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Statement of James R. Doty
Chairman
Public Company Accounting Oversight Board

at a Hearing on

Examining the Agenda of Regulators, SROs, and Standard-Setters for
Accounting, Auditing and Municipal Securities

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets
and Government Sponsored Enterprises

2128 Rayburn House Office Building
September 22, 2016



Statement of James R. Doty
Chairman
Public Company Accounting Oversight Board

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for the opportunity to appear before you today on behalf of the Public Company Accounting Oversight Board ("PCAOB" or "Board") to testify on the work of the PCAOB. I appreciate the Subcommittee's continued interest in high quality audits for public companies and SEC-registered broker-dealers.

I. Introduction

U.S. public securities markets provide a reliable funding mechanism for American and foreign businesses. Our economy is resilient, in part because millions of savers continue to be willing to invest in business enterprises to fuel growth, growth that results in more workers, more savings and more investment. This cycle promotes economic wealth, but it relies on the system of accurate financial disclosures by public companies to the investors who entrust capital to them.

As Chairman, I believe the PCAOB is a vital resource that protects investors and fosters economic resiliency by advancing reliable, informative and independent audits. Accurate and transparent financial audits are a key to promoting investor trust and investment that grows capital markets and drives a healthy economy. Experience tells us the PCAOB's role is essential and our standards and oversight programs are making a real difference on behalf of investors and companies. It is critically important that the PCAOB remain vigilant and independent because persistent economic pressures can threaten the integrity of audits. Going forward, a rapidly changing landscape will require the PCAOB to invest in innovations to meet the needs of investors and enable public companies in our markets to benefit from a lower cost of capital.

I believe that the PCAOB, and the accounting firms that we oversee, play a critical role in enabling markets to provide investors with reliable information upon which to make their own investment decisions. The financial audit is the linchpin for investor confidence in that information, and a reliable audit is one led by an auditor that is independent, objective, and skeptical, and applies the diligence needed to meet PCAOB standards.

If investors lose confidence in financial reporting, they will demand prohibitively high returns as a condition of investing or they may withdraw from the capital markets altogether. The result would be to make it more difficult and expensive to finance the businesses on which our economy depends. Moreover, inaccurate financial reporting can mask poor business strategies or fraud that, if left uncorrected, may result in the misallocation of capital, business failures, and job losses.

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The PCAOB is focused on taking appropriate steps in its inspection and enforcement programs in order to improve audit quality and enhance protection of the investing public. The PCAOB is also using information gained in inspections and investigations, along with information received from investors, audit committee members, auditors and others, to improve auditing and related professional practice standards.

The PCAOB is a non-profit institution established by the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”). It is designed to bring expertise and a variety of perspectives to the task of setting appropriate standards and overseeing the practice of auditing public companies and SEC-registered broker-dealers. By law, all of the PCAOB’s responsibilities are discharged under the oversight of the U.S. Securities and Exchange Commission (“SEC”). Chair Mary Jo White, the Commissioners, and Interim Chief Accountant Wes Bricker have taken a deep interest in the PCAOB’s work. I am grateful for their support and for the strong working relationship they have fostered between our organizations.

II. Current PCAOB Activities and Priorities

A. Inspections

The Sarbanes-Oxley Act requires the PCAOB to conduct a continuing program of inspections of registered accounting firms. There are currently 2,062 accounting firms registered with the Board. The Board’s statutory inspection authority relates to audits of issuers, brokers, and dealers. The Board does not inspect firms that perform no such work, although many such firms have chosen to register anyway.

During an inspection, the PCAOB assesses the auditor’s compliance with applicable laws, rules and professional standards. As part of an inspection, PCAOB inspectors evaluate the design and effectiveness of the audit firm’s quality control system as well as the quality of its work in the portions of audits selected for inspection.

1. Inspections of Public Company Audits

Registered firms that issue audit reports for more than 100 issuers are required to be inspected by the PCAOB annually. In 2015, the last complete cycle of our inspection program, the PCAOB inspected 10 such firms. As part of these inspections, PCAOB inspectors examined portions of approximately 320 audits performed by these firms.

Registered firms that issue audit reports for 100 or fewer issuers are, in general, inspected at least once every three years. The PCAOB inspected 205 such firms in

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2015, including 63 non-U.S. firms located in 29 jurisdictions.¹ In the course of those inspections, PCAOB staff examined portions of 493 audits.

The selection of issuer audits for review is influenced by a number of factors. The selection can be based on the risk that an issuer's financial statements could be materially misstated; characteristics of the particular issuer or its industry; the audit issues likely to be encountered; considerations about the firm, a particular practice office or an individual partner; prior inspection results; or other factors.

The PCAOB prepares a report on each inspection and makes portions of that report publicly available, subject to statutory restrictions on public disclosure. The Board issued 218 inspection reports in 2015.

If an inspection report includes criticisms of or identifies potential defects in a firm's system of quality control, those criticisms are initially kept nonpublic, as required by the Act. The firm has 12 months from the issuance of the inspection report to address the criticisms to the Board's satisfaction. If it does so, the criticisms remain nonpublic. If it does not do so, then, subject to the firm's right to seek SEC review of the Board's determination, the Board publicly discloses those criticisms.

In the PCAOB's 14 years, inspectors have found many examples of high quality work, including evidence of auditors requiring companies to change their accounting or improve their internal controls over the production of financial reports. They are the unsung heroes who avert the scandals that don't happen.

But our inspections have also found and reported numerous instances in which firms' audit reports should not have been issued. These instances include audits of some of the largest companies in the world, as well as mid-size and smaller companies.

Emerging research on our inspections indicates that when we find deficient audits, the engagement teams raise their game – without a commensurate increase in fees but with a statistically significant reduction in restatements.

¹ Based on bilateral protocols we have established, we conducted many of these non-U.S. inspections jointly with our foreign counterparts. Earlier this year, the European Commission issued a new Adequacy Decision covering the next six years, double the term set in the two previous Adequacy Decisions covering our work which supports continued joint inspections with local European audit regulators.

Today, our inspectors can conduct required inspections in all relevant jurisdictions except Belgium, Italy, Ireland, Portugal and China. We have made significant progress toward concluding cooperative agreements with the first four of these jurisdictions. We are actively engaged with our counterparts in all of those jurisdictions to establish cooperative arrangements.

Our joint inspections with counterparts in Europe and elsewhere are another new paradigm, and have proven to be both effective and efficient. We are tearing down impediments to audit quality in the global network firms that the leaders of those firms had not focused on prior to our efforts in this area.

2. Interim Program for Inspections of Firms that Audit Broker-Dealers

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) expanded the PCAOB’s inspection, enforcement, and standard-setting authority to include the auditors and audits of brokers and dealers and authorized the PCAOB to develop an inspection program for auditors of brokers and dealers. The PCAOB has implemented this new authority thoughtfully. We quickly established an interim inspection program in 2011, with the stated objective of developing a permanent program that, with the benefit of experience in the interim program, would reflect informed judgments about cost-effective ways to design the program, including through the consideration of the use of exemptions and frequency provisions.

Under this interim pilot program, the PCAOB plans to conduct 75 inspections of broker-dealer auditors this year, covering portions of approximately 115 audits. This number includes 5 firms that audit more than 100 broker-dealers, 13 firms that audit 21 to 100 broker-dealers, and 57 firms that audit 1 to 20 broker-dealers.

The PCAOB has not issued any firm-specific inspection reports as part of the interim inspection program. Instead, to keep the public informed, the Board has published an annual report on the overall results of the inspections during the interim program. That report is also intended to help auditors understand identified deficiencies and applicable requirements. The fifth such annual progress report was issued last month.

Based on information gathered through the interim inspection program, we are now conducting careful economic analysis of potential approaches to a permanent program. The permanent program will be established by rule, after notice, public comment and, as is the case with all our rules, SEC approval.

In order to maintain a constructive dialogue with these auditors, the PCAOB has conducted numerous forums with broker-dealer auditors around the country. Since 2011, we have held 18 such Forums for Auditors of Broker-Dealers with more than 2,700 attendees. Indeed, on the date of the Subcommittee’s hearing, representatives of the PCAOB are scheduled to conduct a Forum in Jersey City, New Jersey, where we expect approximately 330 people from 120 firms to attend. We plan to continue such

forums going forward, as well as via webinars. We have held three such webinars during the past two years and plan to expand the use of such Web-based, interactive communication tools, in order to be accessible to as many auditors as possible.

C. Enforcement

The Board has authority to impose sanctions on registered firms and associated persons that have violated applicable laws and standards. Disciplinary cases that have become public recently have focused on audit failures related to both U.S. and non-U.S. issuers; violations of applicable standards on quality control and auditing; and auditors' failures to comply with the Board's processes and rules.

The PCAOB made public 44 settled disciplinary orders in 2015, providing for sanctions on auditors ranging from censures to monetary penalties to revocations of registration and bars on association with registered accounting firms. So far in 2016, the PCAOB has made 30 settled disciplinary orders public.

Also in 2015, the Board determined for the first time not to commence disciplinary action against an audit firm based on credit given for the firm's extraordinary cooperation with the PCAOB, including self-reporting and remedial actions, under the terms of a policy statement issued by the Board in April 2013. The Board also issued its first order in which a settling respondent admitted to a disciplinary order's facts, findings and violations.

The PCAOB has also stepped up enforcing compliance with our audit standards and other requirements by registered non-U.S. firms. Recently PCAOB staff have also uncovered evidence suggesting the possibility that registered firms, including some affiliates from large global networks, may have improperly deleted, added to, or altered documents provided to PCAOB inspectors without informing the inspectors of the alterations. Addressing these matters continues to be a high priority for the Enforcement division. To this end, earlier this year, the PCAOB issued a Staff Audit Practice Alert on *Improper Alteration of Audit Documentation*, which reflects the staff's concern about auditors improperly altering audit documentation in connection with a PCAOB inspection or investigation. As the Alert pointed out, "[i]mproperly altering audit documentation is also inconsistent with an auditor's professional duty to act with integrity and as a gatekeeper in the public securities markets."²

The PCAOB closely coordinates its enforcement efforts with the SEC. In certain instances, the PCAOB investigates the auditor's conduct and the SEC focuses its

² See PCAOB Publishes Staff Audit Practice Alert on Improper Alteration of Audit Documents, April 21, 2016.

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investigation on the public company, its management, and other parties. In other cases, upon request of SEC investigators, the PCAOB makes information available to SEC investigators but defers its own investigation to the SEC's, which are resolved in public proceedings.

Under the Sarbanes-Oxley Act as it exists today, the PCAOB's disciplinary proceedings are nonpublic, unless the Board finds there is good cause for a hearing to be public *and* each party consents to public hearings.³ The auditors and audit firms charged with violating applicable laws, rules or standards have little incentive to consent to opening the case against them to public view, and, in fact, none have ever done so.

This state of affairs is not good for investors, for the auditing profession, or for the public at large. Providing transparency to PCAOB enforcement proceedings has gained bipartisan support. In the Senate, Judiciary Committee Chairman Chuck Grassley and Senator Jack Reed have introduced S. 1084, The PCAOB Enforcement Transparency Act. I encourage this Committee and this Congress to support this bill.

III. Auditing and Related Professional Practice Standards

The Sarbanes-Oxley Act also charges the Board with establishing auditing and related professional practice standards for audits of public companies and SEC-registered broker-dealers, and the Board has followed a transparent and fair process for doing so. The Board uses information that it learns in its inspections and from other sources to evaluate the need for changes in auditing standards. In developing new standards, the PCAOB casts a wide net to seek advice from various interested people and groups on ways to improve audits.

The Board's actions are informed by meetings and dialogue with investors, auditors, representatives of public companies and members of the academic community, among other ways through its Standing Advisory Group. The Board also works closely with the SEC on the development of standards and monitors the work of accounting standard setters, such as the Financial Accounting Standards Board, for developments that may affect auditing.

PCAOB standards are rules of the Board. To adopt or change them, the Board uses a notice-and-comment process similar to the process used by federal agencies, under which the Board proposes standards for public comment before adopting new or amended standards in a public meeting. All Board standards must be approved by the SEC before they can become effective.

³ See Sarbanes-Oxley Act, Section 105(c)(2).

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The PCAOB's most recent standard-setting agenda is attached at Appendix 1. All of these projects involve considerable economic analysis, consistent with the PCAOB's staff guidance on economic analysis issued in 2014. This guidance is modeled on the SEC staff's own such guidance and was developed in close consultation with Commission staff.

The PCAOB's guidance sets forth four main elements –

- critically focusing on describing the need for a new rule,
- developing a baseline for measuring the effects of the rule,
- considering reasonable alternatives to the rule, and
- analyzing the economic impact of the rule, including both the costs and the benefits.

By improving our economic analysis of standards under development, we can have greater confidence that the benefits of our standards justify their costs. Moreover, by reviewing the actual effect of standards that have already been implemented, we expect to learn much more about the consequences of new standards, both those intended and any unintended. This is why I have championed the PCAOB's establishment of a Center for Economic Analysis, which brings together many creative minds and experts under the leadership of University of Chicago Professor Luigi Zingales. The Center is an important investment in smarter regulation. Analysis and research performed by the Center can help make our oversight programs more effective and efficient.

We have adopted many improvements related to audit procedures, such as standards on documentation, internal control, risk assessment, engagement quality reviews, communication with audit committees, audits of broker-dealers and transactions involving related parties. We have also adopted independence standards related to the effects of auditor involvement in risky tax shelter work.

More recently, late last year we adopted a transparency rule that will soon provide markets the names of engagement partners and other firms that participate in an audit. Over time, this will allow investors to differentiate auditors on the basis of track records for quality. We are also nearing completion of a multi-year effort to make the audit report more informative for investors, by including a discussion of critical audit matters.

V. The PCAOB's FY2017 Budget

Under the Sarbanes-Oxley Act, the PCAOB's fiscal year begins in January. The Commission has established a rule governing the PCAOB's budget.⁴ That rule provides for several steps to be completed at various points in the year preceding a budget year, beginning with a communication in March on program and operational issues and outlook for the next year before culminating with submission, by December 1 as required by the Sarbanes-Oxley Act, of a final budget that reflects the PCAOB's recoverable budget expenses for that year. We are now deep into the process of developing the 2017 budget, including through close interaction with Commission staff as well as considerable internal analysis, to refine our cost estimates and identify opportunities for savings and efficiencies.

Our 2017 budget is still under development, in consultation with the Commission, which must ultimately approve it. I should point out that, by law, our budget is funded primarily by public companies, brokers and dealers, not taxpayers. In order to adequately address these priorities, the PCAOB needs to, at least, maintain the current budget level. I do anticipate the need for a small increase over our \$257.7 million budget for 2016. This would be for cost of living and annual merit increases, as well as expected expenses for travel, particularly for inspections, information technology (including cybersecurity), and facilities. But we do have a keen sense of stewardship. It is my goal to accomplish our objectives through careful and continuous assessment of the best use of our resources, without a significant increase.

* * *

In conclusion, I appreciate the Subcommittee's interest in the work of the PCAOB and I look forward to continuing to work with you to protect the interests of the investing public in independent, accurate and informative audit reports. I would be happy to answer any questions.

⁴ 17 CFR § 202.190.

STANDARD-SETTING AGENDA
OFFICE OF THE CHIEF AUDITOR
JUNE 30, 2016

The Public Company Accounting Oversight Board ("PCAOB" or "Board") seeks to establish and maintain high-quality auditing and related professional practice standards for audits of issuers and brokers and dealers in support of the PCAOB's overall mission to protect investors and the public interest. The PCAOB's Office of the Chief Auditor ("OCA"), with a continued focus on improving the effectiveness of PCAOB standards, takes a priority-based approach in establishing the standard-setting agenda¹ which may include developing new standards or rules, or amending existing standards or rules.

The standard-setting agenda is informed by the PCAOB's oversight activities, monitoring of the environment, consultation with the Board's Standing Advisory Group ("SAG"), input from the Board's Investor Advisory Group ("IAG"), discussion with the U.S. Securities and Exchange Commission ("SEC") staff, and other factors. In addition, as part of establishing its standard-setting agenda, OCA takes into consideration the work of other standard setters (for example, the International Auditing and Assurance Standards Board ("IAASB"), Financial Accounting Standards Board ("FASB"), and International Accounting Standards Board) in the development of new or modified standards.

The development of new or modified standards includes economic analysis. As part of the process, consideration also is given to the applicability of new standards to audits of emerging growth companies ("EGCs").

Finally, the PCAOB issues staff audit practice alerts prepared by OCA to highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits under the existing requirements of PCAOB standards and relevant laws.

The following table and overview of projects present OCA's current standard-setting agenda. Timing of these projects is subject to change.

¹ The PCAOB is implementing changes to its standard-setting process, and some may affect future versions of the standard-setting agenda, such as the possible inclusion of a PCAOB research agenda.

<p>This standard-setting agenda was prepared by the staff of the Office of the Chief Auditor. Standard-setting agendas, staff consultation papers and staff audit practice alerts are not statements of the Board, nor do they necessarily reflect the views of the Board, individual Board members, or other staff.</p>
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Standard-Setting Projects

Project	Current Stage	Timing
Supervision of Audits Involving Other Auditors	Proposal issued for public comment	Comment period ends July 29, 2016
Auditor's Reporting Model	Reproposal issued for public comment	Comment period ends August 15, 2016
Auditing Accounting Estimates, Including Fair Value Measurements	Drafting proposal	Q1 2017
The Auditor's Use of the Work of Specialists	Drafting proposal	Q1 2017
Going Concern	Next action under consideration	
Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities	Research and outreach	

Standard-Setting Agenda—Project Overviews

- 1. *Supervision of Audits Involving Other Auditors.*** On April 12, 2016, the Board issued for public comment amendments to improve the auditing standards that govern the supervision of audits involving other auditors, and a new auditing standard for situations in which the auditor divides responsibility for the audit with another accounting firm. The roles of other accounting firms and individual accountants in audits (collectively, "other auditors") have taken on greater significance with the increasingly global operations of companies. The lead auditor often involves other auditors at various locations of the company, including in areas of the audit where there is a high risk of material misstatement in the financial statements. The comment period on the proposal ends on July 29, 2016. For further information, see [Rulemaking Docket No. 042](#).
- 2. *Auditor's Reporting Model.*** On May 11, 2016, the Board issued for public comment a repropoed auditor reporting standard. The reproposal revises the Board's initial proposal issued in August 2013 (the "2013 proposal"). The reproposal would retain the pass/fail model in the existing auditor's report, but would update the form and content of the report to make it more relevant and informative to investors and other financial statement users. In particular, the auditor's report would include a description of "critical audit matters," which would provide audit-specific information about especially challenging, subjective, or complex aspects of the audit. In addition, the reproposal includes other improvements, primarily intended to clarify the auditor's role and responsibilities in the audit of financial statements and to make the auditor's report easier to read. The comment period on the repropoed standard and related amendments to PCAOB standards ends on August 15, 2016. While the 2013 proposal also included a new auditing standard, *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*, regarding the auditor's responsibilities for other information outside the financial statements, the Board did not repropoed this standard on May 11, 2016. The staff is continuing to evaluate the other information standard in light of comments received and anticipates making a recommendation for next steps to the Board at a later date. For further information, see [Rulemaking Docket No. 034](#).
- 3. *Auditing Accounting Estimates, Including Fair Value Measurements.*** On August 19, 2014, the PCAOB issued a staff consultation paper to seek public comment on certain issues related to auditing accounting estimates, including fair value measurements. As discussed in the paper, auditing accounting estimates and fair value measurements has proven challenging to auditors. Additionally, there have been changes in the financial reporting frameworks relating to accounting estimates and an increasing use of fair value as a measurement attribute, together with new related disclosure requirements. The paper described the staff's preliminary views concerning the potential need for change and presented potential revisions to

PCAOB standards. The staff is evaluating the responses from commenters in addition to considering feedback received from the discussions at the October 2014 and June 2015 SAG meetings and the September 2015 IAG meeting. In addition, the staff is monitoring developments related to the IAASB's project on Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions. The staff anticipates recommending that the Board propose for public comment revisions to its current standards on auditing accounting estimates, including fair value measurements, in the first quarter of 2017. The project is also being closely coordinated with the project on specialists. For further information, see Staff Consultation Paper: Auditing Accounting Estimates and Fair Value Measurements.

4. **The Auditor's Use of the Work of Specialists.** On May 28, 2015, the PCAOB issued a staff consultation paper to seek public comment on certain matters related to the auditor's use of the work of specialists. As discussed in the paper, the use and importance of specialists has increased in recent years, in part due to the increasing complexity of business transactions and the resulting complexity of information needed to account for those transactions. Specialists covered by the project include specialists employed or engaged by the auditor and also the use by auditors of the work of specialists employed or retained by the company. The paper described the staff's preliminary views concerning the potential need for change and presented potential revisions to PCAOB standards. The staff is evaluating the responses from commenters in addition to considering feedback received from the discussions at the June and November 2015 SAG meetings and the September 2015 IAG meeting. The staff anticipates recommending that the Board propose for public comment revisions to its current standards on the auditor's use of the work of specialists in the first quarter of 2017. The project is also being closely coordinated with the project on auditing accounting estimates, including fair value measurements. For further information, see Staff Consultation Paper No. 2015-01: The Auditor's Use of the Work of Specialists.
5. **Going Concern.** The auditor's evaluation of a company's ability to continue as a going concern is an important part of an audit under PCAOB standards and federal securities law. The purpose of this project is to evaluate potential revisions to the existing PCAOB standard on the auditor's going concern evaluation in light of changes in the relevant accounting requirements² and concerns from investors

² On August 27, 2014, FASB issued Accounting Standards Update No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. On September 22, 2014, the PCAOB issued Staff Audit Practice Alert No. 13, to remind auditors to continue to follow existing PCAOB standards when considering a company's ability to continue as a going concern.

about the effectiveness of auditor going concern reporting. This project is considering, among other things, input from the SAG and IAG, observations from the Board's oversight activities, and relevant research. The staff plans to continue its research and outreach activities to seek input on potential approaches to improving the existing standard and addressing the changes in the accounting requirements. These activities could result in a staff consultation paper, a staff audit practice alert, or other possible actions.

6. ***Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities.*** Deficiencies identified in PCAOB inspections suggest that improvements are needed in firms' systems of quality control. The staff is exploring whether changes to PCAOB quality control standards—including improvements related to assignment and documentation of firm supervisory responsibilities—could prompt firms to improve their quality control systems and, in turn, audit quality. This project is considering, among other things, observations from the Board's oversight activities, relevant research, input from the SAG, and activities of international audit regulators, as well as related PCAOB activities, specifically, the root cause analysis and audit quality indicator initiatives. The staff is also monitoring developments related to the IAASB's project on quality control. The staff also plans to perform outreach (e.g., staff consultation paper or public roundtable) to seek input on current practice and the potential need to improve the quality control standards, taking into account potential impacts on large and small domestic and international firms.