Our focus on audit quality
2016
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*Indicates the number of transparency data points included in the section.*
We are pleased to provide you with the 2016 edition of our annual quality report, the first for us in our respective roles as US Chairman and Senior Partner and US Assurance Leader. We are honored to serve in roles that affect audit quality and appreciate our people who work tirelessly to execute quality audits.

Audit quality is embedded in our Firm’s culture and values, our people, our approach, our technology, and our monitoring as part of a continuous improvement cycle. We are proud of the quality of our audits and our efforts around quality enhancements.

Underlying our focus on quality is an acknowledgement of the role we play in the capital markets. We are guided by our purpose—building trust in society and solving important problems. Maintaining confidence in the quality of our audits is therefore a paramount objective for us. In the pages that follow, we explain how our core behaviors and other factors provide a strong foundation for achieving our audit quality objectives.

This report includes discussion of (1) the changes to our career progression framework, because having the right people to perform our audits is an important part of our ability to perform quality audits and (2) the enhancements we have made to our technology to provide our teams with the best tools to support them throughout each phase of the audit.

As we serve our clients, we create opportunities for our people to gain new experiences. We value our people and leverage their experiences to enhance the quality of our audits and the nature of our clients’ experiences. We embrace diversity and recognize that the more diverse we are, the greater the diversity of ideas we will have to create innovative solutions to complex problems.

Effective July 1, 2016, we combined with PwC Mexico. This further enhances our cultural diversity and positions us to provide more of what our clients are looking to us for: deep local business acumen combined with the strength and resources of the US firm to deliver quality audits.

We recognize the need to monitor our own performance and learn from our experiences. And in doing so, recognize where changes will best enhance our ability to maintain and continuously improve the quality of our audits. This report is intended to provide you with detailed information on our quality journey—where we’ve been, where we are, and where we are going. We’ve included 16 Transparency Data Points to provide additional information about our audit practice and our investment in and focus on audit quality. You’ll see how those measures have changed over the course of the past three years, in most cases providing quantitative evidence of our growth and improvement. While individual transparency data points may not be directly linked to audit quality, we believe the suite of transparency data points included in this report provides useful information that—particularly when combined with additional context and discussion—offers valuable insight to our stakeholders.

We are confident in our ability to continue to meet and exceed expectations. We hope that sharing the specifics of our investments in our audit practice will promote an understanding of the importance our Firm places on performing high-quality audits.

References to Firm, our, and we relate to PricewaterhouseCoopers LLP or PwC US.
Our culture and values

Tone at the top

Our purpose is to build trust in society and solve important problems. Our purpose drives what we say and do with clients and colleagues by informing our choices, guiding our decision-making, and shaping our debates. Inherent in our purpose is our commitment to audit quality. Delivering high-quality audits is a cornerstone to fulfilling our purpose.

One of the most influential elements of an effective organization is the tone set by its leadership. Tone at the top establishes an organization’s expectations of appropriate behavior and defines its values. Effective July 1, 2016, we announced a new leadership team. Specifically, Tim Ryan and Maria Castañón Moats were appointed US Chairman and Senior Partner (“Senior Partner”) and US Assurance Leader (“Assurance Leader”), respectively, but the expectations for our partners and staff remain unchanged—delivering high-quality audits in a manner consistent with the ethical standards and expectations of our profession is our top priority.

Ethical behavior and consistent quality are crucial to everything that we do. We would not have a seat at the table without it. We remain committed to our important role in the capital markets and, as a result, we continue to invest in delivering independent and objective high-quality audits.

We expect our partners and staff to exhibit the core principles underlying our purpose: integrity, objectivity, independence, professionalism, and accountability. Communication plays an important role in reinforcing our purpose. Key messages are conveyed by our Senior Partner, our US Leadership Team, our Assurance Leadership Team, and our Sector Leaders. In addition, these messages are reinforced and modeled by our local leadership and engagement partners. Our performance assessments evaluate how well our partners and staff exhibit the core principles underlying our purpose.

Throughout the Firm, we have ongoing quality-related discussions to gain insights into what we are doing well, where we can continue to improve, and the specific actions expected to achieve those enhancements. These discussions occur through a variety of channels, including town hall meetings, webcasts, leadership visits, and, most importantly, individual coaching. We use confidential surveys to monitor whether our actions and words are effectively conveying the importance of quality to the success of our Firm. The results of these surveys demonstrate that our people understand our audit quality objectives.

“Quality is fundamental to our firm’s purpose and the important role we play in the capital markets. That’s why we invest so much in innovation and our people—to deliver independent and objective high-quality audits.”

—Tim Ryan, US Chairman and Senior Partner

Percentage of assurance professionals surveyed who report receiving consistent messages about the importance of audit quality from both local and Firm leadership:

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<th>FY16</th>
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<td>99%</td>
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“Quality is fundamental to our firm’s purpose and the important role we play in the capital markets. That’s why we invest so much in innovation and our people—to deliver independent and objective high-quality audits.”

—Tim Ryan, US Chairman and Senior Partner
In our culture, we celebrate our successes while also focusing on continuous improvement. We can only be successful delivering high-quality audits when we focus on each of the components of our system of quality control, including our leadership, ethics and independence programs, human capital strategies, learning and development, audit methodology, resource management, and monitoring programs.

Our audit partners have adopted Audit Quality Principles to make clear to one another and our staff what we mean by “audit quality.” At PwC, a quality audit means consistently:

- complying with auditing standards;
- applying a deep and broad understanding of our client’s business and the financial environment in which they operate;
- using our expertise to raise and resolve issues early; and
- exercising professional skepticism in all aspects of our work.

### Accountability

We provide our professionals with guidance on the Firm’s expectations that clearly communicates their responsibility and accountability for planning and performing quality audits. These expectations include compliance with audit and risk management policies; timely scoping, planning, and execution; consultation with appropriate specialists; proactive issues management; adherence to independence and compliance requirements, including mandated training; the exercise of professional skepticism; and the appropriate level of review and supervision.

### Leadership responsibilities

Our Assurance Leadership Team includes partners who oversee our audit practice in various regions, markets, industry groups, and business units. Each has a role in leading the implementation and monitoring of our audit quality initiatives and overseeing our system of quality control. Our market team leaders, market assurance leaders, and regional assurance leaders may assist audit partners in making key decisions that have quality implications, monitor partner assignments and responsibilities, and monitor attendance at required training courses.

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**Percentage of assurance professionals surveyed reporting that they understand the practice’s objectives regarding audit quality**

- **FY16:** 96%
- **FY15:** 97%
- **FY14:** 97%
Partner accountability and compensation

Each partner receives a share of the Firm’s profits based on his or her level of responsibility, the Firm’s performance, and the partner’s performance. Each partner is evaluated in four areas: quality, people, partnership and teamwork, and profitable growth. Individual partner accomplishments are measured based on the partner’s relative performance against established goals. Consistent with professional standards, our audit partners are not evaluated or compensated for selling non-audit services to audit clients.

Quality and other aspects of the partner’s performance are carefully considered in determining a partner’s income and responsibilities. Quality-related matters can result in reduced responsibilities and have a negative financial impact on lead engagement partners, auxiliary partners, quality review partners (QRPs), and specialist support partners (e.g., tax, valuation, actuarial, information technology). When necessary, in order to promptly address quality issues identified, leadership works with the partner to implement a responsive action plan and monitors its implementation and effectiveness.

Non-partner professionals

As with our partners’ annual assessments, the assessment of our non-partner professionals’ performance incorporates the Firm’s quality objectives. Individuals are assessed against the dimensions of the PwC Professional framework, which is discussed on page 8. For those who work on audits, this includes assessment in the areas of accounting and technical knowledge, auditing skills, professional skepticism, issues management, and review and supervision. Our non-partner professionals participate in a performance bonus plan that is based, in part, on the achievement of quality goals and objectives.

If our audit quality objectives are not fully met by non-partner professionals at the manager level or above, they must develop a responsive action plan that is reviewed and approved by a leader who oversees the individual. Our goal is to provide the support and resources necessary for the individual to deliver against our audit quality objectives in the future. Over the course of the fiscal year, their progress is monitored by their market team leader.

Ethics, independence, and objectivity

Ethics

Ethical behavior is the foundation for building trust. We have established a code of conduct and supporting policies that describe the behaviors expected of our partners and professionals. We also provide our people with multiple ways to ask questions or voice concerns, including an anonymous ethics and compliance HelpLine, and a confidential e-mail process.

Protecting client confidentiality and preserving necessary records are also key components of our ethics policies. We have policies prohibiting the misuse of confidential client information (e.g., information concerning non-public deals) in all formats (e.g., email, oral communications, printed documents) and we continue to invest in new processes and technology to safeguard confidential information. These policies are included in training for all new hires, are reinforced as part of required annual training, and are included in annual compliance confirmations required of all partners and staff.

Strength through diversity: Q&A with Maria Castañón Moats, https://www.complianceweek.com

“When we think about what’s next for the audit, we’re thinking about innovating the audit with more technology, more data extraction, and more analysis. That is changing how our people are experiencing the audit. If we use more technology, that frees people up to work on more complex areas.”

—Maria Castañón Moats, US Assurance Leader

Our fiscal year ends June 30th each year.
Independence and objectivity

One key characteristic that distinguishes the auditor from nearly all other professionals is the requirement that we be independent from our audit clients. It is this independence—in fact and appearance—that facilitates our exercise of professional skepticism and ability to objectively arrive at conclusions without being affected by influences that could compromise our professional judgment. And it is this independence that helps promote confidence in audited financial statements.

Our independence policy is based on the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants, and is supplemented, as necessary, to comply with the requirements of US standard setters and regulators (e.g., the PCAOB and the SEC). We provide technology-based tools to support our auditors in maintaining their independence, including systems and processes to:

• identify the entities requiring independence (including, for example, the affiliates, subsidiaries, and related entities of audit clients to which the independence rules also apply);

• document the permissibility of proposed non-audit services;

• facilitate the assessment and monitoring of joint business relationships;

• initiate independence consultations with in-house experts;

• evaluate, pre-approve, and monitor securities and other financial arrangements held by partners, managers, and others to whom independence rules apply;

• automatically record security transactions entered into by our people through major brokerage firms in the Firm’s independence system; and

• document our professionals’ annual confirmation of compliance with these independence policies and other compliance topics.

In March 2016, we launched myIndependence Confirmation. This web-based tool automatically sends engagement independence confirmations to engagement personnel and generates the documentation necessary to evidence the confirmation process.

A team of dedicated professionals (15 partners and 216 staff) help our audit professionals achieve and maintain independence. This team maintains and updates our independence policies and guidance, develops our annual independence training, develops and administers our compliance systems and procedures, and serves as a resource for our people when questions arise. In FY16, this team engaged in approximately 27,500 independence-related consultations.

Personal independence matters are generally either self-identified or identified through our audits of individuals’ personal independence compliance. We have disciplinary policies in place to promote compliance with independence policies and processes. These policies require any breaches of independence rules to be reported and addressed. If such a matter arises, we address and resolve it promptly, including, where appropriate, discussing the matter with the audit committee for the company to which the independence rules apply.

We perform due diligence for all acquisitions we make, including independence-related considerations. We review and assess joint business relationships, procurement arrangements, personal and Firm independence, and client contracts for scope of services.

Partner rotation

SEC and PCAOB requirements provide that both the lead audit partner and QRP on a public company rotate off the audit engagement every five years. We also have rotation policies for auxiliary partners and partners on non-public company audit engagements. We believe that periodically rotating the partners who work on our audits provides a balance between bringing “fresh eyes” to the audit and maintaining a deep understanding of the client and its operations, supported by team continuity. This drives both enhanced objectivity and audit quality. Our practice leaders use systems and processes to manage partner portfolios and rotations on a timely basis, including identifying successor partners who have the skills and capacity to maintain consistent audit quality.
Considerations in undertaking an audit engagement

Our principles for determining whether to accept a new client or continue serving an existing client are fundamental to delivering quality that we believe goes hand-in-hand with our purpose to build trust in society. To maintain objectivity, our acceptance process for new clients includes approvals by multiple levels of risk management partners and market leadership partners. Our assessments for continuing to serve existing clients often require risk management partner and market leadership approvals depending on the nature of the client and the results of our risk assessment. Our procedures for assessing whether to accept a new audit client, or continue to serve an existing client, are designed to identify potential areas of risk and focus on a number of matters, including whether:

- the engagement is allowable under professional and regulatory standards and is within our professional competence and capabilities;
- the entity’s management, board, significant shareholders, and principal owners are people of integrity and good repute;
- the entity’s operations are governed by acceptable standards of behavior;
- there are any unresolved issues involving independence, conflicts of interest, or relationships with other entities; and
- there are any unreasonable timing or resource constraints that would affect our ability to comply with applicable standards.

Key to making our decision to accept or continue an audit engagement is whether we have the resources with the right skills, experience, industry knowledge, and capacity to perform a high-quality audit. We only accept audit engagements for which we believe our audit procedures can satisfactorily address the risk of material financial statement misstatement and that align with our strategies for growing our practice.
Multi-disciplinary firm

Building trust is at the core of our purpose. Credibility and reputation are important components that enable us to build that trust. If we fail to maintain trust, we could suffer irreparable harm to our brand and lose our ability to deliver on our purpose. That is why maintaining the quality and integrity of our audit practice is foundational to our brand, our strategy, and our success.

We believe that a multi-disciplinary firm (that is in full compliance with independence requirements) makes us more knowledgeable of the risks and challenges that affect our audit clients in the rapidly changing business environment. These risks and challenges can include, among many others, different revenue models based on emerging technologies and business models; the impact of cybersecurity threats on internal control over financial reporting; valuation processes due to the expanded use of fair value in financial reporting; forensic investigations; complex income tax matters; and information technology innovations. These are complex issues that require deep understanding and technical knowledge. Continuing to invest in our non-audit practices—and the expertise they provide—helps keep us at the forefront of these and other issues relevant to the audit.

A multi-disciplinary firm also helps us attract and retain top talent. Using specialized skillsets, our non-audit personnel are often instrumental in developing innovative technologies and processes for executing our audit work. The innovative technologies benefit audit quality directly as discussed in the section on Our Technology, but also indirectly through the attraction and retention of auditors who desire to execute their work using efficient and effective technologies and processes.

Our specialists are also often leveraged as part of the audit. For example, valuation specialists, who build competencies performing valuations for non-audit clients, assist audit teams in performing auditing procedures over valuations. Similarly, our tax specialists, who build competencies advising on tax provisions for non-audit clients, assist audit teams in performing audit procedures over tax provisions.

We are, however, also focused on the potential risks to our audit practice presented by our multi-disciplinary strategy. In that regard, we remain focused on maintaining:

- a strong leadership tone focused on:
  - audit quality, independence, professional skepticism, and objectivity; and
- taking a leadership position on profession-wide matters, including providing transparency regarding non-audit services, to help address stakeholder concerns;
- effective independence and monitoring processes; and
- strong governance protocols over the allocation of investment spending to our different businesses.

The general growth of our non-audit businesses is not driven by setting goals for selling non-audit services to our audit clients. We only perform non-audit services for audit clients when (1) it is permitted by applicable professional standards and independence rules and (2) the audit committee agrees—before any services are provided—that such services will not impair our independence.
Our people

Human capital strategies

We remain committed to creating an environment where we are able to attract, develop, and retain the best and brightest in our profession, and have been recognized by several different organizations for our accomplishments in doing so. We see our human capital as critical to our success as a Firm. Our people strategies—including how we recruit and deploy talent, develop skills, identify diverse professional experiences, and provide coaching and feedback—are all essential to our ability to achieve our quality objectives.

The PwC Professional

We have built a global career progression framework called “The PwC Professional” that we believe enables us to continue to be the leading professional services firm. Our objective is to create a well-rounded professional, a whole leader, who exemplifies all of these qualities and can confidently deliver quality, value, and excellence in increasingly complex and rapidly evolving environments.

The career progression framework illustrates how we are developing our people into leaders who possess the capabilities and confidence to produce high-quality work, deliver an efficient and effective experience for our clients, execute our strategy, and support our brand.
Recruiting

Developing the PwC Professional starts with sourcing the best talent by offering a value proposition that is distinctive. We expect much from our people, but in return, we provide competitive compensation with outstanding employee benefits, including our student loan paydown benefit. We provide world-class development opportunities and the chance to work with some of the world’s premier organizations. Our talent acquisition strategy is designed to hire highly-qualified candidates who have diverse backgrounds and skills and come from diverse cultures; possess personal attributes consistent with our Firm’s culture and the PwC Professional; have a questioning mindset and intellectual curiosity; and demonstrate courage and integrity.

On average, PwC will defray $10,000 of student loan debt for eligible recent graduates

Our reputation depends on hiring the most talented professionals available and, in turn, our reputation for quality enables us to attract the best candidates. Our stringent hiring standards for entry-level and experienced professionals, which include assessing academic records and conducting background and reference checks, mean that our newly-hired professionals are well suited to meet the Firm’s quality expectations. In FY16, our Assurance practice hired more than 3,100 new graduates and 2,900 interns, representing an increase of approximately 6% at the entry level, relative to the prior year. We also hired almost 400 experienced professionals. We continue to recruit candidates with science, technology, engineering, and mathematics (STEM) capabilities, as we view these as important skills for the future. In FY16, 13% of our campus hires possessed a STEM degree.

To continuously improve our talent acquisition process, we initiated a project in FY16 to build the talent acquisition function of the future—one that is distinctive, innovative, agile, and efficient. We are on a journey to redesign the talent selection process by selecting and implementing new technologies that increase the effectiveness of our recruiting team, expand access to qualified and diverse talent, and distinguish our brand.

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3 The estimate is based on the average student loan, interest rate, and term of loan. Individual amounts may vary.

4 The use of the term “audit professionals” throughout this document refers to our core audit partners and staff (i.e., specialists, including risk assurance, are excluded). Certain FY14 and FY15 amounts were revised to conform to our FY16 presentation.
“Today, we recognize skills in data analytics, information management, and programming languages as more valuable than ever, along with the leadership skills that enable students to effectively lead, communicate, and collaborate. Tomorrow, we can only imagine how technology will continue to transform our work and the workplace.”

### Professional development

Opportunities for learning and development—whether team-based, in a classroom environment, or technology-based—help our people develop the skills to be a successful PwC Professional. Throughout their tenure with the Firm, we provide our professionals with increasingly challenging experiences and career opportunities. Professional development also occurs through the coaching and real-time development our professionals receive on the job.

Becoming a CPA is an important part of our audit professionals’ career progression, as it demonstrates a mastery of core auditing and accounting knowledge. Passing the CPA exam—a significant step toward obtaining the CPA credential—is a prerequisite for advancement to the audit senior associate level.

In 2016, 18 of the 75 individuals recognized by the AICPA for achieving exceptional results on the CPA exam were from our Firm, the highest percentage among all other public accounting firms.

We’re committed to putting the right people in the right places at the right times more efficiently. That’s why, in 2016, we launched TalentLink, our first global talent management and sourcing platform, giving us network-wide visibility into our people’s skills, experiences, and interests. It gives us the information we need to staff current client engagements for success, build teams to fuel our future growth, and understand the career aspirations and interests of our people.

### Retention

We recognize that turnover rates in the public accounting profession are high, and that our staff, in particular, are in high demand. Accordingly, retaining our highly talented professionals remains a priority and is important to achieving sustained audit quality.

We are dedicated to creating an environment that enables us to deliver the PwC Experience to our people. From embracing our commitment to work flexibility to taking the time to engage and inspire our people on a personal level, we “re-recruit” our people by delivering on the value proposition that a career with PwC provides.

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5 Source: Data driven: What students need to succeed in a rapidly changing business world
Providing our people with flexibility in meeting both their professional and personal obligations is an important component of our retention strategy. In addition to continuing to provide formal flexibility options (such as reduced schedules and remote working arrangements), we are making flexibility discussions part of our culture. For example, we encourage teams to develop “flexibility plans” at the onset of an engagement and identify “flexibility champions” within each team to keep them on track, particularly during peak periods. This energizes our engagement teams’ passion for and commitment to delivering quality, creates a more rewarding experience, and increases their desire to remain with the Firm longer.

Our people initiatives have led to a reduction in average annual hours at all levels and a 20% reduction in hours worked in excess of 40 per week over two years.

Through our weCARE program, we empower and enable all partners and staff to show appreciation and recognize individuals for their contributions and impact. Further, we encourage our staff to participate in our corporate responsibility efforts, such as our Earn Your Future program, pro-bono work for non-profit organizations, volunteering, or giving. These efforts positively impact local communities and also have a positive impact on the retention of our staff, who are purpose driven. For example, our core assurance staff who participate in corporate responsibility-related activities are 7% less likely to leave our Firm than those who don’t participate.

We are seeing the positive impact of these combined efforts reflected in an increase in our Engagement Index. The combination of higher engagement index and lower turnover and hours contributes positively to our quality objectives.
Our diversity and inclusion strategy

Our stakeholders look to us for broad thinking and perspectives, which leads to greater value in the services we provide, innovative solutions to client challenges, and enhanced quality. We are committed to cultivating an inclusive workplace where everyone can succeed in achieving their personal and professional goals. An inclusive workplace enables us to embrace the diversity and richness of backgrounds and perspectives of our people and to leverage their diverse talents.

An integrated approach

PwC has been on a journey to promote diversity and sustain an inclusive environment for all of our people. Today, women and minorities comprise 45% and 32% of our Firm, respectively.

Diversity and inclusion is a firm imperative, and as a result, our chief diversity and inclusion officer reports directly to our US Chairman and Senior Partner. To better align our programs and initiatives with our people and business strategies, our diversity priorities are incorporated into our organization at many levels. Leadership development programs help leaders, managers, and staff build cultural dexterity within their teams. And our PwC Professional career progression framework includes global acumen as a key attribute to demonstrate the importance of having a mindset that transcends geographic and cultural boundaries.

Each of our professionals has personal accountability to sustain an inclusive workplace. Our holistic approach stresses the importance of creating a supportive and engaging environment in which our diverse professionals can thrive. Our approach focuses on three main areas:

- **Early success**: We plant the seeds for our diverse talent pipeline through programs such as our Start internship, which prepares high-achieving minorities who are in their freshman, sophomore, and junior years for success through learning and development opportunities and client service shadowing experiences. The Start internship prepares them for our client service internship. We help full time hires get a strong start through programs like Vanguard—a year-long program designed to support the success of Black/African-American new hires.

- **Leadership development**: We continue to support our diverse professionals throughout their career at PwC by offering distinct leadership development programs. Diamond provides coaching and sponsorship to top-performing minority senior managers and directors. Accelerate is a leadership development program for Asian/Pacific Islander experienced associates. Breakthrough Leadership coaches our experienced higher-performing women. Select Senior works to develop our higher-performing diverse senior associates.

- **Inclusion**: We offer all of our people opportunities to raise their diversity awareness and increase their cultural dexterity. These include initiatives such as PwC’s White Men and Diversity Champions, who educate and engage our white males in recognition of the important role they play in creating an inclusive workplace, and “Blindspots: The Hidden Biases of Good People,” a training course that helps partners and managing directors gain awareness of potential implicit associations and their consequences. We also engage our people in diversity circles for Black/African-Americans, Asians/Pacific Islanders, and Latinos/Hispanics, as well as women, working parents, veterans, LGBT professionals, and individuals who have a disability or care for someone who does.

As a result of our efforts to promote diversity and sustain an inclusive environment, the diversity of our partners has gone from 16% women and 6% minorities in 2006 to 19% women and 13% minorities in 2016. Another testament of our progress is our 2016 new partner class—the most diverse in our history—with 44% women and minorities. We’re proud of the progress we have made to date, but there is still more we want to do to enhance our inclusive culture and to continue to attract talented people who have unique skills, experiences, and ambitions.

“The US Leadership Team is the most diverse we’ve had and brings many different skill sets, experiences and ways of thinking to the table.”

—Tim Ryan, US Chairman and Senior Partner
Our diversity and inclusion strategy is a journey—we recognize there is more we want to do, but we are proud of the progress we’ve made to date. Key milestones include:

PwC becomes an IMPACT 10X10X10 champion for HeForShe, the UN Women’s global gender equity initiative

2007:
Won the Catalyst Award, which recognizes “innovative organizational initiatives that address the recruitment, development, and advancement of all women”

2006:
Launched Diamond—a program for top-performing Black/African-American, Hispanic/Latino and Asian senior managers and directors

2004:
Convened PwC’s LGBT Partner Advisory Board

2001:
Elected first woman to PwC’s Board of Partners and Principals and appointed PwC’s first Chief Diversity Officer

1996:
Added the first woman to National Leadership Team

1995:
Appointed the first Black partner to serve as a Vice Chairman responsible for overseeing the firm’s four lines of service

1990:
Appointed the first woman partner to the Partner Admissions Committee

1979:
Admitted first Black female partner

2016:
Appointed the most diverse US Leadership Team in the history of the firm, including the first female line of service leader, a Latina, to lead US Assurance

2015:
Hosted live “PwC Talks: Being color brave” webcast on the topic of race with Mellody Hobson, President of Ariel Investments

2014:
Established a Disability Strategy Council to enhance the PwC Experience for people with disabilities

2010:
Launched PwC’s Veterans Network

2009:
Launched Vanguard—a year-long program designed to support the success of Black/African American new hires

2007:
Hosted live “PwC Talks: Leaning In, Together” webcast with Sheryl Sandberg, author of “Lean In” and COO of Facebook

2004:
Launched Breakthrough Leadership, a development program for top-performing women senior managers and directors

1995:
Appointed the first Black partner to serve as a Vice Chairman responsible for overseeing the firm’s four lines of service

Please visit www.pwc.com/diversity to learn more about PwC’s Diversity & Inclusion strategy, as well as the awards and recognition we have received for our achievements in this area.
Our focus on audit quality

Learning and development

The composition of our audit teams provides our less experienced professionals the opportunity to work with more seasoned professionals, which promotes meaningful on-the-job training. Judgment is honed by witnessing—in real time—how seasoned auditors approach issue identification, management, and resolution. Our audit partners’ experience facilitates opportunities for our less experienced professionals to learn from more seasoned professionals. Professional skepticism, accounting knowledge, auditing and analytical skills, supervision and review, and issues management are technical capabilities every audit professional is required to develop continuously throughout his/her career.

Partners’ average years of experience at our firm:

FY16 23
FY15 23
FY14 23

“We believe our staffing ratios provide opportunities for our less experienced staff to learn from experienced professionals.”

Leverage ratio of audit-related hours for audit team members:

<table>
<thead>
<tr>
<th></th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partner to Manager*</td>
<td>1 to 3.7</td>
<td>1 to 3.9</td>
<td>1 to 4.1</td>
</tr>
<tr>
<td>Manager* to Staff</td>
<td>1 to 4.1</td>
<td>1 to 4.1</td>
<td>1 to 4.2</td>
</tr>
<tr>
<td>Partner to Staff</td>
<td>1 to 19.2</td>
<td>1 to 20.2</td>
<td>1 to 20.4</td>
</tr>
</tbody>
</table>

*In this graphic, the term “manager” includes managers, senior managers, directors, and managing directors

The experience needed to develop the technical and business acumen required to become an effective auditor hasn’t changed, but it has required the development of new skills. For example, as part of our continued audit transformation and efforts to enhance audit effectiveness, we are training our professionals to use tools to interpret large amounts of data. And to allow our staff to maintain their focus on the areas requiring the most skill and judgment, we continue to shift routine or non-complex work to resources outside of the traditional engagement team.

We also incorporate observations from our Chief Auditor Network, as well as results of surveys, focus groups, and post-course learning assessments when updating our courses.

The significant amount of learning that occurs through on-the-job supervision, review, and mentoring is supplemented through participation in rigorous, Firm-developed learning programs. These programs include a primary focus on auditing and accounting skills, as well as business and industry developments, and are tailored to the experience level of our professionals. With feedback obtained through our monitoring efforts—whether through our own internal inspections process or through analysis of observations from the PCAOB and peer reviews—we continually update and redesign our training curriculum.

“Role models inspire others by bringing possibilities to life. And I believe we all have the power to shape the course of other people’s careers. Active sponsorship makes all the difference when it comes to advancing diverse professionals.”

—Maria Castañón Moats, US Assurance Leader
The effectiveness of our formal learning is enhanced by our national Assurance learning team, which comprises experienced PwC audit professionals who are dedicated to instructing our associates and senior associates, and our Chief Auditors, who play an important role in sharing information and experience with our partners and managers.

We require our audit professionals—from first-year staff to partners—to attend training courses that integrate auditing and accounting concepts for a more effective learning experience. Our managers and partners also attend industry-specific training where they choose courses most relevant to their current roles and responsibilities. In addition, we offer our professionals non-technical training around topics such as project management, issues management, and business communications. The number of hours of auditing and accounting training mandated annually for each professional level can vary from year-to-year based on the curriculum determined necessary by the Assurance learning team and approved by Assurance leadership. On average, where applicable, our professionals consistently complete significantly more training than states require to maintain CPA licensure.

Attendance at mandated training courses is an important component of an individual’s performance assessment and is monitored by the Assurance partners who lead our market teams. Non-attendance at mandated training courses, including independence and ethics training discussed on page 4, or failure to achieve the mandated number of hours of auditing and accounting training can impact an audit professional’s performance evaluation and individual compensation. In addition, all mandated auditing and accounting training courses are followed by learning assessments that require a specified passing grade to help extend the learning experience by testing knowledge gained during the course. The results of these tests also provide participants with a better understanding of where they can focus additional attention in technical areas.

### Number of hours of auditing and accounting training mandated by PwC annually for each professional level:

<table>
<thead>
<tr>
<th>Role</th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners</td>
<td>24–32</td>
<td>32–38</td>
<td>22–30</td>
</tr>
<tr>
<td>Managers/Senior Managers/Directors/MD</td>
<td>24–29</td>
<td>34–45</td>
<td>22–26</td>
</tr>
<tr>
<td>Senior Associates</td>
<td>40</td>
<td>42</td>
<td>48</td>
</tr>
<tr>
<td>Associates</td>
<td>40–80</td>
<td>40–80</td>
<td>40–80</td>
</tr>
</tbody>
</table>

### Average training hours completed per audit professional:

<table>
<thead>
<tr>
<th>Year</th>
<th>Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY14</td>
<td>112</td>
</tr>
<tr>
<td>FY15</td>
<td>101</td>
</tr>
<tr>
<td>FY16</td>
<td>99</td>
</tr>
</tbody>
</table>
Our focus on audit quality

Audit methodology and processes

Our audit methodology is instrumental to audit quality. We continue to innovate the audit process by standardizing, simplifying, and automating our work. This leads to consistency in the execution of our procedures, promotes adherence to professional auditing standards, and improves the experience for our clients through earlier identification and resolution of matters.

Foundational to our methodology is the assessment of risk. The identification and evaluation of risk begins in the planning phase of the audit and continues through issuance of our audit report. After we gain an understanding of the client’s end-to-end business processes, we identify and evaluate the risks within the processes and develop audit programs appropriately responsive to the client’s specific facts and circumstances. We reinforce the importance of timely planning and phasing of audit work by setting deadlines for completion of audit planning, which facilitates the more timely consideration of audit risk and the related response.

In addition to these efforts, we continue to enhance our methodology, training programs, and audit documentation tools to respond to new accounting and auditing standards, changes in risk, and the results of internal and external inspections, including the related analysis of quality drivers. For example, over the past year, our learning and development programs provided training opportunities focused on the consideration of the risk of material misstatement to the financial statements related to client cybersecurity risk management programs. We also reinforced the requirement to evaluate the reliability of the system-generated information used by management in the execution of financial reporting controls and our engagement teams when performing substantive procedures. We also enhanced our documentation tools for review controls in complex areas involving significant estimates and judgments.

In the interest of continuous improvement, over the past year we have:

- introduced further enhancements to the latest version of our global audit software, Aura v6 (see page 22 for further discussion)
- assigned Market Team Transformation Leaders (MTTLs) to drive consistent application of our process improvement framework, our methodology, and use of our advanced tools, technology, and alternative staffing models
- developed certain industry-specific audit programs to improve the focus and consistency of how we address industry-specific risks
- expanded our methodology to include a data auditing approach that uses a standardized computer-assisted auditing technique to test revenue
- reinforced the similarities and differences between our methodology related to engagements conducted in accordance with PCAOB and AICPA standards
- continued to increase leverage of our Service Delivery Centers to drive quality and consistency, and to leverage additional resource pools (see page 17 for further discussion)
Audit committee communications

Audit committee oversight of auditors, including timely, meaningful, and direct exchanges of information, is another key element of sustaining and improving audit quality. Both we, as auditors, and the audit committee benefit from these exchanges. We learn valuable information regarding the audit committee’s points of view and perspectives and fulfill our professional responsibilities to communicate certain important items to the audit committee. The audit committee benefits because our open communications enable them to more effectively execute their oversight role. We are also committed to discussing with the audit committee the results of any PCAOB inspection of our audit engagement for the company, as well as trends from other inspections that may have a bearing on future audits.

For public companies audits, our communications occur at least quarterly. These discussions may include obtaining the audit committee’s views on financial reporting risks and areas that warrant audit attention, discussing the resources to be allocated to the audit, and considering whether the audit fee fairly reflects the audit work to be performed. Required communications include discussions about our independence, our roles, and the roles of management and the audit committee. In addition, the audit committee provides recommendation to the shareholders to ratify our appointment as the company’s independent registered public accountant and reviews and approves our audit and non-audit service fees, where applicable.

Resource management

We continue to invest in ways to phase our work to alleviate peak busy periods for our people. We also continue to advance our transformation agenda to enhance the quality and efficiency of our audits. Expansion of our Engagement Performance & Quality (EPQ) program has enabled more of our teams to realize greater process efficiencies. We also continue to invest in and leverage our Global Delivery Model, as described in further detail below. These efforts have helped us reduce full-year utilization by almost 4 percentage points and utilization for our peak period of January and February by 2 and 6 percentage points, respectively. The reduction in utilization contributed to a significant decline in voluntary turnover, which was discussed in the Retention section of our report beginning on page 10.

Our Global Delivery Model leverages PwC Service Delivery Centers (SDCs) located around the globe to perform standardized and routine audit and administrative procedures. It’s about having access to the right people to do the right work at the right time. The local engagement teams determine how to utilize the SDCs as appropriate for each engagement, which provides the team with more time to focus on more challenging and judgmental aspects of the audit, thus further enhancing audit quality and consistency. This approach enables the local audit team to have more capacity and increased flexibility, improving project management and morale, thereby benefiting our clients and our people. During FY16, we grew our Global Delivery Model by 32% and our Assurance practice commenced use of another SDC location—Manila, Philippines.

Consultation process and use of specialists

All levels of Firm leadership, along with all partners involved in the audit process, play important roles in achieving audit quality and are accountable for their performance in those roles. No audit team, partner, or staff member is ever expected to “go it alone.” To the contrary, as part of our collaborative culture, the audit partner has the ability to leverage the full quality support network of the Firm when complex accounting, auditing, or financial reporting matters arise. This network includes our National Office, Chief Auditor Network, Risk Management Partners, and partners who lead the audit practices in our market and sector groups.

Ratio of partners serving in technical support roles to the total number of audit partners7

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY16</td>
<td>1 to 6.1</td>
</tr>
<tr>
<td>FY15</td>
<td>1 to 6.1</td>
</tr>
<tr>
<td>FY14</td>
<td>1 to 6.3</td>
</tr>
</tbody>
</table>

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7 FY14 and FY15 amounts were revised to conform to our FY16 presentation.
In addition to dedicated, experienced partners and professionals in technical support roles, our engagement teams also draw upon Firm specialists (e.g., valuation specialists) in a variety of accounting and auditing areas. Complex accounting matters may include, but are not limited to, revenue recognition; financial instruments; tax reporting and accounting; fair value determination and reporting, including in the context of business combinations; and information technology. Complex auditing matters may include, but are not limited to, multi-location scoping, auditing estimates and fair values, and various internal control-related matters. The volume, nature, and extent of these matters at our clients will drive the number of specialists’ hours for a given audit.

Consultation and collaboration with specialists in complex, highly technical, or specialized areas are key aspects of our approach to a quality audit. Such discussions help us make the best judgments and align our views within the Firm.

Partners and professionals who provide consultation support also assist audit teams in reviewing the assessments performed by management and audit committees when potential errors are identified in previously issued financial statements. While relatively rare, such assessments may result in a conclusion by the company to restate those financial statements.

**Number of annual restatements as a percentage of issuer audit clients**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY14</td>
<td>1.20%</td>
</tr>
<tr>
<td>FY15</td>
<td>1.16%</td>
</tr>
<tr>
<td>FY16</td>
<td>0.91%</td>
</tr>
</tbody>
</table>

Consultations, presentations, direct client interactions, and distribution of various thought leadership publications, the National Office keeps our audit teams, clients, and other stakeholders informed of matters that may impact the audit, audit quality, or financial reporting, including standard-setting activity and other relevant regulatory matters.

Our audit policies identify specific matters for which National Office consultation is required. We periodically evaluate and update these policies. Audit teams are also encouraged to consult on any matter as appropriate given engagement-specific facts and circumstances. In the event an audit partner initially has a different viewpoint than our National Office, a resolution process provides guidance for elevating the discussion until agreement can be reached.

**Risk Management**

Our risk management network includes experienced audit partners who serve in national, regional, and local roles. Generally, our Risk Management partners have more than 20 years of experience. Regional and local risk management partners devote a portion of their time to risk management activities, while continuing to manage their own engagements. National Risk Management professionals are generally dedicated on a full-time basis and are responsible for the design, development, and execution of the Firm’s risk management policies.

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8 For purposes of this report, issuer audit clients comprise SEC registrants and mutual funds.
Risk Management partners support audit teams in assessing risks (such as whether to undertake or continue an audit engagement), audit execution matters, and applying the Firm’s risk management policies. Audit teams are required to consult with a Risk Management partner on specific issues (such as misstatement evaluation and resolution, principal auditor considerations, and going concern matters), and are encouraged to do so whenever they believe they could benefit from Risk Management partner insights.

**Chief Auditor Network**

Our Chief Auditor Network comprises partners and professionals who provide local, regional, and sector support to our audit teams in the field. Chief Auditors help our audit teams design effective and efficient audit approaches and reinforce the key learning points from audit training and guidance developed by our National Office. Chief Auditors also provide advice on auditing matters through review of certain aspects of selected audit engagements before those audits are completed. Through all of these activities, the Chief Auditor Network is able to provide local and national leaders with insights on overall audit quality trends and progress. Our Chief Auditors contribute to market and industry group meetings focused on audit quality topics and serve as instructors for many of our audit-related training courses.

**Quality Review Partner**

Engagement quality review represents a key component of our quality control system. Partners serving in these roles must have the requisite technical knowledge, experience, and time to perform the role effectively. QRPs are involved in the most important aspects of the audit, including reviewing the audit plan, considering the Firm’s independence, and discussing the significant risks identified by the audit team and the responses to those risks. QRPs are also involved in specific accounting, auditing, and financial reporting and disclosure matters.

Our policies contain guidance for QRPs to understand their responsibilities. We also utilize QRP assistants and have policies and guidance regarding their use. QRP assistants are generally partners with one to five years of experience. All QRPs and QRP assistants are required to take training specific to QRPs before assuming their role.
Engagement Performance & Quality

Engagement Performance & Quality (EPQ) is PwC’s approach to process improvement. For years, world class companies have used process improvement to enhance the quality and efficiency of their products and services. Conducting an audit includes many supporting sub-processes. Orchestrating the execution of those sub-processes can be complex and includes the coordination of various inputs, stakeholders, outputs, and requirements. By improving the sub-processes, we can improve the audit’s overall execution, including quality and efficiency. We can also create a better experience for our clients and our people.

Process improvement generally does not change what audit procedures are performed, but it often impacts how we conduct those procedures. By making changes to the sequence and timing of activities, increasing the level of precision at which we plan, and adding more rigor to project management, we are able to have a positive impact on the audit process.

A core principle of EPQ is building quality at the source—that is, preparing and planning to do the work to get it right the first time, thereby reducing the extent of rework required as the audit process progresses. This not only improves overall quality, it improves efficiency and reduces the compression of work near the end of the audit, allowing more time to focus on key judgments and items of significant risk. We continue to focus on doing the right work, at the right time, and avoiding unnecessary work.

EPQ was rolled out to all audit professionals over the last two years through office-wide trainings across the country and workshops with various individual engagement teams.

In a survey of partners and staff who have participated in an EPQ “deep-dive” workshop:

- **98%** felt that EPQ had a positive impact on the quality of their work
- **97%** felt that EPQ improved the phasing of hours on their engagements
- **96%** felt that EPQ enhanced their client’s experience with the audit

Combined with our other transformation initiatives, EPQ is helping to enhance the audit process—improving the overall client experience, reducing the level of inefficiency and disruption, and ultimately contributing to enhanced audit quality.

Global network

PwC is a member of PricewaterhouseCoopers International Limited (PwCIL), a UK private company limited by guarantee. PwC is the brand under which the member firms of PwCIL operate and provide professional services. Members of the PwC network share knowledge, skills, and resources. This membership facilitates PwC firms working together to provide high-quality services on a global scale to international and local clients, while retaining the advantages of being local businesses—including being knowledgeable about local laws, regulations, standards, and practices.

Effective July 1, 2016, we combined with PwC Mexico. This combination positions us to provide more of what our clients are looking for: deep local business acumen combined with the strength and resources of the US firm. We have more than 600 clients in common with PwC Mexico and our goal is to provide these clients with access to additional breadth and depth of expertise, skills, insights, and experience. And, of course, when we do important work for our clients, it creates opportunities for our people as well.

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9 Please see www.pwc.com/structure for further details.
Quality across the network

High-quality audits across the network are vital to the US firm and our brand, and are the foundation of our purpose. In prior years, this report has highlighted a number of significant efforts undertaken to enhance quality across the network, including Connect, Halo for Journals, and the PwC Professional. In 2016, the PwC network built on these efforts and released a number of global tools designed to enhance the consistency of our audit execution. These efforts included the following:

- Introduced further enhancements to Aura v6, the latest version of our global audit software (see page 22 for further discussion).
- Launched PwC TalentLink, as mentioned in the Our People section of our report. This global resource management platform provides us network-wide visibility into the experiences and expertise of our professionals and allows us to better align resources with resource needs.

We continue to assist member firms in enhancing their quality-focused infrastructure, including helping them enhance their own quality processes. We are active leaders on a task force of member firms that shares learnings and best practices on quality.

Our goal in these efforts is to help other member firms to consistently perform high-quality audits for US issuer clients, or otherwise. Each member firm is responsible for monitoring its own quality control system, including reviewing the quality of its management-level controls and the audit work it has performed. A network team inspects member firms’ reviews of their quality control systems. When areas needing improvement are identified in these reviews, the member firm prepares a remediation plan and the network monitors its implementation.

One of the benefits of membership in a global network is that when a US audit client has multi-national operations, we can work with other member firms to apply their knowledge of local laws and customs in a way that both enhances audit quality and is cost effective. We continually refine how we use the work of these non-US PwC network firms so that all components of our audits meet US standards (when applicable) and satisfy our own quality expectations. We have a global policy and related process for sharing additional information regarding the inspection results of individual partners who lead the work at non-US locations in support of US-led group audit engagements. And in the past year, we have reinforced the requirements and developed and delivered training related to the supervision and review of component auditors in a multi-location audit engagement.

PwC US & PwC Mexico

Better together
Una combinación extraordinaria

July 1, 2016

Together we are approximately 49,000 partners & staff across 5 regions & 21 markets
As a network, we are making significant investments globally in technology aimed at providing our teams with the best tools to support them throughout each phase of the audit. New and enhanced tools help teams to identify and address risks and issues earlier in the audit process, as well as improving project management and the phasing of our work.

At the center of our technology suite is Aura, our global audit platform. Aura is used by nearly 100,000 of our auditors worldwide, driving quality and consistency on a global basis. We are also broadening our use of technology and innovation with newer tools, such as Halo for Journals and Connect. With these newer tools we are conducting audits with additional insights, greater visibility into potential risks, and more consistent execution across our practice.

A key feature of Aura v6 is the Risk and Response module, which assists our auditors in developing high-quality risk-responsive audit plans using robust industry-based risk libraries with underlying linkages to commonly responsive control and substantive audit tests. The use of standard library risks and test procedures promotes consistent, high-quality audit approaches, while also providing teams with the ability to tailor the plan as appropriate. This year, Aura v6 has been further enhanced to allow for more seamless integration of the work performed by our Service Delivery Centers.

Our investment in project management capabilities makes it easy for teams to monitor the status of work in real time. With just a few clicks on a smartphone, tablet, or laptop, anyone on the team can see current progress, with areas highlighted where audit work is ready for review or attention is needed. As a result, teams can identify and address issues earlier in the audit process, which has a positive impact on audit quality and the experience of our clients.

The use of Connect across our network of firms has continued to increase, with more than 33,000 Connect sites in use and more than 314,000 total distinct users worldwide. PwC US continues to be the largest member firm user, with approximately 7,000 sites and roughly 123,000 distinct users, of which approximately 95,000 are external to PwC.

Under our global transformation program, we are piloting new and innovative solutions in the US and around the globe, driving a technology-enabled audit in a digital world. In bringing the audit of the future to today, we are not only transforming the audit, but also the auditor, enhancing the skills of our people, particularly in the areas of technology and data analytics through on-the-job and formal training programs.
Through our data auditing strategy, we continue to develop processes and tools to make better use of data analysis and automated data auditing and validation techniques. These data extraction and visualization capabilities enable the auditor to extract and analyze large volumes of data, focus on potentially higher-risk transactions, while enhancing audit quality and providing deeper insights to our clients.

Halo, our globally branded data extraction, visualization, and auditing platform, is designed to enhance our risk assessment process and facilitate automated testing and data validation in a number of areas. Halo for Journals, our first data-auditing application, helps our audit teams analyze journal entry data to spot unusual trends and patterns. Audit360, Asset Management’s data auditing tool, facilitates automated testing through direct data feeds from the clients’ service providers or through reports uploaded by engagement teams.

Other tools

We continue to pilot several technology solutions that standardize data acquisition and analyze data at the transactional level. This data will also be available to support automated testing procedures and other analytics in support of our audits. We are also developing tools to automate additional audit activities, to further standardize how we audit and document our work.

“One thing is certain: innovative tools and processes require innovative thinkers. This is why we’ve never been more focused on recruiting diverse talent who bring both traditional and new skills, like data analytics, to PwC. The auditors of the future will undoubtedly look different than they do today.”

—Maria Castañón Moats, US Assurance Leader

Why Accounting—Yes, Accounting—Is One Of The Biggest Hubs For Innovation, https://www.linkedin.com
Our monitoring

Continuous improvement cycle

One of the drivers of quality, and fundamental to sustaining and building it, is our ability to identify opportunities for enhancement and quickly respond. The graphic below illustrates our continuous process. Over the last several years, we have expanded our use of pre-issuance reviews and accelerated the timing of the majority of our internal inspections, allowing us to more quickly identify opportunities to enhance quality. After performing an analysis to identify what may have contributed to inspection comments, we develop appropriate actions, such as expanding guidance, developing new or enhanced tools, or implementing additional training. Expediting our analysis has allowed us to communicate updates earlier in the audit cycle, allowing engagement teams more time to incorporate any changes into their audits.
Pre-issuance reviews

One of the ways we monitor quality is by reviewing audit work on certain audit engagements prior to the issuance of our audit reports. In FY15 and FY16, our Chief Auditor Network executed a pre-issuance review program (Estimates Planning Workshops) that targeted the planned audit approach for at least one significant accounting estimate on more than 300 audit engagements each year. The workshops centered on in-person meetings and collaborative dialogue between the Chief Auditors and key engagement team members about the team's planned audit approach. These meetings, along with review of the audit planning documentation, provided valuable engagement-specific reinforcement of topics addressed in our broader audit training programs.

Additionally, our Inspections Group annually performs targeted pre-issuance reviews of both the planned audit approach and the execution of audit procedures for approximately 40-50 audit engagements. The scope of such reviews is primarily focused on the application of recently issued standards and/or policies, audit methodology enhancements, and matters noted during the previous inspections cycles.

Such targeted pre-issuance reviews not only focus on quality, but also provide insight into ways to further improve consistent implementation of our Firm’s methodology and tools. These reviews also provide engagement teams with timely feedback which they are able to incorporate into their audit prior to the completion of fieldwork and communicate, as applicable, observations to the Assurance practice.

Internal inspections

Our internal inspections program provides us with a valuable assessment of how we are executing against professional standards, Firm policies, and our professional obligations. During the inspections process, reviewers evaluate the audit team’s compliance with applicable professional standards and Firm policies, and specifically, the sufficiency of audit evidence and related judgments that support the engagement team’s conclusions.

Under the Firm’s internal inspection program, engagement partners are generally selected for inspection every four years, which is consistent with the requirements set forth in the applicable authoritative standards over quality control. The specific engagements inspected for each partner are selected based on a variety of factors, including the number of hours managed on each audit. Overall, the selection process results in a sample of engagements that is representative of our audit practice (e.g., sector, geography, size) and meets professional and Firm requirements.

The Inspections Group has oversight and ownership of the internal inspections program, including its design, administration, and coordination. The Inspections Group is made up of a core group of experienced audit professionals dedicated to monitoring audit quality, driving consistency in our inspections process, and delivering insights into areas for continued focus. The Inspections Group, along with support from Assurance client-service personnel with relevant industry or technical expertise (e.g., tax, valuation, actuarial science, systems), executes the planned annual inspections. Client-service personnel involved with inspections consist of our higher performing resources, including near-term partner candidates, senior managers and directors nominated by Market Assurance Leaders, as well as Partners nominated by Sector Assurance Leaders. In the 2016 internal inspections of 2015 audits, 957 partners and professional staff participated as reviewers (40% of whom were reviewers in the prior year).

The Inspections Group communicates overall inspections observations and results to the Assurance practice. Further, the Inspections Group works with the Chief Auditor Network, Auditing Services Methods & Tools, Learning and Development, and Firm leadership to determine whether additional guidance or training, modifications to our audit methodology, or additional targeted messaging from leadership are appropriate to sustain and improve audit quality.

Number of issuer audit clients subject to internal inspections

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY16</td>
<td>142</td>
</tr>
<tr>
<td>FY15</td>
<td>160</td>
</tr>
<tr>
<td>FY14</td>
<td>179</td>
</tr>
</tbody>
</table>
The Inspections Group also annually evaluates the Firm’s system of quality control over our audit practice. Our quality control system addresses: (1) leadership’s responsibility related to their quality roles, (2) relevant ethical requirements, (3) considerations in undertaking an audit engagement, (4) human capital needs, (5) engagement performance, and (6) our process for monitoring the effectiveness of our quality control policies and procedures. Our system of quality control is also subject to annual review by professionals from the PwC global network. The most recent annual evaluation confirmed that our system of quality control over our audit practice is designed appropriately and functioning effectively.

The results of our 2016 internal inspections indicate we have continued to enhance our audit quality through our quality initiatives and the diligent efforts of our people. The number of matters identified has declined over the past few years. Based on our 2016 internal inspection results, the following areas warrant our continued focus:

- Updating our understanding of the business process and identifying and assessing risk of material misstatement
  - Consideration of changes in circumstances which impact risks and the likely sources of potential misstatements
  - Evaluation and/or updates to the related control and substantive audit procedures in response to the change(s) in circumstances and all likely sources of misstatements

- Evaluating the design effectiveness and testing the operating effectiveness of controls
  - Understanding and assessing in sufficient detail the control activities and if they are responsive to the change(s) in circumstances
  - Evaluation of the adequacy of the linkage of likely sources of potential misstatement to the related control activities

- Reliability of information used by management
  - Understanding the source of underlying data used by management in control activities
  - Assessing the controls in place to address the risk of material misstatement associated with the use of unreliable information

- Complex estimates, including future cash flows:
  - Evaluation of the reasonableness of assumptions
  - Evaluation of whether the data and reports used in developing assumptions in complex estimates are relevant and reliable (i.e., complete and accurate)

- Reliability of information used by the auditor in substantive testing
We consider a number of quality inputs in assessing the ongoing effectiveness of the Firm’s system of quality control, including internal and external inspection results. There are inherent differences in the methods of selecting audits for internal and external inspection; however, we analyze both internal and external inspection results.

**Compliance rate of issuer audit engagements selected for internal inspection:**

- FY16 96%
- FY15 94%
- FY14 93%

**External inspections**

PCAOB inspections of our public company audit practice provide a data point regarding audit quality and represent an important check on our internal monitoring and assessment processes.

The PCAOB reviews a relatively small percentage of our issuer audit clients annually, using a largely risk-based approach. This risk-based approach is designed to target particularly complex audit areas, industry segments, and clients. In accordance with the Sarbanes-Oxley Act of 2002 (the Act), the PCAOB’s inspection report includes both public and nonpublic portions. The public portion of the inspection report contains an overview of the inspections procedures and observations concerning the engagements inspected. The nonpublic portion of the inspection report contains the PCAOB’s observations and criticisms about a firm’s audit performance and system of quality control, which the Act mandates will not be made public by the PCAOB if a firm addresses those quality control observations to the PCAOB’s satisfaction within 12 months of the date of the inspection report. The most recent inspection report on our audit practice is dated August 10, 2016 (the “2015 Inspection Report”), and describes the results of the PCAOB’s 2015 inspection of 55 (or approximately 3%) of our 2014 year-end public company audits. The number of audits included in Part I has continued to decrease since 2010.

**Part I of the PCAOB Report**

Part I of our 2015 inspection report covers inspections of selected 2014 year-end audits. Partly in response to that report, we continue to focus on the following areas:

- Auditing internal control over financial reporting and testing those controls in a financial statement audit, including primarily testing the design and operating effectiveness of controls involving management review of financial information or accounting analyses

- Sufficiency of evaluation and corroboration of management’s key assumptions, including information that may contradict those assumptions or related management judgments, and testing of key data inputs used in impairment assessments and business combination valuations
Part II of our 2015 inspection report is nonpublic and reflects observations and criticisms identified during the PCAOB's review of certain practices, policies, and processes related to our system of quality control, including observations developed from the engagement-specific findings reported in Part I. Areas of public accounting firm quality control considered by the PCAOB in Part II generally focus on:

- management structure and processes, including the tone at the top;
- practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions;
- policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of a firm’s risk-rating system;
- processes related to a firm’s use of audit work that its foreign affiliates perform on the foreign operations of a firm’s US issuer audit clients; and
- processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control.
As previously noted, if a firm has addressed the quality control matters described in Part II to the PCAOB’s satisfaction within 12 months after the report is issued, then no portion of Part II is made public by the PCAOB. During FY16, the PCAOB informed us that it is satisfied with the actions we took to address observations contained in Part II of our 2013 inspection report (which covered our 2012 year-end audits). The PCAOB has not yet made a determination as to the sufficiency of our actions in response to the nonpublic portions of our 2014 inspection report, for which the 12-month remediation period ended on June 29, 2016.

Specifically, for individual audits, a team of reviewers that is independent from the engagement team identifies potential factors contributing to the quality of the audit. We consider factors relevant to technical knowledge, supervision and review, professional skepticism, engagement resources, and training, among others. These potential causal factors are identified by evaluating engagement information, performing interviews, and reviewing audit working papers, as appropriate.

In addition, we compile data for audits with and without deficiencies. We then compare and contrast the data to identify whether certain factors appear to correlate to audit quality. Examples of this data include the hours incurred on the audit, whether key engagement team members are in the same geography as the client, the number of years that key engagement team members have been on the engagement, the number of other audits that engagement partners are involved in, whether the engagement was subject to a pre-issuance review, and the timing of when the audit work was performed.

Our goal is to understand how quality audits may differ from those with deficiencies, and to use these observations to help continuously improve all of our audits. We evaluate the results of these analyses to identify enhancements that may be useful to implement across the practice. We believe these analyses contribute significantly to the continuing effectiveness of our quality controls.

Analysis of quality drivers

We perform analyses to identify potential factors contributing to audit quality so that we can take actions to continuously improve. One of our primary objectives when conducting such analyses is to identify how the Firm can provide the best possible environment for our engagement teams to deliver a quality audit. We look at audits both with and without deficiencies—whether identified through our own internal inspections process or through external inspections—to help identify possible distinctions and learning opportunities.
The mission of our Governance Insights Center (the “Center”) is to share perspectives with directors about governance matters that will help them to more effectively execute their oversight roles and to enhance the governance and financial reporting acumen of members of the investment community. While the Center’s work encompasses various governance activities, it places a major focus on the core responsibilities of the audit committee, because the audit committee has the primary responsibility for a company’s financial statements and oversight of the external auditor. We do this through a team of seven dedicated professionals who provide directors with in-person trainings, webcasts, and publications that address relevant topics to enhance their skillsets and technical knowledge. For example, we held three corporate director events with approximately 400 directors, held over 200 additional meetings at clients or other events, and issued Audit Committee Effectiveness Series publications, which provided perspectives on important governance matters, including insights on topics such as fraud deterrence, forward-looking guidance, non-GAAP measures, third-party risks, and cybersecurity.

In our interactions with the investment community, we share with, listen to, and learn from a broad cross section of market participants, including asset managers, pension funds, mutual funds, buy-side analysts, sell-side analysts, credit rating agencies, and hedge funds. The topics of interest to this group include governance, sustainability, financial reporting, and portfolio matters. Our mission is to add value by sharing PwC’s insights and educational materials.

During FY16, we shared our insights with the investment community on some of the most complex and pressing issues of the day, including cybersecurity, macroeconomic megatrends, corporate governance, revenue recognition, financial reporting, accounting standards, and disclosure reform. We also hosted six industry-focused meetings and a cross-industry conference for investors/analysts and other investment community participants. Through these events, participation in other external meetings and conferences, individual interactions, and surveys, we gain a better understanding of the critical issues facing companies, directors, and the investment community today. They also give us an opportunity to enhance investment community understanding of the role of the auditor.

Through these valuable interactions, we were able to hear stakeholders’ perspectives on financial reporting, utilize their insights to help inform our points of view, and share perspectives with them.
about financial reporting and accounting standards. We have also begun to consider ways of incorporating those perspectives into our learning environment for our audit professionals.

Professional and regulatory

A strong audit profession is one that facilitates confidence in the capital markets. The execution of high-quality, independent audits is an important component in building that confidence. But to fully earn that confidence—and to remain relevant to our stakeholders—we must do more, including continuing to react to a dynamic environment, which includes an evolving regulatory landscape.

Actions taken by regulators in one part of the world continue to influence the views and behaviors of regulators in other parts of the world. The auditing profession and auditing standards are at the heart of this—for example, the auditor’s reporting model, auditor transparency, and audit quality indicators are just three examples (among many others) that have been debated in the US and abroad.

We have played an active role in these debates, both as an individual Firm and in collaboration with others in the profession by working with the Center for Audit Quality (CAQ). Our Global Chairman, Bob Moritz, recently served as the chair of the CAQ’s Governing Board, and in that capacity helped to lead the profession during these public debates. Our US Chairman and Senior Partner, Tim Ryan, represents PwC on the Governing Board. Our Managing Partner for Assurance Quality, Mike Gallagher, is a member of the CAQ’s Professional Practice Executive Committee and was recently its chair.

Our work with the CAQ is not limited to technical and regulatory discussions. We engage in dialogue about profession-wide matters, including how to attract a sufficient pipeline of talent into the profession with the skillset needed to perform audits of the future and identifying areas where the profession may provide additional value to companies and the capital markets.

We have the privilege of engaging with a wide array of stakeholders, including audit committee members, directors, and members of the investment community. We hear their unique perspectives, insights, and feedback on various regulatory and profession matters. And we share our views and perspectives. Through this dialogue, we can continually evolve our thinking in order to meet the expectations of all our stakeholders.

A strong audit profession is one that facilitates confidence in the capital markets. The execution of high-quality, independent audits is an important component in building that confidence.
Appendix: Legal and governance structure

Legal structure and ownership of the Firm

The Firm is a limited liability partnership established under the laws of the State of Delaware. All interests in the Firm are held by its partners and principals.\(^\text{10}\)

Governance structure of the Firm

The Firm’s Senior Partner serves as Chairman and Chief Executive Officer and manages the Firm pursuant to the powers delegated to him by the Firm’s partners. The Senior Partner may appoint people and committees to assist with Firm management, and discusses the Firm’s philosophy, policies, and direction with the Board of Partners and Principals in its governance role.

To assist in discharging his responsibilities, the Senior Partner has appointed a Leadership Team to work with him to manage the Firm. The responsibilities of the Senior Partner and the Leadership Team include establishing and determining the effectiveness of the Firm’s system of internal control, including controls relating to the quality of the Firm’s audit services. Changes to the Leadership Team are determined by the Senior Partner. The Senior Partner is elected by a partner vote for a four-year term that can be renewed three times, unless limited by age according to the partnership agreement. Members of the Leadership Team as of October 2016 are:

10 A partner is a certified public accountant (CPA) whereas a principal is not. Only CPAs may sign an audit opinion or perform any other function reserved by law or by the firm solely to CPAs. Partners and principals are alike in most other aspects of the partnership, such as sharing in profits/losses, managing risk, developing our staff, investing in client relationships, and performing services for clients. For purposes of this Appendix, “partner” refers to both partners and principals.
Board of Partners and Principals

Authority

Pursuant to the authority delegated to it by the Firm’s partners, the Board is responsible for approving the overall strategic direction of the Firm. It approves long-range strategies and business plans, and major transactions that could significantly affect the Firm's business. Its authority also includes the approval of the Firm's capital policies, the manner in which partners participate in Firm profits, and the admission of new partners.

It approves the compensation of the Senior Partner and members of the Leadership Team as a group, after review and recommendation by a committee of the Board. All candidates proposed by the Senior Partner Nominating Committee to stand for election as Senior Partner must also be approved by the Board.

Composition

Members of the Board are partners and principals of the Firm who have been elected for staggered terms of four years. The Board is chaired by a Lead Director, who is elected by the members of the Board other than the Senior Partner. As of October 2016, there are 16 members of the Board in addition to the Firm’s Senior Partner.

Members of the Board of Partners and Principals—October 2016

Tim Ryan—US Chairman and Senior Partner
Brian Cullinan, Lead Director
John Farina
Thomas Archer
Brendan Dougher
Saverio Fato
Scott Gehsmann
Linda Ianieri
Paul Kepple
James Kolar
Karen Lohnes
Brian Meighan
Jacqueline Olynyk
Alan Page
Michael Quinlan
Deidre Schiela
Michael Swanick

Committees

The Board is assisted by various committees that help to carry out its role. The Risk and Quality (R&Q) Committee provides oversight and monitors the appropriate policies, processes, and procedures for managing and minimizing risks of the Firm. The R&Q Committee also comprises the Accounting and Auditing Practice Committee, which provides oversight of the accounting and audit practice of the Firm.

As requested by the Board, the R&Q Committee reviews regulatory matters that affect the Firm and, as appropriate, other parts of the PwC global network. Such matters may include accounting licensing and professional standards issues, internal and external quality inspection results, and global regulatory trends.

Board member selection process

The partner vote for selecting Board members is on a headcount basis. Partners vote by ranking the candidates for the Board. The candidates with the most votes are elected. Board elections are supervised by an independent election teller.