

LEARN FROM PCAOB INSPECTIONS

Your Prescription for Better Audits
Fifth Edition

A learning experience from



GAAP
Dynamics

Foreword BY ADIGEO

2023 marks the 20th anniversary of the first inspections performed by the PCAOB. Recently, my partner Helen Munter and I were fortunate to attend a very special celebration in Washington, DC to commemorate this event. It was great to spend time with current and former Board and Staff members. It brought back many memories of our 14 years at the PCAOB and caused us to reflect on both the history and the future of the organization. We are both very proud of the organization we helped to build during our time there. We are also blessed to have worked with so many talented and passionate people.

Whenever you celebrate a milestone event such as this, it causes you to stop and think about where the organization is today and what it has accomplished. There is no question that through the work of the PCAOB, audit quality has improved over the last 20 years. We have both seen it during our time at the PCAOB and while working with auditors and firms since leaving. At the same time, the improvements made do not seem to be reflected in the more readily visible and tangible measures of audit quality – inspection findings have recently increased, and enforcement fines are at record levels.

So, what does it all mean? In reflecting on the history of the PCAOB, the changes in the Board over time cannot be ignored. The Sarbanes-Oxley Act appropriately mandated that the board members rotate over time. This has provided fresh perspectives from the new board members as they have come onto the Board. By all accounts, this has had a positive effect on the Board and its staff. But with change comes new priorities and focus. While I think that the current Board is doing a great job of communicating their priorities, the process of change always takes time and effort. Auditors should pay keen attention to the messaging coming from

the Board and Staff and recognize the key areas of focus that are communicated.

As the saying goes, the more things change, the more they stay the same. The challenge for the PCAOB staff when priorities change is to stick to the mandate of the PCAOB's mission, and in doing so continue to ask the same question we asked ourselves every day for 14 years – How are my actions going to improve audit quality at XXX firm? From our own personal experience, there is not always an easy answer to that question.

While we understand that going through an inspection is a difficult and stressful process, in our experience, auditors have embraced the objective of the inspections program and are focused on improving audit quality. However, in the heat of the moment, it is sometimes difficult to see how all the questions, challenges, and findings in an inspection are going to result in a positive improvement in audit quality. We recommend that the next time you are inspected, step back from the process and try to have a conversation with the Staff and challenge yourselves and them as to how the inspection and any findings will serve to improve the quality of your audits.

Congratulations to Mike and the entire GAAP Dynamics team on a book well written – read it with care, and it can really help you and your practice – and may even save you from a dreaded comment form!

John Fiebig
President, ADIGEO
Consulting



ADIGEO

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Preface

What does audit quality have to do with the American dream?

Erica Williams explained it like this¹: “Quality audits bolster investor confidence and help make our capital markets the envy of the world. Whether it’s workers saving for retirement, parents saving to put their kids through college, or anyone who depends on the soundness of our capital markets to invest and build their own version of the American dream - quality audits protect people.”

As the Chair of the Public Company Accounting Oversight Board (PCAOB), the independent audit watchdog, she should know! Established by Congress over 20 years ago as part of the Sarbanes-Oxley Act, the PCAOB oversees the audits of public companies in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

“When I challenge you to uphold the highest standards in audit quality, it is with their families, their savings, and their futures in mind. I urge you to keep them in mind as well. Resist complacency, sharpen your focus and meet your responsibility to verify the honesty our system depends on with a vigilance that is worthy of their trust.”

The PCAOB has four primary duties:

- 1 Register public accounting firms that audit issuers and SEC-registered brokers and dealers.
- 2 Set auditing and related attestation, quality control, ethics, and independence standards.
- 3 Inspect registered public accounting firms’ audits and quality control systems.
- 4 Investigate and discipline firms and auditors for violations of specified laws, rules, or professional standards.



Our eBook focuses on PCAOB inspections of registered accounting firms. The purpose of these inspections is to accurately assess, drive improvement in, and communicate audit quality. Their inspections are designed to review portions of selected audits of public companies and evaluate elements of a firm's system of quality control. Any deficiencies identified during the inspection are evaluated for inclusion in the firm's inspection report and, if included, are communicated within the report as follows:

Part I - Inspection Observations:

- Part I.A: Deficiencies 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(s) on the issuer's financial statements and/or ICFR.
- Part I.B: Deficiencies 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.

Part II - Observations Related to Quality Control

These observations related to criticisms of, or potential defects in, the firm's system of quality control. Part II deficiencies are not publicly disclosed when the report is first issued, but will be made public if any such deficiency is not remediated to the Board's satisfaction within 12 months after issuance of the report.

In this eBook we focus on Part I.A, deficiencies noted in the inspection reports of annually inspected firms.

PCAOB inspection reports describe audit deficiencies noted during inspections of accounting firms and are made public for all to see!

"Those who do not remember the past are condemned to repeat it."

- George Santayana

We published this eBook to help auditors:

- Learn from PCAOB inspection findings,
- Prevent recurring audit deficiencies,
- Improve audit training, and
- Strengthen the quality of their audits.





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Executive Summary

A Diagnosis of PCAOB Inspection Reports

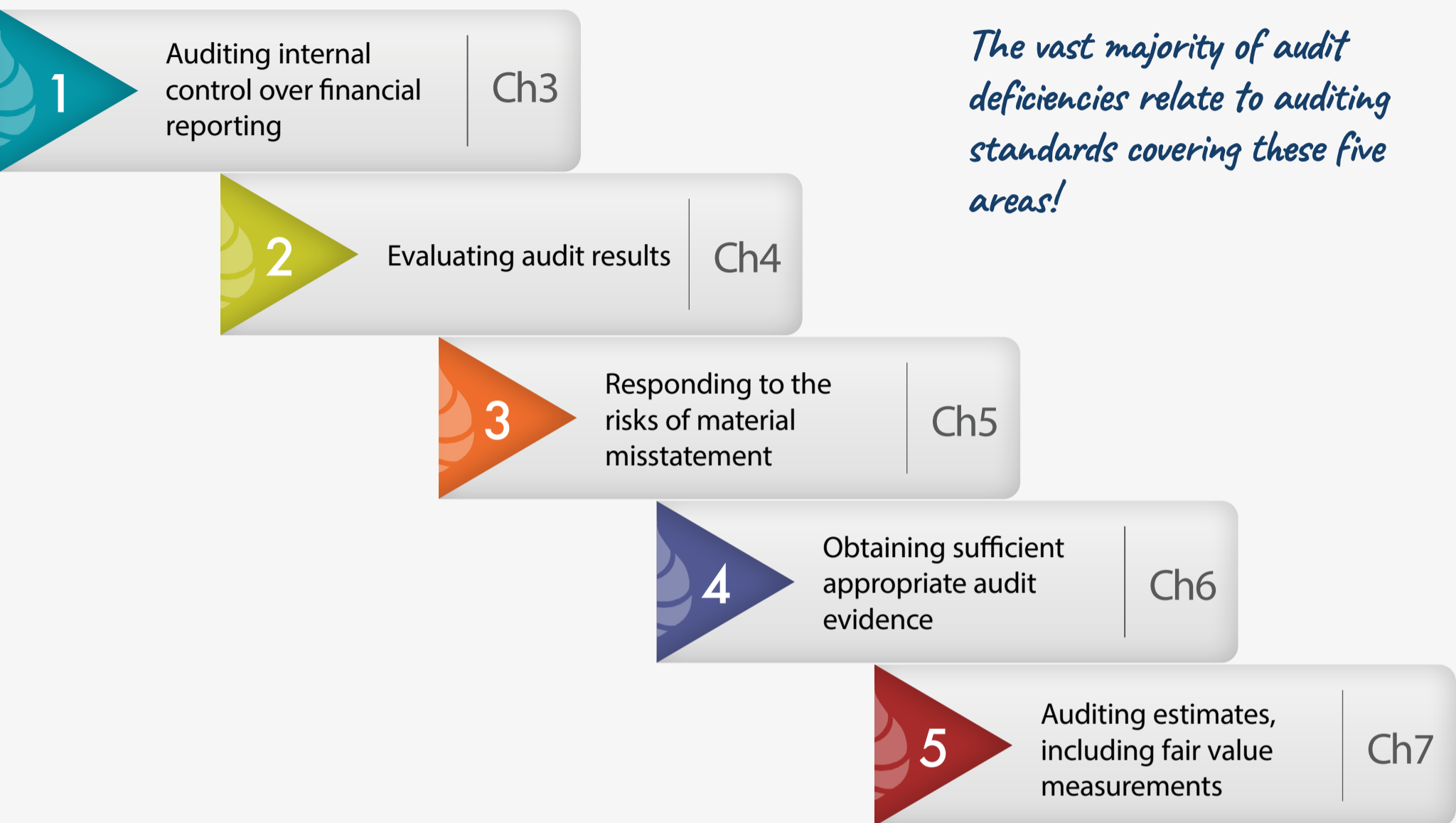


Over the past ten inspection cycles **4** out of **10** audits, on average, contain deficiencies that, in the opinion of the PCAOB, do not have sufficient audit evidence to support the opinions on the financial statements and/or ICFR.

The PCAOB has been around for more than 20 years and, over that time, audit quality has improved. However, according to Chair Williams, “Unfortunately, right now, the trendline is moving in the wrong direction.”¹

Our analysis of 2021 inspection reports for the 12 annually inspected firms ([Chapter 2](#)) shows:

- The combined audit deficiency rate is 26%, an increase of 6 percentage points from 2020.
- The difference between the combined audit deficiency rate of the Big 4 firms (16%) as compared to other annually inspected firms (39%) has grown substantially over the past few years.
- The lowest audit deficiency rate among the annually inspected firms was 4%. The highest was a whopping 76%!
- Unfortunately, the types of audit deficiencies, including the related auditing standards and audit areas, remain unchanged.



In the chapters noted above, we analyze audit deficiencies and provide recommendations to improve audit quality based on the various PCAOB auditing standards. In [Chapter 8](#), we look at deficiencies by audit area. No shock here that revenue and related accounts top the list!

As previously noted, there are other deficiencies identified during inspections that don't relate to the sufficiency or appropriateness of audit evidence supporting the opinions, but rather to other PCAOB standards and rules. These show up in the inspection reports in Parts I.B. and I.C. We summarize these deficiencies and provide other helpful reminders in [Chapter 9](#).

In the final chapter ([Chapter 10](#)), we discuss our top 5 treatment options that firms can take now to improve the quality of their audit training and, ultimately, the quality of their audits.

Without further ado, we present the fifth edition of our PCAOB eBook!

