

Conversations with Audit Committee Chairs: What We Heard & FAQs

Executive Summary

As part of the Public Company Accounting Oversight Board's (PCAOB) strategic goal of enhancing transparency and accessibility, we are committed to engaging more directly and more often with public company audit committees. In 2019, we had conversations with the audit committee chairs of almost all of the U.S. issuers whose audits we inspected and offered them the opportunity to speak with our inspections teams. Once our 2019 inspections are complete, we expect to have spoken with nearly 400 audit committee chairs. By contrast, historically, we have reached out to a small percentage of audit committee chairs during our inspections process. In 2018, for example, we spoke with 88 audit committee chairs.

We view an engaged and informed audit committee as an effective force multiplier in promoting audit quality and were grateful for the opportunity to speak with so many audit committee chairs. Continuous dialogue with audit committees on areas of mutual importance helps us to advance our mission and may assist audit committees in fulfilling their duties. To that end, our conversations focused broadly on audit quality, with specific discussions around such topics as audit committee perspectives of the auditor, new auditing and accounting standards, and technology and innovation.

Audit committee chairs provided informative and valuable feedback on these topics and were appreciative of the opportunity to engage directly with the PCAOB. They expressed particular interest in learning more about the PCAOB's inspections process. Audit committee chairs also often asked for additional tools, resources, and learning opportunities from the PCAOB, and many were interested in learning about what we heard from their peers during these calls.

To that end, in this document we share:

- **What we frequently heard from audit committee chairs and perspectives from them on what is working well to help improve audit quality;**
- **An overview of our inspections process; and**
- **Staff responses to frequently asked questions (FAQs) during the conversations.**

Please note that the PCAOB does not require or necessarily endorse what we heard from audit committee chairs, but we share their perspectives in an effort to provide transparency into the process and as part of the reporting out of what we heard.

This document was prepared by PCAOB staff to help inform audit committees in their interactions with their auditor. The statements contained in the document do not establish rules of the Board, do not constitute determinations of the Board, and have not been approved by the Board. The PCAOB does not set standards for or provide authoritative guidance to audit committee conduct.

Audit Quality

- Most audit committee chairs evaluated audit quality with an emphasis on their engagement team, with a lesser degree of focus on the characteristics of the audit firm. Many noted that if their engagement team was performing well, firm-wide metrics often provided by audit firms in annual audit quality or transparency reports were less relevant to them. Others also noted that they believe audit quality centers on the exercise of judgment, which they said is difficult to measure.
- There were varying levels of familiarity with the term audit quality indicators (AQIs), with the majority of audit committee chairs having little to no familiarity with the term. Many, however, were familiar with metrics commonly thought of as AQIs, particularly related to the quality of the engagement team, including the engagement team's:
 - o Communication (direct, clear, thorough, and timely)
 - o Diversity
 - o Experience
 - o Industry expertise
 - o Knowledge of the issuer and issues
 - o Leadership ability of the lead engagement partner
 - o Location (i.e., key team members live near the issuer)
 - o Quality and continuity (i.e., good succession planning)
 - o Professional skepticism and judgment
 - o Project Management
 - o Responsiveness
 - o Training and continuing education
 - o Use of the firm's national office
 - o Use of the work of specialists
 - o Workload
- Many were aware that their audit firm used shared service centers and had virtually no concerns about them, particularly since the lead engagement partner is ultimately responsible for the quality and service of all aspects of the audit work. They noted that with proper oversight and controls, shared service centers were a good way to concentrate and leverage expertise while providing quality and cost efficient service.



Audit Committee Perspectives: What is Working Well?

- ✓ Asking the auditor if the audit firm has an annual audit quality or transparency report (or other document that outlines how the firm measures audit quality).
- ✓ Understanding and discussing the processes that the auditor has in place to address the previous year's PCAOB inspections report.
- ✓ Reviewing other audit firms' inspections reports to see if there are any lessons learned or questions about potentially similar issues that could be discussed with your auditor. (All PCAOB inspections reports can be found [here](#).)
- ✓ Selecting relevant AQIs to discuss with the engagement team and use as part of an annual evaluation.
- ✓ If the audit firm is using shared service centers, discussing at least annually the audit procedures performed at the shared service centers, what controls are in place, the impact on the quality of the work product, and whether the audit firm is considering additional shared service centers.

Relationship and Communication with the Auditor

- Most audit committee chairs were satisfied with their relationship with their auditors, the service from the audit firm and engagement teams, and the team’s skepticism and judgment.
- They were also generally satisfied with the information they received regarding auditor independence.
- Audit committee chairs described their communication with their auditors as very good and thorough, with many noting that they communicated more frequently around scheduled quarterly meetings, particularly with the lead engagement partner.
- They noted that verbal conversations during and prior to meetings were helpful in highlighting the key issues and areas on which the audit committee should focus.



Audit Committee Perspectives: What is Working Well?

- ✓ Holding a pre-call or meeting with the audit committee chair and lead engagement partner prior to an audit committee meeting to review and refine the meeting agenda and materials.
- ✓ Conducting an assessment—on at least an annual basis—of the engagement team and audit, including discussions around what went well and what could be improved.
- ✓ If your issuer’s audit is selected for PCAOB inspection, asking the audit firm about any matters that arose during the inspection.
- ✓ Having the audit committee chair visit the component location(s) for multi-location audits.
- ✓ Dedicating some audit committee meetings to deep dives on specific topics (e.g., governance processes, cybersecurity, etc.) and having the auditor provide feedback on best practices or other trends they are seeing in those areas.

New Auditing and Accounting Standards

- Audit committee chairs spent significant time discussing new accounting and auditing standards with their auditors and most felt like their auditors were proactive and timely in addressing new requirements.
- Some were concerned about the effects that the overlapping timing of implementation of several new accounting and auditing standards could have on both internal and external auditors' resources and time.
- Most audit committee chairs indicated that, while their audits had not yet been required to implement Critical Audit Matters (CAMs), preparations were going smoothly and they did not anticipate that CAMs would create significant changes to their communications with the auditor.
 - Many were focused on the number of CAMs that were in the auditor's report as well as if they were comparable to the number and type of CAMs disclosed by peers.
 - Some also noted that while the initial discussions around CAMs focused a lot on the language that the auditor would use to describe the CAM, they hoped that going forward the conversations would focus on what CAMs mean and how that impacts the audit process.



Audit Committee Perspectives: What is Working Well?



Discussing new accounting and auditing standards with the auditor as early as possible, at least a year in advance of implementation deadlines.



Creating a timeline to make sure the appropriate processes are in place and milestones are met for implementation of new standards, including the auditing of the implementation.



Using outside consultants or experts to educate the audit committee on new or complex accounting standards.

Technology Driven Changes

- Audit committee chairs had basic familiarity with auditing software tools and technologies. While they were generally supportive of automating pieces of the audit when appropriate, some cautioned that return on investment should be carefully considered. Others noted that it remained to be seen, in their opinions, whether technology will improve or detract from audit quality.
- Some audit committee chairs, particularly of large issuers, noted that the issuer is beginning to implement machine learning into some of its basic internal audit work.
- Some were aware that their audit firm is using data analytics.
- The majority of audit committee chairs we spoke to indicated that the audit committee is primarily responsible for cybersecurity and it is a top priority for the committee and board. Many indicated that they are committing significant resources to cybersecurity detection and prevention, including by hiring third party consultants or dedicated internal resources or teams.



Audit Committee Perspectives: What is Working Well?

- ✓ Using project management software or a site where the audit committee, auditor, and management can all track the status of the audit plan.
- ✓ Discussing the technology and software tools the audit firm is using and how they are being used.
- ✓ Learning more about technology and scheduling time on the audit committee agenda to do deep dives on new and emerging technologies.

PCAOB 2019 Inspections: The Basics

During our conversations with audit committee chairs, many asked questions about our inspection process and the associated audit committee interviews. To that end, below we provide staff responses to common questions related to the basics of our inspections process.

How do you select audits to inspect?

In selecting issuer audits for review, we use both risk-based and random methods of selection. We make most selections based on our internal evaluation of audits we believe present a heightened risk of material misstatement. We focus on risk factors that include economic trends, company or industry developments, issuer market capitalization size and/or changes, audit firm and partner, and inspection history. We select the remaining audits randomly to provide an element of unpredictability.

What does the inspection entail?

A PCAOB inspection is designed to assess compliance with the Sarbanes-Oxley Act, the rules of the Board, the rules of the Securities and Exchange Commission, and professional standards, in connection with the firm's performance of audits, issuance of audit reports, and related matters involving U.S. public companies, other issuers, brokers and dealers. Inspections do not involve the review of all of the firm's audits, nor is it designed to identify every deficiency or cover all areas of the reviewed audits.

While inspections vary by firm, we may focus on auditor's risk assessment processes, financial reporting and audit areas affected by economic trends or pressures, audit areas that present challenges and significant risk, new accounting standards, and areas of recurring audit deficiencies. Additionally, we review quality control areas such as the audit firm's management structure and processes, including tone at the top, practices for partner management, policies and procedures for client acceptance and retention, internal inspections programs, how the firm responds to deficiencies in audit quality, and independence policies and procedures.

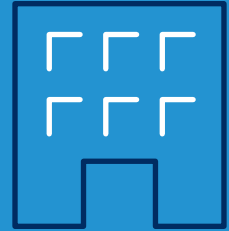
2019 Inspections by the Numbers*

241

Number of audit firms
to be reviewed by our
inspectors, which
includes:

- **12** U.S. Firms with more than 100 issuer audit clients;
- **106** U.S. Firms with 100 or fewer issuer audit clients;
- **65** U.S. Firms that audit broker-dealers; and
- **58** Non-U.S. Firms in over 33 jurisdictions

**Numbers are approximate*



A PCAOB inspection report is not intended to serve as a balanced report card or overall rating tool, and an inspection report should not be interpreted to imply the Board has reached a conclusion about a firm's quality control policies, procedures, or practices. The fact that we include a deficiency in a report — other than those deficiencies for audits with incorrect opinions on the financial statements, Internal Control Over Financial Reporting (ICFR), or incomplete reporting of material weaknesses in ICFR — does not necessarily mean that the issuer's financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist.

What happens if there is a deficiency?

Any deficiencies identified through the inspections process are evaluated for inclusion in the firm's inspection report. Part I of the report includes deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.

A firm's inspection report may also contain a Part II, which includes criticisms of or potential defects in the firm's system of quality control. The Sarbanes-Oxley Act restricts the PCAOB from publicly disclosing Part II deficiencies unless the firm does not address the criticisms and potential defects to the Board's satisfaction no later than 12 months after the issuance of this report. The audit firm, however, is not prevented from sharing such information with the audit committee.

The PCAOB is currently updating the format and structure of its inspections reports and will provide additional detail and insights on the new report in 2020.

Where are inspections conducted?

We usually conduct "on-site" inspections (i.e., at the audit firm's office). We do, however, also conduct inspections at the PCAOB's offices. In those cases, we obtain relevant work papers from the firms and conduct relevant interviews by phone.

How are inspectors assigned to an inspection?

We use experienced auditors to conduct inspections. We assign individual inspectors to specific inspections based on their industry background and expertise, geographic location, and, when necessary, language skills.

How does the PCAOB choose audit committee chairs to interview?

In 2019, we reached out to almost all audit committee chairs of inspected U.S. issuers. We did so to respond to feedback that indicated audit committees wanted more direct and frequent interaction with us. Through our outreach efforts, including these interviews, we are seeking to make the PCAOB more transparent and accessible to relevant stakeholders.

Will information received from audit committee chairs be considered in our inspections approach and evaluation of the firms?

The conversations we have with audit committees during our inspections are an important part of our outreach strategy as outlined in the Board's Strategic Plan. The information we learn and feedback we receive from audit committee discussions will assist the PCAOB in assessing audit firms' compliance with PCAOB standards, as well as inform our oversight activities and future external communications.

During the calls with audit committee chairs, can the PCAOB share inspection results?

The PCAOB is prohibited from sharing information regarding our inspections during the audit committee calls because information related to an inspection is confidential and privileged under Section 105(b)(5)(A) of the Sarbanes-Oxley Act. The audit committee can, however, ask their auditor for information regarding a PCAOB inspection. We encourage audit committee chairs to engage in a direct dialogue with the audit firm about matters that may arise during the inspection. Once an audit firm's PCAOB inspection report is made public, audit committees can find the reports [on our website](#).

Does the PCAOB inspect audit firms outside of the U.S.?

Yes, in addition to inspecting registered public accounting firms located in the U.S., the PCAOB also inspects registered public accounting firms located in non-U.S. jurisdictions on a triennial basis in order to assess those firms' compliance with relevant laws, rules, and standards in connection with their performance of audits, issuance of audit reports, and related matters involving U.S. public companies and other issuers. The PCAOB often enters into formal cooperative arrangements with foreign audit regulators in order to minimize administrative burdens and potential legal or other conflicts that non-U.S. firms may face in the non-U.S. jurisdiction. Because of the position taken by certain non-U.S. authorities, the PCAOB is denied access to conducting inspections in certain non-U.S. jurisdictions, although we continue to seek access to those jurisdictions.

What does the PCAOB do with the information collected during inspections of the audit firms?

The PCAOB uses the information collected during the inspection process in many ways, including to inform our inspections reports, our standard-setting activities, our economic and research analysis work, and other PCAOB publications to inform auditor and other key stakeholders.

Inspection reports of all PCAOB-registered firms may be found [on the PCAOB's website](#).

PCAOB Staff Responses to Frequently Asked Audit Committee Questions

In addition to questions about our inspections process, there were some other frequently asked questions from our conversations with audit committee chairs that we believe may be of interest to a broader audit committee audience. Below are PCAOB staff responses to those questions.

Does the PCAOB have resources, educational training, or events for audit committee members?

Our [strategic plan](#) highlights the Board’s commitment to enhancing our engagement with audit committees. In May, the PCAOB welcomed the [organization’s first-ever liaison](#), Erin Dwyer, to serve as a direct point of contact for investors, audit committees, and preparers.

As a part of this new liaison role, we are working to provide useful resources and information to these groups, including audit committees. For additional information, please visit our webpage dedicated to [resources for Audit Committees](#) where we have a number of publications geared towards audit committees, including a July 2019 publication on [Critical Audit Matters](#), [communications regarding independence](#), the [2019 Staff Inspections Outlook for Audit Committees](#), and more.

If you have any other comments, questions, or concerns, please contact Erin at (202) 591-4176, dwyere@pcaobus.org, or outreach@pcaobus.org.

Does the PCAOB do a cost-benefit analysis of standards?

The PCAOB is committed to robust economic analysis which, among other things, encompasses an analysis of costs and benefits and allows us (and the public) to understand the overall impact of our standard-setting activities on the audit profession, public companies, and users of financial statements.

Economic analysis is undertaken first as we develop standards, including: describing the need for a rule; developing a baseline for measuring the effects of a rule; considering reasonable alternatives to the rule; and analyzing the potential economic impacts of the rule (and alternatives to the rule), including the potential benefits, costs, and unintended consequences. We perform this analysis throughout the process: including when we propose a new or revised standard, where we solicit comments from the public on our analysis; and again when we adopt a new or revised standard.

We have also established a program under which our Office of Economic and Risk Analysis conducts post-implementation reviews of certain PCAOB rules and standards. We have completed one [post-implementation review](#) to date, and will conduct a review of the standard related to the new auditor’s report, which includes CAMs. We will conduct an interim analysis on that standard that will be reported to the public in 2020 and, after a reasonable period of time following full implementation of the new CAMs requirements, we will conduct a post-implementation review.



In addition to resources, we have begun hosting a series of audit committee roundtables with the Board and staff and we will continue to hold stakeholder meetings in the coming year. **If you would like to be notified of these events, please [share your contact information and location](#).**

AQIs: What is the PCAOB's view? How are you seeing them used?

A well-developed definition and set of Audit Quality Indicators could be an effective tool for measuring audit quality, which is why the Board's strategic plan includes an objective to determine, develop, and communicate indicators of audit quality. Our outreach and oversight activities—and our inspections in particular—yield a significant amount of data. Our Office of Economic and Risk Analysis is working to more effectively analyze this data to further identify and communicate factors that correlate with the quality of audit services.

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