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Audit Quality Indicators Update

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Caveat – Disclaimer

This presentation was developed by the staff of the Office of Research and Analysis for the purpose of capturing tentative thinking about audit quality indicators for discussion. It is not a statement of the Board; nor does it necessarily reflect the views of the Board members or other staff.

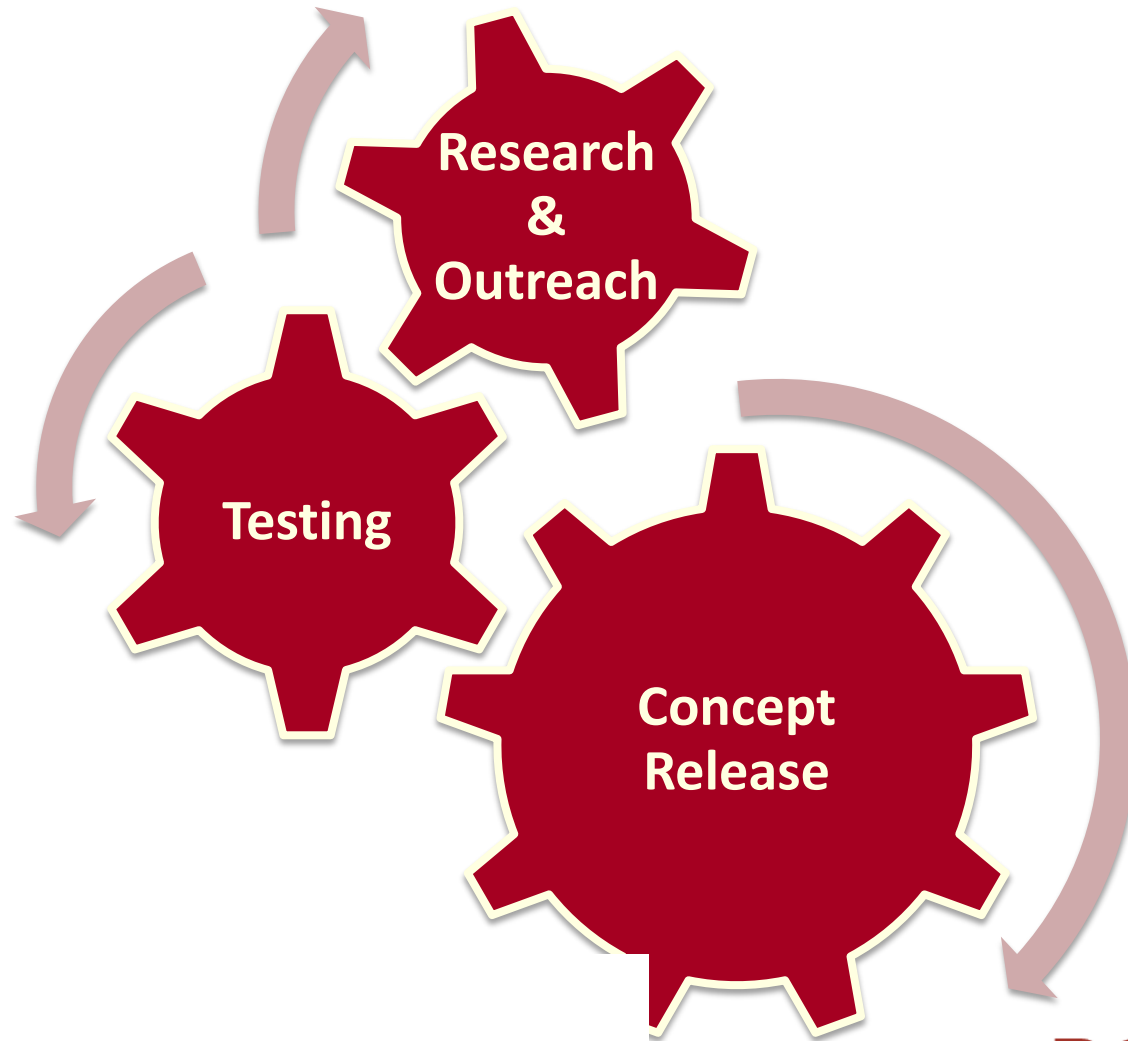
Purpose of Session

- ❑ Review project objectives
- ❑ Update on staff work
- ❑ Outline possible concept release
- ❑ AQIs
- ❑ AQI users and uses
- ❑ Next steps

AQI Project Objectives

- ❑ Inform PCAOB regulatory processes and policy-making with additional insight into audit quality
- ❑ Consider providing audit committees, investors, management, audit firms, other regulators, or the public with AQIs
- ❑ Provide firms with additional incentives to compete based on audit quality
- ❑ Next milestone: concept release around year-end

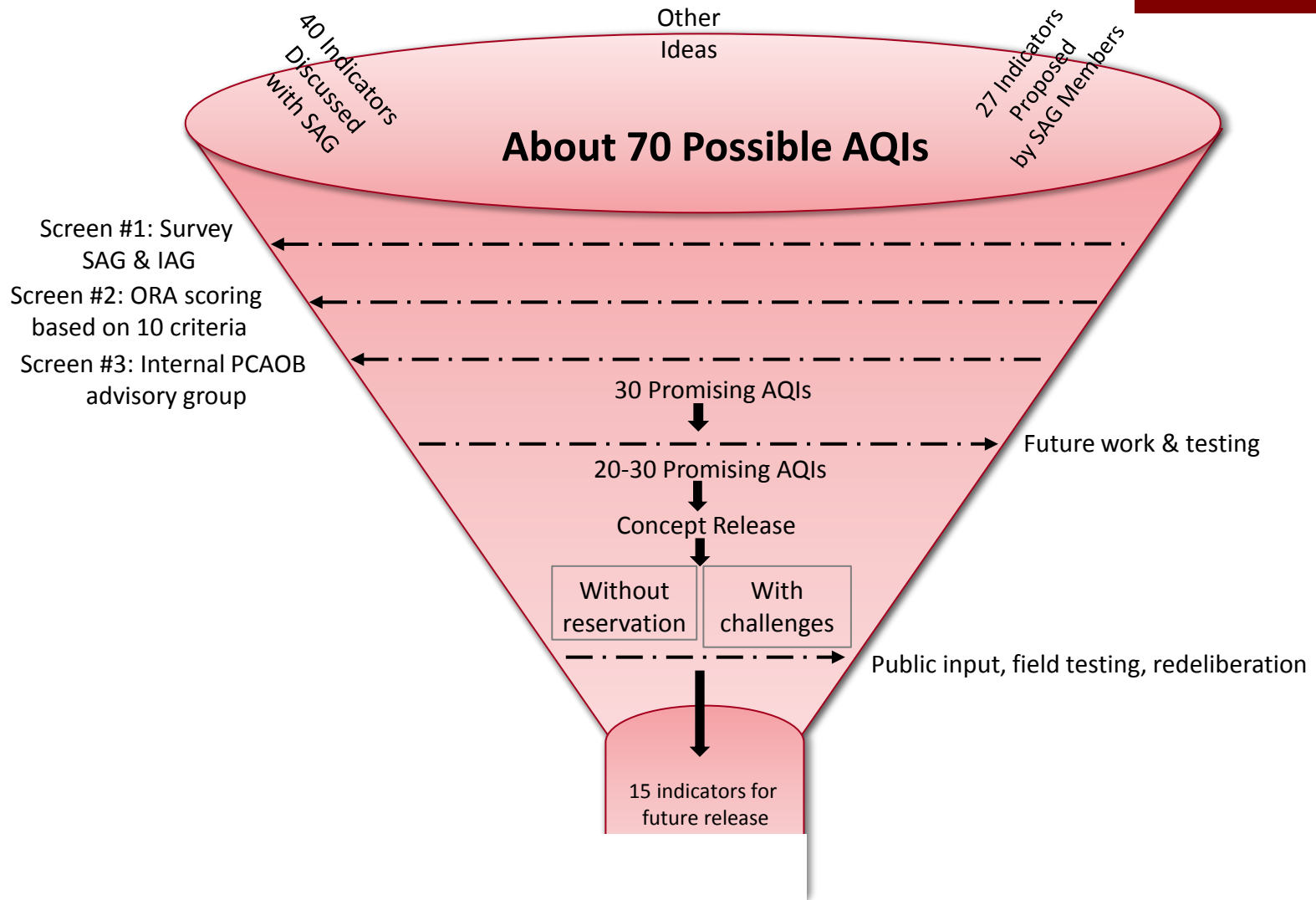
AQI Project Workstreams



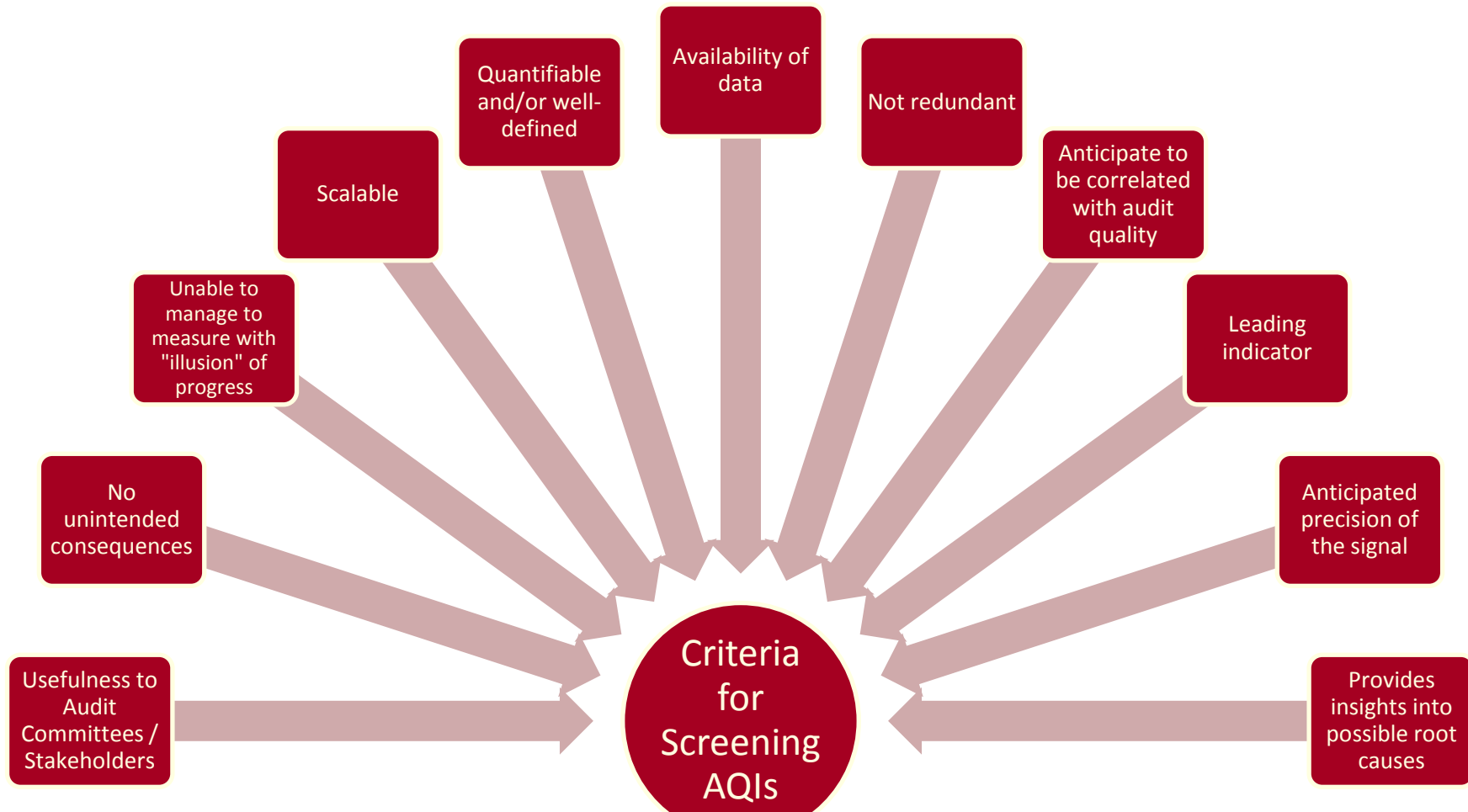
Outside resources consulted



Process For Screening AQIs



Criteria for Screening AQIs



Possible Concept Release

Part I: Objectives and Background

- Pose series of questions related to the objectives

Part II: Definition, Framework, Top AQI Metrics

- Working definition of audit quality
- Three-part audit quality framework: audit inputs, audit processes, and audit results
- Identification of 25 – 30 potential indicators within the framework and explanation of why the staff believes these are most promising
- Pose series of questions related to the proposed indicators

Part III: Potential Use of Metrics

- Unit of measurement (e.g., registered firm level, engagement level)
- Collection of information (e.g., public information, information collected from firms)
- Dissemination of AQI information (e.g., by Board, by firms, etc.)
- Recipients and their use of AQI information (e.g., PCAOB, audit committees, investors, etc.)
- Phasing and scope of project
- Pose series of questions related to the potential uses of indicators

Audit Quality Definition and Framework

Definition

Operating in full compliance with PCAOB standards and SEC requirements in order to (i) meet the needs of an issuer's investors and the marketplace for independent, skeptical, and reliable audits of the issuer's financial statements and (ii) facilitate the timely and effective supply of information to the issuer's audit committee.

Framework

Audit Inputs

Staffing composition

Qualifications

Review and supervision

Audit Processes

Risk assessment

Quality control

Monitoring activities

Audit Results

Financial statements and related disclosures

Internal control over financial reporting

Going concern warnings

Examples of Promising AQIs

Inputs

- Staffing leverage
- Partner workload
- Staff utilization
- Industry expertise
- Outsourcing to service centers

Processes

- Tone at the top: survey of firm personnel
- Audit firm internal quality review results
- PCAOB inspection results
- Senior personnel compensation rewards for audit quality

Results

- Frequency and impact of financial statement restatement for errors
- Timely reporting of internal control weaknesses
- Reasonable warning of going concern
- Material frauds discovered and reported
- Trends in Board and SEC enforcement proceedings

AQI Users¹

Customer	Benefits
Audit Committees	<ul style="list-style-type: none">• Demonstrate due diligence• Assess risk and audit quality• Retain and compensate auditors
Investors	<ul style="list-style-type: none">• Assess risk• Proxy voting
Audit Firms	<ul style="list-style-type: none">• Assess risk• Monitor audit quality• Facilitate root cause analysis to improve remediation efforts
PCAOB	<ul style="list-style-type: none">• Inform policy making• Assist root cause and quality control projects• Stimulate public discussion of and market demand for quality

¹ AQI users also include other regulators (e.g., SEC) and policy makers, company management, business press, academics, and the general public. The staff believes that their information needs are a subset of the information needs of primary users.

AQI Uses: Possible Questions

Area	Possible Questions
Customers	<ul style="list-style-type: none">• Should engagement teams discuss AQIs with audit committees?• Should the public receive AQIs?
Unit of account	<ul style="list-style-type: none">• Audit industry?• Audit firm?• Audit engagement?• Issuer industry?
Collection and dissemination	<ul style="list-style-type: none">• Who should collect and disseminate AQIs?• Voluntary or mandatory?• Should the provider of AQIs provide context?• What are the drivers of costs and benefits?
Phasing and scoping	<ul style="list-style-type: none">• Should steps be phased-in over time?• Should some audit firms or audits of some issuers be exempt?

Next Steps

- ❑ Continue staff solicitation of advice on AQIs
- ❑ Continue developing models for empirical testing of selected AQIs
- ❑ Develop concept release for Board consideration around year-end
 - Public comment period
 - Public roundtables?
 - Staff analysis of comments