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Via e-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 2006-2803

**Re: Request for Public Comment: PCAOB Release No. 2015-005, Concept Release on
Audit Quality Indicators**

To the Board Members and Staff of the
Public Company Accounting Oversight Board (PCAOB):

BDO USA, LLP welcomes this opportunity to comment on the PCAOB's Concept Release on Audit Quality Indicators. Overall, we support the use of audit quality indicators (AQIs), in voluntary discussions with those concerned with the financial reporting and auditing process, particularly the audit committee, that may provide insights about how to evaluate the quality of audits and how high quality audits are achieved. Our involvement in the Center for Audit Quality's AQI pilot activities, as well as our current internal considerations of AQIs as metrics for improving and managing audit quality, continue to shape our views. We strongly believe that further research is needed regarding the relevance and usefulness of the proposed quantitative AQIs as well as further consideration of the significance and complexity of additional qualitative context that such AQIs require in order to be understood by investors or other users who would not otherwise have access to other relevant information related to the conduct of any one audit.

Following our overall comments are specific items that we request that the PCAOB consider to either provide additional clarification or to better align with the PCAOB's stated objectives within the concept release.

Overall Comments

We support efforts put forth by the PCAOB "to identify a portfolio of quantitative measures of public company auditing, whose consistent use may enhance dialogue about and understanding of audits and ways to evaluate their quality." We concur that discussions related to audit professionals, audit processes, and audit results may in turn strengthen audit planning, execution, and communications and thereby, increase audit quality overall. We further agree with the PCAOB that such quantitative measures may only be useful to the various auditing stakeholders (e.g., audit committees, management, audit firms, and audit and other regulators) if presented along with the proper qualitative context.

The two-way dialogue that is the foundation of the audit committee and auditor relationship is dynamic and is shaped by the specific circumstances for each respective audit. We, therefore, believe the most value may potentially be achieved through the emphasis of engagement level AQIs, with the exception of certain over-arching firm-level AQIs that



pertain to leadership of audit firms in terms of demonstrating tone at the top and the demand for accountability through a firm's processes and controls in ensuring consistent audit quality across all engagements. However, in each of those areas, more robust consideration is required by the PCAOB in terms of determining relevant means to provide comparable metrics.

The PCAOB justly highlights in the Concept Release that quantitative AQIs "are not to be considered formulas and may have their greatest use as generators of questions for the auditor. Context - provided by each audit to which the indicators are applied and by the application of the indicators to the audit firm that conducts the audit (and perhaps other firms) - is essential to understanding their meaning and implications." The release further cites that AQIs are meant to be a tool but have inherent limitations. That is: "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." The reason is that they require context.¹ We believe that further research and understanding is needed of: how quantitative metrics can be conveyed appropriately; what the most meaningful metrics may be; how the metrics and context may differ from engagement to engagement; and who should be the conveyors and receivers of such information. We also recognize that, over time and as new facts and circumstances arise, such metrics may continue to evolve and change.

We express similar concerns, as does the PCAOB in the concept release, about both the ability to establish comparability of AQIs among engagements performed by the same audit firm and similar types of engagements performed by different audit firms, given the numerous variables that would have to be considered. Investors, media, and others not directly involved in the audit process, will not benefit from the qualitative context provided during robust discussions around AQIs that take place throughout the course of an audit engagement between the audit committee and the auditor, which will make the plausibility of conveying a complete picture of such variability around quantitative measures as a comparable means to gauge audit quality unlikely.

BDO further expresses concern with respect to an AQI implementation approach that may not allow for both scalability and flexibility among various size firms and types of engagements. We support a non-prescriptive approach that allows for voluntary, non-public disclosure in order to promote a more robust dialogue between the auditor and the audit committee. Such an approach should be applied broadly to all auditing firms and all audit engagements, rather than a phased-in approach that could potentially create an unintended two-tiered environment where audit committees for engagements served by smaller audit firms, in varying industries, or on other types of engagements (e.g., employee benefit audits and registered investment companies) may not fully benefit from discussions with the auditors around AQIs.

Specific Comments

BDO notes that there is no universally accepted definition of audit quality. The PCAOB indicates "quality is a relative concept, and differences among firms may be instructive,

¹ Refer to page 7 of the Concept Release.



when context and the details of AQI data are taken into account.” The PCAOB’s framework for analyzing audit quality, which comprises (i) audit professionals, (ii) audit process, and (iii) audit results, helps shine a brighter light on what, in our experience, has been evolving organically in recent years with the audit committees of our clients. We believe that this framework will continue to evolve as more research is conducted and the PCAOB continues to advance projects related to root cause analysis, AQIs, and enhancements of quality control standards.

In the spirit of providing commentary to the PCAOB that informs about our experiences in analyzing audit quality, we discuss below our involvement in the CAQ AQI pilot, as well as our own observations, internal activities, and efforts and aimed at understanding appropriate measures of audit quality.

Our firm chose to participate in the CAQ’s AQI pilot and worked with several of our public company audit committees to assess the quantitative metrics proposed by the CAQ for relevance and usefulness to the audit committees; the ease or difficulty in gathering the information; and the approach to effectively convey such information. Our discussions with the participating audit committee chairs indicated that while they felt in general such measures at the engagement level were useful, several felt that robust dialogue was already occurring at the critical stages of the audit in conjunction with the communications required by PCAOB Auditing Standard No. 16, *Communications with Audit Committees*. There was also variability among the pilot audit committees in terms of which measures may be more meaningful than others, which supports our belief that a principles-based approach that allows scalability and flexibility may be best. A common theme across the pilots was that quantitative measures required more in-depth information to be provided so that such measures could be understood in terms of the particular audit.

In conjunction with the PCAOB’s Division of Registration and Inspection’s analysis of “root causes” of audit successes and deficiencies, we are currently reviewing our own internal measures with respect to situations in which a negative output event related to audit quality has occurred (e.g., a restatement or inspection finding) related to the identification of the underlying causes of any deficiencies involved, and remediation of those deficiencies in order to inform us as to whether any necessary enhancements to our management processes are warranted. This continues to be an evolving process and will continue to shape our thoughts and commentary with respect to the relevance, feasibility of gathering and measuring data, and the ability to put such information into the proper context to be of potential broader use by others. As a firm, we encourage all of our engagement teams to actively engage in discussion about inspection findings with the audit committees of our clients, which includes how our firm is using such information to continue to take steps toward improving our overall approach to our audit engagements.

As a firm, we have been exploring the value in providing further public transparency into what auditors do. Our research is leading us to the conclusion that auditing firms are expanding their existing transparency reports to provide more quantitative data at the firm level that allows them to further provide context around qualitative efforts to enhance audit quality policies, processes, and procedures. This trend is concurrently being seen on the audit committee side as more and more audit committees of all sizes are voluntarily expanding disclosures in their public filings to address investor requests for more meaningful



qualitative information. Mid-sized auditing firms, like our firm, along with our client base that consists primarily of small to mid-sized public company clients, are recognizing the benefits of these practices and are embracing them as means to enhance the understanding of our current and prospective audit committee clients and their investors as to how we execute audit quality.

The PCAOB makes a poignant comment regarding the often negative context of information that is available to the investor community with respect to the current reporting requirements from inspection reports and restatement disclosures. In recognition of this, we believe investors and others perhaps would be better served and bolstered by a combination of: (1) voluntary auditor disclosures that are promoted through dialogue among the auditor and audit committees; (2) the audit committee's public reports²; (3) the audit firms' public transparency reports; and (4) the addition of more balanced reporting by the PCAOB that perhaps highlights trends emerging from its inspections that emphasize audit quality areas and practices that the PCAOB finds audit firms doing well.

In terms of the specific AQIs posed by the Concept Release, we have the following comments primarily based on engagement level AQIs given the difficulty cited above for providing qualitative analysis to drive comparability at the firm level. We have not commented on other areas where, based on the questions posed by the PCAOB, there seems to be much work needed in terms of better defining the metrics proposed including: The results of independent surveys (how to measure "tone at the top" and variability in audit committee participation); amount of work centralized at service centers (to our knowledge, only the largest firms currently do this); quality ratings and compensation (how to measure "exceptional" and "low" quality ratings across firms); fraud and other financial reporting misconduct; and inferring audit quality from measures of financial reporting quality.

Audit Professionals

Availability

Staffing Leverage: Metrics defined in the Concept Release are computable at the engagement level both for internal and external communication purposes. However, proper defining of engagement level, information regarding issuer size and industry would be necessary to provide context for comparability across engagements.

Partner/Manager/Staff Workloads: While most of the calculations at the engagement and firm level may be fairly easy to compute, we have concerns that publicly disclosing the number of clients managed by partners could easily be taken out of context if not considered along with information about issuer size, complexity of the audit, nature of other responsibilities within the firm, etc. Additionally, client workload information for different points of the year would likely not be a comparable metric at the firm level given the broad range of differing circumstances that affect timing of audit services provided including such things as transactions and varying reporting year-ends and filing dates.

Technical Accounting and Auditing Resources and Persons with Specialized Skill or Knowledge: A metric at the engagement level would likely have very little meaning without

² Refer to the current SEC Concept Release on Possible Revisions to Audit Committee Disclosures.



a comprehensive understanding of the specific circumstances of the engagement requiring consultation and specific expertise. The size of a firm's "National Office" may be of interest relative to its total audit staff along with a description of how such national level resources interact directly with engagement teams (accessibility), the processes and protocols, the experience of such professionals, etc. However, we don't see how comparability across engagements or firms can be established given that the use of technical resources is often non-recurring and is facts and circumstances based.

With regard to persons with specialized skill or knowledge, disclosure of this information would require significant context given that the use of specialists is often more common in certain industries while in others, more facts and circumstances based. Firms not engaged in certain industry or certain types of audits should not be penalized for a lesser use of specialists due to not having significant involvement in a particular industry segment where use of specialists may be more common.

Competence

Turnover of Audit Personnel: While we believe the related metrics are relevant internal monitoring tools, we are uncertain as to how the audit committee or others could appropriately apply a historical turnover percentage to the consideration of audit quality in the current year. Turnover can be construed as good or bad depending on the facts and circumstances and this varies from year to year and is impacted by many things internal and external to the audit firm. These conversations with the audit committee are a natural part of audit planning and execution and are not easily captured in one measure as cited in the Concept Release³. Comparability among firms would be extremely difficult to determine.

Training Hours per Audit Professional: This is an area that is truly a difficult one to compare and assess. While it may be relatively easy to capture "CPE hours" for each professional, information about the content, timing of delivery and quality of such training and direct applicability to the tasks done by each individual within an engagement team is, in our opinion, a true driver of audit quality. Our firm's learning curriculums are customized across individual, level, and industry and are based on the concept that training/learning is not just done in the classroom for CPE credit. Learning is a continuous process that incorporates multiple elements that includes a combination of classroom and self-study work and is complimented by on the job training and firm-wide communications that occur throughout the year. The number of training hours on its own is not reflective in totality of this concept. Additionally, for comparability, similar frameworks would be needed within each of the firms to ensure that the quality of the training was similar. The metrics provided relating to total independence and ethics training does not appear a valuable metric in that all firms would have nearly identical numbers that would approximate the minimum number of hours required by a firm's regulators.

Focus

Audit Hours: Discussions about the focused areas of risk are already occurring with audit committees throughout the course of the audit via robust dialogue and consideration. The relative comparability of an hourly metric by risk area without such robust discussion would

³ Refer to Concept Release page 44.



be difficult to assess as often risk areas change from year to year for a variety of reasons and circumstances.

Audit Process

Incentives

Quality Ratings and Compensation: There needs to be further consideration in terms of this metric. There could potentially be liability involved if personnel ratings, even on an aggregated basis, were publicly disclosed. Definitions and measurements of performance would truly need to be formalized and applied evenly by all firms to make such a metric even potentially valid.

Audit Fees, Effort, and Client Risk: Consideration of risk and audit fees is something that happens organically and is ordinarily a topic of robust discussion between the engagement team and the audit committee. This is truly a subjective area that would require a consistent definition of "high risk" across all firms and all engagements. Risk is not something that can be easily translated from engagement to engagement given the variety of considerations including specific facts and circumstances, control systems, industry, etc.

Independence

Compliance with Independence Requirements: We do not see the value in these metrics as independence is already a monitored area across all firms. See further comments with respect to training above. With respect to the specific calculation of the investment in centralized support for, and monitoring of compliance with, independence requirements per 100 public company audit clients for firms with 500 such clients, at this time, this likely would only apply to a very small percentage of the largest auditing firms. Whether that may "unbalance" the scales between larger and small firms remains questionable.

Infrastructure

Investment in Infrastructure Supporting Quality Auditing: There appears to be significant work needed in this area to even define how a firm's investment could and should be measured with respect to people, processes and technology. At a minimum, how does one define the base level at what a firm may be expected to be investing to lend to audit quality in each of these areas given how different firms are potentially structured, investments made previously, etc.? Also would a more relevant denominator be based on audit-generated revenue?

Monitoring and Remediation

Audit Firm's Internal Quality Review Results and PCAOB Inspection Results: We believe that audit committees have an interest in the results of any internal or external inspection of their company's audit and we encourage such dialogue on our engagements. However, we do not see the usefulness of the firm level metrics to audit committees or the investing public for comparison among firms. First, there are differences among the internal inspection programs within the largest auditing firms that result in varying level of quality within the inspections. Further, one metric is based on a deficiency rating of a magnitude similar to a PCAOB Part I. All firms have a failed audit rating which would include equivalency to a Part I finding, but all firms differ in the application of judgment in classifying engagements within these ratings.



Technical Competency Testing: Regulatory licensing requirements as well as firm training programs focus on continuing education for all audit professionals. Consideration of whether to further create a systemic examination is an undertaking that would require significant time, resources, and research to determine whether there is a meaningful way to capture general audit and accounting knowledge and competency at the various staff levels and whether such measures would be reflective of special knowledge or skills needed to perform certain audits.

Audit Results

Financial Statements

Frequency and Impact of Financial Statement Restatement for Errors: The metric suggested at the engagement level appears to potentially be a firm-level metric. Further, it remains to be seen how an audit committee or an investor might use the metric relating to the firm's top five annual restatements by magnitude without a full population of restatements?

Internal Control and Going Concern

Timely Reporting of Internal Control Weaknesses and Going Concern: This particular metric may already be easily derived from data currently being provided by Audit Analytics and through various communications being provided by the PCAOB. For going concern, we do not see the relevance or usefulness of tracking and possibly disclosing the five largest issuers by market capitalization.

Enforcement and Litigation

Trends in PCAOB and SEC Enforcement Proceedings: The engagement level metric seems largely irrelevant given that there will be nothing to report for most companies.

Trends in Private Litigation: Similar to above, establishing trends reflective of the frequency, nature, and results of private litigation may be irrelevant given that there will be few cases to report on and significant context about whether and how the underlying matters relate specifically to audit quality would be required.

Conclusion

The PCAOB acknowledges that "ultimately each audit committee will have to judge for itself whether and how it wishes to use AQIs in its decision-making." Our comments have been formed based upon our deep understanding of the audit process, our extensive relationships with audit committees, our voluntary participation in the CAQ's AQI Pilot; our active participation in previous standard-setting efforts by the PCAOB in building transparency and audit quality through the issuance of Auditing Standard No. 16, *Audit Committee Communications*; and our current focus on root cause analysis and enhancing our own internal management and monitoring of audit quality.

We take our role in the promotion and execution of quality audit engagements very seriously. As such, we believe that the PCAOB should consider supporting a voluntary, flexible, and principles-based approach that revolves around ongoing discussions between the auditor and the audit committee to allow for the proper qualitative context and



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agreement on, and emphasis of, quantitative AQIs that the audit committee finds relevant to their oversight responsibilities of their respective companies. In this fashion, over time and perhaps in conjunction with public roundtables and piloting, further study on relevant AQIs and measurement practices can better inform on how such AQIs can serve in the promotion of audit quality.

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Chris Smith, National Accounting & Auditing Professional Practice Leader at 310-557-8549 (chsmith@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP