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CORPORATE GOVERNANCE



SUBJECT

PCAOB TRANSITIONS FOR THE FUTURE – PERSPECTIVES OF THE PCAOB CHAIRMAN

SUMMARY

In a recent [speech](#) given during a May auditing symposium, new PCAOB Chairman William Duhnke spoke of the transitions that he intends for the PCAOB, reflecting on the organization's last fifteen years while seeking to define the vision, strategy and operational plans for its next five years.

DETAILS

PCAOB Leadership Changes and Transition Overview

Chairman Duhnke was sworn in as PCAOB Chairman in January 2018. His appointment was followed by a complete replacement of the PCAOB board to include: Kathleen Hamm, J. Robert Brown, James Kaiser, and Duane DesParte. As he indicates in his speech to participants of the 2018 Deloitte and University of Kansas Auditing Symposium, the SEC has assembled a "diverse set of talented and dedicated individuals," each of whom "bring a wealth of relevant experience and skills to the board." Their backgrounds encompass financial reporting, investor-relations, public company, auditing, academia, and board of director experience. Additional significant PCAOB leadership changes include the departures of [Helen Munter](#), Director of Registration and Inspections, [Martin Baumann](#), Chief Auditor and Director of Professional Standards, [Claudius Modesti](#), Director of Enforcement and Investigations, and [Nirav Kapadia](#), Director of the Office of Information Technology and Chief Information Officer. To date, their replacements have not yet been named.

Chairman Duhnke indicates that "with such a significant change in the Board's composition, comes a significant opportunity — a chance to reflect on lessons learned, to innovate, and ultimately to improve how we approach our oversight of the auditing profession in an increasingly dynamic environment." In the PCAOB's 2017 Annual [Report](#), the Chairman's letter promises that "2018 necessarily will be a year of transition for the PCAOB" and the board will "use this as an opportunity to review all aspects of the PCAOB's activities." In his recent Baruch speech, Duhnke distinguishes between the operational activities of the PCAOB and points toward the focus on the strategic planning process for the future.

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Strategic Planning Process

Since 2007, the PCAOB has drafted a strategic plan with a five year outlook created from inward reflection by leaders within the PCAOB. While acknowledging the advances the PCAOB has made with respect to audit quality, Duhnke outlines the opportunity the current board is taking to view things from a broader perspective. Firstly, an [external survey](#) was hosted this spring by an outside consultant to solicit input and feedback from constituents in the market to help shape the strategic priorities of the PCAOB. Participants included investors, management, audit committee members and directors, academics, foreign audit regulators, and auditors. Secondly, the PCAOB has hosted one-on-one facilitated interviews of constituents similar to those who participated in the survey. Thirdly, an internal outreach was performed that gathered insights from the entire PCAOB organization.

The board is currently studying the “fruits of these efforts as we define our key priorities for the coming years.” Chairman Duhnke indicates that key performance measures will likely emerge by which the PCAOB can judge its progress against its strategic plan. The plan is expected to be drafted by the end of July for public comment with a final plan expected to be announced in November with their annual 2019 budget.

Core Values

As part of the transition process, Duhnke has highlighted five preliminary core values that the PCAOB is to embrace:

- ▶ Integrity – adherence to the highest standards of ethical and professional conduct
- ▶ Excellence – promote positive and effective change in all aspects and embrace disruptive innovation
- ▶ Effectiveness – use of resources and pursuit of policies responsive to the changing environment and reflective of careful weighing of relevant cost/benefits through economic and risk analysis
- ▶ Collaboration – breakdown of internal silos and fostering consistent, transparent, impartial and fair engagement with all constituents
- ▶ Accountability – holding itself and the profession accountable for transparently advancing audit quality

The core values are intended to serve as key principles to guide collective PCAOB action and decision-making.

Organizational Assessment

The PCAOB is conducting a comprehensive assessment of itself as an organization to institutionalize a culture of self-examination. Several conclusions have already been reached and include: (1) the need for a fresh look at operational and program designs; and (2) improvements to policy-making and external engagement. Throughout the speech, Duhnke outlines areas for further reflection which is intended to provide insight to a new path forward under his leadership.

Inspections Process

Chairman Duhnke raises the point that many audit firms have “plateaued” with respect to improving their inspection results and the PCAOB will be looking deeper into the potential reasons

as to why this is occurring, including assessing the effectiveness of its current inspection approach. Questions to be asked center around: integrating economic and risk analysis; leveraging collected data; sharing insights with audit committees, audit firms and investors; calibrating inspections to focus on quality control systems to prevent (vs. detect) deficiencies; considering performing more random selections (vs. risk-based) and changing the number of inspections based upon an audit firm’s past performance; revising timing/frequency of inspections; providing additional inspection guidance; and emphasizing cost/benefit analysis.

Additionally, the PCAOB is taking a closer look at its reporting on inspection findings with questions centered on: whether current reporting is meeting the needs of constituents; what additional value-added information may be necessary; means to communicate nature and severity of findings; etc.

As part of this analysis, the PCAOB is also considering other ideas, including what other global regulators are doing and is intent on collaborating in this area. In his speech, Duhnke highlights British and Dutch inspection approaches. The UK Financial Reporting Council (FRC) performs both firm-specific sample audit and firm quality control inspections as well as thematic reviews that consider firm policies, procedures, and practices illuminating best practices to be shared with the public. The Dutch Authority for Financial Markets’ (AFM) approach uses dashboard reporting of the largest firms around a thematic review of audit firms’ control, behavior and culture, and internal supervision to track progress in meeting expectations.

Oversight Programs

The PCAOB is looking beyond its inspections process to consider further enhancements to the following oversight activities:

- ▶ Effectively communicate with investors
- ▶ Respond to needs of audit committees
- ▶ Ensure standards keep pace with the changing data and technology landscape
- ▶ Improve transparency in standard-setting process
- ▶ Procure the right skills and resources within the PCAOB
- ▶ Better leverage economic and risk analysis resources
- ▶ Improve the overall enforcement process

NEXT STEPS

We are encouraged by Chairman Duhnke’s vision and look forward to the PCAOB’s further engagement with the profession, investors, academics, management, and audit committees in the future. BDO will continue to monitor and highlight activities of the PCAOB and work with them to promote audit quality for our clients and our profession. Look for further information on these topics along with other financial reporting and governance activities, trends, and discussion points for our client audit committees and management teams through our [Center for Corporate Governance and Financial Reporting](#).