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Phoebe W. Brown, Secretary
Office of the Secretary
Public Company Oversight Accounting Board
1666 K Street, NW
Washington, DC 20006-2083

28 September 2015

**Re: Concept Release on Audit Quality Indicators,
PCAOB Rulemaking Docket Matter No. 041**

Dear Ms. Brown,

Ernst & Young LLP is pleased to submit these comments to the Public Company Oversight Board (PCAOB or Board) on the Release 2015-005: *Concept Release on Audit Quality Indicators* (the Concept Release).

We support efforts by the Board and others to explore ways to develop relevant audit quality indicators (AQIs or indicators) that could provide stakeholders, such as audit committees, investors, audit firms and regulators, with additional perspective on matters that affect audit quality. We believe that, over time, the use of AQIs has the potential to further strengthen the oversight of audit quality by audit firms, audit committees and audit regulators.

We have actively participated in the development and piloting of the Center for Audit Quality (CAQ) Approach to Audit Quality Indicators, including evaluating feedback about whether the indicators were useful to audit committees in assessing the quality of the audit. We encourage the Board to consider the CAQ's comment letter on the Concept Release, which describes the CAQ's approach and results of the pilot testing in detail.

We note that audit firms, audit committees, regulators and investors are continuing to consider the use of AQIs. As a result, we believe that the PCAOB should continue to support efforts by these stakeholders to determine which AQIs are useful and how they should be communicated rather than mandate the use and disclosure of specific AQIs. This letter includes our views on the benefits and limitations of AQIs, how we currently use AQIs and suggestions for an approach to the use of AQIs.

Benefits of AQIs

We believe that with the appropriate context, AQIs may be a useful tool to help audit committees and auditors identify, consider and discuss factors that are relevant to the performance of a quality audit. We also believe that investors, as well as other stakeholders, can benefit from the use of audit firm-level AQI information.

Audit committees

We believe that certain AQIs, if integrated into required auditor communications with appropriate context, can provide the audit committee with a greater understanding of the audit, the audit process and an audit firm's system of quality control. This should enable audit committees to further engage the auditor on matters that are most important to them and their particular issuer. The results of this enhanced dialogue and oversight could contribute to audit quality. In addition, we believe AQIs can enhance an audit committee's ability to consider matters related to audit quality when evaluating their existing auditor relationship as well as when making an auditor appointment decision.

Auditors

AQIs can enhance an audit firm's ability to monitor compliance with its system of quality control and to timely identify areas where additional attention may be required. Combined with other information, such data can provide insights into factors that influence audit quality and the effect of actions taken to drive enhancements to audit quality.

Investors

AQIs can provide direct and indirect benefits to investors. Investors would benefit from more effective audit committee oversight of the audit that enhances audit quality and therefore improves the confidence in the capital markets. In addition, as discussed in detail below, we believe the evolving practice of audit firms voluntarily publishing various firm-level AQIs, including qualitative information and context for the AQIs, should enhance investors' understanding of a firm's system of quality control and trends in audit quality over time.

Limitations of AQIs – the importance of context

While there are potentially many benefits to the development and communication of AQIs, we note that providing context is critical. By itself, an AQI is merely a statistic or data point. To understand an AQI and how it should be considered in evaluating audit quality, a user would often need to discuss the AQI with the auditor. As a result, as discussed below, we believe that developing engagement-level AQIs to enhance the audit committee's understanding and oversight of the audit is appropriate because audit committee members can engage in a dialogue with the auditor.

Without context and the ability to discuss engagement-level measures with the auditor, other users may be inclined to focus on outliers by comparing AQI data of various issuers. For example, when evaluating the ratio of audit staff to partners between two engagements, a user may incorrectly infer that the audit with a higher ratio may be more susceptible to quality issues than the audit with a lower ratio. However, the difference actually may reflect factors that may not be obvious to an external user such as the expertise of the individual team members and different levels of complexity in the two companies' processes.

Similarly, because promoting a culture of consultation is fundamental to a strong quality control system, a user might incorrectly infer that an audit team that conducts fewer consultations than other audit teams or the industry average may be performing a lower-quality audit. However, the number of

consultations actually may reflect the expertise of the partner in charge or other executives participating in the audit or the underlying risks and complexity of the issuer, its financial reporting and the audit.

Undue focus on such an AQI could cause audit teams to seek unnecessary consultations to increase the metric, diverting firm resources away from more significant matters. Conversely, if a high number of consultations were to be seen as an indication of a weak and inexperienced audit team, this could deter audit teams from pursuing appropriate consultations that are consistent with a quality audit.

These are just a few examples of why context is essential to the appropriate use and interpretation of AQI information. As a result, we believe the disclosure of engagement-level AQIs publicly would not be appropriate. However, as we discuss more fully below, we believe that the public disclosure of firm-wide AQIs may provide investors with insights into the audit practices of public company audit firms and how these practices evolve over time.

How we use AQIs

To help us enhance audit quality, we monitor a number of AQI data at the engagement level as well as by office, region and the firm. We use output measures such as inspections and restatements and a number of input measures such as workload, the timing of engagement performance relative to established milestones and the involvement of various levels of engagement personnel. We also use certain qualitative matters such as the nature and frequency of formal consultations. Our goal is to monitor these data points over time.

We also have been considering whether there are other measures related to audit process inputs that may enable us to obtain more insights on audit quality to help us improve the quality of our audits. In conjunction with this effort, we have been developing ways to enhance our communications with audit committees to provide them with additional insights into audit quality. We have been leveraging the following insights from our participation in the CAQ pilot, the PCAOB's public AQI deliberations and our ongoing interactions with audit committees:

- ▶ No single AQI or suite of AQIs provides a definitive view, forecast or reflection of audit quality. Measures and metrics on their own are not illuminating and can be misleading. Providing context is critical to the use of AQIs in discussions of audit quality with the audit committee.
- ▶ Audit committees in the CAQ pilot said no specific AQI has been viewed as helpful in all cases. The reasons may include the audit committee's familiarity with the audit process, interactions with the audit team and current processes for evaluating the auditor as well as industry differences.
- ▶ Opinions vary among audit committees about what contextual information is useful to their analysis of AQIs. The AQI data can vary from engagement to engagement, demonstrating that without context and additional discussion, indicators could provide information that is not helpful, contains false positives or negatives or promotes misperceptions about factors that may affect audit quality.

- ▶ Some audit committee members have cited a desire for more qualitative information. For example, many of the factors that are critical to audit quality, such as professional judgment and skepticism, are more qualitative than quantitative, and therefore are much more difficult to capture in an numerical indicator.

As a result, we believe context is critical, and that the context provided needs to be tailored to the specific facts and circumstances of the audit firm, the particular audit and the needs of the audit committee and other users.

Finally, in addition to our efforts to use AQI data internally and to enhance our communications with audit committees, we have begun providing investors and other stakeholders with information about our system of quality control and data points that we believe are relevant to audit quality. Since 2012, we have published annually an audit quality report that provides these stakeholders with information about our commitment to executing quality audits, describes various elements of our system of quality control and outlines important areas of focus and investment by the firm on matters that affect audit quality.¹

Our 2014 Audit Quality Report leveraged the insights from the various activities noted above and included a number of data points about our audit practice. It also provided information for the past three years to show stakeholders the trend. Our experience has indicated that the report not only enhanced stakeholders' understanding of our audit practice, but has also served as a catalyst for additional audit quality discussions with both audit committees and other stakeholders. We plan to include a number of data points and descriptions of our efforts to enhance audit quality in our 2015 report as well.

Suggested approach to AQIs

As a result of our experiences with AQI data – both internally and externally – and observations from PCAOB and other regulatory activities on the topic, we believe the PCAOB should consider the following factors in developing an approach to the use of AQIs:

- ▶ There is no consistent definition of audit quality, and due to the nature of the audit process, there are a wide variety of potential AQIs that may be used to evaluate audit quality.
- ▶ Providing context is therefore critical to understanding and interpreting AQIs to avoid misperceptions that might lead to unintended consequences.
- ▶ The development and use of AQIs by audit firms is evolving and will continue to evolve over time.

We believe the PCAOB should allow audit firms and audit committees to continue to voluntarily develop AQIs and should not require a particular set of AQIs and a disclosure approach. We describe our recommendations in more detail below.

¹ See *Our commitment to audit quality – information for audit committees and other stakeholders*, December 2014 at [http://www.ey.com/Publication/vwLUAssets/EY-our-commitment-to-audit-quality-december-2014/\\$File/EY-our-commitment-to-audit-quality-december-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-our-commitment-to-audit-quality-december-2014/$File/EY-our-commitment-to-audit-quality-december-2014.pdf)

Continued study of correlation between AQIs and audit quality

We believe further study by audit firms and the PCAOB is needed to better understand the correlation, if any, of AQIs that represent inputs into the audit process at various levels within the firm (engagement, region, industry, firm) to outputs that indicate the result on audit quality, such as internal and external inspections. Obtaining a clear understanding of any correlation would enhance an audit firm's quality monitoring efforts. It also could enhance an audit firm's ability to identify risks and developments that could adversely affect audit quality and take timely action. In addition, it could provide additional insights into the root causes of identified deficiencies.

Identifying the correlation between AQIs and audit quality outcomes also could enhance the auditor's use of AQIs in discussions with audit committees. A better understanding of the link between AQIs and audit quality would enable the auditor to more directly describe how the AQI reflects characteristics of the audit that can contribute or detract from the performance of a quality audit. This could benefit the audit committee's overall understanding of the auditor and facilitate more effective oversight of the audit process.

Encourage continued development and use of AQIs by auditors and audit committees

As mentioned previously, we believe that audit committees, through their oversight role of the audit and a company's financial reporting, are in the best position to receive and evaluate AQIs, particularly at the engagement level. We believe that AQIs can strengthen the audit committee's oversight of the audit and provide information to help the committee decide whether to reappoint the existing auditor or select a new auditor.

In our interactions with audit committees, no specific AQI has been viewed as helpful in all cases. Audit committees also have expressed different preferences for audit quality information based on their particular facts and circumstances.

As a result, we do not believe that an approach that would mandate disclosure of specific AQIs in all situations would be appropriate at this time. Instead, we believe that the PCAOB should continue to encourage and facilitate collaboration between the auditor and audit committee to determine (1) the factors that are important to a quality audit in a variety of facts and circumstances, (2) the measures and context needed to understand those measures and (3) the manner in which the information should be communicated. We believe such an approach, in conjunction with the analysis discussed previously, should provide insights into the benefit of AQI information over time to both audit committees, audit firms and the PCAOB.

Allow firms to continue to experiment with public disclosure of firm-wide AQIs

We believe the PCAOB should encourage firms to continue to engage with stakeholders in this area as we believe that the information has the potential to provide greater transparency about public company audit practices and promote greater confidence in the capital markets.



As the PCAOB observed in the Concept Release, audit firms have only recently begun disclosing firm-wide AQIs, and disclosures vary by firm. Our experience thus far indicates that there is no consistent view on either the particular matters that are important contributors to the performance of a quality audit or the relative importance of those matters.

We also note that we are still learning from stakeholders how AQIs could be helpful to them. That is, this is an iterative process, and we believe that a regulatory system that sets forth specific disclosure requirements could stifle this innovation. As a result, consistent with our other recommendations, we believe continued support by the PCAOB for voluntary disclosure by audit firms of firm-wide AQIs and engagement with stakeholders about the effectiveness of the approaches audit firms are taking would be most appropriate at this stage.

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We would be pleased to discuss our comments with the Board or its staff at your convenience or participate in the upcoming roundtable discussion.

Very truly yours,

cc:

PCAOB

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