# SPOTLIGHT

## Insights on Culture and Audit Quality

December 2024

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# WHY CULTURE IS SO IMPORTANT FOR AUDIT FIRMS

Culture is broadly defined as a set of shared attitudes, values, goals, and practices that characterize an organization. An organization's culture influences how it establishes its reputation, manages its teams, and sustains productivity. Healthy cultures enable organizations to thrive, while unhealthy cultures can lead to underperformance or worse.

An organization's culture can determine everything from whom they hire to how long those people stay. In essence, culture is the backbone of an organization. It influences every aspect from daily operations to long-term strategy.

Since the passage of the Securities Exchange Act of 1934, auditors have had a critical gatekeeping function in the capital markets. Auditors must operate with integrity, to promote investor confidence and foster trust in the capital markets.

Like any private business, audit firms aim to make a profit. Audit firm leaders – with the tone they set and the culture they foster – are responsible for ensuring that their professionals maintain independence, integrity, and professional skepticism as they also pursue growth and profitability of their audit firms. Indeed, an audit firm's culture contributes to the audit firm's ability to deliver a quality audit. Culture may also detract from audit quality, particularly if leadership says one thing but rewards another.

# OUR FOCUS ON AUDIT FIRM CULTURE

In September 2023, the Division of Registration and Inspections ("we" or "our") launched an initiative focused on culture at audit firms (the "culture initiative"). The objective was to explore and understand drivers of audit firm culture and to probe whether the audit firm's culture had an impact on the rising levels of audit deficiencies we have observed in our inspections since 2020 (See Figure 1).[1]

## Figure 1 – Part I.A. Deficiency Rates



■ 2020  ■ 2021  ■ 2022  ■ 2023

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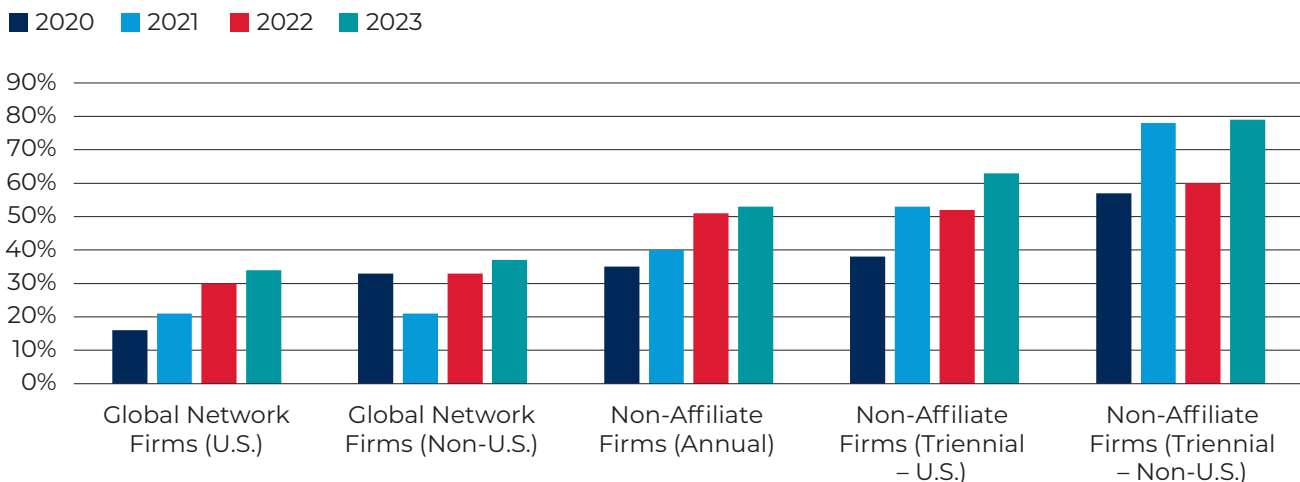
[1]  For more on trends in inspection findings, see the PCAOB Staff Spotlight, "Staff Update on 2023 Inspection Activities" (August 2024), or visit https://pcaobus.org/oversight/inspections/global-network-firms-inspection-data.

To carry out our culture initiative, we:

- Reviewed the inspection results for certain focus areas of the quality control (QC) systems of the Global Network Firms operating in the U.S. (GNFs)[2] – including aspects of governance and leadership, resources, engagement performance, and information and communication – as well as audit firm prepared materials, such as audit firm internal messaging, people survey results, and organizational charts.

- Established a team that conducted 156 interviews at the GNFs. For these interviews, we spoke to 15 audit practice leaders[3] including certain members of the boards of directors/executive leadership teams ("audit leadership"), as well as 141 engagement partners ("other respondents") – collectively, the "respondents."

- Considered audit firm culture in terms of:

  o **Behaviors.** Actions that reflect the tone at the top or demonstrate appropriate responses to matters, such as client pressures and demands, and the courage to lead or speak up during challenging situations.

  o **Decisions.** Audit firm responses to certain behaviors, including decisions to reward or negatively hold audit leadership accountable.

  o **Firm Systems and Structures.** Policies, procedures, and organizational structures at audit firms that include, among other things, performance management systems, ethics, and code of conduct.

This Spotlight provides a view into inspection observations on audit firm culture and key insights from our culture initiative.

# ASPECTS OF QUALITY CONTROL THAT MAY AFFECT AUDIT FIRM CULTURE

We have long been interested in the connection between audit firm culture and audit quality. An audit firm's culture can significantly impact audit quality.

An audit firm's QC system has a critical link to audit firm culture, as QC lays the groundwork for everything auditors do. Each year, we perform QC inspection procedures on all audit firms selected for inspection, as effective QC systems are necessary for consistent high-quality audits and to reduce the likelihood of audit deficiencies. For each audit firm, we (1) update our understanding of the design of the audit firm's QC system; (2) perform topic-specific and/or firm-specific inspection procedures related to the effectiveness of certain QC topics;[4] and (3) evaluate whether the engagement performance deficiencies, individually or in the aggregate, evidence a potential deficiency in the QC system.

An audit firm's QC system encompasses the audit firm's organizational structure, the policies adopted, and procedures established to provide the audit firm with reasonable assurance of complying with applicable professional standards. The following are

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[2] Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, BDO USA, P.C., and Grant Thornton LLP.

[3] Our team interviewed partners in the following roles in audit leadership: Office Leader, Regional/Industry/Service Line Leader, Quality Leader, People Leader, Information Technology Partner/Managing Director, Board Member/Executive Leadership, and Audit Practice Leaders.

[4] Refer to Appendix: QC Standards for additional information about our existing and newly adopted QC standards.

important QC topics, among others, that we believe have an effect on audit firm culture:

- **Governance and Leadership** – This QC topic addresses the environment that enables the effective oversight and operation of the QC system and directs the audit firm's culture, decision-making processes, organizational structure, and leadership. Tone at the top, often considered as a proxy for firm culture, is embedded within this topic.

- **Resources** – This QC topic addresses the audit firm's processes for obtaining, developing, using, maintaining, allocating, and assigning the audit firm's resources to enable the design, implementation, and operation of the audit firm's QC system and the performance of its engagements. The audit firm's resources include people, financial, technological, and intellectual resources, and resources from a network or third-party provider.

- **Engagement Performance** – This QC topic addresses the audit firm's processes relating to the performance of the audit firm's audit engagements by its firm personnel and others in accordance with applicable professional standards and legal requirements. To the extent appropriate, and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement.

- **Information and Communication** – This QC topic addresses the audit firm's processes for obtaining, generating, and using information to enable the design, implementation, and operation of the QC system and the performance of its engagements, and for communicating information within the audit firm and to external parties on a timely basis.

We considered these QC topics when conducting our culture initiative interviews of audit leadership and other respondents with varying levels of responsibility. Throughout this Spotlight, we describe observations related to these QC topics from our QC inspection procedures and culture initiative interviews including observations regarding what may have contributed to the increase in inspection findings since 2020.

## Observations on Governance and Leadership

Audit firm governance and leadership are the foundation of a QC system. Governance and leadership establish the environment in which the audit firm's QC system operates and the importance of audit quality.

Audit leadership has responsibility for shaping audit firm culture and setting the overall tone. While implementing the right policies and procedures is crucial, creating a strong tone at the top goes beyond mere words. Leaders exemplify the desired culture through their actions.

### Focus on Leadership's Commitment to Integrity and Audit Quality

Less experienced firm personnel at each audit firm closely observe their managers' actions. If they witness managers taking shortcuts or making exceptions for certain partners, they might believe that this is the way to advance. Conversely, firm personnel who are trained to act with integrity and uphold ethical standards reinforce each other with the support of audit leadership. We believe audit leaders who fail to demonstrate professional conduct and do not support firm personnel in making tough decisions for high audit quality will ultimately fail in their role as gatekeepers.

Through our QC inspection procedures, we assessed steps firms have taken to embed integrity and a commitment to audit quality in the audit firm's culture. We considered, for example, the following:

- Has the audit firm established core values related to integrity and audit quality? If so, is leadership responsible for setting a strong tone at the top consistent with these values?

- Does audit leadership emphasize its commitment to integrity and audit quality through its communications?

- Does the audit firm use employee surveys? If so, how often? How are the results used, what is the process for developing actions to respond to feedback received, and how does the audit firm monitor the effectiveness of the actions?

- How does the audit firm emphasize integrity and audit quality in the performance management process, including holding professionals responsible for negative events and/or incentivizing professionals for positive quality events or meeting audit quality indicators?

- Have there been any changes to the audit firms' guidance, communications, and training to make them more effective?

- Does the audit firm have independent board members or an independent advisory committee?

- Does the audit firm have a board subcommittee focused on areas that are relevant to audit quality?

- What is the level of representation of the audit practice on the board, including whether the board is led by a member of the audit practice?

Our QC inspection procedures generally indicate that audit firm leaders have increased the frequency of internal communications with firm personnel compared to the rate in prior years, and those communications emphasized the importance of performing quality audits, exercising professional skepticism, upholding audit firm values, and acting with integrity. The audit firms also provided guidance and training related to auditing in a remote work environment.

During our culture initiative, we asked the respondents to identify the most important component of their audit firms' culture. The most frequently cited component among both audit leadership and other respondents was audit quality. The next most frequent response pertained to financial measures including growth, profitability, and financial performance.

We also asked if the audit firms consistently communicated or demonstrated their culture and tone at the top and whether respondents believed the firm personnel of each audit firm viewed the culture and tone at the top consistent with the views of the respondents. The majority of respondents noted the following as common reasons why respondents thought the views of firm personnel on culture differed from their own view:

- **Generational Differences** – Some respondents cited generational differences. Respondents perceived a sentiment among newer firm personnel that having a long-term profession (tenure) is not valued as much as developing skills and moving on.

- **Stage of Career** – Some respondents mentioned newer firm personnel may not fully understand all aspects of audit firm culture and how that culture has developed over time.

- **Tenure and Experience** – For some respondents, their view on culture and tone varied based on their tenure and the situations they may have had to navigate over their career.

## Focus on Professional Skepticism

Establishing the right tone at the top is essential for fostering an auditor's professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence. It is crucial for audit leadership to empower less experienced team members to use professional skepticism, while protecting them from client, engagement team, or audit firm pressures. Less experienced team members should be provided with adequate time to complete their procedures instead of being urged to conclude the audit swiftly.

Through our QC inspection procedures, we observed steps the audit firms have taken to focus firm personnel on the importance of professional skepticism (e.g., guidance, training, communications, performance management). As part of these observations, we also considered the following questions:

- Do the audit firm's communications/ guidance emphasize the importance of professional skepticism?

- Is there a framework or other practical guidance to aid professionals in applying professional skepticism?

- Are there circumstances where use of professional skepticism guidance/ framework is mandatory?

- Does the audit firm have any training regarding professional skepticism? If so, how often and for whom?

- Does the audit firm consider professional skepticism as a potential factor when performing any root cause analysis?

- Is professional skepticism considered in the performance management process?

We learned that the audit firms' messaging focused on the use of professional skepticism because of the increased risks for fraud

in a hybrid work environment, including cybersecurity-related issues.

During our culture initiative interviews, approximately 98% of respondents across the six GNFs indicated their audit firm had a culture that promotes professional skepticism. When we asked what formal mechanisms were in place, most respondents noted that while there is audit firm training and messaging, the most effective way to learn is through observation on engagements. Respondents noted that as a result, professional skepticism may have been affected by the shift to a predominantly virtual environment during the pandemic and the subsequent hybrid work environment.

## Focus on Strategic Decisions and Actions

An audit firm's operating strategy, including investments in people and technology, organizational structure, and globalization, can affect audit quality.

Through our QC inspection procedures, we aimed to understand whether the audit firm has a strategic plan, and we considered whether strategic decisions and actions emphasize audit quality. We observed that all six GNFs emphasized audit quality in their strategic plans.

When we asked respondents participating in the culture initiative what investments had been made to drive improved audit quality in the last three years, the common responses across all audit firms were investments towards the respective current audit platforms and software/technology/digital tools. Four of the audit firms appear to have focused their investments on the standardization of templates and workpapers. Other highlights included:

- The respondents of two audit firms noted an investment in the standardization of

workpapers at a much greater rate than the other audit firms.

- Several respondents at one audit firm discussed the future of auditing and what the audit firm is doing to advance the audit experience. Audit leadership at this firm described the next generation audit platform as not just technology but taking a fresh look at the process of auditing and how to deliver a more engaging and successful experience for firm personnel.

- Three audit firms' respondents mentioned investing in their respective audit firm's quality network[5] at what they considered to be a greater rate than the other audit firms.

- All audit firms noted investment in artificial intelligence.

We also noted that approximately 99% of respondents indicated that the current structure of their respective audit firms does not hinder audit quality. We noted the following across several audit firms:

- Approximately 92% of one audit firm's respondents indicated the current structure either helps or has no effect on audit quality. They indicated the move to the current more centralized, national structure is driving better consistency in audits. Moving the information technology (IT) audit practice under the assurance practice was also cited as a positive movement towards driving audit quality.

- At another audit firm, approximately 15% of respondents would like to see a greater balance between industry and geography as it pertains to staffing. One respondent noted that the audit firm's current focus on geography could affect audit quality. The respondent noted that individuals were being staffed on engagements, in some situations, because they were available and within the same area, without consideration for fit for the job or their capabilities.

- At yet another audit firm, respondents noted that while they were satisfied with the current structure, approximately 20% would like to see a greater balance between industry and geography as it pertains to staffing.

- All of one audit firm's respondents indicated the current structure either helps or has no effect on audit quality. They also noted that the audit firm needs to continue to maintain a balance between industry and geography. Additionally, the current service line structure (Tax, Audit, and Advisory) may be reevaluated and there is consideration to ensure a new service line structure will not undermine audit quality.

## Observations on Resources

We believe that it is important for audit leadership to prioritize audit quality in their hiring, retention, and promotion practices for all professionals, making it an integral part of the promotion and compensation process.

### Focus on Resource Management

We routinely performed QC inspection procedures on the audit firm's resource management of partners as well as its firm personnel. We focused, among other topics, on the audit firm's policies and procedures for advancement, deployment, evaluation, and negative and positive audit quality events. We considered, for example, the following questions:

**Advancement** – Has the audit firm established the following to ensure that candidates selected for advancement have the qualifications

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5   In this Spotlight, the term "quality network" refers to an audit firm's centralized function that aids engagement teams in areas such as professional practice development, audit methodology and consultations.

necessary for fulfillment of the responsibilities that they will be called on to assume:

- Expected competencies by level.

- Minimum experience by level.

- Minimum training by level.

- Minimum performance ratings for promotion.

**Evaluation** – Do the audit firm's policies and procedures related to the evaluation of partner performance consider the following:

- The frequency of performance evaluations and the ratings scale used in the evaluations.

- Whether the audit firm considers audit quality, including inspection results, and compliance with firm independence policies in the performance ratings.

- Whether the audit firm considers sales of non-audit services in performance ratings, and whether there is significant weighting of these sales when determining ratings.

- The level of documentation required to support discussions of considerations of quality and performance ratings.

**Negative Audit Quality Events** – Does the audit firm assess whether partners or other firm personnel are responsible for negative audit quality events (e.g., internal and external inspection results, restatements, independence violations)? In addition, what is the audit firm's response to negative audit quality events? Does the audit firm have established action or development plans, and monitoring procedures to ensure the plans are appropriately designed, followed, and completed in a timely manner? Following a negative audit quality event, does the audit firm reevaluate clients and/or assignments, including consideration of a reduction in workload or removal from leadership roles or

engagements? Are there financial implications for partners or other firm personnel following a negative quality event?

**Positive Audit Quality Events** – Does the audit firm consider positive audit quality events (e.g., meeting the audit firm's engagement performance metrics) as part of its recognition and rewards programs?

We learned from our QC inspection procedures that there were opportunities at some audit firms to improve resource planning and monitoring of staffing workloads and that certain audit firms lacked documented competencies expected by staff level. We have also noted that negative audit quality events were not sufficiently evaluated or attributed to firm personnel and that processes to develop, monitor, and complete related action plans could be improved. There are also opportunities for some audit firms to improve performance evaluation processes such as accumulation of all relevant data or ensuring complete documentation of various factors considered for promotions, ratings, and compensation. In addition, there was a lack of timeliness of performance evaluations at certain audit firms, resulting in current-year negative audit quality events being considered in the subsequent performance year.

During our culture initiative interviews, we asked what the respondents believed was the top factor in determining increases in partners' salaries and bonuses. All respondents from audit leadership of four audit firms included audit quality in their response as the top factor, and the audit leadership of the other two audit firms stated that an audit partner's business portfolio and complexity of clients was the top factor.

When respondents were asked about the effect of positive versus negative audit quality events, the majority of respondents other than audit leadership at all six audit firms indicated that penalties for negative audit quality events outweigh rewards or incentives for positive

audit quality events. Several respondents highlighted the notion that negative audit quality events are easier to define than positive audit quality events, the latter of which are viewed as "table stakes" for performance. As a result, the rewards and outcomes for positive audit quality events are incremental, whereas the repercussions for negative audit quality events can have more drastic consequences for a partner's career, potentially leading to a reduction in partner units or low-quality ratings.

Audit leadership for two audit firms agreed that the penalties for negative audit quality events outweigh the positive incentives, while the audit leadership for two other audit firms believed the incentives and penalties are balanced. For the remaining audit firms, some audit leadership believed the positive incentives outweigh the negative but acknowledged that the negative audit quality event itself as well as the accountability for those events can be demoralizing. Another respondent from audit leadership also noted that having a bad track record can limit career progression.

Respondents of one of the six audit firms cited that the incentives of working on public company engagements at the audit firm are declining for both partners and firm personnel due to the increased pressures, extra time requirements, and other demands required for completing a public company audit. Another respondent from this audit firm stated that while most of the audit firm's revenue comes from private company engagements, the audit firm is attempting to make partners understand that they must serve public company clients. Some respondents from this audit firm recalled firm personnel citing long hours, poor staffing, and the pressure of inspections as reasons why they do not want to work on public company engagements. Overall, respondents at this audit firm stated that partner promotions are more attainable for a senior manager who only works on private

engagements due to the decreased probability of having a negative audit quality event from PCAOB inspections.

## Focus on Hiring and Retention

We focused, among other topics, on the audit firm's policies and procedures for hiring and retention through recognition and rewards. We considered, for example, the following:

**Hiring** – Are the audit firm's policies and procedures designed to ensure that those hired possess the appropriate characteristics to enable them to perform competently? Does the audit firm have policies and procedures related to experienced hires (senior associates through managing director levels) and direct admit partners?

**Recognition and Rewards** – Have there been any changes to the audit firm's recognition and rewards programs from the prior year such as changes to how partners are compensated, including sharing of revenues or income between different service lines? Have there been any changes to the audit firm's recognition and rewards programs, including compensation changes?

We learned from our QC inspection procedures that certain audit firms considered the loss of talent a risk to audit quality and implemented measures to address increased turnover, including adjusting compensation and rewards programs.

We also identified through our culture initiative certain trends highlighting the impact acquisitions and hiring partners from other audit firms could have on the audit firm's culture and tone at the top, which potentially could have affected audit quality. We identified differences among the audit firms in the percentage of partners interviewed that started their careers at the audit firm compared to those that were direct admit partners or were

hired as senior managers and promoted to partner. Based on information gathered during our interviews, we recognized that the audit firms with the highest percentage of respondents that started their careers in the respective audit firm had the lowest deficiency rates over the last three years. In contrast, the audit firms with the lowest percentage of respondents that started their careers in the respective audit firm had the highest deficiency rates over the last three years.

We also noted the following:

- Respondents from one audit firm said that acquisitions and hiring of experienced personnel have affected audit quality due to the amount of time required to develop a consistent and unified culture. Additionally, the respondents noted there are differences in views on audit firm culture between acquired offices and legacy offices, which may lead to a fragmentation in the understanding of the importance of audit quality. Additionally, the respondents said, these new employees have ideas on how to implement changes, but there is tension between their ideas and the legacy firm personnel's ideas. However, there was nothing raised by audit leadership in their interviews to suggest that leadership knew of this tension.

- A respondent from another audit firm noted an increase in hiring in the last two years and a difference in the new hires' approach and interactions with existing employees and assimilating into the culture.

Through our interviews, we noted that respondents from all six GNFs identified resource challenges, and having the appropriate resources in the right place, as either a factor for increasing deficiencies or as a general overall concern. Of note:

- Respondents at one audit firm noted that the investment in people led to a higher

retention rate. However, in some cases, other respondents at the same audit firm felt they currently had more than enough resources, but there were still concerns over the accounting pipeline.

- At another audit firm, leadership indicated a belief that there is not a resource challenge, and the right people are in the right place to implement audit quality. However, approximately 41% of other respondents at the same audit firm indicated concerns about firm personnel and partner competency as well as overall availability of resources. Additionally, one respondent said that during the "great resignation," a fear of giving meaningful feedback led to retention of firm personnel that were not adept in auditing.

- Respondents at one audit firm identified not having the right resources at the right time and an overall lack of resources as barriers to audit quality.

- Respondents across all audit firms noted that the younger generation of students and firm personnel have differing views on careers than their older counterparts, with many viewing their work more as a job, rather than a career, and are therefore more likely to leave the profession if presented with more attractive opportunities.

- Several respondents across all audit firms indicated the shortage of new accountants entering the profession is an issue that needs to be widely addressed. Respondents noted that industry compensation is unfavorable compared to entry-level positions in the finance and consulting fields, while the 150-credit hour requirement to obtain a CPA license is a significant barrier to entry for many students. One respondent noted that a fifth year of schooling, needed to fulfill the 150-credit hour requirement, has led to deterring students from pursuing a CPA license, as

"it is the opportunity cost of the $60K one earns while working and the $60K spent on tuition (excluding living expenses)."

## Observations on Engagement Performance

An audit firm's culture is dependent upon the establishment of policies and procedures that provide the audit firm with reasonable assurance that the work performed by firm personnel meets applicable professional standards, regulatory requirements, and the audit firm's standards of quality. This includes all phases of the design and execution of engagements as well as engagement quality reviews.

### Focus on Responsibility and Accountability

Through our QC inspection procedures, we seek to understand whether the audit firm has a process to assess whether the engagement team members, partners, and/or engagement quality reviewers are responsible for internal and PCAOB inspection findings ("responsibility analysis") and we consider, for example:

- Whether the audit firms' responsibility analysis includes a review of underlying documentation.

- Whether the responsibility analysis includes interviews with engagement team members.

- Whether there are consequences if an individual is deemed responsible for the finding.

- The qualifications of the individuals assessing the responsibility for the findings.

We have noted through our QC inspection procedures that when audit firms disagree with PCAOB findings, it often results in a lack of accountability for that finding and remedial processes to ensure it is not repeated.

During our culture initiative interviews we noted that a minority of respondents from five of the six audit firms refused to take responsibility for the increase in inspection findings and said, in their view, PCAOB inspections were getting more difficult. These comments were made despite the fact that the PCAOB has historically inspected against our standards and continues to do so.

In addition, respondents from all six audit firms noted the overall business environment becoming more complex, with evolving technology, environmental, and global political risks as a reason for the increase in inspection findings.

### Focus on Centralization and Standardization

Our QC inspection procedures are designed to understand whether the audit firm has implemented any tools, forms, and templates related to engagement performance, including those that guide:

- Client acceptance and continuance.

- Reviews of audit work performed, including the work of engagement quality reviewers.

- Using other auditors as a principal auditor.

- Evaluating other auditors used.

- The engagement team when:

  o Using a specialist.

  o Consulting outside the engagement team.

  o Performing risk assessment.

  o Implementing new auditing or accounting standards.

  o Calculating materiality.

  o Documenting the rationale for the selected materiality.

In addition, we consider whether any of these tools, forms, and templates are required to be used; and whether the audit firm performs procedures to monitor use of the tools, forms, and templates.

Through our QC inspection procedures, we have noted that some audit firms are dedicated to applying lessons learned from PCAOB inspections and the audit firms' internal inspection process and have made adjustments on a real-time basis to their policies, procedures, tools, and templates related to the execution of audits. Some audit firms also have dedicated groups responsible for testing the firms' QC processes, as well as the implementation of questionnaires, checklists, templates, and other guidance to assist in QC system monitoring procedures.

However, at certain audit firms we noted that there was a lack of clarity of audit firm policy related to the use of tools and templates or the optional use of these tools; and we noted that there was inconsistent usage of tools and templates by the engagement teams at those audit firms.

We noted during the culture initiative that the degree of centralized and standardized processes, tools, and templates at the audit firms is important to ensuring consistent application and promotion of audit quality. For example:

- Two audit firms implemented centralized structures and standardized processes several years ago, which allowed for more consistent culture messaging and audit execution. Respondents at both audit firms cited having a national quality network as a key resource in performing consultations and seeking advice on complex audit issues, which the respondents believe has helped promote strong audit quality at their audit firms.

- One of those audit firms has an auditor network where auditors can consult with audit experts (without a charge code),[6] and the respondents noted that it removes the stigma of firm personnel asking questions at any level.

In contrast, the remaining four audit firms are trying to incorporate more centralization and standardization throughout their audit practices. These four audit firms, to varying degrees, have recognized the importance of centralization and standardization and its impact on culture – and are in various stages of implementing changes to increase the level of centralization and standardization. For example:

- Respondents from one audit firm cited a lack of centralization and standardization as a potential cause for the increase in inspection findings over the last three years. Engagement teams previously had a lot of flexibility in documenting audit procedures, leading to inconsistencies and variation among engagements and geographies. As a result, in 2023, the audit firm implemented a plan to restructure its audit practice, shifting to a more centralized national model. Approximately 65% of the audit firm's respondents listed the centralization of the audit firm structure and the standardization of audit tools and templates to increase consistency in execution and documentation as important investments being made by the audit firm. While many respondents noted the standardized templates were helpful, some indicated that the implementation of the templates has led to some change fatigue and frustration. The audit practice leader noted the volume of changes created a lot of stress in the system and could have a negative impact before the audit firm sees positive results.

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[6]  In this Spotlight, a charge code is a unique identifier assigned to a specific client or engagement. It is part of an audit firm's revenue management and helps to capture and track the time and services rendered by firm personnel.

- Another audit practice leader from the same firm stated that two other audit firms had an advantage during the pandemic, as those audit firms were able to benefit from having "more evolved" centralized and standardized processes and procedures. The audit practice leader noted that those two audit firms did not have geographic barriers in how procedures were performed and could pull in firm personnel from any geographic location when working remotely.

## Focus on Use of Shared Service Centers

As noted in a December 2023 Spotlight – "Observations From the Target Team's 2022 Inspections" – the term shared service center (SSC) refers to an entity – affiliated with one or more audit firms – that mostly provides resources and services remotely to core engagement teams. SSC personnel traditionally serve in associate or senior associate roles in an engagement team. The services provided are typically more traditional standardized audit procedures, such as testing the mathematical accuracy of schedules prepared by a public company. SSCs may be based inside and/or outside the U.S. and may or may not be subsidiaries of a U.S. audit firm.

Through QC inspection procedures, we considered the audit firms' policies related to the use of SSCs and have noted that audit firms were increasing the use of SSCs to perform certain audit procedures. For example, we have noted that one audit firm has a goal for all U.S. engagement teams to increase the use of its SSC to approximately 20% of total audit hours. The work is currently focused on low risk and low judgment areas, but we are seeing greater use of SSCs in areas such as IT general controls and manual control testing. Another audit firm's use of SSCs increased approximately 28% during 2023 to approximately 84,000 hours, or approximately 6% of total audit firm issuer and broker-dealer

hours. In addition, we have noted the SSC resources are providing direct audit support to engagement teams for standardized and/or low judgment audit procedures.

During our culture initiative interviews, respondents raised concerns over pressuring engagement teams to use SSC resources. Respondents described their view that the use of SSC resources is removing foundational skills and experiences from newer firm personnel, potentially depriving these personnel of basic skills leading to difficulties in reviewing those areas as they progress in their careers. One respondent noted, "Our staff now will never see cash testing, as it is done offshore. We are going to see the impact of that when they are managers."

- Respondents from three audit firms mentioned the use of SSCs as a factor that benefits audit quality in terms of standardization of work that does not require significant judgment. The SSC model also allows for consistency, but respondents acknowledged there is a learning curve in ensuring those SSC resources are well integrated into the overall audit team.

- One respondent indicated pressures exist to utilize SSC resources to not only maximize efficiency and drive quality, but also profitability.

- Another respondent noted that revenue growth is emphasized, but not at the expense of audit quality. However, there are also pressures to "get the [profit] margins right" which include specific metrics to send work overseas.

- One audit firm has invested in sending members from U.S. engagement teams to the SSCs to meet with resources to support integration as well as having those SSC resources work in the U.S. for a period to gain knowledge to bring back to the SSCs.

# Observations on Information and Communication

Our QC inspection procedures are also designed to understand the audit firm's policies and procedures related to the identification, capture, processing, and maintenance of information by the audit firm's information systems to support the operation of the audit firm's QC system and the performance of its engagements in accordance with applicable professional and legal requirements.

## Focus on Communications

Our QC inspection procedures are designed to understand the policies and procedures the audit firm has implemented related to communications. We consider how the firm communicates its audit firm's policies and procedures such as:

- What does the audit firm communicate to firm personnel and other participants (including global networks) who support the operation of the QC system and performance of its engagements?

- What does the audit firm communicate to its personnel and other participants (including global networks) to enable them to understand and carry out their responsibilities?

- What does the audit firm communicate to external parties (e.g., audit committees, the PCAOB)?

Through our QC inspection procedures, we have noted that certain audit firms have emphasized timely communication to audit professionals about audit quality, technical accounting and auditing updates, and/or firm policies, procedures, and guidance.

We noted that respondents in the culture initiative indicated that while audit leadership is responsible for communicating consistent messaging, it is incumbent upon the engagement partners to demonstrate those behaviors articulated by audit leadership.

## Focus on Work Environment

Our QC inspection procedures also considered whether there were changes to the audit firms' QC systems to address the potential risks related to managing firm personnel in remote or hybrid work arrangements.

After the pandemic, the audit firms were messaging internally about return-to-office strategies and approaches for hybrid work with a continued focus on performing high-quality audits. The audit firms also issued reminders and guidance such as auditing virtually and considerations for the performance of supervision and review in a virtual environment, including supervision and review of component auditors. Guidance was provided on topics related to audit client personnel turnover and shortages, hybrid work, and pace of economic recovery.

We noted that respondents in the culture initiative described how the onset of working from home during the pandemic affected how partners and firm personnel experienced or assimilated into the audit firms' respective cultures, due to the loss of in-person interactions. Further, respondents cited several reasons for the difficulties in getting audit teams back into the office, including clients that are still working remotely and the fear of firm personnel leaving.

Respondents also noted that remote and hybrid work at the audit firms led to potential learning challenges among entry-level firm personnel. In addition, many respondents cited learning challenges and a decrease in readiness of firm personnel on engagements due to not working in-person as often as before the pandemic, leading to a loss in the apprenticeship culture at the audit firms.

Based on interviews, we noted the following:

- Approximately 64% of all respondents stated that improving work-life balance for firm personnel improves audit quality. However, the other respondents stated that improving work-life balance hinders audit quality because the delayed development of firm personnel affected productivity and made it difficult for some to meet deadlines and expectations.

- Certain respondents even noted that as work-life balance improved for firm personnel, partner work-life balance diminished.

- While four of the six audit firms have implemented return-to-office policies, respondents assert that more in-person learning and interactions are needed to bridge the gap in the knowledge of firm personnel and restore the audit firms' apprenticeship culture.

- Some respondents across all audit firms stated that audit leadership has been too easy on firm personnel and not forceful enough in enforcing in-office policies.

- Respondents from one audit firm noted that managers and partners were stepping down a level to do the audit work traditionally performed by more junior personnel, and as such, engagements were losing a level of scrutiny in the review of audit workpapers.

# KEY INSIGHTS ON AUDIT FIRM CULTURE

As we described in this Spotlight, our QC inspection procedures demonstrate that, in general, audit firms emphasize the importance of performing quality audits, exercising professional skepticism, upholding audit firm values, and acting with integrity. While audit quality may have been the factor audit leadership claimed was most important, a significant percentage of the other respondents from our culture initiative interviews thought other factors – such as financial measures including growth, profitability, and financial performance – were more important to the audit firm. This may have, in turn, contributed to an increase in audit deficiencies in the past three years. We noted the following key insights:

1. **Audit firm culture can drive audit quality – positively or negatively.**

   The results of our interviews support the idea that audit firm culture can impact audit quality, for better or worse. We believe that an audit firm's personnel are the backbone of an audit firm's culture, and respondents said that constant turnover can have an effect on consistency and ultimately, audit quality. We recognized that the audit firms with the highest percentage of respondents that started their careers in the respective audit firm had the lowest deficiency rates over the last three years.

2. **Centralization and standardization may be correlated with audit quality.**

   Similarly, we observed that audit firms with cultures marked by more centralization of the audit firm structure and standardization of audit processes, tools and templates appear to have fewer deviations in their procedures nationally and fewer Part I.A deficiencies.

3. **The remote/hybrid work environment affects audit firm culture.**

   Respondents from our culture initiative interviews suggested that the pandemic and the remote/hybrid work environment has impacted the audit firms' apprenticeship model for on-the-job training, dissemination of culture, and professional skepticism.

4. **Audit firms need to promote a culture of accountability to support audit quality.**

   We believe that audit firms have room to improve when it comes to creating cultures of accountability. We observed, for example, that negative audit quality events (e.g., internal and external inspection results, restatements, independence violations) at some audit firms are not sufficiently evaluated or attributed to firm personnel. Rather than accepting responsibility for negative audit quality events, respondents from all six audit firms pointed to the complexity of their audit clients as a reason for the increase in audit findings. A minority of respondents from five out of the six audit firms also pointed to external factors for the increase in audit findings – such as PCAOB inspections getting more difficult, despite the fact that the PCAOB has historically inspected against our standards and continues to do so. In addition, there was a lack of timeliness of performance evaluations at certain audit firms, resulting in current-year negative quality events being considered in the subsequent performance year.

5. **Certain firm personnel may lack foundational skills.**

   Some respondents had concerns about the competency of certain firm personnel and the appropriateness of how engagements are staffed. Respondents also expressed concern that the push for the use of shared service centers is removing foundational skills and experiences from firm personnel. This lack of experience in basic audit skills could lead to additional difficulties as those individuals progress in their careers.

6. **Audit leadership sends mixed messages.**

   Some respondents indicated that audit firm leaders send mixed messages to engagement partners and other firm personnel about incentives and penalties for positive and negative audit quality events, respectively. In the view of these respondents, audit firms need to ensure that the factors that drive adjustments to compensation are aligned with behaviors that promote audit quality and are clearly communicated to firm personnel.

## WHAT'S NEXT?

The PCAOB continues to be concerned about recent trends in audit quality as reflected in the overall deficiency rates in our recently published inspections reports. Sustainable improvements in audit quality are needed. We are committed to working with audit firms and other stakeholders to further explore how various behaviors and other influences potentially affect audit quality. We plan to enhance our understanding through continued discussions with firm personnel to gain their perspectives of the audit firm's culture, for example, on questions such as the following:

- Who is responsible for audit firm culture, and when does that responsibility begin?

- How do new or updated policies and procedures affect audit quality?

- Will governance changes affect professionals and inspire new leaders or additional investments into the audit practice?

- Do recent scandals in the accounting or financial sectors deter future students from entering the profession?

- Has there been more progress on resolving the accounting pipeline issues, including entry-level salaries?

- How does audit firm growth, including a potential focus on selling and/or delivering

non-audit services, influence the culture of the firm?

- How does the audit firm continue to instill trust in the public markets?

- Does a weak tone at the top foster an environment that leads to a lack of professional skepticism?

There is much to learn about the effect of audit firm culture, and QC 1000 will encourage audit firms to turn their attention internally to ensure they have the appropriate controls designed and, if applicable, implemented to address risks and to enhance audit quality and identify the root cause of deficiencies. Although our culture initiative began in the U.S., culture does not have boundaries, and we plan to

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further understand the reach behaviors have within global firm networks, including through collaboration with other regulators.

# APPENDIX: QC STANDARDS

Effective QC systems are crucial for consistent high-quality audits, and other engagements under PCAOB standards. QC Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, QC Section 30, *Monitoring a CPA Firm's Accounting and Auditing Practice*, QC Section 40, *The Personnel Management Element of a Firm's System of Quality Control – Competencies Required by a Practitioner-in-Charge of an Attest Engagement*, and SEC Practice Section 1000.08 (d), (l), (m), (n), (o) - *Requirements of Membership* are collectively referred to as the QC Standards. Under the QC Standards, a QC system is broadly defined as a process to provide an audit firm with reasonable assurance that its personnel comply with professional standards applicable to its accounting and auditing practice and the firm's standards of quality.

All registered audit firms are required to design and implement a QC system to provide this reasonable assurance in accordance with the QC Standards. Pursuant to the QC Standards, the nature, extent, and formality of an audit firm's QC policies and procedures should be appropriately comprehensive and suitably designed in relation to the audit firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of firm personnel, and the nature and complexity of the audit firm's practice.

The inspection of an audit firm's QC system consists of assessing the audit firm's compliance with existing QC Standards, primarily through inquiry and inspection of audit firm documentation, and through gathering information surrounding firm-wide policies, procedures, and controls established by the audit firm. Collectively, these QC inspection procedures provide a comprehensive understanding as to how

an audit firm obtains reasonable assurance that its personnel comply with applicable professional standards and the audit firm's standards of quality.

On May 13, 2024, the PCAOB adopted a new quality control standard QC 1000, *A Firm's System of Quality Control* ("QC 1000"), which will take effect on December 15, 2025. QC 1000 is an integrated, risk-based standard that includes (i) establishing quality objectives, (ii) identifying and assessing quality risks to the achievement of the quality objectives, (iii) designing and implementing quality responses to address the quality risks, and (iv) monitoring the audit firm's QC system and remediating any deficiencies; and that encourages an ongoing feedback loop to drive continuous improvement of the QC system. Frequent and consistent communication from leadership to firm personnel regarding the commitment to quality is important in order

to create an appropriate culture and tone at the top. QC 1000 focuses on communicating and promoting key professional attributes by recognizing and reinforcing the audit firm's role in protecting the interests of investors and the public interest by meeting the firm's responsibilities; the importance of adhering to appropriate standards of conduct; the importance of professional ethics, values, and attitudes; and expected behavior and responsibility of firm personnel for quality both in QC-related activities and the performance of engagements. Collectively, these attributes and expected behaviors are the foundation of an effective QC system. The new standard establishes annual evaluation requirements as well as annual reporting requirements to the PCAOB on a new, non-public reporting form, Form QC. For additional information on the new auditing standard, visit our Standards page and Implementation Resources for PCAOB Standards and Rules - Quality Control.

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