U.S. Securities and Exchange Commission
Investor Advisory Committee
Panel Discussion
"Competition and Regulatory Reform at the PCAOB"

Written Statement of

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Written Statement

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Summary

- Trust in the quality of information is necessary, and the people of PwC, as also across the audit profession, play an important role. Understanding expectations and acting with integrity and maintaining independence form the foundation upon which we earn trust.

- Trust is also earned by saying what we will do, sharing why, delivering what we said we would, and doing so transparently. And, when things do not work as expected (and every so often, they will not), we learn from the experience and improve.

- Investors can make billions being 100% right, 50+% of the time. Boards and investors expect audit opinions to be 100% right, 100% of the time. That's always our goal. We reissue (or withdraw) our reports when we discover a material misstatement. At PwC this past year, 99+% of our public company audit reports held up in the public markets without reissuance related to material misstatements.[1]

- We are selected, engaged, overseen, and compensated by independent audit committees—a vital source of investor protection. We address audit reports to the board and stockholders.

- The public company financial reporting system has been reviewed over the years. In the early 2000's, far-sighted policy makers instituted comprehensive reforms to business financial practices in the Sarbanes-Oxley Act. Those reforms are serving investors and the public well.

- As the world, business, and technology continues to evolve, we all must continue to challenge ourselves about how trust is earned and delivered, asking questions like do we have a culture that embraces our public responsibility, are we communicating enough about emerging risks, and where else could assurance benefit investors and the public?

Introduction

Good morning Chair Gensler, Commissioners, Investor Advisory Committee (IAC) Chair Jennifer Marietta-Westberg, IAC Assistant Secretary, J.W. Verrett, other IAC members and fellow panelists. Thank you for inviting me to address the topics of auditing and regulatory reform.

Trust in the quality of information is necessary for any complex society, including our own, to function. People everywhere want some measure of assurance—something they can trust. Many factors play a role in earning that trust. The rule of law, institutions, objectivity, and expertise are key elements, each individually and working together, that build trust between providers and users of information. Trust is built on an approach of inclusion—not exclusion—of a diversity of thoughts, backgrounds, perspectives, functions, and disciplines.

[1] The numbers for integrated reports are 99.1% and for financial statement only reports are 99.7%. See PwC Audit Quality Report available at https://www.pwc.com/us/en/services/audit-assurance/assets/pwc-2021-audit-quality-report.pdf

Trust is enhanced by the expertise and independence of a vibrant auditing profession, both in the public and private markets. Assurance delivered by trusted auditors, who are independent and objective, is a cornerstone for the health of our financial and capital markets and our economy, and, in a certain respect, the well-being of our society.

A widespread demand exists for audited financial statements. The demand exists across many different stakeholders—investors, lenders, customers, employees, boards. It exists in regulated sectors and activities of our economy as well as those that are unregulated—public companies, private companies, nonprofits, and charities regularly provide audited financial statements, whether in accordance with mandates, contractual agreements or voluntarily. Independent audits build trust in society and are a cornerstone of our entire economy.

As an auditor and former Chief Accountant of the U.S. Securities and Exchange Commission (SEC), I believe the role of the auditor is noble. I would like to see the reputation of the profession increase to match its importance, particularly as we seek to expand the diversity and depth of talent necessary to meet the changing needs of the marketplace. I also would like to see the profession's expertise and integrity be part of the solution for additional investor protections and market quality relating to environmental, social and governance (ESG) information, eXtensible Business Reporting Language (XBRL) information, benchmark information, cyber risk management, and other vital market information.

These are all examples of areas where parts of the markets are receiving and therefore using information that does not benefit from assurance, but not without costs to the users of the information and the markets more broadly. For example, aggregated data publicly available from XBRL US website suggests that approximately 50% of the tags of information furnished by Fortune 500 companies and available on the SEC's website have at least one error. Assurance is one element that could help identify and resolve quality issues for investors, broadening access to the benefits of structured, machine-readable data.

Markets operate most efficiently when there is reliable, quality information that stakeholders can use to make decisions. The markets have long embraced the value of auditors. Even before formation of the SEC in 1934, many companies made available audited financial statements. By 1926, more than 90% of companies trading on the New York Stock Exchange were audited by CPAs, even though at the time audits were not a requirement to list companies there.[2]

The audit is designed with benefits and costs in mind, including the benefit of a lower cost of capital for audited companies over time offset by the costs. Assurance delivers outsized benefits—in public and private markets alike. One only has to look at the circumstances where there is a lack of trust in information provided by a company or a class of them to appreciate the significance of a source of independent assurance.

The New Equation

At PwC, we are driven by our purpose—to build trust in society and solve important problems. To help achieve that purpose, in July of this year we launched a new global strategy, The New Equation. With our new strategy, the U.S. firm realigned our firm to bring together our trust-based services into our Trust Solutions segment and create the largest trust platform in the world. This shift reflects our commitment to quality and laser focus on enhancing investor and stakeholder trust in the markets in which we operate.

[2] See Center for Audit Quality, Value of the Audit: A Brief History and the Path Forward, page 4, available at https://www.thecaq.org/wp-content/uploads/2021/06/caq_value-of-the-audit_2021-06-B.pdf.

We implemented these changes to address the reality that the world is changing at an unyieldingly rapid pace. As we studied the business environment, we saw that companies, directors, and others need to build trust on more information. Today, assurance varies according to the nature and location of information. Information may be:

- Audited information, like financial statements and internal controls over financial reporting.
- Information derived from or reconciled to audited financial information, like earnings releases, compensation data, non-GAAP information, and portions of MD&A.
- Carbon and other environmental data, human capital demographics, cyber risk management information, and other vital ESG information are generally derived from a variety of sources and are often not derived from or reconciled to audited financial information or within the current scope of internal controls over financial reporting.
- Information that may be important to a company, long-term value creation and sustainability such as information about a company's supply chain, or the nature or fairness of a company's business conduct or that of its trading partners, which often is not be derived or reconciled to audited financial information or within the current scope of internal controls over financial reporting.

As auditors, we strive to foster an environment of trust, one where investors can live their economic lives relatively free of suspicion and mistrust about the core infrastructure of material information and investor safeguards. At PwC we support finding ways for the audit profession to provide trust on more information.

To move trust in information forward and do it well takes all of us—a community of diverse, talented and committed business leaders and their boards, internal and external auditors, investors, regulators, policymakers, academics and other professionals—relentlessly working together. The effectiveness of any one group doing it alone is illusory. Trust, trustworthiness, objectivity and expertise are all essential ingredients. Confidence in an audit is earned in no small part because of the open-source standards that auditors apply when performing the audit, developed by regulatory mandates for public companies and general acceptance in the private sector.

Building trust also requires executives, board members, investors and others to be proficient in trust as an essential skill set. It requires them to "walk the walk" of a commitment to building trust. We're launching PwC's Trust Leadership Institute this fall for 10,000 leaders over 3 years, which will help equip them to operate successfully in ways that help earn trust, deliver sustainable outcomes, and positively impact both business and society.

Power of People + Technology

At PwC, we are transforming the audit with the power of people and technology.

People

We need to prepare future professionals adequately for the complexity of financial reporting and auditing in a dynamic and global environment.

At PwC, we are also continuing to work on broadening access to the profession, and collaborating with the entire profession in doing so. We are recruiting, developing and retaining diverse talent in new ways—including building relationships with Historically Black Colleges and Universities, Hispanic Serving

Institutions and community colleges—and investing in the experience of our racially and ethnically diverse colleagues, from associate through partner.

Earlier this year, we launched an evolution of our Access Your Potential (AYP) program. Through this effort, we aim to expand the number of Black and Latinx professionals that join the firm to better reflect the diversity in higher education enrollment. PwC committed $125 million to support 25,000 Black and Latinx college students as they begin their careers, and PwC aspires to hire 10,000 Black and Latinx students into roles at the firm by 2026. Our goal is to help enable students from all backgrounds to have an equal opportunity to succeed, changing students' trajectories and uplifting their communities.

We are focused on cultivating an exceptional people experience—offering our people a culture of caring and belonging, being a great place to build their futures and giving them the everyday support they need to learn and grow.

Last year, we released our first Diversity & Inclusion Transparency Report showing the progress we've made and the work we still want to do to continue to support parity of experience for all of our people. We continue to build a culture of belonging—one where we move from awareness to empathy and demonstrate inclusive leadership. But as much as we've learned from our progress, we know that we're not yet where we want to be.

As we strive to improve diversity and inclusion within our own firm and throughout the profession, we know that we cannot accomplish this on our own—it requires learning from many, including other businesses, nonprofits and educational institutions. That's why PwC co-founded CEO Action for Diversity and Inclusion, the largest CEO-driven business commitment to advance diversity and inclusion within the workplace. Since 2016, we have worked with nearly 2,000 CEOs and thousands of their organizations' Chief Human Resource Offices and Chief Diversity Officers to focus on collective progress, measurable action and meaningful change for our organizations and communities. Last year, we built on that foundation and created CEO Action for Racial Equity, the first-of-its-kind, business-led initiative mobilizing corporate America to advance racial equity through public policy and corporate engagement strategies. Rallying approximately 100 companies, we've been able to help advocate for public policies around eight issue areas that disproportionately impact Black people in America.

Development of the next generation of audit professionals who are prepared to take on a high bar of professional status is vital to public accounting. As with generations past, today's audit professionals earn their professional status in society, derived from rigorous requirements, such as:

- The work they perform is endowed with a public responsibility and interest—the "P" in CPA.
- They undergo a recognized educational process at an entry level with a formal examination.
- They have an ongoing educational requirement to stay current and adapt to market, business, and regulatory changes.
- They possess a body of specialized knowledge with credentialing requirements.
- They conform to a standard of professional qualifications.
- They are licensed and subject to ethics, compliance, and conduct obligations with disciplinary activities for possible noncompliance.
- They maintain certain standards of conduct, with work subject to expert-level review or for public company audits, regulatory inspections.

Technology

Combining professional expertise, judgment, and experience with technological tools helps advance audits with the power of data-driven decision-making to maximize quality impact and minimize unnecessary disruption.

At PwC, our audit—called Tomorrow's Audit, Today—is human-led, tech-powered and digitally amplified. Driven by a quality-first, purpose-always mindset, we continually seek to discover how technology can help solve complex business challenges, build trust and identify new opportunities for assurance.

The platforms that power our audit are just the beginning. We are pursuing new ways of using data to identify risks, detect anomalies, and surface insights, increasing the application of Artificial Intelligence to the audit, redefining digital collaboration, and elevating the experience for our people and our clients in the process.

In addition, investors are paying more attention to technological developments. The audit profession has to evolve to keep pace with this disruption and transformation. New skills need to be learned, better and more refined techniques need to be deployed, and auditors need to execute technology-enabled procedures to assess client controls and financial outcomes. As technology's power and pervasiveness continues to increase, so have our opportunities to change the world. When our better selves and the greatest aspects of technology are brought together, there is no opportunity too great for us to achieve.

Commitment to Quality

A commitment to quality underpins our strategy.

Our [PwC US 2021 Audit Quality Report] provides timely insight into how our culture, values, people, and processes came together to deliver on our audit quality objectives during an unprecedented year.[3]

In our report, we provide an update on how we, as a U.S. firm, delivered on our audit quality objectives over the past unprecedented year and how this is reflected in our transparency data points. It also includes information regarding our approach to ESG reporting; ongoing commitment to diversity and inclusion; focus on living our values and maintaining independence; and innovative, risk-based audit approach.

The report also provides information about our structure and governance, including the role of external directors on our U.S. Board and our diverse Assurance Quality Advisory Committee (AQAC).

As one measure of outcomes, we anticipate only one of the 58 PwC audit engagements that were subject to inspection in 2020 being included in Part 1.A of the PCAOB's inspection report.[4] Audit quality is an ongoing journey and requires our commitment to continuous improvement. This anticipated achievement also demonstrates that investments we have made in quality have positively impacted the results of the 2020 inspection of 2019-year end audits. Although we are proud of this achievement, the firm recognizes that sustaining audit quality improvement steps is an ongoing journey and requires a commitment to continuous improvement.

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[3] Bricker, Wes, and Kaminsky, Kathryn. "Our focus on audit quality." PwC.com. Last modified August 23, 2021. https://www.pwc.com/us/en/services/audit-assurance/library/audit-quality-report.html.
[4] When an engagement is included in a report, it does not mean there was a material misstatement in the financial statements. Rather, it means that in the PCAOB's view there was a lack of audit evidence at the time of when the auditor issued the audit report. See https://pcaobus.org/oversight/inspections/inspection-procedures

Audit Quality Indicators

One element of the audit quality discussion is how to indicate, convey, or portray it. This is not a new or uniquely U.S. topic, nor is it straightforward. PwC publishes a definition of audit quality along with various operational and other quantitative indicators of the quality of an audit.

Audit quality indicators (AQIs) has been a recurring topic in regulatory, professional, practice, and academic discussions. Even a comprehensive suite of audit quality indicators accompanied by sufficient qualitative context may not provide complete information to assess audit quality, as some elements of audit quality do not lend themselves to being evaluated quantitatively (such as due care and professional skepticism). At PwC, for this reason, we commonly describe our measures as “Transparency Data Points” because of the context and expertise necessary to combine with the data points—which collectively go into a judgment about audit quality.

Many firms, including PwC, have made significant advances in providing transparency data points and other information in our audit quality reports from which several lessons can be drawn.

The first lesson over time relates to how one defines audit quality. PwC provides a definition in our audit quality reports. Our firm’s definition is among several that are available. There are different definitions available in academic literature. The U.S. Government Accountability Office has a definition.[5] The PCAOB’s former Standing Advisory Group developed a definition.[6] None of these definitions are mutually exclusive, but their focuses on audit quality are different. The statement made by the U.K. Financial Reporting Council in 2006 still holds true today: “*There is no single agreed definition of audit quality that can be used as a ‘standard’ against which actual performance can be assessed.*”[7]

A second lesson over time is the limitations of measures in fully capturing audit quality. Assessing audit quality includes consideration of areas such as root cause analyses, correlations, and operational measures. Such an assessment does not take the place of a professional understanding of audit practices derived from a combination of experience and expertise, by which we:

- ask tough questions;
- apply an objective and skeptical mindset;
- embrace the supervision, review, and inspections processes as a way to continuously learn and improve;
- stay current on professional standards;
- have timely, meaningful exchanges with audit committees and management;
- plan our work and resolve issues in a timely and thorough fashion;
- remain alert for emerging risks and issues that need deeper analysis;
- act with professionalism; and
- recognize our role in the capital markets.

There are no set definitions of operational measures, individually or together, that take the place of context and expertise to evaluate audit quality. This is not unique to auditing. For example, would it produce optimal results to hire a candidate based solely on a GPA or based solely on their alma mater? Would it be optimal for a student to select classes based solely on professors’ teaching evaluations?

[5] See page 13 of the GAO report titled, “Public Accounting Firms - Required Study on the Potential Effects of Mandatory Audit Firm Rotation”.
[6] See “Discussion - Audit Quality Indicators” at the PCAOB’s Standing Advisory Group meeting in 2013.
[7] See the FRC’s discussion paper on “Promoting Audit Quality.”

In making progress, we have learned over time that the consistency, comparability, and decision-usefulness of audit quality indicators are impacted by the realities that:

- Audit quality overlaps with, but is distinct from, financial reporting quality. For any given policy question there is a fundamental question: is the issue one of audit quality, or financial reporting quality, or both?
- Audits are delivered with different methodologies and technology across audit firms, industries, engagements or audit partners. As a result, some indicators may not be comparable.[8]
- Audit quality indicators that relate to firm-level characteristics may not be decision-useful or generalizable for any particular audit or engagement because of the vital impact of individual professionals. Conversely, individual audit deficiencies also may not be generalized to all of a firm's engagements. For example, an analyst may wish to use an indicator at a firm level to reach an inference about the quality of an audit for a company's financial statement disclosures that she plans to use in making an investment decision. The analyst would rightly note that the firm-level indicators are unlikely to yield generalizable insight into the quality of the audit report she is using. Of course, firm-level indicators can provide important insights about quality for the firm overall and can also be a useful frame of reference when considering engagement-specific indicators.
- The audit committee plays a key role in overseeing external auditors as part of the broader financial reporting process. In the U.S. and a number of other countries, audit committees take direct responsibility for the external audit relationship -- the appointment, retention, compensation, and oversight of the work of an external auditor. Auditors report directly to the committee, rather than management, and this structure best positions the auditors to raise contentious issues about management's responsibilities with the audit committee.

A third lesson over time is that the decision-usefulness of a set of audit quality indicators depends also on the user's expertise to apply sensible meaning to the data. The PCAOB's concept release in 2015 makes this point as well in noting that audits may fall into the category of "credence goods."[9]

As academic literature notes,[10] disclosures about the quality of credence goods—whether an audit, a medical procedure, a computer repair, or other areas—are not the typical solution to raising the bar on quality because disclosure is only useful when users of the disclosure have expertise to interpret the data and make decisions from it. There are other, more direct solutions. For this and other reasons, the solutions in the mature U.S. market infrastructure for the informational problems faced by buyers of audit services include:

- regulation to a set of professional standards—the auditing standards by the PCAOB;
- professional licensing and codes of conduct—CPA licensing, AICPA Code of Professional Conduct and PCAOB and SEC ethics and independence rules;
- prospect of market pressure and legal and regulatory liability for noncompliance with professional standards;
- competition among service providers to deliver quality results;

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[8]For example, an audit firm that has made the required investments to achieve significant advances in technology would conduct audits differently from another firm that has not made such advancements. This will result in the composition of engagement teams differing across the two firms, yet audit quality may or may not be different. Thus, different values of the same audit quality indicators across firms may inappropriately suggest differing audit quality while the underlying audit quality is in fact the same, while on the other hand the same value of this indicator may suggest similar audit quality across two firms while it fails to reflect what may be underlying different audit quality.

[9] See the PCAOB's Concept Release on Audit Quality Indicators in 2015.

[10] See Balafoutas, L and R. Kerschbamer. 2020. "Credence goods in the literature: What the past fifteen years have taught us about fraud, incentives, and the role of institutions" Journal of Behavioral and Experimental Finance.

- reputation of service providers for providing quality; and
- expertise of the buyer, ultimately embodied in the decisions of an independent audit committee regarding quality, liability and reputational matters.

Well-informed audit committees can be effective at mitigating the informational problem, both through their expertise to assess audit quality and through their direct discussions with auditors to access additional information.

Since the information content of AQIs varies and the expertise of users and the nature of their specific decisions are not uniform, in practice user decision guides are valuable tools.[11] The guides can help external users in different roles (such as an audit committee member or an investor), regulators, and other policy makers in considering whether and to what extent AQIs can inform their respective decisions.

Competition

Audit quality and competition may overlap, but they are not the same. Competition in the U.S. markets have been studied over time, including by the GAO in 2008. The GAO determined that continued concentration in the audit market for large public companies did not call for immediate action.[12] The GAO considered a number of proposals such as mandatory audit firm rotation, audit firm financial statement disclosure, and breaking up the largest firms into more firms. The GAO found that, while each could offer certain benefits, each proposal also presents at least some significant disadvantages as well as limited effectiveness, feasibility, and benefit.

In my experience, competition among the large firms is robust. I also see mid-tier firms in the marketplace competing vigorously. Based on recent available data from Audit Analytics[13] June 2021, the Big Four:

- Audit 47% of all U.S. public companies. Audit firm choice, competition, selection, and retention is done at the company level, through an independent audit committee, resulting in the count of firms being a useful measure for assessments of competition, and perhaps more useful than others that conflate factors like percentage of assets or revenue audited.
- Audit 91% of large accelerated filers. Audit committees of larger companies tend to select a larger, more integrated firm to address their often multinational, complex audit needs.

In my experience with investors, boards, audit committees, and other leaders, the prevailing view in the investing and business world is that the system is working and without a need for drastic action. In my experience, investors remain primarily interested in the quality of the audit services, including the auditor's independence.

Yet, there are opportunities to continue encouraging competition. Technology is an area where barriers to access by independent firms could be addressed. For example, we need to study regulatory barriers to smaller firms' access to critical, shared audit technology. Creating the ability to access shared, specialized audit technology and related expertise to supplement smaller firms' technical capabilities for performing

[11] For example, the Center for Audit Quality has published an Audit Quality Disclosure Framework to help guide preparers of audit quality disclosures, available at https://www.thecaq.org/wp-content/uploads/2019/03/caq_audit_quality_disclosure_framework_2019-01.pdf
[12] See Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action, available at https://www.gao.gov/products/gao-08-163
[13] Hallas, Nicole, and Kristyn Plante. "Who Audits Public Companies – 2021 Edition." Audit Analytics. Last modified June 17, 2021. https://blog.auditanalytics.com/who-audits-public-companies-2021-edition/.

public company audits could provide midsize and smaller firms with capacity and capability as they perform audit procedures.

The PCAOB's Critical Role

PwC supports the critical role that regulators, including the PCAOB, can serve in continuously enhancing the quality of audit services to protect investors and markets. Investors (managers and owners, among others) have essential perspectives to provide to the PCAOB as it fulfills its mission.

The PCAOB's mission is to oversee the audits of public companies and brokers and dealers in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB's responsibilities are broad—they include standard setting, registration and inspection of audit firms, and enforcement authority. Accordingly, for us as auditors, the PCAOB fills a critical oversight role in the capital markets.

The PCAOB's inspection program has played a critical role in improving the quality of independent audits. PCAOB inspections are rigorous, even in spite of the challenges of the current COVID pandemic, and they spur learning, improvement, raising the bar on quality and identifying emerging risks and trends.

The PCAOB also fulfills its mission through the establishment and maintenance of rigorous auditing standards that must keep pace with the evolution in financial reporting. Economic analysis helps the PCAOB meet this statutory obligation, including whether to adopt new requirements and impose corresponding burdens. Changes in standards over the past several years include enhancing performance in some of the most complex parts of the audit, such as auditing accounting estimates, including fair value measurements and the auditor's use of the work of specialists.

We also have implemented the PCAOB's auditor reporting standard. The report is addressed to the Board and stockholders. It retains a pass/fail opinion, while adding clarity regarding responsibility for fraud, adds reporting for critical audit matters, discloses audit firm tenure, among other revisions. The auditor's report was a strong step forward for users of the audit. We have also implemented the PCAOB's transparency and accountability measures, such as reporting of other firms involved in a group audit and individual audit partner names on Form AP.

Turning to international collaboration, in today's interconnected world economy, investors depend on quality auditing and auditing standards around the world. U.S. investors routinely invest in companies based outside the United States and listed in non-U.S. jurisdictions to diversify their portfolios.

Oversight and governance of international audit and related standards (audit and assurance, ethical and educational standards) are important so that standards and guidance for auditors support the delivery of quality audits around the world.

Accordingly, I believe that it serves investors' interests for the PCAOB to continue its involvement in international matters, including through the work of IFIAR. Since a substantial portion of audits of many public companies registered in the U.S. are centered outside the United States, the capital markets benefit when standard setters work with regulators and standard setters in other countries and with international agencies. This also helps to limit the costs incurred because of regulatory fragmentation across markets, which is ultimately borne by investors.

Conclusion

The U.S. financial reporting structure is sophisticated and mature, with many interdependent components, such as the internal control frameworks, corporate governance codes, accounting standards, and audits.[14] To advance the system, we must both understand and evaluate each element. What updates to the internal controls framework should be considered to stay current with technology innovations and new ways of working? Is corporate governance meeting the right objectives? Should we broaden the scope of audits or deepen them? These questions were also all on the table when the Sarbanes-Oxley Act was passed, and the success of the act illustrates how changes to the interrelated components of the financial reporting structure should work together.

As we move forward as PwC and as an accounting profession, we acknowledge our critical role in building trust in capital markets. Confidence in the quality of material information is necessary for a complex society to function, and markets operate most efficiently when there's reliable, quality information stakeholders can use to make decisions. Providing assurance services over this information is a significant responsibility, and I'm confident that we are well positioned to move forward together, continuing to advance the U.S. reporting infrastructure in the public interest.

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[14]See "U.S. Financial Reporting Structure for Public Issuers."