

# Inspections Overview

---

Tim Sikes & Khalilah Imperatrice  
Division of Registration and Inspections  
October 26, 2023

# DISCLAIMER

The views we express are our own and do not necessarily reflect the views of the Board as a whole, any individual Board members, or other staff.

This slide intentionally left blank

This slide intentionally left blank

# 2022 COMMON DEFICIENCIES

Areas of common deficiencies in 2022 inspections:

- Internal Controls over Financial Reporting
- Revenue and Related Accounts
- Accounting Estimates

# AUDIT COMMITTEE COMMUNICATIONS REQUIREMENTS

AS 1301 requires the auditor to communicate with the issuer's audit committee regarding certain matters related to the conduct of an audit and to obtain certain information from the audit committee relevant to the audit.

- The auditor should communicate the overall audit strategy, timing of the audit, and significant risks (AS 1301.09, .11)
- As part of the overall audit strategy, the auditor should communicate the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that perform audit procedures in the current audit (AS 1301.10)
- The auditor should communicate the significant accounting policies and practices, critical accounting policies and practices, critical accounting estimates, and significant and unusual transactions (AS 1301.12)

This slide intentionally left blank

# FRAUD PROCEDURES REQUIREMENTS

The auditor is responsible to plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud

- *AS 2401, Consideration of Fraud in a Financial Statement Audit*
- *Paragraphs .14 and .15 of AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
- *Paragraphs .52 through .85 of AS 2110, The Auditor's Responses to the Risks of Material Misstatement*



# FRAUD PROCEDURES REQUIREMENTS (CONT'D)

- Identify fraud risk factors
  - Fraud risk factors are events or conditions indicating:
    - Incentive or pressure to perpetrate fraud
    - Opportunity to carry out the fraud
    - An attitude or rationalization that justify the fraudulent action
- Assess fraud risk factors
- Inquire
- Perform analytical procedures
- Respond to assessed fraud risk factors
- Communicate where applicable
- Document

# FRAUD PROCEDURES REQUIREMENTS (CONT'D)

Audit procedures performed to specifically address the risk of management override of controls (AS 2401.57 through .67A)

- Examine journal entries and other adjustments for evidence of possible material misstatement due to fraud
- Review accounting estimates for biases that could result in material misstatement due to fraud
- Evaluate whether the business purpose for significant unusual transactions indicates that the transactions may have been entered into to engage fraud

# JOURNAL ENTRY TESTING REQUIREMENTS

Examine journal entries and other adjustments for evidence of possible material misstatement due to fraud:

- Obtain an understanding of the entity's financial reporting process and the controls over journal entries and other adjustments
- Identify and select journal entries and other adjustments for testing
- Determine the timing of the testing
- Inquire of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments

This slide intentionally left blank

# INDEPENDENCE REQUIREMENTS

## Rule 3520, *Auditor Independence*

- A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period
- Rule 3520 requires the audit firm to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws

# INDEPENDENCE REQUIREMENTS (CONT'D)

## Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*

- When seeking audit committee pre-approval to perform for an issuer audit client any permissible tax service, the public accounting firm shall:
  - Describe, in writing, to the audit committee of the issuer certain aspects pertaining to the tax service
  - Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm
  - Document the substance of its discussion with the audit committee of the issuer

# INDEPENDENCE REQUIREMENTS (CONT'D)

## Rule 3526, *Communication with Audit Committees Concerning Independence*

- Prior to accepting an initial engagement, the public accounting firm must describe and discuss certain aspects with the audit committee and document the substance of its discussion, including:
  - Describe, in writing, to the audit committee of the potential audit client, all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit client or persons in financial reporting oversight roles at the potential audit client that, as of the date of the communication, may reasonably be thought to bear on independence.
  - Discuss and document its discussion with the audit committee of the potential audit client the potential effects of the relationships described above on the independence of the registered public accounting firm, should it be appointed the potential audit client's auditor.

This slide intentionally left blank



# GOOD PRACTICES

- We identified several good practices in our recent inspections that may influence overall audit quality
- A good practice could be a procedure, technique, or methodology that is appropriately comprehensive and suitably designed in relation to an audit firm's size, and the nature and complexity of the audit firm's practice that may contribute to the quality of audit services



# GOOD PRACTICES – AUDIT COMMITTEE COMMUNICATIONS

Good practices for required communications to the audit committee included new or revised templates and checklists

- Relevant information in these templates and checklists include:
  - Discussing all significant risks identified through its risk assessment procedures
  - Communicating the names, locations, and planned responsibilities of other independent accounting firms that performed audit procedures in an audit

# GOOD PRACTICES – FRAUD PROCEDURES AND JOURNAL ENTRY TESTING

Good practices relating to fraud procedures and journal entry testing included training, new or revised templates, and a pre-issuance review program

- Mandatory training for all partners and professional staff that discussed mandatory journal entry testing
- Mandatory training for all partners and professional staff that included content on AS 2401
- Updated mandatory journal entry testing template that included specific procedures for testing the journal entry population
- A pre-issuance review program with a focus on journal entry testing

# GOOD PRACTICES – INDEPENDENCE

Good practices relating to independence included updates to existing templates, checklists, and policies

- An audit firm updated the engagement letter template to include a signature of the issuer's audit committee chair as evidence of pre-approval for audit and non-audit services
- An audit firm included a detailed pre-approval checklist requiring the auditor to describe, assess and document services being provided
- Audit firms have put in place policies and procedures providing for sanctions for on personal independence violations

# 2023 INSPECTIONS

- Our 2023 inspection plan is informed by economic and geopolitical volatility and the potential repercussions on public company audits
- We continue to select financial statement focus areas that are generally more complex in nature, require significant judgment, and/or may be particularly susceptible to change
- Independence will remain an area of focus this year, particularly an audit firm's independence with respect to non-audit services
- For more information, please see ***Staff Priorities for 2023 Inspections***



# OTHER AREAS OF INSPECTION

We also focused on other areas when conducting our inspections including the following:

- Compliance with auditor independence requirements
- Determination and communication of critical audit matters
- Audit areas with continued deficiencies
- Compliance with existing QC standards
- Auditing of digital assets
- Responding to cyber threats
- Use of data and technology in the audit



# KEY REMINDERS

Auditors need to:

- One, know that audit quality is trending down for the second year in a row
  - PCAOB Chair Erica Williams has called those results “unacceptable” and challenged auditors to sharpen their focus and prioritize their efforts to increase audit quality and ensure investors are protected
- Two, understand the business of the public company and its environment to understand the events, conditions, and activities that might reasonably be expected to have a significant effect on the risks of material misstatement
- Three, focus on the basics of audit work such as performing core procedures like evaluating information for reliability

# KEY REMINDERS (CONT'D)

Auditors need to:

- Four, exercise professional skepticism, an attitude that includes a questioning mind, when gathering and objectively evaluating audit evidence
- Finally, consider the impact of economic sanctions on financial reporting and compliance with laws and regulations



This slide intentionally left blank

# QUESTIONS

