

West Audit Committee Network

October 2018

WACN

SUMMARY of THEMES

Innovation, the digital audit, and the future of audit regulation

Many industries, including the audit profession, are being transformed by new and emerging technologies. At the same time, the Public Company Accounting Oversight Board (PCAOB) has undergone its own transformation, with five new board members and a new strategic plan. On October 3–4, 2018, West Audit Committee Network (WACN) members met in San Jose, CA, to discuss innovation in both the trucking industry and the audit profession, as well as new developments at the PCAOB and Securities and Exchange Commission (SEC).

Trucking innovation

Last year, PACCAR, the manufacturer of Kenworth, Peterbilt, and DAF trucks, opened its Silicon Valley Innovation Center to expand its research and development capabilities and enhance its relationships with the technology industry. Members met with Jake Montero, the center's general manager, to discuss the company's approach. *"Our role in PACCAR is to look for technology to support the long-term development of our three major brands' products. We talk to a lot of start-ups here in Silicon Valley to work with them to use their technology on our trucks,"* Mr. Montero said. He told members the center has four main focus areas: (1) advanced driver-assistance systems; (2) additive manufacturing; (3) machine learning; and (4) vehicle connectivity.

Members were interested to learn how PACCAR collaborates with other companies. Mr. Montero discussed the excitement in the technology sector about the concept of autonomy: *"We are working with a number of technology companies on different projects. In one case, we are developing a more near-term solution focused on platooning vehicles to improve safety and enhance fuel economy."*

While self-driving trucks offer many benefits, such as fuel efficiency, passenger safety, and cost savings, there are still many unresolved challenges to consider before these vehicles will be commonplace on our highways and roads. One member brought up the moral dilemma of programming the vehicles: *"The ethical decision tree is a hard one, and right now it is in the hands of the companies. Will the government get involved? Who is responsible when an accident occurs? There is still a lot to consider."*

Mr. Montero agreed that there are still many unresolved issues: *"Even with the safest system, you can't change physics."*

Audit tools and technologies

WACN members visited EY's wavespace site in San Jose to see how auditors are deploying new technology to transform many aspects of public-company audits. Members saw a demonstration of Canvas, EY's digital audit hub, which connects audit teams to one another and to their clients to create a single, global audit platform. Canvas is a fully integrated portal which allows teams and clients to communicate better. For example, documents can be shared between companies and auditors directly on the platform, eliminating email exchanges and therefore enhancing security. Canvas also allows the firm to ensure that its teams are staying on track and to better allocate resources where necessary.

In addition, EY demonstrated Helix, its suite of data-analytics tools for use in its audits. These tools use advanced methods, including artificial intelligence, to analyze data from the transaction level up to the consolidated trial balance. Many of these tools are customized to sector-specific audit issues, such as automotive warranties, insurance premium collection, and trade spending. While audit analytics tools are rapidly improving, progress has been incremental. Accounting firms are working toward continuous monitoring, but right now it is a very rare exception. Today, firms are focused on using data to speed up the identification of outliers so that auditors know where to focus their time.

An inflection point for US audit regulation

Members discussed recent developments at the PCAOB and SEC with EY's David Kane. Members also participated in a separate, off-the-record, dialogue with Kathleen Hamm, one of the PCAOB's five new board members, and Wesley Bricker, the SEC's chief accountant. The following reflects only the conversation with Mr. Kane.

Members were interested to learn how the PCAOB and SEC are working together. Mr. Kane noted, *"Having the two appear together for this meeting sends a strong signal of their relationship and the engagement they are looking to have with audit committee chairs."* The PCAOB is undergoing a comprehensive review of its operations. This review included a period of stakeholder engagement during which the PCAOB conducted a public survey and interviews with public accounting firms, investors, and corporate leaders; the result was the publication of the PCAOB's draft strategic plan. Mr. Kane noted that in addition to the changes on its board, the PCAOB is also in the process of replacing all of its division leaders.

Several issues dominated the conversation between members and Mr. Kane:

- **Improving the PCAOB's inspections and reports.** Members were eager to learn about the PCAOB's review of its inspections process. One member spoke of the state of audit quality: *"I don't think audit quality is a huge struggle—I think it has already improved. The focus of inspections should be on the ability to adapt to technological change."* Mr. Kane added, *"The PCAOB is considering focusing its inspections efforts more on preventative measures as opposed to individual engagements. Attention will shift to the quality-control systems in*

place at the audit firms, including how firms are thinking about new technology.” Members also expressed frustration with the lack of timeliness and usefulness of the PCAOB’s reports. Mr. Kane told members that the PCAOB is considering changes to its reporting process to make it *“more simplified, with thematic reviews based on certain topics and compared across firms.”*

- **Keeping up with technological change in the audit profession.** Members were interested in learning what the PCAOB is doing to equip itself for the digital transformation of the audit profession and the new risks created by innovation. Mr. Kane said the PCAOB is focused on what the large public accounting firms are doing to drive further improvements to audit quality. Members hope the PCAOB will work closely with auditors as they develop digital tools to enhance their audits. One said, *“In a data-analytics environment, is there a way for the audit firms to get preapproval from the PCAOB that their technology is appropriate? I worry that these models will be seen for the first time during an inspection and be cited as insufficient. We need to bridge this gap as technology evolves.”*
- **Critical audit matter disclosures (CAMs).** Large accelerated filers will begin disclosing CAMs in 2019. External auditors are doing dry runs with companies and audit committees this year to provide for early quality control. One member said, *“I could see a problem with new issues coming to light in the CAMs and surprising the audit committee. How can we avoid this happening?”* Mr. Kane stressed the importance of dry runs: *“While still early, conversations with audit committees have not been an issue to date but being attuned to that risk and talking through it with your auditor ahead of time is essential.”*
- **Engaging with audit committees.** Mr. Kane said the PCAOB and SEC appear willing to engage with external stakeholders, including audit committees. *“The SEC and PCAOB have respect for the work you do and want more proactive engagement. Think about how you can help them—ideas and forums where you can come together. They see this as an opportunity to collaborate with you,”* he said. One member encouraged others to be more proactive with feedback: *“The PCAOB has submitted many proposals and always asks for comments, but rarely do they receive any from audit committee members. We need to do more to engage on this.”*

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Meeting participants:

North Chapter:

- Bev Briscoe, Goldcorp
- Joe Bronson, Jacobs Engineering Group and Maxim Integrated Products
- Judy Bruner, Seagate Technology and Varian Medical Systems
- Henry DeNero, Western Digital
- Jeff Epstein, Twilio
- Earl Fry, Hawaiian Holdings
- Bala Iyer, Power Integrations
- Sue James, Coherent
- Lou Lavigne, DocuSign, Novocure, and Zynga
- Cathy Lego, Cypress Semiconductor

South Chapter:

- Vanessa Chang, Transocean
- Traci Dolan, Steel Dynamics
- Burl East, Comunidad Realty Partners
- David Engelman, PrivateBancorp
- Leslie Heisz, Edwards Lifesciences
- Diana Laing, Macerich
- Ed Lamb, Real Industry
- Steve Page, AeroVironment
- Jane Peverett, CIBC
- Dick Poladian, Occidental Petroleum and Public Storage
- Stephanie Streeter, Kohl's
- Joe Tesoriero, Smart & Final Stores

EY was represented by the following:

- Lee Dutra, San Francisco Office Managing Partner, West Region
- Kay Matthews, Vice Chair and West Region Managing Partner
- Todd Moody, West Region Managing Partner of Markets and Accounts
- Mike Verbeck, West Region Assurance Managing Partner