

September 29, 2015

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

Re: PCAOB Release No. 2015-005, "Rulemaking Docket Matter No. 41: Concept Release on Audit Quality Indicators"

Dear Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) Release No. 2015-005, "Concept Release on Audit Quality Indicators," (Concept Release) and commends the Board for its efforts and outreach to gather information about audit quality indicators.

We offer, for the Board's consideration, our views which are organized into the following sections:

1. Purpose of Audit Quality Indicators
2. Voluntary Nature of Audit Quality Indicators
3. Scalability of Audit Quality Indicators
4. Consistency of Audit Quality Indicators, including an example in Attachment A, "Example of Computational Complexities for One Indicator: Staffing Leverage"

### ***Purpose of Audit Quality Indicators (AQI)***

As noted by the Board, the "goal of the AQI project is to improve the ability of persons to evaluate the quality of audits in which they are involved or on which they rely and to enhance discussions among interested parties." In addition, the Board notes the AQIs were developed using three principles. The first principle is AQIs "should be quantitative whenever possible, to add consistency of the approach and objectivity to what would otherwise in most situations be only subjective judgments." The second principle asserts AQIs "should generate data that enables users to pose critical questions." Lastly, AQIs "should be used and function together as a balanced portfolio of audit quality." The Board also notes users could include company management, the business press, academics, and the general public.

We are concerned the above concepts and principles are not clearly aligned and contain two major shortcomings. The first shortcoming is definitional—the contradiction occurs in the desire for maximum objectivity in the measurement with the recognition of meaningful subjectivity in their evaluation. Each issuer's circumstances contain many variables in creating the optimal resource configuration for the best possible audit. Providing an inventory of specified computational indicators could easily distract an Audit Committee from the task of identifying the specific indicators which are much more meaningful in their circumstances.

The second shortcoming is interpretative. Simply put, it is not always self-evident "which direction" is a "better measurement" for a particular indicator. In Attachment A, we provide some observations regarding the computational complexities of a seemingly straight-forward AQI on staffing leverage. However, more important than the detailed matters we have identified is the overly simplistic idea that

less leverage is, by definition, better than more leverage. Audit tasks should be performed by personnel most suited for the task. Complex tasks should likely be handled by experienced personnel, while less complex tasks should likely be handled by personnel who gain proficiency by performing those tasks frequently. An engagement can be underleveraged as well as overleveraged. Too much leverage can result in a situation where the individuals are less focused, or not as fully engaged, than individuals at the proper experience level. Too little leverage can also lead to unnecessary cost.

Optimal leverage is engagement specific, and is heavily driven by the size and complexity of an issuer. Less leverage is not always more conducive to audit quality. Firm level leverage statistics will be almost incomparable across firms as differences will be driven primarily by differences in the characteristics of the firm's client profile than differences due to quality decisions made by the firm.

The first principle of AQIs is the indicator should be quantitative whenever possible to add consistency and objectivity. However, in discussion of the second principle, and throughout the Concept Release, it is noted the AQIs should generate discussion and the contextual support is almost always required. We believe the discussion of an AQI is far more valuable than the quantitative measure. We are concerned many users will attempt to utilize the quantitative measures as balanced scorecards, which is a misleading concept. Unfortunately, evidence already exists which illustrates when computations are presented for complex audit quality matters, nuance is quickly lost in the public debate. The PCAOB inspection reports for the annually inspected firms are anticipated by the business press and are covered expeditiously when released. The information in the inspection reports has been consistently improved to provide more context, such as expanded information of the linkage between deficiencies and the related standards. Yet the main thrust of most coverage is a simple "error rate" concept in which the number of engagements with one or more deficiencies is divided by the number of engagements inspected. This computation, which is not provided within the inspection report, has become the most popular statistic used in measuring inspection results. The existence of this rate is a positive from a regulatory perspective and audit performance as firms are incented to reduce deficiencies and secure a better score. However, it is effectively meaningless to an audit committee attempting to evaluate an auditor for their specific circumstances. The implications of the detail of the deficiencies by source are much more relevant to issuers as they consider audit quality as all, or none, of a firm's identified deficiencies might apply to their circumstances. We are very concerned that more "scorecard measurements" will distract audit committees from a tailored, nuanced search for the data most relevant to their specific needs.

Issuers have different risks and audits are structured differently to address these risks, therefore simply utilizing quantitative AQI measures could be very misleading. As noted by the Board, and we agree, the AQI data will almost always require context. In fact, we believe AQI data will always require context for the user. With that noted, we believe audit committees are in the best position to request, receive and discuss AQIs with audit firms both for recurring audits and proposals. The audit committee is responsible for the hiring and firing of the auditors, for understanding and managing risk associated with the issuer and for fulfilling its fiduciary duties. To that end, we encourage the Board to consider the role of the audit committee when determining how to proceed. Clearly stated, we do not believe AQIs should be provided to any user other than the audit committee as a result of the above discussed matters related to risk and context of each AQI.

### ***Voluntary Nature of Audit Quality Indicators***

As noted above, we believe the audit committee is in the best position to meet the goal of the AQI project. The audit committee understands the risks associated with the issuer, they are responsible for both the internal auditors and the hiring and firing of external auditors and they have a fiduciary responsibility to investors. Audit committees meet their needs through various different processes and procedures which differs issuer to issuer. Because of their responsibilities and the different processes and procedures utilized to meet those responsibilities, we believe AQIs should be provided on a voluntary basis based on the needs of the audit committee to carry out their responsibilities. A voluntary approach gives significant

flexibility to the audit committee to gather AQIs important to them based on their understanding of the risks facing the issuer. The AQIs would be supplemented with dialogue between the audit committee and the auditors, based on what is relevant. A voluntary approach would also ensure the costs are appropriately aligned with the benefit. As noted by the Board, "ultimately each audit committee will have to judge for itself whether and how it wishes to use AQIs in its decision-making." We agree with this statement which is the primary reason AQIs should be voluntary based on the audit committee needs.

### ***Scalability of Audit Quality Indicators***

The Board indicates the issues of scalability are complex and more time might be needed to study scaling. We appreciate the complexities associated with scaling the AQIs, including whether or not AQIs should be used for entities in certain industries (e.g. broker-dealers, benefit plans, registered investment companies) as well as divided along the size of audit firms for implementation. We do not believe excluding audit firms or excluding entities in certain industries is the right approach. As noted above, audit committees should be able to request any information from audit firms in order to discharge their responsibilities. We also note that this should be completely voluntary and driven by the audit committee. As such, scalability should not have to be addressed because the AQIs will be driven by the needs of the audit committee and what they desire based on the risks associated with the issuer.

### ***Consistency of Audit Quality Indicators***

The first principle is AQIs should be "quantitative whenever possible, to add consistency of approach and objectivity to what would otherwise in most situations be only subjective judgments." A quantitative analysis can provide consistency but only if the definition of how to make the quantitative calculation is very clear and is appropriate for the entire auditing profession. Reading through the 28 AQIs, and the multiple calculations within those 28 AQIs, there are certain assumptions made which could cause inconsistency in calculations from firm to firm or even engagement to engagement.

If AQIs are to be comparable across all firms (without context) as suggested by the first principle, then additional definitions might be warranted to make the calculations consistent. For example, AQI #1, "Staffing Leverage," requires calculations for partners and managers time. Some firms utilize other descriptions in their staffing model such as a director but there is no guidance as to how to include their time. As a result, some firms will include them with managers while other firms will include them with partners. Also, the leverage calculation appears to assume that all partner time is supervision and review. In some cases, partners charge time to an engagement because they are performing detail work on the audit rather than supervising or reviewing, which hinders comparability.

We have provided as Attachment A to this letter, an analysis of AQI #1, "Staffing Leverage," in which we identify various assumptions and concerns with the potential consistency of the calculation both at the engagement level and firm level. As noted, we believe most of the AQIs would need further definition in order to create more consistency in the quantitative calculation. However, additional definition may not be necessary if the AQIs are strictly voluntary, selected by the audit committee, include dialogue with the audit firm to understand how calculations were made and the context of what the quantitative calculation means for the engagement.

Crowe Horwath LLP appreciates the efforts the PCAOB has undertaken in identifying AQIs which might be beneficial to audit committees and enhance discussions among audit committee and audit firms.

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We would be pleased to respond to any questions regarding our comments. Should you have any questions please contact James A. Dolinar at (630) 574-1649, Michael G. Yates at (574) 236-7644 or Sydney Garmong at (202) 779-9911.

Cordially,

A handwritten signature in cursive script that reads "Crowe Horwath LLP". The signature is written in dark ink and is positioned above the printed name of the firm.

Crowe Horwath LLP

Attachment A, "Example of Computational Complexities for One Indicator: Staffing Leverage"

ATTACHMENT A:  
 Example of Computational Complexities for One Indicator: Staffing Leverage

As mentioned in our comment letter on page 3, there are various assumptions implied within the audit quality indicators (AQIs) which will inhibit the ability to evaluate data appropriately. For example this will apply to: year over year comparisons; engagement statistics to firm statistics and; especially firm to firm comparisons. To demonstrate, we selected one AQI to illustrate our point. Below are observations regarding AQI #1, "Staffing Leverage."

*Staffing Leverage. The "staffing leverage" indicator measures the time of experienced senior personnel relative to the volume of auditor work they oversee.*

*Illustrative Calculations:<sup>1</sup>*

<i>Engagement Level<sup>2</sup></i>	<i>Firm Level</i>
<i>a. Ratio of audit partners' chargeable hours for the engagement to chargeable hours of all other engagement personnel</i>	<i>a. Ratio of firm audit partners' chargeable hours to chargeable hours of all other engagement personnel</i>
<i>b. Ratio of audit partners' chargeable hours for the engagement to chargeable hours of audit managers' on the engagement</i>	<i>b. Ratio of firm audit partners' chargeable hours to firm audit managers' chargeable hours</i>
<i>c. Ratio of audit managers' chargeable hours for the engagement to chargeable hours of all staff below manager on the engagement</i>	<i>c. Ratio of firm audit managers' chargeable hours to chargeable hours of all staff below manager</i>

*Partners and managers are responsible for oversight of the audit and the audit team, which will include less experienced staff. Sufficient time to oversee the work of the audit staff is typically critical to quality. The lower the amount of partners' time per audit managers and audit staff time, the wider the scope of partners' and managers' supervision and review responsibilities, and the greater the risk that partners and managers may not have sufficient time to supervise and review staff work and evaluate audit judgments. Less extensive supervision raises the risk of less effective audit procedures and a reduction in audit quality.*

<sup>1</sup> *Hours spent by partners as engagement quality reviewers would not be counted for purposes of these calculations.*

<sup>2</sup> *The definition of "engagement level" in the case of global audits is an open question on which comment has been specifically requested. See Concept Release, Question 14a), at page 16.*

Our observations or additional questions regarding this audit quality indicator are noted below.

1. The definition of staffing leverage indicates "time of experienced senior personnel" is important, however the term "senior personnel" is not clearly defined. Does this include only partners or all levels with supervisory responsibilities, including seniors, managers, senior managers, directors and partners?
2. Does "audit partners' chargeable hours" include partners who are utilized as specialists?
3. Calculations shown refer to "managers' chargeable hours" –
  - a. Does the term managers include managers and senior managers?

- b. Should managers include others within the firm who may not have that title but carry out this function in principle? For example, some firms use the title "directors." Should directors be included with managers or senior personnel? A senior staff who supervises and reviews – where should those hours be reported?
  - c. Additionally, some firms use the term senior staff or in-charges. Should they be included with managers or staff?
  - d. At times, smaller public company engagements may not have a manager assigned and use an experienced senior staff to perform the same type of review as a manager. Is this person's time included in the manager category?
  - e. There appears to be an assumption that all manager time is spent on supervision and review. What if some of the manager's time is spent performing detailed audit procedures, how is this time to be calculated for this AQI?
4. Partners might charge time to an engagement because they are performing detail audit work and not supervising or reviewing. There appears to be an assumption that all partner time is incurred as supervision and review.
5. Do all audit firms have these defined positions or should managers be defined based on a guiding principle definition?
6. There is an assumption that all partners and all managers are equally experienced. Is this an appropriate assumption considering partner experience may likely range from 1-30 years of experience at the partner level.
7. There is an assumption that the leverage model should be consistent between engagements and firms. Is this assumption correct considering different industries and or risks on engagements?
8. Do engagement hours include hours spent by the National Office or its equivalent for consultation? The audit partner does not supervise the National Office personnel so how should National Office hours be accounted for whether spent by a partner or manager?
9. All non-managers appear to be grouped into a single category of "staff" who are labeled as less experienced. Should the level of experience a "staff" has on the client or industry matter prior to putting all individuals in one category?
10. It appears there is an assumption all partners, managers and staff have certain industry experience but that has not been specified except identifying staff as less experienced. Is this assumption correct?
11. There is an assumption that all time is charged to the client by all levels. Is this assumption correct? Some firms may charge travel time while other firms do not. How is this time considered in the AQI?
12. Firms utilize different methodologies and technology which will impact total hours. How should technology efficiencies impact this AQI?
13. Should all AQI data be gathered by industry since the leverage model may change by industry?
14. At the firm level, should the statistics be accumulated for the issuer audit practice separate of non-issuer audit practice? There is no indication of how firms keep such data, however, leverage models might change significantly between issuers and non-issuers in which case an overall firm level calculation would be inappropriately skewed.
15. As noted in footnote 2, an open question is how should the hours be accounted for on a global basis? On a global basis, supervision and level descriptions may not match the pre-defined leverage terminology noted by PCAOB and thus could cause incompatibility in calculated amounts. In addition, the hours are not always gathered on an international basis thus causing additional administrative time (cost) of data gathering. We agree with the question and look forward to guidance.
16. Many entities outside of the United States have statutory audit requirements. Often times these statutory audits and the work done for PCAOB purposes are done at the same time and time is comingled. Therefore, obtaining a clear perspective of chargeable hours for PCAOB purposes and by level is more difficult if not impossible to clearly and accurately determine. How should this be handled?

17. As noted with 16 above, there might be requirements for stand-alone audits in the United States and thus in those situations, it also might be very difficult, if not impossible, to clearly and accurately determine the appropriate chargeable hours and by level that supported the PCAOB audit opinion. How should this be handled?

Below the illustrative calculations table, the concept release notes the following: "The lower the amount of partners' time per audit managers and audit staff time, the wider the scope of partners' and managers' supervision and review responsibilities..." It is unclear why the concept release indicates a calculation of partners' hours to managers and staff hours but then concludes on the scope of partners' and managers' review responsibilities. It would appear the conclusion would only speak to the scope of the partners' review.