

LEARN FROM PCAOB INSPECTIONS

Your Prescription for Better Audits
Sixth Edition

A learning experience from



Foreword BY ADIGEO

If today's regulatory landscape seems different to you, then you are not alone. Consistently, we are hearing from our clients that the tone from the PCAOB has changed, and the bar has been raised. We are seeing this for ourselves as we help our clients through the inspection process and sit across the table from the PCAOB inspectors. The level of challenge and the detailed questioning seem to be at a level not seen before. And the results are not good. PCAOB Chair Erica Williams has often mentioned the declining inspection results in her remarks, and Christine Gunia, Director of Registration and Inspections used the word "disturbing" more than once when describing the inspection results in her comments at the December AICPA conference.

In addition, enforcement fines are at an all-time high. The rhetoric used by the PCAOB Chair when describing these enforcement matters is sharp and clear. This is a board intent on punishing anyone who doesn't follow the rules. This has included numerous enforcement matters for what are considered Part I.B and I.C violations in the PCAOB's expanded reporting format.

This has left many firms discouraged. Some firms have publicly said they are getting out of the business of auditing public companies.

While none of this is good news, we have seen something different in our practice over the last few years. As we have continued to grow our practice and have worked with more and more firms, we have consistently seen that today's issuer auditors are thoughtful, experienced, and knowledgeable professionals intent on doing good audits and protecting the public interest.

So, where is the disconnect? I think a big part of the difficulty firms are facing today is keeping up with the PCAOB's changing priorities. While the PCAOB has consistently published its current findings and its priorities for each year, even this has not proven to be timely enough to allow firms to get ahead of the issues that may result in an inspection finding. This is why I think resources like this eBook from GAAP Dynamics are so important for auditors and their practices. The insights provided here can help auditors better understand where the PCAOB is focusing its attention. I am also happy that the eBook covers Part I.B: Other Instances of Non-Compliance with PCAOB Standards and Rules and Part I.C: Independence findings. These have been a source of numerous findings from inspections and enforcement settled orders. Auditors should pay close attention to the findings in these areas to avoid unnecessary issues.

Congratulations to Mike and the entire GAAP Dynamics team on a book well written – read it with care as it can really help you and your practice – and may even save you from a dreaded inspection issue!

John Fiebig

President, ADIGEO Consulting



ADIGEO

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Preface

What does audit quality have to do with the American dream?

Erica Williams explained it like this¹: “Quality audits bolster investor confidence and help make our capital markets the envy of the world. Whether it’s workers saving for retirement, parents saving to put their kids through college, or anyone who depends on the soundness of our capital markets to invest and build their own version of the American dream - quality audits protect people.”

As the Chair of the Public Company Accounting Oversight Board (PCAOB), the independent audit watchdog, she should know! Established by Congress over 20 years ago as part of the Sarbanes-Oxley Act, the PCAOB oversees the audits of public companies in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

“When I challenge you to uphold the highest standards in audit quality, it is with their families, their savings, and their futures in mind. I urge you to keep them in mind as well. Resist complacency, sharpen your focus and meet your responsibility to verify the honesty our system depends on with a vigilance that is worthy of their trust.”

The PCAOB has four primary duties:

- 1 Register public accounting firms that audit issuers and SEC-registered brokers and dealers.
- 2 Set auditing and related attestation, quality control, ethics, and independence standards.
- 3 Inspect registered public accounting firms’ audits and quality control systems.
- 4 Investigate and discipline firms and auditors for violations of specified laws, rules, or professional standards.



Our eBook focuses on PCAOB inspections of registered accounting firms. The purpose of these inspections is to accurately assess, drive improvement in, and communicate audit quality. Their inspections are designed to review portions of selected audits of public companies and evaluate elements of a firm's system of quality control. Any deficiencies identified during the inspection are evaluated for inclusion in the firm's inspection report and, if included, are communicated within the report as follows:

Part I - Inspection Observations:

- Part I.A: Deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion(s) on the issuer's financial statements and/or ICFR.
- Part I.B: Deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.
- Part I.C: Discusses instances of non-compliance with PCAOB rules related to maintaining independence

Part II - Observations Related to Quality Control

These observations related to criticisms of, or potential defects in, the firm's system of quality control. Part II deficiencies are not publicly disclosed when the report is first issued, but will be made public if any such deficiency is not remediated to the Board's satisfaction within 12 months after issuance of the report.

In this eBook we focus on Part I.A, deficiencies noted in the inspection reports of annually inspected firms, although in Chapter 9 we discuss the other observations noted above.

PCAOB inspection reports describe audit deficiencies noted during inspections of accounting firms and are made public for all to see!

"Those who do not remember the past are condemned to repeat it."
- George Santayana

We published this eBook to help auditors:

- Learn from PCAOB inspection findings,
- Prevent recurring audit deficiencies,
- Improve audit training, and
- Strengthen the quality of their audits.





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Executive Summary

A Diagnosis of PCAOB Inspection Reports

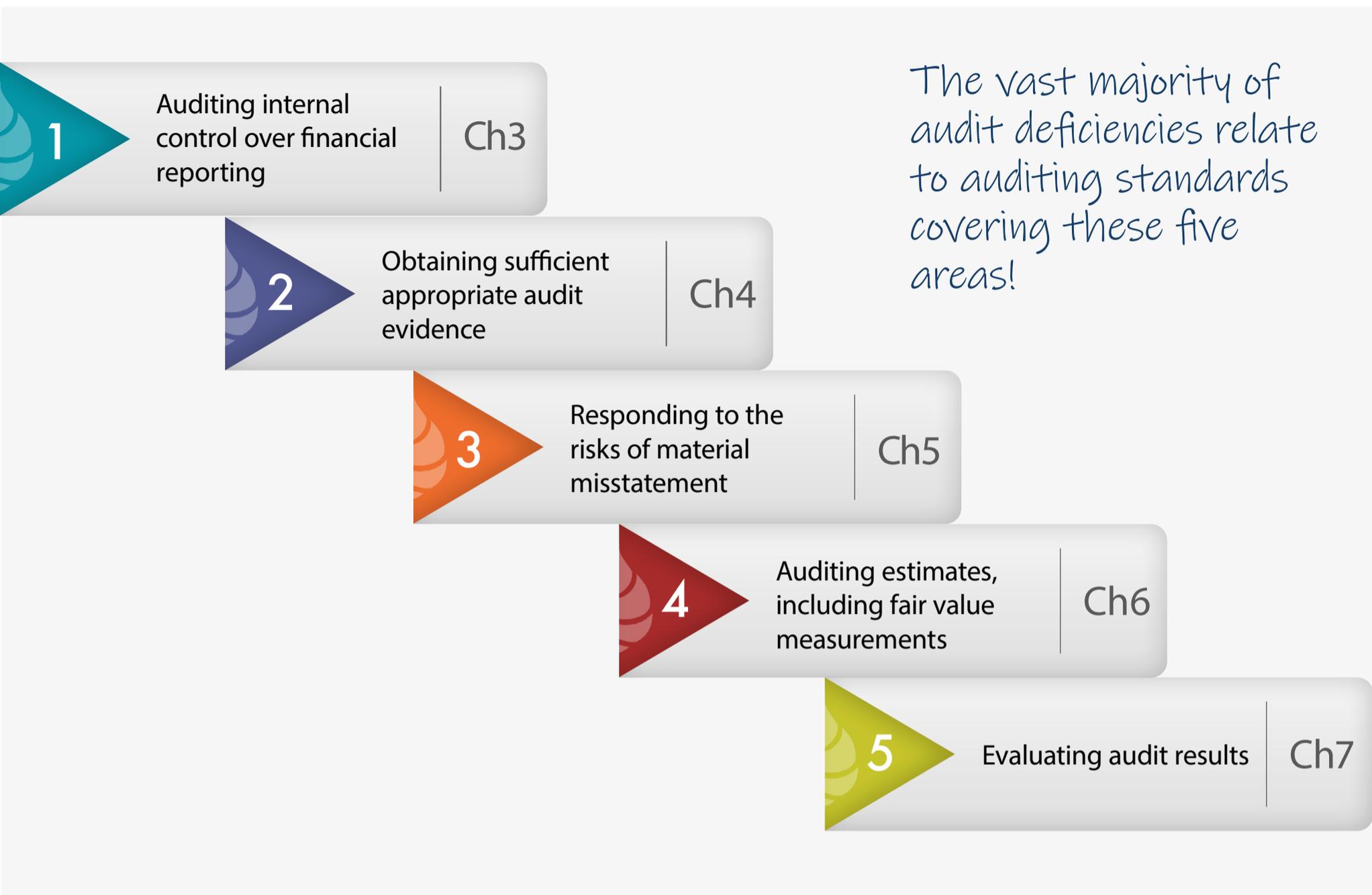


During the most recent inspection cycle **4** out of **10** audits, on average, contain deficiencies that, in the opinion of the PCAOB, do not have sufficient audit evidence to support the opinions on the financial statements and/or ICFR.

The PCAOB has been around for more than 20 years and, over that time, audit quality has improved. However, according to Chair Williams, “Unfortunately, right now, the trendline is moving in the wrong direction.”¹

Our analysis of 2022 inspection reports for the 14 annually inspected firms ([Chapter 2](#)) shows:

- The combined audit deficiency rate is 37%, an increase of 11 percentage points from 2021.
- The difference between the combined audit deficiency rate of the global network firms (30%) as compared to other annually inspected firms (51%) continues to be grow.
- The lowest audit deficiency rate among the annually inspected firms was 7%. The highest was 100% (meaning ALL the audits inspected performed by this firm had deficiencies!).
- Unfortunately, the types of audit deficiencies, including the related auditing standards and audit areas, remain unchanged.



In the chapters noted above, we analyze audit deficiencies and provide recommendations to improve audit quality based on the various PCAOB auditing standards. In [Chapter 8](#), we look at deficiencies by audit area. No shock here that revenue and related accounts top the list!

As previously noted, there are other deficiencies identified during inspections that don't relate to the sufficiency or appropriateness of audit evidence supporting the opinions, but rather to other PCAOB standards and rules. These show up in the inspection reports in Parts I.B. and I.C. We summarize these deficiencies and provide other helpful reminders in [Chapter 9](#).

In the final chapter ([Chapter 10](#)), we discuss our top 5 treatment options that firms can take now to improve the quality of their audit training and, ultimately, the quality of their audits.

Without further ado, we present the sixth edition of our PCAOB eBook!

