In brief

National Office

PCAOB proposes additional reporting by auditors

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At a glance

The PCAOB issued two proposals that would significantly expand public reporting by audit firms about their audits and audit practices. Firms that audit large accelerated filers and accelerated filers would be required to publicly report certain proposed metrics at the firm and engagement levels. Additional reporting on firm financial, governance, and network information, as well as more timely and expanded special reporting, including on cybersecurity matters, would also be required.

What happened?

On April 9, the PCAOB issued two proposals that would significantly expand public reporting by audit firms about their audits and audit practices: *Firm and Engagement Metrics* and *Firm Reporting*.

Within the proposals, the PCAOB cites feedback from its current and former Investor Advisory Groups, as well as responses to its 2015 Concept Release on Audit Quality Indicators and recommendations of the U.S. Department of Treasury's Advisory Committee on the Auditing Profession. This includes certain investors and investor-related groups' requests for greater audit firm transparency, which was also noted in response to the Board's proposed QC 1000, *A Firm's System of Quality Control*. The PCAOB also asserts that additional data and information about firms would assist investors in making informed decisions when exercising oversight of public companies, including whether to approve the ratification of the auditor and the election of audit committee members.

Firm and engagement metrics proposal

The PCAOB is proposing to require certain registered public accounting firms to publicly report specified metrics relating to their audits and audit practices. The PCAOB acknowledges that some firms already publicly disclose certain firm-level metrics through audit quality reports, transparency reports, or similar documents.[1] However, in the PCAOB's view, the current voluntary reporting regime does not provide consistent, comparable information on which stakeholders can rely to inform their decisions over time.

What specific metrics would be reported?

As described in the proposal, the PCAOB is proposing metrics in 11 areas. Unless specifically indicated, these metrics will be publicly disclosed at both the firm and individual engagement levels. The proposal provides additional details on how the metrics would be calculated, including whether they would convey information about the firm's entire audit practice or only its issuer engagements.

[1] PwC publishes its annual Audit Quality Report using transparency data points to provide stakeholders with information the firm believes is relevant in relation to audit quality.

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Topic	Proposed metric(s)
Partner and manager involvement	Hours worked by senior professionals relative to more junior staff across the firm's issuer engagements and on each engagement
Workload	Average weekly hours worked on a quarterly basis by engagement partners and by other partners, managers, and staff, including time attributable to engagements, administrative duties, and all other matters
Audit resources – use of auditor's specialists and shared service centers	• Percentage of issuer engagements that used specialists and shared service centers at the firm level • Hours provided by specialists and shared service centers for each engagement
Experience of audit personnel	Average number of years worked at a public accounting firm (whether or not PCAOB-registered) by senior professionals across the firm and on each engagement
Industry experience of audit personnel	Average years of experience of senior professionals in key industries audited by the firm at the firm level and the audited company's primary industry for each engagement
Retention and tenure	Continuity of senior professionals (through departures, reassignments, etc.) across the firm and for each engagement
Audit hours and risk areas (engagement level only)	Hours spent by senior professionals on significant risks, critical accounting policies, and critical accounting estimates relative to total audit hours for each engagement
Allocation of audit hours	Percentage of hours incurred prior to and following an issuer's year end across the firm's issuer engagements and for each engagement
Quality performance ratings and compensation (firm level only)	Relative changes in partner compensation (as a percentage of adjustment for the highest rated group) between groups of partners based on internal quality performance ratings
Audit firm internal monitoring	• Percentage of issuer engagements subject to internal monitoring and the percentage with engagement deficiencies at the firm level • Whether the engagement was selected for monitoring and, if so, whether there were engagement deficiencies and the nature of engagement deficiencies for each engagement
Restatement history (firm level only)	Restatements of financial statements and management reports on internal control over financial reporting (ICFR) that were audited by the firm over the past five years

For whom and how will this reporting be provided?

The proposed reporting requirements focus on situations where the Board believes additional perspective about the audit and the auditor would be most likely to inform investment and proxy voting decisions. Publicly available firm-level reporting would be required of every firm that audits at least one accelerated filer or large accelerated filer as defined by the SEC.

Engagement-level reporting would be required for every audit of an accelerated or large accelerated filer. This information would be made publicly available via an amended Form AP, retitled *Audit Participants and Metrics*, which is generally required to be filed within 35 days after the auditor's report is included in a document filed with the SEC.

"[The proposal] represents an overreach of regulatory power and stands to undermine competition in the audit marketplace as well as investor protection."

– Dissent of PCAOB Board member Christina Ho

Firm reporting proposal

The proposed changes include enhanced reporting of firm financial, governance, and network information; more timely and expanded special reporting; and reporting on cybersecurity, among other topics.

The PCAOB requests information from firms and routinely collects supplemental audit firm information through the inspection process (for example, select financial information and information on audit firm boards of directors). In addition to transparency benefits, the PCAOB stated that enhanced reporting requirements would facilitate its regulatory functions, and thus better inform its oversight activities to protect investors.

What information would be required?

The enhanced reporting would include:

Topic	Proposed reporting
Financial information	• Additional fee information for all registered firms • Confidential financial statements (for the largest registered firms)
Audit firm governance information	Additional information regarding the firm's leadership, legal structure, ownership, and other governance, including information that would govern a change in the form of the organization
Network information	A more detailed description of any network arrangement to which a registered firm is subject, including a description of the network legal and ownership structure, network-related financial obligations, information-sharing arrangements between the network and registered firm, and network governing boards or individuals to which the registered firm is accountable
Cybersecurity[2]	• Prompt confidential reporting of significant cybersecurity events • Periodic reporting of a brief description of the firm's policies and procedures, if any, to identify and manage cybersecurity risks
Material events[2]	Events that pose a material risk, or represent a material change, to the firm's organization, operations, liquidity or financial resources, or provision of audit services (confidential)
Update of firm's quality control policies and procedures for QC 1000	Assuming proposed QC 1000 is adopted by the Board and approved by the SEC, changes to firm policies and procedures made in response to the new quality control standard

The role of the audit committee in overseeing auditors

As explained in Section 10A(m) of the Securities Exchange Act of 1934, the audit committee of an issuer is directly responsible for the appointment, compensation, retention, and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report, and the independent auditor reports directly to the audit committee. In addition, in connection with these oversight responsibilities, the audit committee has ultimate authority to approve all audit engagement fees and terms. The PCAOB proposals suggest that making information available to an audit committee regarding both the specific audit and auditor it oversees as well as the audits and auditors of its peer companies would assist the audit committee in carrying out this statutory mandate.

[2] These disclosures are similar to what is required by the SEC for public companies.

The SEC has previously considered whether and how audit committees may be using information such as audit quality indicators or other metrics. In July 2015, the SEC issued a concept release, *Possible Revisions to Audit Committee Disclosures*, which sought public comment regarding the audit committee's reporting requirements. The concept release focused on the audit committee's reporting of its responsibilities and activities with respect to its oversight of the independent auditor. The SEC asked: (1) if audit quality indicators are used by the audit committee in the evaluation of the auditor, whether there should be disclosure about the indicators used, including the nature, timing, and extent of audit quality indicators considered by the audit committee, and (2) if audit quality indicators are not used by the audit committee in the evaluation of the auditor, whether any disclosures regarding the assessment of audit quality should be provided.

The SEC's concept release explained that the reporting of additional information by the audit committee with respect to its oversight of the auditor may provide useful information to investors as it evaluates the audit committee's performance, including in connection with their votes for or against directors who are members of the audit committee, the ratification of the auditor, or their investment decisions. However, as noted in the PCAOB's proposal, investor voting on a proposal to ratify the appointment of the audit firm is not statutorily required, and in many cases, the ratification vote is non-binding. The SEC's concept release, which has not been further acted upon, did not suggest that investors themselves would or should be responsible for directly evaluating the auditor's performance – this is ultimately the responsibility of the audit committee and the PCAOB through its inspection and enforcement regimes. The PCAOB did not evaluate how the proposed information might be used by investors to make investment decisions.

What's next?

The PCAOB seeks feedback from all stakeholders about both proposals, including whether the enhanced reporting would provide investors, audit committees, and other stakeholders with relevant information. The proposals also ask about the economic analysis.

In the proposals, the PCAOB stated that audit committees could benefit from having additional context when deciding whether to select or retain a firm and overseeing a firm's work. Accordingly, management and audit committees may have views on firm- and engagement-level metrics they currently receive from their auditors.

Comments on both proposals are due by June 7, 2024.

To have a deeper discussion, contact:

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