

# Inspections Overview

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# DISCLAIMER

Any views expressed are my own and do not necessarily reflect the views of the Board as a whole, any individual Board Member, or other staff.

# AGENDA

- Observations from 2020 Inspections.
- Outlook of 2021 Inspections.
- Examples of selected good practices.



# 2020 INSPECTION RESULTS

- In 2020, the PCAOB completed inspections of 153 audit firms and reviewed portions of 617 audits.
- We identified a reduction of deficiencies in 2020 compared to our 2019 inspections for the majority of our annually inspected audit firms.
- Our triennially inspected audit firms showed some improvements, however, deficiencies continue to remain high.



# 2020 COMMON DEFICIENCIES

Areas of common deficiencies in 2020 inspections:

- Internal Controls over Financial Reporting;
- Revenue;
- Accounting estimates;
- Inventory; and,
- Critical Audit Matters, Independence, and Form AP.

# 2020 COMMON DEFICIENCIES

## Revenue (under Topic 606)

- When determining revenue based on transfer of services provided to customers, the auditor did not evaluate whether the performance obligation for the services was satisfied before revenue was recognized.
- The auditor did not evaluate whether customer contracts met the collectability criteria required to identify a contract with a customer.
- When determining revenue based on performance obligations satisfied over time, the auditor did not obtain sufficient appropriate audit evidence from related measure of progress, including reasonableness of the total expected cost to satisfy remaining performance obligations or the accuracy of the estimated total units to be completed.

# 2020 COMMON DEFICIENCIES

## Accounting Estimates

- Auditors did not obtain sufficient appropriate audit evidence to support the assumptions used, or perform procedures to resolve any known contradictory evidence, when evaluating the reasonableness of financial statement forecasts used to determine the fair value of certain acquired assets.
- Auditors reviewed management's memorandum describing assumptions used in determining the allowance for loan loss, but did not evaluate evidence supporting certain assumption changes from the prior year, or lack of changes, when evaluating the reasonableness of such assumptions.
- Auditors did not evaluate the appropriateness of the valuation models and the reasonableness of significant assumptions used by the public company in determining the fair value of investment securities.
- Auditors did not perform sufficient procedures to resolve any known contradictory evidence when evaluating the recoverability of certain long-lived assets.

# 2020 COMMON DEFICIENCIES

## Inventory

- Auditors limited their procedures to inquiries of management and did not perform procedures to satisfy themselves as to whether the cycle count program produces results substantially the same as those that would be obtained by a count of all items each year.



# 2020 COMMON DEFICIENCIES

## Critical Audit Matters

- Auditors performed procedures to determine whether or not matters were critical audit matters but did not include in those procedures one or more matters that met the criteria as a potential critical audit matter.
- Auditors, when communicating a critical audit matter in their reports, did not accurately describe how it was addressed in the audit, or the principal considerations that led the auditor to determine that the matter was a critical audit matter.

# 2020 COMMON DEFICIENCIES

## Form AP

- Auditors did not file, or timely file, their reports on Form AP.
- An auditor's Form AP either contained inaccurate information or omitted information related to the participation in the audit by certain other accounting firms.

# OBSERVATIONS RELATED TO QUALITY CONTROL

## Independence

- Certain inspected audit firms continue to report a high rate of noncompliance by audit firm personnel reporting their financial relationships into the audit firms' monitoring systems.
- Observed deficiencies related to PCAOB Rule 3524, *Audit Committee Preapproval of Certain Tax Services*, and PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*.

# OBSERVATIONS RELATED TO QUALITY CONTROL

## Engagement Quality Review (EQR)

- Deficiencies identified through our inspection procedures in areas that require the engagement quality reviewer's evaluation; for example, in areas where the engagement team identified a significant risk, including in some cases, a fraud risk.
- Engagement quality reviewers did not maintain objectivity in performing the review as they assumed responsibilities of an engagement team member and performed audit procedures, or had served as the engagement partner during either of the two preceding audits.

# OBSERVATIONS RELATED TO QUALITY CONTROL

## Internal Monitoring

- Deficiencies observed through inspection procedures that were not identified through an audit firm's internal inspection procedures directed to the same engagements.

# GOOD PRACTICES

- We identified a number of good practices in our 2020 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 – MONITORING AND COACHING

- Certain audit firms have increased the level of real-time monitoring of audits, such as implementing pre-issuance reviews or coaching programs.
- Performing monitoring activities for audits in process enables deficiencies to be identified and remediated on a timely basis, including prior to the issuance of the auditor's report. In addition, such monitoring enables consideration of similar deficiencies that might be present on other in-process engagements.

# GOOD PRACTICES – INCREASED SUPERVISION

- Many audit firms use specialists when auditing complex estimates.
- Some auditors increased their level of oversight of the work of specialists to enhance communications in order to better understand the procedures performed and determine that such procedures are responsive to the risks identified.

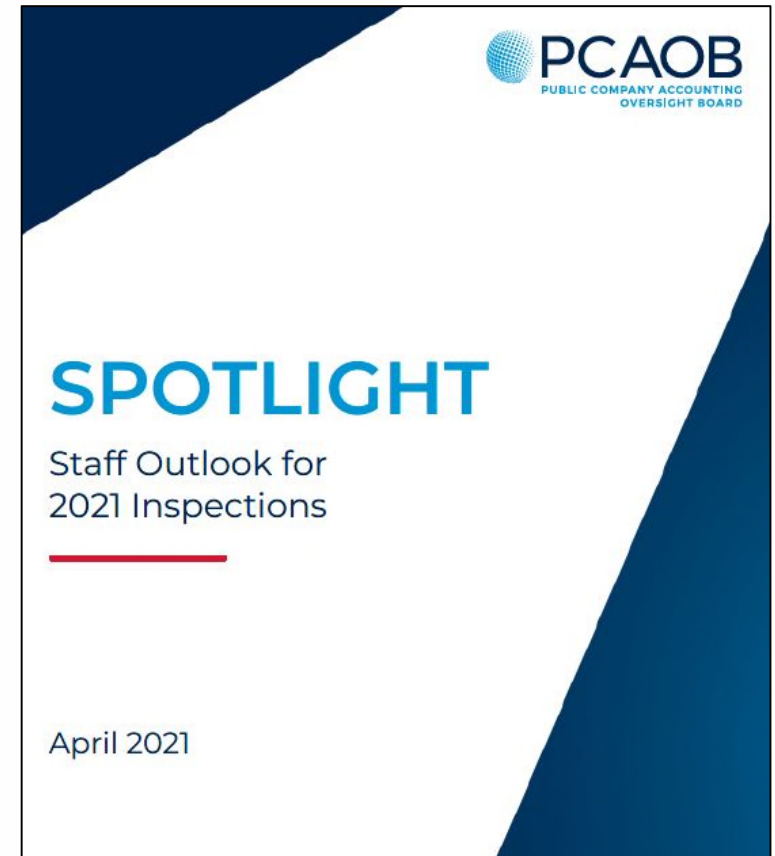


# GOOD PRACTICES – FOR SMALLER FIRMS

- Monitoring the workload and expertise of engagement quality reviewers and hiring qualified and experienced third-party engagement quality reviewers when audit firms have no expertise or insufficient expertise internally to perform an engagement quality review.
- Providing focused industry training and tailoring work programs dealing with industry-specific risks and issues, including purchasing such materials from third parties as necessary.

# 2021 INSPECTIONS

- Many of our inspection plans for this year are presented in our ***Staff Outlook for 2021 Inspections.***
- Also in April, we released a **2021 *Inspections Outlook*** resource guide for **audit committees**, which may be useful for audit committees to shape informative conversations with their auditors.



# OVERVIEW OF PRINCIPAL CHANGES

- We had to two primary objectives in making changes to our inspections:
  - Respond to the financial reporting and audit risks posed by the COVID-19 pandemic.
  - Reduce the predictability of our inspections.



# 2021 AUDIT SELECTIONS

- Focus on the effects of the pandemic on public companies' financial reporting.
- Select audits for review in industries experiencing particularly significant disruptions or elevated risks during the pandemic.
- Select more non-traditional focus areas for inspection.
- Continue to target areas that have higher risk of material misstatements or recurring audit deficiencies.

# 2021 AREAS OF FOCUS

- Inspections focused on certain financial statement items and other reporting matters that have been particularly affected by the pandemic.
- Included areas such as impairments, going concern assessments, allowance for loan losses, and the increased risk of fraud.



# HOW WE MADE OUR SELECTIONS

- Adopted an inspections approach that enhanced the overall unpredictability of inspections.
- Significantly increased the percentage of audits selected randomly.
- Encouraged firms to consistently strive for the performance of quality audits on all public companies, rather than focus on those perceived to be more likely selected for review as part of a PCAOB inspection.

# RECURRING DEFICIENCIES

- Focused on areas of continued deficiencies.
- Assessed how firms-recurring deficiencies by reviewing firm-specific methodologies and policies within its quality control system designed to identify and remediate deficiencies.
- Inspected the tools, techniques, and approaches firms use to identify the underlying causes of audit deficiencies.
- Inspected how firms evaluate and implement remedial actions to prevent deficiencies from recurring.

# 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;
  - Implementation of new auditing standards;
  - Supervision of audits involving other auditors; and
  - Auditing of digital assets.





# KEY REMINDERS

- First, auditors need to exercise due professional care and professional skepticism.



# KEY REMINDERS

- Second, auditors should identify and assess the risks of material misstatement due to error or fraud throughout the audit.
- New challenges may arise, and auditors have a responsibility to adjust their audits to respond to new or evolving risks of material misstatement, including fraud risks.



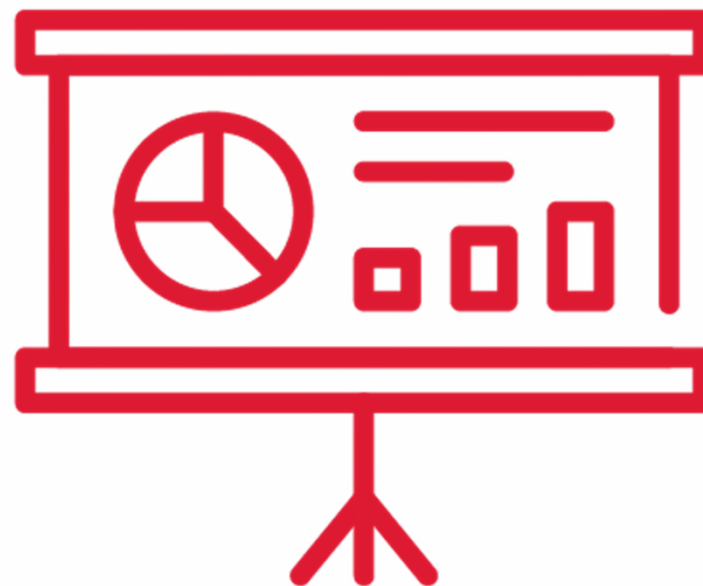
# KEY REMINDERS

- Third, auditors should establish a materiality level for the financial statements as a whole that is appropriate in light of the particular circumstances, and reevaluate as circumstances evolve.



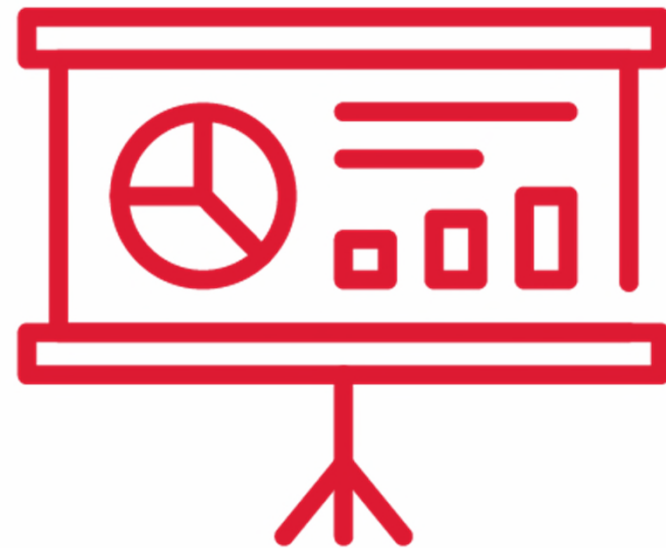
# KEY REMINDERS

- Fourth, auditors need to understand the public company's processes to develop its accounting estimates, including the methods, data, and assumptions used, and the extent to which the processes involve the use of third parties.



# KEY REMINDERS

- Fifth, auditors should take into account the nature of the public company, the nature of assigned work for each engagement team member, the risks of material misstatement, and each team member's knowledge, skill, and ability.
- Auditors should also consider the need for changes in their planned approach due to remote work environments.



# KEY REMINDERS

- Sixth, auditors need to comply with PCAOB and Securities and Exchange Commission auditor independence rules.
- Changes in the public company's and the auditor's circumstances may give rise to situations that could threaten auditor independence.



# CONCLUSION

Much of today's discussion may be found within our Spotlight documents on the PCAOB website.

<https://pcaobus.org/resources/staff-publications>

Please submit any questions or feedback you might have on this presentation to [forum@pcaobus.org](mailto:forum@pcaobus.org).

