

June 7, 2024

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

Re: Firm and Engagement Metrics

Dear Chair Williams:

Americans for Financial Reform Education Fund (AFREF) and the undersigned organizations appreciate the opportunity to comment on the important proposal by the Public Company Accounting Oversight Board (PCAOB) to require certain registered public accounting firms to publicly report specified firm- and engagement-level metrics. We strongly support this proposal, as it would provide investors, audit committees, and other stakeholders critical information to compare audit firms, make better-informed decisions, and enhance auditor accountability.

Importance of the proposal

Currently, when companies seek approval of the auditor, proxy statements must provide basic background information. Other than the identity of the firm, however, disclosure is mostly limited to audit fees and pre-approval policies implemented by the audit committee.¹ There is nothing in the current required disclosure regime for proxy statements that provides shareholders with useful information concerning the quality of the audit or the audit firm. While the SEC has encouraged these types of disclosures, it has never required them.² The proposed metrics would fill this gap by equipping shareholders with useful information to weigh when deciding whether or not to ratify the auditor and voting for the election of the members of the audit committee.

Disclosure of the proposed metrics would also benefit audit committees. A small number of audit committees acknowledge in their proxy statements that they use metrics most likely

¹ Item 10, Schedule 14A-1, 17 CFR 240.14a-101 (requiring disclosure of audit-related fees, tax fees and all other fees). There is also some required disclosure of the use of part-time employees.

² Concept Release, Possible Revisions to Audit Committee Disclosures, Exchange Act Release No. 75344 (admin. proc. July 1, 2015) (“In those cases where a company voluntarily seeks ratification of its auditor, requiring additional disclosure may be useful to promote informed voting decisions. The Commission is interested in feedback on potential disclosure about the board of directors’ policy, if any, for annual shareholder vote on the selection of the auditor, and the audit committee’s consideration of the voting results in evaluating and selecting the audit firm, including situations where the audit firm fails to achieve majority support. Such disclosure could provide useful information to shareholders as to how and why the board is seeking ratification of the auditor, as well as the implication of the shareholder vote being solicited.”).

provided by the auditor.³ The precise nature of the metrics, however, is too often vague.⁴ The proposed metrics would provide audit committees with a more uniform, comparable data for assessing audit quality and the quality of the audit firm.

Recommendations

Below, we make a few recommendations to make the metrics more useful, comparable, and less susceptible to gaming that could obfuscate the information intended to be made available.

1. Add a specific number of years of audit experience to the definition of “manager.”

Senior managers at the largest firms usually have been employed for around a decade and perform much of the actual oversight of the audit. However, the term “manager,” which is used throughout the proposal, is not defined with sufficient specificity (“Accountants or other professional staff commonly referred to as managers or senior managers (or persons in an equivalent position) who participate in audits.”) As a result, firms seeking to increase the percentage of time spent on audits by managers could increase the number of managers simply by changing existing titles of lower ranked and less experienced employees. For that reason, we recommend adding a specific number of years of audit experience to the definition of “manager.”

2. Make the metric measuring experience of partners (other than the engagement partner or the engagement quality review partner) weighted.

The core engagement team includes “partners” who worked ten or more hours on the engagement. One metric requires the average experience of partners on the core engagement team. See Metric 6.4 (“Average years of experience for Partners (excluding the engagement partner), and Managers on the Core Engagement Team.”). This provides an incentive to have a

³ See Proxy Statement, Leidos Holdings, Inc., March 12, 2024 (audit and finance committee considers “the audit firm’s audit quality indicators”). See also J. Robert Brown, Jr., *Audit Committees, Audit Quality, and Investor Protection*, Board Member, PCAOB, Commissione Nazionale per le Società e la Borsa, Rome, Italy, Sept. 27, 2019, https://pcaobus.org/news-events/speeches/speech-detail/audit-committees-audit-quality-and-investor-protection_706 (“In the U.S., public companies are, on a voluntary basis, increasingly disclosing in their proxy statements the AQIs used by audit committees to evaluate audit firms. The AQIs range from the quality of the engagement partner and team, to the technical expertise of the audit team in industries such as insurance, financial services, oil & gas, telecommunications or government contracts, to the quality of the engagement partner and team, to the candor of the communications between the auditor and the audit committee.”).

⁴ See Proxy Statement, Playtika Holding Corp., April 26, 2024 (“In connection with its oversight responsibilities, the Audit Committee assesses the performance of our independent registered public accounting firm on an annual basis. In conducting its assessment, the Audit Committee considers various audit quality indicators including firm reputation, support, competency and service by the engagement team, including industry expertise, management’s input as to the firm’s technical expertise and knowledge; and quality and breadth of services provided relative to the cost of those services.”); Proxy Statement, Verizon Communications, Inc., (March 25, 2024) (factors considered by audit committee including “Ernst & Young’s historical performance and its recent performance during its engagement for the 2023 fiscal year, including with respect to key audit quality indicators, such as the continuity of the engagement team, the use by Ernst & Young of specialists, and Ernst & Young’s tenure in the industry”).

number of very experienced partners provide modest assistance (for example, 11 hours) in order to be included in, and significantly improve, the metric. A better approach would be a weighted average.

3. Include hours spent on the audit by the Engagement Quality Review (EQR) partner and any specialist “engaged but not employed” in total audit hours; exclude or separately show hours spent on interim reviews under AS 4105.

“Total audit hours” is used to measure, among other things, the number of hours performed before the first of the year and after the first of the year. Where a significant percentage of audit work is done before the first of the year, there is less likelihood that the firm will have to rush to finish the work. When audits are rushed, more mistakes are made. Auditors also have more incentives when they are rushed to paper over problems or red flags.

The term “total audit hours” includes all hours devoted to the audit, the interim review (those conducted on quarterly reports), and the audit of the Internal Control over Financial Reporting (ICFR). With interim review hours included, the metric will generally show that most hours were conducted before the first of the year. These hours should be excluded or disaggregated to present a clearer picture.

The term “total audit hours” also does not include time spent by the Engagement Quality Review (EQR) partner (the person who reviews the audit to make sure it is done correctly) or specialists that are “engaged but not employed.” Because the omission of these hours affects the denominator of the metric and they are part of the audit, both should be included. If excluded, the metric will overstate the percentage of involvement by engagement partners and other members of the audit team. Moreover, excluding them may provide incentives (depending upon the impact on the denominator) to game the metric by using specialists “engaged but not employed.”

Additionally, auditors rely heavily on the advice of specialists to judge the reasonableness of critical climate- and energy-related assumptions (e.g., future fossil fuel production volumes and prices, inputs to asset impairment testing, and expected carbon prices).⁵ Specialists can be independent, employed by or affiliated with the auditor, or even employed by or affiliated with the public company itself. The last scenario may present a conflict of interest, and investors would benefit from understanding whether and to what extent an auditor relies on various types of specialists for critical audit judgments. This should be disclosed at the engagement level as both the number of hours and percentage of total audit time performed by a) independent specialists, b) auditor-affiliated specialists, and c) management-affiliated specialists on areas of

⁵ Carbon Tracker Initiative, “Flying Blind: the glaring absence of climate risks in financial reporting,” 2021. <https://carbontracker.org/reports/flying-blind-the-glaring-absence-of-climate-risks-in-financial-reporting/>

significant risk and critical accounting estimates. In addition, metrics on the use of specialists would be more useful if broken down by industry. For example, in the oil and gas industry, many auditors are failing to adequately address how climate-related risks impact critical accounting estimates and assumptions, which may be due to a lack of expertise or conflicts of interest. Allowing investors to compare use of specialists across industries will help them identify auditor deficiencies of in-house expertise, for example, in assessing the effect of the clean energy transition on significant audit judgments.

4. Define compensation to include all significant categories of compensation, including bonuses and deferred compensation.

One firm-level metric provides for disclosure of the average compensation for partners based upon their quality performance ratings, but compensation is not defined. While the definition need not be as complex as what is used for executive officers of public companies (*see* Item 402 of Regulation S-K), the proposal should at least specify the categories of payments included in the calculation. Some categories such as deferred compensation are often not treated as taxable income. A firm defining “compensation” as taxable income might, therefore, not include those amounts. We therefore recommend that all significant categories of compensation be included in the definition, including bonuses and deferred compensation.

5. Disaggregate certain metrics.

A number of metrics combine managers and partners (excluding the engagement partner). These include the percentage of hours spent on the audit (6.1), audit experience generally (6.4), audit experience in the relevant industry (6.5), retention rates (6.6), and the time spent in certain critical areas (6.7). These metrics should be disaggregated into managers and partners.

Firm-level metrics in many cases also should be disaggregated. For example, Item 4.4 calls for the “average years of experience at a public accounting firm” by all engagement partners and all partners/managers. The metric will provide a single data point for the entire firm. The data would be more useful if broken down by industry. The release has a proposed list of industries (pp. 63-64) that could be used.

“Hours worked” include all hours worked (on all engagements) and includes hours spent on training and development. The metric should break out training and development.

6. Include procedures designed to uncover fraud in the areas of significant risk; require hours for fraud detection to be disaggregated.

One metric seeks to provide data on the time spent on significant risks associated with the audit and on critical accounting policies and estimates (Item 6.7: “Percentage of total audit hours

incurred by partners and managers on the engagement team on significant risks, critical accounting policies and practices, and critical accounting estimates”). The metric does not specifically include time spent during the audit on the procedures undertaken to uncover fraud. The metric should include fraud procedures, and the number of hours spent on fraud procedures should be disaggregated.

7. Require metrics to be disclosed on or before November 30th.

The proposal would require firm-level metrics to be disclosed in November and engagement-level metrics would be disclosed 35 days after the audit report is issued (for the previous year’s audit). For large public companies, that means early April.

As a matter of timing, shareholders will need the information when voting on auditor ratification. Most shareholder meetings are held in April, May, and June. For those held in April, this data will be arriving late in the voting process. Therefore, an earlier filing date would make the information more useful.

Audit committees also have timing issues. These committees need the information when reapproving the firm and when considering the audit plan presented by the auditor. These decisions are made sometime before the beginning of the fiscal year (likely during the fourth quarter). The April deadline for engagement-level metrics would therefore arrive too late to inform the process.

One possibility that would solve both shareholder and audit committee timing issues would be to have both sets of metrics made public in November. The alternative would be to require that the auditor provide the audit committee with the audit-level metrics earlier, before public disclosure, perhaps in November, when the firm-level metrics are made public. In this case, shareholders would know that the metrics made public were considered by the audit committee when approving the auditor.

8. Require Form AP and Form FM to be filed using XBRL.

The PCAOB requires some data (Form AP) to be filed in Extensible Markup Language (“XML”), a machine-readable language. Financial statements filed with the SEC, however, must be filed using Extensible Business Reporting Language (XBRL), a related but somewhat different machine-readable language.

Application of a common language (XBRL) would facilitate the use of data filed at the SEC and the PCAOB. Researchers increasingly compare data from Form AP and financial statements filed with the SEC.⁶ The PCAOB should require all forms to be filed using XBRL.

⁶ Quinn Swanquist & Jamie Teterin, *New Evidence on Audit Partner Expertise and Audit Outcomes*, April 18, 2024.

9. Require publicly traded “closed end” investment companies, registered open end investment companies, and broker-dealers that are publicly traded to disclose the proposed metrics.

The proposal metrics do not apply to audits of investment companies or broker-dealers. While investors do not generally vote on audit firms for broker-dealers,⁷ they do sometimes for mutual funds.⁸ Moreover, audit committees in both sets of entities presumably approve the auditor (for the broker-dealer, it would be done by the board of the subsidiary or, more likely, the audit committee of the holding company). Investors, when ratifying firms even if not “typical,” and audit committees, when approving the auditor at both investment companies and broker-dealers, would benefit from engagement-level metrics.

10. Provide a fixed schedule for review of the metrics.

This is the first effort by the PCAOB to develop comparable metrics. It is likely that over time, the value of particular metrics will shift and the need for additional metrics will become apparent. The formula for the metrics will likely require change, either because a particular metric does not provide the intended data and/or because the metric provides excessive discretion and therefore does not result in comparable data.

The PCAOB should, therefore, put in place a defined process for periodic review of the metrics. The PCAOB should, for example, commit to a review of the metrics on a periodic basis (for example, every two years) and reconsideration of the metrics one year after the review.

The PCAOB has in the past committed to studying the effects of standards (post implementation review) but this is both voluntary and mostly a “thumbs up or thumbs down” approach. We recommend the PCAOB put in place a structure that makes this review required and routine.

We thank the PCAOB for engaging in this important process to institute a disclosure regime to facilitate the evaluation of audit and audit firm quality. We appreciate the PCAOB’s consideration of our recommendations to improve the disclosures’ usefulness and comparability. For further discussion, please contact Natalia Renta at natalia@ourfinancialsecurity.org.

Sincerely,

⁷ Most brokers are small, are not associated with public companies, and provide “introducing” services but do not actually execute trades. Larger brokers, including those who perform clearing functions, are rarely a free-standing public company. Instead, they are more commonly the subsidiaries of public companies. Presumably, however, the audit committee of the holding company approves the auditor.

⁸ https://www.ici.org/viewpoints/view_18_proxy_environment

American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)
American Federation of State, County and Municipal Employees (AFSCME)
American Federation of Teachers (AFT)
Americans for Financial Reform Education Fund
Better Markets
Citizen Works
Consumer Federation of America
Friends Fiduciary Corporation
Institute for Agriculture and Trade Policy
Interfaith Center on Corporate Responsibility
Public Citizen
Zevin Asset Management