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**STANDING ADVISORY GROUP MEETING**

**AUDIT COMMITTEE OUTREACH**

**MAY 15-16, 2013**

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**INTRODUCTION**

In connection with its 2012-2016 Strategic Plan, the Board identified as a near-term priority a project to “enhanc[e] PCAOB’s outreach to and interaction with audit committees to constructively engage in areas of common interest, including auditor independence and audit quality.”<sup>1</sup> The Board seeks input into the most effective approach of such efforts, and this paper is intended to prepare members of the PCAOB Standing Advisory Group (“SAG”) for a discussion about potential enhancements to the PCAOB’s outreach to and interaction with members of audit committees. The briefing paper provides background information about the Board’s previous outreach and SAG members will be asked to provide feedback on the following issues:

- Objectives of the Board’s outreach efforts;
- Effectiveness of the Board’s past outreach efforts; and
- Potential approaches to future outreach efforts.

Audit committees play a vital role in our capital markets’ investor protection framework through their oversight of the audit engagement and the company’s financial reporting process. The Sarbanes-Oxley Act of 2002, as amended, enhanced the scope of the oversight role played by the public company audit committee, by, among other things, making audit committees of listed companies “directly responsible for the appointment, compensation and oversight” of auditors, imposing stricter independence requirements, and promoting increased expertise among all public company audit committee members in financial reporting matters.<sup>2</sup>

These requirements, and related rules promulgated by the Securities and Exchange Commission and securities exchanges, are an important complement to the Board’s mission to protect the interests of investors and further the public interest in the

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<sup>1</sup> Public Company Accounting Oversight Board Strategic Plan: Improving the Relevance and Quality of the Audit for the Protection and Benefit of Investors 2012-2016 (Nov. 30, 2012) at 5.

<sup>2</sup> See Sarbanes-Oxley Act §§ 301 and 407.

This paper was developed by the staff of the PCAOB as of May 1, 2013 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 or staff.

preparation of informative, accurate and independent audit reports.<sup>3</sup> Consistent with its near-term priority regarding audit committees, the Board is considering whether additional outreach efforts, including through more direct face-to-face interaction with audit committee members, would be mutually beneficial to the PCAOB and audit committees in carrying out their respective oversight roles. With the overarching goal of enhancing auditor independence and improving audit quality, the Board's outreach efforts may be aimed at the following objectives:

- a. Enhancing the ability of audit committees to discuss auditor inspection findings with their auditors and to understand their relevance and significance to the audited company;
- b. Enhancing the ability of audit committees to evaluate the independence, objectivity and professional skepticism of their auditors;
- c. Assisting audit committees in focusing their attention on relevant and emerging audit risks and issues;
- d. Providing a mechanism for feedback to the Board from audit committees on the effectiveness of the Board's regulatory activities, including inspections, reporting, and standard-setting priorities;
- e. Obtaining input from audit committees regarding the Board's project on audit quality indicators; and
- f. Finding ways for the PCAOB and audit committees to collaborate on efforts to enhance communication and interaction with investors about matters of interest to them, consistent with the respective roles and responsibilities of the Board and audit committees.

## **BACKGROUND**

The Board took steps early in its existence to commence a dialogue with audit committees. For example, since 2004, the Board periodically has held Forums on Auditing in the Small Business Environment. These forums were designed to share important information about PCAOB activities with registered public accounting firms that operate in the small business community. Some of these forums also featured sessions or separate meetings for directors and financial executives of small public companies to address PCAOB issues affecting smaller public companies.

In 2007, during his tenure as a PCAOB Board Member, Daniel Goelzer authored a series of informational outlines and published an article directed at audit committees

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<sup>3</sup> See Sarbanes-Oxley Act § 102. The PCAOB does not, however, have jurisdiction to regulate audit committees.

and intended to explain the PCAOB's processes and activities.<sup>4</sup> The Board also periodically has issued documents or announcements directed at broader audiences but which also may be of assistance to audit committees. These include, among others:

- General reports summarizing the Board's activities and inspection findings as well as statements discussing the Board's policies or processes,<sup>5</sup>
- Staff audit practice alerts intended to highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits, and other guidance intended to provide the staff's views on issues related to the implementation of the standards of the PCAOB,<sup>6</sup> and
- Public statements, speeches, and articles by PCAOB Board members about a variety of aspects of the Board's activities, policies, findings and plans.<sup>7</sup>

Finally, in connection with particular standard-setting projects, the Board historically has obtained input from members of audit committees through the SAG, public roundtables, and other formal and informal meetings.

More recently, the Board has heard from audit committee members that their oversight activities could be enhanced if audit committee members received more information about the PCAOB's activities. For example, during the Board's public meetings on Auditor Independence and Audit Firm Rotation in March and June 2012, several panelists discussed the role of the audit committee in ensuring audit firm independence. Several themes emerged, including a desire by some to strengthen audit committees, to enhance audit committee expertise and education, and to increase the dialogue between the PCAOB and audit committees, particularly with respect to inspection information related to specific firms.<sup>8</sup>

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<sup>4</sup> See, e.g., Daniel L. Goelzer, "What Audit Committees Should Know About the Work of the Public Company Accounting Oversight Board," The Review of Securities and Commodities Regulation Vol. 41 at 61 (March 19, 2008).

<sup>5</sup> See <http://pcaobus.org/Inspections/Pages/PublicReports.aspx>.

<sup>6</sup> See <http://pcaobus.org/Standards/Pages/Guidance.aspx>.

<sup>7</sup> See <http://pcaobus.org/About/Board/Pages/default.aspx>.

<sup>8</sup> Examples of the views of audit committee members on these points can be found in recent panel discussions at PCAOB Public Meetings on Firm Independence and Rotation, including Session Four of the Board's June 28, 2012 public meeting (see [http://pcaobus.org/News/Events/Pages/06282012\\_PublicMeeting.aspx](http://pcaobus.org/News/Events/Pages/06282012_PublicMeeting.aspx) for archived webcast and transcript), and Session Nine of the Board's March 21-22, 2012 public meeting (see [http://pcaobus.org/News/Events/Pages/03212012\\_PublicMeeting.aspx](http://pcaobus.org/News/Events/Pages/03212012_PublicMeeting.aspx) for archived webcast and transcript).

On August 1, 2012, in part to respond to such calls for information, the Board issued a release, *Information for Audit Committees about the PCAOB Inspection Process*,<sup>9</sup> to help audit committees of public company boards of directors to engage in meaningful discussion with registered audit firms about the results of PCAOB inspections. The release provides information about the meaning of PCAOB inspection findings in engagement reviews and quality control findings. The release also suggests specific approaches that an audit committee might consider for initiating or enhancing inspection-related discussions with an audit firm, highlighting areas of inquiry that audit committees may wish to address with their auditors.

The August release recognizes, however, that the Board's ability to communicate with audit committees about firm-specific inspection activities is limited by the confidentiality provisions of the Sarbanes-Oxley Act, stating:

The Act does not, however, permit the Board to make public, or otherwise to share with an audit committee, all of the information obtained by the Board that could assist an audit committee in carrying out its role. Because of restrictions in the Act, many PCAOB inspection reports include a portion that is nonpublic. By law, the Board cannot disclose to an audit committee the nonpublic portion of an inspection report or other nonpublic inspection information – including whether the inspection identified deficiencies in the audit that the audit committee oversees – and the Board cannot compel an audit firm to disclose such information to an audit committee. Beyond the public portion of an inspection report, voluntary disclosure by the inspected audit firm is an audit committee's only means of obtaining information concerning a PCAOB inspection.<sup>10</sup>

Although the Board cannot provide audit committees with nonpublic information about specific inspections, the Audit Committee Release provides information about the inspection process, and the meaning of reported results, in a way that may better equip audit committees to engage in meaningful discussion with audit firms about the results of inspections

On August 15, the Board issued a standard, Auditing Standard No. 16, *Communications with Audit Committees*, intended to enhance the relevance and timeliness of the

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<sup>9</sup> See *Information for Audit Committees about the PCAOB Inspection Process*, PCAOB Release No. 2012-003 (Aug. 1, 2012) (“Audit Committee Release”).

<sup>10</sup> See Audit Committee Release at 1.

communications between a public company's auditor and its audit committee.<sup>11</sup> The standard requires the auditor to communicate certain significant matters regarding the audit and the financial statements to the audit committee, which should assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Effective two-way communication between the auditor and the audit committee on such relevant matters also will benefit the auditor in performing an effective audit.<sup>12</sup>

Finally, in connection with its 2012-2016 Strategic Plan, the Board identified as a near-term priority a project to identify audit quality measures, with a longer-term goal of tracking such measures with respect to domestic global network firms and reporting such measures over time. Due to audit committees' role in overseeing audit quality, the Board anticipates that audit committees would have an interest in this project.

The Board seeks to explore what additional outreach efforts could benefit audit committees and the PCAOB in connection with their common interests in investor protection. Thus, through the following discussion questions, the Board seeks input from the SAG about the most effective approach to and focus of its enhanced audit committee outreach. The Board will consider SAG member views in its determination about appropriate near-term and long-term efforts in this area and will update the SAG at future meetings about its activities and experiences.

## **DISCUSSION QUESTIONS**

### *Objectives of the Board's outreach efforts*

1. Do you agree with the objectives of the PCAOB's enhanced outreach to audit committees? Are there other objectives the PCAOB should consider?

### *Effectiveness of the Board's past outreach efforts*

2. Have you participated in any of the PCAOB's past outreach efforts or utilized any of the materials described above? In your experience, have you found that the

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<sup>11</sup> See Auditing Standard No. 16, *Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Sec. 380*, PCAOB Release No. 2012-004 (Aug. 15, 2012). This Standard was approved by the Securities and Exchange Commission on December 17, 2012, and is effective for audits of fiscal years beginning on or after December 15, 2012.

<sup>12</sup> The SAG discussed the audit committee communications standard at a number of its meetings, including meetings on: June 21-22, 2004; June 8, 2005; October 5-6, 2005; October 14-15, 2009; and July 15, 2010.

PCAOB's past outreach, materials, and educational efforts been valuable? How could these efforts be enhanced?

*Potential approaches to future outreach efforts*

3. What topics would be helpful to audit committees that the PCAOB should address in its outreach efforts?
4. One particular challenge in connection with any interaction between the PCAOB and audit committees is that, as noted above, the PCAOB is legally prohibited from providing certain types of firm-specific information to audit committees. Given this legal restriction, are there effective approaches to communication or particular discussion topics that would be useful to audit committees?
5. What methods would be helpful and effective for the Board to use to receive input from audit committees regarding audit quality measures and indicators that would be useful in their oversight of auditors?
6. The Board may wish to reach the largest number of audit committee members (perhaps best achieved through one-way communications, such as the publication of reports) but also maximize the two-way exchange of ideas between the Board and audit committee members (perhaps best accomplished through face-to-face meetings between the Board and small groups of audit committee members). How can the Board best balance these goals? What else should the Board consider in determining the appropriate format for its outreach efforts?
7. Should the Board find ways to work with audit committee members to facilitate enhanced communications and interactions with investors? What potential steps should the Board take to achieve this objective?