# 2021 Inspection Baker Tilly US, LLP

(Headquartered in Chicago, Illinois)

November 7, 2022



PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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# 2021 INSPECTION

In the 2021 inspection of Baker Tilly US, LLP, the Public Company Accounting Oversight Board (PCAOB) assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review 11 audits of issuers with fiscal years generally ending in 2020. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

## 2021 Inspection Approach

In selecting issuer audits for review, we use a risk-based method of selection. We make selections based on (1) our internal evaluation of audits we believe have a heightened risk of material misstatement, including those with challenging audit areas, and (2) other risk-based characteristics, including issuer and firm considerations. In certain situations, we may select all of the firm's issuer audits for review.

When we review an audit, we do not review every aspect of the audit. Rather, we generally focus our attention on audit areas we believe to be of greater complexity, areas of greater significance or with a heightened risk of material misstatement to the issuer's financial statements, and areas of recurring deficiencies. We may also select some audit areas for review in a manner designed to incorporate unpredictability.

Our selection of audits for review does not necessarily constitute a representative sample of the firm's total population of issuer audits. Additionally, our inspection findings are specific to the particular portions of the issuer audits reviewed. They are not an assessment of all of the firm's audit work nor of all of the audit procedures performed for the audits reviewed.

View the details on the scope of our inspections and our inspections procedures.

# OVERVIEW OF THE 2021 INSPECTION AND HISTORICAL DATA BY INSPECTION YEAR

The following information provides an overview of our 2021 inspection as well as data from the previous inspection. We use a risk-based method to select audits for review and to identify areas on which we focus our review. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and audit areas from inspection to inspection and firm to firm. Further, a firm's business, the applicable auditing standards, or other factors can change from the time of one inspection to the next. As a result of these variations, we caution that our inspection results are not necessarily comparable over time or among firms.

## Firm Data and Audits Selected for Review

| | 2021 | 2018 |
|---|---|---|
| **Firm data** | | |
| **Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures** | 110 | 74 |
| **Total engagement partners on issuer audit work**[1] | 43 | 31 |
| **Audits reviewed** | | |
| **Total audits reviewed**[2] | 11 | 9 |
| **Audits in which the firm was the principal auditor** | 11 | 9 |
| **Integrated audits of financial statements and internal control over financial reporting (ICFR)** | 3 | 6 |
| **Audits with Part I.A deficiencies** | 5 | 3 |

If we include a deficiency in Part I.A of our report, it does not necessarily mean that the firm has not addressed the deficiency. In many cases, the firm has performed remedial actions after the deficiency was identified. Depending on the circumstances, remedial actions may include performing additional audit procedures, informing management of the issuer of the need for changes to the financial statements or reporting on ICFR, or taking steps to prevent reliance on prior audit reports.

[1] The number of engagement partners on issuer audit work represents the total number of firm personnel (not necessarily limited to personnel with an ownership interest) who had primary responsibility for an issuer audit (as defined in AS 1201, *Supervision of the Audit Engagement*) during the twelve-month period preceding the outset of the inspection.

[2] The population of issuer audits from which audits are selected for review may differ from the issuer audits at the outset of the inspection procedures due to variations such as new issuer audit clients for which the firm has not yet issued an audit report or issuer audit clients lost prior to the outset of the inspection.

Our inspection may include a review, on a sample basis, of the adequacy of a firm's remedial actions, either with respect to previously identified deficiencies or deficiencies identified during the current inspection. If a firm does not take appropriate actions to address deficiencies, we may criticize its system of quality control or pursue a disciplinary action.

If we include a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — it does not necessarily mean that the issuer's financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. It is often not possible for us to reach a conclusion on those points based on our inspection procedures and related findings because, for example, we have only the information that the auditor retained and the issuer's public disclosures. We do not have direct access to the issuer's management, underlying books and records, and other information.

In connection with our 2021 inspection procedures for one audit, the issuer restated its financial statements to correct a misstatement, and the firm revised and reissued its report on the financial statements. The issuer also revised its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

Our 2021 inspection procedures also involved one audit for which the issuer, unrelated to our review, restated its financial statements to correct a misstatement and the firm revised and reissued its report on the financial statements. The issuer also revised its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

## Audit Areas Most Frequently Reviewed

This table reflects the audit areas we have selected most frequently for review in the 2021 inspection and the previous inspection. For the issuer audits selected for review, we selected these areas because they were generally significant to the issuer's financial statements, may have included complex issues for auditors, and/or involved complex judgments in (1) estimating and auditing the reported value of related accounts and disclosures and (2) implementing and auditing the related controls.

| 2021 | | 2018 | |
|---|---|---|---|
| **Audit area** | **Audits reviewed** | **Audit area** | **Audits reviewed** |
| **Revenue and related accounts** | 6 | **Revenue and related accounts** | 5 |
| **Allowance for loan and lease losses** | 4 | **Investment securities** | 3 |
| **Inventory** | 2 | **Inventory** | 2 |
| **Business combinations** | 2 | **Allowance for loan and lease losses** | 2 |
| **Goodwill and intangible assets** | 2 | **Long-lived assets** | 1 |

# PART I: INSPECTION OBSERVATIONS

Part I.A of our report discusses deficiencies, if any, that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.

Part I.B discusses deficiencies, if any, that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

Consistent with the Sarbanes-Oxley Act ("Act"), it is the Board's assessment that nothing in Part I of this report deals with a criticism of, or potential defect in, the firm's quality control system. We discuss any such criticisms or potential defects in Part II. Further, you should not infer from any Part I deficiency, or combination of deficiencies, that we identified a quality control finding in Part II. Section 104(g)(2) of the Act restricts us from publicly disclosing Part II deficiencies unless the firm does not address the criticisms or potential defects to the Board's satisfaction no later than 12 months after the issuance of this report.

## Classification of Audits with Part I.A Deficiencies

Within Part I.A of this report, we classify each issuer audit in one of the categories discussed below based on the Part I.A deficiency or deficiencies identified in our review.

The purpose of this classification system is to group and present issuer audits by the number of Part I.A deficiencies we identified within the audit as well as to highlight audits with an incorrect opinion on the financial statements and/or ICFR.

### Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

This classification includes instances where a deficiency was identified in connection with our inspection and, as a result, an issuer's financial statements were determined to be materially misstated, and the issuer restated its financial statements. It also includes instances where a deficiency was identified in connection with our inspection and, as a result, an issuer's ICFR was determined to be ineffective, or there were additional material weaknesses that the firm did not identify, and the firm withdrew its opinion, or revised its report, on ICFR. This classification does not include instances where, unrelated to our review, an issuer restated its financial statements and/or an issuer's ICFR was determined to be ineffective. We include any deficiencies identified in connection with our reviews of these audits in the audits with multiple deficiencies or audits with a single deficiency classification below.

### Audits with Multiple Deficiencies

This classification includes instances where multiple deficiencies were identified that related to a combination of one or more financial statement accounts, disclosures, and/or important controls in an ICFR audit.

## Audits with a Single Deficiency

This classification includes instances where a single deficiency was identified that related to a financial statement account or disclosure or to an important control in an ICFR audit.

# PART I.A: AUDITS WITH UNSUPPORTED OPINIONS

This section of our report discusses the deficiencies identified, by specific issuer audit reviewed, in the audit work supporting the firm's opinion on the issuer's financial statements and/or ICFR.

We identify each issuer by a letter (e.g., Issuer A). Each deficiency could relate to several auditing standards, but we reference the PCAOB standard(s) that most directly relates to the requirement with which the firm did not comply.

We present issuer audits below within their respective deficiency classifications (as discussed previously). Within the classifications, we generally present the audits based on our assessment as to the relative significance of the identified deficiencies, taking into account the significance of the financial statement accounts and/or disclosures affected, and/or the nature or extent of the deficiencies.

## Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

### Issuer A – Information Technology

#### Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Inventory** and **Revenue**.

#### Description of the deficiencies identified

With respect to **Inventory**:

The issuer reported a reserve for inventory. The firm did not identify and test any controls over the appropriateness of the method and certain assumptions used to determine the reserve. (AS 2201.39) In addition, the firm selected for testing a control that included a review of certain assumptions used to determine the reserve for individual inventory items. The firm did not evaluate the specific review procedures that the control owners performed to evaluate the reasonableness of the assumptions. (AS 2201.42 and .44)

The firm's approach for substantively testing the reserve was to test the issuer's process. The firm did not perform any procedures to evaluate whether the method used to develop the reserve was appropriate. (AS 2501.10) In addition, the firm did not perform procedures to evaluate the reasonableness of certain significant assumptions beyond inquiry and performing a retrospective analysis. (AS 2501.16)

In connection with our review, the issuer reevaluated its accounting for the reserve for inventory and concluded that a material misstatement existed that had not been previously identified. The issuer subsequently corrected this misstatement in a restatement of its financial statements, and the firm revised and reissued its report on the financial statements. The issuer also reevaluated its controls over the reserve for inventory and concluded that a material weakness existed that had not been previously identified. The issuer subsequently reflected this material weakness in a revision to its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

With respect to **Revenue**:

The issuer reported revenue from the sale of products. The following deficiencies were identified:

- The firm selected for testing a control that included reviews of product pricing. The firm did not evaluate the review procedures that certain of the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. Further, the firm did not test the design and operating effectiveness of another aspect of this control. (AS 2201.42 and .44)

- The firm selected for testing a control that included the review of price overrides. The firm did not test the specific review procedures that the control owner performed to evaluate the appropriateness of price changes. (AS 2201.42 and .44)

- The firm did not identify and test any controls over the accuracy and completeness of information used in the operation of one of the above controls and another control over the review of journal entries related to revenue. (AS 2201.39)

The sample size the firm used in its substantive procedures to test product revenue was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

The issuer also reported revenue from the performance of services. The firm did not identify and test any controls over the satisfaction of performance obligations for this revenue. (AS 2201.39)

The sample size the firm used in its substantive procedures to test service revenue was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

## Audits with Multiple Deficiencies

### Issuer B – Financials

#### Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to the **Allowance for Loan and Lease Losses (ALLL)**.

## Description of the deficiencies identified

The issuer reported certain loans for which the borrowers were provided temporary payment relief under the law. The issuer identified that one borrower did not make any subsequent payments on a loan for which it had previously been provided payment relief. As a result, the issuer determined that the value of this loan was dependent on the underlying collateral. The issuer estimated the fair value of the loan's collateral and recorded a specific provision within the ALLL. The following deficiencies were identified:

- The firm did not identify and test any controls that addressed the valuation of loans for which the borrowers had received temporary payment relief under the law. (AS 2201.39)
- The firm did not perform procedures, beyond obtaining the issuer's analysis, to test the reasonableness of this specific provision. (AS 2501.07)[3]

Unrelated to our review, the issuer received additional information concerning the value of the collateral for the above loan and concluded that a material misstatement existed that had not been previously identified. The issuer subsequently corrected this misstatement in a restatement of its financial statements, and the firm revised and reissued its report on the financial statements. The issuer also reevaluated its controls over the valuation of similar loans and concluded that a material weakness existed that had not been previously identified. The issuer subsequently reflected this material weakness in a revision to its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report to include this material weakness.

The issuer's ALLL included a reserve for loans collectively evaluated for impairment. This reserve included a component that was determined by using certain qualitative factors. The following deficiencies were identified:

- The firm selected for testing controls that consisted of the issuer's reviews of the ALLL. The firm did not identify and test any controls over the accuracy and completeness of certain data and/or reports used in the operation of these controls. (AS 2201.39)
- The firm selected for testing controls that consisted of the issuer's review of the qualitative component of the ALLL. The firm did not evaluate the specific review procedures that the control owners performed to evaluate the reasonableness of the basis point adjustments for the qualitative factors. (AS 2201.42 and .44)
- The firm's approach for substantively testing the reserve was to review and test management's process. The firm did not perform procedures to evaluate the reasonableness of certain basis

[3] This citation and the AS 2501 citation for other deficiencies for this issuer audit refer to AS 2501, *Auditing Accounting Estimates*, which was in effect for this audit. This standard was replaced by AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, which became effective for audits of financial statements for fiscal years ending on or after December 15, 2020.

points that were applied to determine the qualitative component, beyond comparing these basis points to the basis points that were applied in prior years and concluding on their overall reasonableness. (AS 2501.09, .10, and .11)

## Issuer C – Financials

### Type of audit and related areas affected

In our review, we identified deficiencies in the ICFR audit related to the **Allowance for Loan Losses (ALL)** and **Goodwill**.

### Description of the deficiencies identified

With respect to the **ALL**:

The issuer's general reserve component of the ALL included a qualitative reserve. For each of the qualitative factors evaluated in determining the reserve, the issuer assigned a risk level and then assigned basis point adjustments based on the risk level. The firm selected for testing several controls over the review of the ALL. The firm did not evaluate the specific review procedures the control owners performed to evaluate the reasonableness of the risk levels and related basis point adjustments. (AS 2201.42 and .44)

With respect to the **Goodwill**:

The issuer performed a qualitative assessment to determine whether or not a triggering event had occurred. The firm selected for testing a control that included a review of this assessment. The firm did not evaluate the specific review procedures that the control owner performed to evaluate the occurrence of the triggering events. (AS 2201.42 and .44)

## Issuer D – Consumer Discretionary

### Type of audit and related area affected

In our review, we identified deficiencies in the financial statement audit related to **Revenue**.

### Description of the deficiencies identified

The firm did not perform sufficient procedures to test the reliability of reports obtained from the issuer's franchisees that it used in its substantive procedures, because it limited its procedures to performing a walkthrough of the issuer's process to access the reports and vouching certain transactions. (AS 1105.04 and .06)

The firm selected for confirmation a sample of revenue transactions. The firm emailed the franchisees the confirmation request and received electronic responses. The firm did not consider performing procedures to address the risk associated with electronic responses, beyond verifying the correspondent's name was consistent with the authorized respondent's name. (AS 2310.29)

## Audits with a Single Deficiency

### Issuer E

#### Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to a **Business Combination**.

#### Description of the deficiency identified

During the year, the issuer acquired a business, including an intangible asset. The issuer developed assumptions to determine the fair value of the acquired intangible asset. The firm did not perform procedures, beyond inquiry of management, to evaluate the reasonableness of a significant assumption. (AS 2501.16)

# PART I.B: OTHER INSTANCES OF NON-COMPLIANCE WITH PCAOB STANDARDS OR RULES

This section of our report discusses any deficiencies we identified that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

When we review an audit, we do not review every aspect of the audit. As a result, the areas below were not necessarily reviewed on every audit. In some cases, we assess the firm's compliance with specific PCAOB standards or rules on other audits that were not reviewed and include any instances of non-compliance below.

The deficiencies below are presented in numerical order based on the PCAOB standard or rule with which the firm did not comply. We identified the following deficiencies:

- In one of 11 audits reviewed, the firm did not make a required communication to the issuer's audit committee related to the name, location, and planned responsibilities of an other accounting firm that performed audit procedures in the audit. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In one of 11 audits reviewed, the firm did not communicate to the issuer's audit committee all of the critical accounting estimates. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In three of 11 audits reviewed, the year the firm began serving consecutively as the company's auditor that was included in the firm's audit report was incorrect. In these instances, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

- In two of six audits reviewed, the engagement team performed procedures to determine whether or not matters were critical audit matters but did not include in those procedures one or more matters that were communicated, or required to be communicated, to the issuer's audit committee and that related to accounts or disclosures that were material to the financial statements. In these instances, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. These instances of non-compliance do not necessarily mean that other critical audit matters should have been communicated in the auditor's report.

- In one of 11 audits reviewed, the firm did not file its report on Form AP by the relevant deadline. In this instance, the firm was non-compliant with PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants.*

- In one of 11 audits reviewed, the firm's report on Form AP contained inaccurate information related to the participation in the audit by certain other accounting firms. In this instance, the firm was non-compliant with PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

- In one of 11 audits reviewed, the firm did not make a required communication to the issuer's audit committee related to the potential effects of the relationships that, as of the date of the firm's annual communication, may have been reasonably thought to bear on the independence of the firm. In this instance, the firm was non-compliant with PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence.*

# PART II: OBSERVATIONS RELATED TO QUALITY CONTROL

Part II of our report discusses criticisms of, and potential defects in, the firm's system of quality control.

We include deficiencies in Part II if an analysis of the inspection results, including the results of the reviews of individual audits, indicates that the firm's system of quality control does not provide reasonable assurance that firm personnel will comply with applicable professional standards and requirements. Generally, the report's description of quality control criticisms is based on observations from our inspection procedures.

This report does not reflect changes or improvements to the firm's system of quality control that the firm may have made subsequent to the period covered by our inspection. The Board does consider such changes or improvements in assessing whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

When we issue our reports, we do not make public criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified. If a firm does not address to the Board's satisfaction any criticism of, or potential defect in, the firm's system of quality control within 12 months after the issuance of our report, we will make public any such deficiency.

# APPENDIX A: FIRM'S RESPONSE TO THE DRAFT INSPECTION REPORT

Pursuant to Section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the firm provided a written response to a draft of this report. Pursuant to Section 104(f) of the Act and PCAOB Rule 4007(b), the firm's response, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available.

In addition, pursuant to Section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

Baker Tilly US, LLP
205 N Michigan Ave, 28th Fl
Chicago, IL 60601-5927
United States of America

T: +1 (312) 729 8000
F: +1 (312) 729 8199

bakertilly.com

September 13, 2022

Mr. George Botic, Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006

**Re: Response to Part I of the Draft Report on the 2021 Inspection of Baker Tilly US, LLP**

Dear Mr. Botic:

We appreciate the opportunity to provide our response to Part I of the Public Company Accounting Oversight Board's (the PCAOB) Draft Report on the 2021 Inspection of Baker Tilly US, LLP (the Draft Report).

We have evaluated the matters set forth in Part I of the Draft Report and have taken actions appropriate under PCAOB rules and auditing standards, including, where applicable, AS 2901, *Consideration of Omitted Procedures After the Report Date* and AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.*

We are committed to advancing audit quality, and the work of the PCAOB and its staff provides valuable insight to our quality improvement process. We look forward to continuing to collaborate with the PCAOB to pursue our shared objectives.

Sincerely,

Baker Tilly US, LLP

BAKER TILLY US, LLP