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**STANDING ADVISORY GROUP MEETING**  
**PANEL DISCUSSION – AUDIT QUALITY INDICATORS**  
**NOVEMBER 29-30, 2017**

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**Introduction**

At the November 29-30, 2017 Standing Advisory Group ("SAG") meeting, a panel will discuss audit quality indicators ("AQIs"), including how AQIs are being used by audit firms and audit committee members, and insights from the academic literature. This paper provides background information and outlines the topics that the panelists will address. After the panel's presentation, SAG members will have the opportunity to provide input on the uses of AQIs and potential next steps for the Board to consider.

**Background**

AQIs are quantitative measures that may provide insights about how to evaluate the quality of audits and about how high quality audits are achieved. AQIs, taken together with qualitative context, may inform discussions among those concerned with the financial reporting and auditing process, for example, audit committees and audit firms. Enhanced discussions, in turn, may strengthen audit planning, execution, and communication.

In July 2015, the Board issued a concept release to seek public comment on the content and possible uses of a group of potential AQIs.<sup>1</sup> Discussions in the release

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<sup>1</sup> See PCAOB Release No. 2015-005, *Concept Release on Audit Quality Indicators; Notice of Roundtable* (July 2015). The Concept Release was informed by, among other things, SAG member input on the content and uses of AQIs. See meetings of the SAG on Nov. 12-13, 2015, June 24-25, 2014, Nov. 13-14, 2013, and May 15-16, 2013.

This paper was developed by the staff of the Office of the Chief Auditor as of November 15, 2017 to foster discussion among the members of the Standing Advisory Group. It is not a statement of the Board; nor does it necessarily reflect the views of the Board, Board members, or staff.

included: (i) the nature of the potential indicators, (ii) the usefulness of the indicators, (iii) suggestions for other indicators, (iv) potential users of the indicators, and (v) an approach to implementation over time of an AQI project.

## **Current Practices Regarding AQIs**

### *PCAOB and Other Regulators*

The Board has noted that there is an opportunity to leverage the market's interest in information about the audit, including through encouraging use of audit quality indicators, in order to enhance the relevance of the audit.<sup>2</sup> The PCAOB continues to monitor the voluntary uses of AQIs.

PCAOB inspections staff has also actively incorporated audit quality indicator information into the inspection program to drive improvements to audit quality.<sup>3</sup> For example, inspections teams have considered various detailed measures as part of the inspections process for certain annually-inspected firms.

Other regulators are also encouraging and monitoring the use of AQIs. Some regulators have required firms to publish a mandatory set of AQIs, while others have adopted a more flexible, principles-based approach.<sup>4</sup> Some regulators continue to study the use and disclosure of AQIs. For example, in 2014 the Canadian Public Accountability Board ("CPAB") issued a publication encouraging firms to increase the transparency of audit quality measures and recommending that audit committees initiate dialogue with their auditor.<sup>5</sup> In 2017, CPAB issued an interim report on an AQI pilot

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<sup>2</sup> See PCAOB, *Public Company Accounting Oversight Board Strategic Plan: Improving the Quality of the Audit for the Protection and Benefit of Investors, 2016 – 2020*, at 9.

<sup>3</sup> See Jeanette M. Franzel, Board Member, PCAOB, *Innovative & Robust Audit Profession to Serve Investors and the Public Interest*, address at the 16<sup>th</sup> Annual Financial Reporting Conference (May 4, 2017).

<sup>4</sup> See Federation of European Accountants, *Overview of Audit Quality Indicators Initiatives, Update to December 2015 edition* (July 2016).

<sup>5</sup> See CPAB, *Audit Quality Indicators: In Search of the Right Measures* (Nov. 2014).

project, noting that their observations to date suggest that AQIs could have significant potential to positively impact audit quality.<sup>6</sup>

### *Firms*

In recent years, some firms have begun releasing annual reports that describe how they focus on audit quality.<sup>7</sup> Some of these reports present firm-level audit quality indicators and acknowledge that such quantitative metrics are useful in providing insights about audit quality. In addition, the Center for Audit Quality ("CAQ"), an affiliate of the American Institute of Certified Public Accountants, has noted that the qualitative discussions between auditors and audit committees regarding AQIs are also important.<sup>8</sup>

AQIs are also used internally by some firms as a monitoring tool. For example, some firms compile and analyze specific quantitative metrics to identify and follow up on potential issues and to help make improvements.<sup>9</sup>

Also, some firms have worked with audit committees to develop and share engagement-level AQIs to help the audit committee fulfill its oversight responsibilities. For example, the CAQ conducted pilot testing of AQIs on 30 audit engagements. In addition, the CAQ conducted outreach with interested stakeholders. The outreach and pilot testing "has led to an understanding that audit committee members may benefit from a multidimensional resource that can assist them in gauging the performance of the audit using qualitative and quantitative factors."<sup>10</sup>

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<sup>6</sup> See CPAB, *2016 Audit Quality Indicators Pilot Project, Interim Report Summary* (2016).

<sup>7</sup> See Deloitte, *US Audit Quality Report* (Dec. 2016); Ernst & Young, *Our Commitment to Audit Quality* (Dec. 2016); KPMG, *Enhancing Audit Quality* (Dec. 2016); and PwC, *Our Focus on Audit Quality* (2017).

<sup>8</sup> See CAQ, *CAQ Approach to Audit Quality Indicators* (Apr. 2014).

<sup>9</sup> See, e.g., Deloitte, *US Audit Quality Report* (Dec. 2016), and KPMG, *Enhancing Audit Quality* (Dec. 2016).

<sup>10</sup> See CAQ, *Audit Quality Indicators, The Journey and Path Ahead* (Jan. 2016).

### *Audit Committees*

Audit committees are using AQIs to help in their oversight of the audit firm. A recent survey of corporate directors found that 58 percent of respondents indicated that they formally use one or more AQI-like quantitative metrics in their oversight of auditors.<sup>11</sup>

Some audit committee members have informed the PCAOB that they are requesting engagement-level AQIs from the auditor to aid in their oversight of the audit process. These audit committee members have also indicated that that two-way communication between the audit committee and auditor regarding the qualitative aspects of the engagement-level AQIs is important.<sup>12</sup>

### **Academic Literature**

There is a large body of research on audit quality.<sup>13</sup> The research examines, among other things,

- Definitions of audit quality
- Drivers of audit quality
- Frameworks to evaluate audit quality

In addition, some research explores the linkage between audit quality and AQIs. Many academic papers on audit quality suggest AQIs could be beneficial.<sup>14</sup>

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<sup>11</sup> See PwC, *2017 Annual Corporate Directors Survey* (2017).

<sup>12</sup> This is similar to the views expressed by others. For example, some commenters, particularly audit firms, on the PCAOB's concept release noted the importance of two-way dialog with audit committees to provide context regarding the engagement-level AQIs. Comment letters are available at <https://pcaobus.org/Rulemaking/Pages/Docket041Comments.aspx>.

<sup>13</sup> See, e.g., Mark L. DeFond and Jieying Zhang, *A Review of Archival Auditing Research* (Aug. 2014) (working paper, available in Social Science Research Network).

<sup>14</sup> See, e.g., W. Robert Knechel, Gopal Krishnan, Mikhail Pevzner, Lori Shefchik, and Uma Velury, *Audit Quality: Insights from the Academic Literature*, 32 *Auditing: A Journal of Practice & Theory* 385 (2013).

## Panel Discussion

The panel discussion will consist of:

- A SAG member from a public accounting firm, who will discuss the firm's use of AQIs, both at the firm- and engagement-level, and the firm's communications of AQIs to audit committees and to financial statement users;
- An audit committee member, who will discuss how audit committees use AQIs to help oversee and assess the firm's engagement performance; and
- An academic who has performed extensive research regarding AQIs, who will discuss the research regarding AQIs and potential avenues for future research.

Broadly, the presentations and discussion plan to address the following topics, among others:

- The nature and extent of the sharing of AQIs with audit committees
- Disclosure of firm-level AQIs in annual firm audit quality reports
- How firms are using AQIs internally to manage their audit practice
- How firms are using AQIs in determining root causes of audit deficiencies
- How audit committees are using AQIs in their oversight of the auditor
- Qualitative aspects of discussions between auditors and audit committees regarding AQIs
- How the use of AQIs by audit committees may evolve
- Existing academic research on AQIs and potential areas for future research

SAG members will have the opportunity to discuss the topic, including sharing their views on the content and uses of AQIs, and potential implications to PCAOB standards.

The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.