

SPOTLIGHT

Staff Priorities for 2023 Inspections

April 2023

This document represents the views of PCAOB staff and not necessarily those of the Board. It is not a rule, policy, or statement of the Board.

CONTENTS

Overview	3
Enhancing Our Inspection Program	3
2023 Inspection Considerations	4
Risk of Fraud	4
Auditing and Accounting Risks	5
Risk Assessment and Internal Controls	7
Financial Services Specific Considerations	7
Broker-Dealer Specific Considerations	7
Digital Assets	8
M&A, Including De-SPAC Transactions	8
Use of the Work of Other Auditors	8
Quality Control	8
Talent and Its Impact on Audit Quality	9
Independence	9
Other Areas of Inspection	9
Critical Audit Matters (CAMs)	9
Cybersecurity	10
Use of Data and Technology	11

OVERVIEW

Inspecting registered public accounting firms' audits and quality control (QC) systems for compliance with applicable laws, rules, and professional standards is one of the most important tools the PCAOB has to protect investors. Inspections also provide an opportunity to inform the PCAOB's standard-setting activities by observing firms' practices. This Spotlight highlights certain priorities that the Division of Registration and Inspections ("we") has planned during 2023 inspections and is published for the benefit of audit firms, audit committees, investors, and other stakeholders.

The 2023 inspection plan primarily covers the review of 2022 fiscal year-end audits. Our inspection program is designed to review portions of the selected audits of public companies and broker-dealers and to evaluate elements of a firm's QC systems. Our 2023 inspection plan considered overall business risks present in 2022. A few of these business risks included:

- Disruptions in supply chains.
- Volatility in financial and commodity markets due to such things as inflation, interest rates, and currency fluctuations.
- The trend of deal cancellations and redemptions related to special purpose acquisition companies (SPACs).
- Mergers and acquisitions (M&A) activities, including de-SPAC transactions.
- The ongoing impact of the remote/hybrid work environment.

Global financial conditions, fiscal and monetary tightening, and economic uncertainties have increased existing financial reporting and audit risks that public companies, broker-dealers,

The PCAOB ("the Board") was created to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB oversees the audits of public companies and brokers and dealers registered with the U.S. Securities and Exchange Commission (SEC) through various oversight activities.

and their auditors needed to consider. These conditions have heightened the need for auditors to exercise professional skepticism in identifying and assessing risks of material misstatement and to plan and perform audit procedures in response to their assessments of the risks of material misstatement and fraud in the financial statements.

ENHANCING OUR INSPECTION PROGRAM

The Board's strategic plan includes a goal to enhance its inspection program. In 2023, one enhancement is the expansion of the number of public company audits we select to review. Each year, several factors influence the number of public company and broker-dealer audits that we select for inspection, including prior inspection results and the emerging risks pertaining to a particular audit firm or industry.

In 2023, we will continue to apply an approach to selecting audits of public companies and broker-dealers where some audits are selected based on risk and some audits are selected randomly. Our approach emphasizes audits of:

- Public companies in industries and sectors potentially impacted by uncertainties and volatility in the economic and geopolitical environment.

- Fortune 100 companies.
- Public companies with a sizable or volatile market capitalization.
- Public companies or broker-dealers with material or significant digital asset activities.
- Public companies engaging in M&A activities, including de-SPAC transactions.
- Broker-dealers that conduct business with customers including those that file compliance reports (many of whom typically hold customer funds and maintain control over the custody of customer securities) and others that provide customers with various investment opportunities, such as introducing brokers.

We will expand the number of audits we will review for certain annual firms. For approximately 90% of the selected audits, we plan to perform a traditional review – which is typically over two to three financial statement focus areas – and additional review procedures, as we have done in prior years. For the remaining 10%, we plan to perform tailored review procedures, where we will generally choose one focus area of the audit to review. Examples of audits that may be more suitable for these tailored review procedures include:

- Audits performed by certain offices and/or industry practices of an audit firm that had a number of prior audit deficiencies.
- Audits where our inspectors found significant engagement deficiencies in 2022 and the focus area and/or partner involved has not changed.

These enhancements to our approach will allow us to (1) address the increased audit risks emanating from the uncertainties and volatility in the economic and geopolitical environment, (2) further assess the effects of the continued remote/hybrid work environment on

compliance with our auditing standards, and (3) maintain a level of unpredictability.

2023 INSPECTION CONSIDERATIONS

The 2023 inspection plan primarily covers the review of 2022 fiscal year-end audits and takes into account the business risks that were important for auditors to consider when planning and performing audit procedures. As discussed below, in 2023 the planned inspection focus includes:

Risk of Fraud

The economic environment may have created greater opportunities, incentives, and pressures to commit fraud. We will increase our focus on fraud-related audit procedures performed in accordance with AS 2110, *Identifying and Assessing Risks of Material Misstatement*, AS 2401, *Consideration of Fraud in a Financial Statement Audit*, and AS 2405, *Illegal Acts by Clients*.

We will look at how the auditors identified and assessed risks of material misstatements due to fraud when planning and performing the audit, including how the auditors:

1. Evaluated the design of the public companies' and broker-dealers' controls that are intended to address risks of fraud, including risk of management override of controls, and how the auditor determined whether those controls have been implemented.
2. Considered how fraud could be perpetrated or concealed by presenting incomplete or inaccurate disclosures or by omitting disclosures necessary for the financial statements to be presented fairly in conformity with the applicable financial reporting framework.

3. Considered the responses from inquiries of management and the audit committee concerning whether possible illegal acts, such as potential noncompliance with sanctions and other laws or regulations, have occurred.
 4. Evaluated whether the business purpose for significant unusual transactions indicated that the transactions may have been fraudulent.
 5. Inquired about whether management has received tips and complaints regarding the public company's financial reporting (including submissions to the audit committee of concerns regarding questionable accounting or auditing matters of the company) and, if so, management's response.
2. The auditor's consideration of materiality.
 3. Responses to identified and assessed risks of material misstatement, including the risk of fraud.
 4. How the auditor exercised professional skepticism in (i) judgmental areas susceptible to management bias, including in evaluating accounting estimates and related significant assumptions in significant accounts and disclosures and (ii) developing expectations about plausible relationships among data to be analyzed.
 5. The nature and extent of audit procedures related to financial statement presentation and disclosures.
 6. The procedures auditors performed to evaluate the accounting for significant unusual transactions, including those with related parties.
 7. Whether sufficient appropriate audit evidence was obtained.

Auditing and Accounting Risks

We will continue to select financial statement focus areas that are material in amount, are complex in nature, require significant judgment, and/or may be particularly susceptible to changes in economic conditions, for both financial reporting and internal controls.

We plan to examine:

1. The auditor's identification and assessment of risks, including the procedures performed to obtain an understanding of the public company's or broker-dealer's objectives and strategies, and any related business risks that could reasonably be expected to result in material misstatement of the financial statements.

Financial Reporting and Audit Risks

The existence of the following factors may increase the risk of inaccurate, incomplete, or untimely financial information and may have required changes to the audit procedures:

- Unreasonable assumptions and models used to value complex financial instruments and accounting estimates (e.g., derivatives).
- Increased volatility in financial and commodity markets due to fluctuations in interest rates and inflationary trends.
- Unreasonable assumptions in future financial projections used to account for estimates in business combinations; asset impairment; impairment of goodwill and intangible assets; loss contingencies and valuation allowances; and revenue.
- Unreasonable assumptions affecting the timing and amount of revenue recognition due to supply chain disruptions, negative effects of COVID-19, and geopolitical conflicts.
- Complexities regarding existence and valuation of inventory, due to challenges with inventory build-up and obsolescence.
- Challenges with accounting for foreign currency and the effects of foreign currency transaction and translation adjustments on the financial statements, including the statement of cash flows, due to the rising value of the U.S. dollar at public companies with significant foreign operations.
- Financial, economic, and business uncertainties that impact the auditor's evaluation of the public company's ability to continue as a going concern, such as the public company's inability to access funds through borrowings due to violation of debt covenants or deal cancellations.
- Economic conditions that could adversely affect a public company's ability to meet certain criteria and/or assumptions, such as whether or not a public company has the ability and intent to not sell investment securities it has designated as "held-to-maturity."
- Complexities in the public company's activities that may impact disclosures regarding (1) contingent liabilities, (2) changes in classification of financial instruments between level 2 and level 3, (3) concentrations of credit risk, and (4) related party transactions that may result in omitted, incomplete, or inaccurate disclosures.

Risk Assessment and Internal Controls

During our review, we will evaluate the auditor's procedures to (1) design and implement overall responses that address risks of material misstatement, (2) understand, identify, and test relevant controls, and (3) modify the audit approach based on identified control deficiencies.

We will consider the auditor's response to uncertainties in the economic and geopolitical environment that may cause modifications to the public company's or broker-dealer's operating structure and business processes that may affect its flow of transactions, financial reporting processes, and the timing and operation of related controls, including information technology and review controls.

We will also consider the auditor's response to the public company's or broker-dealer's information technology environment, which may be highly complex (e.g., multiple information technology systems, off-shore central data centers) and which may impact the execution of audit procedures performed.

Financial Services Specific Considerations

Interest rates, inflation, and uncertainty and volatility in the digital assets markets, among other things, have resulted in increased risks to the financial services sector. These risks require significant management and auditor consideration. For example, ongoing changes in interest rates can have a material effect on a company's liquidity position, future income and expenses, valuation of investments in securities, ability to meet margin requirements, ability to meet long-term debt obligations, and ability to continue as a going concern.

We plan to continue selecting audits of public companies in the financial services sector potentially impacted by these risks. Our reviews will place an emphasis on audit areas that are particularly sensitive to these risks such as the auditor's:

- Risk assessment procedures, including whether the auditor has obtained an understanding of the company and its business, including internal and external factors, such as inflation, rising interest rates, and access to capital. This will also include whether the auditor revised its risk assessment during the audit for significant emerging factors;
- Responses to risks of material misstatement, including whether the engagement team involved a specialist, or enhanced supervision and review of the engagement for complex areas;
- Procedures over disclosures, including those pertaining to liquidity risks and uncertainties; and
- Evaluation of going concern, subsequent events, critical audit matters, or emphasis of matter paragraphs that may be applicable for the auditor's report.

Broker-Dealer Specific Considerations

We plan to continue to understand how the auditor addressed the risk of fraud, including the misappropriation of customer assets. We will place an emphasis on the audit firm's procedures relating to revenue identified as having a significant risk, internal controls over compliance with the customer protection rules, and review procedures where broker-dealers have filed an exemption report with respect to such rules.

Digital Assets

Digital asset activity is increasing and presents unique risks, including potential fraud risks due to volatility and lack of regulation, which requires an appropriate risk assessment and audit response. Audit firms may not have staff with the expertise to identify and assess risks related to digital assets and may not appropriately tailor their audit procedures to address these risks.

In 2023, we will continue to select 2022 fiscal year-end audits of identified public companies and broker-dealers with material digital assets. In addition, our target team will complete review procedures on selected audits of identified public companies with material digital assets. This supplemental work will also provide further opportunities to consider an audit firm's policies and procedures, including training, consultations, and the development of audit tools and techniques specific to digital assets.

M&A, Including De-SPAC Transactions

While the volatile financial markets and rising interest rates in 2022 made it less favorable for public companies to finance M&A activities, the value of M&A transactions in certain industries and sectors, such as information technology, have been sizeable, requiring continued monitoring.

For these M&A transactions (including de-SPACs), we will evaluate the auditor's work on the following: (1) valuation and accounting of financial instruments using complex valuation models, (2) business combinations including reverse mergers, (3) internal control over financial reporting, (4) financial statement presentation and disclosure, (5) significant equity or debt restructuring, and (6) the entity's ability to continue as a going concern.

Target Team's 2023 Topics

We established a target team in 2019 to execute in-depth reviews across audit firms using information gathering inspection procedures that extended beyond traditional inspection procedures. During 2023, the target team will focus on audits of public companies that include risks related to digital assets, first year audits, multi-location audits, and significant or unusual events or transactions.

Use of the Work of Other Auditors

Various challenges may have existed for auditors in the use of the work of other auditors, including a remote/hybrid environment, restrictions on travel due to on-going effects of COVID-19, and/or geopolitical instability.

We will place particular emphasis on understanding (1) how other auditors were used (including, but not limited to, those in Russia, Belarus, and Ukraine), (2) how lead auditors may have modified their audit approach, (3) whether the use of other auditors in multi-location audits was modified due to restrictions on travel, and (4) the lead auditor's supervision of the activities of other auditors.

Quality Control

Effective QC systems are necessary for the performance of consistent high-quality audits and to prevent audit deficiencies. We have observed increased audit quality where firms have placed emphasis on the design and operation of their QC systems. We will continue to perform QC procedures, including assessing

firm compliance with existing PCAOB QC standards, primarily through inquiry, review of public company and broker-dealer audits, and inspection of certain audit firm documentation. In addition to our planned inspection procedures, we will place emphasis on the audit firm's hiring challenges (which were affected by the "great resignation") and independence, which is a recurring deficiency.

Talent and Its Impact on Audit Quality

Audit firms continued to address hiring challenges throughout 2022 by promoting internally and hiring both junior and experienced staff to fill vacancies, including those at senior levels. The relative percentage of staff who received their onboarding, training, and professional development exclusively or primarily in a remote work environment, and who have performed audits exclusively or primarily in a remote work environment, continued to increase.

We will review and test the policies and procedures the audit firms have implemented to hire professionals that possess characteristics to enable them to perform competently. In addition, we will seek to understand the audit firms' policies around supervision of the engagement team members, as well as by the audit firms' shared service centers or designated centers of excellence. We will also consider whether deficiencies identified during reviews of selected audits and focus areas are indicative of deficiencies in an audit firm's QC system relative to areas such as supervision and review and personnel management. We will continue to monitor whether adjustments in our inspection procedures are necessary to address risks related to auditing in a remote/hybrid environment.

Independence

Given the importance of auditor independence to the public's trust in the quality of audit services, and the historical deficiencies

identified, independence will remain a priority in 2023 inspections. We will:

- Understand and assess an audit firm's monitoring of independence throughout the audit and professional engagement period – including the audit firm's identification and assessment of violations of its own policies and procedures – for possible QC concerns.
- Evaluate compliance with the independence rules for permissible, significant non-audit services, and their preapproval, including PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*.
- Review audit firms' communications with audit committees concerning independence.
- Review the audit firms' responses to independence related QC concerns in past inspections (e.g., high rates of exceptions noted by the audit firms' personal independence compliance testing).
- Increase our attention to evaluating an audit firm's policies and procedures over independence, including with respect to providing non-audit services.
- Monitor the creation of alternative practice structures by certain firms and related private equity investment groups, and how these firms manage risks related to independence.

Other Areas of Inspection

Critical Audit Matters (CAMs)

CAM communications are intended to inform investors and other financial statement users about matters that require especially challenging, subjective, or complex auditor judgement, and the auditor's response to those matters. The effects of rapidly changing macroeconomic environment may be relevant

to an auditor's determination of whether a matter is a CAM and if so, may also be relevant to the auditor's communication of that CAM. In 2023, we will continue to focus on audit firms' compliance with the requirements for CAMs, particularly among triennially inspected firms that will undergo their first inspection since the implementation of CAMs.

Cybersecurity

Increased reliance on technology has posed a greater risk of cybersecurity attacks to public companies and broker-dealers, including

those with multinational operations and those in certain industries such as financial institutions and utility companies. For audits selected for review where a cyber incident has been identified, we will review the audit firm's response, including whether the auditor assessed the likelihood and magnitude of potential misstatement and how it may have modified its audit approach. In addition, we will review any new or modified firm policies and procedures supporting the audit firm's own cybersecurity program.

Reminders for Auditors

1. Understand the business of the public company or broker-dealer 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.
2. Understand the potential for material misstatement due to fraud.
3. Focus on the basics of audit work such as performing core procedures like evaluating information for reliability.
4. When using information produced by a public company or broker-dealer as audit evidence, evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to (1) test the accuracy and completeness of the information or test the controls over the accuracy and completeness of that information and (2) evaluate whether the information is sufficiently precise and detailed for purposes of the audit.
5. Exercise professional skepticism, an attitude that includes a questioning mind, when gathering and objectively evaluating audit evidence.
6. Consider the impact of economic sanctions on financial reporting and compliance with laws and regulations.
7. Consider whether a cybersecurity-related incident impacting financial reporting occurred at the public company or broker-dealer that may require modification to the planned audit approach.
8. Perform procedures for the purpose of ascertaining the occurrence of subsequent events that may require adjustment to or disclosure in the financial statements (e.g., subsequent events that may affect realization of assets or the settlement of estimated liabilities that may require adjustment and/disclosure in the financial statements).

Use of Data and Technology

Given the continuing rapid pace of technological evolution in the audit of financial statements and in the audit of the effectiveness of internal control over financial reporting, we will continue to inquire about changes in the use of technology in auditing and financial reporting and obtain a more in-depth understanding of how auditors are using technology-based tools in assessing and responding to risks of material misstatement whether due to error or fraud.

We Want to Hear From You

The PCAOB strives to improve our external communications and provide information that is timely, relevant, and accessible. **We invite you to share your views on this document by filling out our survey**, which should take no more than two minutes to complete.

STAY CONNECTED TO THE PCAOB



Contact Us



Subscribe



PCAOB



@PCAOB_News