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A Summary of the May 15–16 Meeting of the PCAOB's Standing Advisory Group

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Introduction

At the May 15–16, 2013, PCAOB Standing Advisory Group (SAG) meeting, the PCAOB gave an update on recent developments, including an overview of its current and future standard-setting activities. In addition, the PCAOB and SAG discussed:¹

- Potential modifications and changes to future general reports.
- Enhancing outreach to audit committees.
- Potential audit quality indicators (AQIs).

The next SAG meeting is scheduled for November 13–14, 2013.

Recent PCAOB Developments

Chairman James Doty summarized recent PCAOB activities and policy initiatives that have been completed or are in progress, including:

- The issuance of [PCAOB Release 2013-002](#)² on March 26, 2013. (For more information on this release, see Deloitte's April 9, 2013, [Heads Up](#).)
- The issuance of [PCAOB Release 2013-004](#)³ on May 7, 2013. (For more information on this release, see Deloitte's June 21, 2013, [Heads Up](#).)⁴
- Gathering input on its [concept release](#)⁵ on auditor independence and audit firm rotation (see Deloitte's August 26, 2011, [Heads Up](#), for more information on the concept release) and related activities including the release of [PCAOB Staff Audit Practice Alert 10](#)⁶ on December 4, 2012. As indicated in the PCAOB's [standard-setting agenda](#) (discussed below), the PCAOB has not set a timeline for actions on this project but continues to consider next steps and to monitor developments in Europe related to similar topics.

¹ The SAG meeting included PCAOB presentations as well as nonpublic breakout sessions on May 15. The PCAOB staff presented a summary of the nonpublic breakout discussions to the entire SAG on May 16.

² PCAOB Release No. 2013-002, *Proposed Framework for Reorganization of PCAOB Auditing Standards; and Related Amendments to PCAOB Auditing Standards and Rules*.

³ PCAOB Release No. 2013-004, *Proposed Auditing Standard — Related Parties; Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions; and Other Proposed Amendments to PCAOB Auditing Standards*.

⁴ Deputy Chief Auditor Greg Scates, Associate Chief Auditor Brian Degano, and Assistant Chief Auditor Nicolas Grillo provided a summary of the reproposal on related parties and other amendments, including those related to unusual transactions and the auditor's consideration of executive compensation.

⁵ PCAOB Release No. 2011-006, *Concept Release on Auditor Independence and Audit Firm Rotation; Notice of Roundtable*.

⁶ PCAOB Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits*.

Chairman Doty discussed near-term PCAOB priorities.

- Increasing transparency by requiring public disclosure of the name of the engagement partner. (See the “Standard-Setting Agenda” section below for the timing of the next expected action.)
- Modification of the auditor reporting model to increase the utility of the audit report for users. (See the “Standard-Setting Agenda” section below for the timing of the next expected action.)
- Continued efforts to develop cross-border arrangements for the PCAOB to conduct joint inspections outside the United States. Chairman Doty specifically mentioned the PCAOB’s efforts to reach an agreement with Chinese authorities to inspect PCAOB registered firms in Mainland China and Hong Kong. Subsequently, on May 24, 2013, the PCAOB announced that it had entered into a [Memorandum of Understanding](#) (MoU) on enforcement cooperation with the China Securities Regulatory Commission and the Ministry of Finance.⁷ Although an MoU regarding inspections has not yet been reached, Chairman Doty indicated in the [press release](#) that he is expecting continued progress.
- The PCAOB’s interest in furthering relationships with audit oversight counterparts outside the United States. In this regard, PCAOB board member Lewis Ferguson was elected chairman of the International Forum of Independent Audit Regulators (IFIAR)⁸ during the organization’s plenary meeting held in the Netherlands on April 15–17, 2013. Mr. Ferguson, who was the vice chairman of the organization, will serve a two-year term that expires in April 2015. PCAOB board member Steven Harris continues to chair the IFIAR’s Investor Working Group.
- Chairman Doty also mentioned the following near-term priorities or initiatives:
 - The PCAOB’s continued focus on global network firm inspections.
 - Standard-setting activities focused on applicability to and costs for emerging growth companies (EGCs).
 - Deepening inspection analysis and reporting on results.
 - Furthering audit committee outreach.
 - The development of AQIs that can be tracked over time and across the profession and global firms.
 - The continuation of the broker-dealer interim inspection program into next year.

Standard-Setting Agenda

Chief Auditor and Director of Professional Standards Martin Baumann provided an update on the PCAOB’s various standard-setting activities and reviewed its standard-setting agenda. Regarding the PCAOB’s standard-setting approach, Mr. Baumann stated that the “goal in the Office of Chief Auditor is continuous improvement in audit quality through continually improving audit standards.”

Mr. Baumann emphasized that the JOBS Act⁹ continues to affect standard-setting activities. He explained that while the Board’s rulemaking process has always involved certain elements of economic analysis, the JOBS Act now requires the SEC to perform a specific economic analysis when considering whether PCAOB rules should apply to EGCs (see Deloitte’s April 2, 2012 (updated May 8, 2012), [Heads Up](#) for more information). The PCAOB has hired an economic advisor to the Office of the Chief Auditor, who will assist in this analysis.

⁷ The MoU establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in both countries’ respective jurisdictions. More specifically, it provides a mechanism for the parties to request and receive from each other assistance in obtaining documents and information in furtherance of their investigative duties.

⁸ IFIAR was established in 2006 and concentrates on sharing knowledge and experiences of auditor oversight bodies, focusing on inspections, promoting collaboration, and providing a platform for dialogue.

⁹ The Jumpstart Our Business Startups Act.

In developing its proposal related to the auditor's reporting model, the PCAOB has been following the IAASB's project on the same topic.

Before reviewing the agenda, Mr. Baumann discussed the importance of the public comment period to the standard-setting process and emphasized that his office welcomes empirical evidence on the estimated costs to implement new standards.

According to its updated agenda, the PCAOB expects to take action on the following projects:

Project	Action
Action Expected Between April 2013 and September 2013	
Auditor's Reporting Model	Proposal
Auditor's Responsibilities With Respect to Other Accounting Firms, Individual Accountants, and Specialists	Proposal
Audit Transparency: Identification of the Engagement Partner	Adoption or reproposal
Possible Action Between April 2013 and September 2013 (Timing Dependent on Third Parties)	
Audits of Brokers and Dealers ¹⁰	Adoption or reproposal
Going Concern ¹¹	Proposal
Other Active Projects (No Timetable)	
Audit Transparency: Identification of Other Public Accounting Firms or Persons Not Employed by the Auditor	Adoption or reproposal
Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities	Concept release
Auditing Accounting Estimates, Including Fair Value Measurements and Related Disclosures	Proposal
Auditor Independence and Audit Firm Rotation	Next steps under consideration
Confirmation	Reproposal
Subsequent Events	Proposal

Editor's Note: The PCAOB's most significant near-term project is related to the auditor's reporting model. The Board expects to issue a proposed standard on this topic in July or August of 2013. In developing the proposal, the PCAOB has been following the International Auditing and Assurance Standards Board's (IAASB's) project on the same topic. Arnold Schilder, chairman of the IAASB and an observer to the SAG, provided an update on the [IAASB project](#) during the SAG meeting. Chairman Schilder stated that he expects the IAASB to issue an exposure draft for public comment shortly after its June 2013 meeting. He also noted that the PCAOB and IAASB have collaborated extensively on this effort by "applying conscious parallelism." Chairman Schilder noted that the IAASB's proposal will focus on adding a discussion of "key audit matters" addressed in the audit (for audits of public interest entities). Such discussion of "key audit matters" will likely include (1) the most significant aspects of the audit, (2) the auditor's responses, and (3) when applicable, references to the relevant amounts and disclosures in the financial statements.

¹⁰ The timing of this project depends on the SEC's adoption of amendments to Rule 17a-5.

¹¹ The timing of this project depends on the timing of the FASB's going-concern project. Lawrence Smith, FASB board member, noted at the SAG meeting that an exposure draft is expected to be issued in June 2013. Mr. Baumann stated that the PCAOB intends to time the release of a proposed standard shortly after the FASB releases its exposure draft.

Ms. Munter discussed the Board's interest in identifying ways to communicate information obtained through its inspections to the public in a more meaningful way.

Board's General Reports

Helen Munter, director, Division of Registration and Inspections, and Santina Rocca, deputy director, Division of Registration and Inspections, presented an overview of the Board's project to improve the usefulness of its [general reports](#)¹² (including "Rule 4010" reports¹³). Ms. Munter discussed the Board's interest in identifying ways to communicate information obtained through its inspections to the public in a more meaningful way. General reports are currently the PCAOB's primary medium for communicating audit quality issues that broadly affect the profession.

Ms. Munter introduced the discussion by citing some statistics on inspections:

- Currently, there are roughly 2,400 registered firms.
- Over the last 10 years, a portion of nearly 9,000 audits have been inspected and close to 2,000 inspection reports have been issued.
- Each year, the Division of Registration and Inspections issues roughly 200 inspection reports to registered firms.

To solicit feedback on the project to improve the usefulness of the Board's general reports, the Board held a nonpublic breakout session during which SAG members were asked to provide input on the following questions:

- What type of information about inspection findings and observations would be useful for the Board to publish in its general reports, and for which constituencies (e.g., audit committees, investors, audit professionals, academics, and other regulators)?
- What format for general reports is useful? For example, should the Board consider adopting formats that are similar to those used by other regulators around the world (e.g., the UK's Financial Reporting Council, the Australian Securities & Investments Commission, and the Canadian Public Accountability Board)?
- Have past reports been useful, and what can be done to make them more useful?
- What topics should be addressed in future reports, and should such topics be narrow or broad in scope?

Ms. Munter emphasized that the PCAOB will first seek input on general reports and then initiate activities to improve them.

On the second day of the SAG meeting, the PCAOB staff summarized the input received during the breakout session and noted that SAG members:

- Generally supported the PCAOB's efforts and believed that the general reports are a useful tool for the public.
- When asked about information that should be in general reports, emphasized the need for a balance between success and deficiency trends and suggested that general reports discuss how audit quality has improved.
- Indicated that general reports should include actionable items that auditors can put into practice.
- Commented that the timeliness of the reports is critical to the reports' usefulness and that providing a report immediately after an inspection season and before the next audit busy season would allow professionals to address observations before the next audit is completed.

¹² The PCAOB staff's [briefing paper](#) on future general reports states, "General reports often discuss observations from the inspection program in a way that is intended to be informative and helpful to auditors. These reports also give investors, audit committees, and others the benefit of information and analysis concerning highlighted audit issues, or a summary and analysis of results from inspections of a specified category of firms over a particular period." Unlike inspection reports, general reports are not firm-specific.

¹³ PCAOB Rule 4010, *Board Public Reports*, permits the Board to "at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate."

The Board is considering whether additional outreach to audit committees would be mutually beneficial.

- Suggested that the PCAOB establish a specific schedule for issuing general reports and perhaps publish an annual report similar to that issued by other regulators around the world. Other members suggested that issuing “flash reports” on specific topics would be an efficient and timely means of disseminating information.
- Recommended that the PCAOB consider:
 - Creating additional reports geared toward specific audiences, such as audit committees or investors, yet still maintain general reports for the broader public. Alternatively, they suggested that sections in a report could be targeted to specific audiences.
 - Writing the reports in more simplistic language and in a more readable format, and including an executive summary, to provide more utility to users.
 - Focusing on industry, issuer size, and environmental and economic factors.
 - Distributing the reports by using other channels, such as professional organizations, webcasts, press conferences, and technology applications.

In wrapping up the session, Ms. Munter mentioned that she plans to continue outreach efforts on this topic. In addition, she noted that “Rule 4010” reports on the implementation of recent PCAOB auditing standards are scheduled for release this year.

Audit Committee Outreach

PCAOB board members Jeanette Franzel and Jay Hanson led a discussion on audit committee outreach efforts. The Board is considering whether additional outreach efforts would be mutually beneficial and better enable audit committees and the PCAOB to carry out their respective oversight roles. Ms. Franzel provided an overview of the Board’s objectives regarding its outreach efforts. The PCAOB staff’s [briefing paper](#) on audit committee outreach indicates that such objectives include the following:

- 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.

SAG members were asked to provide feedback on the following topics:

- Objectives of the Board’s outreach efforts (mentioned above).
- Effectiveness of the Board’s past outreach efforts, such as:
 - [PCAOB Release 2012-003](#).¹⁴
 - Discussions with major audit committees regarding input on outreach.
 - Forums on auditing in the small business environment, which have been held since 2004.
 - Public statements and speeches by PCAOB board members.
- Potential approaches to future outreach efforts.

¹⁴ PCAOB Release No. 2012-003, *Information for Audit Committees About the PCAOB Inspection Process*.

The Board sought feedback from the SAG to assess whether AQIs would be helpful and whether the project should be pursued.

Before they opened the discussion, Ms. Franzel and Mr. Hanson asked SAG members to raise their hands if they directionally agreed with the PCAOB's effort to increase audit committee outreach. The majority of SAG members indicated their support for the effort. During the discussion, SAG members also expressed the following views:

- The PCAOB should continue its efforts to help audit committees understand the PCAOB's role in audit quality and provide additional information to support audit committees.
- Collaboration with other professional organizations, such as the National Association of Corporate Directors, is a good way to reach audit committees. In addition, the PCAOB should consider mirroring the National Compliance Outreach Program for Broker-Dealers.¹⁵
- The PCAOB should consider leveraging auditors to conduct outreach to audit committees and continue to encourage a two-way dialogue between auditors and audit committees.
- Publications such as PCAOB Release 2012-003 are useful in explaining the PCAOB's role, perspective, or rationale and in providing actionable steps for audit committees. Additional publications written for audit committees would be well-received.
- The PCAOB inspection staff should consider holding more discussions with audit committees during inspections, which would increase its presence with audit committees and increase audit committees' understanding of the inspection process.

Audit Quality Indicators

Greg Jonas, director in the Office of Research and Analysis, George Wilfert, deputy director Office of Research and Analysis, Andres Vinelli, deputy director and chief economist, and Tim Gustafson, associate director of policy support provided an overview of the AQIs project and its expected outcomes. Mr. Jonas stated that the PCAOB believes that AQIs may ultimately be "a package of indicators (say 15 or so) that are indicative of audit quality and that could be useful for decision making." He emphasized that the PCAOB has yet to deliberate any conclusions on AQIs and explained that the Board is seeking feedback from the SAG to assess whether AQIs would be helpful and whether the project should be pursued. The PCAOB staff's [discussion paper](#) on AQIs outlines near-term (2013) goals for the project, which include the following:

- Survey existing studies on AQI[s] and engage with constituents who are currently studying or implementing AQIs;
- Develop initial views about a definition of audit quality, a framework for thinking about audit quality, and examples of AQIs;
- Seek input on initial views from . . . thought-leaders. Adjust the tentative thinking based on that input; and,
- If revised views on audit quality and AQI[s] offer sufficient promise, expose initial views for public comment.

The PCAOB designed four separate, nonpublic breakout sessions, which were attended by SAG members from diverse backgrounds (e.g., audit professionals, academics, audit committee members, investor groups). SAG members were asked to complete an "Audit Quality Indicators Feedback Form" before the meeting and to further refine their survey responses during the breakout sessions. The survey asked SAG members to (1) provide input on the usefulness of the 40 AQIs listed in the discussion paper (see [Appendix](#)), (2) supply any additional recommendations for AQIs not listed by the PCAOB, and (3) provide their thoughts on the potential framework and the definition of audit quality.

¹⁵ Sponsored jointly by the Financial Industry Regulatory Authority and the SEC's Office of Compliance Inspections and Examinations (in coordination with the SEC's Division of Trading and Markets), the National Compliance Outreach Program for Broker-Dealers is designed to help risk, audit, and compliance officers promote strong compliance practices for investor protection. See the [SEC's Web site](#) for additional information.

SAG members are generally supportive of the PCAOB's efforts in developing AQIs.

On the second day of the SAG meeting, Mr. Wilfert summarized the feedback received during the breakout sessions and from the surveys, which included the following:

- SAG members are generally supportive of the PCAOB's efforts in developing AQIs.
- Highlights about the dozen metrics that were the most supported and the dozen that were the least supported by SAG members (of the 40 metrics presented in the discussion paper).
- The PCAOB's suggested definition for audit quality¹⁶ was considered directionally correct, but SAG members suggested that it should incorporate language on compliance with standards.
- The audit quality [framework](#) presented in the AQIs discussion paper should be simplified to improve its understandability and usability.
- When determining which unit of measurement is most appropriate for an AQI, the nature of the AQI should dictate the unit of measurement, and cost-benefit analysis should be applied.
- More context is needed for each AQI for stakeholders to properly understand and interpret metrics.
- SAG members cautioned the Board to remain mindful of unintended consequences (e.g., potential misinterpretation of what a particular AQI means).
- SAG members suggested 27 additional possible AQIs.

Editor's Note: The PCAOB announced at the meeting that the input received (including the details of which metrics were most supported and which were least supported, as well as the detailed results of the survey exercise) was confidential and would therefore remain nonpublic for the time being. The Board further explained that typical PCAOB rulemaking processes would be followed if the PCAOB decides to pursue a rule-making effort on this topic.

To wrap up the session, Mr. Jonas noted that on the basis of the feedback, the project to develop AQIs is worth pursuing and that the project team and the Board will consider next steps.

¹⁶ The AQI [discussion paper](#) notes that the PCAOB defines audit quality as "meeting investors' needs for independent and reliable audits and robust audit committee communications on" (1) "financial statements, including related disclosures"; (2) "assurance about internal control"; and (3) "going concern warnings." Before the SAG meeting, the CAQ provided a [comment letter](#) to the PCAOB that contained its additional thoughts on factors that should be considered in the definition of audit quality.

Appendix — Possible Audit Quality Indicators and PCAOB Staff Descriptions

The table below is adapted from the PCAOB staff's [discussion paper](#) on AQIs. It defines and describes the staff's views on potential AQIs related to operational inputs, processes, and results.

Operational Inputs (People)		
Metric	PCAOB Staff Description	
1. Ratio of partners to staff	Measures the number of staff managed per partner. If partners have excessive responsibility for the oversight of staff, they may not have sufficient time to execute and/or supervise and review appropriate audit procedures, thereby possibly affecting audit quality.	
2. Partner and staff utilization percentages/workloads	Measures the number of hours that partners and staff work beyond a customary workload. If partners and staff have excessive workloads, they may not have sufficient time to execute and/or supervise and review appropriate audit procedures, thereby possibly affecting audit quality.	
3. Chargeable hours per professional	Measures the number of hours that partners and staff devote to client responsibilities. If partners and staff have excessive client responsibilities, they may not have sufficient time to execute and/or supervise and review appropriate audit procedures, thereby possibly affecting audit quality.	
4. Excessive turnover and transfers of audit personnel	Measures the amount of turnover and transfers of audit personnel. While some attrition is expected, an excessive amount of audit staff turnover may adversely affect audit quality.	
5. Average years of experience/headcount composition	Measures the average years of experience of audit professionals, as well as the headcount composition (i.e., number and percentage of associates, senior associates, managers, senior managers, and partners). Such an indicator could possibly provide a method into objectively evaluating the knowledge and competency of an engagement team, an office, and/or a firm, and its effect on audit quality.	
6. Industry expertise and proficiency	Measures an audit professional's knowledge within a particular industry. This particular measure could examine the substance and amount of specific industry training received by an audit professional and/or the years of experience devoted to a particular industry by an audit professional. Academic research in the area of auditor industry experience has been found to be positively related to the quality of audits.	
7. Training hours per audit professional	Measures the amount of formal training hours received by each audit professional. Sufficient formal training on accounting and auditing topics is important so that audit professionals are equipped with the requisite skills and knowledge to execute a quality audit.	
8. Number of accounting and auditing consultations	Measures the number of accounting and auditing consultations at the engagement, office, and/or firm level. While such a measure is typically dependent on an individual engagement's degree of difficulty, a higher number of consultations may indicate a firm is actively promoting consultation and collaboration with others for the benefit of audit quality.	
9. Percentage of work outsources to service centers	Measures the percentage of work, in terms of total audit hours, that is outsourced to service centers. Over the past several years, large public accounting firms have begun using offshore entities to perform certain audit procedures for US-based clients. While limited academic research has highlighted both advantages and disadvantages of outsourced work, it may have an effect on audit quality.	
10. Technical resource FTEs	Measures the number of full-time equivalent ("FTE") audit professionals devoted to serving as technical resources. This measurement can be useful for understanding whether a firm sufficiently promotes consultation and collaboration with others, and its overall commitment to a competent and quality audit.	
11. Specialist hours as a percentage of overall engagement hours	Measures the percentage of specialist hours as a percentage of overall engagement hours. This measurement can be useful for understanding whether a firm sufficiently promotes consultation and collaboration with others for the benefit of audit quality.	

Operational Inputs (People)		
Metric	PCAOB Staff Description	
12.	Fly-in partners and managers involved in the audit	Measures the proximity of partners and managers to others involved in the audit. If partners and managers are geographically removed from a particular client, they may not have a sufficient presence to supervise and review appropriate audit procedures, thereby possibly affecting audit quality.
13.	Partner, manager, engagement quality reviewer hours and timing relative to total audit effort	Captures the relative involvement, as measured by hours and the timing of these hours, that a partner, manager, and engagement quality reviewer represent in comparison to total audit hours. If partners, managers, and engagement quality reviewers have excessive workloads, they may not devote sufficient time to execute and/or supervise and review appropriate audit procedures for a particular issuer audit, thereby possibly affecting audit quality.
Processes		
Metric	PCAOB Staff Description	
1.	Number and substance of firm leadership communications on audit quality and investors’ interests	Communicating a firm’s commitment to quality, integrity, objectivity, independence, professional skepticism, and public accountability is important. A measure could be developed to track the number and substance of a firm’s leadership communications on audit quality and investors’ interests that could give insight into a firm’s tone at the top and its overall commitment to audit quality.
2.	Anonymous survey of firm personnel about the firm’s tone at the top, hiring success, training, supervision, and to what extent a firm rewards standing up to client pressure	Consider developing an anonymous survey that could be randomly sent to various firm personnel at different levels. The survey could solicit both objective and subjective insights by asking participants to rank and comment about their particular firm’s tone at the top, hiring process, training, supervision, and to what extent a firm rewards standing up to client pressure. Objective results of the survey could be useful for making comparisons amongst firms and evaluating any correlations with audit quality.
3.	Metrics related to independence, testing, and compliance	Consider developing metrics to measure compliance with independence rules and standards. Such metrics may be helpful in assessing a firm’s overall commitment to maintaining independence and its possible effect on audit quality.
4.	Nature and quantity of firm proposals and marketing materials with respect to audit quality and independence	Commercial considerations can sometimes influence audit performance. While marketing is key to any successful business, a firm’s assurance marketing materials could be examined for language that may be at odds with audit quality and independence (e.g., “trusted business partner,” etc.)
5.	Number and nature of internal quality review findings	The number and nature of findings identified through a firm’s internal quality review program may be an indicator of audit quality. This indicator, over time, may provide comparative information to assess the direction of a firm’s efforts toward improving audit quality. Additionally, having many internal findings, along with appropriate remediation, might indicate a thorough approach to internal quality review at a firm.
6.	Number and nature of PCAOB inspection findings	The number and nature of findings identified through PCAOB inspections may be an indicator of audit quality. This indicator, over time, may provide comparative information to assess the direction of a firm’s efforts toward improving audit quality.
7.	Average compensation at partner and manager level to ensure adequate financial incentive and resources	Average compensation at the partner and manager level could serve as a useful data point that could be assessed for possible correlations with audit quality. Partners and managers that are well-compensated through strong financial incentives may be more apt to raise issues on a particular audit, thereby possibly improving audit quality.
8.	Compensation trends of prematurely-rotated partners	Prematurely-rotated partners are those partners that are requested to be removed by a client, its audit committee, and/or the firm’s leadership. Depending on the reason for removal, tracking such compensation trends for these partners could be helpful in assessing a firm’s commitment to audit quality.
9.	Relative emphasis on technical competence and fortitude in the partner and manager evaluation and compensation processes	The relative emphasis on technical competence and fortitude in the partner and manager evaluation and compensation process could serve as a useful data point that could be assessed for possible correlations with audit quality. Partners and managers that are incentivized for technical competence and fortitude may be more apt to raise issues on a particular audit, thereby possibly improving audit quality.

Processes	
Metric	PCAOB Staff Description
10. Credentials of new hires and recruiting: academic achievement; best companies to work for rankings; compensation levels	Credentials of new hires could be measured in terms of the number of accounting and/or auditing units completed at the undergraduate and graduate level. Compensation levels and whether a firm is included in best companies to work for rankings could both serve as useful data points that could be assessed for possible correlations with a firm's ability to attract and retain top talent, which may have a positive correlation with audit quality.
11. Technical competency testing	Technical competency is an important factor in audit quality. Consider creating a uniform and standardized audit test that partners and staff of each firm may be required to take on a periodic basis. Results from this test could be useful in assessing and refining a firm's audit quality initiatives.
12. Leverage ratio of audit staff to partners	Measures the ratio of audit staff to partners. A higher ratio may indicate partners have excessive responsibility for the oversight of staff, which may indicate insufficient time to execute and/or supervise and review appropriate audit procedures, thereby possibly affecting audit quality.
13. Number and size of auditor resignations	Measures the number and substance of auditor resignations, which may provide insight into a firm's judgment around the quality of its issuer portfolio. In addition, such an indicator may demonstrate a firm's fortitude and how much emphasis it places on audit quality rather than commercial considerations.
14. Percentage of client assessed as high risk	Measures the overall percentage of a firm's clients that were determined to be high risk, which may provide insight into a firm's judgment around the quality of its issuer portfolio. Such an indicator may demonstrate the degree of emphasis a firm places on commercial considerations as compared to audit quality.
15. Level of firm investment in infrastructure supporting quality auditing	Measures the amount of spending earmarked toward areas such as technology and systems, training and guidance, audit methodology and risk management tools, and technical consulting resources. A firm's conscientious investment in such infrastructure should theoretically help to improve audit quality.
Results	
Metric	PCAOB Staff Description
1. Frequency and market impact of financial statement restatements for errors	<p>Restatements that correct misstatements are a relatively solid indicator of audit quality. Restatement measures of interest might be the frequency of restatements, length of restated periods, and materiality of restatements (restatements due to changes in accounting principles would be excluded).</p> <p>Frequency of restatements may indicate problems with audit quality; however, a user of financial statements needs to be aware of other factors that may affect the interpretation of this indicator such as the complexity of financial statements, among many other factors. Length of restated periods, as well as the materiality of restatements, indicates how promptly misstatements are uncovered and corrected.</p> <p>Restatement materiality can both be measured and evaluated in terms of the magnitude of the restatement (often measured by the effect on the issuer income) and the market reaction. The staff believes that the market reaction of restatements is a more relevant factor to objectively measure materiality.</p>
2. Number and percentage of unqualified ICFR opinions with material errors in the following year	Measures the number and percentage of unqualified ICFR opinions with material errors reported in the following year. The failure of an auditor to timely identify material weaknesses prior to a restatement may suggest poor audit quality.
3. Number of material weaknesses cited in conjunction with material errors	Measures the number of material weaknesses cited in conjunction with material errors. The number and nature of material weaknesses pertaining to ICFR identified by the auditor prior to a restatement may not only be an indicator of a quality audit, but also may indicate future financial reporting problems for the issuer.

Results		
Metric	PCAOB Staff Description	
4. Number of audit reports including a going concern opinion which did not have a subsequent bankruptcy	The auditor is required to evaluate the ability of the company to continue as a going concern for the next 12-month period. To relate this measure to audit quality and the ability of the auditor to predict the financial situation of the issuer, it needs to be cross-referenced with subsequent performance (e.g., bankruptcies). This indicator could help in identifying instances of an auditor who provided an inappropriate going concern warning to investors.	
5. Number of audit reports lacking a going concern opinion which had a subsequent bankruptcy	The auditor is required to evaluate the ability of the company to continue as a going concern for the next 12-month period. To relate this measure to audit quality and the ability of the auditor to predict the financial situation of the issuer, it needs to be cross-referenced with subsequent performance (e.g., bankruptcies). When evaluating whether a Type II error occurred (i.e., the auditor did not issue a going concern opinion and the issuer subsequently declared bankruptcy), consideration should be given as to whether the bankruptcy was realistically predictable.	
6. Surveys of audit committees about the quality of communications from the auditor	Consider administering a survey of audit committee members. The survey could solicit both objective and subjective insights by requesting participants to rank and comment about their particular auditor's quality of communications. Objective results of the survey could be useful for making comparisons amongst firms and evaluating any correlations with audit quality.	
7. Trends in practice protection costs	A firm that is more frequently sued may incur greater costs defending itself against litigation. Trends in practice protection costs may therefore provide insightful quantitative information about a firm's general state of audit quality.	
8. Trends in frequency, magnitude, and results of litigation against auditors	Trends in the frequency, magnitude, and results of litigation against auditors may provide objective and quantitative information about the risk profile of a firm's issuer portfolio. These trends may also serve to highlight the direction of a firm's audit quality initiatives.	
9. Frequency, nature, and market impact of reported frauds	Trends in the frequency, nature, and market impact of reported frauds may provide insights into the risk profile of a firm's issuer portfolio and/or its consideration of fraud in an audit. Trends in frauds identified by the auditor may also offer evidence of the firm's commitment to audit quality.	
10. Number and nature of internal quality review findings	The number and nature of findings identified through a firm's internal quality review may be an indicator of audit quality. This indicator, over time, may provide comparative information to assess the direction of a firm's efforts toward improving audit quality. Additionally, having many internal findings, along with appropriate remediation, might indicate a thorough approach to internal quality review at a firm.	
11. Number and nature of PCAOB inspection findings	The number and nature of findings identified through PCAOB inspections may be an indicator of audit quality. This indicator, over time, may provide comparative information to assess the direction of a firm's efforts toward improving audit quality.	
12. Trends in PCAOB and SEC enforcement actions	The PCAOB has authority to investigate and discipline registered public accounting firms and persons associated with those firms for noncompliance with the Sarbanes-Oxley Act of 2002, the rules of the PCAOB and the Securities and Exchange Commission, and other laws, rules, and professional standards governing the audits of public companies, brokers, and dealers. When violations are found, the PCAOB can impose appropriate sanctions. Trends in PCAOB and SEC enforcement actions against a particular firm may help to underscore either improvements and/or deterioration in its audit quality.	

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