

# SPOTLIGHT

## 2021 Conversations With Audit Committee Chairs

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March 2022

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## AT A GLANCE



# 477

### Number of audits

reviewed by our inspectors in 2021



# 244

### Number of conversations

that our inspection staff had with audit committee chairs in 2021

## Takeaways From 2021 Conversations With Audit Committee Chairs



### Required communications between auditor and audit committee

When asked which required communications generated the most discussion with their auditors in 2021, audit committee chairs frequently pointed to accounting matters, with top topics discussed being goodwill accounting and impairments, revenue recognition, and recording credit losses.



### Review/discussion of PCAOB inspection reports

Of those audit committee chairs who answered this question definitively (i.e., yes or no), roughly 70% told us that they either review the PCAOB's inspection report independently or discuss it with their auditor. Responses from those who discussed the report included viewing it as a source of insights, a useful data point among many, a facilitator of comparisons between firms, or a catalyst for discussion.



### Discussion outside required communications

Beyond required communications, audit committee chairs said they looked to auditors for perspective on management/tone at the top, big-picture business trends, and the regulatory state of play in financial reporting and standard setting.



### Quality control systems at audit firms

While many indicated that they could only speak at a high level on the topic, most audit committee chairs expressed satisfaction with their audit firms' approach to quality control.



### Auditor's use of technology

Many audit committee chairs continued to see transformative potential in the use of technology, although some also highlighted potential challenges.



### Auditor strengths and areas for improvement

For those audit committee chairs discussing auditor strengths, many cited their appreciation for comprehensive, timely, and focused communication from their auditors. Those offering critiques of their auditors often flagged instances of poor communication, work left to the last minute, and turnover on the audit team.



### Information outside the financial statements

Of those who indicated affirmatively that they were discussing information outside the financials with their auditors, roughly 70% of audit committee chairs cited environmental, social, and governance (ESG) matters as a key area of discussion.

## INTRODUCTION: WHY ENGAGEMENT WITH AUDIT COMMITTEES MATTERS FOR THE PCAOB

Each year, the Public Company Accounting Oversight Board (PCAOB) reaches out to audit committee chairs at U.S. public companies whose audits we inspect, inviting them to connect with staff from our Division of Registration and Inspections for a substantive conversation covering a range of topics related to oversight of external auditors.

In 2021, more than 240 audit committee chairs accepted our invitation to talk. This publication presents high-level observations and takeaways from those conversations.

We offer sincere thanks to the audit committee chairs who shared their time and perspective with us, as we believe these conversations are important and beneficial for our organization, audit committees, and others. This belief springs from the fact that audit committees in the United States have a critical job mandated by law: oversight of the auditor and the audit process. Thus, in our view, engaged and informed audit committees can be a force for elevating audit quality to the benefit of investors and our capital markets broadly.

The PCAOB's maintenance of a robust and ongoing dialogue with audit committee chairs helps us to enhance our understanding of the auditing and financial reporting environment and to gain insights that can help us enhance our oversight, initiatives, and activities. We also feel that this engagement provides audit committees an opportunity to meet the PCAOB, to ask us questions, and to get a better understanding of our priorities and work.



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### A Note on Our Approach

The questions asked in these conversations were largely open-ended or unstructured; responses from audit committee chairs were captured in notes taken by our staff. We then analyzed those call notes, which led to observations regarding recurring themes and patterns in the conversations.

In this publication, we share our observations to provide insights and a reference point for audit committee members, auditors, investors, and others. As noted in the disclaimer on the cover of this publication, this document should not be viewed as formal guidance or an endorsement of our observations.

## COMMUNICATIONS WITH THE AUDITOR

### Required Communications

PCAOB Auditing Standard AS 1301, *Communications with Audit Committees*, requires the auditor to communicate with the company's audit committee regarding certain matters related to the conduct of the audit and to obtain certain information from the audit committee relevant to the audit.

In our 2021 conversations with audit committee chairs, we asked which of those required communications topics occupied the most time during audit committee meetings. The following topics were raised most often in reply:

- **Accounting matters:** When asked about top areas of discussion in required communications with the auditor, audit committee chairs most frequently pointed to accounting policies and practices. Impairments and goodwill accounting issues were often mentioned, with many audit committee chairs referencing the accounting implications of the COVID-19 crisis on important areas of the economy (e.g., energy prices, travel demand, and retail space). Revenue recognition also came up consistently in the discussion, as well as implementation of the new accounting standard on credit losses.
- **CAMs:** New PCAOB requirements related to the disclosure of critical audit matters (CAMs) took effect in June 2019 for audits of large accelerated filers and in December 2020 for all other companies to which the requirements apply. Numerous audit committee chairs said that CAMs were an important topic discussed with their auditors, including focus on how CAMs were identified and disclosed.
- **The audit process:** In the context of required communications, audit committee chairs regularly noted their discussion with the auditors about the conduct of the audit, including planning, scope, procedures, auditor needs, levels of cooperation, new standards, and other developments.
- **Controls:** Among AS 1301's required communications is discussion of the auditor's evaluation of the quality of the company's financial reporting. In our conversations on required communications, over a dozen audit committee chairs

## Discussion of New Requirements for Estimates and Specialists

In 2020, new requirements went into effect around auditing accounting estimates and auditor's use of the work of specialists.

We asked audit committee chairs whether they had had any discussions with their auditor about changes that may have resulted from the new standard(s) or any challenges they may have had in applying the new requirements.

Audit committee chairs indicated that they discussed the new requirements with their auditor and did not indicate any challenges encountered. A good practice that was noted was early communications by the auditor, well in advance of the effective date of the new standards.

said they spent significant time with their auditors discussing matters related to controls, notably in the context of cybersecurity incidents, the implementation of information technology (such as enterprise-wide systems), and the impact of spinoffs and other transactions related to capital structure.

- **COVID-19:** "COVID was a big topic," was a recurring theme in our 2021 conversations with audit committee chairs. They mentioned their discussions with auditors regarding the impact of the COVID-19 crisis on company liquidity, going concern assessments, relevant disclosures, as well as management of the audit in the remote environment and the audit risk assessment.

- **Independence:** Audit committees regularly cited independence as a top point of discussion, with a focus on any reported violations and how independence issues were addressed and remediated.
- **Risks:** AS 1301 stipulates that the auditor's communications with audit committees should include discussion of overall audit

strategy, timing of the audit, and significant risks. The audit committee chairs that we spoke to frequently mentioned risk as a focal point of discussion with their auditors, including communication regarding high-risk areas and risks related to fraud, changes in accounting practices, and management override of controls.

## What's Working: Communications Between Auditors and Audit Committees

The importance of good communication with auditors has been a dominant theme in our conversations with audit committee chairs. So what's working for audit committees in communicating with their auditors? The following were frequently cited in our 2021 conversations.



**Thorough and well-prepped meetings:** Several audit committee chairs that we spoke to attributed the success of their meetings with auditors to having a thorough meeting agenda, such as quarterly calls ahead of earnings releases where all key accounting topics are addressed. Others noted the importance of meeting prep, such as getting meeting materials in advance and holding pre-meetings to preview discussion.



**Dialogue:** Numerous audit committee chairs stressed that their communications with auditors were effective thanks to dialogue, both formal and informal. Audit committee chairs mentioned the value of ongoing, less-scripted communications, including in settings such as impromptu phone calls or meals.



**Focus on topics that matter:** While they value thoroughness, audit committee chairs also expressed appreciation for the auditor's ability to focus and prioritize their communications. This focus includes adeptness in highlighting and bringing key issues to the forefront, as well as holding "deep dives" or educational sessions on noteworthy or emerging topics. In one conversation, an audit committee chair mentioned having educational sessions with their auditor three times a year on topics such as mergers and acquisitions, cybersecurity, and use of technology in the audit.

## Discussion Outside of Required Communications

Communications between audit committees and auditors may extend beyond required topics stipulated in PCAOB standards. We asked audit committee chairs if they discussed information beyond the requirements of AS 1301 and, if so, which topics were discussed. While responses varied, three prevalent themes emerged.

- **Gauging management “tone at the top” and competence:** Audit committee chairs often told us that they use the auditor as a sounding board to enhance their understanding of management. We heard from several chairs that they looked to the auditor to provide a view on whether management is setting the right tone at the top of the company. Audit committee chairs also viewed the auditor as a resource in gauging the strength of key management positions and departments, notably in accounting and finance.
- **The big picture:** In our 2021 conversations, audit committee chairs often said their discussions with auditors touched on big picture-topics, in terms of both the economy broadly and for particular industries. This perspective included discussion of industry trends and background, challenges in the current operating environment, and views on what might be “around the corner.”
- **Regulatory issues:** Alongside providing the economic and industry big picture, audit committees said they viewed their auditors as resources on gaining an understanding of the regulatory environment, particularly regarding accounting and auditing matters. Auditors, we were told repeatedly, can provide the committee with a view on

developments at regulators and standard setters such as the Financial Accounting Standards Board, the PCAOB, and the U.S. Securities and Exchange Commission.

## AUDITOR STRENGTHS AND AREAS FOR IMPROVEMENT

We asked audit committee chairs about areas (1) where they thought auditors perform well and (2) where they have room to improve.

Generally, audit committee chairs voiced satisfaction with the work of their auditors, although we did also hear comments regarding areas for improvement.

### Where Auditors Perform Well

- **Comprehensive and timely communication:** More than any other factor, audit committee chairs indicated that their satisfaction with the auditor’s work was driven in large part by comprehensive, timely communication. (See box, “What’s Working: Communications Between Auditors and Audit Committees” on page 6.) In particular, audit committees said they valued candor and transparency, “plain English,” open lines of communication, and communications free from a promotional or “selling” tone.
- **Deep knowledge of the industry:** Audit committee chairs often expressed appreciation for audit partners and other professionals on the engagement team having a strong background or understanding of the company’s industry, especially in sectors (e.g., natural resources) with industry-specific accounting rules or issues.



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- A proactive and responsive approach:** Many audit committee chairs signaled that they appreciate a proactive mindset on the part of the auditors, including prompt contact when issues arise. As one chair phrased it, the auditor can and should offer “yellow flags” — not just red ones. Availability and access to partners was also flagged as a strength, as was responsiveness to staffing needs (e.g., requests to have audit staff with specific backgrounds).
- Use of technology:** Several audit committee chairs pointed to the auditor’s use of technology as a strength, describing how auditors were deploying automation, data analytics, and artificial intelligence to improve the efficiency of the audit, as well as the amount of information that can be audited with the use of technology. One chair added appreciation for the auditor’s ability to explain how technology can be used to identify risk areas and to make the audit more effective. (For more on technology benefits, see the “Use of Technology” section on page 11.)

## Where Auditors Have Room for Improvement

- Last-minute pileups:** Like most people, audit committee chairs do not appreciate last-minute scrambles or surprises. Several indicated that they challenge their auditors continually to adjust workflows to avoid pileups, particularly at year-end.
- More use of technology:** While use of technology is often cited as a strength, technology also appears to be a source of concern for some audit committee chairs. In our conversations, several indicated to us that they wished to see more deployment of technology to improve the effectiveness of the audit. We also heard some concerns that technology might weaken the audit by eliminating critical human interaction. (For more on technology concerns, see the “Use of Technology” section on page 11.)
- Management of costs and fees:** Several audit committee chairs touched on concerns related to costs and fees, notably management of costs and prompt communication of budget overruns.
- Communications shortfalls:** We heard scattered concerns from audit committee chairs regarding instances where they felt auditor communications fell short. Other audit committee chairs said they would like to see better communication between internal and external audit functions.
- Turnover:** Several audit committee chairs indicated a concern with turnover on the engagement team.

## PCAOB INSPECTION REPORTS

PCAOB inspections are designed to review portions of selected audits of public companies and to evaluate elements of a firm's quality control system. [Each PCAOB inspection results in a report](#), which summarizes any deficiencies found in the reviews of selected audit engagements, as well as other violations of PCAOB rules. The reports can be useful for audit committees to consult for improving audit quality.

In our 2021 conversations, roughly 70% of audit committee chairs said that they reviewed PCAOB inspection reports independently and/or discussed them with their auditor.

### The Utility of PCAOB Inspection Reports

We asked audit committee chairs if (and how) they felt our inspection reports supported the audit committee's oversight of the auditor. In the responses, the following three themes were clear.

- **Insights:** Numerous audit committee chairs described the reports as either a source of good information or as a single data point that can supplement other sources. Audit committee chairs said they reviewed the report to check for warning signs and to understand the number or nature of findings, trends in findings over the years, and how the firm responds to the report.
- **Facilitator of comparisons:** Audit committee chairs frequently told us that the reports are helpful as a means to understand how one firm is doing relative to its peers, particularly in terms of numbers

of findings identified. One audit committee chair noted reviewing reports issued for several of the largest firms — not just the company's auditor — to get to get an understanding of overall trends.

- **Catalyst for discussion:** Our conversations revealed that, for many audit committee chairs, the value of the PCAOB inspection report is that it can serve as a jumping-off point for further discussion. Audit committee chairs said they go through the report with the audit partner or others to probe findings and/or get a better sense of what the firm is doing to remediate deficiencies.

### Concerns With PCAOB Inspection Reports

- **Timeliness:** Several audit committee chairs shared concerns about the timeliness of PCAOB inspection reports. Namely, the gap in time between the inspection period and the issuance of the report led some to doubt whether the report was still useful or actionable. The PCAOB recognizes the importance of sharing information and insights from our inspections on a more timely basis and is focused on accelerating the issuance of our inspection reports going forward.
- **Level of detail provided:** In terms of concerns regarding PCAOB inspection reports, comments tended to focus on the level of detail provided in the reports. Audit committee chairs expressed interest in additional types of information, such as findings broken down by industry or more information on good practices observed. The PCAOB welcomes such input as we consider ways to provide insights to the public about our oversight activities.

## The Statutory Limits on What the PCAOB Can Share About Inspections of a Particular Company's Audit

In our conversations with audit committee chairs, we occasionally field questions regarding what we found during our inspection of a particular company's audit. Our response is that there are limits to what we can share. That's because Section 105(b)(5)(A) of the Sarbanes-Oxley Act prohibits the PCAOB from sharing information regarding our inspection with audit committees or others.

Audit committee members can ask their auditor for information regarding a PCAOB inspection, including information on a particular company's audit, and we encourage them to engage in a dialogue with the audit firm about matters that may have come up during the inspection.

## FIRM QUALITY CONTROL SYSTEMS

The PCAOB believes that a strong quality control (QC) system is foundational for audit firms to execute consistent, high-quality audits in accordance with PCAOB standards.

We asked audit committee chairs to share their thoughts on their audit firm's QC system, namely (1) what they thought was working well and (2) areas that could use improvement.

The predominant view we heard was that audit firms were doing a satisfactory job with QC, although several audit committee chairs offered a caveat that they could only provide high-level impressions regarding this topic. The following themes were recurring in our conversations about QC.

- **Standardized processes:** In the QC context, several audit committee members pointed to the importance and value of robust, consistent firm processes across the U.S. firms and the global networks. As we heard repeatedly, the existence of established, standardized processes enhances confidence in QC.
- **Continuous education:** In the context of quality control, audit committee chairs tended to emphasize the importance of continuous education to keep audit staff abreast of changes, notably in standards and methodologies. This continuous education includes (1) on-the-job training and (2) the firm's dedicated training sessions.
- **Layers of review and use of specialists:** Audit committee chairs' positive perception of QC were also shaped by their satisfaction with the presence of multiple layers of review at the firms, including engagement quality reviewers, consultations with the national office, and industry or topic specialists. Audit committee chairs also cited internal inspections capabilities, peer reviews, and consultation with specialists in areas such as valuation.
- **Tone at the top:** Several audit committee chairs applauded the fact that their audit firms were putting a strong emphasis on tone at the top and sound governance. One chair noted her view that tone at the top is a strong driver of audit quality.

## ANNUAL ASSESSMENTS OF THE EXTERNAL AUDITOR

While not mandatory, a formal, annual assessment of the external auditor by the audit committee can be a beneficial process, and various organizations have created resources to aid in this process.

We asked audit committee chairs (1) whether they performed an annual assessment of the auditor and (2), if so, the types of assessments they performed or topics/questions that they found particularly useful. Of those audit committee chairs who answered this question definitively, roughly 75% said they did perform an annual assessment of the external auditor, with the remainder indicating that they did not perform an assessment or only did so informally.

In responses regarding techniques mentioned for assessing the audit firm, the following came up most frequently.

- **Surveys of the audit committee:** Those who perform formal assessments of the external auditors often mentioned their use of surveys and checklists to gauge auditor proficiency, independence, engagement with management, and other topics. Audit committee chairs described questionnaires of varying length. One committee, for example, used a checklist of 30 questions, with a rating scale of one to five for each question.
- **Survey of management:** Similarly, audit committee chairs regularly mentioned management surveys as part of the auditor assessment process. One chair mentioned that the management survey (consisting of 10 questions) was the same that the audit committee itself used to guide its

assessment. At one multinational company, an audit committee chair noted that surveys were also distributed to colleagues in non-U.S. offices to gauge the quality of audit service from firms in other jurisdictions participating in the audit.

- **Meetings:** Some audit committee chairs emphasized the importance of meetings as part of a formal process. An audit committee chair described a set of three executive sessions devoted to the assessment: one session with the auditors, one with management, and one with only audit committee members.
- **Multiple assessment techniques:** Several audit committee members mentioned that their assessment proceeds with a mix of techniques to get a fuller view of the firm's performance. Surveys, for example, are often paired with meetings or discussions.

## USE OF TECHNOLOGY

A key PCAOB strategic goal has been to anticipate and respond to the changing IT environment, specifically emerging technologies and the related risks and opportunities.

We asked audit committees to tell us about how they are thinking about emerging technologies, inviting their comments from both the point of view of the public company itself and the audit firm.

We also probed audit committee chairs as to whether they perceived any limitations on their auditor's use of emerging technologies. Roughly 90% of those answering the question definitively indicated that they were not aware of limitations on the auditor's use of technology. Of those who mentioned limitations, nearly all answers related to technical issues (e.g., antiquated legacy systems used by the public company).



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Audit committee chairs said data analytics could help auditors to spot anomalies (particularly in areas such as revenue recognition), to detect fraud, and to identify and assess risks.

### Auditor's Use of Technology: Positives

Many audit committee chairs continued to see transformative potential in the use of technology.

- **Data analytics:** In terms of the positive potential for the application of technology, data analytics received the most mentions in our 2021 conversations. Audit committee chairs said data analytics could help auditors to spot anomalies (particularly in areas such as revenue recognition), to detect fraud, and to identify and assess risks.
- **Automation:** Audit committee chairs noted significant potential for technology to automate tasks, thereby enhancing the efficiency of the audit process. Automation, we heard several audit committee chairs say, can constrain or even reduce costs. One chair noted that automation can free up the engagement team to focus on risks.
- **Testing:** We heard frequently that technology will enable auditors to test entire data sets, reducing the need for sample testing.

### Auditor's Use of Technology: Challenges

When it comes to the impact of technology on the audit, comments in our conversations were not uniformly positive or bullish. We heard a variety of concerns.

- **Cybersecurity:** Cybersecurity concerns permeated our 2021 conversations with audit committee chairs, including our discussion of how auditors are using technology. As with public companies, audit committee chairs told us, technology systems at audit firms are vulnerable to hacking. Additionally, as one audit committee chair emphasized, a ransomware or similar attack affecting the company's data would impact the engagement team's ability to perform procedures.
- **Quality control:** While they frequently hailed the potential of automation to increase efficiency, audit committee chairs in equal measure emphasized the need for quality control in the use of technology. As we heard repeatedly, low-grade information cannot be predictive. In the view of one audit committee chair, automation can make people lazy, which is why checks and balances are essential as automation becomes more prevalent.



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One recurring idea that we heard from audit committee chairs is that emerging technologies, despite all their promise, may never be a silver bullet.

- **Room to improve and grow:** In discussing emerging technology, audit committee chairs often put an emphasis on “emerging.” Artificial intelligence (AI) and other technologies, they pointed out, are still in their early stages of adoption and utility, with plenty of room for improvement. For one audit committee chair, the emerging nature of AI underscored the need for increased and ongoing educating of the audit committee by the auditor on its uses, benefits, and challenges.
- **Not a silver bullet:** One recurring idea that we heard from audit committee chairs is that emerging technologies, despite all their promise, may never be a silver bullet. One audit committee chair, for example, expressed the view that emerging technologies should be thought of as supplemental tools. Another suggested that reliance on technology may be just the opposite of a silver bullet, to the extent that it dulls auditors’ ability or inclination to incorporate their business insights into procedures.

## INFORMATION OUTSIDE THE AUDITED FINANCIAL STATEMENTS

The PCAOB oversees audits of financial statements. We are aware, however, that some investors and other stakeholders are interested in information that exists outside of the audited financial statements, such as ESG or non-GAAP measures.

We asked audit committee chairs whether they were having any discussions with their auditor about this information. Of those who answered



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Judging by our conversations, matters related to ESG are either already at the top of many audit committee agendas or they are gaining such prominence.

this question definitively, roughly 75% said yes, they were having discussions regarding other information.

- **ESG:** Of those who indicated affirmatively that they were discussing information outside the financials with their auditors, roughly 70% of audit committee chairs cited ESG as an increasingly key area of discussion. And, judging by our conversations, matters related to ESG are either already at the top of many audit committee agendas or they are gaining such prominence. “Huge issue,” “hot topic,” “pressure from investors” were recurring phrases. One audit committee chair said she would be shocked to hear that a board was not thinking about ESG and holding discussions around environmental impact. In terms of the role of the auditor, while responses varied, many audit committee chairs indicated that auditor involvement remained largely at a preliminary or high level. Particular areas of interest include discussion around accuracy of data, as well as the potential need for new processes or controls.

- **Non-GAAP measures:** Audit committee chairs frequently mentioned that they turn to their auditors for perspective on the use of non-GAAP information. Several that we spoke to referenced earnings before interest, taxes, depreciation, and amortization as a key metric for discussion, along with measures used by the company that might exclude stock compensation or other items. Chairs emphasized that audit committees need a full understanding of such information and how they reconcile with GAAP. In the view of audit committee chairs, auditors can be a source of perspective on such measures, especially given their experience with other clients that may be using them.

## Continuing the Conversation

We look forward to continuing our dialogue with audit committees in 2022. In the meantime, audit committee members and others can visit our **audit committee page** for resources and to sign up for updates. Also, we welcome comments on this publication or other matters. You can fill out our short **reader survey** or email us at **info@pcaobus.org**.

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