

Audit Committee Leadership Network

April 2021

ACLN

VIEWPOINTS

Dialogue with EY's Independent Audit Quality Committee

Policymakers, regulators, investors, audit committees, and audit firms all stress the importance of high-quality audits to well-functioning capital markets. Yet they acknowledge that it can be difficult to assess the performance of firms and their engagement teams. Myriad factors come into play, operating at both the firm level and the specific engagement level, and many are evolving over time as well as interacting with each other. EY established its Independent Audit Quality Committee (IAQC) in 2018 to advise EY senior leadership on the many aspects of the firm's business and operations that affect audit quality.

On March 9, 2021, members of the Audit Committee Leadership Network (ACLN) gathered virtually with the three members of the IAQC—Bill McNabb (chair), Dina Dublon, and Jeanette Franzel—to share perspectives on audit quality and the challenges of assessing it.

For biographies of the guests, see Appendix 1 on page 8. For a complete list of participants, see Appendix 2 on page 10.

Executive summary

The discussion touched on the IAQC itself and then explored several key considerations that its work has raised regarding audit quality:

- **What is the role of the IAQC?** (page 2)

The IAQC provides feedback and advice to EY's senior leadership about the impact of the firm's business, operations, culture, talent strategy, governance, and risk management on audit quality. While the IAQC is not a fiduciary body with a formal governance role, EY wants it to think and act like a typical board. The guests underscored how transparent and open EY has been in supporting the committee's work, and they noted that the firm has been very receptive to committee perspectives.

- **Key considerations in assessing audit quality** (page 3)

Audit quality depends on both firm-level policies and their effective implementation at the engagement level. The members of the IAQC identified several areas where these efforts are particularly important and where the IAQC focuses its attention. For example, technology is transforming audits, improving their efficiency and yielding new insights, and the IAQC is focused on whether audit personnel are comfortable in deploying it. In addition, culture shapes behavior in profound ways, including the communication and independence

that audit committee chairs consider critical to successful audits. Audits of global companies that span multiple jurisdictions may require particular attention from the lead partner and the audit committee. Ultimately, as audit chairs and guests agreed, one of the most important and challenging considerations is the quality of the lead partner and his or her team. Guests noted that audit firms' own quality control systems can help produce meaningful insights for audit committees.

For a list of discussion questions for audit committees, see Appendix 3 on page 12.

What is the role of the IAQC?

Established in 2018, the IAQC brings independent and diverse perspectives to EY's effort to improve audit quality. It is currently comprised of the following members:

- **Bill McNabb (chair)**, former chair and CEO of Vanguard and current board member of UnitedHealth and IBM
- **Jeanette Franzel**, former member of the Public Company Accounting Oversight Board (PCAOB) and former managing director of the Government Accountability Office
- **Dina Dublon**, former chief financial officer at JPMorgan Chase & Co. and current board member of PepsiCo, T. Rowe Price, and Motive Capital Corp.

The IAQC provides feedback and advice to EY's senior leadership on audit quality and audit practice related matters, as well as aspects of the firm's business, operations, culture, talent strategy, governance, and risk management that impact audit quality.

Its meetings in 2020 focused on topics including EY's increasing use of data and technology in the audit, its processes for implementing new accounting and auditing standards, and the ways it provides its professionals with skills and tools to support a data-driven audit. The IAQC also covered diversity and inclusiveness, performance management, partner assignments, training, and workload management.¹ The IAQC considered how quality control could be maintained while managing pandemic risk and supporting EY's professional staff.

ACLN members had several questions about the IAQC and its work. Some were curious about its precise role: Is it part of the governance of EY, or is it more of an advisory board? How much authority does the group have? As one member framed it, *"If the IAQC and management disagree, what happens?"*²

IAQC members discussed these questions both before and during the meeting. *"It's very important that people understand that we're not a governance body in the traditional fiduciary sense,"* Mr. McNabb explained in advance of the meeting. He noted that, while the IAQC is only in an advisory role, EY wants the IAQC to think like a board. As an example, in the meeting Mr. McNabb shared that the IAQC applies a framework often used by boards, focusing on talent, strategy, and risk. In the event of a disagreement, he noted, *"it would be management's call, not ours."* But as Ms. Franzel explained, *"The group is certainly interested*

in positive outcomes, and the transparency about the activities and members of the IAQC provides accountability.”

One ACLN member remarked on the challenges that oversight bodies face in trying to understand what is going on within an organization: *“It requires a level of involvement, getting out to talk to engagement partners. It’s a classic case of, in a board oversight role, How do you get to substance?”* IAQC members emphasized how forthcoming and transparent EY has been. *“ACLN members will be surprised at how much senior management time we get,”* Mr. McNabb said in advance of the meeting, adding, *“I have never felt managed by the management team. There’s always extraordinary openness.”* Ms. Dublon noted that the IAQC hears about sensitive issues and takes them very seriously. In the meeting, Mr. McNabb underscored the point: *“One thing EY committed to with the three of us was transparency. We’ve had a great look into the firm at all levels, whether it’s business results or indicators of audit quality itself.”*

However, the IAQC members explained that evaluating audit quality has its own inherent difficulties, especially in the current environment. Many variables are involved, Ms. Franzel noted: *“Audit quality is a holistic endeavor; it’s not just about process, but leadership, firm governance, people policies, etcetera.”* And, as Ms. Dublon explained, identifying trends is difficult in a time of rapid change and upheaval: *“What is clear to all of us is that we are dealing with a situation that is continually changing. Business systems are constantly changing. Are auditors aware enough of how business is changing?”* The pandemic has further complicated matters, Mr. McNabb pointed out: *“COVID adds so many variables.”*

Key considerations in assessing audit quality

A chief focus for the IAQC is EY’s firmwide policies, processes, and initiatives aimed at audit quality. These firmwide efforts are of interest to audit committees, regardless of their auditor, since they heavily influence the quality of their specific engagements. The discussion of the IAQC’s firm-level efforts raised issues in the areas of technology, culture, network risk, and quality control processes. For each of these areas, however, important considerations also emerge at the engagement level. How are firm-wide efforts implemented on individual engagements? Ms. Franzel explained, *“We look at this from all angles: at the firm level and also at the level of specific engagements. A detailed nuts-and-bolts conversation about quality metrics and unusual risks on individual engagements that are flagged in the firm-wide process is super important.”* She noted that firm leadership and the IAQC discuss how the firms consider and address risks at the client level. A particularly important engagement-level consideration is the quality of the engagement team.

Technology

Audit firms invest substantial resources to deploy new technologies, which can be transformational for firms and individual audits. In premeeting conversations, ACLN members

agreed that technology can substantially affect audit quality, and many said that technology can be a key differentiator between firms. One member noted, *“Instead of sampling, you have the whole data set. Technology is turning auditing into a computer-driven, technology-driven environment, and it’s so much better than sampling.”* Another member added that automated data coverage frees up auditors to focus on high-risk areas. In addition, technology can help track the progress of an audit and predict audit quality, as Mr. McNabb explained: *“One good predictor of quality is looking at how the work is balanced throughout the year. The timing issue has been a key predictor.”*

The importance of technology is reflected in the IAQC’s efforts. *“We spend a lot of time understanding and monitoring the use of technology in the audit process and how it’s changing the way the audit is done, not just in terms of efficiency but in terms of insights gained,”* Ms. Dublon explained. She added that technology is *“an increasingly critical issue as companies themselves are using technology in prosecuting their own business.”*

Even with a strong firm-wide effort on technology, however, implementation may vary between individual engagements. Mr. McNabb noted that some members of an audit team may be less comfortable about using technology and the firm is focused on this: *“We met with an EY engagement team to understand how easy it is to actually use technology, and we heard that some managers were less comfortable.”* Fully realizing the promise of technology may require more training of partners and staff.

Moreover, technological improvements can create their own risks to audit quality. *“I’m concerned about increased use of technology, both internally and through outsourcing or the use of shared service centers,”* a member said before the meeting. The member noted that outsourcing can create challenges in ensuring consistent audit quality. One member questioned whether the cost of technology can present barriers to entry for smaller firms, reducing competition.

Culture and communication

An ACLN member asked the guests, *“The culture in which talent performs is very important. How does the IAQC look at the culture of the firm and how the firm assesses client culture?”* Ms. Franzel confirmed the importance of culture: *“Culture is something we discuss at every single meeting, including firm governance, tone at the top, etcetera. Norms influence people in their daily behavior. We provide input and feedback on EY’s efforts related to culture.”* Mr. McNabb echoed this comment, sharing that the IAQC goes deep and gets into the details, including on what is communicated to the firm. *“We’ve even participated in town halls,”* he noted.

In premeeting conversations about the qualities ACLN members look for in their audit teams, members highlighted several elements closely linked to the culture of a firm and an audit team. Open and proactive communication was one of them. Members expect audit partners to quickly surface potentially challenging news. *“We have such an open, transparent relationship*

with the auditors,” one said. In the meeting, a member underscored the importance of proactive engagement on the audit plan: “When audit planning takes place, I want discussion with the auditor before the plan is written, to see where they see potholes. Those are fundamental to audit quality.”

Even issues that seem technically immaterial could be important, since they could be part of a bigger problem. One member said, *“I expect them to tell us the problem even if it’s not material.”* The courage and ability to come forward with ideas and challenges improves the audit. *“I like it when the auditors find something our folks didn’t find,”* another member said.

A related element is a spirit of independence, balanced with a collaborative attitude. Challenging management is important, but so is interacting effectively with the people involved. As one member put it, *“How do you ensure the right level of cooperation with adequate tension? The auditor is adequately alert without being disruptive—a little friction, but not something that starts a fire.”*

As with technology, cultural elements may operate differently at the engagement level than at the firm level. Are the firm’s values and norms fully realized within the audit team working on a specific engagement? The interaction of an audit firm’s overall culture with that of a client company can affect the culture within an audit team.

Network risk

Transnational execution may pose challenges for audits of global companies. A member asked, *“How do you look at audit quality for an international company that has portfolio companies in different jurisdictions audited by different firms?”* Mr. McNabb acknowledged the *“network risk”* that emerges when separate firms handle parts of an audit.

In premeeting conversations, audit chairs discussed how they address this risk. Some insist that the global lead partner be involved in audit work within high-risk countries. One member expects the lead to evaluate teams globally and know who is doing the work in those locations. Other audit chairs travel internationally to meet external audit teams, and some said they expect the engagement team, including the lead partner, to do so as well. Members also want audit firms to be open about their challenges in specific geographic regions. *“I want to hear it from the auditor,”* one said, *“not in the news.”*

Quality of the engagement team

Summing up his thoughts on assessing audit quality, Mr. McNabb drew attention to what he considered a key issue: *“Audit chairs may have a hard time understanding the quality of an audit team. Overall satisfaction is correlated with the quality of the people, so it’s about getting some exposure to how the lead people think about their team and their progression.”*

This point echoed the comments of many ACLN members who said they pay close attention to the lead partner. *“The driver of quality is the strength of the lead partner and what kind of*

team that person attracts,” one said. Lead partners must have the technical proficiency to perform a sound audit and to support their opinion on the fairness and accuracy of financial statements. Audit chairs seek comfort that the partner has proficiency in auditing standards, technical standards, and accounting principles, including changes in regulatory standards.

There is no replacement for experience with the client’s industry, issues, and strategies. A member said, *“Any audit, in my opinion, is a function of the underlying understanding of the business or enterprise you are evaluating.”* Audit chairs look for both breadth and depth of experience so that a team can deliver value beyond the audit plan. For example, the team might *“have suggestions for how the audit committee could function more effectively, based on other audit committee interactions,”* a member noted.

Lead partners do not personally handle every detail, but they are nonetheless responsible for ensuring a high level of service, including the makeup and culture of the team. Spreading expertise throughout the ranks strengthens an audit team. One member pointed out that lead partners should train subordinates and refrain from hoarding work. Audit chairs said that knowing team members deepens the relationship and gives greater insight into an audit.

Internal quality controls

The IAQC members highlighted EY’s quality control system as a resource for them in assessing audit quality. While inspection reports by the PCAOB are helpful—and the IAQC looks at them closely—EY’s own reviews go deeper. Ms. Dublon explained, *“There is a very thorough audit-quality review process—internal audit at EY.”* She observed that EY reviews look at more audits than the PCAOB typically inspects, and that a comparison of issues comes up when looking at internal audit versus the PCAOB’s evaluation.

These reviews could be a resource for audit committees as well, Ms. Dublon noted: *“You can engage with audit firms on these issues.”* Ms. Franzel agreed, noting that audit committees can ask the partners about internal reviews: *“You can ask if they have had any of their jobs reviewed and inspected. What did they learn and what will they do differently?”*

Conclusion

The IAQC’s analysis of audit quality at EY offers lessons for audit committees assessing the quality of their companies’ audits, highlighting important areas to focus on. Ms. Dublon noted, *“I have better insights on audit quality from being part of the IAQC.”* Firm-level efforts in areas such as technology and culture, for example, are key considerations with implications for quality at the engagement level. At the same time, both the guests and ACLN members noted that there is no substitute for the quality of the specific people assigned to an engagement. An ACLN member likened the Big Four to good hospitals but emphasized the need to find the best doctors within them: *“Each firm can provide good quality. It all comes down to the team.”*

About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Biographies of guests

Dina Dublon joined the board of directors of PepsiCo in 2005 and currently serves as the chair of its public policy and sustainability committee and a member of the compensation committee.

In 2019, Ms. Dublon was named to the board of T. Rowe Price, where she is a member of the audit committee and the executive compensation and management development committee. Previously, she was executive vice president and chief financial officer at JPMorgan Chase & Co. She held numerous positions at JPMorgan Chase and its predecessor companies, including corporate treasurer, managing director of the Financial Institutions Division, and head of asset liability management.

Ms. Dublon also previously served on the boards of Deutsche Bank, Accenture, and Microsoft Corporation. Dina also serves on the board of overseers of Columbia University's Mailman School of Public Health since 2018 and previously served on the faculty of Harvard Business School and on the boards of several nonprofit organizations, including the Women's Refugee Commission and Global Fund for Women.

Ms. Dublon received her BA from Hebrew University of Jerusalem and her MS from Carnegie Mellon University Tepper School of Business.

Jeanette Franzel has extensive experience and expertise in governance, risk, internal controls, financial reporting, financial auditing, compliance, and emerging trends in the accounting profession. Currently, Ms. Franzel serves on the EY Independent Audit Quality Committee for the US Audit Practice. In this capacity, she counsels EY senior leadership on areas and actions that can further strengthen audit quality.

Ms. Franzel also provides expert consulting to the Center for Audit Excellence at the US Government Accountability Office (GAO). In 2019, she led projects to assess organizational capacity of the Supreme Audit Institutions of the Republic of Armenia and the Dominican Republic, and she continues to be involved in audit capacity building efforts in those countries. She has recently begun a similar project with the government of the Bahamas.

She also serves on the Research Advisory Board of the Center for Audit Quality (CAQ), advising the CAQ in promoting independent academic research that has important, real-world impact on audit quality. Ms. Franzel is an incoming board member for the North Carolina Association of CPAs.

Ms. Franzel was previously a member of the Public Company Accounting Oversight Board (PCAOB) where she provided strategic oversight for all PCAOB mission programs to oversee the audits of public companies and brokers and dealers that file with the Securities and

Exchange Commission (SEC). She was appointed by the SEC in February 2012 and served until January 2018.

She brought extensive audit experience to the PCAOB after a distinguished career at the GAO. She ended her tenure as Managing Director, overseeing all aspects of GAO's financial audits of the US federal government. During and after the financial crisis, Ms. Franzel's team provided oversight of the government's efforts to stabilize the financial markets and promote economic recovery.

Ms. Franzel has testified numerous times before congressional committees and subcommittees on governance and accountability issues. She is a Certified Public Accountant and Certified Internal Auditor, and she received her MBA degree from George Mason University in Fairfax, Virginia.

Bill McNabb is the former chairman and chief executive officer of Vanguard. He joined Vanguard in 1986. In 2008, he became chief executive officer; in 2010, he became chairman of the board of directors and the board of trustees. He stepped down as chief executive officer at the end of 2017 and as chairman at the end of 2018. Earlier in his career, he led each of Vanguard's client facing business divisions.

Mr. McNabb is active in the investment management industry and served as the chairman of the Investment Company Institute's board of governors from 2013 to 2016. A board member of UnitedHealth Group, IBM, and Axiom, he is also chairman of EY's Independent Audit Quality Committee.

In January 2021, he joined the board of Tilney Smith & Williamson, a UK wealth management and professional services group, as a non-executive director. He is a board member of CECP: The CEO Force for Good, a board member of the Philadelphia School Partnership, and the chair of the board of the Zoological Society of Philadelphia. In addition, he is the executive in residence at the Raj & Kamla Gupta Governance Institute at the LeBow College of Business and a member of the Advisory Board of the Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School. He is a senior fellow of the Wharton Center for Leadership and Change Management. He also serves on the Dartmouth Athletic Advisory Board.

Mr. McNabb earned a BA at Dartmouth College and an MBA from the Wharton School of the University of Pennsylvania.

Appendix 2: Participants

The following ACLN members participated in all or part of the meeting:

- Alan Bennett, Halliburton and Fluor
- Barbara Byrne, ViacomCBS
- Pam Craig, Merck
- Pam Daley, BlackRock
- Dan Dickinson, Caterpillar
- Dave Dillon, 3M and Union Pacific
- Bill Easter, Delta Air Lines
- Lynn Elsenhans, Saudi Aramco
- Fritz Henderson, Marriott
- Bob Herz, Morgan Stanley
- David Herzog, MetLife and DXC Technology
- Charles Holley, Amgen and Carrier Global
- Michele Hooper, United Airlines
- Hugh Johnston, Microsoft
- Ahhil Johri, Cardinal Health
- Mike Losh, Aon
- John Lowe, Phillips 66
- Edward Ludwig, CVS
- Brad Martin, FedEx
- Suzanne Nora Johnson, Pfizer
- Chuck Noski, Wells Fargo
- Leeny Oberg, Adobe
- Louise Parent, FIS
- Peter Porrino, AIG
- Paula Price, Accenture
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Gerald Smith, Eaton
- Tracey Travis, Facebook
- Jim Turley, Citigroup and Emerson Electric
- John Veihmeyer, Ford
- Robin Washington, Salesforce.com
- David Weinberg, The Coca-Cola Company
- Maggie Wilderotter, Hewlett Packard Enterprise

The following European Audit Committee Leadership Network members participated in part or all of the meeting:

- Alison Carnwath, BASF and Zurich Insurance
- Margarete Haase, ING
- Liz Hewitt, National Grid
- Dagmar Kollmann, Deutsche Telekom
- Kalidas Madhavpeddi, Glencore
- David Meline, ABB
- Bernard Ramanantsoa, Orange
- Sarah Russell, Nordea
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE

EY was represented in all or part of the meeting by the following:

- Kelly Grier, EY US Chair and Americas Managing Partner
- John King, EY Americas Vice Chair of Assurance Services
- Steve Klemash, EY Americas Leader, Center for Board Matters

Appendix 3: Discussion questions for audit committees

- ? How can independent perspectives contribute to enhancing audit quality?
- ? What questions would you be asking if you were a member of an independent committee such as the IAQC?
- ? How do you assess an audit firm's technology? Do you consider technology to be a differentiator among the Big Four firms?
- ? How do you evaluate your auditor at a firm level? What characteristics of the firm are most important?
- ? How useful are regulatory and audit firm reports about audit quality? What would you do to improve them?
- ? What questions would you be asking related to audit quality at the firm level if you were a member of the IAQC?
- ? What signs give you confidence in an audit team? In an engagement partner?
- ? How do you evaluate the external auditor's communication with the audit committee and management? How do you provide feedback?
- ? What quantitative measures of audit quality do you find useful? How do you collect data on the performance of the audit team?

Endnotes

¹ Ernst & Young LLP, *Our Commitment to Audit Quality* (New York: Ernst & Young LLP, November 2020), 9.

² *PreView* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.