PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SPOTLIGHT

Staff Priorities for 2025 Inspections and Interactions With Audit Committees

December 2024

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In keeping with its congressionally mandated mission, the PCAOB works tirelessly to improve audit quality for the benefit of investors. Since 2019, the Division of Registration and Inspections ("we" or "staff") has advanced this work by annually communicating topics that we believe auditors should consider when planning and performing their current and upcoming audits. This Spotlight provides an overview of our inspection priorities for 2025.

Our 2025 inspection plan primarily covers the review of 2024 fiscal year-end audits, many of which will be completed by audit firms in the first quarter of 2025.

This Spotlight is not intended to summarize the entirety of our planned inspection activities which, by design, include certain unpredictable procedures and selections that are adjusted as necessary for emerging topics.

The Scope of PCAOB Inspections

Our inspection program is continuous and designed to review portions of selected audits of public companies and certain U.S. Securities and Exchange Commission (SEC) registered broker-dealers and to evaluate elements of an audit firm's quality control (QC) system to assess the audit firm's compliance with our standards and rules, as well as other regulatory and professional requirements that are applicable to the audit firm.

KEY FEATURES OF OUR 2025 INSPECTION PROGRAM

Consistent with the Board's Strategic Plan, we will continue to enhance our inspections program using a data-driven and risk-based approach. Key features of our inspection program include:

- **Engagements reviewed** – Each year, several factors influence our inspection approach to public company and broker-dealer audits (or engagements) that we select for inspection. These factors include prior inspection results and emerging risks, such as significant digital asset transactions, pertaining to a particular audit engagement or industry.[1]
- **Inspection procedures** – In addition to reviewing focus areas selected specifically from each public company audit we select for review, we will continue to perform certain inspection procedures on every engagement selected to assess compliance with auditing standards related to independence, fraud, audit findings, audit committee communications, Form AP reporting, the auditor's report, engagement quality review, and audit documentation.
- **Root cause and firm culture** – Some audit firms continue to face challenges delivering quality audits as evidenced by (1) the increasing trend of audit deficiencies in recent years and (2) deficiencies identified that have recurred for numerous years. Although there have been signs of a "leveling off" in deficiencies at the largest audit firms, we are interested in why deficiency trends are not improving more quickly and the impact of audit firms' cultures in this failure to improve. See the section "Culture at Audit Firms" below.
- **Improving the timeliness of inspection reports** – In August 2024, we posted the inspection reports for all 2023 annually

[1] Please see our Spotlight – "Staff Update on 2023 Inspection Activities" – for more information.

inspected firms, months sooner than in previous years, and we have been posting triennial inspection reports faster as well. We believe improving the timeliness of inspection reports is helpful to inform the public and to promote timelier remediation and improved audit quality by these audit firms. We also want to help smaller firms understand their inspection results and begin any remediation efforts sooner, particularly because deficiency rates of smaller audit firms, or the triennially inspected firms, are not improving more quickly. To help smaller audit firms improve audit quality, we have launched a publication series, Audit Focus, that is targeted at smaller audit firms and that highlights key reminders, good practices, and common deficiencies.

The Importance of Firm Quality Control Remediation

Part II of the PCAOB's inspection reports includes criticisms of, and potential defects in, an audit firm's system of quality control, to the extent any are identified. By statute, when inspection reports are first issued, the public will not see Part II of the reports. If an audit firm does not address to the Board's satisfaction the criticisms of, and potential defects in, its system of quality control within 12 months after the initial issuance of our report, those criticisms will be made public.

Based on extensive experience with remediations of quality control criticisms contained in inspection reports, we periodically update our website to include key factors that we consider in remediation – including how we evaluate the design of training programs the firms implement to address QC criticisms, our expectations on the timing of remediation implementation, and more – in connection with our development of recommendations to the Board on firm remediation efforts.

Please visit our **Remediation** page and "**Staff Guidance Concerning the Remediation Process**" page. The latter was updated with new considerations in October 2024.

Selections and Prioritized Sectors/Industries

We will place continuing emphasis on selecting audits of public companies in industries and sectors (1) with specialized accounting and/or that may be negatively impacted by uncertainties and volatility in the economic and geopolitical environment, (2) where we have previously found a higher number of deficiencies, or (3) where public companies are more likely to have a going concern risk. In 2025, our selection process will prioritize the following sectors:

- **Financial** – The financial sector continues to be affected by interest rates and commercial real estate exposure in loan portfolios and investment securities. Auditors will need to exercise professional skepticism in (1) evaluating significant assumptions used in the allowance for credit losses and in the valuation of commercial mortgage-backed investment securities and (2) assessing the public company's liquidity when evaluating the classification of investment securities. Please see our Spotlight – "Bank Financial Reporting Audits" – for more information.
- **Real estate** – The pandemic disrupted the commercial real estate sector as many employees began, and continue to some degree, to work remotely. The long-term impact remains uncertain. Public companies that have significant commercial real estate holdings often have high debt

levels and may have their ability to refinance their debt impacted by changing interest rates and tightening of credit. These factors may also affect the valuations of properties and supporting discounted cash flows analyses. Auditing assumptions underlying the valuation of real estate assets is an area of heightened risk requiring auditor skepticism and judgement. Please see our Spotlight – "Auditing Considerations Related to Commercial Real Estate" – for more information.

- **Information technology** – Public companies in this sector, which includes technology, hardware, and semiconductor companies, have financial statement accounts, disclosures, and related internal controls that tend to be complex. This is often due to complex revenue recognition requirements, including complex contractual arrangements with customers, and the reliance on significant judgments in financial reporting. This sector continues to experience change with the adoption of new technologies, including artificial intelligence (AI), and the resulting demand for newer, more advanced chips and storage that increases the valuation risks associated with inventory. Disruptions to the supply chain can also impact revenue recognition. The risk of fraud due to management override, although not unique to this sector, is often heightened due to earnings pressures.

In addition, we will also do the following:

- Continue our emphasis on selecting audits of public companies engaging in merger and acquisition activities or business combinations due to the typical complexities of the accounting and related audit procedures.
- Continue our emphasis on selecting audits of broker-dealers that file compliance reports and others that provide customers with various investment opportunities, such as introducing brokers.
- Consider selection of public companies that have changed their supply chain and/or logistics. This can increase audit risk as internal controls may change, and new jurisdictions, if applicable to the sourcing and/or logistical changes, may introduce new complexities unique to the location. These factors may increase the risk associated with the valuation of inventory and the impairment risk of existing facilities.

2025 INSPECTION CONSIDERATIONS

Our 2025 inspection plan focuses on risks and other considerations that – based on PCAOB standards and communications – should be important for auditors when planning and performing risk assessments and audit procedures. We plan to continue performing our inspections with a focus on areas that pose a risk to audit quality. The following describes areas of inspection emphasis for which we plan to perform procedures.

Audit Execution Challenges

Auditors may respond to internal firm or external fee-related pressures to reduce hours and fees. These factors include:

- **Choosing an appropriate materiality** – Auditors may look for ways to decrease audit hours, like determining a more aggressive, or higher, materiality level. We will evaluate significant year-over-year materiality changes and scoping of multi-location audits.
- **Technology used in the audit** – We will continue to inquire about the use of technology in audit procedures, particularly focusing on instances where technology is used in procedures to respond to identified

risks of material misstatement. The nature, timing, and extent of the use of technology-based tools in an audit should be tailored to the particular facts and circumstances of each engagement.

New Auditing Standards

The issuance of several new auditing standards presents an enhanced risk that firms will not properly apply those standards.

The amendments to current PCAOB standards related to AS 1201, *Supervision of the Audit Engagement*, and AS 2101, *Audit Planning*, as well as the new AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, are effective for audits of fiscal years ending on or after December 15, 2024. We plan to continue to perform procedures related to supervision of other auditors where there was significant involvement of other auditors. We encourage you to also read a summary of other revisions related to the adoption of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

The new AS 2310, *The Auditor's Use of Confirmation*, is effective for audits of fiscal years ending on or after June 15, 2025. While most issuer audits selected for review in 2025 will have fiscal year ends prior to June 15, 2025, public company audits performed later in calendar year 2025 will need to adopt the new standard.

Critical Audit Matters

In 2024, we selected and reviewed audits to better understand the reasons that the average number of critical audit matters (CAMs) per audit report has declined over time, as indicated in our post-implementation review of CAMs. While the inspection results to date have not provided any conclusive reason for the declines we have observed, we plan to continue selecting some audits where the auditor reported a single CAM or reported no CAMs.

The PCAOB currently has a project that seeks to understand why there continues to be a decrease in the average number of CAMs reported in the auditor's report over time and whether there is a need for guidance, changes to PCAOB standards, or other regulatory action to improve such reporting, including information that is provided as part of the CAM reporting. Please see the project description for more information.

Use of Technology by Public Companies

Increased use of technology, including the resulting increase in the threat of cybersecurity incidents, presents unique risks to both public companies and broker-dealers. We will continue to focus on reviews of audits of public companies with known cybersecurity incidents and will review the audit firm's response and how it may have modified its audit approach, if appropriate. We will also review the disclosures made by the public company or broker-dealer in compliance with the SEC cybersecurity incident disclosure requirements and other information regarding the public company's cybersecurity risk management. Please visit the SEC website for more information regarding this SEC rule.

Some public companies may integrate and utilize generative artificial intelligence (GenAI)[2] in operational and financial reporting processes,

[2] GenAI is a technology that can produce new content, including text, images, audio, or video, when prompted by a user. Unlike traditional AI, which focuses on solving specific tasks using predefined rules or patterns in users' data, GenAI creates new content in response to user instructions or queries using algorithms that are trained using specified information, often open-source information such as text and images from the internet. These algorithms use iterative training and feedback loops enabling the generative models to create a wide range of content. Please also see our Spotlight – "Staff Update on Outreach Activities Related to the Integration of Generative Artificial Intelligence in Audits and Financial Reporting" – for more information.

which could amplify certain existing information technology risks, or potentially create new risks that previously did not exist. We will continue to be alert broadly for public companies that disclose significant investment in AI and will continue to evaluate the audit procedures over information technology general controls (ITGC) and other related controls.

Crypto Assets

Risks of material misstatement related to audits involving crypto assets include (1) challenges in testing existence and rights to crypto assets, (2) identifying and testing ITGC controls related to crypto assets and blockchain transactions, and (3) considering the risk of evaluating fraud and other illegal acts given the anonymous nature of crypto assets. Other challenges include determining the completeness and accuracy of audit evidence obtained from a distributed ledger network. We will continue to focus on identifying public companies and broker-dealers that have material crypto asset holdings and significant transactions related to crypto assets. The Financial Accounting Standards Board issued Accounting Standards Update No. 2023-08, *Accounting for and Disclosure of Crypto Assets*, the first U.S. GAAP explicit to the accounting and disclosure of crypto assets. Although the guidance is not effective until fiscal years beginning after Dec. 15, 2024, early adoption is permitted, and we will look for public companies and broker-dealers that have adopted the new standard.

Quality Control

Consistent with prior years, we will continue to perform procedures over QC systems to assess compliance with existing PCAOB QC standards, which include inquiry, review of public company and broker-dealer audits, and inspection of select firm QC documentation. The nature, timing, and extent of the QC procedures are scaled to be responsive to the size, nature, structure, and complexity of the audit firm.

Our Target Team in 2025

The Division of Registration and Inspections has a target team consisting of inspectors who focus on emerging audit risks and other topics that the staff believes could have important implications for audits and reviews performed by the audit firms we inspect.

For 2025, we plan to consider review of (1) audits that use shared service centers, (2) engagements where work is referred into the U.S. by other auditors, and (3) use of software audit tools in selected audits. If emerging risks arise, interim reviews may be performed to focus on these risks.

We will continue to focus on QC procedures to assess compliance with QC standards, specific to independence and client acceptance, including when registered accounting firms enter alternative practice structures, including via private or public equity investments.

QC 1000, *A Firm's System of Quality Control*, and related amendments to PCAOB standards, rules, and forms was adopted by the Board on May 13, 2024 and approved by the SEC on September 9, 2024. QC 1000 replaces standards that were developed decades ago by the American Institute of Certified Public Accountants, before the PCAOB was established, and which were adopted by the PCAOB on an interim, transitional basis in 2003. While QC 1000 requires all accounting firms registered with the PCAOB to design a quality control system that meets the requirements of QC 1000, registered firms are only required to implement and operate the quality control system in compliance with QC 1000 when they lead an engagement under PCAOB standards, play a substantial role in the preparation or furnishing of an audit report, or have current responsibilities under applicable professional and legal requirements regarding any such engagement.

The related amendments include expanding the auditor's responsibility to respond to deficiencies on completed engagements under an amended and retitled AS 2901, *Responding to Engagement Deficiencies After Issuance of the Auditor's Report*. These changes would extend the scope of AS 2901 to cover engagement deficiencies in audits of internal control over financial reporting, incorporate the concepts and terminology introduced in QC 1000, and bring the standard into alignment with the auditor's existing responsibility to obtain sufficient appropriate audit evidence to support the opinion. Additionally, related amendments to AT No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, and AT No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, prompt auditors of registered broker-dealers to take appropriate action if they discover that the opinion or conclusion in a previously issued attestation report was not supported. Finally, the related amendments replace existing standard ET 102, *Integrity and Objectivity*, with a new standard, EI 1000, *Integrity and Objectivity*, to better align PCAOB ethics requirements with the scope, approach, and terminology of QC 1000.

QC 1000 and the related amendments discussed above will be effective on December 15, 2025. The first annual evaluation period will cover the period beginning on the effective date of the standard (i.e., December 15, 2025) and ending on September 30, 2026. Subsequent evaluation periods will cover the 12-month period ending on September 30.

Our inspection teams will begin to make inquiries regarding a firm's adoption preparation plans for this new quality control standard and the related amendments.

Culture at Audit Firms

In 2023, we created a dedicated team to evaluate culture across the six U.S. affiliates of the Global Network Firms. This initiative included interviewing firm personnel and evaluating other documentation. This review informs our understanding of culture at audit firms – and the potential impact on audit quality. We plan to continue this initiative during 2025. (For more, see our Spotlight – "Insights on Culture and Audit Quality" – published in December 2024.)

INTERACTIONS WITH AUDIT COMMITTEES

Audit committees are vitally important to our capital markets – both to the public companies seeking capital and to the investors who provide that capital. The PCAOB and audit committees have a shared purpose: protecting investors and maintaining the integrity of our capital markets. As a result, the PCAOB strives to assist audit committees in their role of selecting and supervising the work of their independent auditors.

Audit Committee Outreach

As described in our June 2024 Spotlight – "2023 Conversations With Audit Committee Chairs" – dialogues between the PCAOB and audit committee chairs continue to provide valuable insights on audits and the work of audit committees. We plan to continue to seek opportunities to interact with the audit committee chairs on some public company audits selected for review.

Questions for Audit Committees To Consider

In the context of the PCAOB's 2025 inspections, the following suggested questions may be of interest to audit committee members to consider amongst themselves or in discussions with their independent auditors. These questions supplement and build on other sets of questions we have suggested in recent Spotlights.

These questions, designed principally to facilitate further discussion, represent the views of staff and not necessarily those of the Board. The PCAOB does not set standards for, or provide authoritative guidance on, audit committee conduct.

1. Beyond what auditors are required to communicate to the audit committee, are there any aspects of the company's internal control over financial reporting that management could enhance or strengthen to ensure management overrides relate to appropriate exceptions or atypical transactions are appropriately recorded, and that both are appropriately communicated?
2. Which audit issues were especially challenging to conclude upon that were not disclosed as a CAM? What consideration was given to disclosing that as a CAM?
3. Did the company have any transactions or business risks that the auditor scoped out of the audit based on planned materiality? If so, what were they?
4. Are there any areas of the audit where the company can facilitate, or further facilitate, the audit team's use of technology to streamline testing, but more importantly to improve the efficacy of the testing?

Tell Us What You Think

Was this Spotlight helpful to you? In fulfilling our mission to serve investors and the public, the PCAOB wants to know how we can improve our communication and provide information that is timely, relevant, and accessible. We welcome comments on this publication or other matters. You can fill out our **short reader survey** or email us at **info@pcaobus.org**.

5. Do the audit workpapers contain any personal or confidential information about people or the company that is unnecessary to be retained, or be retained unmasked, as audit evidence or that can be removed prior to finalizing the audit documentation?
6. It is important for auditors to understand the company so they can perform their assignments well and, as such, we appreciate retention within the audit team where appropriate and possible so that knowledge grows and deepens. Are there any members of the audit team that did not return this year? If so, why did they not return? What is the experience of any new staff assigned to the engagement? Are they new to the audit firm? What parts of the audit did they work on? What assistance and supervision are in place for new team members?

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