Audit Focus

Engagement Acceptance

PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

The decision of whether or not to accept an engagement is a critical part of the audit process. Audit firms have a responsibility to undertake only those engagements that they can reasonably expect to be completed with professional competence.

This edition of Audit Focus highlights key reminders for auditors from PCAOB standards related to engagement acceptance for the initial engagements of auditors who audit smaller public companies or brokers and dealers ("broker-dealers"). The Audit Focus also shares good practices that the PCAOB staff ("staff") has observed.

APPLICABLE PCAOB STANDARDS

Under QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, ("QC 20") an audit firm's quality control system should encompass the element of acceptance of clients and engagements and include policies and procedures to decide whether to accept a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the audit firm with reasonable assurance that the firm (a) undertakes only those engagements that the firm can reasonably expect to be completed with professional competence and (b) appropriately considers the risks associated with providing professional services in the particular circumstances. Audit firms should regularly monitor whether firm personnel are following the policies and procedures established by the firm's quality control system for client acceptance.

About the Audit Focus Series

Audit Focus is a series of PCAOB publications that aims to provide easy-to-digest information to auditors, especially those who audit smaller public companies and/or broker-dealers. Each edition of Audit Focus reiterates the applicable auditing standards, rules, and/or staff guidance, as well as offers reminders and good practices tailored to PCAOB-registered auditors of smaller public companies and/or broker-dealers – all with an eye toward protecting investors and improving audit quality.

This document, which was published in July 2025, represents the views of PCAOB staff and not necessarily those of the Board. It is not a rule, policy, or statement of the Board.

On May 13, 2024, the PCAOB adopted a new quality control standard: QC 1000, *A Firm's System of Quality Control* ("QC 1000"). The new standard and related amendments will take effect on December 15, 2025, and are generally consistent with an audit firm's existing responsibilities regarding engagement acceptance decisions under QC 20. QC 1000 expands on the requirements for engagement acceptance in QC 20 with regard to considering the necessary information about the nature and circumstances of the engagement, making appropriate judgments about the associated risks, and the audit firm's ability to mitigate those risks and perform an engagement in accordance with applicable professional and legal requirements. Please refer to "Staff Guidance - Insights for Firms" and "Staff Presentation: Quality Control - Acceptance and Continuance" for additional information.

AS 2610, *Initial Audits – Communications Between Predecessor and Successor Auditors* ("AS 2610"), governs communications between predecessor and successor auditors when a change of auditors is in process or has taken place. Inquiry of the predecessor auditor is a necessary procedure because the predecessor auditor may be able to provide information that will assist the successor auditor in determining whether to accept the engagement.

AS 1301, *Communications with Audit Committees* ("AS 1301") states that the auditor should discuss with the audit committee any significant issues that the auditor discussed with management in connection with the appointment of the auditor.

REMINDERS

Evaluating Information

When contemplating engagement acceptance or performing engagement acceptance procedures using information available, auditors need to carefully consider their ability to perform an audit in accordance with PCAOB standards. That consideration includes analyzing factors and questions such as the following:

- Were there any recent changes in ownership, company management, the board of directors, or the composition of the audit committee related to the prospective engagement? What were the reasons for the changes?
- What are the qualifications of the company's current management team and the audit committee associated with the prospective engagement, and do these qualifications enable them to execute their roles and responsibilities effectively?
- Has the audit firm considered any previous restatements or material weaknesses (e.g., nature of restatements, nature of deficiencies, whether they are long-standing, etc.)?
- Were there any risk factors that indicate that company management and those charged with governance lack integrity?
- Has the audit firm thoroughly considered whether its personnel are free from any obligation to, or interest in, the prospective engagement, company management, or the company's owners?
- Is the audit firm independent or will the audit firm be able to become independent for the audit and professional engagement period?
- Does the audit firm have sufficient knowledge and experience or appropriate access to subject matter experts, including relevant industry expertise, to undertake the work?
- Was the company's management or audit committee aware of any improper activities conducted by the former auditor during interim reviews or annual audits, including activities related to the supervision of the audit or to the engagement quality review?
- Was the company's management or audit committee aware of any illegal acts identified by the predecessor auditor and not reported to the U.S. Securities and Exchange Commission (SEC or "Commission") or any other relevant regulators?

An audit firm’s rationale for engagement acceptance, and its assessment of relevant factors, such as those mentioned above, if applicable, should be documented along with any additional procedures that firm personnel perform to mitigate the issues identified, including any plans for ongoing monitoring of these engagements by the audit firm as part of its quality control system.

Change of Auditors

AS 2610.09 states that the successor auditor should make specific and reasonable inquiries of the predecessor auditor regarding matters that will assist the successor auditor in determining whether to accept the engagement. Such inquiries should include:

- Is there information that might bear on the integrity of management?
- Did the predecessor auditor have any disagreements with management as to accounting principles, auditing procedures, or other similarly significant matters?
- What communications were made between the predecessor auditor and the audit committee (or others with equivalent authority and responsibility), regarding fraud, illegal acts by clients, and internal-control-related matters?
- What is the predecessor auditor’s understanding as to the reason for the change of auditors?
- What is the predecessor auditor’s understanding of the nature of the company’s relationships and transactions with related parties and significant unusual transactions?

Other inquiries of the predecessor auditor which could provide insight into the reason for the change could include whether communications were made in accordance with AS 1301.04, .15, .22 or .23. Such inquiries could include:

- Were there any matters that were difficult or contentious for which the predecessor auditor consulted outside the engagement team that were determined are relevant to the audit committee's oversight of the financial reporting process?
- Were there any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report?
- Were there any significant difficulties encountered during the audit including (but not limited to) significant delays by management, an unreasonably brief time within which to complete the audit, unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence, unreasonable management restrictions encountered by the auditor on the conduct of the audit, and management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor?

During engagement acceptance, while determining the nature, timing, and extent of procedures, it is important for the successor auditor to consider the operational status of the predecessor auditor. Some predecessor auditors may have ceased operations, while others are no longer permitted to appear or practice before the Commission and file audit reports pursuant to Rule 102(e) of the Commission’s Rules of Practice or have had their registration with the PCAOB suspended or revoked (collectively, “a suspended firm”). An audit firm may also not be available or willing to communicate with a successor auditor. Furthermore, there may be concerns over the reliability of a suspended firm’s work.

Where a predecessor audit firm has ceased operations, the successor auditor should consider Auditing Interpretation 23: *Departures from Unqualified Opinions and Other Reporting Circumstances: Auditing Interpretations of AS 3105*. Topic 15 provides guidance for situations in which prior-period financial statements, audited by a predecessor auditor that has ceased operations, are presented for comparative purposes with current-period audited financial statements.

Successor Auditor Responsibilities: Consideration of Opening Balances

AS 2610.13 states that the "successor auditor's review of the predecessor auditor's working papers may affect the nature, timing, and extent of the successor auditor's procedures with respect to the opening balances and consistency of accounting principles…the nature, timing, and extent of audit work performed, and the conclusions reached in both these areas are solely the responsibility of the successor auditor." As such, the successor auditor's procedures are specific to the facts and circumstances of the public company or broker-dealer. The successor auditor must obtain sufficient appropriate evidential matters to afford a reasonable basis for expressing an opinion on the financial statements or internal control over financial reporting (ICFR) it has been engaged to audit, including evaluating the consistency of the application of accounting principles. The audit evidence used in analyzing any potential adjustments required to the opening balances – and consistency of accounting principles – is a matter of professional judgment but must be sufficient and appropriate. Such audit evidence may include:

- The most recent audited financial statements.
- The predecessor auditor's report thereon.
- The results of inquiry of the predecessor auditor.
- The results of the successor auditor's review of the predecessor auditor's working papers relating to the most recently completed audit.
- Audit procedures performed on the current period's transactions that may provide evidence about the opening balances or consistency.

Successor Auditor Responsibilities: Reaudit Engagements

As a reminder, financial information for each fiscal year presented in a company's filing (e.g., Form 10-K, Form 20-F, Form 10-Q) must be audited or reviewed, as required by Regulation S-X, by a qualified and independent audit firm. AS 2610.14-.20 addresses situations where the auditor is asked to audit and report on financial statements that have been previously audited and reported on.

If the successor auditor accepts a reaudit engagement, it should plan and perform the audit in accordance with the standards of the PCAOB as if the original audit had never taken place. The successor auditor should not assume responsibility for the predecessor auditor's work or divide responsibility for the reaudit with the predecessor auditor.

In a reaudit engagement, if the successor auditor is unable to obtain sufficient appropriate audit evidence to express an opinion on the financial statements, the successor auditor should qualify or disclaim an opinion due to the inability to perform procedures the successor auditor considers necessary in the circumstances.

Good Practices

We have observed the following good practices that audit firms who audit smaller public companies or broker-dealers have implemented in the area of client acceptance:

Assessing Partner Capacity

In both the acceptance and continuance process, audit firms have implemented a "scorecard" where points are assigned to a partner based on the number and type of audits already served. More points indicate a higher workload. The goal is to keep each partner's workload at a level where they are below a certain points threshold and are therefore able to serve a new or existing engagement. Partners exceeding the point goal are required to discuss partner assignment with leadership to determine their capacity to take on another engagement.

Implementation of a Pre-Assessment Process

Before bidding on the engagement, audit firms implemented an evaluation team to pre-vet potential engagement prospects to determine whether the engagement is an appropriate fit for the audit firm.

Use of Templates

Audit firms used templates to help guide a balanced decision on whether or not to proceed with a potential engagement opportunity. The template includes certain risk factors that may not align with the audit firm's desire to move forward with the potential engagement.

Industry Expertise

Audit firms have revised their policies to decline accepting any engagement for which the audit firm does not have the requisite expertise or resources. For example, some audit firms have chosen to no longer accept integrated audits or audit engagements from companies in specific industries.

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