

Briefing to the PCAOB - Recommendations

Subcommittee on Inspections & Data Transparency
PCAOB Investor Advisory Group Meeting
June 7, 2023

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Our Charge

- Providing advice to the Board on how to enhance the PCAOB's audit firm inspections for the benefit of investors.
 - Explore possible ways to improve the inspection process and enhance the reporting of results related to PCAOB inspections.
 - May also compare the PCAOB's inspection process, funding, and staffing to other international regulators that have similar inspection programs.

Details of the SIDT

- Members: Alicia Damley, Parveen P. Gupta (Chair), Nemit Shroff and Lynn E. Turner.
- Process: Regular (virtual) meetings to discuss and review current state of PCAOB Inspections and Data Transparency. Review of relevant academic research and non-academic materials to inform us. Vigorous debate about findings and recommendations.
- Outcome: A list of recommendations, in priority order, endorsed by the IAG at a future date.
- Caveat: Given the evolution of AI and technology, the execution of future audits and the inspections and data transparency regime will need to proactively evolve

Recommendation #1

- Audit firm provided data and information gathered as part of the inspections currently made public should be available to the investors and the public in a searchable database
 - Facilitate easier investor access and analysis.
 - Draw meaningful and holistic conclusions about trends and issues including audit quality, auditor independence and financial reporting quality.

Recommendation #2

- Board review and revise its Bylaws and Rules such as EC-9 to allow disclosure, in its final inspection report, the name of the public company (“issuer”) whose audit it inspected during the year.
 - The Sarbanes-Oxley Act of 2002 did not require that such information be withheld from the investors and the public.
 - Disclosure of the names of such public companies will help investors interpret and collate myriad of other information already made public by The Board.
 - Include in searchable database, enabling cross-referencing to other regulatory agency disclosure

Recommendation #3

- Board expand the searchable database to enhance investor protection with the following type of information:

Note: list has not been cross-referenced to PCAOB data collection as this SIDT information request remains outstanding

- Issuer details: total assets, total revenue, date of last PCAOB inspection
- Audit engagement details: firm tenure, lead/engagement/review partner name(s), lead/engagement/review partner tenure(s), office, audit fee, audit team size, total number of PCAOB findings, major findings, audit adjustments recommended/made (Dr/Cr)
- Engagement partner details: independence metrics, compensation metrics, restatements, enforcement actions, number of independence and ethics violations
- Date of completion of corrective actions
- Audit firm details: total audit partners, total audit staff, number of independence and ethics violations, audit fee % office audit and total revenue, office revenue % firm revenue
- Information on audit quality indicators available

Recommendation #4

- The Board adhere to a strict timeline in releasing its final inspection reports for each inspected audit
 - Final inspection report should be available to investors and the public before date of vote on the ratification of the external auditor during company's next shareholders' meeting.
 - Helps raise the reappointment stakes for the external auditors.
 - Helps registrant's audit committee provide better oversight on recommending auditor reappointment.

Recommendation #5

- In each final inspection report, the Board disclose the key risk criteria used in selecting the audit for inspection.
- If an audit for inspection was selected on a random basis, the inspection report should clearly state so to enable investors to draw informed conclusions about the inspected audit, and the registrant including its industry, peer group etc.

Recommendation #6

- The Board consider making public the specific actions the inspection team asked of the auditor for each audit that did not comply with the PCAOB Standards.
- Waiting to disclose such information in the final inspection report diminishes the value-relevant of such information to investors and the public.

Recommendation #7

- The Board benchmark its “cycle time” (time from the day the inspection begins to the day the final inspection report is issued to the investors and the public) with other federal regulatory agencies such as the FDIC etc. to implement improvements to its processes to reduce the “cycle time” to be able to issue the final report in a timely manner (see Recommendation #4).

Recommendation #8

- The Board revisit the language surrounding the recently implemented changes to its inspection reports such as information provided to communicate independence violations etc.
 - For example, disclosures pertaining to the independence violations leaves investors and the public to wonder why the Board, when informed of the independence violations, took no action to understand the reasons underlying the non-compliance.
 - Investors are left to wonder whether the inspection team took any steps to independently determine if auditor's objectivity and independence were not indeed impaired.

Recommendation #9

- The Board consider revising AS3101 “Auditors Report on an Audit of Financial Statements” to require:
 1. disclosure of the amount the auditor used to assess whether uncorrected audit adjustments were material at the conclusion of the audit,
 2. the basis for making that determination , and
 3. a list of audit adjustments the auditor proposed, that were either material and corrected by the management, or determined to be immaterial to the consolidated financial statements but were not corrected. (See Recommendation #3)

Recommendation #10

- Trust in the PCAOB is based on the agency consistently fulfilling its mission to protect investors and ensure audit reports are informative, accurate and independent. Concern has been expressed from various sources as to whether the board has always met its mandate. Regular reviews would help alleviate such concerns.
- It is common that when federal agencies undertake such reviews, they are made available to the public. The PCAOB should undertake a review of its policies, such as EC 9, to ensure that they all support the achievement of its mission.
- The policies of the PCAOB should include proper guardrails, with input from investors and the public, to ensure the Board consistently fulfills its mission.

Recommendation #11

- We fully understand that this recommendation may fall outside the scope and jurisdiction of the Board.
- Nevertheless, we recommend that The Board pursue an initiative aimed at making public audit work papers after a significant period of elapsed time e.g. five or more years.
- Pre-knowledge that work papers will be made public in the future will further incentivize audit firms to be more thorough in their audits upfront, encouraging additional discipline and diligence at the time of audit

Discussion & Questions