

September 29, 2015

VIA E-MAIL: comments@pcaobus.org

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

RE: PCAOB Rulemaking Docket Matter No. 041

Dear Members of the Board and Staff:

Dixon Hughes Goodman LLP (DHG) welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2015-005, *Concept Release on Audit Quality Indicators* (Concept Release). Headquartered in Charlotte, NC, DHG ranks among the top 20 public accounting firms in the nation, with more than 1,800 professionals and staff in 12 states, and is a member of Praxity, a global alliance of independent firms.

DHG acknowledges and supports the PCAOB's efforts in developing a balanced portfolio of audit quality indicators (AQIs) that could provide additional insights into evaluating the quality of audits, including perspectives on factors that may contribute to or detract from audit quality. We also commend the PCAOB for its thoughtful approach to developing the Concept Release, including its outreach efforts and consideration of other approaches¹ and those of regulators in other jurisdictions.²

This letter includes our views, observations, and recommendations on the Concept Release. Our responses are framed by our experiences serving middle-market public issuers and nonpublic broker-dealers, and includes our concerns regarding the potential implications certain AQIs could have on smaller to medium-sized accounting firms.

Overview

DHG believes AQIs can be most effective as drivers of audit quality when reporting is conducted on a voluntary basis between the auditor and the audit committee, and is focused primarily on engagement-level indicators, with firm-level information provided to add context or enhance understanding of engagement-specific matters. We believe this approach would promote a robust dialogue between the audit committee and the engagement team, which is critical to providing the context necessary to understand the potential significance and meaning of the indicators. Further, due to the nature and number of inputs that can impact the quality of an audit, no single metric should be viewed as having a causal relationship to audit quality. Therefore, a portfolio of AQIs should be balanced, working collectively to inform discussion, with no single, determinative indicator. The discussion of AQIs should also be an

¹ For example, *CAQ Approach to Audit Quality Indicators*, April 24, 2014.

² For example, the Financial Reporting Council, *The Audit Quality Framework*, February 28, 2008 and International Auditing and Assurance Standards Board, *A Framework for Audit Quality – Key Elements that Create an Environment for Audit Quality*, February 18, 2014.

iterative process that evolves over time, allowing for the adjustment of the portfolio of AQIs based upon information needs of the audit committee.

In addition, Appendix A includes general observations on certain proposed AQIs that we believe, taken together with qualitative context, may provide audit committees with additional transparency into the audit. We also include observations on certain proposed AQIs that we believe could have potential unintended consequences, particularly for smaller and medium-sized accounting firms.

Focus on Audit Committees

As public company audit committees have a statutory responsibility for appointing, compensating and overseeing the external auditor, we believe they are in the best position to evaluate AQI information. A balanced portfolio of AQIs, provided with appropriate context, could be useful in enhancing audit committees' understanding of matters that may contribute to the performance of a quality audit (e.g., better understanding the audit firm's policies, procedures, and processes related to its system of quality control), and potentially assist audit committees in discharging their statutory responsibilities. Additionally, AQIs may provide audit committees additional insight into the dynamics of the engagement team and may assist audit committees in better understanding the risks to audit quality.

Engagement-Level AQIs

DHG believes AQIs can be most effective as drivers of audit quality when discussions between the auditor and audit committee are primarily focused on engagement-level indicators. Further, certain firm-wide indicators, such as a discussion of the firm's leadership and tone at the top, could provide context and enhance understanding of engagement-specific matters. However, careful consideration should be taken in providing firm-level information, particularly as it relates to smaller and medium-sized accounting firms. For instance, due to the smaller portfolios of public issuers for many smaller and medium-sized accounting firms, providing firm-level information, in certain instances, may inadvertently result in providing information that is client-specific and possibly confidential.

Importance of Context

Due to their inherent complexities and limitations, quantitative AQIs (whether input or output measures) cannot adequately communicate and measure audit quality relative to any particular engagement or firm, and can only provide perspective on factors that may contribute to or detract from audit quality when accompanied by contextual narrative. For instance, comparability of data varies from engagement to engagement and, without context and additional discussion, this data may provide meaningless results or lead to misperceptions about audit quality.

Without context, including robust two-way dialog between the auditor and audit committee, AQIs (whether engagement or firm-level) could be misinterpreted, resulting in unintended consequences and misuse of the AQIs. Context is especially important for engagement-level AQIs because without it the information is insufficient for decision-making or comparative purposes.

Balanced Portfolio

Audit engagements are not commodities that are comparable on a like-kind basis; every audit engagement has unique characteristics based on the client's risks and uncertainties. Therefore, we do not believe there is a 'one-size-fits-all' approach to identifying and communicating a consistent portfolio of AQIs. Additionally, although an AQI may provide insight into a particular facet of an audit, it does not

provide a full-picture into the quality of an audit. Therefore, it is crucial that the portfolio of AQIs is balanced, working in concert, to inform discussion and limit any potential focus on one single indicator. Further, AQIs are not prescriptive, and should evolve over time, allowing audit committees flexibility in tailoring AQIs based upon matters they believe are most relevant to their audit.

Reporting of AQIs

DHG does not support mandatory public reporting of AQIs, as such reporting would lack critical background and context that is essential in understanding the value of the information. This could lead to significant stakeholder misinterpretations, which, in turn, would decrease the usefulness of the information. Further, a mandated and publicized set of AQIs could result in an overemphasis on managing to those indicators and possibly result in a checklist approach to evaluating the conditions of an audit. Alternatively, we believe a voluntary approach to discussing AQI information between auditors and audit committees would allow audit committees flexibility in determining when, and what, AQIs should be discussed based upon the audit committees' information and reporting needs.

Importance of Additional Study

DHG supports the PCAOB's endeavors in this area, and commends the PCAOB in recognizing the need for additional outreach and for planning to conduct additional stakeholder outreach through a public roundtable. However, additional experience and empirical evidence is necessary to truly understand and evaluate how a potential set of AQIs, or changes in AQIs over time, correlate to audit quality. We are aware the Center for Audit Quality (CAQ) has gained significant insights in this area, through its pilot-testing of the *CAQ Approach to Audit Quality Indicators*.³ We strongly encourage the PCAOB to consider these results; as well as consideration of its own formal pilot-testing program with audit firms and audit committees, prior to considering whether formal policy-making is needed.

* * * *

DHG is supportive of providing additional transparency into the audit and believes the discussion of AQIs can be most effective when conducted on a voluntary basis between the auditor and the audit committee, focused primarily on engagement-level indicators. We appreciate the opportunity to comment on the Concept Release and are pleased to discuss any questions the Board and its Staff may have concerning our comments. Please direct any questions to Dave Hinshaw, Managing Partner, Professional Standards Group at 704.367.7095 (dave.hinshaw@dhgllp.com) and Jeffrey Rapaglia, Partner, Professional Standards Group at 704.367.5914 (jeff.rapaglia@dhgllp.com).

Sincerely,

Dixon Hughes Goodman LLP

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³ See, *CAQ Approach to Audit Quality Indicators*, April 24, 2014.

Appendix A – Observations Related to Certain PCAOB Proposed AQIs

The following are general observations on certain AQIs proposed within the Concept Release. As mentioned, DHG supports voluntary discussions of certain AQIs at an engagement level with the audit committee, with firm-level detail provided to add additional context to the engagement-level AQIs. Further, while certain AQIs may assist audit committees in their oversight role, AQIs require context to be meaningful. Our comments below are based on these premises.

Audit Professionals

Availability

We support, and already provide, certain information related to staff leveraging and engagement team workloads to audit committees throughout the audit engagement. We believe these measures provide meaningful insight into an engagement team's (particularly senior team members) volume of audit responsibilities. However, context is important to limit the suggestion of an ideal workload average, and provide information on non-chargeable responsibilities of engagement team members. For instance, a partner may participate in internal (or external) task forces or have certain administrative responsibilities.

Further, we support providing contextual information related to an audit firm's technical accounting and auditing resources, and access to persons with specialized skills. However, we do not believe there should be quantitative information associated with these measures, as the manner in which such technical and specialized resources are accessed (employed or engaged) will vary between accounting firms, particularly smaller to medium-sized accounting firms. Additionally, providing quantitative measures may imply that such resources are needed on every engagement, as opposed to being based on the client's facts and circumstances (including an evaluation of the client's risk).

Competence

We support, and already provide, certain information regarding the experience level of engagement teams, including information related to an engagement team's industry experience, and relevant training. However, similar to the previous point, we do not believe there should be specific quantitative measures, due to the risk that such measures could imply an ideal state (e.g., a particular experience level or engagement staffing mix is indicative of audit quality) that could hinder the development of audit personnel, particularly as it relates to smaller and medium-sized accounting firms. For instance, many smaller and medium-sized accounting firms provide flexibility to audit professionals, allowing them to experience various industries and clientele, and providing quantitative measures in this area could hinder an audit professional's ability to develop expertise in new industries. Further, we do not believe turnover is an appropriate measure of audit quality, as it could be the result of a variety of circumstances (e.g., promotions, partner rotation requirements).

Focus

Audit hours and risk areas are discussed extensively with audit committees throughout the audit engagement. This includes a discussion of the overall audit approach, results of the risk assessment process, a summary of the significant risks identified through risk assessment, and planned testing based on those results. Therefore, there may be value in providing certain audit hours information by significant risk areas. However, we do not believe such information should be provided at a firm level, as risk areas will vary considerably between engagements.

Audit Process

Tone at the top and leadership

Surveys, if constructive (and executed) effectively to elicit feedback that is responsive to their objectives, may be relevant in evaluating certain elements of an audit firm's culture. However, surveys (that are provided without any context) can also subject to bias and misinterpretations. Therefore, a survey of firm's culture, and tone at the top, without contextual information provided through discussion, may not be a relevant indicator of audit quality. Alternatively, we support providing additional contextual information regarding an audit firm's leadership structure and how an audit firm emphasizes, through its tone at the top, adherence to professional standards, independence and objectivity, and how it holds itself accountable for the effectiveness of its system of quality control.

Audit fees, effort and client risk

Audit fees, effort, and client risks are discussed extensively with audit committees throughout the audit engagement. This includes discussion of changes in audit fees year-over-year, understanding audit timelines and phases, and providing context regarding the chargeable hours for partners and managers on the engagement. Therefore, we support expansion of discussions that would provide audit committees with additional insight into the audit process. However, we do not believe such information should be provided at a firm level, as engagement information differs considerably between clients, based on the varying complexity and nature of operations, and does not lend itself to direct comparability.

Infrastructure

We support providing narrative information to the audit committee regarding the audit firm's infrastructure investments in supporting audit quality. However, we do not support providing quantitative measures, due to the subjective interpretations amongst stakeholders of what is considered an infrastructure investment. In addition, such a measure may lack scalability due to structural differences between audit firms. For instance, in how audit firms access technical resources and specialized skills (e.g. employed or engaged).

Monitoring and Remediation

We believe there is value in discussing information related to internal quality reviews and PCAOB inspection results with the audit committee, and engagement teams already provide much of this information as part of the audit. However, careful consideration must be given in providing firm-level information, particularly as it relates to smaller and medium-sized accounting firms, as providing such information may inadvertently result in providing information that is client specific and possibly confidential.

Audit Results

Financial Statements

At an engagement level, issues related to restatements, material weaknesses, fraud, and other potential financial reporting misconduct are already discussed extensively with the audit committee. For instance, if there is evidence of a potential material weakness or restatement, the audit committee would be fully aware of the potential magnitude and impact of such matters, and these matters would be discussed extensively, in most instances supported by written documentation, between the auditor and audit committee throughout the audit.

However, we do not believe there is any value in providing similar information on a firm-level basis. For one, such information is subject to significant misinterpretation. For instance, *'restatements resulting from fraud or other financial reporting misconduct'* may have numerous interpretations depending on one's view of what constitutes financial reporting misconduct. We are also not aware of any data readily available that would allow this information to be accumulated without significant effort. In addition, similar to providing firm-level inspection and internal quality review information, due to the smaller portfolios of public issuers for many smaller and medium-sized accounting firms, providing firm-level information may inadvertently result in providing information that is client specific and possibly confidential.

Measures of Financial Reporting Quality

We appreciate the Board considering whether measures of financial reporting quality used by investment analysts, academics, and regulators can be used as measures of audit quality. However, we have significant concerns that the broad definition of such measures could result in misinterpretations, and may vary extensively depending on the engagement and audit committee's informational needs. We believe extensive study is needed (including pilot testing) to refine the definition and determine if these measures have any correlation to audit quality.

Going Concern

We appreciate the Board considering an indicator focusing on the timeliness of the auditor's use of a going concern paragraph in its opinions. However, this area is undergoing significant change. For instance, on August 27, 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which describes management's responsibilities regarding disclosure of uncertainties about an entity's ability to continue as a going concern. We are also aware that the staff is currently evaluating potential revisions to the existing PCAOB auditing standards in light of these recent changes in the accounting standards, and is developing a consultation paper that would seek stakeholder input on potential approaches to improving the performance and reporting requirements in the existing standard.⁴ Given these developments, we encourage the PCAOB to table consideration of this indicator until the Board completes its consideration of potential changes in the related auditing standards.

Enforcement and Litigation

Any information regarding finalized PCAOB and SEC enforcement proceedings (whether engagement or firm specific) is already available to the public, and discussed extensively with the audit committee. However, the small population associated with such proceedings can detract from their informational value. Private litigation is also riddled with class action filings that are without merit, often dismissed, and not indicative of failed audits. Further, if a case is settled, it may be a function of an audit firm minimizing defense costs, as opposed to being an indication of audit quality.

⁴ See, PCAOB Standard-Setting Agenda, June 30, 2015.