



Office of the Secretary  
PCAOB

Submitted via email:  
[comments@pcaobus.org](mailto:comments@pcaobus.org)

29 September 2015

Dear Sir or Madam,

**Re: FEE comments on the PCAOB Concept release on Audit Quality Indicators**

FEE (the Federation of European Accountants) welcomes the opportunity to comment on the PCAOB Concept release on “Audit Quality Indicators” (hereafter referred to as “AQI”).

FEE supports actions taken to enhance audit quality. Audit quality has always been important and events of the last few years have highlighted its relevance to preparers, auditors and regulators alike. We are committed to playing our role as the European representative of the accountancy profession and to furthering the profession's contribution to society.

Despite its importance, audit quality remains an elusive construct both to define and to measure. The recently published IAASB Framework for Audit Quality<sup>1</sup> considers it to be a **combination of drivers** including objective inputs, outputs and complex interactions of these factors with legal, regulatory, professional and cultural aspects. The objective evaluation of audit quality is further complicated, depending on the perspective from which audit quality is assessed, whereby an understanding of the context is essential in interpreting audit quality indicators. Regulators, investors or audit committee members may have different perception of, and thus criteria for such an evaluation.

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<sup>1</sup> <http://www.ifac.org/publications-resources/framework-audit-quality-key-elements-create-environment-audit-quality>

As a way of demonstrating audit quality, FEE agrees that AQIs are worth exploring. This is the sought objective of a number of recent initiatives around the world, some of which are taking the option of AQI – to be reported either privately or publicly. In this regard, FEE is currently undertaking a project to understand all these various international initiatives that explore the option of AQIs and take stock of their outcome. We hope that this exercise will help us understand the state of play and inform our vision at European level further.

FEE strongly believes in an approach that would follow a high level and principles-based approach. As many accounting firms are global, it would be detrimental to have different, and potentially restrictive, ways of demonstrating quality in various jurisdictions; an international solution would be preferable. To do so, the ideal approach would be for the different concerned stakeholders to engage and work together in order to experiment, and finally arrive at a globally accepted set of AQIs. FEE believes that firms should be demonstrating audit quality, but differentiation is needed. A few AQIs might be more suitable for general public consumption whereas many others are likely less so and could be used, for instance, to inform more detailed discussions with audit committees.

When focusing on an extensive list of AQIs, FEE thinks that the PCAOB should be cautious not to lose sight of the main objective, i.e. demonstrating the quality of the audit, as an outcome. Without this main objective in mind, AQIs may add an unnecessary burden to firms without a meaningful benefit. There are also contextual factors to take into account, such as the accounting firms' risk profile, firms and audit teams' areas of expertise, and the countries in which firms are operating. A consideration of AQIs in the absence of such contextual information could lead to misinterpretation, potentially resulting in misinformed decisions. Qualitative contextual explanations on what the figures demonstrate are equally important and may need to be emphasised further. For instance, it is not only the number of training hours, but also the focus of the training, the quality of the trainer, etc. that matters. Generally speaking, it is not clear from some of the proposed AQIs what "good" would mean for a particular indicator, which is surely a deficiency in the usefulness of such an AQI. It is possible that some of the information may help in a root cause analysis of audit deficiencies, but this would not be appropriate for general publication. In addition, professional scepticism is also an important quality factor when performing audits. We wonder how this can be depicted in ratios and percentages.

FEE believes that there is merit in exploring approaches where all the relevant stakeholders work together on a principles-based approach starting from a low level voluntary initiative, experimenting and building it up to arrive to a meaningful set of indicators. AQIs could be used by individual firms in assessing the need for improvements of their internal quality control measures and as a basis for discussion with audit committees. The end goal is to ensure that audit quality can be optimised and demonstrated and that audit committees have appropriate information on which to base their decisions when selecting their auditor. If AQIs are not made public, there will not be any "market influence" that could be beneficial to drive change. The extent to which AQIs should be made publicly available would need careful deliberation, as mere comparisons of numerical AQIs could be potentially unhelpful.

From a European perspective, an important aspect of audit quality that seems to be missing in the concept release is the **audit report**. The recent European developments that make audit reports more informative have proven to be a holistic way to demonstrate quality. The changes introduced, especially the requirement to describe in the audit report the most significant assessed risks of material misstatement, are particularly momentous. They (will) enable the profession to provide more meaningful and transparent information to stakeholders. The readers of the audit report get much more information about how the audit is executed and are therefore more effectively able to challenge the approach taken. For example, they may challenge the focus areas of the audit, which can lead to change in the firm's approach and thus an improvement in audit quality. These changes represent key historical steps towards improving the way auditors communicate the value of their work and FEE anticipates that, as auditors and firms gain experience from practice, this will continue to evolve.

Our detailed responses to the questions stated in the AQI Concept release are set out below. For further information on this FEE<sup>2</sup> letter, please contact Hilde Blomme on +32 (0)2 893 33 77 or via email at [hilde.blomme@fee.be](mailto:hilde.blomme@fee.be) or Noémi Robert on +32 (0)2 893 33 80 or via email at [noemi.robert@fee.be](mailto:noemi.robert@fee.be) from the FEE team.

Yours sincerely,



Petr Kriz  
FEE President



Olivier Boutellis-Taft  
FEE Chief Executive

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<sup>2</sup> FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 47 professional institutes of accountants and auditors from 36 European countries, including all 28 EU member states. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 800,000 professional accountants working in different capacities in public practice, small and large firms, government and education – all of whom contribute to a more efficient, transparent and sustainable European economy.

## **Appendix 1: Responses to Questions**

### **Questions 1-4: Overview**

In its concept release, the PCAOB seems to envision an extensive list of AQIs. FEE thinks that the PCAOB should be cautious not to lose sight of the main objective of AQIs, i.e. demonstrating the quality of the audit, as this may add burden to firms without effective results. It seems that the PCAOB is exploring solutions around a lot of detailed quantitative data while FEE believes that, on their own without appropriate contextual information, ratios and percentages alone will never demonstrate quality properly. Even in instances where indicators are the same, the definitions at firm level may differ, and calculation methodologies may vary. This may lead to unintended consequences that in the end could be detrimental to audit quality. An effective result would need to strike a proper balance between costs and benefits, especially having in mind smaller firms that could have difficulty absorbing huge costs to implement systems to gather data that may be of little use in the end.

As a consequence, it appears that a better way to develop AQIs would be for the different concerned stakeholders to engage and work together in order to experiment, and finally arrive at a globally acceptable and compatible set of AQIs. FEE doubts that a detailed, restrictive, and single way of approaching AQIs can be required, especially from the start of implementation. AQIs might be better dealt with within a 'framework', by setting up a principles-based approach from which firms would be able to distil AQIs they see beneficial to focus on. For FEE, audit quality and determination of AQIs is a matter of experimenting and communicating. AQIs need to be set within a 'framework' which is adaptable and capable of being changed quickly. Firms will have to build on experience and demonstrate quality at a very high level.

The use of AQIs could be a great driver to quality if used properly, i.e. not as a database, but rather within context and supplemented with qualitative explanations.

If not, FEE believes that negative consequences could arise such as:

- Raw data used for comparison, but that are not comparable due to different contexts and calculation methodologies;
- Large numbers of data that are in the end not useful to stakeholders, but that are very costly for firms to develop, gather and maintain; or
- An adherence to 'ideal' AQI data, possibly to the detriment of audit quality on some individual engagements driving competition to 'look good on paper' only.

These negative consequences could be alleviated by applying a high level, principles-based and holistic approach to AQIs.

FEE believes that AQI data should not be made available without context and qualitative explanations. To understand AQIs, contextual factors are instrumental such as the accounting firms' risk profile, firms and audit teams' areas of expertise, and the countries in which firms are operating. Equally important for the data collection itself is the qualitative explanation about what the data demonstrates. Without any context or guidance as to whether a particular AQI should be high or low in order to demonstrate high quality and explanation of the level reported, we doubt that stakeholders will be able to use this data effectively. For instance, it is not only the number of trainings' hours, but also of the focus of the training, the quality of the trainer, etc. that matters. Professional scepticism is also an important quality when performing audits. We wonder how this can be depicted in these ratios.

### **Questions 5-21: Selection of Indicators**

FEE believes that AQI data should not be made available without context and qualitative explanations. The elements of "context" should be added depending on the outcome of the AQI. We do not believe that a database of AQIs would be ever useful to users and to audit quality in general.

We have some concerns on some specific AQIs currently discussed in the Concept Release, such as:

- Some of the proposed AQIs are not directly indicative of audit quality and are likely to be only useful if the underlying reasons are assessed too, e.g., firm turnover rates, survey results of firm personnel (a thorough analysis would be needed to avoid misinterpretation), investment in infrastructure, survey of audit committee members etc.
- Measuring experience of audit personnel by the number of years in the present assignment while rotation requirements as safeguards to independence are already in place;
- Using audit results or measures of financial reporting quality etc. are also questionable – e.g., are matters such as reporting fraud and numbers of restatements really meaningful indicators of audit quality or do they say more about the clients themselves?

Detailed though AQIs are, FEE has some doubts about the effective comparability of AQIs in practice. Even if it is the same indicator, the definition at firm level may be different, and the calculation methodology may vary. Without a proper appreciation of the context, users will not be able to interpret AQIs in any meaningful way.

Given the developments that currently take place in this area, FEE also believes that, in developing AQIs, the PCAOB will over time need to reflect audit innovation to recognise developments in audit approaches made by standard setters and individual firms.

### **Questions 22-39: Use of Audit Quality Indicators**

Different potential users, including firms, audit committees, regulators, investors, have different information needs, either at the firm level or at the engagement level, either publicly or privately available. The PCAOB is not targeting specific users of the AQIs explored, but rather tries to respond to all these information needs. A cost-benefit analysis would be advisable to find which AQIs to which potential users would be the most beneficial to demonstrate quality. As explained above, FEE believes that an understanding of the contextual factors is essential to users, and for this reason urges the PCAOB to carefully consider whether and, if so, which AQIs might be made publically available. In particular, consideration needs to be given as to how to ensure the usefulness of AQIs is not diminished, e.g., should basic comparisons of numerical AQIs be made without an appropriate contextual understanding.

FEE thinks that focusing on AQIs to audit committee members to base any in-depth discussion is the best way forward. If the purpose is to discuss the audit of the financial statements, AQIs at the engagement level would be the most appropriate while if it is to support a tendering process, AQIs at the firm level would be more informative to support discussion.