

The Public Company Accounting Oversight Board's (PCAOB)

Investor Advisory Working Group

Progress and Update Report

on

Advisory Committee on Accounting Profession's Recommendations

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Advisory Committee on the Auditing Profession: Update and Progress on Recommendations

Section I: Overview and Summary

In May 2007, Secretary of the Treasury, Henry M. Paulson announced the Department of Treasury was establishing the Advisory Committee on the Auditing Profession (ACAP or the Committee) to consider and develop recommendations relating to the sustainability of the auditing profession. The ACAP held its initial meeting in October 2007. The Advisory Committee was comprised of 21 members. The members included a former Federal Reserve Chairman, a former Securities and Exchange Commission (SEC) Chairman, former SEC Chief Accountants, attorneys, auditors, corporate board members, businesspersons, and representatives of investors.

The ACAP held numerous meetings and public hearings during 2007 and 2008. ACAP considered both, oral and written submissions in its deliberations. It published and exposed a draft report for comments. On October 6, 2008, the ACAP issued its final report and recommendations. Those recommendations were directed to various organizations: the SEC, the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA), the American Accounting Association (AAA), and the National Association of State Boards of Accountancy (NASBA).

The charge of our Working Group was to document and provide commentary on the degree of progress made to date on each of the ACAP recommendations contained in its Final Report issued on October 6, 2008. The Committee offered thirty-one recommendations in three key areas: (1) Human Capital, (2) Firm Structure and Finances, and (3) Concentration and Competition. To deliver on its mandate, our Working Group adopted a two-pronged approach to gather information. One, we conducted our own research from publicly available sources¹. Two, we sent letters to the following organizations soliciting their response to document the progress that each has made on recommendations applicable to them.

- Mr. Ken Bishop, President and Chief Executive Officer, National Association of State Boards of Accountancy, June 27, 2016. Response received on September 12, 2016.
- Mr. James Doty, Chairman, Public Company Accounting Oversight Board, June 27, 2016. Response Received on September 16, 2016.
- Honorable Jacob J. Lew, Secretary of the Treasury, United States Department of Treasury, August 15, 2016.
- Mr. Barry C. Melancon, President and Chief Executive Officer, American Institute of Certified Public Accountants, June 27, 2016, Response received on September 27, 2016.
- Ms. Tracey Sutherland, Executive Director, American Accounting Association, June 27, 2016. Response received on September 16, 2016.
- Ms. Mary Jo White, Chair, U.S. Securities and Exchange Commission, June 27, 2016. Response received on October 13, 2016.








As of October 21, 2016, the Working Group received response from each of the above organizations with the exception of the U.S. Treasury Department. The Working Group appreciates the input it has received from each of the organizations. Appendix 1 includes copies of the original response letters received by the Working Group.²

¹ We thank Ms. Meredith Tate, a Lehigh University MS in accounting student, for her research help in researching information on the implementation of each recommendation from publicly available sources.









² The American Accounting Association provided a number of published reports from the Pathways Commission and other summaries of links etc. that are not included in this appendix as these are publicly available from the Pathways Commission website: <http://commons.aaahq.org/groups/2d690969a3/summary>








In the course of their deliberations, the ACAP members and the supporting Treasury Department staff spent considerable time, and incurred significant cost. However, our review suggests that since the issuance of the ACAP Report, there has been no comprehensive monitoring either by the Department of Treasury or any voluntary periodic reporting to the Department on progress related to Committee’s recommendations by any of the above-mentioned organizations. We reviewed the U.S. Department of Treasury website³ dedicated to ACAP but did not find any updates or action items relating to the ACAP recommendations. **We believe that industry-wide initiatives of this nature should in the future include a monitoring and public reporting mechanism with respect to the implementation of recommendations made.**






The table provided below presents the status of the progress to date on each of the 31 ACAP recommendations in each of the three categories. The recommendations, even when implemented, vary in their effectiveness and completeness, and all too often, the recommendations have not been implemented in a manner meaningful to investors. The Working Group has attempted to capture the status of the recommendations using a green, yellow, and red color system. Green indicates the issue has been acted upon with successful results. Yellow indicates some implementation has occurred, but more remains to be done if a recommendation is to be implemented in a satisfactory manner. Finally, red indicates that little or no meaningful progress has occurred. The Working Group understands there may be differences of views relating to the color-coding of each recommendation but hopes that our use of this framework will encourage greater debate on the degree of progress made to-date and whether the various organizations have taken actions to meaningfully protect investors.





Category	Recommendation	Sub Recommendation	Organizations	Current Status
Human Capital	Recommendation 1. Implement market-driven, dynamic curricula and content for accounting students that continuously evolve to meet the needs of the auditing profession and help prepare new entrants to the profession to perform high quality audits.	a) Regularly update the accounting certification examinations to reflect changes in the accounting profession, its relevant professional and ethical standards, and the skills and knowledge required to serve increasingly global capital markets.	AAA, AICPA, NASBA	
		(b) Reflect real world changes in the business environment more rapidly in teaching materials.	AAA, AICPA, NASBA	
		(c) Require that schools build into accounting curricula current market developments.	AAA, AICPA, NASBA	
	Recommendation 2. Improve the representation and retention of minorities in the auditing profession so as to enrich the pool of human capital in the profession.	(a) Recruit minorities into the auditing profession from other disciplines and careers.	AAA, AICPA	
		(b) Institute initiatives to increase the retention of minorities in the profession.	AAA, AICPA	
		(c) Emphasize the role of community colleges in the recruitment of minorities into the auditing profession.	AAA, AICPA	
		(d) Emphasize the utility and effectiveness of cross-sabbaticals and internships with faculty and students at Historically Black	AAA, AICPA	

³ U.S. Department of Treasury ACAP Link: <https://www.treasury.gov/about/organizational-structure/offices/Pages/acap-index.aspx>

		Colleges and Universities.		
		(e) Increase the numbers of minority accounting doctorates through focused efforts.	AAA, AICPA	
	Recommendation 3. Ensure a sufficiently robust supply of qualified accounting faculty to meet demand for the future and help prepare new entrants to the profession to perform high quality audits.	(a) Increase the supply of accounting faculty through public and private funding and raise the number of professionally qualified faculty that teach on campuses.	AAA, AICPA	
		(b) Emphasize the utility and effectiveness of cross-sabbaticals.	AAA, AICPA	
		(c) Create a variety of tangible and sufficiently attractive incentives that will motivate private sector institutions to fund both accounting faculty and faculty research, to provide practice materials for academic research and for participation of professionals in behavioral and field study projects, and to encourage practicing accountants to pursue careers as academically and professionally qualified faculty.	AAA, AICPA	
	Recommendation 4. Develop and maintain consistent demographic and higher education program profile data.		AAA	
	Recommendation 5. Encourage the American Institute of Certified Public Accountants (AICPA) and the American Accounting Association jointly to form a commission to provide a timely study of the possible future structure of higher education for the accounting profession.		AAA, AICPA	
Firm Structure and Finances	Recommendation 1. Urge the Securities and Exchange Commission (SEC), and Congress as appropriate, to provide for the creation by the Public Company Accounting Oversight Board (PCAOB) of a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding fraud prevention and detection, and further, the development of best practices regarding fraud prevention and detection.		PCAOB, SEC	
	Recommendation 2. Encourage greater regulatory cooperation and oversight of the public company auditing profession to improve the quality of the audit process and enhance confidence in the auditing profession and financial reporting.	(a) Institute the following mechanism to encourage the states to substantially adopt the mobility provisions of the Uniform Accountancy Act, Fifth Edition (UAA): If states have failed to adopt the mobility	NASBA	

		provisions of the UAA by December 31, 2010, Congress should pass a federal provision requiring those states to adopt these provisions.		
		(b) Require regular and formal roundtable meetings of regulators and other governmental enforcement bodies in a cooperative effort to improve regulatory effectiveness and reduce the incidence of duplicative and potentially inconsistent enforcement regimes.	NASBA, PCAOB, SEC	
		(c) Urge the states to create greater financial and operational independence of their state boards of accountancy.	NASBA	
	Recommendation 3. Urge the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms.		NASBA, PCAOB, SEC	
	Recommendation 4. Urge the SEC to amend Form 8-K disclosure requirements to characterize appropriately and report every public company auditor change and to require auditing firms to notify the PCAOB of any premature engagement partner changes on public company audit clients.		PCAOB, SEC	
	Recommendation 5. Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model. Further, urge that the PCAOB and the SEC clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards.		PCAOB, SEC	
	Recommendation 6. Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report.		PCAOB	
	Recommendation 7. Urge the PCAOB to require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU's Eighth Directive, Article 40		PCAOB	

	Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VIII [Concentration and Competition] of this Report. Further, urge the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements.			
Concentration and Competition	Recommendation 1. Reduce barriers to the growth of smaller auditing firms consistent with an overall policy goal of promoting audit quality. Because smaller auditing firms are likely to become significant competitors in the market for larger company audits only in the long term, the Committee recognizes that Recommendation 2 will be a higher priority in the near term.	(a) Require disclosure by public companies in their registration statements, annual reports, and proxy statements of any provisions in agreements with third parties that limit auditor choice.	SEC	
		(b) Include representatives of smaller auditing firms in committees, public forums, fellowships, and other engagements.	AICPA, PCAOB, SEC	
	Recommendation 2. Monitor potential sources of catastrophic risk faced by public company auditing firms and create a mechanism for the preservation and rehabilitation of troubled larger public company auditing firms.	(a) As part of its current oversight over registered auditing firms, the PCAOB should monitor potential sources of catastrophic risk, which would threaten audit quality.	PCAOB, SEC	
		(b) Establish a mechanism to assist in the preservation and rehabilitation of a troubled larger auditing firm. A first step would encourage larger auditing firms to adopt voluntarily a contingent streamlined internal governance mechanism that could be triggered in the event of threatening circumstances. If the governance mechanism failed to stabilize the firm, a second step would permit the SEC to appoint a court-approved trustee to seek to preserve and rehabilitate the firm by addressing the threatening situation, including through a reorganization, or if such a step were unsuccessful, to pursue an orderly transition.	PCAOB, SEC	
	Recommendation 3. Recommend the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and		AAA, PCAOB	

	effectiveness and requiring auditing firms to publicly disclose these indicators. Assuming development and disclosure of indicators of audit quality are feasible, require the PCAOB to monitor these indicators.			
	Recommendation 4. Promote the understanding of and compliance with auditor independence requirements among auditors, investors, public companies, audit committees, and boards of directors, in order to enhance investor confidence in the quality of audit processes and audits.	(a) Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible. The AICPA and state boards of accountancy should clarify and prominently note that differences exist between the SEC and PCAOB standards (applicable to public companies) and the AICPA and state standards (applicable in all circumstances, but subject to SEC and PCAOB standards, in the case of public companies) and indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements. This compilation should not require rulemaking by either the SEC or the PCAOB because it only calls for assembly and compilation of existing rules.	AICPA, NASBA, PCAOB, SEC	
		(b) Develop training materials to help foster and maintain the application of healthy professional skepticism with respect to issues of independence and other conflicts among public company auditors, and inspect auditing firms, through the PCAOB inspection process, for independence training of partners and mid-career professionals.	AICPA, NASBA, PCAOB	
	Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.		SEC	
	Recommendation 6. Enhance regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the United States.		PCAOB	

Section II: ACAP Recommendations Promote Investor Protection and Capital Formation

Capital markets in the U.S. and around the globe take capital from investors, and provide it to companies who in turn use it to create jobs, build plants, develop new technologies, foster innovation, and fuel economic growth. Investors in turn look to the capital markets to provide them with a return on their capital at a known level of risk, relying significantly on the audit report to discover and highlight for them the financial statement risk.

Accurate, timely and complete financial information is required by investors to provide a basis for investment and capital allocation decisions. It is the “Lifeblood” of the U.S. capital markets. When market participants fail to provide that information investor confidence in the capital markets is lost. We have witnessed the catastrophic consequences of these failures during the great depression of the 1930’s, the recession of the 1970’s, the U.S. savings and loan scandals of the 1980’s, the financial statement frauds of the late 2000, and the more recent fallout from the financial crisis and the ensuing great recession. Such revelations shock the capital markets and result in huge drops in the value of the companies, much to the detriment of the financial security of investors.

Since 1933, the Securities Laws have required independent audits of corporations selling public securities in the U.S. capital markets to ensure the integrity of information received by the investors for capital allocation decisions. In fact, independent auditors are the ONLY professionals required to be hired by a corporation selling such securities.

Investors do not have direct access to an issuer’s books and records and therefore must rely on auditors to perform a public watchdog function. This audit function serves an independent set of eyes to check the credibility and integrity of the financial information management publishes and provides to investors. In commenting on the role of auditors, the U.S. Supreme Court has categorically stated (emphasis added):

By certifying the public reports that collectively depict a corporation’s financial status, the independent auditor assumes a **public** responsibility **transcending** any employment relationship with the client. The independent public accountant performing this special function **owes ultimate allegiance to the corporation’s creditors and stockholders**, as well as to the **investing public**. This “**public watchdog**” function demands that the accountant maintain **total independence** from the client at all times, and requires **complete fidelity to the public trust**.⁴

In light of the demise of Arthur Andersen a decade and a half ago, the financial stability of the auditing profession became more important to investors. These investors rely on quality audits to make informed decisions regarding an investment in a company. As the ACAP final report aptly notes, that stability arises from (1) competent human capital, (2) a firm structure that ensures sound governance, transparency, high audit quality, and clear communication to investors, and (3) enhanced competition based on audit quality and effectiveness. The ACAP recommendations advance the quality of audits for investors in the following ways.

First, the recommendations call for providing investors greater transparency with respect to the quality of audits. The current auditing standards require that auditors provide investors with “reasonable assurance” on the financial statements and accompanying disclosures. Reasonable assurance is defined as a “high” level of assurance. However, investors today are left completely in the dark with respect to the final product they receive and whether it does in-fact provide the

⁴ United States v. Arthur Young & Co. 465 U.S. 805 (1984)

level of assurance they perceive they are receiving. The ACAP recommendations, if fully implemented, would provide greater protection to investors by:

1. Requiring disclosure to investors of indicators of audit quality. Too often, it has been argued that the profession has not defined and established such indicators, so that investors can evaluate the quality of a company's auditors prior to voting on their appointment. The fact that such indicators remain undefined eight years after the publication of the ACAP recommendations, give rise to a legitimate concern that the audit firms are not adequately measuring the quality of their individual audits. Results of inspection reports of the PCAOB from the past three years and a continuing significant rate of financial statement restatements also support this investor concern.
2. Requiring clearer communication to investors of the results of the audit in a transparent fashion. Unfortunately, the audit report issued at the conclusion of an audit today fails to provide useful information the auditor may be aware of, which if disclosed to investors, may result in the investor changing their investment decisions. As the ACAP report notes, the public has appropriately raised questions when large frauds have gone undetected. In some instances, the auditors were aware of problems with financial statements, but issued their reports without further comment anyway. The expanded audit report called for by the ACAP would require the auditor to be more transparent with respect to their key findings set forth in their audit report. The Working Group notes that investors have warmly received some of the expanded audit reports that have been issued in some foreign jurisdictions. The signature of the audit partner on the audit opinion would also establish greater accountability supported by the investment community. Clarifying the auditors' obligation to detect material financial statement fraud has been called for not only by the ACAP, but by investors as well. Too often auditors have argued in courts, they do not have an obligation to do so when circumstances such as collusion exists, even if they have not properly conducted an audit in accordance with generally accepted auditing standards ("GAAS"). This is inconsistent with the "public watchdog" function that the U.S. Supreme Court has promulgated.

Establishing a fraud research center that could perform research related to improving detection, prevention and disclosure of fraud would also contribute to higher quality audits. The PCAOB is uniquely situated to investigate and study instances of fraud, including when an independent audit did, or did not, detect that fraud. A study of these circumstances, and the facts surrounding them, and creating a data base of that information that other public researchers could access, could provide the PCAOB with an ability to understand, and act on, how to make audits more effective for investors. A common database accessible to all concerned entities would help piece together fraudulent behavior and provide a basis for remedial recommendations.

3. Enhancing the transparency and governance of the large audit firms is another important element of the ACAP recommendations that remain unaddressed. Public companies in the United States, and many other parts of the world, are required to provide investors with specific information regarding their financial condition and results. They are also required to adopt certain governance standards, including those mandating levels of independence of those in governance and oversight positions. The largest audit firms in the U.S. and abroad are not public companies with outside investors. Yet they have an unequivocal obligation to investors and the public. They have that obligation because of a legislative mandate that public companies acquire and pay for their services here in the U.S. Yet in the past, investors have incurred losses when there was a lack of transparency into the management and governance of the large, international auditing firms. This has contributed to poor quality audits of misstated financial statements of public companies.

Many capital market participants incurred losses when the audit quality of Arthur Andersen was called-into question around the globe and the firm ceased its operations. Accordingly, improving the governance of the audit firms, and increasing their transparency to match standards applicable to public companies, would enhance investor confidence in the decision making of these firms and the reliability of their audits.

4. Continuing to increase the competency and expertise of those who perform audits of public companies. The ACAP recommendations call for the establishment of market driven, dynamic curricula designed to attract and keep the best people in the profession. For example, the ACAP recommended that expanded course work and professional examinations should address fraud examination and forensic auditing, ethical standards, financial risk management, valuation, and their application. The ACAP noted that curricula have traditionally been all too slow to change, and recommended that changing market conditions and changes in the business environment be incorporated into accounting curricula and teaching materials more rapidly. High quality audits require that highly competent partners and audit staff perform them. That level of competency must be maintained throughout an auditor's career. The ACAP recommendations for college curricula, as well as improved governance, and transparency including for audit quality, would all contribute to highly competent auditors performing critically important work on behalf of investors.

Section III: The Working Group's Top-5 Recommended Implementation Priorities for the PCAOB

The Working Group noted that the ACAP Recommendations address a variety of issues and topics. Each member of the Working Group prioritized the recommendations in terms of the anticipated benefit to investors. The Working Group concluded it would be more effective to focus on a select number of especially critical recommendations to increase the likelihood of meaningful results over the near term that will enhance the quality of the audits and protect investor interests.

The Working Group recommends that in the near term the PCAOB, and the SEC focus on implementing the following five recommendations with respect to the audits of public companies and the audit firms who perform those audits. We believe these ACAP recommendations should receive the highest priority by the PCAOB and the SEC as they affect transparency and audit quality, which are so critical for investor protection and capital formation in the United States.⁵ The five recommendations are grouped under the original three categories of the ACAP report.

I. Concentration and Competition

Audit Quality Indicators: The Working Group members believe that the PCAOB and SEC should develop and finalize a standard that establishes indicators of audit quality for both the audit of a public company as well as internal controls, processes and procedures on a global, firm wide basis. Audit Quality Indicators (AQIs) should be set for (1) the international firm, (2) its affiliates who perform public company audits and (3) for the performance of individual audit engagements. The indicators for a specific public company audit should be disclosed not only to audit committees who oversee the performance of the audit, but also to investors who ratify the appointment of the external auditor in the annual general meeting. Currently, almost no information is provided to investors to help them make an informed decision whether an auditor has performed high quality audit and should be reappointed, or has failed to do so and should be terminated. Disclosure of audit quality indicators to investors would allow them to make

⁵ While prioritizing these recommendations, all Working Group members continue to support the implementation of all the ACAP recommendations as set forth in the ACAP Final report.

informed decisions when voting on the auditor. Along with the disclosure of the name of the audit partner responsible for an audit, AQIs will give investors useful information with respect to partners and their audit firms who do quality work, as well as those who do not. In this respect, information necessary for an investor to make an informed decision is also necessary if the capital markets are to appropriately reward those who achieve high levels of performance.⁶

We also believe that one clear indicator of quality, or the lack thereof occurs when an audit firm rotates an audit engagement partner before the mandatory partner rotation at the end of five years. While there may be good explanations for such rotations, such as a death, there have also been early rotations when an audit partner did not agree with the accounting used in financial statements provided to investors. Accordingly, we strongly believe that the SEC should revise its Form 8-K disclosure requirements to require disclosure to investors of any partner rotations occurring prior to their full five-year terms on the audit, and the reason for the rotation.

Some have said that an investor can now gather that information from the new PCAOB Form AP. However, that would be a highly time consuming and inefficient use of resources as the investor would have to:

- Each year identify the lead audit engagement partner.
- Retrieve and review prior years Form AP filings to see how long that individual has served as the audit engagement partner.

Moreover, notwithstanding the availability of this information, the investor still would have no knowledge of the reason the change in audit partner occurred. We therefore believe that the new Form AP disclosures do not adequately advance investor protection or facilitate capital formation.

Finally, the PCAOB's audit inspection findings provide a good gage of audit quality. However, these findings are of no value to investors, unless they know what audits they relate to. Accordingly, it is important the transparency of the inspection reports be increased so that investors know which audits did not comply with professional standards. This information should no longer be withheld from investors who today vote to approve the auditors without this highly relevant data.

II. Firm Structure and Finances

Creation by the PCAOB of a national center to facilitate sharing of fraud prevention and detection experiences, practices and data and innovation in fraud prevention and detection methodologies. In its response to the Working Group's request letter, the PCAOB stated that it developed a preliminary outline for such a center, and in April 2010, it posted to its web site an announcement-soliciting candidate to serve as Director of a Fraud Center. However, the PCAOB has not moved forward with this initiative since that time.

The PCAOB response notes that it has undertaken fraud case studies and the development of a fraud database within the Center of Economic Analysis (CEA). On its web site the PCAOB says the activities of the center are: (1) Preparing economic analysis to inform standard setting and other PCAOB rulemaking, (2) Fostering economic research on audit-related topics, including the role and relevance of the audit in capital markets, and (3) Developing economic tools for use in PCAOB oversight programs.

⁶ We note that in their December 2015, Audit Quality Report, Deloitte has been field testing AQI's and pilot testing them on live audit engagements. Investors might be surprised to learn that firms have not always measured and monitored AQI's consistent with the statement that one manages what one measures. We also note that Deloitte has appointed an audit quality advisory council that meets on a regular basis.

Accordingly, the CEA lacks the focus of a National Center for Fraud Prevention that was recommended by the ACAP. Rather it appears to be an office that performs cost-benefit analysis to support or oppose rule making efforts. Unfortunately, such analysis often fails to quantify benefits to investors while highlighting costs imposed on the users of investor capital. The benefits to investors are inherently difficult to capture in dollar figures in comparison to the costs that are readily estimated and provided by the public companies.

The PCAOB has also created an Office of Research and Analysis (ORA) with the following purpose, as described on the PCAOB's website:

Office of Research and Analysis (ORA) supports the Board's oversight activities by providing information critical to its regulatory oversight. ORA analyses risks affecting public accounting firms and researches risks to audit quality to inform policy options that support the Board's goals and objectives. Specifically, ORA is responsible for the aggregation of raw data and providing analysis that enables effective decision-making. This responsibility includes evaluating and implementing technological capabilities to enhance quantitative and qualitative analyses. ORA also supports the Board's risk-based inspection and enforcement programs by identifying and analyzing emerging audit and accounting issues that present elevated audit risk of audit failure. The office reports on these risks to PCAOB inspectors and others.

ORA's mandate, however, does not fulfill the ACAP recommendation relating to research and prevention of fraud. To that end, it appears as if both the CEA and ORA lack the necessary prominence of a national fraud center supported by the ACAP. They also lack a focus on the research and prevention of fraud. In addition, the PCAOB website provides little to no research on fraud, its detection and prevention, eight years after the recommendation of the ACAP and six years after the PCAOB first contemplated the creation of a fraud center.

The Working Group strongly urges the PCAOB to create National Fraud Center. However, what the Center does and what it accomplishes is more important than what it is named. In particular, such a Center should:

- Be located within the PCAOB where it can access data from inspections, investigations, and audit firms.
- Be led and staffed by full time PCAOB staff, including as appropriate full time academic fellows.
- Be dedicated on a full-time basis to the goals set forth by the ACAP, including the creation of a database. Providing other researchers public access to the database would enhance its utility and resulting innovation.

Improving the Audit Report. The PCAOB response to the Working Group's request letter sets forth steps it has taken to date to improve the audit report. The first step has resulted in a PCAOB final standard titled "Improving Transparency through Disclosure of Engagement Partner and Certain Other Participants in Audits." This Standard becomes effective in 2017. Under the final rules, audit firms will file a new PCAOB Form for each issuer audit, disclosing the following information (1) The name of the engagement partner, (2) The name, location, and extent of participation of each other accounting firm participating in the audit whose work constituted at least 5% of total audit hours; and (3) The number and aggregate extent of participation of all

other accounting firms participating in the audit whose individual participation was less than 5% of total audit hours.

The information will be filed on Form AP, *Auditor Reporting of Certain Audit Participants*, and will be available in a searchable database on the Board's website. This new standard is a positive step forward, but makes it much more difficult, time consuming and costly to monitor this data. It also falls short of requiring the auditor partner sign the report as required in other parts of the world, such as Europe and China.

The PCAOB's response letter also reports that it continues to work on improving the quality and transparency of the report auditors issue to investors. We strongly support the PCAOB's continuing efforts in this regard. We note that the auditor's report is the primary means by which the auditor communicates to the investor regarding its audit of the financial statements.

We strongly urge the PCAOB to move expeditiously to complete its project on the auditor's report. The PCAOB's response letter states it has been actively involved with this project for six years, since 2010. We believe that should be more than sufficient time in which to study, evaluate, propose and adopt a new reporting model. We note that other jurisdictions have adopted enhanced auditor reporting models subsequent to the recommendations of the ACAP and the PCAOB adding the project to its agenda. Investors have found such enhanced reporting to be very informative.⁷

We hope the PCAOB will carefully consider investor comments on the auditor report when finalizing its standards. We believe the report should:

- Clarify the auditor's responsibility for detecting material financial statement fraud in a manner consistent with the obligation an auditor has to the investing public.
- Include a requirement to disclose individual critical audit matters that would be material *to an investor* when making an investment decision, including a commentary from the auditor setting forth how those matters were audited and resolved. As set forth in various court decisions, SEC Staff Accounting Bulletin No. 99, and FASB literature, materiality should be based on a determination as to whether or not the investor's decision would be influenced by the information.
- Disclose the tenure of the auditor.
- Enhance the investors understanding of the audit and its results, as well as financial statement risk.⁸

Enhancing Audit Firm Transparency and Governance. Recommendations 3 and 7 of the ACAP with respect to Firm Structure and Finances, recommended that the PCAOB and SEC:

- ...analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of audit firms.

⁷ See for example the differences in the independent auditor's report addressed to the Annual General Meeting of Shareholders and Supervisory Board of Aegon N.V. Report on the financial statements 2015, issued in the Netherlands; and the Report of Independent Registered Public Accounting Firm addressed to The Supervisory Board, the Executive Board and Shareholders of Aegon N.V. in Aegon's U.S. filed Form 10-K for 2015.

⁸ Ibid.

- ...require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU’s Eight Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness...

Neither of these recommendations has been implemented. We note that in Europe the audit firms do comply with the EU’s Directive and provide to the public, on their websites, their annual transparency reports. We also reviewed the annual reports these firms provide on the website of the U.S. affiliate of the international firm. Typically, the U.S. firm report is shorter and noticeably less transparent than the EU annual report. They contain limited financial information with respect to the financial viability of the firm and certainly do not provide a set of financial statements prepared in accordance with generally accepted accounting principles. They also provide limited information to investors with respect to audit quality. In that regard, we believe that the U.S. firm transparency reports are not consistent with “best practice.”

The lack of transparency raises serious questions as to whether or not at some point in time the PCAOB will be faced with the issue of whether an auditing firm is too big to fail. Auditing firms have failed in the past when the quality of their audits failed to meet professional standards. It can certainly happen again. In light of the unique legislative mandate for independent audits of public companies, the need for transparency of the financial results and conditions of these firms is essential and should be required of them as a responsibility associated with their unique and somewhat protected status in our economy. Recent settlements by the audit firms of cases involving inadequate audits only serve to raise the need for greater transparency to a higher level. It is worth noting the ACAP did request detailed financial information from the firms but they did not comply.

We also noted the manner in which the audit firms’ annual reports discuss their respective International and U.S. firm governance structures. Typically, these are governing boards comprised of senior partners, elected by other partners in the firm. As such they are not independent governance structures, and do not provide independent oversight or perspectives consistent with best governance practices today.⁹

We believe the U.S. firms should demonstrate their commitment to leadership and best practices by adopting the recommendations of the ACAP for independent and meaningful governance structures, as well as transparency reports. However, it has been eight years since the publication of the final ACAP report and recommendations and only limited progress, at best, has been made in the intervening period. The Working Group strongly urges the PCAOB and the SEC to implement the ACAP’s recommendations of greater transparency and independent governance in the large international audit firms.

Human Capital

Market-driven, Dynamic Accounting Curricula: The ACAP recognized that auditing is a “human capital” intensive activity. The vibrancy and sustainability of a robust auditing profession is highly dependent upon the quality of “human capital” that chooses to pursue this craft and willingly shoulders the tremendous responsibility associated with advancing the public interest. The ACAP Final Report stated, “It is essential that these professionals continue to be educated and trained to review, judge, and question all accounting and auditing matters with skepticism and critical perspective.”

⁹ We noted that in some foreign jurisdictions, a foreign affiliate of an international audit firm has established a public interest oversight board or committee for that particular affiliate of the firm. It appears partners in the leadership of the firm select the members of such boards.

The AICPA's Trend studies on the demand and supply of accounting graduates suggest that enrollments in accounting programs as well as the number of students graduating with accounting degrees is steadily rising. However, we believe that the more relevant issue is whether the "accounting supply-chain" is producing "fit for purpose" accounting graduates.

Accordingly, the ACAP recommended that "...market driven, dynamic curricula and content for accounting students..." be implemented; that teaching materials "reflect real world changes in the business environment more rapidly..." and that "schools build into accounting curricula current market developments." The Working Group supports this recommendation, as its implementation will directly contribute to the competency of audit staff.

Business and investment transactions become ever more complex with the passage of time, compounding the risks faced by preparers, auditors and users of financial statements of public entities. To audit these complex transactions successfully, the "auditor needs to be very bright, motivated, well-trained, and most importantly, committed to the public's interest."¹⁰ Rhetorically speaking, does the "human capital" joining the auditing profession today meet all of these criteria? If not, why not? Moreover, what can be done to ensure a "fit for purpose" supply-chain of human capital to the auditing profession?

While this progress report discusses in Section IV the steps taken by the AAA and AICPA to improve the quality of accounting and auditing education, we were unable to identify what specific progress had been made with regard to maintaining the currency of the accounting and auditing curricula by the university accounting programs. Specifically, the Working Group believes that the AAA should monitor (through research or other mechanisms) on a regular basis how accounting and other business school curriculum is set, who sets it, and how often is it updated in response to changing market conditions. More specifically, the AAA should fund research into what curriculum changes are occurring and in which universities and why, and share this research with regulators, academics, and the public.

The Working Group believes that the following forces present significant hurdles in developing and maintaining a "fit for purpose" supply chain of human capital for the auditing profession under the current environment. As part of its research, the AAA should also study the impact of these countervailing forces on the human capital supply chain with the intent to initiate a dialogue and search for solutions that would arrest the migration of the best and the brightest from entering the auditing profession.

- Higher financial returns than auditing (i.e., starting salary) offered by the alternative career paths such as consulting, investment banking, asset management, and the legal and medical professions.
- Lack of understanding and recognition by many in the university higher administration (i.e., business school deans) that accounting programs are a unique breed and need to be accorded much more autonomy, pedagogically, operationally and financially, than other programs within the business school. This seriously constricts accounting programs' ability to offer a state-of-the-art curriculum to their students while not incentivizing accounting faculty to engage with the accounting profession.
- Increasing pressures on the pre-tenure and tenured faculty to publish research articles in "elite" academic accounting journals resulting in "teaching" and "interaction with the accounting professionals" being relegated to as distractions. Further, ever increasing

¹⁰ This is the exact statement that Joseph Carcello, one of the Working Group member, made in his written testimony to the ACAP on November 25, 2007. His full testimony (which we believe is as relevant today as it was then) can be accessed at: <https://www.treasury.gov/about/organizational-structure/offices/Pages/submissions.aspx>

sentiment on University campuses that research is the “only” thing that matters for tenure and promotion is compromising innovation in accounting curriculum and quality of instruction in the classrooms.

- Implementation of the 150-credit hour requirement that focuses on counting the credits rather than developing students’ much needed judgment skills and content knowledge to audit complex business transactions. All too often during recruiting, prospective employers focus on whether the students meet the “check-list” of “CPA Ready” requirements rather than on whether the student has gone through a systematic body of curriculum (i.e., a post-graduate degree in accounting¹¹) and educational experiences to develop “mature judgment” and superior content knowledge that builds on their undergraduate degree in accounting. The sub-group believes that by encouraging students to earn their 150-credit hours through a post-graduate degree in accounting, rather than simply cramming it into the undergraduate curriculum through “overloading” and taking proverbial “basket-weaving” courses will go a long way in enhancing the professional judgment and competency of the staff auditors. To that end, prospective employers should incentivize students to pursue post-graduate education in accounting through their hiring practices (i.e., differential in starting salary for someone with a post-graduate degree vis-à-vis someone with 150-credit hours crammed into an undergraduate accounting degree). Such an explicit recognition of the post-graduate accounting education will also motivate University accounting programs to offer graduate-level curriculum that would develop judgement and competency in their students.
- Some Universities have begun to offer a one year Masters in Accounting Program. Such a program can offer a beneficial year of study and advance knowledge to students with an undergraduate degree in accounting. However, as a means of generating additional tuition revenues, universities also permit students without an undergraduate accounting degree to enroll in these programs and complete them in the one year. We believe those programs do not provide sufficient accounting and auditing knowledge necessary for entry-level employees in a public accounting firm.
- Significant variation in the educational requirements of the 54 State Boards of Accountancy to sit for the Uniform CPA Examination¹² does not help ensure consistency in the educational training of the potential CPAs entering the auditing profession.
- Separately accredited accounting programs may not be preparing the UG accounting students in the required skill set because the dominant accrediting organization (i.e., AACASB) evaluates applicant’s accounting curriculum in light of its own “mission” which may not prepare graduates for public accounting mission of protecting “public interest”.
- Increasing number of professoriate joining the faculty ranks without any professional certification or practical accounting experience, or both.

We propose that in its research, the AAA consider exploring if the following actions may mitigate the potential negative effects of some of these forces:

¹¹ This issue was also raised in the dissenting statement filed by a member of the ACAP Committee while voting on the ACAP Recommendations.

¹² Griffin, Richard B., B. Wynne Griffin, and Robert L. Putman, (2008), “Is There Uniformity in the Education Requirements of State Boards of Accountancy to sit for the Uniform Certified Public Accountant Exam?” *International Journal of the Academic Business World*, spring 2008, Vol. 2, Issue 1. Griffin, Richard B. and Robert L. Putman, “If CPA’s in a Non-Metropolitan Area Developed an Accounting Major, the Accounting Curriculum Would be?” *The Journal of Academic Administration in Higher Education*, fall 2005, Vol. 1, Issue 3.

- NASBA and the AAA should work closely with the PCAOB to understand its inspection findings to determine the extent to which lack of sufficient training and/or professional judgement was at the root cause of deficient audits. For example, we note the PCAOB inspection reports have indicated auditing staff lacked the necessary education and training with respect to evaluating and testing of internal accounting controls. This knowledge should drive NASBA and the AAA to work with the 54 State Boards of Accountancy to help them update and maintain the relevancy and the currency of the entry requirements to sit for the CPA examination, to obtain a CPA license, and to require continuing education credits.¹³
- NASBA and the AAA should create a task force with representatives from regulators and other relevant stakeholders to consider the feasibility of implementing the 150-credit hour requirement through the completion of a post-graduate degree in accounting.
- The accounting program accrediting agencies (i.e., AACSB) should reconsider their “mission-driven” approach to reviewing/accrediting accounting programs in favor of a “public-interest” mission.
- PCAOB uses fines it receives to offer scholarships to accounting students. We believe that is a good use of that resource and commend the PCAOB for doing so. However, in order to enhance the training of entry-level employees entering the profession, we believe the PCAOB should dedicate those scholarships to students undertaking further accounting education and training through graduate level masters in accounting programs.

Section IV: Update and Progress on Specific Recommendations

This section summarizes the progress on each of the ACAP recommendations as reported in the response letters of the organizations identified in Section I and based on the Working Group’s research of publicly available materials. We note each organization was asked to describe his/her organization’s efforts to implement certain specific ACAP recommendations that the Working Group believes were most applicable to their organization. These are identified below. However, some organizations chose to provide their responses in a commentary form rather than responding specifically to the recommendations that were assigned to them. Thus, we have done our best to incorporate their responses under the relevant recommendations.

Human Capital

Recommendation 1

Implement market-driven, dynamic curricula and content for accounting students that continuously evolve to meet the needs of the auditing profession and help prepare new entrants to the profession to perform high quality audits. (Respondents: AAA, AICPA, NASBA)

- a. Regularly update the accounting certification examinations to reflect changes in the accounting profession, its relevant professional and ethical standards, and the skills and knowledge required to serve increasingly global capital markets. (Respondents: AAA, AICPA, NASBA)
- b. Reflect real world changes in the business environment more rapidly in teaching materials. (Respondents: AAA, AICPA, NASBA)

¹³ To be clear, the ACAP subgroup is not proposing disclosure of the inspection findings to NASBA but sharing of the knowledge gained from the inspections as it relates to “human capital” issues.

- c. Require that schools build into accounting curricula current market developments.
(Respondents: AAA, AICPA, NASBA)

Update and Progress:

The following update is based on the responses provided by the AAA, AICPA, NASBA and our research based on publicly available information.

Uniform CPA Examination

The responsibility for the CPA Exam is shared among the AICPA, the State Boards, and the NASBA. The AICPA is responsible for setting and scoring the CPA examination. The State Boards are responsible for evaluating the eligibility of candidates to sit for the CPA exam and communicating to the candidates the results of the exam. The NASBA is responsible for maintaining the national candidate database and for matching the score data that it receives from the AICPA with candidate details. NASBA maintains the record of candidates who have passed the examination. Additionally, the AICPA and the NASBA also coordinate the “reciprocity” agreements with foreign jurisdictions.

In 2014, the AICPA, in conjunction with NASBA, launched a practice analysis—a comprehensive research project aimed at identifying the knowledge and skills required of newly licensed CPAs to ensure that they are ready to meet the current and future needs of the accounting profession¹⁴. As part of this practice, analysis large-scale surveys were conducted of the newly licensed CPAs and those who supervise them. Input was also sought from the SEC and the PCAOB. The AICPA received nearly 50 comment letters from firms and organizations and more than 30 comment letters from individuals. In aggregate, the comment letters represented more than 600 comments for consideration. In February 2016, following a thorough review of all comments, the Board of Examiners unanimously approved the final content, structure and design of the Exam. The results of the practice analysis were exposed for public comment. This analysis informed the next version of the CPA examination that is set to launch on April 1, 2017. The AICPA is also implementing a recurring practice process that will continue to inform what updates may be needed to the examination on a periodic basis. The items in the AICPA’s test bank are continually reviewed for obsolescence, and questions are purged as necessary.

The revised exam will increase assessment of higher-order cognitive skills, include analysis and evaluation-level tasks, and increase the use of simulations that provide real-world situations. Key details regarding the revised CPA exam include the following:

- The Exam will remain structured by the four existing sections—Auditing and Attestation (AUD), Business Environment and Concepts (BEC), Financial Accounting and Reporting (FAR) and Regulation (REG).
- The Exam will have an increased emphasis on testing higher order skills that include, but are not limited to, critical thinking, problem-solving and analytical ability.
- Each section will have a blueprint illustrating the content knowledge and skill levels that may be tested on the Exam, which are, in turn, linked directly to tasks that are representative of the work of a newly licensed CPA.

¹⁴ The 119 page Practice Analysis Final Report provides more details on the process and the rationale for the changes. See <http://www.aicpa.org/BecomeACPA/CPAExam/nextexam/DownloadableDocuments/2016-practice-analysis-final-report.pdf>

- More task-based simulations (TBSs) will be used to test a combination of content knowledge and higher order skills, which will include aspects of professional skepticism as appropriate. TBSs will be added to the BEC section.
- Total Exam testing time will increase from 14 to 16 hours—four sections of four hours each.

NASBA acknowledges that there remains a significant diversity in requirements to sit for the CPA examination across the 54 jurisdictions. Further, none of the jurisdictions requires a postgraduate degree in accounting as a prerequisite for the CPA examination. The implementation of the 150-credit hour requirement appears to have undercut the original intent of providing aspiring CPAs with skills and knowledge beyond the traditional four-year undergraduate education. A similar issue was raised in the dissenting opinion of one of the ACAP Committee members. Consequently, enrollments in post-graduate accounting and tax programs continue to significantly lag behind the enrollments in the bachelors' in accounting programs. According to the 2015 AICPA Trends Survey,¹⁵ for the 2013-14 academic year, only 18% were enrolled in the post-graduate accounting/tax programs.

Maintaining Relevancy and Currency of Teaching Materials

The AAA reports that it has not commissioned any specific research that studies changes in the accounting curricula of the universities/colleges since the issuance of the ACAP report. However, working with the AICPA, in 2010, it created *The Pathways Commission on Accounting Higher Education* to study the future structure of higher education for the accounting profession and develop recommendations for educational pathways to engage and retain the strongest possible community of students, academics, practitioners, and other knowledgeable leaders in the practice and study of accounting. The Commission released its Report in July 2012 which was followed by three annual updates on progress and several other brief reports on establishing a national center for accounting education excellence, integrating professionally-oriented faculty, examining non-traditional doctoral education, accounting curricula of the future, and recognizing high quality teaching.

The AAA has promoted the advancement of accounting education through various means such as establishing Centers for Advancing Accounting, sponsoring various teaching awards, providing publication outlets to share and disseminate accounting education research and accounting curricula, and sponsoring accounting education related conferences, symposia, boot camps, and seminars. The AAA also collaborates with other professional organizations such as the Financial Accounting Standards Board (FASB) and the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) to provide subsidized access to their resources to the faculty and students. The AAA also works collaboratively with many public accounting firms in making a variety of their resources available to University accounting educators to help them maintain the relevancy and currency of their accounting curriculum.

It is important to note that the AAA does not have any direct influence or leverage over accounting curricula being offered at a university. Thus, it relies on voluntary adoption of better pedagogy and teaching practices within university accounting programs to attract the best and the brightest students to the undergraduate accounting major and graduate-level accounting programs.

In addition to the influence that the AICPA can exert, through the CPA Exam content, in changing the university accounting curricula, it has also made available to university accounting educators, and current and aspiring students, a variety of resources to advance accounting

¹⁵ American Institute of Certified Public Accountants (AICPA), 2015, Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits, AICPA, Durham, North Carolina.

education. For example, in 2014, the AICPA launched a website and a newsletter by providing accounting educators with lesson plans and other resources to integrate accounting curricula with the evolving skills needed for effective auditing. Similarly, it launched a website, designed to help accounting students learn more about the public accounting profession.

It should be noted that the NASBA, individual State Boards of Accountancy and various accrediting agencies¹⁶ are in a better position than the AAA to exert more meaningful and direct influence on university accounting curricula. For example, the NASBA and the individual State Boards of Accountancy can influence university curriculum in accounting and business by reducing the variation in the number of semester credit hours and types of courses required of the candidates in accounting and business to sit for the CPA examination.

They can exert this influence by prescribing a higher-level of specificity in their education requirements. Although the majority of the State Boards do not prescribe a high-level of specificity in their education requirements for licensing as a CPA, they do specify requirements relating to a certain minimum level of coverage in accounting, auditing and business subjects.¹⁷ NASBA actively interacts with the AAA representatives and willing faculty educators and disseminates information about its practice analysis activities by presenting at various educator conferences.

Overall, in addressing the goal of more rapidly reflecting real world changes in the business environment into accounting curricula and related teaching materials, the AAA, the AICPA and NASBA rely on voluntary adoption or market competition (i.e., the extent to which the graduates of a program are sought after by employers).

Recommendation 2

Improve the representation and retention of minorities in the auditing profession so as to enrich the pool of human capital in the profession. (Respondents: AAA and AICPA).

- a. Recruit minorities into the auditing profession from other disciplines and careers. (Respondents: AAA and AICPA).
- b. Institute initiatives to increase the retention of minorities in the profession. (Respondents: AAA and AICPA).
- c. Emphasize the role of community colleges in the recruitment of minorities into the auditing profession. (Respondents: AAA and AICPA).
- d. Emphasize the utility and effectiveness of cross-sabbaticals and internships with faculty and students at Historically Black Colleges and Universities. (Respondents: AAA and AICPA).

¹⁶ Association to Advance Collegiate Schools of Business (AACSB) and the Accreditation Council for Business Schools and Programs (ACBSP).

¹⁷ We did not find any recent studies that (1) examine the extent to which educational requirements vary among the 54 state jurisdictions and (2) studies that compare and contrast the accounting curriculum at the accredited and non-accredited universities. However, two research studies by Richard B. Griffin and co-authors find that there is a significant variation in entry educational requirements among the 54 jurisdictions. Similarly, (2005), there exists a wide variation in accounting curriculum across the accredited accounting programs. The two studies are Griffin, Richard B., B. Wynne Griffin, and Robert L. Putman, (2008), "Is There Uniformity in the Education Requirements of State Boards of Accountancy to sit for the Uniform Certified Public Accountant Exam?" *International Journal of the Academic Business World*, spring 2008, Vol. 2, Issue 1. Griffin, Richard B. and Robert L. Putman, "If CPA's in a Non-Metropolitan Area Developed an Accounting Major, the Accounting Curriculum Would be?" *The Journal of Academic Administration in Higher Education*, fall 2005, Vol. 1, Issue 3.

- e. Increase the numbers of minority accounting doctorates through focused efforts. (Respondents: AAA and AICPA).

Update and Progress:

The following update is based on the responses provided by the AAA, AICPA and our research based on publicly available information.

According to the 2008 AICPA Trends Survey, 32% of the graduates with Bachelors and Masters Degrees were non-whites.¹⁸ In 2015, the percentage increased slightly to 38%. Similarly, in 2008, only 28% of the new accounting hires were non-whites. In 2015, the percentage has increased slightly to 31%. In other words, based on this survey, little progress has been made in this regard since the issuance of the ACAP report in 2008.

In response to the Working Group, the AICPA reported three specific programs in support of implementing this recommendation. First, in 2012, it established a National Commission on Diversity and Inclusion with the goal of developing strategies to recruit, retain, and advance under-represented minorities. The 21-member Commission consists of representatives from minority professional advocacy groups such as ALFPA, Ascend, NABA, and NCPACA, CPA firms, state CPA societies and leaders from business and industry, government and education. Second, the AICPA Fellowship for Minority Doctoral Students focuses on increasing the number of minority CPAs who serve as role models and mentors in the classroom. The AICPA Foundation awards annual fellowships of \$12,000 to full-time minority accounting scholars who demonstrate significant potential to become accounting educators. The program, so far, has provided funding to more than 150 minority doctoral candidates.

Various large public accounting firms have initiated and sustained efforts in this area. For example, the Ph.D. project that was started in 1994 by the KPMG Foundation, Citi, AACSB, and GMAC has quadrupled the number of minority business PhDs in the U.S. since its inception (294 in 1994 to 1,300 today).

The AICPA informed the Working Group that during the fall of 2016 it plans to launch several initiatives to attract minorities to the profession. They include a national awareness campaign; and a recognition program for high school students and a pilot program at select universities, including HBCU/HCI institutions, to provide influential faculty with resources to prepare students for the CPA exam.

Another dimension of diversity is inclusion and promotion of female professionals to the ranks of partners. Although, today, females lead two of the four large public accounting firms,¹⁹ according to the 2016 Annual Rosenberg Survey “after posting increases every year since the 13.6% in 2006...the percentage of female partners this year was 16.3% down from 17.2% last year.”²⁰

Recommendation 3

Ensure a sufficiently robust supply of qualified accounting faculty to meet demand for the future and help prepare new entrants to the profession to perform high quality audits. (Respondents: AAA and AICPA).

¹⁸ American Institute of Certified Public Accountants (AICPA), 2008, Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits, AICPA, Durham, North Carolina.

¹⁹ Ms. Lynn Doughtie is the U.S. Chairman and CEO of KPMG and Ms. Cathy Engelbert is the CEO of Deloitte LLP.

²⁰ The Rosenberg Survey, National Survey of CPA Firm Statistics, 18th Annual Edition, 2016. This survey is available for a fee at <https://rosenbergsurvey.com/product/2016-rosenberg-survey/>

- (a) Increase the supply of accounting faculty through public and private funding and raise the number of professionally qualified faculty that teach on campuses. (Respondents: AAA and AICPA).
- (b) Emphasize the utility and effectiveness of cross-sabbaticals. (Respondents: AAA and AICPA).
- (c) Create a variety of tangible and sufficiently attractive incentives that will motivate private sector institutions to fund both accounting faculty and faculty research, to provide practice materials for academic research and for participation of professionals in behavioral and field study projects, and to encourage practicing accountants to pursue careers as academically and professionally qualified faculty. (Respondents: AAA and AICPA).

Update and Progress:

The following update is based on the responses provided by the AAA, AICPA and our research based on publicly available information.

The AICPA Foundation, in conjunction with large public accounting firms, launched the Accounting Scholars Doctoral (ADS) Program in June 2008 to address the growing shortage of academically qualified university accounting faculty, especially those with recent experience in the practice of auditing and tax. At the time the ADS program was created, over 43 percent of current accounting faculty members at U.S. colleges and universities were 55 or older, many preparing for retirement from the field. Meanwhile, student enrollment in college accounting programs continues to rise. Strong doctoral accounting faculties are essential for advancing the body of professional knowledge and to prepare talented, skilled accountants for emerging opportunities. The AICPA Foundation and partners have committed \$17 million to related initiatives over the years.

Meanwhile, the AAA, working with the AICPA, through its efforts on the Pathways Commission has issued various subgroup reports that advance this recommendation. More specifically, the reports on “An Examination of Non-Traditional Doctoral Education” and “How Integrating Professionally Oriented Faculty Enhances an Institution’s Mission” suggest some solutions on maintaining an adequate supply of qualified accounting faculty. These efforts are leading more practicing accountants to consider teaching later in their careers as professionally focused faculty.

While not specifically related to the ACAP recommendations, it should be noted that the SEC has long offered an Academic Fellowship Program in the Office of the Chief Accountant (OCA) and the Division of the Corporation Finance. In addition, the PCAOB established its Academic Fellow Program in 2009.

Both private and public sector funding for accounting research remains negligible when compared to research funding in other professions such as medicine. It may be perhaps because the nature and tenor of accounting research has changed considerably over the years. The divide between the academic research and its use by the practice/regulatory community is widening because all too often policy makers and practicing accountants do not find majority of academic research (with the exception of a limited number of research studies) useful to their endeavors.

Recommendation 4

Develop and maintain consistent demographic and higher education program profile data. (Respondent: AAA)

Update and Progress:

The following update is based on the responses provided by the AAA and our research based on publicly available information.

To address the problems that arise from the lack of consistent demographic and higher education program profile data concerning the accounting profession, the ACAP recommended establishment of a national cooperative committee comprised of organizations such as the AICPA and the AAA. This recommendation was made to facilitate better understanding, monitoring, evaluation, and decision-making with respect to various human capital related issues in the auditing profession.

Although some of the efforts that existed at the time of this recommendation (such as the AICPA Trends Survey) remain in place today, there is yet to be a nationally coordinated effort to create a national database that would provide to all interested users, including investors, information on the quality and competence of the human capital populating the auditing and accounting profession.

Recommendation 5

Encourage the American Institute of Certified Public Accountants (AICPA) and the American Accounting Association jointly to form a commission to provide a timely study of the possible future structure of higher education for the accounting profession. (Respondents: AAA and AICPA).

Update and Progress:

Following update is based on the responses provided by the AAA and the AICPA and our research based on publicly available information.

As noted above, in 2012 the AAA and the AICPA formed the Pathways Commission on Accounting Higher Education, bringing together more than 100 volunteers from practice and academia. Many programs and initiatives were created and both organizations continue to support the activities of the Commission. For example, the Commission's efforts in the area of Integrating Professionally Oriented Faculty in the Classroom influenced recalibration by the AACSB of its two-tier model of academically and professionally qualified faculty into a four-tier model of classifying faculty that gives due credit to schools for hiring faculty with real-world experience.

Although the Pathways Commission has put forth many ideas, it remains to be seen how many will actually make it into the practice of teaching accounting at universities, especially given the fact that there is a growing emphasis and pressure for faculty to publish in elite academic accounting journals that are not widely read by policy makers and the practicing accounting community.

Firm Structure and Finances

Recommendation 1

Urge the Securities and Exchange Commission (SEC), and Congress as appropriate, to provide for the creation by the Public Company Accounting Oversight Board (PCAOB) of a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding fraud prevention and detection, and further, the development of best practices regarding fraud prevention and detection. (Respondents: PCAOB and SEC).

Update and Progress:

The following update is based on the responses provided by the PCAOB and the SEC and our research based on publicly available information.

In 2010, the PCAOB posted on its website an announcement-soliciting candidate for the position of the Director of the National Center on Fraud Prevention and Detection. Separately, the status of the Fraud Center is listed as “ongoing consideration.” However, in 2014 the PCAOB established a new Center for Economic Analysis. According to the PCAOB, it has two specific initiatives that relate to fraud in financial reporting:

- *Fraud case studies:* An initiative to analyze specific instances of fraud to better understand and identify commonalities across cases (including, for example, ‘red flags’) as well as actions that could have uncovered the fraud. The cases seek to shed light on how the fraud developed over time, highlight economic impacts of the fraud, and identify key ‘takeaways’ based on a detailed analysis of the audit work performed. These studies support internal training and are intended to have other uses.
- *Fraud database:* An initiative to make better data on financial statement fraud available to the public. One goal is to encourage academics/researchers to explore issues related to accounting fraud and that can inform PCAOB oversight. In addition, the fraud database expects to provide the PCAOB with:
 - Access to information used in the development of economic analysis in standard setting;
 - An enhanced understanding of how standards might address problems in practice;
 - An ability to analyze robust data that may, among other things, inform the PCAOB’s risk assessments; and
 - Support for fulfilling its investor protection mandate by a continuing focus and structured analysis of fraud

Nowhere did we find any explanation as to why the PCAOB chose not to follow through on its 2010 initiative. One of the many hallmarks of a profession is extensive sharing of information among the parties entrusted with public interest responsibility and those who oversee and monitor them. For example, in the medical profession when a surgeon discovers a better way to conduct a surgery or deliver patient care, such advances are shared either through publication of journal articles in well-recognized journals or through demonstrations to peers and others. On the contrary, in the public accounting profession, such open and unrestricted sharing of advances in auditing practices does not occur—through firms or through the regulators entrusted with protecting the public interest.

Recommendation 2

Encourage greater regulatory cooperation and oversight of the public company auditing profession to improve the quality of the audit process and enhance confidence in the auditing profession and financial reporting. (Respondents: NASBA and SEC).

- (a) Institute the following mechanism to encourage the states to substantially adopt the mobility provisions of the Uniform Accountancy Act, Fifth Edition (UAA): If states have failed to adopt the mobility provisions of the UAA by December 31, 2010, Congress

should pass a federal provision requiring those states to adopt these provisions. (Respondent: NASBA).

(b) Require regular and formal roundtable meetings of regulators and other governmental enforcement bodies in a cooperative effort to improve regulatory effectiveness and reduce the incidence of duplicative and potentially inconsistent enforcement regimes. (Respondents: NASBA, PCAOB and SEC).

(c) Urge the states to create greater financial and operational independence of their state boards of accountancy. (Respondent: NASBA).

Update and Progress:

The following update is based on the responses provided by NASBA, PCAOB, SEC and our research based on publicly available information.

Mobility Provisions

NASBA reported to the Working Group that 49 of the 54 jurisdictions have adopted the individual mobility provisions of the Uniform Accountancy Act (UAA) (now in the seventh Edition as of May 2014). Mobility remains under consideration and discussion in Hawaii. NASBA and the AICPA worked closely with the State Boards of Accountancy across the U.S. to encourage passage of this legislation. The current version of the UAA also has incorporated the concept of firm mobility to make such language available to states that wish to consider it. As of the date of the response from NASBA, 17 jurisdictions allow for firm mobility.

Streamlining of the Regulatory and the Enforcement Regime

NASBA holds regular roundtable meetings at its periodic meetings/conferences with representatives of the various State Boards of Accountancy. It also conducts breakout sessions for chairs and executive directors of the State Boards of Accountancy to discuss topics and trends of current interest, to share information and ask questions. It also holds a separate annual Executive Director and Legal Conference to facilitate sharing of information among the staff and legal counsel of various state boards. NASBA invites leaders from Federal Regulatory and enforcement agencies to speak and participate at its regional and national conferences/meetings.

NASBA's senior leadership meets with the PCAOB board members annually to discuss current projects and policies. The staffs of both organizations have an ongoing dialogue. The NASBA staff also meets periodically with the SEC, the Department of Labor, and other relevant federal agency staff to discuss enforcement processes and efforts. NASBA's website disseminates information and tools relating to enforcement process and actions.

The PCAOB reported to the Working Group that its staff coordinates and meets regularly with various regulators to discuss issues of common interest in their respective oversight responsibilities, including quarterly meetings among the FASB, SEC and PCAOB as well as meeting with IAASB, AICPA, GAO, IFIAR, DOL, FinRA, and U.S. Federal Financial Regulatory Agencies.

With respect to the ACAP recommendation encouraging greater regulatory cooperation and oversight of the public company auditing profession, the SEC reported to the Working Group that the objective of their cooperation and frequent dialogue with the PCAOB is to assess whether more should and could be done in their oversight of auditors. Among the regulatory activities that the SEC engages in, the SEC staff and the PCAOB staff foster robust cooperation, engage with co-extensive enforcement authority over auditors, and meet formally on a quarterly basis and more frequently on routine oversight and standard setting activities.

The SEC Division of Enforcement's Financial Reporting and Auditing ("FRAud") Group focuses on financial reporting and audit failures, and the Division also launched its "Operation Broken Gate" initiative to identify auditors who neglect their duties and the auditing standards. Recent examples of SEC auditor enforcement efforts, in close coordination with the PCAOB; include charges against two national firms and associated partners for deficient audits²¹ and numerous sanctions of other firms stemming from Operation Broken Gate²².

In addition, the SEC and the PCAOB are involved with the International Forum of Independent Audit Regulators ("IFIAR"), which brings together independent audit regulators from 51 jurisdictions to collaborate on regulatory activity. Committee 1 of International Organization of Securities Commissions' ("IOSCO") of which the SEC is a member, represents IOSCO as an observer at meetings of IFIAR. The PCAOB participates and has an active leadership role in IFIAR. Additionally, the Financial Stability Board ("FSB"), which brings together senior policy makers from G20 countries, has held roundtables on effective audit regulation and oversight.

Financial and Operational Independence of State Boards of Accountancy

NASBA serves as an advocate for its member State Boards by monitoring legislative developments that could negatively affect the financial and operational independence of the State Boards. It has a dedicated Director of Governmental and Legislative Affairs whose sole mandate is to advocate to the legislators on behalf of its Member State Boards of Accountancy.

Recommendation 3

Urge the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms. (Respondents: NASBA, PCAOB and SEC).

Update and Progress:

The following update is based on the responses provided by NASBA, PCAOB, SEC and our research based on publicly available information.

The PCAOB reported to the Working Group that as part of its regular oversight it engages in dialogues with the largest CPA firms regarding their governance practices. NASBA reported to the Working Group that it has taken no direct action regarding this recommendation. However, pursuant to the public protection mandate afforded to Boards of Accountancy, NASBA's Regulatory Response Committee does assess requests for comment on proposals issued by the PCAOB, the SEC and the other state and federal accounting regulatory bodies.

As it relates to improving the transparency of audit firms, the SEC reports that, the IOSCO's Committee 1 led the effort to recently publish a "Statement on Transparency of Firms that Audit Public Companies" to promote good practice and contribute to high quality audit firm transparency reports.²³ A senior member of OCA chaired the Committee. Additionally, the Commission Staff is aware of, supports, and encourages the current efforts certain audit firms are making to improve transparency in their reporting with respect to matters such as firm governance and the system of quality control for their financial statement audits.

²¹ See, for example, following two press releases mentioned in SEC response: <https://www.sec.gov/news/pressrelease/2015-184.html> and <https://www.sec.gov/news/pressrelease/2015-272.html>

²² See, for example. Following press release mentioned in SEC response: <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543281121>

²³ IOSCO Final Report: Statement on Transparency of Firms that Audit Public Companies, November 2015, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD511.pdf>

As it relates to governance matters, the SEC issued a concept release in July 2015 seeking public comment regarding audit committee reporting requirements, including potential disclosure requirements regarding shareholder ratification and audit committee input in selecting the audit engagement partner, among many other important matters.²⁴ The SEC staff is currently reviewing and analyzing over 100 comment letters received in response to the concept release and monitoring any voluntary changes from the awareness brought to the issues to determine potential next steps to propose to the Commission for consideration.

In our brief review of the publicly available information on large public accounting firms, we do find some information on their governance structure, processes and practices. However, the disclosures on CPA Firm Governance are more informative in the reports issued by the large public accounting firms in the United Kingdom than in the U.S. Neither the SEC nor the PCAOB has taken any action to implement the ACAP recommendations on this important topic.

Recommendation 4

Urge the SEC to amend Form 8-K disclosure requirements to characterize appropriately and report every public company auditor change and to require auditing firms to notify the PCAOB of any premature engagement partner changes on public company audit clients. (Respondents: PCAOB and SEC).

Update and Progress:

The following update is based on the responses provided by PCAOB, SEC and our research based on publicly available information.

Currently, SEC rules require disclosure of certain information to investors on public company auditor changes. The Final Rule became effective on August 23, 2004.²⁵ Form 8-K, Item 4.01 requires the following disclosure regarding a change in the registrant's certifying accountant:

(a) If an independent accountant who was previously engaged as the principal accountant to audit the registrant's financial statements, or an independent accountant upon whom the principal accountant expressed reliance in its report regarding a significant subsidiary, resigns (or indicates that it declines to stand for re-appointment after completion of the current audit) or is dismissed, disclose the information required by Item 304(a)(1) of Regulation S-K (17 CFR 229.304(a)(1) of this chapter), including compliance with Item 304(a)(3) of Regulation S-K (17 CFR 229.304(a)(3) of this chapter).

(b) If a new independent accountant has been engaged as either the principal accountant to audit the registrant's financial statements or as an independent accountant on whom the principal accountant is expected to express reliance in its report regarding a significant subsidiary, the registrant must disclose the information required by Item 304(a)(2) of Regulation S-K (17 CFR 229.304(a)(2)).

The resignation or dismissal of an independent accountant, or their refusal to stand for re-appointment, is a reportable event separate from the engagement of a new independent accountant. On some occasions, two reports on Form 8-K are required for a single change in accountants, the first on the resignation (or refusal to stand for re-appointment) or dismissal of the former accountant and the second when the new accountant is engaged. Information required in

²⁴ United States Securities and Exchange Commission, Concept Release "Possible Revisions to Audit Committee Disclosures, July 1, 2015. Available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD511.pdf>

²⁵ United States Securities and Exchange Commission, Final Rule on Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date. 2004. Available at: <https://www.sec.gov/rules/final/33-8400.htm>. Also see <https://www.sec.gov/about/forms/form8-k.pdf>.

the second Form 8-K in such situations need not be provided to the extent that it has been reported previously in the first Form 8-K.

Recommendation 5

Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model. Further, urge that the PCAOB and the SEC clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards. (Respondents: SEC and PCAOB).

Update and Progress:

The following update is based on the responses provided by PCAOB, SEC and our research based on publicly available information.

The PCAOB provided the Working Group with the following summary of its activities relating to this issue:

- 2011 – PCAOB issued a concept release with the objective being to discuss several alternatives for changing the auditor's reporting model that could increase its transparency and relevance to the financial statement users. Concept release was followed by roundtable discussions and discussion at 2011 and 2012 Standing Advisory Group (SAG) meetings.²⁶
- 2013 – PCAOB proposed an auditor-reporting standard that would require the auditor to communicate in the auditor's report "critical audit matters" specific to each audit (PCAOB Release 2013-005). The proposal also added the phrase, "whether due to error or fraud" in the auditor's report when describing the auditor's responsibilities under the PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatements.
- May 2016 – Standards re-proposed. The re-proposal included critical audit matters that would inform investors and other financial statement users of matters arising from the audit that required especially challenging, subjective, or complex aspects of the audit as they relate to the relevant financial statement accounts and disclosures. (PCAOB Release 2016-003).
- 2016—Re-proposal discussed with SAG; planned IAG discussion.

Recommendation 6

Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report. (Respondent: PCAOB).

Update and Progress:

Following update is based on the responses provided by the PCAOB and our research based on the publicly available information.

The PCAOB provided the Working Group with the following summary of its activities relating to this issue:

²⁶ The Working Group notes that the Investor Advisory Group has raised this issue in its annual meetings in recent years. It is true also regarding mandating engagement partner signature and audit quality indicators.

- 2009--Concept Release regarding a standard to require engagement partner to sign audit report.
- 2011 – Board proposed standard requiring disclosure of the engagement partner’s name in the auditor’s report.
- 2011 – Discussions at November SAG meeting.
- 2013 - Standards re-proposed.
- 2015 – Supplemental request for comment issued to solicit comment on disclosure of name of the engagement partner and information about certain other participants in the audit on a new PCAOB form, Form AP, *Auditor Reporting of Certain Audit Participants* (“Form AP”).
- December 2015 – Board adopted final rules requiring the public disclosure of the name of the engagement partner and other accounting firms participating in the audit on Form AP for each completed audit on new form AP and did not adopt a signature requirement.

In addition to filing this information on Form AP, the audit firm may voluntarily provide information about the engagement partner, other accounting firms, or both in the auditor's report. The information on Form AP will be available in a searchable database on the PCAOB's website, which will include unique ID numbers for both engagement partners and firms to facilitate identification over time. Form AP has a basic filing deadline of 35 days after the auditor's report is first filed with the SEC, with a shorter deadline of 10 days after the auditor's report is first filed with the SEC for IPOs. Firms will file Form AP through the PCAOB's existing web-based Registration, Annual, and Special Reporting system.

The Board has chosen a phased effective date and the new rules will take effect as follows:

- (i.) Engagement partner: auditors' reports issued on or after January 31, 2017 or three months after SEC approval of the final rules, whichever is later
- (ii.) Other accounting firms: auditors' reports issued on or after June 30, 2017.

The SEC approved the PCAOB Rule on Form AP on May 9, 2016.²⁷

Recommendation 7

Urge the PCAOB to require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU’s Eighth Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VIII [Concentration and Competition] of this Report. Further, urge the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements. (Respondent: PCAOB).

Update and Progress:

The following update is based on the responses provided by the PCAOB and our research based on publicly available information.

²⁷ United States Securities and Exchange Commission, Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to auditing Standards. The approval order is available at <https://www.sec.gov/rules/pcaob/2016/34-77787.pdf>

Article 40 of the 8th Directive of the European Commission in summary requires that auditors of member states auditing public companies should publish annual transparency reports to provide information on the audit firm's structure and governance, and its system of ensuring audit quality. This legislation was in debate since October 2010 and was passed finally on April 14, 2014.

The legislation also reaffirmed the then existing EU requirement for audit firms to publish an annual transparency report and imposes the following additional requirements:

- A description of the firm's policy concerning the rotation of key audit partners and staff
- Financial information with a firm's total annual turnover (or gross revenue) divided into audit fees paid by the Public Interest Entities (PIEs), audit fees paid by other entities and fees for non-audit services
- Where the firm is a member of a network:
 - The name of each firm that is a member of the network;
 - The countries in which each firm that is a member of the network is qualified as a statutory auditor or has its registered office, central administration or place of business; and
 - The total turnover of the audit firms that are members of the network.
- An annual list of all PIEs the audit firm audits broken by the revenue they generate.²⁸

The PCAOB appears not to have made comparable progress in this area, although, disclosures on Form AP are viewed by the PCAOB as enhancing the transparency of the audit firms. The PCAOB reported the following to the Working Group with regard to progress on Audit Quality Indicators (AQIs):

- 2013 – IAG and SAG discussions on Audit Quality Indicators.
- 2014 & 2015 – Continued discussions with SAG on Audit Quality Indicators;
- Presentation on Audit Quality Indicators at IFIAR.
- 2015 – Concept release issued on Audit Quality Indicators.
- 2015 – Discussion with SAG of comments on Concept Release and possible next steps on AQIs.
- Comments on concept released analyzed; planning for ways to continue to study AQIs, and to encourage their voluntary use.

Concentration and Competition

Recommendation 1

Reduce barriers to the growth of smaller auditing firms consistent with an overall policy goal of promoting audit quality. Because smaller auditing firms are likely to become significant

²⁸ See Ernst & Young Publication for a Summary. Available at [https://webforms.ey.com/Publication/vwLUAssets/EY_-_European_Union_audit_legislation/\\$FILE/EY-pov-european-union-audit-legislation-april-2014.pdf](https://webforms.ey.com/Publication/vwLUAssets/EY_-_European_Union_audit_legislation/$FILE/EY-pov-european-union-audit-legislation-april-2014.pdf)

competitors in the market for larger company audits only in the long term, the Committee recognizes that Recommendation 2 will be a higher priority in the near term. (Respondent: SEC).

- (a) Require disclosure by public companies in their registration statements, annual reports, and proxy statements of any provisions in agreements with third parties that limit auditor choice. (Respondent: SEC).
- (b) Include representatives of smaller auditing firms in committees, public forums, fellowships, and other engagements. (Respondents: AICPA, PCAOB and SEC).

Update and Progress:

The following update is based on the responses provided by AICPA, PCAOB, SEC and our research based on publicly available information.

Disclosures on Limiting Auditor Choice

In the context of reducing barriers to competition for smaller audit firms, the Final Report included a recommendation to require disclosure by registrants of provisions in agreements that limit auditor choice. In this regard, the SEC reports that while registrants must disclose information about material definitive agreements; those disclosure requirements do not generally specify disclosures regarding provisions within agreements that limit auditor choice. Our quick search of the Form 8-K Item 1.01 filings revealed no such disclosures. The audit committee concept release previously mentioned solicits feedback regarding possible disclosures of factors considered by the audit committee when selecting or retaining the auditor, which could include information about consideration of smaller audit firms. As mentioned previously, the release also discusses potential additional disclosures related to the ratification by shareholders of the selection of the independent auditor.

Representation from Smaller Audit Firms

The PCAOB noted in its response to the Working Group that it includes representatives from smaller firms on SAG, IAG, and in various public meetings. Currently, SAG has 38 members, of whom seven members are from large (4) and non-Big4 (3) public accounting firms. However, it should be noted that the Big 4 audit firms have been given “permanent” seats at the table of SAG, unlike the smaller audit firms and investor organizations, which rotate periodically. Likewise, the IAG has 22 members and there is a mix of representatives from larger and smaller organizations. The PCAOB also conducts outreach to smaller auditing firms as well as firms that audit broker dealers.

In this regard, the SEC reported to the Working Group that the SEC staff in OCA has encouraged applicants from firms of all sizes to apply to our professional accounting fellowship programs. Successful applicants have included former employees from small and mid-size firms. The office also utilizes professionals from other regulators and other SEC offices and divisions on a time-limited basis to provide the multi-disciplinary talent needed for today's priorities. Our search of the SEC's website yielded no results to document the proportion of professional accounting fellows that have served the Commission since the release of the ACAP recommendation.

AICPA has not provided a response to this recommendation but our individual experience informs us that the Institute does include representatives from the smaller public accounting firms in its various committees and meetings. However, like the SEC, there is no such disclosure on the AICPA's website on a regular basis.

Recommendation 2

Monitor potential sources of catastrophic risk faced by public company auditing firms and create a mechanism for the preservation and rehabilitation of troubled larger public company auditing firms. (Respondents: PCAOB and SEC).

- (a) As part of its current oversight over registered auditing firms, the PCAOB should monitor potential sources of catastrophic risk which would threaten audit quality. (Respondents: PCAOB and SEC).
- (b) Establish a mechanism to assist in the preservation and rehabilitation of a troubled larger auditing firm. A first step would encourage larger auditing firms to adopt voluntarily a contingent streamlined internal governance mechanism that could be triggered in the event of threatening circumstances. If the governance mechanism failed to stabilize the firm, a second step would permit the SEC to appoint a court-approved trustee to seek to preserve and rehabilitate the firm by addressing the threatening situation, including through a reorganization, or if such a step were unsuccessful, to pursue an orderly transition. (Respondents: PCAOB and SEC).

Update and Progress:

The following update is based on the responses provided by PCAOB, SEC and our research based on publicly available information.

In its 2014-2018 Strategic Plan, the PCAOB, lists many strategies to deliver on its second objective: “Through inspections and enforcement actions and initiatives, respond to audit opinions issued without reasonable basis, understand root causes of deficiencies, and communicate insights on audit practices.” One of the strategies relates to monitoring and analyzing the business models of audit firms. To execute this strategy, the Board collects and analyzes information describing business models for registered accounting firms, with a focus on identifying and responding to potential audit quality risks posed by such business models. The same focus continues in the 2015-2019 Strategic Plan.

The SEC provided no specific response on its efforts to implement this recommendation.

Recommendation 3

Recommend the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and effectiveness and requiring auditing firms to publicly disclose these indicators. Assuming development and disclosure of indicators of audit quality are feasible, require the PCAOB to monitor these indicators. (Respondents: AAA and PCAOB).

Update and Progress:

The following update is based on the responses provided by AAA, PCAOB and our research based on publicly available information.

The PCAOB reported the following to the Working Group:

- 2013 – IAG and SAG discussions on Audit Quality Indicators.
- 2014 & 2015 – Continued discussions with SAG on Audit Quality Indicators; presentation on Audit Quality Indicators at IFIAR.
- 2015 – Concept release issued on Audit Quality Indicators.

- 2015 – Discussion with SAG of comments on Concept Release and possible next steps on AQIs.
- Comments on concept release analyzed; planning for ways to continue to study AQIs, and to encourage their voluntary use.

AAA provided no direct response on its efforts in this area.

To date, no Standards or Rules have been adopted by the PCAOB or the SEC with respect to the definition, measurement, management or disclosure of audit quality indicators at either individual audit or firm-wide level.

Recommendation 4

Promote the understanding of and compliance with auditor independence requirements among auditors, investors, public companies, audit committees, and boards of directors, in order to enhance investor confidence in the quality of audit processes and audits. (Respondents: AICPA, NASBA, PCAOB, and SEC).

- (a) Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible. The AICPA and state boards of accountancy should clarify and prominently note that differences exist between the SEC and PCAOB standards (applicable to public companies) and the AICPA and state standards (applicable in all circumstances, but subject to SEC and PCAOB standards, in the case of public companies) and indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements. This compilation should not require rulemaking by either the SEC or the PCAOB because it only calls for assembly and compilation of existing rules. (Respondents: AICPA, NASBA, PCAOB, and SEC).
- (b) Develop training materials to help foster and maintain the application of healthy professional skepticism with respect to issues of independence and other conflicts among public company auditors, and inspect auditing firms, through the PCAOB inspection process, for independence training of partners and mid-career professionals. (Respondents: AICPA, NASBA, and PCAOB).

Update and Progress:

The following update is based on the responses provided by AICPA, NASBA, PCAOB, SEC and our research based on publicly available information.

Independence Requirements

Through the AICPA Professional Ethics Executive Committee (PEEC), the AICPA devotes resources to “independence and ethics” activities. PEEC has developed many initiatives and resources in recent years related to this recommendation, including:

- Revising the AICPA Code of Professional Conduct so CPAs can more easily apply the rules and reach correct conclusions.
- Developing the AICPA Plain English Guide to Independence to assist CPAs in understanding independence requirements.
- Maintaining an up-to-date comparison of AICPA and SEC independence requirements, in addition to comparisons of the AICPA rules with those of the GAO and DOL.

Additionally, the AICPA produces and offers several behavioral and regulatory ethics courses that explore the distinctive ethical code of the profession.

NASBA and most State Boards of Accountancy have websites that include links to the jurisdictions law and rules, including its Code of Conduct/Ethics. Many boards have adopted the AICPA Code of Conduct by reference and others have adopted with some exceptions. If the Code is adopted with exceptions, the Board lists exceptions to the Code in its rules.

PCAOB's Department of Registrations and Inspections continues to monitor for compliance with independence requirements.

The SEC reported to the Working Group that its staff continues to emphasize the importance of the independence requirements through speeches²⁹, forums, and other public venues. In addition, staff within the SEC Division of Enforcement has been active in bringing cases against auditors who violate independence rules. As an example, the SEC recently brought two cases against a large firm and three former partners for auditor independence failures due to inappropriately close personal relationships.³⁰

Audit independence rules are available online and in searchable digital formats through private sector vendors.

Training for Professional Skepticism

The PCAOB in 2012 issued Staff Audit Practice Alert No. 10 on Maintaining and Applying Professional Skepticism in Audits. Additionally, the PCAOB reported the following initiatives in its response to the Working Group:

- 2011 – PCAOB launched the Forum for Auditors of Broker-Dealers. To promote accessibility, this forum has been held in various US locations, is offered at no cost and provides an opportunity for auditors of brokers or dealers to learn about and discuss PCAOB issues by attending seminars, webinars and discussions with PCAOB staff and Board members.
- 2004 - PCAOB launched the Forum on Auditing in the Small Business Environment, a program for representatives of the small business community to learn more about PCAOB work and the impact of new auditing standards. To promote accessibility, forum has been held in various US locations, is offered at no cost, and provides an opportunity for auditors from smaller registered public accounting firms to learn about and discuss PCAOB issues by attending seminars, webinars and discussions with PCAOB staff and Board members.

NASBA reported to the Working Group that the AICPA is in the midst of several projects focused on enhancing audit quality and the future of practice monitoring. NASBA State Board volunteers serve on most of the AICPA Committees and Task Forces involved in these projects. NASBA, on behalf of Boards of Accountancy, is also actively monitoring these projects, providing feedback to the AICPA and information to Boards of Accountancy through various outlets, including monthly newsletters and regional and annual conferences. NASBA's wholly owned subsidiary, the NASBA Center for Public Trust focused on advancing ethical leadership in

²⁹ For example, see the following speeches by the SEC Staff: <https://www.sec.gov/news/speech/bricker-remarks-aicpa-national-conf-banks-savings-institutions.html> and <https://www.sec.gov/news/speech/bricker-remarks-35th-financial-reporting-institute-conference.html>

³⁰ For example, see the following release by the SEC sanctioning a partner on violating independence rules: <https://www.sec.gov/news/pressrelease/2016-187.html>

business, institutions, and organizations. It provides periodic training on ethics matters and sponsors Student Center for Public Trust chapters on university campuses across the nation. As part of its training programs, it has sponsored Center for Audit Quality case study sessions on professional skepticism, conflicts of interest and independence topics.

As reported by the AICPA in their response, it has launched the Enhancing Audit Quality initiative, a comprehensive effort to consider auditing of private entities through multiple touch points, particularly where quality issues have emerged. Simultaneously, the ASEC and the Auditing Standards Board (ASB) are collaborating on activities to advance auditing in the future and open doors to transform the traditional financial statement audit.

Recommendation 5

Adopt annual shareholder ratification of public company auditors by all public companies. (Respondent: SEC).

Update and Progress:

The following update is based on the responses provided by the SEC and our research based on the publicly available information.

Based on our research, a large majority of public companies in U.S. permit an annual shareholder vote on auditor ratification. This vote is non-binding. However, no action has been taken by the SEC to make shareholder ratification of public company auditors a mandatory requirement.

Recommendation 6

Enhance regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the United States. (Respondent: PCAOB).

Update and Progress:

Following update is based on the responses provided by the PCAOB and our research based on publicly available information.

The PCAOB reported to the Working Group that it continues efforts to collaborate through:

- International inspections (as of September 2015, in 45 countries).
- International Auditor Regulatory Institute (established in 2007).
- Leadership roles in international organizations and regular participation in Enforcement and Inspection workshops of IFIAR.
- Coordination of cross-border information sharing, investigations and resources sharing.