

SEIAG Emerging Issues in Auditing Subcommittee Update

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Process

1. **SEAIG June 2023 survey of SEIAG members identified fraud as being in the top 3 among emerging issue.**
2. **In the November 2023 SEIAG meeting we brainstormed ways the PCAOB could enhance fraud detection by the auditor.**
3. **We compiled the suggestions, reorganized them and surveyed the SEIAG again to solicit more specific feedback. Thank you to the 10 of you that responded, some of the responses were quite detailed!**
4. **We further revised our compilation of suggestions on how to improve fraud detection**
5. **I will briefly summarize these suggestions in two parts.**
 1. **Part 1 – Revisions to audit procedures, guidance, or standards**
 2. **Part 2 - Programs and policies for the PCAOB to consider in its internal operations.**

Note: The complete list of suggestions was provided to the SEIAG and will be provided to the Chief Auditor and Board.

Part 1: Suggestions on revisions to audit procedures, standards or guidance to enhance fraud detection

Issues 1 and 2: Discussion between the Auditor and the Audit Committee/Management about fraud is insufficient

- Most of the 10 responses supported issuing guidance or a spotlight to enhance these discussions
- Some specific suggestions included
 - Specifying who and when it should occur,
 - Expanding inquiry beyond the C-suite,
 - Looking at IAASB revisions
 - Enhancing discussion of disclosure and materiality
 - Inquire about the audit committees process over governance of fraud risk
 - A concern noted that dialogue may provide false assurances

Issue 3: Auditors may not have sufficient understanding of the auditee's business operations inhibiting fraud detection

Most respondents agree that it is critical for auditors to have a robust understanding of the client business.

- Some specific suggestions included:
 - Numerous survey responses supported the PCAOB to issue “Staff Guidance”, such as the SEC’s Staff Accounting Bulletins, that provide further interpretations of the auditing standards with illustrative examples.
 - Consider using the information from inspection reports to issue further PCAOB staff guidance as a tool to assist the auditors.
 - Consider requiring auditors to perform trend analysis across accounts and with competitors.

Issue 4: The engagement team may not be sufficiently focused on fraud when doing audit work, can we improve fraud brainstorming sessions

- General survey responses support expanding the brainstorming session to include more team members such as specialists, however the entire team is not plausible
- Consider issuing a spotlight on how to lead an effective brainstorming discussion
- Consider collaboration with others such as regulators and academics to identify root causes and share lessons learned

Issue 5: Audit manuals used to guide audit execution may not sufficiently address fraud

- Consider tying in consideration of key performance indicators
- Enhance the requirement to understand what financial information is received by stakeholders to focus on specific areas of potential management override
- Some concerns noted that benchmarking may not be available or cost effective for all auditors
- Consider the following types of staff guidance:
 - Testing journal entries and adjustments for override
 - How to incorporate unpredictability into the audit procedures
 - Enhanced focus on understanding management's fraud risk assessment

Issue 6: Additional tools or models to consider

- Create a Fraud prevention center to compile research and discovery of fraud
- Follow the O'Malley 2000 report recommendations including the requirement of forensic type fieldwork
- Develop questions designed to invoke professional skepticism
- Use data analytics and AI to address fraud
- The most common fraud schemes involve revenue recognition, reserve manipulation, and inventory misstatement - it would seem that related standards should address fraud risk.

Issue 7: Whistleblowers are the main way fraud is caught, however the auditor does not pay sufficient attention to this area

- Require auditor to understand process, programs and procedures for whistle blower with tests on hotlines
- Survey response indicated that NOCLAR proposal may have related requirements, such that it is good to ensure consistency
- Share best practices

Issue 8: Auditors may detect fraud but ignore the red flags or may not follow up

- Generally, the 10 survey responses did not support for additional guidance as most respondents felt AS 2401 is clear.
- Many cited that AS 2401 further clarifies that fraud is a broad legal concept and auditors can't make legal conclusions.
- A few respondents did support additional guidance on use case examples, lessons learned, and materiality considerations

Issue 9: Audit procedures do not have sufficient evaluation of potential omitted disclosures

- Some respondents did not support for requiring the auditor to attend disclosure committee meetings or to require the auditor to compare disclosures across industry.
- Many cited management's responsibility for DCP/ICFR and including required disclosures in SEC filings and one suggested there could be independence concerns.
- Respondents also noted the auditor's extensive procedures/tools for documenting compliance with the GAAP checklist.

Part 2: Suggestions on changes to PCAOB operations to address fraud risk

Suggestion 1: Create a fraud center

- Create a repository of fraud schemes and related tests to help auditors identify and act upon red flags
- Compile suggested tools and techniques to identify fraud
- Compile a list of best practices for whistleblower programs to provide a benchmark to compare with company's whistleblower programs
- Hire forensic experts in the center who can play a role in standard setting or inspection
- Share findings from inspections about fraud detection techniques
- Develop a consultation process not limited to fraud to advise auditors on best audit procedures in complicated situations

Suggestion 2: Consider how best to disclose fraud risks or procedures done to detect fraud to stakeholders

- It may be possible to use Critical Audit Matters to enhance disclosures
- Expectations gap exists in part due to lack of communication
- Auditors could disclose fraud that may be detected more clearly in financial statements

Suggestion 3: Enhance the PCAOB's whistleblower reporting program

- Use some monetary penalties to compensate whistleblowers via rewards, these monies can be used by whistleblowers to hire lawyers that enable reporting. We note this may require a change to Sarbanes Oxley, which requires that penalties be used for scholarships.
- Make the reporting truly anonymous to reduce the concern of reporting

Comments, Questions or Additional Suggestions?

- If you have additional comments you could not share during the meeting due to time constraints please consider sending them to the EIA Subcommittee members or to PCAOB staff
- We are considering further deliberation of AI as a focus topic for the EIA subcommittee, If you have suggestions on specific AI topics or topics other than AI that we should focus on please let us know