
STANDING ADVISORY GROUP MEETING

Effective Communications Between Auditors and Audit Committees

DECEMBER 1, 2016

As part of its mission to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the PCAOB is committed to constructive engagement and information sharing with audit committees in areas of common interest.

Both the auditor and the audit committee benefit from a meaningful exchange of information regarding significant risks of material misstatement in the financial statements and other matters that may affect the integrity of the company's financial reports. Communications between the auditor and the audit committee allow the audit committee to be well-informed about accounting and disclosure matters, including the auditor's evaluation of matters that are significant to the financial statements, and to be better able to carry out its oversight role. Communications with the audit committee provide auditors with a forum that is different from management's to discuss matters about the audit and the company's financial reporting process.

At the December 1, 2016 SAG meeting, a panel of SAG members will discuss effective communications between auditors and audit committees. The discussion is intended to further the dialogue on how auditors and audit committees communicate effectively. A panel consisting of audit committee chairs, audit partners, and a chief financial officer will discuss a broad range of topics, which may include, among others:

- How audit committees stay informed about current and emerging issues;
- Whether and how auditors are providing audit quality indicators to audit committees, and how audit committees are using them;
- Audit committee use of PCAOB inspection reports; and
- Frequency and depth of auditor communications with audit committees (e.g., use of executive sessions, nature of discussions between audit committee meetings).

After the panel presentations, SAG members will have the opportunity to discuss their views regarding the topic, including current communication practices between

This paper was developed by the staff of the Office of the Chief Auditor as of November 18, 2016 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.

auditors and audit committees and the PCAOB's role in promoting effective communications.

Background

Audit committees play a vital role in the capital markets' investor protection framework through their oversight of the audit engagement and their company's financial reporting process. The PCAOB has engaged audit committees in a variety of ways, including through:

- Issuance of AS No. 16, *Communications with Audit Committees*;
- Issuance of Board Release, *Information for Audit Committees about the PCAOB Inspection Process*
- Board member outreach to audit committees;
- SAG meetings;
- PCAOB's Audit Committee Dialogue;
- Board Reports and Staff Briefs on PCAOB Inspections;
- Concept Release on Audit Quality Indicators; and
- Information for Audit Committees webpage.

AS No. 16, which was adopted in August 2012, improves the audit by enhancing communications between auditors and audit committees. The standard establishes requirements that enhance the relevance, timeliness, and quality of the communications between the auditor and the audit committee. The enhanced relevance, timeliness, and quality of communications should facilitate audit committees' financial reporting oversight, fostering improved financial reporting, thereby benefitting investors.

In August 2012, the Board issued a release titled *Information for Audit Committees about the PCAOB Inspection Process*. The document was issued to assist audit committees in (1) understanding the PCAOB's inspections of their audit firms and (2) gathering useful information from their audit firms about those inspections.

PCAOB Board members conduct outreach with audit committees through participation in conferences for and meetings with audit committee members. Board members provide information about the work of the PCAOB, including inspections, standard setting, and international activities.

The SAG discussed auditor/audit committee communications at its May 2013 meeting. Among the topics discussed were the objectives of the Board's outreach efforts, the effectiveness of the Board's past outreach efforts, and potential approaches to future outreach efforts. Since then, the PCAOB has developed a number of publications of interest to audit committees and other stakeholders:

- *Publication of PCAOB's Audit Committee Dialogue.* In May 2015, the PCAOB published *Audit Committee Dialogue*, a digital outreach communication to audit committees. This *Dialogue* highlighted insights from PCAOB inspections and discussed recurring areas of concern and emerging risks related to increases in mergers and acquisitions, falling oil prices, undistributed foreign earnings, and maintaining audit quality while growing other business. The *Dialogue* also offered potential questions for audit committee members to ask their auditors.
- *Publication of the concept release on Audit Quality Indicators.* In July 2015, the Board issued a concept release titled *Audit Quality Indicators*. Audit quality indicators are a potential portfolio of quantitative measures that may provide new insights about how high quality audits are achieved. Taken together with qualitative context, the indicators may inform discussions among those concerned with the financial reporting and auditing process, for example between audit committees and audit firms. Enhanced discussions between audit committees and auditors, in turn, may strengthen audit planning, execution, and communication. The staff discussed comments on the concept release at the November 2015 SAG meeting. Many SAG members expressed that it is important for audit committees and auditors to discuss relevant audit quality indicators.

The PCAOB has issued several reports and staff briefs regarding inspections in 2016:

- *Staff Inspection Brief Detailing Scope and Objectives of 2016 Inspections of Auditors of Public Companies* (July 2016). This staff inspection brief notes, among other things, that the PCAOB continues to focus on public company audit areas where inspectors have found frequent and recurring deficiencies, such as auditing internal control over financial reporting, assessing and responding to risks of material misstatement, and auditing accounting estimates, including fair value measurements.
- *Report Describing Inspection Observations Related to Audit Firms' Communications with Audit Committees* (April 2016) – This general report notes that in most of the audits inspected during 2014 where the PCAOB auditing standard on *Communications with Audit Committees* was applicable,

Inspections staff identified no failures to comply with the requirements of the standard.

- *Staff Inspection Brief Previewing 2015 Inspection Findings* (April 2016) --In preliminary 2015 inspection results outlined in this staff inspection brief, the most frequent audit deficiencies continued to be in three key areas: auditing internal control over financial reporting; assessing and responding to risks of material misstatement; and auditing accounting estimates, including fair value measurements.

These documents and reports are available on the PCAOB's Information for Audit Committees web page. That web page also includes information regarding the Board's approved rules soon to become effective and recent standard-setting projects.¹

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The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

¹ See the PCAOB's *Information for Audit Committees* webpage at <https://pcaobus.org/Information/Pages/AuditCommitteeMembers.aspx>.