

## Edward W. Trott Talks to The FASB Report about Sarbanes-Oxley, the PCAOB, and the FASB

The Sarbanes-Oxley Act of 2002 instituted a number of significant changes. *The FASB Report* asks Board member Edward W. Trott to respond to two frequently asked questions received from the FASB's constituents.

### Q How has the Sarbanes-Oxley Act affected the FASB?

The Act established criteria that must be met by an accounting standard-setting body in order for that body's work product to be recognized as "generally accepted." In April 2003 (through the issuance of Release 33-8221), the SEC determined that the FASB and its parent organization, the Financial Accounting Foundation (FAF), satisfied those criteria.

The Act required just one change to the operations of the FASB in order for the FASB and the FAF to comply with the Act's criteria. That change relates to the way the FASB is funded. The FASB is now funded by the mechanism established by the Act that replaces voluntary contributions with a mandatory funding model for public companies.

In addition to confirming that the SEC would continue to treat FASB accounting standards as "authoritative," the Release also discussed the SEC's working relationship with the FASB and the FAF. Finally, the Release stated that the SEC expects the FASB to take the following actions:

*Consider, in adopting accounting principles, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors, including consideration of moving towards greater reliance on principles-based accounting standards whenever it is reasonable to do so;*

*Take reasonable steps to continue to improve the timeliness with which it completes its projects, while satisfying appropriate public notice and comment requirements; and*

*Continue to be objective in its decision-making and to weigh carefully the views of its constituents and the expected benefits and perceived costs of each standard.* [Footnotes to the above have been omitted.]

The SEC's Release confirmed the importance of the FASB's independence by stating:

*While effective oversight of the FASB's activities is necessary in order for the Commission to carry out its responsibilities under the securities laws, we recognize the importance of the FASB's*

*independence. By virtue of today's Commission determination, the FASB will continue its role as the preeminent accounting standard setter in the private sector. In performing this role, the FASB must use independent judgment in setting standards and should not be constrained in its exploration and discussion of issues. This is necessary to ensure that the standards developed are free from bias and have the maximum credibility in the business and investing communities.* [Footnote to the above has been omitted.]

### Q The Act created the Public Company Accounting Oversight Board (PCAOB). What is the relationship between the FASB and the PCAOB?

The PCAOB's website includes the following Mission Statement:

*The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.*


As part of its oversight of auditors, the PCAOB (1) registers public accounting firms that prepare audit reports for public companies, (2) establishes auditing, quality control, ethics, independence, and other standards related to the preparation of audit reports for public companies, (3) conducts inspections of registered firms, and (4) conducts investigations and disciplinary proceedings concerning registered firms. The inspection of registered firms will examine in detail the conduct of selected audit and review engagements for public companies including conformity with auditing and independence standards and the auditors' evaluation of the public companies' compliance with accounting standards.

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.

Thus, the FASB's area of responsibility is the development and promulgation of accounting standards that are used by both public and private companies to prepare financial statements, and the PCAOB's area of responsibility is the auditing profession that audits the financial statements of public companies.

Although there is no formal relationship between the FASB and PCAOB in the sense that neither Board reports to or is subject to oversight of the other, the two Boards share a common goal of contributing to the effective and efficient functioning of the capital markets. In order to achieve this common goal, the two Boards each have understandings about the other.

Specifically, the FASB understands that the PCAOB, through its inspection program, may identify areas that require new accounting standards, areas in which existing standards should be



improved, and areas in which additional guidance is needed to implement an existing accounting standard. Additionally, the FASB understands that the PCAOB will provide input about the audit implications of proposed accounting standards.

In turn, the PCAOB understands that the FASB will keep it informed about new accounting guidance the FASB plans to issue, so that the PCAOB can consider whether additions to, or changes in, audit and reporting standards are needed. Additionally, the FASB and PCAOB will be working together to move accounting and financial reporting guidance that is presently provided in the auditing literature to the accounting literature.

In order to work toward their common goal of contributing to the efficient and effective functioning of the capital markets, and to manage the interface between their areas of responsibility, representatives of the FASB and PCAOB participate on each Board's advisory bodies and meet regularly to keep each other informed of actions, plans, and findings. This coordination effort also includes participation by the SEC staff.

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