

Heads Up

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SEC and PCAOB Take Steps Toward Enhancing Audit Committee and Auditor Disclosures

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Introduction

Recently, the SEC published a [concept release¹](#) on possible revisions to audit committee disclosures, and the PCAOB issued (1) a [supplemental request for comment²](#) on rules to require disclosures about the audit partner and certain other audit participants and (2) a [concept release³](#) on audit quality indicators (AQIs). These three releases contemplate expanding disclosures about an audit and how the audit committee oversees the auditor.

This *Heads Up* gives an overview of the releases and focuses on those of the PCAOB.

SEC's Concept Release on Audit Committee Disclosures

The responsibilities of audit committees have changed significantly since the SEC's adoption of audit committee disclosure requirements in 1999.⁴ Accordingly, the Commission recently decided to publish a concept release on possible revisions to audit committee disclosures and seek feedback on those revisions, particularly those pertaining to disclosures about audit committees' oversight of independent auditors. As explained in an SEC [press release](#), "the concept release invites comment on whether Commission disclosure requirements should be refined to provide more insight into the information the audit committee used and the factors it considered in overseeing the independent auditor."

The SEC's concept release discusses specific potential changes to audit committee disclosure requirements, including those related to the following:

- A. Audit Committee's Oversight of the Auditor
 1. Additional Information Regarding the Communications Between the Audit Committee and the Auditor
 2. The Frequency with which the Audit Committee Met with the Auditor
 3. Review of and Discussion About the Auditor's Internal Quality Review and Most Recent PCAOB Inspection Report
 4. Whether and How the Audit Committee Assesses, Promotes and Reinforces the Auditor's Objectivity and Professional Skepticism

¹ SEC Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*.

² PCAOB Release No. 2015-004, *Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form*.

³ PCAOB Release No. 2015-005, *Concept Release on Audit Quality Indicators — Notice of Roundtable*. A concept release is a step before rulemaking and is designed to gather public comment about potential topics of future rulemaking.

⁴ See SEC Regulation S-K, Item 407, "Corporate Governance."

- B. Audit Committee's Process for Appointing or Retaining the Auditor
 - 1. How the Audit Committee Assessed the Auditor, Including the Auditor's Independence, Objectivity and Audit Quality, and the Audit Committee's Rationale for Selecting or Retaining the Auditor
 - 2. If the Audit Committee Sought Requests for Proposal for the Independent Audit, the Process the Committee Undertook to Seek Such Proposals and the Factors They Considered in Selecting the Auditor
 - 3. The Board of Directors' Policy, if any, for an Annual Shareholder Vote on the Selection of the Auditor, and the Audit Committee's Consideration of the Voting Results in its Evaluation and Selection of the Audit Firm
- C. Qualifications of the Audit Firm and Certain Members of the Engagement Team Selected By the Audit Committee
 - 1. Disclosures of Certain Individuals on the Engagement Team
 - 2. Audit Committee Input in Selecting the Engagement Partner
 - 3. The Number of Years the Auditor has Audited the Company
 - 4. Other Firms Involved in the Audit

In addition, the concept release explores options for the location of such potential disclosures and solicits feedback on the impact that related rules may have on smaller reporting companies and emerging growth companies (EGCs).

For more information on the SEC's concept release, including details about submitting comments on the release to the SEC, see Deloitte LLP's July 2015 *Audit Committee Brief*.

PCAOB's Supplemental Request for Comment on Disclosures About Certain Audit Participants

The PCAOB's transparency project has been a multiyear effort to increase the information available about certain audit participants. The PCAOB's latest supplemental request for comment is another step in this process as the Board seeks input on an approach to disclosing the following:

- The name of the engagement partner on the current-year audit.
- The names, country locations of headquarters, and extent of participation of other public accounting firms participating in the audit (above a 5 percent threshold based on total audit hours). This disclosure would include certain non-U.S. member firms of global networks.

Under this proposed approach, registered public accounting firms would be required to disclose such information on a new PCAOB form⁵ ("Form AP") filed with the PCAOB rather than in the auditor's report as previously proposed in the PCAOB's 2013 *release*⁶ on improving the transparency of audits. The information provided on Form AP would be available for public review indefinitely via a searchable database on the PCAOB's Web site. The PCAOB is considering this alternative approach to address concerns raised in stakeholders' comments on the 2013 release regarding the practical and legal challenges of providing such information in the auditor's report, including the need to obtain consents from parties named in the auditor's report.⁷ Voluntary disclosure in the auditor's report in addition to the filing of Form AP would be permissible under the alternative approach presented.

Form AP would be filed through the PCAOB's Registration, Annual & Special Reporting system in a manner similar to how other required PCAOB forms are filed by registered public accounting firms. The deadline for filing Form AP would be 30 days from the date the auditor's report was first included in an SEC filing, except in the case of initial public offerings (IPOs), for which there would be a deadline of 10 days. The shorter deadline for IPOs would ensure that such information is made publicly available before any IPO road show that may occur. If the PCAOB's new proposal is adopted, Form AP would

⁵ PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*.

⁶ PCAOB Release No. 2013-009, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit*.

⁷ For more information on the 2013 release, see Deloitte's January 6, 2014, *Heads Up*.

need to be filed for auditors' reports issued or reissued on or after June 30, 2016, or three months after the SEC approves the requirement, whichever occurs later.

The PCAOB is seeking input on all aspects of the alternative presented, including its economic implications. The PCAOB acknowledges that the alternative approach may result in higher search costs for investors who will have to access more than one source to obtain information about a particular audit; at the same time, however, the alternative may prove more practical and lower search costs for those investors who, for example, wish to obtain information about an individual engagement partner across multiple engagements in one location (on the PCAOB's Web site). The PCAOB believes that while the alternative approach may result in higher direct costs for registered public accounting firms, particularly when first implemented, it would avoid ongoing costs associated with obtaining consents under the approach proposed in the 2013 release.

Disclosures About Certain Other Audit Firm Participants

Certain aspects of the proposed requirements in the 2013 release to provide information about other accounting firms participating in the audit have been carried forward to the Form AP approach, although some details of the specific requirements have been revised. The overall objective remains the same — to provide information that helps financial statement users (1) ascertain whether other public accounting firms identified are registered with, and subject to inspections by, the PCAOB and (2) access the results of such inspections if applicable.

Information about other firms would need to be included on Form AP depending on the extent of their participation in the audit and whether such participation is estimated to be 5 percent or more of the total audit hours as of the date of the auditor's report. The table below describes the related disclosures that would be required under the new proposal.

	Disclosures If Audit Participation Meets or Exceeds 5% Threshold	Disclosures If Audit Participation Is Less Than 5% Threshold
Independent public accounting firms (such firms may or may not be affiliated with the accounting firm issuing the auditor's report)	<ul style="list-style-type: none">• The legal name of the public accounting firm(s).• The country of the headquarters' office.• The percentage of hours attributable to the audits or audit procedures performed in the audit in relation to the total hours for the most recent period's audit. This information may be provided as either a single percentage or a series of ranges as follows:<ul style="list-style-type: none">◦ 5% to less than 10%.◦ 10% to less than 20%.◦ 20% to less than 30%, and so forth.	<ul style="list-style-type: none">• The number of other public accounting firms whose individual participation is less than 5% of the total audit hours.• Aggregate percentage of participation of such firms. This information may be provided as either a single percentage or a series of ranges as follows:<ul style="list-style-type: none">◦ 5% to less than 10%.◦ 10% to less than 20%.◦ 20% to less than 30%, and so forth.

The following are excluded from the required disclosures proposed in the supplemental request for comment:

- The "engagement quality reviewer."
- The "person who performed the review pursuant to Securities and Exchange Commission Practice Section 1000.45 Appendix K."⁸

⁸ SEC Practice Section (SECPS) 1000.45 Appendix K, *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*.

- “[S]pecialists engaged, not employed, by the Firm.”
- “[I]nternal auditors, other company personnel, or third parties working under the direction of management or the audit committee who provided direct assistance in the *audit* of internal control over financial reporting.”
- “[I]nternal auditors who provided direct assistance in the *audit* of the financial statements.”

In addition, the alternative proposes either (1) removing the requirement previously proposed in the 2013 release to disclose information about the participation of nonaccounting firms altogether (which would result in excluding disclosures about certain offshore service centers, consultants, and entities that provide leased employees to accounting firms) or (2) narrowing the previously proposed requirement for such information by excluding from the definition of nonaccounting firms any “entities that are controlled by or are under common control with the auditor.” These changes were aimed at mitigating concerns raised about the potential negative effects of the requirement previously proposed in the 2013 release to disclose information on nonaccounting firms. Specifically, commenters were concerned that the inclusion of such information may be misinterpreted and that the approach may be biased against smaller accounting firms that engage outside specialists instead of employing in-house specialists as larger firms do. The Board is seeking comment on options (1) and (2).

Editor’s Note: The 2013 release proposed disclosure of the following information about nonaccounting firms (aggregated by country):

- The country of residence of the natural persons participating in the audit.
- The percentage of hours attributable to the audits or audit procedures performed in the audit in relation to the total hours for the most recent period’s audit. This information may be provided as either a single percentage or a series of ranges as follows:
 - Five percent to less than 10 percent.
 - Ten percent to less than 20 percent.
 - Twenty percent to less than 30 percent, and so forth.

PCAOB’s Concept Release on AQIs

The PCAOB’s concept release on AQIs reflects past efforts that include (1) prioritization of the Board’s AQI project in 2013, (2) the development of an AQI [working paper](#) presented by the staff of the Board’s Office of Research and Analysis to the PCAOB Standing Advisory Group (SAG) later that year, and (3) several subsequent public meetings involving both the PCAOB Investor Advisory Group and the SAG.⁹ The PCAOB’s objective is to develop a portfolio of AQIs that may provide new insights about:

- How to evaluate the quality of audits.
- How high-quality audits are achieved.

The PCAOB believes that the use of AQIs would help (1) inform discussions between audit committees and audit firms, (2) improve audit execution, (3) encourage audit firm competition based on audit quality, and (4) increase the transparency of audits.

⁹ For information about AQI issues discussed at the SAG’s May 2013 and November 2013 meetings, see Deloitte’s [June 25, 2013](#), and [December 10, 2013](#), *Heads Up* newsletters.

The concept release presents 28 potential AQIs, which have been narrowed down from the initial list of almost 80. The Board's goal is to eventually reduce the list to an even smaller number of indicators to maximize manageability and effectiveness; however, the Board has stated that it is willing to consider additional indicators as well. As noted in a PCAOB [news release](#), the AQIs presented are grouped into three categories:

- **Audit Professionals** — measures dealing with the availability, competence, and focus of those performing the audit.
- **Audit Process** — measures concerning an audit firm's tone at the top and leadership, incentives, independence, investment in infrastructure needed to support quality auditing, and monitoring and remediation activities.
- **Audit Results** — measures relating to financial statements (such as the number and impact of restatements, and measures of financial reporting quality), internal control over financial reporting, going concern reporting, communications between auditors and audit committees, and enforcement and litigation.

The concept release solicits feedback on various aspects of AQIs, including (1) the portfolio of potential indicators; (2) the compilation, distribution, and use of AQI data; (3) whether AQI usage should be mandatory or voluntary; (4) the scope of the requirements, including the parties to whom AQIs should be reported; (5) the potential for a phased-in adoption of AQIs if they are mandatory; and (6) the value of such indicators to audit committees, audit firms, investors, and regulators. In addition to seeking formal feedback, the Board plans to hold a public roundtable in the fourth quarter of 2015 to discuss views and comments on the concept release. Details of the roundtable have not yet been released.

The PCAOB is not alone in efforts to identify potential AQIs. In April 2014, the Center for Audit Quality (CAQ) released the [CAQ Approach to Audit Quality Indicators](#), which includes a list of potential AQIs and suggestions for how to communicate the metrics associated with AQIs to audit committees.

Although the specific indicators contemplated by the CAQ differ from those proposed by the PCAOB's latest concept release, the overall themes of the AQIs are consistent in that they emphasize tone at the top, engagement-team-specific metrics (e.g., knowledge, workload, and experience), monitoring of audit quality, and audit reporting. The CAQ is currently pilot testing its potential AQIs to solicit feedback from audit committees, audit engagement teams, and accounting firms so that it can continue to refine these indicators and enhance its guidance on communicating them.

The PCAOB's potential 28 indicators are listed in the [appendix](#) to this *Heads Up*, where they are compared at a high level with the CAQ's potential AQIs. Against the backdrop of the PCAOB and CAQ activities, Deloitte has been pursuing the use of internal performance indicators, which are discussed in the firm's March 2015 [Audit Committee Brief](#).

Feedback on the PCAOB's Releases

We encourage stakeholders to study the PCAOB's supplemental request for comment as well as its concept release on AQIs and submit comments to the PCAOB.

With respect to the supplemental request for comment, the PCAOB seeks feedback on the following:

- Benefits and costs of disclosure on Form AP as compared with the benefits and costs of disclosure in the auditor's report.
- Whether the use of Form AP would mitigate liability concerns previously raised, and the considerations and consequences related to voluntary disclosure in the auditor's report.
- Desired search criteria and functionality of a Form AP database.
- Filing deadline for Form AP.
- Whether disclosures related to nonaccounting firm audit participants should be required.
- Whether the proposed disclosures on Form AP should apply to EGCs.

- Whether Form AP poses specific issues for brokers, dealers, or other entities.
- Whether the effective date proposed is feasible.

Regarding the PCAOB's concept release on AQIs, the Board seeks feedback on 73 questions, including those related to the following:

- The "nature of the potential indicators."
- The "usefulness of particular indicators described in the release."
- "[S]uggestions for other indicators."
- "[P]otential users of the indicators."
- An "approach to implementation over time."

Editor's Note: Although the PCAOB sets out a number of specific questions in each document, it does not necessarily expect that each commenter will answer all of the questions. Some commenters will choose to answer some or all of the questions directly. However, it is common for commenters to provide general comments that are not explicitly tied to questions presented in the PCAOB's releases. Either approach or a combination of the two approaches is acceptable.

Comments to the PCAOB may be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the PCAOB's Web site at www.pcaobus.org.

- All comments related to the supplemental request for comment should refer to PCAOB Rulemaking Docket Matter No. 029 in the subject or reference line and should be received by the Board no later than August 31, 2015.
- All comments related to the concept release on AQIs should refer to PCAOB Rulemaking Docket Matter No. 041 in the subject or reference line and should be received by the Board no later than September 29, 2015.

Appendix — PCAOB's Potential AQIs

The table below is adapted from the PCAOB's concept release on AQIs.

Audit Professionals	
Indicator	Factor
1. Staffing leverage*	
2. Partner workload*	
3. Manager and staff workload*	Availability
4. Technical accounting and auditing resources*	
5. Persons with specialized skill and knowledge*	
6. Experience of audit personnel*	
7. Industry experience of audit personnel*	
8. Turnover of audit personnel*	Competence
9. Amount of audit work centralized at service centers	
10. Training hours per audit professional*	
11. Audit hours and risk areas*	Focus
12. Allocation of audit hours to phases of the audit*	
Audit Process	
Indicator	Factor
13. Results of independent survey of firm personnel*	Tone at the top and leadership
14. Quality ratings and compensation	Incentives
15. Audit fees, effort, and client risk	
16. Compliance with independence requirements	Independence
17. Investment in infrastructure supporting quality auditing	Infrastructure
18. Audit firms' internal quality review results*	
19. PCAOB inspection results*	Monitoring and remediation
20. Technical competency testing	
Audit Results	
Indicator	Factor
21. Frequency and impact of financial statement restatements for errors*	
22. Fraud and other financial reporting misconduct	Financial statements
23. Inferring audit quality from measures of financial reporting quality	
24. Timely reporting of internal control weaknesses	Internal control
25. Timely reporting of going-concern issues	Going concern
26. Results of independent surveys of audit committee members	Communications between auditors and audit committees
27. Trends in PCAOB and SEC enforcement proceedings	Enforcement and litigation
28. Trends in private litigation	

* The CAQ's potential AQIs consider a similar concept.

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