. Training and guidance are being improved, where necessary. However, most of the firms did not indicate whether performing high quality audits would be the most important part of compensation and promotion decisions.

The Panel also recommended that the firms review and ascertain whether they need to augment their audit guidance in various areas, including:

- The process by which auditors identify risk.
- The effectiveness of auditors' work on internal controls.
- The linkage of risk assessments to the nature, timing, and extent of substantive tests.
- The level of involvement of IT specialists or auditors with such knowledge in the audit process.
- Analytical procedures, reliance on internal auditors, and reporting to audit committees.
- Using at least experienced managers to review the resolution of "exceptions" found in the course of an audit.
- Cut-off tests of revenue when inherent or control risks relating to such transactions are other than low, and when there is a high level of sales transactions or individually significant sales transactions near the end of the reporting period.
- Using analysts' reports, forecasts, and other information management provides to the investment community and the public, to assist the auditor in understanding the entity's business and evaluating the materiality of potential adjustments.

The ten firms that replied to the POB's request indicated that they had responded positively, in varying degrees, to most of the above recommendations to enhance their audit guidance. Some needed to make less significant enhancements than others, as they already had built some of the recommendations into their audit methodologies. A few recommendations did not elicit a response from the majority, namely, the recommendation that auditors increase their cut-off tests of revenue and that a partner be involved in evaluating the client's reserve activity and other critical issues during interim reviews.

The Panel recommended that audit firms recognize that the board of directors and audit committee, acting on the behalf of the shareholders, are the parties to whom they are accountable. In that spirit, the Panel recommended that firms gain an explicit understanding of the audit committee's expectations and respond to them appropriately. The firms believe that they understand who their ultimate client is and continue to work with boards of directors and audit committees to ensure that they understand their role.

The Panel further recommended that the firms' internal inspection programs cover the use of IT specialists, internal auditors, and experienced audit professionals in the assessment of inherent and internal control risks and corresponding tests of controls, and the linkage to substantive procedures. The firms' responses addressed most of these items.

The Panel report noted the need for improvements in worldwide accounting and auditing quality. The firms appear to share this view. Most of the firms report that all or most of their international offices are subject to internal reviews and that each office must meet minimum global firm standards.

The Panel recommended that the firms ensure that their representatives on the SEC Practice Section (SECPS) Executive Committee have sufficient authority and responsibility to commit their firms to protecting the public interest whenever this would conflict with a more favorable business position, and ensure that the public interest remains the paramount objective in the representative's decision-making and voting. The firms have represented that their respective members have the necessary authority and focus on the public interest.

The firms cited a variety of practices that they believe have helped enhance audit effectiveness. Among these are:

- Requiring all professionals to take a computer-based training program, "Consideration of Fraud in the Financial Statement Audit."

- Requiring all partners and managers to take a two-hour training session delivered by forensic experts to increase the awareness of risks that result in financial statement fraud.

- Creating an awareness video that covers revenue issues, such as "bill and hold" transactions, side agreements, right of return, percentage of completion, and channel stuffing, and a four-hour training course that supplements the video.

- Creating new practice aids and guidance for receivable confirmations, including guidance on when accounts receivable must be confirmed and when e-mail and fax responses are acceptable.

- Sharing its client acceptance and retention risk assessment guidance, which includes performing background checks on key client personnel prior to accepting the client, with other firms.

Recommendations to the Peer Review Committee

The Panel made numerous recommendations to enhance the effectiveness of peer reviews. One of the most significant was that the PRC implement all the recommendations in the January 25, 2000, report of the SECPS's Peer Review Process Task Force. The PRC has made progress in this regard and continues to work on implementing the recommendations. The PRC conducted a pilot program during 2001 to test certain aspects of the planned changes to the peer review process and is planning to implement additional recommendations in 2002.

The Task Force's major recommendation was that the peer review process provide for differences between the reviews of the largest firms and other firms, in recognition of the greater public interest in the largest firms' audit practices. The Task Force also recommended that some portion of the review of the largest firms be performed each year, with an annual report being furnished to the PRC and the POB and a triennial report continuing to be made available to the public. In addition, the Task Force recommended that the public report on all peer reviews be expanded to provide more information about the scope and results of the review performed. The Task Force also recommended that reviewers:

- Place more emphasis on important issues currently facing the profession, the industry and the entity whose audit is being reviewed.

- Place more emphasis on the qualitative aspects of the elements of quality control and engagements reviewed.

- Conduct focus group sessions of seniors and managers within the offices reviewed and increase the emphasis on interviewing members of the engagement teams whose audits are being reviewed.

- Integrate the reviews more thoroughly with the firms' internal inspection programs.

- Identify best practices and matters for the attention of standard setters and disseminate this information.

The PRC accomplished the following:

- Expanded the peer review report to provide more information about the reviews. For example, the new reports better describe the objectives of a peer review and how they are conducted. In addition, the peer review reports were streamlined to make them more understandable in situations where the reports are modified or adverse.

- Directed reviewers to conduct focus group sessions of seniors and managers within the offices reviewed, at least for the largest firms.

- Changed the SECPS membership requirements to require the largest firms to have specified annual procedures performed during the years between their triennial peer reviews. The procedures for 2001 were substantially completed, but no reports were issued. The PRC intends to fully implement these procedures and issue reports in 2002.

- Developed pilot supplemental review questionnaires for use on a sample of the largest firms' engagements. These questionnaires placed more emphasis on important issues and on the qualitative aspects of the engagements, although not as much emphasis on the qualitative aspects as the Panel had in its Quasi Peer Reviews. In addition, reviewers placed more emphasis on gathering information from interviews of the members of those engagement teams. While the reviewers collected some information on best practices and matters for the attention of standards setters, the information was not considered by the PRC to be important enough to be reported to others. The reviewers' experiences with the pilot program were discussed at two debriefing sessions held by the PRC. The POB encourages the PRC to collect such information in a more formal manner during the 2002 peer reviews to enhance the PRC's consideration and reporting of it.

The PRC has made progress on or implemented the recommendations regarding enhancing the training programs for peer reviewers, evaluating their performance, and making peer review reports and materials accessible on the Internet.

The Panel made some additional recommendations to the PRC that, for the most part, have not been accepted or implemented. They include:

- Making clear to peer reviewers that the POB, as the public's representative, not the firm being reviewed, is the primary client.

- Covering the business aspects of the reviewed firm's practice that are closely related to the firm's professional practice.

- Developing specific performance measures, to be included in the peer review report, that relate to the quality of the reviewed firm's practice/effectiveness of audits. (The Task Force also made a similar recommendation.)

The PRC has implemented the Panel's recommendation that peer reviews cover the U.S. firm's reviews of selected financial reports/filings of foreign registrants that are audited by the U.S. firm's foreign-associated firms.

In many of the technical, firm management, and personnel-related matters that the Panel considered, the Panel recognized that the peer review process is a critical element in "closing the loop" to provide assurance to the public that audit performance measures up to high standards and continues to improve. As a consequence, the Panel recommended that the PRC request peer reviewers, when reviewing those matters, to:

- Evaluate the adequacy of the firms' policies and procedures, guidance materials, and training materials.

- Emphasize these matters in their reviews, often including making more qualitative judgments.

- Assess the timeliness, frequency and appropriateness of internal messages from firm leaders about audit quality.

- Assess the role that performing high-quality professional work plays in performance reviews and in compensation, promotion and retention decisions.

- Assess the extent of time pressures on audit engagements and the firm's success in managing those pressures.

- Include their findings with respect to those matters in their report to the PRC.

The PRC has partially implemented the first five items as part of conducting the focus group sessions and using the pilot supplemental review questionnaires described previously. The last recommendation was not implemented.

The PRC intends to amend its peer review standards after it has had experience with and successfully implemented the Task Force's and the Panel's recommendations.

Almost all of the firms that audit public companies are subject to peer review. The Panel also recommended that the SEC mandate required peer reviews for all firms that audit public companies. As to foreign-based firms, the Panel recommended that the requirement be extended to participating in the peer review or similar monitoring programs in their locations. The Commission responded that, since less than 100 domestic firms that audit public companies are not peer reviewed, it may need to consider the costs and benefits of mandating peer reviews for those relatively few firms. The SEC staff supports peer reviews of foreign-based firms and intends to encourage the efforts of the IFAC in this area.

Enhancing Auditor Independence

The Panel made recommendations regarding auditor independence in two areas – non-audit services and the governance, operating policies, and POB oversight of the Independence Standards Board (ISB).

While the Panel did not recommend that auditors be prohibited from performing any or all non-audit services for audit clients, it did urge the ISB to identify factors that auditors, audit committees, and client management should consider in determining the appropriateness of a specific non-audit service. The Panel further recommended that the SEC and the ISB evaluate on an ongoing basis the effectiveness of the disclosures about the provision of non-audit services made by auditors to audit committees under ISB Standard No. 1 and by registrants under the

SEC's proxy requirements. The Panel recommended that the ISB reconstitute its membership to include proportionately greater public representation, and that the POB's Charter give it oversight of the ISB.

The Panel's recommendations in these areas have been overtaken by events that transpired since the Panel's report and before its recommendations could be implemented. In November 2000, the SEC issued new independence rules, including new proxy disclosure rules related to non-audit services; in July 2001, the ISB voted to terminate its existence; and in early 2002 the five largest accounting firms announced their intent to no longer provide internal audit and certain information technology services to their audit clients. These events essentially preempted the Panel's recommendations to the ISB.

As a result, there is little authoritative guidance on the factors that auditors, audit committees, and client management should consider in determining the appropriateness of a specific non-audit service, other than those contained in the Panel's report. The SEC has stated, however, that its staff will continue to evaluate the effectiveness of disclosures made pursuant both to ISB No. 1 and the SEC proxy requirements during its review and comment process, enforcement investigations, and other staff activities. The SEC also has indicated that its staff intends to consult with the AICPA's Professional Ethics Executive Committee (PEEC) and others to address independence issues.

Governance of the Auditing Profession

An entire chapter of the Panel's report was devoted to the governance of the auditing profession. A major portion of that chapter included a discussion of and recommendations for a new system of governance based on a strengthened, independent POB with a formal charter that would specify the Board's responsibilities and powers.

The POB's Charter was adopted by the AICPA and the POB in February 2001. Departures from the Panel's recommendations are described below. The essential elements of the POB's responsibilities and powers granted by the Charter include an initial budget ceiling of $5.2 million, exclusive of unanticipated oversight reviews, that is adjusted annually for inflation; oversight of the SECPS and its various committees, task forces, and activities; and oversight of the ISB (see the discussion above) and the ASB.

The Charter differs in certain ways from the Panel's prescription:

- The POB does not have sole authority to determine its budget, as the Panel recommended. The POB staff believes, however, that neither the budget ceiling nor the Charter's requirement that it consult with the SECPS Executive Committee and possibly the AICPA Board of Directors on budgetary matters creates impediments to the POB's authority to determine its own budget and financial and other resources, and the profession's obligation to provide those resources.
- The Panel recommended that the members of the POB's nominating committee should be appointed by the POB from names suggested by public and private

institutions that are most concerned with the quality of audits and financial reporting. The POB's charter, however, provides for the nominating committee to consist of the POB chair or designee, a former public member of the AICPA Board to be selected by the AICPA Board, and a person from the private sector to be selected by the other two committee members. The POB staff believes that the Charter's process for appointing the nominating committee is simpler and better than the process recommended by the Panel.

- The POB's charter does not provide for establishing an advisory council, as the Panel recommended. Instead, the charter provides for the POB to hold an annual outreach meeting to solicit views and recommendations about the accounting profession's self-regulatory program and the POB's oversight process. In addition, the POB's charter provides that the tri-annual review of the POB's effectiveness address whether the annual outreach meeting alleviates the need for an advisory council. The Charter did not establish an advisory council because it was believed that a combination of outreach meetings, discussions with SEC staff, and meetings of the POB's Coordinating Task Force (all of which took place in 2001) would provide adequate means of obtaining views and recommendations about the accounting profession's self-regulatory programs and the POB's oversight process. The outreach meetings also provide a vehicle that helps to achieve the objective of another Panel recommendation, namely, facilitating meaningful continuing dialogue between the POB and state boards of accountancy.

The POB staff believes that its Charter substantially complies with the spirit of the Panel's recommendations for the Charter. However, SEC Chairman Pitt's proposal for a Public Accountability Board that would supersede the POB, was one of the reasons which led to the POB's decision to terminate its existence, renders academic both the POB's Charter and any differences between the Charter and the Panel's recommendations.

The Panel also recommended that the AICPA provide and allocate additional resources to the ASB, SECPS, and QCIC staffs. The AICPA has stated that it has provided and is committed to providing the financial and human resources necessary to meet its mandates and to assist in protecting the public interest.

In addition, the Panel recommended that the SECPS Executive Committee continue to approve the members of its constituent committees (QCIC, PRC, and SEC Regulations Committee, and the Professional Issues Task Force that issues periodic "Practice Alerts" to auditors of SEC registrants) and that these committees continue to report to the Executive Committee. These approvals and reporting relationships continue in effect.

<u>Improving Audit Effectiveness Globally</u>

The Panel recommended that the self-regulatory structure of the international auditing profession include the creation of a global oversight body that would monitor and report on the activities of the self-regulatory organizations of individual countries. That body should ensure that IFAC imposes on its member organizations minimum guidelines for the self-regulation of the auditing profession in each country. The Panel's report also included recommendations on the governance, structure, and responsibilities of the global oversight body.

A global oversight body – the International Public Oversight Board (IPOB) – is being organized. The seven-member board that is being assembled will include representatives from IFAC, the International Organization of Securities Commissions (IOSCO), and leading monetary and lending agencies. Early drafts of the IPOB's charter have been modeled after the U.S. POB's new charter.

The IPOB's responsibilities will include oversight of international quality control standards and the progress of individual countries' self-regulatory organizations in promoting external quality reviews and reporting on their results. A global peer review process, to be monitored by the IPOB, is in the formative stages, with implementation anticipated within approximately five years. An international QCIC-type process also is under consideration.

The global self-regulatory structure proposed by the Panel included a body composed of audit firms – which currently refers to itself as the Forum of Firms (FOF) – that would work with IFAC to raise international standards and provide funding for the IPOB. The FOF, consisting of the five largest and most other sizable transnational audit firms, has been formed, and its constitution and operating policies were approved by IFAC in April 2001.

Improving the Disciplinary Process

The Panel recommended that QCIC should enhance its disciplinary process when it decides, after studying a case involving an alleged audit failure, to refer the matter to the PEEC because there may be engagement personnel issues of significance or because QCIC believes PEEC should open an investigation of certain engagement personnel. In those situations PEEC informs the firm involved that PEEC's consideration of the matter is being deferred in accordance with the Ethics Division's policy, pending the termination/completion of the litigation or public regulatory investigation, or the end of the threat of litigation. In order to protect the public in these situations, the Panel recommended that the firm be required to select one of three options, if it had not already done so, regarding the engagement partner (or other engagement personnel in some instances) during the period of deferral, if the partner was still with the firm:

- Terminate or retire the partner.

- Remove the partner from all public company audit engagements until the Ethics Division's process is completed.

- Perform an additional second partner review of all public company audit engagements completed by the partner in the 12 months prior to the deferral and subject the partner to additional oversight on all public company audit engagements for at least one year.

The QCIC promptly adopted this recommendation and the SECPS adopted a membership requirement, “Procedures in Connection with an Alleged Audit Failure,” that is consistent with the Panel’s recommendation.

QCIC also has adopted the Panel’s other recommendations to it regarding:

- Providing the ASB with information on its findings with respect to litigation involving fraud and with its views on the detection of fraud as the ASB was developing its proposed new SAS.

- Initiating ongoing reviews with the ASB, PEEC, and PRC regarding factors that appear to be influencing audit performance.

- Enhancing its access to industry specialists and experts with whom it can consult as necessary during its consideration of cases.

The Panel also recommended that the SEC allocate additional resources to enforcement activities, recognizing the budgetary constraints under which the SEC operates. In 2000 the SEC took several “first steps” to target financial fraud and audit failures, including increasing the number of accountants in enforcement activities and creating a Financial Fraud Task Force for accelerated investigations of major cases of fraud.

The Panel noted that the SEC’s enforcement releases provide useful lessons, and recommended that the SEC periodically analyze them and publish the results. The Commission has noted its limited resources and stated its doubts about the marginal benefits of staff analyses, given that other organizations study the enforcement releases. The Panel also suggested that the SEC document information about the auditor’s work when misstatements occur, even if the auditor is not named in the release. The SEC indicated that it does, and will continue to, document the role of auditors in financial frauds.

Accounting Issues

The Panel recommended that the FASB add three accounting issues to its agenda: revenue recognition, estimates and judgments, and going concern considerations.

The Panel believed that an authoritative standard on the broad principles of revenue recognition was needed. More recently, the SEC also has suggested that the FASB consider a similar project. In January 2002, the FASB issued a request for comments on a proposal to undertake a project related to the recognition of revenues and liabilities.

The Panel also noted issues surrounding the accounting for contingent liabilities and other estimated expenses and losses. The Panel noted that the existing literature offers little clarification on when the intent of management can result in an asset having been impaired or a liability having been created. Accordingly, the Panel recommended that the FASB clarify the accounting for contingencies to enable more consistent application of the criteria for accruing losses. The FASB has not added a project that would respond to this recommendation to its agenda. The FASB noted, however, the existence of certain projects of the FASB and the EITF related to impairments and liabilities in a business combination. The proposed project on revenue and liabilities also may address aspects of the Panel's recommendation.

An auditor is required to assess an entity's viability and the related disclosures. The Panel noted, however, that accounting standards do not address definitional and disclosure issues related to whether an entity can continue as a going concern. Accordingly, it recommended that the FASB define the going concern concept (clarifying that management, not the auditor, has the primary responsibility to assess viability) and promulgate disclosure requirements. The FASB has discussed the Panel's recommendation with the AICPA but has not determined to take any action on it.

Audit Committees

The Panel noted that a strong, independent audit committee is an increasingly important element in corporate governance. The Panel had several suggestions for audit committees, addressing communications with auditors, internal control, fraud deterrence and detection, estimates and judgments, and auditors' performance of non-audit services.

The more significant recommendations were that audit committees should:

- Devote more time and attention to internal control discussions with management and both internal and external auditors.
- Evaluate the nature of their companies' various reserves and review reserve activity with management and auditors.
- Specify that the auditor is accountable to the board and audit committee.
- Inquire about time pressures on auditors.
- Ensure that their agenda focuses on, among other things, significant risks, key controls, interim financial data, management policies and practices for communications with analysts, and qualitative aspects of financial reporting.
- Require that management and the auditor advise the committee of any plans on the part of the client to employ audit firm personnel.
- Request management to report on the control environment and how it serves to deter and detect fraud.
- Pre-approve non-audit services that exceed a threshold determined by the committee.

Some organizations (such as the Financial Executives International) drew their members' attention to the Panel's report. Also, the SEC Chairman sent a letter in January 2001 to the audit committee chairmen of the largest 5,000 public companies, citing the Panel's guidance that audit committees could use to determine the appropriateness of non-audit services performed by the company's auditor. He encouraged audit committees to consider that guidance in their discussions with auditors.

The POB has no effective way to determine the extent to which audit committees have studied or acted on the Panel's recommendations. The POB staff believes that recent events have made the Panel's recommendations in this area all the more relevant and urges all boards of directors and their audit committees to consider them.

The following pages contain all recommendations in the Panel report, sorted by addressee, and the status of responses as of February 15, 2002. Each recommendation includes the paragraph number to indicate its location in the Panel Report.

Recommendations	Status
Auditing Standards Board	
2.23 Many of the Panel's recommendations to the ASB in specific areas suggest the need to examine existing auditing standards critically, with the objective of revising or replacing some or all of them with more specific and definitive guidance containing imperatives to guide auditors in formulating their judgments and carrying out their work. (Some of the recommendations to the ASB seek to make its quality control standards similarly more specific and definitive.) In so doing, the ASB should not pay blind homage to the current audit risk model when there are more useful or practical alternative approaches.	General charge to the ASB that should be kept in mind as "a mission statement" message for the development of new auditing standards.
2.24 A call for standards that provide specific and definitive guidance is not a call for standards that diminish or remove the need for auditor judgment. Nor is it a call for standards that incorporate detailed checklists of auditing procedures. A good example of an existing standard that the Panel believes contains a specific and definitive imperative is found in the section of SAS No. 67, The Confirmation Process, titled "Confirmation of Accounts Receivable." In fact, a number of the Panel's recommendations call for auditors to make explicit judgments in areas where they may not always be doing so.	General charge to the ASB that should be kept in mind as "a mission statement" message for the development of new auditing standards.
2.25 By observing that the ASB need not adhere to the current audit risk model, the Panel implicitly recognizes the potential for changes to that model to promote audit effectiveness and meet the ever-changing needs of the auditing profession. The ASB should not feel constrained to follow a model that is inflexible and incapable of being adapted to meet emerging needs or new business conditions. For now, however, the Panel's evaluation of the audit risk model essentially supports its continuation, as enhanced and updated by the Panel's recommendations.	General charge to the ASB that should be kept in mind as "a mission statement" message for the development of new auditing standards.
2.26 A major objective of auditing standards should be to help audits serve not only to detect material fraud but also, by being perceived as rigorous, to deter fraud from occurring in the first place. Toward that end, the Panel recommends that auditing standards require auditors to possess a far deeper understanding of the entity's business processes, risks and controls, and that substantive tests with the principal objective of detecting material financial statement fraud be designed and performed on all audits.	General charge to the ASB that should be kept in mind as "a mission statement" message for the development of new auditing standards.
2.27 The Panel believes that the ASB, with its access to staff and volunteer resources with information technology expertise and its contacts with the	

academic community, could act as a catalyst for identifying how technology might facilitate and improve the audit process. Research efforts in partnership with audit firms and academia might lead to breakthrough ideas that could benefit the auditing profession. The Panel encourages the ASB to pursue this suggestion.	General charge to the ASB that should be kept in mind as "a mission statement" message for the development of new auditing standards.
Assessing inherent risk 2.48 The Panel recommends that the ASB: Require the auditor to make inherent risk assessments for significant account balances and classes of transactions by considering what could go wrong at the individual assertion level No longer permit the auditor to default to assessing inherent risk at the maximum for efficiency or other reasons without considering what could go wrong in specific financial statement assertions Provide additional guidance regarding the factors that affect inherent risk, including the entity's business processes and risks, and the depth of the auditor's understanding of those factors Indicate the depth of auditor knowledge and the nature of activities or procedures (and provide some examples of such activities or procedures) that the auditor might perform to support assessing inherent risk (at both the financial statement and account or class of transactions levels) below the maximum	The task force is currently addressing these recommendations. The ASB's expectations are to vote out an exposure draft in the fall of 2002. The revised standards will require the auditors to: Make risk assessments for significant account balances and classes of transactions. Eliminate the ability to default to maximum inherent risk assessment. Expand the range and depth of information that the auditor should understand about the entity and its environment, including its internal control, as part of the basis for assessing the risks of material misstatements to the financial statements. Provide guidance regarding factors that affect the risks of material misstatement. Require the auditor to support the risk assessment.
Multi-location audits 2.57 The Panel recommends that the ASB: Develop more specific and definitive standards for multi-location audits to cover such matters as: How the auditor's consideration of the control environment (taken alone or in combination with other factors) should influence the selection of locations to be covered or the way procedures are to be carried out The extent of knowledge and involvement needed by the auditor with final responsibility for decisions about the locations and the key personnel assigned to perform the work at them Criteria (including materiality considerations) for periodically rotating	The ASB has assigned an AITF member to work with the IAPC Subcommittee, which is working on this topic. While technically not an official member of the IAPC subcommittee, the AITF member will have an opportunity to participate in discussion and to debate the issues. As the IAPC work develops, the AIFT will evaluate how to incorporate such guidance into U.S. GAAS and what changes, if any, need to be made to a U.S. standard to be responsive to the recommendations. The IAPC subcommittee has met once and was

the coverage of smaller locations Reliance on internal auditors for coverage of various locations Methods of establishing materiality at different locations The scope of work to be performed at different sizes and types of locations Emphasize in its guidance that accounting systems, controls, personnel and other circumstances can vary widely from location to location within an entity, and that these variations should be considered explicitly in decisions about how many and which locations to visit and the nature, timing and extent of work to be performed at each of them. The guidance also should recognize that analytical procedures may be useful in helping to select the locations to be visited, especially when there are many rather homogeneous locations.	expected to meet again in March 2002, at which time it is expected to make known its significant issues and preliminary conclusions.
Assessing control risk	
2.77 The Panel recommends that the ASB: Provide more specific guidance on: The required depth of auditor knowledge and understanding about internal control Whether and to what extent auditors may rely on their assessments of the effectiveness of the control environment (including corporate governance) and management's high-level monitoring of the business to support control risk assessments below the maximum The nature and extent of documentation needed, particularly to support the auditor's consideration of internal control in planning the audit and in assessing control risk The circumstances, if any, in which auditors may rely entirely on detailed audit tests with either no reliance on controls or reliance only at the control environment level Identifying and focusing on key controls for the purpose of determining what could go wrong and what controls to test Linking the "components of internal control," including transaction-level controls, with identified risks and detailed audit tests The nature, timing and extent of controls testing in varying circumstances The circumstances, if any, permitting rotating tests of controls over two or more years in areas in which the auditor intends to rely on controls The circumstances, if any, in which tests of controls also may constitute substantive tests (dual purpose tests) The necessary level of testing of management reports and other	Some of these recommendations were addressed in SAS No. 94 (see below), such as the fourth sub-bullet. The Joint Risk Assessments Task Force is reviewing the auditor's consideration of the risk assessment process, including the necessary understanding of the entity and its environment, the entity's response to risk, and how the auditor should use the risk assessment to determine the auditing procedures to be performed. A more robust understanding of the entity and the risks of material misstatements to the financial statements will be required. Specific categories for understanding are expected to include: Nature of the entity; Industry, regulatory and other external factors including accounting policies; Objectives and strategies and related business risks, as well as the entity's own risk assessment process; Measurement and monitoring of the entity's performance; and Internal control including the control

internal data sources used by the auditor in performing analytical procedures or other audit tests Indicate the importance of having personnel with significant audit and industry experience participate in performing internal control work, particularly at the planning stage	environment, the information system relevant to financial reporting and relating business processes, control procedures, and monitoring of controls. The task force is considering each of these bullet points. Additionally, as part of developing the new standard(s), the task force will consider and specificy documentation requirements. An exposure draft is expected in the Fall 2002.
Give priority to completing the work of the ASB technology task force that was formed to consider the manner in which auditing standards taken as a whole appropriately reflect the use and impact of information technology and whether changes should be made to auditing standards	SAS No. 94 approved by ASB in April 2001.
Linking the risk assessments to substantive tests	
2.106 The Panel recommends that the ASB: *Linkage* Develop more definitive authoritative guidance on linking the nature, timing and extent of substantive tests to risk assessments, including guidance aimed at the nature of procedures and at reducing the incidence of inadequate sample sizes and variations in sample sizes in similar circumstances. *Substantive Tests* Articulate more precisely the considerations that should be present to overcome the presumption that it is necessary to send confirmations. Undertake research to develop more effective methods of confirmation or other means of obtaining evidence from third parties, such as through the use of technology.	The Joint Risk Assessments Task Force is working on a project, the expected output of which will be a new standard(s) that will provide guidance to auditors linking the auditor's risk assessment to the nature, timing and extent of auditing procedures. An exposure draft is expected in the Fall 2002. While the task force is addressing the second bullet, it has not yet determined whether it is necessary to conduct research to achieve the objectives of the last bullet of the recommendation. Note: This is a joint ASB/IAPC task force. The "Linkage" task force (which was recently combined into the Joint Risk Assessments Task Force) met a few times but dealt only with peripheral matters. It has yet to get to the crux of the project, namely guidance for linking the assessed levels of risk to the nature, timing and extent of procedures performed. The original plan was the products of the three task forces (risk assessments, fraud and tests of assertions) would be exposed together as a package of amendments to codify and amend the fieldwork standards. However, risk assessment and

	linkage have been delayed, and the current plan is to attempt to complete the fraud standard in advance of the others.
Analytical procedures	
2.123 The Panel recommends that the ASB: Enhance auditing standards for analytical procedures to provide more specificity about what auditors need to do to design and perform analytical procedures in differing circumstances. The auditing standards should: Provide guidance on how to design substantive analytical procedures for different types of accounts and assertions Clearly articulate how relevant auditing concepts (e.g., the concepts of planning materiality, control risk assessment and testing of controls, and desired levels of assurance) influence the design and performance of analytical procedures Provide guidance on linking analytical procedures in the overall review stage to the auditor's conclusions reached in the audit and the sufficiency of the audit evidence that supports those conclusions	The ASB's Analytical Procedures Audit Guide Working Group has revised and updated the prior Analytical Procedures Audit Practice Study (APS). This document has been upgraded to an Audit Guide, *Analytical Procedures*. The document was published in September 2001. The task force is currently working on a project, the expected output of which will be a new standard(s) that will provided guidance to auditors, linking various risk assessment processes to the nature, timing and extent of auditing procedures.
Develop more guidance on when it is appropriate (and when it is inappropriate) for the auditor to rely on management's explanations during the course of the audit and on obtaining additional evidence to corroborate those explanations	Reliance on management's expectations and the need to corroborate those explanations have been addressed in the *Analytical Procedures* Audit Guide and will further be addressed in the linkage process. Additionally, the fraud exposure draft will have a section dealing with evaluating whether analytical procedures performed as substantives tests or in the overall review stage of the audit indicate a previously unrecognized risk of material misstatement due to fraud.
Specify appropriate documentation requirements	Amendment to SAS No. 56 included in SAS 96, *Audit Documentation*, issued in January 2002, addresses this recommendation.
Auditing revenue	
2.139 The Panel recommends that the ASB: Require that auditors test the cutoff of revenue when inherent or control risks relating to such transactions are other than low and specifically when there is a high level of sales transactions or individually significant sales transactions near the end of the reporting period. Cutoff tests should be more extensive than tests of only a few transactions before and after the close of the period. Cutoff testing often should require the auditor's physical presence at	Cutoff and confirmation issues have been addressed in the *Auditing Revenues in Certain Industries* Guide, issued in June 2001. However, a specific requirement to test the cut-off of revenue is not included in the guide.

the entity's location(s) at period end. Clarify its standard on the confirmation process (SAS No. 67) to address the circumstances in which confirmation of the terms of transactions should be required. The terms of revenue transactions should be confirmed whenever the transactions are individually significant and the risks associated with revenue recognition or the existence of receivables is high. This might be appropriate even if the auditor believes that confirmation of balances is ineffective.	This issue is also being considered by the Joint Risk Assessments Task Force in its deliberations regarding the linking of risk assessments to the design of auditing procedures. The ASB has not issued further guidance clarifying the circumstances in which confirmation of the terms of transactions should be required, other than to recommend this procedure in the aforementioned Audit Guide.
Give the highest priority to completing its proposed audit guide for revenue recognition	The new Audit Guide, *Auditing Revenue in Certain Industries*, was issued in June 2001.
Auditing estimates and judgments	
2.160 The Panel recommends that the ASB: Provide detailed guidance regarding the auditing of reserves. The Panel understands that the ASB intends to prepare a guide for auditing reserves along the lines of the Notice to Readers, Audit Issues in Revenue Recognition, that it issued in 1999. The Panel urges the ASB to assign a high priority to this effort and provide guidance on what constitutes sufficient evidence to support reserve balances and activity, including what is needed to corroborate documentation generated by the entity.	ASB staff guidance in process; expected issuance date is the Spring of 2002.
Establish a protocol to assess the auditability of proposed accounting standards prior to their issuance. Any field tests of proposed standards also should include evaluations of their auditability. Further, the liaison between the ASB and the FASB that exists currently should be made formal to help ensure timely identification of and reaction to audit issues related to accounting standards.	Discussions with FASB and AcSec staff have occurred. A comment letter was issued on auditability issues related to FASB Proposed ED, *Business Combinations and Intangible Assets -- Accounting for Goodwill*. The Audit & Attest staff and ASB will continue to monitor the development of new accounting standards and will provide input and comments to accounting standard setters when auditability issues are identified. However, a formal protocol has not been established.
Materiality, waived adjustments and analysts' expectations	
2.177 The Panel recommends that the ASB: Provide additional authoritative guidance to assist auditors in determining whether identified misstatements are material. (The Panel understands the ASB is considering this subject.)	Four Auditing Interpretations were issued in October 2000. The task force is considering analysts' expectations

Require the auditor to consider published analysts' reports and forecasts (in addition to other information) when gaining an understanding of the entity's business and industry, assessing risks and considering whether the effects of identified misstatements are qualitative material.	in its deliberations on gaining a proper understanding to plan and conduct an audit.
Specify, in cooperation with the FASB if necessary, that there be only one method of handling prior periods' uncorrected misstatements when determining whether proposed adjustments are material. (The Panel understands that this matter is on the ASB's agenda and recognizes that the ASB and FASB likely would need to develop an appropriate method of transitioning to the chosen method.)	After consideration of the issue with all affected constituencies, the project was suspended. This item will be discussed with the SEC during the March liaison meeting. The ASB asserts that they are ready to draft additional guidance once the accounting issues are addressed.
Going concern considerations	
2.187 The Panel recommends that the ASB provide expanded guidance and specific examples of the auditing procedures to be performed and the audit evidence to be obtained when considering management's plans for mitigating the adverse effects of conditions and events that raised the auditor's substantial doubt about the entity's ability to continue as a going concern. Particular consideration should be given to circumstances in which reliance is placed on proposed cost reductions and other prospective financial information.	Amendment to SAS No. 59 included in SAS No. 96, *Audit Documentation*, issued in January 2002 enhances the documentation requirements. ASB would like to undertake a project to revise SAS 59, but currently believes that such a project would be more effective after the accounting recommendations are addressed. The ASB is revising SAS No. 71, Interim Financial Information, to update and enhance the guidance on reviews of interim financial statements. The current standard has no guidance related to going concern issues. This project would include those issues, but the ASB feels handicapped significantly by the lack of accounting standards in this area. (See status of recommendation to the FASB at 2.190.)
Internal Auditors	
2.199 The Panel recommends that the Auditing Standards Board revise SAS No. 65 to establish more definitive and specific criteria and requirements for testing the work performed by internal audit.	AITF has discussed the recommendation and concluded that the discussion in the Panel report did not support the recommendation and decided not to revise the SAS. However, the ASB staff was directed to update the APS entitled, *The Independent Auditor's Consideration of the Work of Internal Auditors.*

Establishing audit standards	
2.232 The Panel recommends that the ASB: GAAS Hierarchy and Access to Guidance Definitively set forth the “hierarchy” of GAAS, including the authoritative status of existing AICPA guidance. The SASs should specify the guidance auditors should use in performing audits, whether that guidance is explicitly in the SASs or elsewhere.	SAS 95, *Generally Accepted Auditing Standards,* was issued in December 2001. This standard addresses the GAAS hierarchy.
Ensure distribution and accessibility of ASB pronouncements to all AICPA members who provide attest services	Accessibility to all AICPA Professional Standards is available through CPA2Biz electronically or hard copy. AICPA professional standards are also available through PPC’s CD.
Auditing Standards and Quality Control Standards Generally Review all the standards of fieldwork not addressed elsewhere in this report for the purpose of ensuring that they are sufficiently specific and definitive, either within the SASs or elsewhere in the GAAS hierarchy, to guide auditors in formulating their judgments and carrying out their work. While the ASB may decide to differentiate between auditing standards applicable to both non-public and public entities and those applicable only to public entities, in general the Panel discourages such practice, especially with standards of fieldwork, since investors might be confused by the varying levels of audit quality that could result.	This recommendation will be addressed on an ongoing basis by respective task forces.
Perform a similar review, in collaboration with the Peer Review Committee and QCIC, of the Statements on Quality Control Standards to ensure that they also are specific and definitive. (See the Panel’s recommendations to the SEC Practice Section and the ASB in the section “Enhancing Peer Reviews” in Chapter 6.)	The Joint Quality Control Standards Task Force is considering matters related to Statements on Quality Control Standards (SQCSs) to determine whether additional standards, amendments, interpretations or supplementary guidance are needed. The above task force is also revising the AICPA’s, *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm’s Accounting and Auditing Practice* to reflect the two most recent SQCSs and the recommendations in the Panel report. As a result of this updating process, recommendations may be made to the ASB, as appropriate, to amend the SQCS to add more specificity to the Quality Control standards. The Joint Quality Control Standards Task Force consists of representatives of the AICPA’s ASB, the Accounting and Review Services Committee, the Peer Review

	Board, the Quality Control Inquiry Committee, and the SEC Practice Section Peer Review Committee.
Materiality Evaluate the guidance in SAS No. 47, Audit Risk and Materiality in Conducting an Audit, on the auditor's consideration of materiality in planning the audit and designing audit tests and on how materiality and risk assessments are related.	The Joint Risk Assessment Task Force is considering the recommendation.
As part of this effort, the ASB also should review its auditing standard on audit sampling, SAS No. 39, Audit Sampling. The ASB's review should address whether more definitive guidance in the area of materiality – including the effects of materiality judgments on decisions about audit emphasis, the extent of audit testing and sample sizes related to specific objectives – might lead to more effective audits.	Recommendation considered in revised (and upgraded) Audit Guide, *Audit Sampling*. The new guide was issued in June 2001.
The ASB should request firms to share with it their guidance on materiality to assist it in its deliberations. The ASB also should consider appropriate research (possibly with the cooperation of firms, academic researchers and peer reviewers) on how the materiality concept is applied in practice. The Panel believes that this effort likely will result in modifications to auditing standards, unless the ASB is satisfied on the basis of its research that the present guidance is sufficient to drive effective materiality judgments in planning the audit and designing audit tests.	
Working Papers and Documentation Enhance SAS No. 41, Working Papers, to include criteria regarding the minimum documentation working papers should contain. The criteria for documentation to be included in working papers should be sufficiently specific to enable reviewers to understand the audit work performed, who performed and reviewed the work, and the nature of the audit evidence examined.	SAS 96, *Audit* Documentation, was issued in January 2002 addressing this recommendation.
Provide sufficient guidance in the quality control standards about working paper documentation to enable firms and peer reviewers to judge the quality of engagement performance (including the supervision of the work of assistants). The ASB should link the two sets of working paper standards to each other.	SAS 96 includes footnotes references to quality control standards. Joint Quality Control Task Force is considering the need for revised guidance to address documentation issues relating to documenting compliance with QC policies.

Review all the fieldwork standards to ensure that there is definitive guidance within the SASs (or elsewhere in the GAAS hierarchy) on the type and extent of documentation that should be contained in the working papers. For example, the ASB should consider areas where specific documentation requirements similar to those contained in SAS No. 82, Consideration of Fraud in a Financial Statement Audit, would likely enhance audit effectiveness, and it should amend or modify the SASs accordingly.	SAS 96, *Audit Documentation*, includes amendments to SAS No. 47, 56 and 59. All future task forces will be instructed to specifically consider documentation requirements.
2.233 The Panel recommends that, consistent with the POB's role of oversight over the ASB's agenda and processes, the POB review the ASB's prioritization, timetable and process for addressing the Panel's recommendations to it. In so doing, the POB and the ASB should consider the following observations and insights offered by the Panel:	The POB has established oversight over the ASB's agenda and process.
Priorities and Timetable	
This chapter and Chapter 3 contain many recommendations to the ASB. These recommendations have been organized along the same lines as the QPR, generally tracking the key elements of the audit risk model, but they have not been assigned priorities. The Panel has expressed the view that its recommendations to the ASB in Chapter 3 reasonably could be effective starting with audits of financial statements for periods commencing after December 31, 2001. Otherwise, it has not endeavored to prioritize its recommendations or set forth a timetable for their implementation. The Panel recognizes, however, that its recommendations in some audit areas are closely linked with those in other areas and require coordination when the ASB sets priorities and its agenda. The POB should ensure that the recommendations are addressed in a timely and effective manner.	The POB has established a tracking mechanism for reporting actions and progress on the Panel's recommendations and task forces of the ASB are currently working on Chapter 3 recommendations.
ASB Due Process	
The Panel is aware that the ASB follows due process in formulating and promulgating GAAS and quality control standards, including subjecting its proposed pronouncements to public exposure and comment. The ASB process weighs the relative benefits of its proposals with the attendant costs of implementing them. While respecting the importance of the ASB's due process, the Panel expresses confidence that its recommendations to the ASB, taken as a whole, are both reasonable and capable of implementation in a cost-effective manner.	The POB is cognizant of the due process in establishing GAAS and has closely monitored the due process followed in formulating and voting on the exposure draft covering audit documentation. The POB is providing input and commentary about due process as appropriate.

Research and Innovation	
The Panel is aware that current or future research by the academic community and others may be relevant to matters addressed in its recommendations to the ASB. Furthermore, the Panel acknowledges that the ASB will need to adapt GAAS and quality control standards to respond to new or evolving business conditions and demands on auditors. The Panel has developed its recommendations to meet both the current needs of investors for assurances on financial statements required under the present securities laws and the needs of investors in the reasonably foreseeable future. The Panel has not attempted, however, to predict the future "state-of-the-art" in accounting, the quantity or nature of financial and non-financial information that will be demanded by the marketplace, or how such information might be disseminated to and assimilated by investors in the longer term. (Chapter 8 contains the Panel's vision of some issues that pose a challenge in the years ahead.) Although the Panel believes that the ASB should consider carefully the results of research and the visions of accounting and auditing futurists, the ASB should not delay its timely pursuit of the Panel's recommendations until the research has been completed and evaluated.	The ASB has commissioned several research proposals and the POB has requested an inventory and status report from the ASB on research projects.
Earnings management and fraud	
3.48 The Panel recommends that the ASB develop stronger and more definitive auditing standards to effect a substantial change in auditors' performance and thereby improve the likelihood that auditors will detect fraudulent financial reporting.	Various standards being developed by the ASB will include, among other things, the following: Revised approach to assessing risk factors. Increased inquiry of management and others. Role of team discussions. Presumption that certain procedures should be performed to address risk of management override of controls.
3.49 The Panel envisions that the new requirements would be over and above those that are now contemplated by a GAAS audit. The degree to which these requirements would require additional audit effort is likely to vary with a number of factors, such as the size and complexity of the entity's operations and the difficulty of applying accounting principles that call for management to make judgments involving subjective estimates. The additional audit effort also would be influenced by the auditors' risk assessments – including their assessments of management's motivations (potentially at many levels of an entity) to manage earnings and meet the expectations of the financial community or of higher levels of management – and their understanding and tests of internal control. The Panel believes that the incremental audit effort	The ASB has not specifically adopted the specific Panel's recommendation that a "forensic phase" be included in all audits. However, in February 2002, the ASB voted to expose a draft of a new Statement on Auditing Standards. Though the Exposure Draft does not call for a "forensic-type" phases, it incorporates many of the Panel's specific recommendations. The proposal includes guidance about: • Engagement personnel discussing the risks of

that would result from this recommendation ordinarily would neither constitute a dominant part of the audit nor be inconsequential. Under "Consideration of Exposure Draft Comments on the Forensic-type Phase" at the end of this chapter, the Panel provides the ASB with its observations on factors that ordinarily would influence how much additional audit effort would be required.	material misstatement due to fraud. • Expanding inquiries of entity personnel regarding the risk of fraud. • Identifying risks that may result in a material misstatement due to fraud. • Evaluating the entity's programs and controls that address the identified risks. • Planning and performing procedures that respond to the identified risks. • Planning and performing procedures that further address the risk of management override of controls. • Evaluating audit test results. • Communicating conclusions about fraud to management, the audit committee, and others. • Documenting the auditor's consideration of fraud.
3.50 The Panel further believes it is reasonable that the strengthened standards be effective starting with audits of financial statements for periods commencing after December 31, 2001.	The 2001 date will not be met.
3.51 To implement the foregoing recommendation, the Panel recommends that the ASB require the following in all audits:	
Planning and Supervision Discussion by supervisory engagement personnel (including the auditor with final authority, usually the engagement partner) with other engagement team members about the vulnerability of the entity to fraud. This discussion should encompass what is expected of team members in dealing with a potential for fraud in the specific areas of the audit assigned to them. An important objective of these discussions would be to identify the appropriate engagement team members to address the potential for fraud (e.g., the engagement team members who should interview company personnel) and how their work is to be supervised and reviewed. This recommendation requires a significant strengthening of the first standard of fieldwork that "the work is to be adequately planned and assistants, if any, are to be properly supervised." The objective of a strengthened standard is to ensure a substantive dialogue among members of an engagement team about	According to the ASB, The Fraud Task Force has considered all of the Panel's Chapter 3 recommendations as part of its deliberations. At the February 2002 ASB meeting, the ASB approved the Exposure Draft, referred to in 3.49 above, that it believes is responsive to the Panel's recommendations. The ASB intends to issue a final standard by the end of 2002 effective for periods beginning on or after December 15, 2002.

"what could go wrong" and "how fraud might be perpetrated." This dialogue should guide how engagement team members address the possibility of fraud, including how procedures (including inquiries) might be designed to address that possibility. The strengthened standard should be sufficiently specific that these activities are carried out by engagement teams (and thus involve engagement partners) at all significant locations. The engagement team members to be involved in this dialogue should include information technology and other specialists assigned to the audit. Decisions about the actions to be taken by individual engagement team members should be documented.	
Forensic-type Fieldwork Phase Introduction of a "forensic-type fieldwork phase". Not unlike the traditional planning, interim, final and review phases of audits, this new forensic-type phase should become an integral part of the audit, with careful thought given to how and when it is to be carried out. A forensic-type fieldwork phase does not mean converting a GAAS audit to a "fraud audit." Rather, the characterization of this phase of a GAAS audit as a forensic-type phase seeks to convey an attitudinal shift in the auditor's degree of skepticism. Furthermore, use of the word phase does not mean that the work cannot be integrated throughout the audit. During this phase, auditors should modify the otherwise neutral concept of professional skepticism and presume the possibility of dishonesty at various levels of management, including collusion, override of internal control and falsification of documents. The key question that auditors should ask is "Where is the entity vulnerable to financial statement fraud if management were inclined to perpetrate it?" Auditing standards should require in this phase: Performance of substantive tests directed at the possibility of fraud, including tests to detect the override of internal control by management (recognizing that management includes many levels of personnel in an entity, including personnel outside of the United States, and not just top corporate-level management). The nature, timing and extent of such tests should be guided (at a minimum) by the following criteria. Tests should be centered around the balance sheet date for balance sheet accounts and throughout the year (including the latest quarter) for income statement accounts, in the following areas (some of which may overlap): High-risk areas (at the specific account and assertion level) identified by the engagement team as areas where the opportunity to perpetrate fraud is higher than normal. Candidates for such identification would include balance	The revised fraud standard Exposure Draft does not specifically mention a "forensic fieldwork stage" the task force and ASB believe the exposure draft responds to the spirit of these recommendations. The proposed statement increases the focus on professional skepticism including (a) the discussion of its importance in engagement team planning meetings and (b) its effect as it relates to the gathering and evaluation of evidential matter when fraud risks are identified. The proposed statement implements this recommendation by specifying selected substantive procedures that would be "…appropriate for every audit – absent a conclusion by the auditor that, in the particular circumstances, their performance is unnecessary." The proposed statement provides examples of circumstances involving audits of nonpublic entities that might overcome the need to perform the procedures, and indicates that in a public entity audit the procedures should always be performed.

sheet or income statement accounts affected by revenue recognition policies, deferred costs, asset additions resulting from complex transactions such as business combinations accounted for as purchases, reserves that are highly dependent on management's intentions or representations, accounts (or elements of them) not subject to systems-driven controls, and related party transactions. Areas for which Accounting Principles Board Opinion No. 20 requires disclosure of significant accounting policies Material balance sheet accounts that generally "turn over" several times throughout the year (e.g., trade receivables, inventory, payables, cash and securities) Non-standard entries (including entries made to computer records) requiring management's involvement or approval. (The ASB should define the term non-standard entries for this purpose). Auditors should consider incorporating a surprise or unpredictability element in their tests. Examples of what they should consider include the following: Recounts of inventory items or unannounced visits to locations Interviews of financial and non-financial company personnel in different areas or locations. Interviews of company information technology personnel may be appropriate to inquire about possible overrides of computer-related controls. Inquiries of company personnel (including legal personnel) responsible for addressing reports by company employees or others alleging irregularities also should be made. (For example, some companies have employee "hot lines" that enable confidential reporting of possible improprieties or violations of company policies.) Requests for written confirmations from company employees regarding matters about which they have made representations to the auditors Requests for written confirmations from customers or vendors that otherwise would not be undertaken and that are carefully tailored to address the nature and specific terms of the underlying transactions, for example, to assist in identifying "side agreements" allowing a right of return or other concessions Tests of accounts not ordinarily performed annually Tests of accounts traditionally or frequently deemed "low risk" The tests should be either tests of details or precise substantive analytical procedures, but not tests of controls. (Tests of controls may not be effective in detecting fraud because management can override controls.) The external auditor should not use the work of internal auditors in carrying out tests directed at the possibility of fraud. The internal auditors may provide limited direct assistance to the external auditor, and may perform similar procedures to supplement the work of the external auditor.	The substantive tests proposed to address this management override issue would be: Examining journal entries. Reviewing accounting estimates for bias, including a retrospective analysis. Evaluation the business rationale for significant unusual transactions.

Use of technologically advanced auditing tools should be encouraged. Non-corporate and non-U.S. locations should be covered by substantive tests directed at the possibility of fraud. Some rotation over a reasonable number of audit periods would be acceptable. Re-review by supervisory audit personnel, at the conclusion of the audit, of high-risk areas to reassess whether conditions identified during fieldwork or test results (e.g., exceptions and related explanations by entity personnel) might call for additional tests.	
Retrospective Audit Procedures Introduction of retrospective audit procedures, calling for an analysis of selected opening balance sheet accounts of previously audited financial statements. The accounts should be selected using risk-based or other criteria specified by the ASB. The ASB also should provide guidance on the types of tests to be applied to the accounts. The objective of the audit tests should be to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight. This retrospective look at and testing of accounts that previously had been audited is intended to act as a fraud deterrent by posing a threat to the successful concealment of fraud, not to second-guess reasonable judgments based on information available at the time the financial statements were originally issued. Consequently, the auditor should modify the otherwise "neutral" concept of professional skepticism, as discussed above.	
Review and Documentation Debriefing of engagement team members assigned to perform retrospective procedures and procedures during the forensic-type phase by supervisory personnel, and assessing the propriety of follow-up actions and conclusions reached, both of which should be documented. Specific documentation relating to the retrospective procedures and the procedures carried out during the forensic-type phase of the audit, including the results of the assessments made.	The proposed fraud Exposure Draft significantly extends documentation requirements – requiring documentation supporting compliance with substantially all the major requirements of the statement.
Procedural Guidance for Interim Periods Include in its standards specific guidance for the application of procedures in interim periods using a forensic-type approach equivalent to that described above. In this connection, the Panel believes that the ASB should consider the observations in the 1999 COSO Report that many frauds are	The SAS 71 Task Force is considering the need to provide revised guidance dealing with the performance of interim procedures.

initiated in interim periods. Provide criteria for the areas that should be addressed in reviews of interim financial information. Such criteria might include, for example, areas involving a high degree of subjectivity (e.g., merger-related or restructuring reserves), areas involving complex accounting standards (e.g., software revenue recognition), related party transactions and areas where controls are particularly susceptible to being overridden (e.g., sales cut-off).	The Task Force is considering the nature and extent of procedures that might be applied on an interim basis to detect fraud and how such procedures would fit into the audit risk model. Further the Task Force hopes to present a discussion draft to the ASB at its April 2002 meeting.
Provide guidance on how procedures employed in interim periods that address the potential for fraud in financial reporting also may be useful as "continuous auditing" techniques to improve full-year audits. The Panel understands the need to separate auditors' responsibilities in an audit of financial statements from those in a limited review of interim financial information. However, it encourages the ASB to research and address concepts of continuous auditing in furtherance of a more effective audit model.	The proposed statement provides a discussion of when an auditor might elect to apply substantive tests to transactions occurring earlier in or throughout the reporting period.
Enhancing peer reviews	
6.42 The Panel recommends that the ASB, in collaboration with the Peer Review Committee and QCIC, review the quality control standards and make them more specific and definitive for firms with public clients, especially for the largest firms. The Panel also recommends that the three groups establish a mechanism for ongoing monitoring of the standards to keep them current. (See the Panel's recommendations to the ASB on Auditing Standards and Quality Control Standards Generally in the section in Chapter 2 on "Establishing Auditing Standards.")	The Quality Control Task Force is considering the specificity of the standards as well as the non-authoritative Quality Control Guide. Although there are frequent contacts between the staff and the committee members, the staff Directors began a formal process in the Spring of 2001 to meet quarterly to discuss common projects, issues and where applicable, ideas with respect to changes in standards or guidance. Additionally, AITF will begin a formal liaison with QCIC and has scheduled its first meeting for May 8, 2002.
International	
7.48 The Panel recommends that the ASB and IAPC initiate a formal collaborative effort to harmonize auditing standards and achieve their global acceptance. Others interested in auditing standard setting should be invited to participate in this effort.	ASB and IAPC have initiated some joint activities: The Joint Risk Assessments Task Force is a true joint task force, intended to result in a common document. *Auditing Fair Value Measurements and Disclosures* is an IAPC exposure draft, for which the ASB issued an Invitation to Comment. The intent is to solicit U.S. comments that will be used to influence the IAPC document so that once issued, its quality will be such that it will be the basis for a new SAS to be exposed in the Spring of 2002.

	IAPC is an observer at the ASB fraud task force. ASB is an observer at one IAPC task force on group audits. An ASB staff member attends all IAPC meetings (and certain task force meetings) and serves as a technical adviser to the US representative on IAPC. IFAC staff usually attends ASB meetings and some task force meetings. There are frequent staff and chair contacts, as well as with counterparts in the UK and Canada.
7.49 While the Panel encourages this initiative, it also believes that such an effort should be conducted in parallel with the ASB's consideration of its other recommendations. (See the Panel's recommendation to the POB and the ASB under "Establishing Auditing Standards" in Chapter 2.)	ASB continues to consider Panel recommendations while it works towards convergence of U.S. and International Auditing Standards.
Audit Firms	
2.28 Many of the Panel's recommendations in specific areas suggest that audit firms need to undertake substantive efforts to reestablish the importance of the role of independent auditors within their organizations and thereby reinvigorate their audit practices. They should provide guidance to their audit personnel that is specific and definitive and should focus more on training audit personnel in the methodologies that support their audit practices (including how to both use technology and audit their clients' use of it). Audit firms should embed intolerance for audit failures in their cultures. The concept of professional skepticism should be taught effectively and the role of auditors in the detection, and implicitly in the deterrence, of fraud reinforced.	The POB staff received responses from the eight largest firms, as well as two other firms. The firm's responses generally were extensive and provided sufficient details about the activities in implementing the Panel recommendations. Overall, the firms appear to have been responsive to the recommendations or believe they previously implemented the substance of the recommendation.
2.29 Definitive professional standards and well-conceived firm policies, procedures, guidance materials, practice aids and audit training programs must be accompanied by a strong commitment by the audit firms to make continuous improvements in their processes and strive to meet the goal of "zero defects." The firms' leaders should convey a tone of high professionalism as the principal message to their auditors and should develop systems for incentives, compensatory rewards and penalties, and promotions that not only mirror the tone but also make it a reality.	The majority of the responding firms have adapted the management tone and goal of "zero defects". In a number of instances, the firms' professional guidance was enhanced as a result of the Panel recommendations.

Assessing engagement risk	
2.39 The Panel recommends that audit firms consider adopting sophisticated, computerized systems for identifying engagement risk that involve both quantitative and qualitative factors, including a search for potentially derogatory or other information about the entity and its principal owners and officers, and integrating those systems into their audits. A cooperative effort by the firms to share best practices should facilitate implementing this recommendation.	Most of the responding firms have adopted or previously developed an automated engagement risk model. One firm reported using a tool that informs engagement teams of significant stock movements, litigation and negative analysts commentaries of their clients.
Assessing inherent risk	
2.49 The Panel recommends that audit firms:	
Review and ascertain whether they need to augment their policies and guidance on assessing inherent risk, for example, to cover the types of matters described in the recommendations to the ASB	Many of the responding firms believe their existing policies are adequately documented. In several instances, the firm clarified their guidance on assessing inherent risk.
Require that a partner be actively involved in making inherent risk assessments at both the overall financial statement level and the assertion level for significant account balances and classes of transactions	The responding firms have a QC requirement that mandates the engagement partner be involved in engagement risk assessment activities, such as assessing inherent risk.
Require that the inherent risk assessments for high-risk clients be reviewed by the concurring partner or an industry expert before the related tests of controls and substantive tests are designed and performed	There are many diverse polices and procedures for complying with this recommendation. All of the responding firms have some requirement of the involvement of a concurring review partner or an industry leader in the planning for a high-risk engagement. Engrained in the planning is the explicit or implicit requirement to concur with the assessment of inherent risk.
Review their training materials on assessing inherent risk and ascertain whether they need to be augmented, in terms of either the time devoted to the subject or the materials used, such as by “real-life” case studies on assessing inherent risk. The training should reinforce the need for every engagement team to take the necessary time to gain a thorough understanding of the entity’s business and industry and do a thorough job of assessing inherent risk, at both the overall financial statement level and the assertion level for significant account balances and classes of transactions.	The majority of the firms have enhanced their existing training to incorporate “real-life” case studies.

Assessing control risk	
2.78 The Panel recommends that audit firms place a high priority on enhancing the overall effectiveness of auditors' work on internal control, particularly with respect to the depth and substance of their knowledge about companies' information systems. The following areas should be addressed:	
Audit practice – Firms of all sizes should examine critically their audit work on internal control. In many situations, firms should increase the engagement time allotted to internal control, particularly in the audit planning phase. They also should raise the level of involvement by more experienced audit personnel. Audit personnel who supervise engagements should be directed to focus on increasing the engagement team's knowledge of important information systems and controls. They should focus particularly on (1) obtaining a more thorough understanding of information systems relevant to financial reporting and the related risks and controls, (2) identifying and evaluating the design of key controls, (3) linking controls with identified risks and substantive audit tests, (4) designing tests of the operating effectiveness of controls, (5) considering the results of the tests of controls, and (6) considering how decisions about the nature, timing and extent of controls testing affected audit effectiveness.	All of the firms responded to this recommendation positively. The firms appear to be sensitive to the linkage between the assessments of internal control risk, and the results of related control tests, to other audit procedures.
Professional development – Training programs should place greater emphasis on each of the components of internal control as well as on assessing and testing controls. The objective should be to increase significantly the overall effectiveness of auditors in identifying and responding to risks, key controls and control deficiencies in the control environment and information systems.	Several firms created new training modules for understanding and evaluating an IT system and how to integrate the IT risks into the audit activities. Other firms reported previously addressing this recommendation in their course curriculum.
Information technology – The Panel sees an increasing need for auditors to have a higher level of technology skills and for more effective participation in audits by information technology specialists. Their participation should include assessing the risk that erroneous information may affect the financial statements, assessing the adequacy of controls and designing tests of their operating effectiveness. Firms should develop specific training materials and programs to make auditors more knowledgeable about information technology, and information technology specialists more knowledgeable about auditing. Information technology specialists should be integrated more effectively and consistently into the audit process. There should be joint training of auditors and specialists, starting at the partner and manager levels. Firms without such specialized capabilities should develop appropriate cooperative arrangements to ensure that information technology risks and controls are fully addressed in the audit.	All of the firms responded positively to this recommendation. The most common forms of implementation included: Increasing the number of IT specialists in the local offices. Redesigning the audit methodology to better stress the integration of information technology specialists. Involving the IT professionals in more engagements.

Inspection programs – Internal inspection programs should increase their focus on internal control work, the effective involvement of information technology specialists and the effective involvement of experienced audit personnel in this area.	About half of the firms reported integrating this Panel recommendation into their inspection procedures. The other half did not specifically respond as to whether they have implemented this recommendation.
Linking the risk assessments to substantive tests	
2.107 The Panel recommends that audit firms: Linkage Review their policies and procedures and guidance materials with respect to linking risk assessments to the nature, timing and extent of substantive tests, including designing substantive procedures that address all assertions where risk is not low, and establishing sample sizes that are large enough to provide sufficient evidence whenever sampling (as defined in SAS No. 39) is employed Review their training materials with respect to linkage and sampling and ascertain whether they need to be augmented, with respect to either the time devoted to the subjects or the materials used, such as by developing "real-life" case studies	All of the firms report that their audit model links the risk assessment of internal control to the nature, timing and extent of their audit testwork. The firms also stress the linking concept in training. One firm reported that this concept is stressed at every level of training.
Substantive Tests	
Emphasize to their personnel the importance of obtaining evidence from third parties whenever possible and that the presumption that receivables are to be confirmed when they are material is not easily overcome	The firms reported creating new practice aids and re-emphasizing the importance of obtaining third party evidence.
Provide more guidance to their personnel on other types of information, in addition to or in lieu of receivable balances, that might be confirmed	All of the firms believe they implemented or had previously implemented this recommendation.
Develop case studies or other communications to audit personnel that illustrate the dangers of losing control over the confirmation process, of accepting facsimile responses to confirmation requests without taking appropriate precautions, and of not following up and appropriately resolving all exceptions noted during the audit	Most of the firms reported emphasizing "real-life" or potentially "real" scenarios emphasizing the importance of sending out, controlling and receiving confirmations.
Require that at least an experienced audit manager review the resolution of all "exceptions" noted during the audit and be satisfied that they were resolved appropriately and that appropriate decisions regarding the need for additional substantive tests were made	A small majority of the firms reported having a requirement that at least a senior manager review the resolution of all "exceptions." The remaining firms stated: a) the partner is allowed the discretion of determining the level involved in resolving "exceptions"; b) the level of clearing the "exception" is not specified by the firm; and c) no specific response to this Panel recommendation. In this instance the firm did not respond as to whether they have implemented this Panel recommendation.

Resolution of Issues	
Reinforce the importance of consulting on important issues	See response directly below.
Vigorously enforce their consultation policies by taking strong actions with respect to those who do not consult when they should, as revealed by the firm's inspection program or other events	The majority of the firms responded positively to this recommendation. One firm reported issuing guidance requiring consultation on significant matters, with enforcement against those who fail to consult in the appropriate circumstances. Another firm reported summarizing and communicated to all audit personnel the required consultation procedures in a practice aid issued in April 2001.
Analytical procedures	
2.124 The Panel recommends that audit firms:	
Ensure that their audit methodologies provide definitive guidance on analytical procedures. At a minimum, specific guidance should be provided in the following areas:	The firms reported that the list following list of Panel recommendations has either been implemented or was previously included in the firm's audit methodology and guidance.
Developing expectations	
Characteristics and reliability of different types of data	
Using planning materiality in designing substantive analytical procedures	
Establishing desired levels of assurance for substantive analytical procedures	
Establishing precision levels that depend on the level of assurance the auditor desires from analytical procedures	
Relating control risk assessments to the objectives of analytical procedures	
Considering the role of account-level or assertion-level risk assessments (e.g., low-risk vs. high-risk assessments) in designing analytical procedures	
The effect of the nature of particular accounts or assertions (e.g., balance sheet vs. income statement accounts) on analytical procedures	
Identifying, investigating and evaluating the results of analytical procedures (including obtaining additional evidence to corroborate the responses to inquiries)	

Specifying the appropriate level of personnel assigned to perform analytical procedures, and the responsibilities of those assigned to review their work	
Assessing the results of analytical procedures in the final stage of the audit	
Documentation requirements consistent with the objectives of the analytical procedures	
Ensuring that training programs specifically address analytical procedures, are taken by all levels of audit personnel and employ “real-life, practical, how-to” case examples in varying circumstances that illustrate the firm’s methodology and guidance. Depending on levels of personnel, such training programs should include basic concepts of financial statement analysis as well as techniques used by analysts in evaluating the securities of different types of entities.	All of the firms reported that this area is covered in training programs.
Auditing revenue	
2.140 The Panel recommends that audit firms:	
Test the cutoff of revenue when inherent or control risks relating to such transactions are other than low, and specifically when there is a high level of sales transactions or individually significant sales transactions near the end of the reporting period. Cutoff tests should be more extensive than tests of only a few transactions before and after the close of the period. Cutoff testing often should require the auditor’s physical presence at the entity’s location(s) at period end.	All of the firms reported the importance of revenue cut-off. However, most of the firms were silent as to whether they had specifically implemented this recommendation.
Develop training materials, including case studies, focused on auditing revenue recognition issues in specific industries. Require professionals working on engagements in those industries to complete the training	All of the firms stress the importance of revenue recognition and cut-off testwork in training. One firm reported producing and including a video in training that covers “bill and hold”, side agreements, right of return, percentage of completion and channel stuffing. Another firm reported issuing a practice aid in October 2001, reminding engagement teams to document significant considerations in auditing revenues, including cut-off procedures.
Auditing estimates and judgments	
2.161 The Panel recommends that audit firms:	
Provide training on the application of SAS No. 57 and the provisions of SFAS No. 5 and related guidance	Most of the firms reported that estimates and judgments are covered in training.

	One firm reported creating guidance in 27 different industries on the most likely estimate risk for those companies. They are currently working on expanding the guidance to include 13 more industries.
Encourage engagement teams to apply audit tests to reserve activity on a timely basis – for example, during the performance of interim reviews	A small majority of the firms report that engagement personnel are required to perform substantive procedures during interim on areas such as reserves and other significant transactions. Several firms report that they encourage, but do not require engagement personnel to perform such procedures at interim. One firm reported that their policies exceed the procedures required by SAS No. 71, but do not specially require that audit tests are performed.
Adopt policies or internal guidance that promotes partner and manager involvement in the evaluation of reserve activity during interim reviews (if they do not already have such policies or guidance)	A small majority of the firms reported that they comply with this Panel recommendation. The remaining firms were silent with respect to the implementation of this Panel recommendation.
Materiality, waived adjustments and analysts' expectations	
2.178 The Panel recommends that audit firms adopt policies (unless they already have done so) requiring engagement teams to:	
Obtain analysts' reports and forecasts as part of gaining an understanding of the entity's business, consider the effects of those forecasts and the information in those reports when assessing risks and evaluating important issues, and include them among the factors considered when evaluating the materiality of potential adjustments	The firm's have either reported positive implementation to this recommendation or to the spirit of the recommendation. For example, one firm reports that analysts' reports are one source used in establishing an understanding of the clients business. The firm's policy also identifies analysts' earnings forecast as an important qualitative factor in assessing materiality. Another firm reports that they require that third party expectations be considered when performing analytical reviews and evaluating audit differences. Yet another firm reported that analysts' evaluations are one of the considerations in evaluating materiality and waived adjustments.

Obtain an understanding of the entity's policies and processes, if any, for communicating information to analysts	The firms responded in two ways to this recommendation: 1) the firm did not believe that it was appropriate to specifically require gaining an understanding of how management communicates with analysts, or 2) they were silent with respect to implementing this specific recommendation.
Become aware of the information management provides to analysts, such as by reading transcripts of the presentations or by listening to management's presentations to analysts when the presentations are available by telephone, videotape, the Internet or other public communications vehicles	The majority of the firms responded that they have implemented this recommendation. One firm reported that their guidance requires that analysts' recommendation be documented as part of the planning process. Another firm reported that the national/regional office provides engagement teams certain information about their clients, such as a) negative analysts reports, b) significant stock movement and c) litigation.
Going concern considerations	
2.188 The Panel recommends that audit firms incorporate the following matters into their training programs and audit methodologies:	
Specific guidance on considering management's plans for mitigating the adverse effects of conditions and events that created the auditor's substantial doubt about the entity's ability to continue as a going concern, including guidance on evidence supporting proposed cost reductions or other prospective financial information	All of the firms reported implementing this Panel recommendation or assert that the appropriate guidance regarding assessing the going concern consideration was in place prior to the Panel's report. One firm reported that they required the use a practice aid when a heightened risk of failure exists. The firm requires consultation when engagement teams identify going concern considerations. The firm has also performed a review of their entire client portfolio flagging the clients that have an increased going concern risk. One firm reported issuing a practice aid on going concern in October 2001, which provides comprehensive and detailed guidance on considering management's plan for mitigating the adverse effects of the conditions and events that led to substantial doubt and outlines the circumstances that require consultation.

Practice aids, such as a template for confirming plans involving third-party financial support, and "real-life" examples of evidential matter that corroborates representations regarding management's plans, as well as examples of evidential matter that does not	Most of the firms reported enhancing their quality control system as a result of this Panel recommendation. One reported this recommendation was previously a part of their system of quality control prior to the recommendation. One firm reported that in February 2001, the Firm's national office hosted a conference call for audit partners to discuss going concern matters in the context of the current economic situation. In Charge-training also covers this area. Another firm reported that they designed a new practice aid to address the going concern assumption and to document the engagement team's consideration.
Internal Auditors	
2.200 The Panel recommends that audit firms:	
Review the adequacy of their policies requiring auditors to test the work performed by internal audit and to document their work relating to internal audit.	All of the firms responded positively to this recommendation. One firm issued a practice aid, which includes guidance on testing the work performed by the internal auditor and the required documentation. One firm has developed a practice aid that documents the engagement teams assessment and reliance on the company's internal audit function.
Consider during their internal inspection programs whether engagement teams are using the work of internal audit excessively, especially on large engagements.	The majority of the firms did not respond to this recommendation. One firm reported that the internal inspection considers whether the engagement team gained an understanding of the internal audit function and whether they used the internal auditors work as evidence and follow GAAS in doing so. Another firm reported that they review reliance on internal auditors when performing inspections. In the last two inspections, there were no instances where a review team concluded that the engagement team relied excessively on the internal auditors.

Communicating with audit committees	
2.217 The Panel recommends that audit firms:	
Recognize the board of directors and audit committee, acting on behalf of the shareholders, as the parties to whom they are accountable and tailor their relationships and communications accordingly	All of the firms reported that they understand that the board and directors and audit committee was their ultimate client, acting on behalf of the shareholders.
Make sure the audit committee's expectations are fully understood and that their communications with the committee are directly responsive to those expectations	Several of the firms reported that they have publications that assist the audit committee and board directors in ensuring they understand their role and function.
Reexamine firm guidance for reporting to audit committees and, if applicable, modify the guidance to promote candid discussions with the committee on:	One firm reported having issued extensive guidance on how to conduct candid discussion with the audit committees about risks, risk management and internal controls, and the quality of financial reporting and accounting.
Significant information system risks, including those related to any industry-specific regulations or issues	
Qualitative observations about internal control	
Earnings management and fraud	
3.52 The Panel recommends that audit firms:	
Begin working immediately with the concepts in the recommendations to the ASB to enhance the auditor's ability to detect financial statement fraud. The results of those efforts should be shared with the ASB for consideration in developing its standards, with the intent of expediting the standard-setting process.	The firms represent that they are ready to implement the enhanced fraud standards when they are issued.
Develop or expand training programs for auditors at all levels oriented toward responsibilities and procedures for fraud detection. These programs should emphasize interviewing skills and the exercise of professional skepticism, as well as testing techniques. They also should emphasize (especially to staff and in-charge personnel) that misappropriation of assets is a significant risk and that being alert to its possibility at any level in an entity is necessary. Training programs should include case examples of how defalcations might be effected, the types of controls over the safeguarding of assets that are effective in preventing and detecting defalcations, and how defalcations are concealed. Special emphasis should be given to how information technology might be used to misappropriate assets and disguise the results.	All the firms report that the concept of fraud and relevant auditing standards are integrated into the audit training curriculum.
Using auditors with forensic audit backgrounds to assist in this training would be beneficial. Personnel with experience in industries where the risk of	Most of the firms either did not respond to this Panel recommendation or they reported they are in the midst of

material misappropriations of assets is believed to be high (e.g., in certain cash-intensive industries) also might be used to assist in such training.	a pilot study designed to implement the recommendation. One firm reported that in 2001, all partners and managers were required to take a two-hour session delivered by forensic experts. The objective of the session was to increase awareness of issues that result in financial statement fraud.
These programs should be implemented as soon as practicable, but in any event no later than when the ASB issues its strengthened standards. Furthermore, training programs of this nature should not be one-time events. Firms should be committed to refreshing and improving these programs as circumstances in clients and industries evolve and more is learned about fraud.	The firms are waiting for the ASB to issue a new standard before implementing enhanced fraud audit procedures. In the meantime, each firm addresses fraud in their training curriculum.
Discuss with audit committees the vulnerability of the entity to fraudulent financial reporting and the entity's exposure to misappropriation of assets	The majority of the firms did not respond to this recommendation. However, one firm reported that their existing audit policies address the responsibility to communicate to audit committees the existence of fraudulent financial reporting and misappropriation of assets.
Professional leadership – the tone at the top	
4.5 The Panel recommends that audit firms:	
Emphasize to all audit personnel the importance of performing high-quality professional work. This message should be delivered frequently by the CEO, COO, leaders at the firm's regional and office levels, and the head of the assurance practice, as well as by the firm's top technical partners. It should stand out above all other messages.	All of the firms responded positively to this Panel recommendation. All the firms are sending out the message of the importance of performing high quality audits, from upper management on down.
The message should be a positive, constructive message that is refreshed frequently so it commands attention, rather than becoming a tired slogan that is ignored. For example, it might reference specific situations where client management, audit committees or others recognized and applauded audit quality. In addition, situations could be recognized in which individuals or engagement teams took difficult stands on earnings management issues, issues involving possible management fraud or illegal acts, or contentious accounting issues. Other messages might cover important developments in the profession that affect the quality of accounting and auditing.	All of the firms responded positively to this Panel recommendation. One firm responded that the Managing Partner of the Firm routinely presents material at staff training courses. One firm responded that the Chairman and the Vice Chairman have communicated the importance of audit quality and the Panel's recommendations in recent communications.

Address the importance of the role and responsibility of audit professionals, as well as the concepts of integrity and objectivity, independence, professional skepticism and accountability to the public. These concepts should be introduced on or near the day professionals, both experienced and inexperienced, are hired. They should be reinforced regularly and be integral to the firm's training efforts.	Most of the firm responded positively to this Panel recommendation. Several of the firms did not specifically respond to this Panel recommendation.
Develop marketing and advertising messages targeted to users of audited financial statements, coordinated with similar AICPA messages, which promote the importance of audits.	Most of the firm did not respond to this Panel recommendation.
Professional development	
4.16 The Panel recommends that audit firms:	
Support and adopt the competency-based learning concepts in the AICPA exposure draft, Statement on Standards for Continuing Professional Education, and use a core competency model that is similar in design to the AICPA model as a basis for career planning and self-assessing whether individual performance and competency goals are being achieved	Most of the firms reported that they have been supportive of and have adopted this recommendation.
Make increased knowledge and skills a high priority for all experience levels, with a particular focus on meeting the increased audit demands called for by the Panel's recommendations in Chapters 2 and 3	All of the firms responded positively to this recommendation. One firm reported that professionals receive approximately 80 to 100 hours training a year. One firm reported that a training curriculum is developed that meets the needs of professionals necessary to effectively fulfill the requirements of the varying roles on the audit engagement.
Personnel management	
4.21 The Panel recommends that audit firms:	
Review performance measures for all experience levels, and ensure that performing high-quality audits is appropriately recognized as the highest priority in performance evaluations and in compensation, promotion and retention decisions for all personnel. The measures should focus on such matters as (1) the depth and substance of understanding of the client's business and risks, (2) responsiveness to unexpected or unplanned conditions encountered in audits, (3) development of innovative audit approaches, (4) professional skepticism and persistence, and (5) knowledge of accounting principles and practices.	All of the firms reported that quality is one of the elements considered in promoting and increasing compensation. None of the firms stated positively that high quality audits was recognized as the highest priority in these decisions.

Work cooperatively with the SECPS in developing effective measures of audit quality and incorporate those measures into their internal inspection processes. (See the Panel's recommendations to the SEC Practice Section in the section "Enhancing Peer Reviews" in Chapter 6.)	All of the firms reported that they are active and work cooperatively with the SECPS.
Time pressures on auditors	
4.27 The Panel recommends that audit firms:	
Expand the client acceptance and continuance assessment processes to include inquiries about possible time pressures on specific engagements that could create an environment in which audit quality might be compromised.	Some of the firms reported that time pressures are on the factors the firm considers in determining client continuance. Several other firms did not specifically respond to this Panel recommendation.
Provide guidance and training on actions that engagement partners and other supervisory personnel should consider in managing time pressures	Several of the firms reported that they offer training in time management, while other firms did not specifically respond to this Panel recommendation.
Incorporate appropriate measures of partners' and other supervisory personnel's abilities to manage time pressures in upward evaluations or other similar feedback processes	Several of the firms reported that they have upward feedback programs, while other firms did not specifically respond to this Panel recommendation.
Reaffirm periodically with partners and managers the importance of establishing realistic time budgets and work loads	Most of the firms did not specifically respond to this recommendation. However, one firm reported that in early 2001, an Assurance leadership communication to partners, addressed the topic of dealing with pressures associated with the profession.
International	
7.47 While the changes in the SECPS membership rules described earlier in this chapter are important first steps, the Panel believes that additional steps are necessary to effect significant improvements in worldwide accounting and auditing quality. The Panel believes that the major firms share this view and that they are in varying stages of upgrading their international quality for the benefit of all users of audited financial statements, not just those who invest in companies whose securities are registered with the SEC. Accordingly, the Panel recommends that audit firms:	
Implement uniform audit methodologies throughout the world that use international auditing standards as the base minimum	Most of the firms reported that they have one common global audit methodology.

Subject all audit practice units to periodic inspection procedures covering all audits, not just foreign registrants or affiliates of U.S. SEC registrants	Most of the firms report all worldwide offices are subject to a compliance monitoring program and internal practice review.
Assign personnel throughout the world to function as technical consultants in the application of international accounting and auditing standards. Firms should consider establishing intra-firm international "clearinghouses" to resolve differences in the application of international accounting and auditing standards and promote consistency of practice.	Most of the firms responded positively to this Panel recommendation. One firm reported recently establishing an internal International Accounting Standards Board, which has the responsibility for matters associated with International Accounting Standards ("IAS"). The Board is responsible for issuing definitive interpretations on IAS standards and determining the appropriate accounting treatment. Another firm reported having an active expatriate program, with U.S. partners assigned throughout the world to assist with technical and client service matters.
SECPS Peer Review Committee	
Assessing inherent risk	
2.50 The Panel recommends that the SECPS Peer Review Committee:	
Request that peer reviewers evaluate the adequacy and extent of implementation of firms' methodologies, guidance and training materials relating to assessing inherent risk	Included in pilot program supplemental review questionnaire
Include items in the peer review questionnaires that address the appropriateness of the inherent risk assessments made, whether they were made at the appropriate financial statement levels, who made and reviewed them, and whether they were made and reviewed on a timely basis	No action. PRC is still considering how to implement this recommendation. The small Firms have discussed this recommendation as recently as February 5, 2002
Request that peer reviewers include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Assessing control risk	
2.79 The Panel recommends that the SECPS Peer Review Committee:	
Develop more detailed inquiries for peer reviewers about firms' methodologies and engagement performance relating to audit work on internal	A portion of this recommendation is included in pilot program supplemental review questionnaire. The PRC is

control, focusing particularly on internal control considerations in planning the audit. Peer review inquiries also should focus on the depth of the engagement team's understanding of the entity's information system and related risks that are relevant to financial reporting. In addition, they should address the engagement team's effectiveness in identifying, testing and assessing key controls, and the sufficiency of the involvement of experienced professionals.	still considering this recommendation.
Instruct peer review team captains to include professionals with the necessary specialized technology expertise on their peer review teams.	Not specifically addressed, h*owever*, the reviews of large firms generally include such personnel on the peer review teams.
Request that peer reviewers include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Linking the risk assessments to substantive tests	
2.108 The Panel recommends that the SECPS Peer Review Committee:	
Linkage	
Request that peer reviewers evaluate the adequacy of firms' policies, procedures, guidance and training materials relating to linkage decisions, including those involving the selection of the appropriate procedures and sampling	Included in pilot program supplemental review questionnaire, except with respect to sampling
Request that peer reviewers determine whether firms have conducted the requisite training in these areas and evaluate the effectiveness of the engagement teams' implementation of the firms' methodology and guidance materials	Included in pilot program supplemental review questionnaire, except with respect to sampling
Include items in the peer review questionnaires that are similar to those covered in the QPRs, such as whether the specific tests performed or other actions taken in response to the risk assessments were appropriate and sufficient, whether the thought processes that led to the specific tests or actions were thorough and gave appropriate consideration to the appropriate factors, whether those who initially selected and subsequently reviewed the specific tests or other actions had the appropriate knowledge and skills and did so on a timely basis, and whether the extent of substantive tests (including, when appropriate, sample sizes) was sufficient	No action has occurred on this recommendation. However, some of this occurs informally when the Team Captain provides the reviewed firm oral recommendations.

Substantive Tests	
Request that peer reviewers evaluate whether engagement teams are (a) confirming receivables whenever they are material unless the presumption that receivables will be confirmed clearly has been overcome, (b) confirming other types of information in addition to, or in lieu of, receivable balances, when appropriate, (c) maintaining control over the confirmation process, (d) taking appropriate precautions when facsimile responses to confirmations are received, and (e) appropriately following up and resolving any exceptions noted and, when appropriate, performing additional audit tests	Items a and e covered in AICPA peer review questionnaire. Item b covered in pilot program supplemental review questionnaire. Items c and d not covered
Resolution of Issues	
Request that peer reviewers consider whether there were any issues on the audit engagements reviewed for which they believed consultation would have been prudent (or was required by firm policy) and for which it did not occur (or was not documented)	Covered in AICPA peer review questionnaire
Reporting	
Request that peer reviewers include their findings in these areas in their reports to the SECPS Peer Review Committee	No action.
Analytical procedures	
2.125 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Evaluate firms' methodology, guidance and training materials relating to analytical procedures	Included in pilot program supplemental review questionnaire
Determine whether firms have carried out the requisite training and evaluate the effectiveness of the firms' implementation of their methodology related to analytical procedures on audit engagements	Included in pilot program supplemental review questionnaire
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Auditing revenue	
2.141 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	

Consider the adequacy of firms' policies, guidance and training (and any changes in them) in the area of auditing revenue recognition	Included in pilot program supplemental review questionnaire
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Auditing estimates and judgments	
2.162 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Evaluate firms' policies, training and guidance materials on auditing estimates and	Included in pilot program supplemental review questionnaire
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Materiality, waived adjustments and analysts' expectations	
2.179 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Evaluate the effectiveness with which engagement teams implement SAS No. 89 and SAB No. 99 and determine whether additional guidance or training is needed	Included in pilot program supplemental review questionnaire
Review and evaluate firms' policies, if any, for understanding the entity's policies and processes for communicating information to analysts; obtaining analysts' reports and forecasts, and considering them when assessing risks and evaluating important issues and the materiality of potential adjustments; and becoming aware of the information management provides to analysts	Included in pilot program supplemental review questionnaire. However, the concept of reviewing analysts' reports is not included in professional standards.
Evaluate the effectiveness with which engagement teams implement their firm's policies and determine whether additional guidance or training is needed	Included in pilot program supplemental review questionnaire
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Going concern considerations	
2.189 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Evaluate the adequacy of firms' guidance and training (and any changes in them) in the area of going concern considerations	Included in pilot program supplemental review questionnaire

Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Internal Auditors	
2.201 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Address the adequacy of firms’ policies, procedures and guidance on the testing of internal audit work and the documentation of auditors’ considerations and work related to internal audit.	Some coverage in AICPA engagement questionnaire. Not covered in pilot program supplemental review questionnaire this year.
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action has been taken on this recommendation as of February 15, 2002.
Communicating with audit committees	
2.218 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Address the adequacy of firms’ guidance on reporting to audit committees.	Included in pilot program supplemental review questionnaire
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Earnings management and fraud	
3.53 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Evaluate the implementation of the strengthened auditing standards issued by the ASB and evaluate the training programs developed in response to the Panel’s recommendations to audit firms. The Peer Review Committee should develop guidance for peer reviewers to conduct these evaluations. The evaluations should address the priority given by the firms to fraud-related training; the involvement of supervisory engagement personnel in planning, supervision and review; and the adequacy of documentation.	Awaiting action by the ASB. The pilot program covered the revenue recognition aspect of earnings management.
Include their findings in this area in their reports to the SECPS Peer Review Committee.	Awaiting action by the ASB.

Professional leadership – the tone at the top	
4.6 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Assess the timeliness, frequency and appropriateness of internal messages from firm leaders about audit quality	Covered generally in pilot program focus group meetings with reviewed firm personnel.
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Professional development	
4.17 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Assess whether engagement teams have the requisite knowledge and skills for the particular engagements	Included as a procedure in SECPS and POB oversight.
Make qualitative assessments of the audit firm's policies and performance related to professional development	Included in pilot program supplemental review questionnaire.
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Personnel management	
4.22 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Assess the role that performing high-quality professional work plays in performance reviews and in compensation, promotion and retention decisions at all levels of audit personnel	Covered generally in pilot program focus group meetings with reviewed firm personnel.
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.
Time pressures on auditors	
4.28 The Panel recommends that the SECPS Peer Review Committee request that peer reviewers:	
Assess the extent of time pressures on audit engagements and the firm's success in managing those pressures	Covered generally in pilot program focus group meetings with reviewed firm personnel.
Include their findings in this area in their reports to the SECPS Peer Review Committee	No action.

SEC Practice Section of the AICPA	
2.30 Many of the Panel's recommendations reflect a belief that the SECPS should be the source of both leadership and specific guidance to audit firms in the effort to strengthen their quality controls. Only with specific guidance can peer reviewers effectively assess compliance with quality control standards. The SECPS Peer Review Committee should make its peer reviews of firms not only more frequent, but also more rigorous. The role of peer review in a program of continuous improvement of audit effectiveness should be given high priority. The SECPS's role in providing assurance that audits are being conducted effectively, with appropriate oversight by the POB, is critical to maintaining the profession's right to regulate itself.	
6.32 The Panel recommends that:	
The SECPS Executive Committee retain its responsibility for approving members of the PRC, the QCIC, the SEC Regulations Committee and the PITF	No action required.
The preceding four groups continue to report to the Executive Committee	No action required.
The SECPS continue to fund the ISB	2001/2 ISB Budget approved at May EC meeting.
Audit committees	
Communicating and reporting on internal control	
2.88 The Panel recommends that audit committees increase the time and attention they devote to discussions of internal control with management and both the internal and external auditors. Specifically, audit committees should:	The POB has no effective way to determine the extent to which audit committees have studied or acted on the Panel's recommendations.
Obtain a written report from management on the effectiveness of internal control over financial reporting (ordinarily using the criteria in the 1992 report of the Committee of Sponsoring Organizations of the Treadway Commission [COSO]). Annual reporting by management on internal control to the audit committee is necessary for the effective discharge of the audit committee's responsibilities and will serve as a catalyst for its more substantive involvement in the area of internal control and a more meaningful dialogue with the internal and external auditors about controls. It also should provide a basis for discussions about the degree of the external auditor's involvement with internal control during the financial statement audit.	

Establish specific expectations with management and the internal and external auditors about the qualitative information needs of the committee related to internal control. Particular emphasis should be given to understanding management's and the auditors' views on (1) the control environment and (2) the controls (or lack thereof) over financial reporting, with particular attention to controls in higher-risk areas of the company's information systems. In addition, these discussions should include the effects of technology on current and future information systems	
Auditing estimates and judgments	
2.164 The Panel recommends that audit committees evaluate the nature of entities' reserves and review activity in them with both management and the auditors.	
Communicating with audit committees	
2.219 The Panel recommends that audit committees:	
Specify in their charters and reflect in their actions, as recommended by the Blue Ribbon Committee, "that the outside auditor is ultimately accountable to the board of directors and the audit committee, as representatives of the shareholders, and that these shareholder representatives have the ultimate authority and responsibility to select, evaluate, and where appropriate, replace the outside auditors (or to nominate the outside auditors to be proposed for shareholder approval in any proxy statement)."	
Develop a formal calendar of activities related to those areas of responsibility prescribed in the committee charter, including a meeting plan that is reviewed and agreed to by the entire board. The meeting plan should include communications between the committee chair or full committee and the auditor before the release of interim or year-end financial data. In addition, the Panel recommends a minimum of two face-to-face meetings during the year with the external auditor and at least one executive session with the internal and external auditors without management's presence.	

Take charge of their agenda and ensure, in particular, that it focuses on, among other matters, risks directly affecting the financial statements, key controls, interim financial information, policies and practices for management's communications with analysts, and the qualitative aspects of financial reporting	
Inquire about time pressures on the auditor, including pressures on the timing of audit procedures; the degree of management's cooperation with the auditor; and their potential effects on audit effectiveness	
Review the internal and external auditors' performance on an annual basis; exercise responsibility, as the external auditor's primary client, to assess the auditor's responsiveness to the committee's and board of directors' expectations; and be satisfied that the auditor is appropriately compensated for performing a thorough audit	
Require the auditor and management to advise the committee of the entity's plans to hire any of the audit firm's personnel into high-level positions, and the actions, if any, that the auditor and management intend to take to ensure that the auditor maintains independence	
Earnings management and fraud	
3.54 The Panel recommends that audit committees:	
Request management to report on the control environment within the entity and how that environment and the entity's policies and procedures (including management's monitoring activities) serve to prevent and detect financial statement fraud. Such reporting should acknowledge, in explicit terms, that fraud prevention and detection are primarily the responsibility of management. It also should help audit committees assess the strength of management's commitment to a culture of intolerance for improper conduct. Furthermore, audit committees should seek the views of auditors on their assessment of the risks of financial statement fraud and their understanding of the controls designed to mitigate such risks.	
Accept responsibility for ascertaining that the auditors receive the necessary cooperation from management to carry out their duties in accordance with the strengthened auditing standards to be developed by the ASB.	

Non-audit services	
5.30 The Panel recommends that audit committees pre-approve non-audit services that exceed a threshold determined by the committee. This recommendation is consistent with the recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees regarding auditors' services. The threshold should be at a level that ensures that significant services are pre-approved, but not so low that the committee assumes a management function. When audit committees determine whether to approve specific non-audit services, the Panel recommends that they consider the same guiding principle and the factors suggested above for use by the ISB.	
Securities and Exchange Commission	
Communicating and reporting on internal control	
2.89 The Panel recommends that, if management is required to report to shareholders on the effectiveness of internal control, the SEC require either external auditor reporting on internal control or management to explicitly state that the external auditors do not express an opinion on internal control. Otherwise, the Panel believes that investors may draw unwarranted inferences about auditors' involvement with and responsibility for the appropriateness of management's assertions in such reports or about the degree of internal control work that auditors perform in connection with their audits of financial statements.	The SEC asserts that if the Commission determines to pursue the adoption of a requirement for management to report on the effectiveness of the registrant's internal system, the SEC staff will consider recommending that the Commission also adopt provisions that clearly stipulate the auditor's role in relation to the management's report.
Non-audit services	
5.31 The Panel recommends that the SEC and the ISB evaluate on a continuing basis the effectiveness of the disclosures made under Independence Standard No. 1 and the SEC's new audit committee disclosure requirements, as well as any new rules issued by the ISB or by the SEC pursuant to its rule-making initiatives.	The SEC staff will continue to evaluate the effectiveness of letters from auditors to audit committees under ISB No. 1, and the Commission's new audit committee disclosure requirements, during the review and comment process, enforcement investigations, oversight of the profession's peer review and other self-regulatory programs, and during other discussion with registrants and the auditors of their financial statements.
6.36 The Panel recommends that the SEC, as the statutory overseer of the quality of audits of SEC registrants:	

Encourage and support the ISB in carrying out its mission, recognizing that the SEC retains ultimate authority over auditor independence with respect to SEC registrants	The ISB disbanded as of July 31, 2001. The SEC staff intends to consult with the AICPA's Professional Ethics Executive Committee as appropriate. The Commission also intends to support the POB, and to the extent appropriate and as requested by the POB or its staff, assist the POB in conducting its activities.
Support the IIC and work with the ISB to clarify the IIC's role	
Assist in implementing the POB's activities contemplated by the charter	
Support the POB's authority as enumerated in its charter to enable the POB to serve as an independent, effective, unifying leader of the profession's voluntary self-regulatory process	
Enhancing peer reviews	
6.43 The Panel recommends that the SEC mandate that all firms that audit SEC registrants be enrolled in a peer review or similar monitoring program that includes public oversight. With respect to foreign-based audit firms, the requirement should extend to the peer review or similar monitoring programs or processes in their foreign locations. (See the Panel's recommendations to the International Federation of Accountants on Quality Assurance over Auditing in Chapter 7.)	The SEC staff estimates that less than 100 domestic accounting firms that file audit reports with the SEC are not in a peer review program. Before considering this requirement, the SEC may need to consider the cost versus the benefit of mandating such a requirement.
Enhancing the disciplinary process	
6.59 The Panel recommends that the SEC allocate additional resources to its enforcement activities directed at allegations of failed audits. The Panel recognizes that a finite budget imposes limitations on the SEC's ability to apply its investigative resources wherever needed. A larger budget allocation to enforcement efforts directed at allegations of failed audits would have salutary effects on the accounting profession, and reassure the investing public that the main "cop on the beat" recognizes the critical importance of audits and the deterrent effects of vigorous enforcement.	During 2000, the SEC began to increase the number of accountants on its staff. Also, in 2000, the SEC created a Financial Fraud Task Force to investigate certain major accounting fraud cases on an accelerated basis using teams of specialized accountants and other professionals. Additionally, the SEC is now investigating auditors, when relevant; at the same time they are investigating company and insider personnel to reduce the duplication of effort.
6.60 Because the Panel believes the study of the AAERs described in Appendix F was very useful and provided valuable information to supplement the evidence obtained from other activities, the Panel recommends that the SEC:	
Periodically, such as annually or biennially, undertake a similar study and disseminate the results	The SEC staff believes that such an analysis is beneficial to registrants, the auditing profession, and the SEC staff.

	However, it appears to the staff, that significant AAERs are currently analyzed and digested on a real time basis by a number of organizations, including the press, the accounting profession, accounting and auditing standard setters, academia, and others. The marginal benefits of an additional annual or biennial study by the staff therefore may not be sufficient to justify the resources it would take to complete such a study.
Document information on the auditors' work in every enforcement investigation involving materially misstated financial statements, not just those in which the auditor is named in an AAER. (In making this recommendation, the Panel recognizes that the SEC staff routinely examines the auditors' involvement in each case.) The SEC staff may wish to employ the Panel's questionnaire as a guide in identifying the types of information to be documented.	When appropriate, the Division of Enforcement does, and will continue to, document in AAER's the role of auditors in financial frauds.
Financial Accounting Standards Board	
Auditing revenue	
2.142 The Panel recommends that the FASB add revenue recognition to its agenda. The Panel believes that an authoritative statement on the broad principles of revenue recognition is sorely needed. Because this may be a long-term project, in the interim the FASB (or other appropriate bodies such as the Accounting Standards Executive Committee [AcSEC] or the Emerging Issues Task Force [EITF]) should identify and resolve or clarify areas of diverse or uncertain practice.	The FASB is determining the scope of a possible major project on revenue recognition. In January 2002, the FASB issued a request for comments on a proposal to undertake a project related to the recognition of revenues and liabilities. Additionally, the EITF has addressed a number of narrow revenue recognition issues over the past several years.
Auditing estimates and judgments	
2.163 The Panel recommends that the FASB:	
Clarify the accounting for contingencies to enable more consistent application of the criteria for accruing losses.	FASB issued an Exposure Draft on "Accounting for the Impairment or Disposal of Long-Lived Assets" and for obligations associated with disposal activities in October 2000. This guidance will replace the guidance currently contained in EITF 94-3, *"Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity".* The FASB does not believe that a recommendation to reconsider accounting for contingencies is appropriate at this time.

Establish a protocol with the ASB to assess the auditability of proposed accounting standards before they are issued, including evaluations of auditability when proposed standards are field tested	The FASB has met with the ASB to discuss the Panel's recommendation. The ASB stated that they will work with AcSEC to provide input on audit concerns that they identify with proposed accounting standards. The ASB has also acknowledged that they feel free to communicate with the FASB, if they deem appropriate, on audit issues, arising from newly issued standards. To date the ASB has not identified activities that the FASB needs to take with respect to this area. Additionally, no formal protocol has been established between the two parties.
Formalize the existing liaison between the ASB and the FASB to help ensure timely identification of and reaction to audit issues arising from newly issued standards	The FASB staff has worked closely with the Audit Issues Task Force of the ASB on several implementation issues that arose following the issuance of FASB 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* No formal protocol has been established between the two parties.
Going concern considerations	
2.190 The Panel recommends that the FASB: Define the going concern concept and clarify that management, not the auditor, has the primary responsibility to assess whether the entity has the ability to remain a going concern Consider the appropriateness of the one-year time horizon in SAS No. 59. The FASB should evaluate this time horizon and recognize its importance to auditors in framing their audit reports. Promulgate explicit going concern disclosure requirements to fit various circumstances. Such requirements should include disclosures about the entity's reliance on the financial support of related or third parties to mitigate the adverse effects of conditions and events that create substantial doubt about the entity's ability to continue as a going concern.	The FASB has met with the AICPA to discuss the Panel's recommendations. The AICPA agrees that the aspects of the recommendations concerning the auditor's reports should be directed to the ASB rather than FASB. The annual FASAC survey on new agenda priorities asks respondent to evaluation a project on going concern issues. Such a project could consider: A definition of the going concern concept. A clarification that management has the primary responsibility to assess whether the entity has the ability to remain a going concern. Consideration of disclosure with respect to going-concern considerations. The results of the FASAC survey were discussed at the December 4, 2001 Council meeting. The FASB has not determined whether to take any action. Additionally, the ASB is revising SAS 71, *Interim Financial Information*, to update enhance the guidance on reviews of interim financial statements. The current

	standard has no guidance related to going concern issues.
Public Oversight Board	
Proposed system of governance	
6.23 The Panel recommends that the auditing profession's system of governance be unified under a strengthened, independent POB that oversees the profession's activities with respect to standard setting, monitoring, discipline and special reviews. Accordingly, the POB should oversee the ASB, the ISB, the SECPS Executive Committee, QCIC, the SECPS Peer Review Committee, the Professional Issues Task Force (PITF), the SEC Regulations Committee and the standard-setting activities of the PEEC that relate to audits of public companies. The POB should serve as the oversight body to whom the SEC, the state boards of accountancy, the auditing profession and the public should look for leadership. This leadership position is intended to enhance communications among the profession's self-regulatory bodies in order to facilitate the profession's continuous improvement efforts and identify and resolve important issues on a timely basis.	The Charter of the POB approved by its members and the AICPA Board of Directors in February 2001 unifies and strengthens the POB's oversight of the professions activities.
6.24 The Panel recommends that the POB, AICPA, SECPS and SEC work together to create and implement a formal charter for the POB that would include the responsibilities and powers enumerated in this report. The POB, AICPA, SECPS, SEC and major firms should agree to the charter and cooperate in facilitating its implementation.	- see above
6.25 The Panel believes the charter should cover the following matters: The POB's sole authority to determine its budget and financial and other resources, and the profession's obligation to provide those resources. The Panel strongly believes that such "no-strings-attached funding" is absolutely essential if the POB is to be effective and independent of the profession and if the profession's self-regulatory system is to be viable. The profession must not be able to control or cut off the POB's financial resources and thereby cause irreparable harm to the profession's self-regulatory system by destroying the POB's independence and others' confidence in it. The POB's annual statement of expenditures should be audited and included in the POB's Annual Report to evidence its financial accountability.	Section VI.A of the Charter provide for "adequate no-strings" finding. Once the POB submits and consults on its annual budget, as called for above, the EC and the AICPA Board shall not withhold funding for any reason. Section VIII.D. of the Charter requires the POB to include an audited statement of expenses in its annual report.
The POB's authority to oversee the activities of the ASB, the ISB, the SECPS Executive Committee, QCIC, the SECPS Peer Review Committee, the	The POB Charter provides for the POB to consult on the nominations for members of the EC, ASB and the ISB

PITF, the SEC Regulations Committee and the standard-setting activities of the PEEC that relate to audits of public companies. The POB should approve all appointments to the ASB, SECPS Executive Committee and ISB's Independence Issues Committee (IIC), as well as the ISB members who represent the public accounting profession. Annually the POB should evaluate whether the resources that the AICPA and the SECPS provide to the ASB and the SECPS are sufficient for those bodies to meet their mandates. In addition, the POB should oversee the AICPA's evaluation, compensation, hiring and promotion decisions with respect to its employees who constitute the ASB and SECPS staffs.	and shall concur in the appointment of the Chair's of the EC and ASB. The POB Charter calls for the POB to evaluate resources of the SECPS and ASB and information to support these evaluations has been requested.
Term limits for POB members. POB members should be limited to two five-year terms, with staggered terms to ensure continuity.	POB Charter provision II.D.
A nominating committee responsible for identifying and nominating new POB members. The nominating committee should be appointed by the POB from names suggested by public and private institutions that are most concerned with the quality of audits and financial reporting.	POB Charter provision II.B.
An advisory council to advise the POB on issues related to projects on its agenda, new agenda items, project priorities and related matters. The POB should appoint the council members, whose service should be limited to two three-year terms. The council should comprise nine to fifteen people selected from the constituencies that are concerned with audit quality and financial reporting matters, thus ensuring the broadest spectrum of participants in the self-regulation of the auditing profession. Council members should serve on a voluntary, part-time basis and be available to meet with the POB at regularly scheduled intervals (e.g., two to four times a year).	POB Charter provision VIII.F. provides for a review panel to be selected to evaluate the effectiveness of the POB oversight role and process at the end of three years. The review panel is to specifically report on "a review of the effectiveness of the annual outreach meeting in Section VIII.H. and whether this annual outreach meeting alleviates the need for an advisory council."
A coordinating task force of the chairs of each body within the POB's oversight. This task force would be responsible for sharing information related to each body's activities. It should meet periodically (e.g., two to four times a year) to ensure effective communications among the bodies subject to POB oversight. For example, the task force would provide a formal means for QCIC and the PRC to communicate to the ASB, ISB and PEEC their findings and the resulting implications for changes in standards.	POB Charter provision VII.B. provides for a Coordinating Task Force and its first meeting was held on October 11, 2001.
The POB's authority to commission special reviews related to significant professional matters that affect the public's confidence in the profession. One such matter is the perceived lack of candid and timely public reporting of why and how highly publicized audit failures and frauds occurred, together with an analysis of the effectiveness of generally accepted auditing standards in such circumstances and the actions that have been taken or will be taken to ensure that such problems do not recur.	POB Charter provision VI.A. provides for the formation and budgeting of both "anticipated oversight reviews" and "unanticipated oversight reviews."

6.26 The Panel recommends that the POB, SEC, AICPA, SECPS and major firms promptly agree to a charter for the POB. The Panel understands that there are two matters in the August 22, 2000, draft charter that are still under negotiation: (1) the POB's role in the appointment of the chairs of the ASB and the SECPS Executive Committee, and (2) the procedures for amending the charter. Upon the successful conclusion of these negotiations, the Panel believes the charter will result in a major step forward in the governance of the profession. The draft charter includes a provision for the POB to conduct an annual "outreach" meeting with representatives from the constituencies that are concerned with audit quality and financial reporting matters. While this may alleviate the need for a nominating committee and advisory council, the Panel recommends that this issue be addressed in three years as part of the POB's review of the effectiveness of the self-regulatory oversight process as contemplated in the draft charter.	POB Charter was approved by its members and the AICPA Board of Directors in February 2001.
6.27 The Panel recommends that the POB and SEC acknowledge the need to maintain a continuing dialogue that will foster a cooperative relationship, protect and enhance mutual respect and confidence, and increase the public's respect for the profession and its role in the capital markets.	Ongoing dialogue with the SEC is occurring.
6.28 The Panel recommends that the POB and state boards of accountancy, perhaps through the National Association of State Boards of Accountancy, determine how best to facilitate meaningful continuing dialogue between the POB and state boards.	Action required. As of February 15, 2002, no action has commenced.
6.29 The Panel recommends that the POB:	
Enhance its resources, including augmenting its staff with additional qualified technical professionals, in order to implement the POB's expanded oversight role. Among other matters, the augmented staff would assist the POB in overseeing the peer reviews of the largest firms. The POB should identify such professionals as soon as possible.	POB staff resources have been enhanced, several qualified technical professionals have been retained, and the search for an additional full time staff member was achieved with the hiring of John Weber.
Review its charter periodically to ensure its continuing adequacy in the light of changing circumstances and, if appropriate, work with the AICPA, SECPS and SEC to amend it	Ongoing and should be reported each year in the POB Annual Report.
Review periodically the effectiveness of the ASB, the ISB, the SECPS and other groups that it oversees and include its findings and conclusions in its Annual Report	POB Charter provision VIII.C. required an annual evaluation and recommendations with respect to those organizations subject to POB oversight to be included in the POB Annual Report.

Summarize in its Annual Report the status of all AICPA Ethics Division investigations of audits of SEC registrants when the civil litigation and public regulatory investigations have been concluded (see the fourth recommendation to the AICPA below)	The POB staff is working with the AICPA Ethics Division to format such reporting in the POB Annual Report.
Increase its public communications to expand the public's awareness of the POB, its activities and its value to the capital markets	POB web site has been created and its Annual Report has been expanded and is receiving ongoing attention.
6.30 The Panel recommends that the SECPS and POB staffs compile data from their oversight of peer reviews and QCIC investigations that will enhance the diagnostic value of the peer review and QCIC findings to standard setters and audit firms. The data should be communicated to the profession and, when appropriate, to the public in the POB's Annual Report. The data might include the following:	Database elements have been agreed to and AICPA database is in process of being programmed.
Disciplinary measures taken by member firms resulting from substandard performance	
The audit firms' fraud risk assessments and related responses, if any, on audits where fraud is subsequently discovered	
Data related to emerging issues that identify needed modifications to professional standards or best practices guidance	
Data on non-audit services provided to the audit clients encompassed by peer reviews and QCIC investigations	
Enhancing peer reviews	
6.41 The Panel recommends that the POB, by using its augmented staff (see paragraph 6.29), expand its oversight throughout the peer reviews of the largest firms on a "real-time" basis. The expanded role should include, at a minimum:	The POB has augmented its staff with the hiring of part-time and one full time staff.
Reviewing the qualifications of the peer review firm and the review team captain	This recommendation has been implemented.
Attending important meetings, focus groups and interviews with firm personnel	This recommendation has been implemented.
Reviewing the draft peer review reports before they are provided to others	At a minimum, POB expects to review drafts at the same time as the reviewed firm.
Overseeing the following: The planning of the review The review of the internal inspection program The practice office and National office reviews	This recommendation has been implemented.

The debriefing of engagement reviewers at the conclusion of the reviews The resolution of issues that arise during the reviews	
6.56 (5). The processes implemented by SECPS member firms when they choose Option C should be subject to peer review and oversight by the POB. At least one engagement to which Option C is being applied should be a mandatory selection in the firm's peer review and annual inspection program. If the POB disagrees with a member firm's selection or method of applying Option C, it should promptly make its views known to the firm, SECPS committee representatives and the SEC through its normal communication channels, and to the public through its Annual Report and other publications.	The PRC will develop an annual program to address this recommendation. This is underway.
6.56 (6). The POB should report on these activities in its Annual Report on an aggregate, no-name basis, including matters that are concluded through the retirement of the partner, Ethics Division decisions or settlement of litigation.	These activities will be reported in the 2001 POB Annual Report.
6.57 The Panel recommends that the POB and SECPS review the results of implementing these recommendations over a two- to three-year period to determine their effectiveness. If the POB determines that these recommendations have not satisfactorily protected the public, the Panel recommends that the POB, in cooperation with the SEC, then seek legislation to achieve the protections necessary to make the disciplinary process more effective.	The POB will include the evaluation as part of the review panel evaluation called for by the POB Charter provision VIII.F.
6.58 The Panel recommends that the POB, concurrent with its oversight of the disciplinary process outlined above, leverage the knowledge it gains to determine whether changes in professional standards or further guidance is needed and communicate these findings to the appropriate standard setters or authoritative bodies.	The POB will implement this recommendation through its Coordinating Task Force called for by the POB Charter provision VII.B.
SECPS Quality Control Inquiry Committee	
Earnings management and fraud	
3.55 The Panel recommends that the SECPS Quality Control Inquiry Committee (QCIC):	At its November 2000 meeting, the QCIC concluded that it was supportive of the observations and recommendations of the Panel regarding fraud;

	consequently, the QCIC had no further observations or recommendations for the Fraud Task Force at this time. The QCIC agreed that it would consider providing comments to the Fraud Task Force as it finalizes its study. A three-member task force of the QCIC met with the chair of the ASB's Fraud Task Force and two other members on June13, 2001 to provide comments on a draft SAS. Mr. Landsittel, the chair of the Fraud Task Force met with the QCIC at its August 2001 meeting to discuss the ASB Fraud Status Report. The committee expressed support for the up front communication contemplated to occur between the engagement partner and the rest of the audit team concerning the consideration of fraud.
• Assess the results of the ASB's research on the effectiveness of SAS No. 82, together with information that it has on litigation involving allegations of fraud, to determine whether it believes that the ASB should consider providing further guidance on fraud risk assessment.	The ASB has issued an Exposure Draft enhancing the fraud standards. QCIC is monitoring and will provide input as appropriate.
• Initiate ongoing reviews with the ASB, the SECPS Peer Review Committee and the AICPA's Professional Ethics Executive Committee regarding factors that appear to be influencing audit performance, with a view toward enhancing auditors' fraud detection capabilities. (QCIC is in a unique position to conduct these activities because it usually is the group that addresses allegations of audit failure on a timely basis and thus can act as a catalyst for appropriate action.)	POB Coordinating Task Force is the vehicle that is accomplishing this Panel recommendation.
Proposed system of governance	
6.33 The Panel recommends that QCIC establish a panel of industry specialists and experts whose members would be drawn from the practicing profession and industry and who would be available to QCIC members and the POB and SECPS staffs for consultation on various matters, such as industry issues and the application of accounting standards.	In response to this recommendation, the QCIC, at its February 2001 meeting, recommended immediate implementation of the following process. The QCIC will maintain an inventory of member industry and technical skills. In the event that a QCIC member, POB or SECPS Staff ("review team") considers consultation outside the team to be necessary, the first consultation source will be another QCIC member with

	identified industry skills. The review team will be responsible to make this contact as considered necessary. Consultation beyond QCIC membership will be initiated by the "review team." This consultation will be coordinated by the QCIC Senior Technical Manager, through contact with the Big 5 firm representatives of the SECPS Executive Committee. It is expected that the SECPS Executive Committee member will then identify a specific experienced and highly qualified partner to consult with the review team. The review team will be responsible to request such consultation and to identify, if possible, specific areas in question. The consulting partner, if not a QCIC member, will not be advised of the client or auditor name and will not have access to the case background materials or claim. The QCIC Senior Technical Manager will be responsible to assure no conflict exists with firms involved in the case and the consulting firm.
Enhancing the disciplinary process	
6.56 The Panel recommends the following procedures when civil litigation or a criminal or public regulatory investigation contains allegations of an audit failure:	The SECPS has adopted a Membership Requirement to "Improve Disciplinary Process" - Appendix M SECPS 1000.46 "Procedures in Connection with an Alleged Audit Failure". This Requirement is to be consistent with the Panel's recommendation when implemented in accordance with the QCIC operating procedure that requires a firm to review other SEC engagement for which engagement partner is responsible.
1. Firms should continue to report cases in accordance with QCIC's current requirement, but the AICPA should devote more resources to QCIC to speed up the process.	
2. A firm should, as soon as reasonably possible after the commencement of the litigation against the firm, conduct an internal review of the subject engagement to evaluate the performance of the senior engagement personnel. In addition, in its meeting with the QCIC committee member and staff and the POB staff, the firm would respond to a standard question regarding whether the firm had conducted such a review. A person who is knowledgeable, or one who has become knowledgeable, about the	

circumstances of the engagement should be present at the meeting to discuss the engagement.	
3. QCIC should conduct its usual inquiries. If QCIC assigns a 3 rating and there is a subsequent Ethics Division investigation, or assigns a 4 rating, the Ethics Division would open a case file. The Ethics Division would then inform the firm that its consideration of the matter was being deferred in accordance with the Ethics Division's policy, pending the termination/completion of the litigation or public regulatory investigation, or the end of the threat of litigation.	
4. Upon notification by the Ethics Division regarding its deferral, and in order to protect the public, the firm would select one of the following three options, if it had not already done so, to apply to the engagement partner during the period of the deferral, if the partner was still with the firm:	
A. Terminate or retire the partner	
B. Remove the partner from all public company audit engagements until the Ethics Division's process is completed	
C. Perform an additional second partner review of all public company audit engagements completed by the partner in the 12 months prior to the deferral. The firm would report the results of such review to both QCIC and the POB.	
Subject the partner to additional oversight on all public company audit engagements for at least one year by requiring that the concurring partner review be performed by an experienced senior technical partner appointed by the firm's managing partner/CEO. In addition to the required concurring partner review procedures, this review must include, at a minimum, timely involvement in:	
Significant planning activities	
Determination of risk assessments and the design of tests of controls and substantive audit procedures	
Thereafter subject the partner to those additional oversight procedures that the firm's managing partner/CEO determines are necessary to protect the public, based on the firm's evaluation of the partner's performance	
8. If the Ethics Division becomes aware of a matter (e.g., through a complaint letter or newspaper report) involving the financial reporting of an SEC registrant in which the SECPS member firm has not been made a party, and the Division otherwise would open an investigation, it instead should refer the matter to QCIC for further action, and the firm should be notified of such referral.	Several cases were put on the QCIC agenda that fell into this category.

9. QCIC frequently may not have sufficient information to proceed in connection with matters in which the firm has not been made a party. In such cases, QCIC should close the matter without prejudice, and the Ethics Division should not open a case on the matter. However, QCIC would retain the right to reopen the matter if it obtained additional information. If the matter ends without the firm having been made a party, it would remain closed. If the firm becomes a party at a later date, the QCIC reporting requirement should be reduced to 15 days for the matter.	
10. Once an Ethics Division deferral is lifted, the Ethics Division should expedite its investigation of the matter. The AICPA should allocate additional resources to both QCIC and the Ethics Division to enable both bodies to perform their responsibilities promptly and effectively	The Ethics Division has increased their resources and the processing of cases involving public companies is a priority.
AICPA	
Professional leadership – the tone at the top	
4.7 The Panel recommends that the AICPA develop messages targeted to both audit professionals and users of audited financial statements that promote the importance of audits.	The AICPA's Audit and Attest staff is developing action plans to promote and enhance the image of the audit and the audit and assurance professional. It is anticipated that these plans will incorporate communications to both audit professionals and users of audited financial statements.
Professional development	
4.18 The Panel recommends that the AICPA assist firms in adopting the competency-based learning concepts in the AICPA exposure draft, Statement on Standards for Continuing Professional Education, and in using a core competency model that is similar in design to the AICPA model as a basis for career planning and self-assessing whether individual performance and competency goals are being achieved.	The AICPA is finalizing a core competency based model that will be applicable for auditor and assurance personnel. Once finalized, this computerized model will be made available to firms for their use in the career planning process of establishing competencies and evaluating staff against those competencies.
Smaller firm considerations	
4.32 The Panel recommends that the AICPA:	
Provide greater audit-related assistance to smaller firms, particularly technical and industry accounting and auditing support and consultation	The AICPA maintains a technical hotline that provides accounting and auditing technical assistance to many

	small firms. When industry accounting questions arise that these individuals are unable to answer, the caller is referred to another AICPA technical specialist with expertise in that industry. The AICPA believes that the availability of the professional standards on-line, coupled with on-line learning is providing substantial assistance to small firms.
Consider additional means by which smaller firms can meet the SECPS concurring partner requirement	The SEC Practice Section maintains a database of individuals who request to perform concurring reviews for member firms that do not have sufficient resources to perform that function internally.
Develop software and other tools to assist smaller firms in assessing engagement risk (client acceptance and continuance)	
Proposed system of governance	
6.23 The Panel recommends that the auditing profession's system of governance be unified under a strengthened, independent POB that oversees the profession's activities with respect to standard setting, monitoring, discipline and special reviews. Accordingly, the POB should oversee the ASB, the ISB, the SECPS Executive Committee, QCIC, the SECPS Peer Review Committee, the Professional Issues Task Force (PITF), the SEC Regulations Committee and the standard-setting activities of the PEEC that relate to audits of public companies. The POB should serve as the oversight body to whom the SEC, the state boards of accountancy, the auditing profession and the public should look for leadership. This leadership position is intended to enhance communications among the profession's self-regulatory bodies in order to facilitate the profession's continuous improvement efforts and identify and resolve important issues on a timely basis.	The AICPA and SECPS have worked with the POB for several months to develop and approve a charter that meets the spirit of the recommendations contained in the Panel's report. The AICPA Board of Directors approved a formal charter for the POB in early 2001. The SECPS Peer Review and Quality Control Inquiry Committees are considering the types of information that could be relevant to the profession or standards setters for modification of standards or best practices guidance. These committees are formalizing their processes for communicating issues that are noted in its reviews or inquiries to the profession and standard setters.
6.31 The Panel recommends that:	
The constituencies (both practitioners and non-practitioners) represented on the ASB remain unchanged; however, at least a majority of the members should be from CPA firms that provide attest services to SEC clients	No action required. Constituency and majority of members are consistent with recommendation.
The AICPA provide the resources necessary for the ASB to meet its mandates	Will be assessed annually and reported upon in the POB Annual Report.
The AICPA provide the resources necessary for the SECPS to meet its staffing needs, including providing QCIC with the resources needed to enable it to act quickly in investigating alleged audit failures and thereby preserve the candid dialogue with SECPS member firms that presently adds to the effectiveness of the QCIC process	The AICPA has provided and is committed to providing the financial and human resources necessary for the SECPS, including the QCIC, to meet its mandates.

The Ethics Division takes all necessary actions to ensure timely processing of investigations involving audits of SEC registrants when the civil litigation and public regulatory investigations have been concluded. The Ethics Division should establish reasonable time frames for these matters and report the status of all such matters to the POB semiannually.	The Ethics Division has agreed to make available all necessary information to meet this Panel recommendation. However, the data is not available on a timely basis to include in the 2001 POB annual report.
The ASB, SECPS and PEEC staffs remain employees of the AICPA	No action required.
Independence Standards Board	
Non-audit services	The POB should monitor ISB developments during 2001 and then reach a decision as to the applicability of the ISB Panel recommendations. The SEC has amended Financial Reporting Release No. 50 to state that it will no longer look to the ISB for leadership in establishing and improving auditor independence standards applicable to auditors of the financial statements of Commission registrants. The ISB was dissolved on July 31, 2001.
5.29 The Panel recommends that, whatever the outcome of the SEC's rule-making initiatives, the ISB identify factors to be considered by auditors, audit committees and client management (a) when implementing Independence Standard No. 1 and the SEC's new audit committee disclosure requirements and (b) when determining whether a specific non-audit service is appropriate. In determining the appropriateness of a particular service, one guiding principle should be whether the service facilitates the performance of the audit, improves the client's financial reporting process, or is otherwise in the public interest. The factors to consider might include:	
Whether the service is being performed principally for the audit committee	
The effects of the service, if any, on audit effectiveness or on the quality and timeliness of the entity's financial reporting process	
Whether the service would be performed by specialists (e.g., technology specialists) who ordinarily also provide recurring audit support	
Whether the service would be performed by audit personnel and, if so, whether it will enhance their knowledge of the entity's business and operations	
Whether the role of those performing the service (e.g., a role where neutrality, impartiality and auditor skepticism are likely to be subverted) would be inconsistent with the auditor's role	

Whether the audit firm's personnel would be assuming a management role or creating a mutuality of interest with management	
Whether the auditors, in effect, would be "auditing their own numbers"	
Whether the project must be started and completed very quickly	
Whether the audit firm has unique expertise in the service	
The size of the fee(s) for the non-audit service(s)	
The Panel recognizes that considerable judgment may be required in reaching a conclusion regarding the appropriateness of an audit firm's performing a specific non-audit service for a specific public audit client.	
5.31 The Panel recommends that the SEC and the ISB evaluate on a continuing basis the effectiveness of the disclosures made under Independence Standard No. 1 and the SEC's new audit committee disclosure requirements, as well as any new rules issued by the ISB or by the SEC pursuant to its rule-making initiatives.	
Proposed system of governance	
6.35 The Panel recommends that:	
The ISB reconstitute its membership to include four members representing the public and three members representing the public accounting profession (currently the membership is four and four)	
The public members retain responsibility for the selection of their replacements, with the POB being consulted on the selections	
Two of the members representing the public accounting profession be selected by the SECPS Executive Committee from member firms, with the third member continuing to be the AICPA president or his or her designee	
The ISB retain sole authority to determine its budget and other resources.	
The ISB retain its staff and the responsibility for their hiring, supervision and compensation	

International Federation of Accountants	
International	
7.46 The Panel recommends to IFAC that the global self-regulatory structure of the international auditing profession meet the following criteria:	A global oversight board (IPOB) is being organized. Its seven members will come from IFAC, two from IOSCO, and from leading monetary and lending agencies. Member nominations are being screened now. IPOB's initially drafted charter has been modeled after the US POB's new charter.
Public Interest Oversight The global self-regulatory structure should have as its centerpiece a global oversight body to monitor and report on the activities of individual country self-regulatory organizations (or the member organizations of IFAC that expressly serve that purpose). The charter of this oversight body should establish clearly that its primary goal is to serve the public interest. Membership in this body should be established through a mechanism that ensures its independence and viability. (The Panel's recommendations to the U.S. Public Oversight Board [POB], included in Chapter 6, may be helpful to IFAC in this regard, recognizing that a global structure would not operate in exactly the same manner as the POB.)	
The global oversight body should ensure that IFAC imposes on its member organizations clear and unequivocal minimum guidelines for the self-regulation of the auditing profession in each country subscribing to its oversight. Timetables for achieving goals should be established on a by-country basis.	
International Auditing Practices Committee The global oversight body should be consulted on the membership appointments and agenda of IAPC and evaluate the efficacy of the ISAs and the progress made in achieving their global acceptance. It should ensure that IAPC's standards are comprehensive and sufficiently specific and rigorous so that they serve as appropriate benchmarks to judge the work of auditors. (See "Establishing Auditing Standards" in Chapter 2 for the Panel's recommendations to the ASB.)	Although the IPOB has not yet been formed, IFAC is seeking to reorganize and strengthen the IAPC. Intention is to add staff resources and to upgrade the technical quality of the members.
IAPC's deliberations should be open to the public and the basis for and outcome of its actions published. Dissenting views of its members should be published to promote the goal of transparency, encourage development of the highest-quality standards and assist in their proper interpretation.	

Quality Assurance over Auditing A key element of quality assurance by individual self-regulatory organizations should be external reviews of the quality controls of audit firms over their accounting and auditing practices. Minimum global standards for quality control over the audit function should serve as the benchmark for these reviews. (See "Recent Changes to SECPS Membership Requirements" above.) IAPC (or an equivalent technical body) should establish these quality controls standards with due process. The global oversight body should evaluate these standards and the progress of the individual self-regulatory organizations in promoting external reviews and reporting on their results. (See the Panel's recommendation to the SEC in the section "Enhancing Peer Reviews" in Chapter 6.)	TAC is designing a global peer review process. They anticipate a three-stage implementation of (1) benchmarking (agreed-upon procedures to compare firm policies with IFAC standards on auditing, quality control, and ethics); (2) compliance (evaluation of internal inspection programs), and (3) global peer reviews. It is anticipated that all three stages are to be completed for all firms in about five years. Some peer reviewers are likely to be appointed beginning this summer. US-based firms are likely to use their existing peer reviewers.
Ethics and Independence The oversight body should evaluate the adequacy of IFAC's ethics standards, including independence standards (for firms and individual auditors), in serving the interests of public investors, creditors and other users of financial statements.	
Education The oversight body should assess IFAC's process for evaluating the education and training of auditors on a by-country basis and its initiatives for establishing high-level, minimum educational standards for the auditing profession. This process should include monitoring the progress of the profession in each country toward achieving established goals.	
By-Country Monitoring, Investigations and Discipline The global oversight body should establish a framework for monitoring the accountancy profession to guide the individual country self-regulatory organizations (or equivalent bodies, if not formally designated as self-regulatory organizations).	TAC is looking at a system of investigations, and is considering a QCIC-type model as well as the UK joint monitoring and other models.
Key elements that the global oversight body should ask each country's self-regulatory organization to address include: (1) accounting standards adopted and in use and the status of efforts toward convergence with IASC standards, (2) auditing standards adopted and in use and the status of efforts to apply IAPC standards, (3) ethics (including independence) standards adopted and in use and the status of efforts to adopt international standards as a minimum,	

(4) educational levels and skills and the status of efforts to achieve goals, (5) quality reviews (including peer reviews) and the status of efforts to achieve goals, (6) monitoring of practice quality by investigating allegations of audit deficiencies or failures and the status of efforts to achieve goals, (7) disciplinary activities and the status of efforts to achieve goals, and (8) the regulatory environment over global financing and changes occurring in that environment.	
Membership Requirements of IFAC-sponsored Group of Audit Firms Membership requirements of the proposed group of audit firms that will work with IFAC to raise international standards should include periodic reports by those firms to the global oversight body about their structure and operations.	This recommendation may be considered after the IPOB is formed. FOF includes the Big 5, and most sizable transnational audit firms, who audit a high percentage of listed companies around the world. Most firms have a US unit that is a member of SECPS. FOF members will pay all costs of the IPOB, the FOF and some IFAC costs. FOF's constitution and operating procedures were approved in April by the FOF and IFAC. TAC has fifteen members, the Big 5 plus 10 other firms. TAC has observers on key IFAC committees. It has just hired a director and is seeking a senior technical manager.
Monitoring the Global Auditing Profession A system for monitoring the global auditing profession should be established by IFAC that provides for reporting to the global oversight body by the individual self-regulatory organizations. This monitoring activity should address the key elements described above for individual countries.	
Reporting to the Public There should be comprehensive annual reports to the public by the global oversight body on its activities, including the results of its monitoring of the quality assurance functions for the auditing profession on a by-country basis. Such reporting should describe the nature of the self-regulatory processes followed in each country and the results of reporting by each country's individual self-regulatory organization. These reports should address the progress being made by each country toward achieving goals in the areas of standards, quality assurance, ethics and independence, education, monitoring and investigations, and discipline. The global oversight body's goal should be to bring "transparency" to how the global auditing profession functions and serves the interests of investors.	

International Auditing Practices Committee	
International	
7.48 The Panel recommends that the ASB and IAPC initiate a formal collaborative effort to harmonize auditing standards and achieve their global acceptance. Others interested in auditing standard setting should be invited to participate in this effort.	
7.49 While the Panel encourages this initiative, it also believes that such an effort should be conducted in parallel with the ASB's consideration of its other recommendations. (See the Panel's recommendation to the POB and the ASB under "Establishing Auditing Standards" in Chapter 2.)	
State Boards of Accountancy	
Proposed system of governance	
6.28 The Panel recommends that the POB and state boards of accountancy, perhaps through the National Association of State Boards of Accountancy, determine how best to facilitate meaningful continuing dialogue between the POB and state boards.	
Member Firms of the SECPS Represented on the SECPS Executive Committee	
Proposed system of governance	
6.34 The Panel recommends that each member firm ensure that its representative on the SECPS Executive Committee has sufficient authority and responsibility to commit the firm to the protection of the public interest when this conflicts with a more favorable business position, and ensure that the public interest remains the paramount objective in the representative's decision making and voting.	