Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

September 29, 2015

RE: PCAOB Rulemaking Docket Matter No. 041: *Concept Release on Audit Quality Indicators*

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") *Concept Release on Audit Quality Indicators* (the "Concept Release"). We support the Board's efforts to develop and seek public comment on a potential portfolio of quantitative measures related to public company auditing (commonly referred to as "audit quality indicators," "indicators," or "AQIs"). We commend the Board and its staff for continued outreach on this topic, including convening a public roundtable about the Concept Release.

In this letter, we offer our views regarding certain aspects of the Concept Release. Our views are organized into the following sections:

- Overview
- The term "audit quality indicator"
- Engagement-level audit quality indicators
- Firm-level audit quality indicators

Overview

Our views are informed by our involvement in various AQI initiatives in recent years, which have included discussions about the potential uses of AQIs with audit committees and academics. These efforts encompass pilot testing and our participation on the Center for Audit Quality's (the "CAQ") task force on AQIs. Our pilot testing included, in part, the CAQ's set of potential AQIs introduced in the April 2014 paper the *CAQ Approach to Audit Quality Indicators* (the "CAQ Approach").[1] In addition, since 2011 we have voluntarily disclosed in our annual quality report, *Our Focus on Audit Quality* (the "Annual Audit Quality Report"),[2] certain firm-level measures that provide additional information about our audit practice and our investment in and focus on quality. We have continued to expand and enhance our disclosures, increasing the number of measures (which since 2013 we refer to as Transparency Data Points) based on the positive feedback we have received from stakeholders. We plan to

[1] The CAQ Approach is available at http://www.thecaq.org/docs/reports-and-publications/caq-approach-to-audit-quality-indicators-april-2014.pdf?sfvrsn=2
[2] A copy of our most recent report *Our Focus on Audit Quality* is available at http://www.pwc.com/us/en/audit-assurance-services/publications/our-focus-on-audit-quality.jhtml.

continue to enhance such disclosures in our 2015 Annual Audit Quality Report. Similarly, we use quantitative measures to monitor certain aspects of our system of quality control and to assist us in identifying potential root causes of audit findings.[3] Our experience and involvement in these efforts has provided us some insights into the benefits and challenges of using quantitative measures, as well as the cost of producing and reporting these measures.

Audit quality comprises many elements and related inputs, and based on our experience, the relative importance of these may vary depending on their intended use by, and the needs of, the users of the information. Also, as stated in the Concept Release, "[t]he effort is new, and by their very nature audit quality indicators must be capable of change over time to reflect advances in learning and changes in the way audits are conducted."[4] As a result, different users will likely value different indicators and the indicators will most likely need to continuously evolve. Due to these factors, and the newness of the effort, more study is most likely needed to determine which measures, if any, could be viewed as having a relationship to audit quality, and the extent thereof. We, therefore, agree with the Concept Release, which states, "[t]he indicators are meant to be a tool. As such, they have inherent limitations that have to be recognized if they are to be effective. They are not algorithms, benchmarks, or safe harbors against enforcement or other claims, and they do not lead directly to formulas for determining the quality of a particular audit or whether an auditor has met its obligations."[5] We also agree with the statement that "[t]he reason AQIs cannot be used in any of these ways is that analysis of AQI data almost always requires a context."[6] While we agree AQIs at a minimum require adequate context, even a comprehensive suite of audit quality indicators that is accompanied by sufficient context is only a contributing factor in considering audit quality as certain elements of audit quality do not lend themselves to being evaluated quantitatively (such as due care and professional skepticism). As a result, even after further study, we may learn that there are limited relationships to audit quality but the indicators may still contribute to transparency that allows for a more informed discussion related to audit quality.

As a result of the factors above, we support a market-based approach. We believe audit committees should receive engagement-level AQIs as they are in the best position to consider the context, including the two-way dialogue needed, to determine whether any response is warranted. This context may also include communication of certain firm-level AQIs to audit committees. Under this approach, audit committees would select which AQIs are communicated to them. This will allow audit committees to tailor the set of AQIs to those that aid them in their auditor oversight role.

We also support the public communication of firm-level AQIs in audit firm transparency or quality reports and believe that market participants over time will influence audit firms as to which measures are relevant to them. Under a market-based approach, the PCAOB serves an important role in developing examples of AQIs for the market participants to consider and to encourage the use and further development of AQIs. Our rationale for these views is discussed in the following sections.

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3 Consistent with the Concept Release, page 22.
4 The Concept Release, page 14.
5 The Concept Release, page 7.
6 The Concept Release, page 7.

The term "audit quality indicator"

There is no one definition of audit quality, or a universally accepted audit quality framework and, as discussed above, there are many different elements and inputs that may impact audit quality. It is therefore important to establish the meaning of the term "audit quality indicator" with respect to the objectives of the project as the term can mean different things to different stakeholders. We believe that AQIs represent a suite of data points that, along with contextual information, may enhance understanding of audits and provide information about a firm's investment in and focus on quality.

Without a common understanding, there is the risk that a more direct and causal relationship may be thought to exist between AQIs and audit quality. As the Concept Release states, AQIs "do not lead directly to formulas for determining the quality of a particular audit or whether an auditor has met its obligations."[7] For this reason, our Annual Audit Quality Report not only includes the definition and description of such measures, along with contextual information, but we have also opted to refer to these measures as Transparency Data Points. We have used this terminology to be clear about their intended use in increasing transparency and to minimize the inference that the measures directly correlate to audit quality. If this project progresses, we believe that it is critical to define what an AQI does and does not represent so that AQIs are used appropriately. For example, we agree with the Concept Release that AQIs "may inform discussions among those concerned with the financial reporting and auditing process,"[8] by stakeholders receiving them.

Engagement-level audit quality indicators

We believe that engagement-level AQIs will provide the most benefit to audit committees given their responsibilities, including oversight of the auditors, and their knowledge and interaction with the company. As noted in the Concept Release, "the indicators are intended to provide information to help frame the oversight and evaluation of a current or pending audit."[9] "Independent audit committees of the boards of directors of listed companies are directly responsible by statute or regulation for the appointment, level of compensation, and oversight of their companies' auditors… and those auditors report directly to the audit committee."[10] Focusing on communication with the audit committee allows the AQIs to be discussed with those responsible for overseeing the independent audit.

As noted in the Concept Release, "an audit committee would likely focus first on AQI data at the engagement-level for the audit the committee oversees."[11] We also believe that evaluation of engagement-level AQIs by the audit committee could be enhanced by audit firms providing, where appropriate, certain firm-level indicators for additional context. Audit committees, with their overall knowledge of the company, experience with the auditors, and understanding of what is relevant for the users of the financial statements in their oversight role, are able to engage in a two-way dialogue by posing critical questions to the auditor. We believe that a dialogue between the audit committee and the audit firm about engagement-level AQIs could facilitate an active discussion on matters important to the execution of the audit, as well as enhance the audit committee's ability to evaluate actions that have been or may need to be taken. In addition, a two-way dialogue can provide additional context with respect

[7] The Concept Release, page 7.
[8] The Concept Release, page 1.
[9] The Concept Release, page 19.
[10] The Concept Release, page 18.
[11] The Concept Release, page 19.

to the various measures, as well as provide further perspective on matters and their potential impact on the execution of the specific audit. Enhanced communication through the use of AQIs at the engagement-level could also drive actions that might help maintain or increase audit quality on an engagement and may also assist audit committees in evaluating the effectiveness of the engagement team.

We believe audit committees are in the best position to determine what information they need related to their responsibilities and, therefore, communication of specific AQIs should not be mandated. Audit committees are already receiving (or have the ability to request) information that enables them to evaluate the performance of the auditor. The information includes quantitative and qualitative elements, including the composition of the engagement team, knowledge and judgment in the areas of accounting and auditing, understanding of the company's business and strategy, their interaction with management, local presence, reputation, etc. which do not always lend themselves to a quantitative assessment. Also, mandating the communication of prescribed, quantitative engagement-level AQIs may lead to a de-emphasis on the importance and discussion around other more relevant information, whether quantitative AQIs or qualitative elements. Allowing audit committees to select engagement-level AQIs most appropriate for their audits will provide the best opportunity for the audit committee to communicate with the audit firms on what is most important to them.

Our experience with the various AQI initiatives, including our participation in the CAQ pilot, has demonstrated to us the importance of tailoring the indicators and contextual information provided to an audit committee based on, among other factors, the nature of the entity, business and auditing risks, and the needs and interests of the audit committee. For example, broad measures of engagement team compliance with general training requirements and years of audit experience may be sufficient for one audit committee to understand the competence of the engagement team; however, in a highly specialized industry such as energy or banking, an audit committee might value an understanding of more targeted information on specialized training and technical expertise in certain complex and challenging areas related to the audit. Our experience during the pilot testing has also shown that the presentation and discussion of less meaningful measures or those that are already readily available dilutes the discussion of other more meaningful data presented.

We believe AQIs are likely to be misleading without contextual information and, consistent with the Concept Release, believe they "may have their greatest use as generators of questions for the auditor."[12] As such, we believe that engagement-level AQIs should be accompanied by two-way dialogue with the auditor. For this reason and those discussed above, we do not support the public disclosure of engagement-level AQIs.

These views are consistent with those of the CAQ, which were informed by the CAQ Approach that included a broader population for the pilot testing (30 audit engagements).

Firm-level audit quality indicators

We support public reporting of firm-level AQIs, accompanied by appropriate written context. For the last several years we have voluntarily disclosed Transparency Data Points in our Annual Audit Quality Report, which provides information about our audit practice and our investments in and focus on quality.

We believe firm-level AQIs should not be mandated or prescribed because differences in the firms could make it difficult to achieve consistency and comparability of AQIs, even with written context, due to:

[12] The Concept Release, page 3.

- differences in management and organizational structure,
- the degree of specialization in certain industries and geographies,
- differences in systems and processes in support of the system of quality control,
- differences in leverage models, nature of clients, etc.,
- varying initiatives and investments related to audit quality,
- changes in business and risks to audit quality, and
- the types of data readily available and related costs associated with producing AQIs.

For example, a firm's investment in its auditing practice infrastructure as a percentage of revenue may not be comparable across different size firms and as stated in the Concept Release "[d]efining the expenditures that represent such investment, however, is difficult."[13] For example, significant judgment may be needed for firms to distinguish between normal operating costs compared to investments in audit quality. In addition, while a firm's investment in auditing practice infrastructure can demonstrate its commitment to audit quality, it may also be an indicator that the firm needs to invest more than other firms as a result of poor quality results. Such comparison may lead to inappropriate conclusions. Also, prescribing a suite of audit quality indicators may be difficult due to the different sizes of firms.

Due to the many elements and inputs related to audit quality, we believe over time the market is in the best position to decide what is relevant. We believe the market will eventually determine the most relevant measures based on feedback from stakeholders and their evolving needs in a changing business environment. We believe this approach, by being flexible and market-based, will achieve the greatest benefit and minimize the risk that a suite of indicators does not achieve its objective or become irrelevant.

Even under a market-based approach, there are certain indicators that we do not believe should be further considered as part of a suite of potential indicators as we believe the unintended consequences or possibility for misinterpretation are such that they cannot be overcome. Certain of the indicators pertaining to audit results included in the Concept Release relate to historical events and may not provide timely information given the nature of the process, such as trends in private litigation, trends in PCAOB and SEC enforcement proceedings, and the frequency and impact of financial restatements due to errors.[14] The specific facts and circumstances of each event are unique, including the amount and type of information that may become publicly available, and therefore such events do not lend themselves to being represented in a quantitative fashion. In addition, the outcome of each such situation could be based on a number of factors not necessarily related to quality issues affecting a particular firm or auditing in general. For example, there is a long lag time in enforcement proceedings and litigation events and, as noted in the Concept Release, "the quality of the information is uncertain, given the fact that a particular litigation may or may not result in findings of liability, and the amount of information derived from settled litigation is ambiguous."[15] Similarly, the impact (magnitude) of financial restatements for errors is not easily measured and differs depending on what financial statement or disclosure is impacted. We, therefore, do not support these as AQIs on the basis that they may not provide timely information and can be misleading. Also, in Appendix A of the Concept Release, the PCAOB puts forth concerns about the proposed timely reporting on going concern issues. We are in agreement with the concerns raised around context and unintended consequences and do not think that these factors can be overcome.

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[13] The Concept Release, page A-16.
[14] The Concept Release, page 13.
[15] The Concept Release, page A-26.

With respect to other proposed AQIs, there is merit in many of the concepts and potential indicators but additional evaluation and consideration will most likely be necessary as the PCAOB and we continue our efforts related to AQIs, especially if it is determined that the communication of any such indicators would be mandated.

Conclusion

We support the Board's efforts to develop a potential portfolio of AQIs. We believe these efforts may assist in developing a market-based approach to communicating AQIs. We believe a market-based approach is best as it will most likely achieve an outcome of the most relevant AQIs being communicated and discussed among the different stakeholders.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Michael J. Gallagher (646-471-6331) or Andrea Yin (973-236-5727) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP