PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SPOTLIGHT

Staff Update and Preview of 2022 Inspection Observations

July 2023

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OVERVIEW

In 2022, the PCAOB advanced its investor-protection mission by inspecting 157 audit firms, reviewing portions of 710 audits (excluding its separate brokers and dealers audit inspection program). This Spotlight presents our aggregate observations from these inspections for investors and other stakeholders. We share the observations in this publication as a preview of the 2022 inspection reports that we will publish for the individual audit firms inspected.

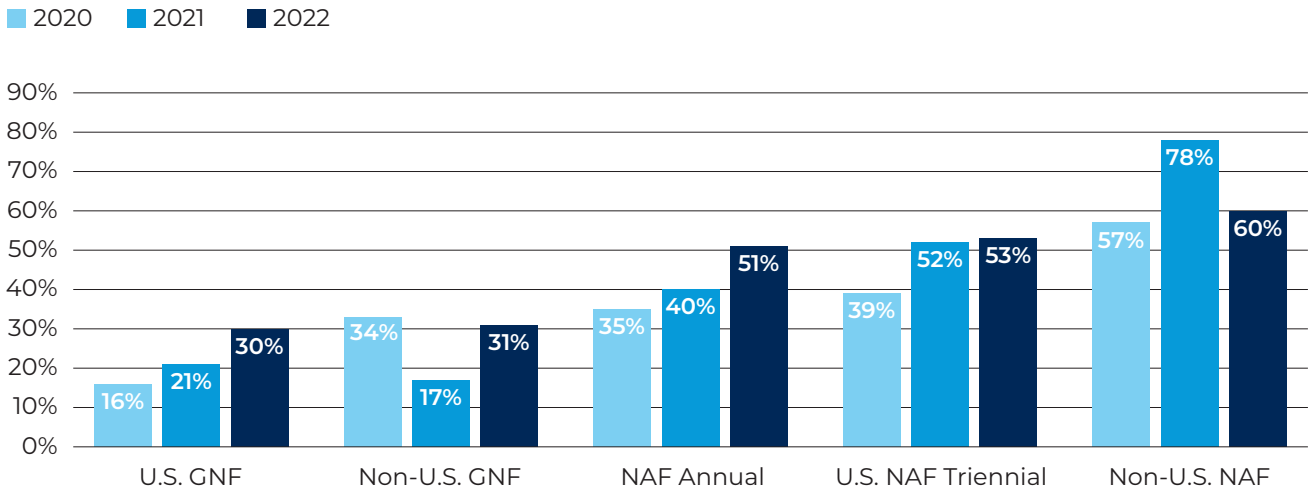
As discussed in section I, the PCAOB continued a rigorous program of inspections in 2022, including an element of selection unpredictability. Our procedures anticipated financial reporting and audit risks driven by economic conditions, particularly those related to complex accounting or judgment required from the auditor.

Key Findings

In our 2022 inspections, we observed the following:

- **Audit deficiencies rose in 2022.** In a concerning trend, the percentage of audit engagements reviewed that are expected to be included in Part I.A of an inspection report is higher in 2022, in nearly all firm categories, than in 2021. PCAOB staff expects approximately 40% of the audits reviewed will have one or more Part I.A deficiencies, up from 34% in 2021 and 29% in 2020. The most significant increase in 2022 was observed within the Global Network Firms (GNF) category of firms inspected by the PCAOB (including both U.S. and non-U.S. GNF). The following table illustrates this unsettling trend in the issuer program by firm category. Please see "Terms Used in This Spotlight" below.

Figure 1 – Part I.A Findings by Program Over Three Years



Note: The percentage represents the proportion of total engagements reviewed that are included in Part I.A of the inspection reports.

- **Noncompliance with PCAOB standards and rules rose in 2022.** The percentage of engagements reviewed that are expected to be included in Part I.B is higher than the prior year, largely due to an increase in deficiencies related to critical audit matters, audit committee communications, and audit documentation. PCAOB staff expects that approximately 46% of the audits reviewed will have one or more deficiencies discussed in Part I.B of the individual firm's inspection reports, up from 40% in 2021, and 26% in 2020. The meaning of the Part categories is discussed immediately below.
- **Audit firms can learn from good practices.** As discussed in section V, we also observed positive practices that we believe may be effective in enhancing a firm's quality control system – and audit quality generally. We encourage auditors to consider how these practices may apply to their audit engagements and to implement changes to engagement procedures proactively to enhance audit quality in the public interest and to help ensure compliance with PCAOB standards.
- **The percentage of randomly selected engagements expected to be in Part I.A is lower than the percentage expected for risk-based selections.** This trend is consistent with the prior years.

Many of the financial statement audit observations discussed in this Spotlight relate to insufficient testing of estimates and/or data and reports used to support audit conclusions. Many other observations relate to auditors' testing of controls that include a review element, specifically auditors' insufficient testing of whether such controls operated at a level of precision sufficient to prevent or detect material misstatements, a continuing challenge for many firms.

We observed a third successive year of increased engagements reviewed with at least one "comment form" (the initial communication to audit firms of observed deficiencies from our inspections). As noted in connection with Figure 1 above, we are concerned with the increase in observations that are included in Part I.A of our inspection reports. Some audits have both Part I.A and Part I.B deficiencies, and so PCAOB staff expects that approximately 61% of the 710 audits the PCAOB reviewed in 2022 will have one or more Part I.A and/or Part I.B deficiencies, up from 55% in 2021 and 44% percent in 2020.

Although we do not perform analyses to determine the root causes of the deficiencies our inspectors identify, many firms do. Certain firms have indicated that this deterioration of audit quality may in part be attributable to higher-than-normal staff turnover, use of less experienced staff in general, and the ongoing impact of COVID-19 and related remote work.

Our Mission

The PCAOB regulates the audits of public companies and SEC-registered brokers and dealers in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

Inspecting registered public accounting firms' audits and quality control systems for compliance with applicable laws, rules, and 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.

Auditors may find this publication useful as they continue to plan and perform their audits, and audit committees may also benefit from the use of this publication as a reference point when speaking with and evaluating their auditors. This information will help inform investors and other interested parties more fully about the inspection process and the matters we identify in our inspections.

Terms Used in This Spotlight

PCAOB Inspection Reports[1]

- **Part I.A** of our PCAOB inspection reports 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(s) on the issuer's financial statements and/or internal control over financial reporting (ICFR).
- **Part I.B** discusses certain deficiencies, if any, that relate to instances of noncompliance with PCAOB standards or rules other than those where the firm had not obtained sufficient appropriate audit evidence to support its opinion(s). This section does not discuss instances of potential noncompliance with U.S. Securities and Exchange Commission (SEC) rules or instances of noncompliance with PCAOB rules related to maintaining independence.
- **Part I.C** discusses instances of potential noncompliance with SEC rules or instances of noncompliance with PCAOB rules, if any, related to maintaining independence.

The PCAOB inspects brokers and dealers ("broker-dealers") registered with the SEC that are obligated to file financial statements subject to audit by a PCAOB-registered firm. This is the first year that we have included in this Spotlight certain comparable information from our separate inspections of the audits of SEC-registered broker-dealers.

PCAOB Inspection Programs

To provide additional information this year, this Spotlight will provide aggregated information by PCAOB inspection program.

- **U.S. GNF** – These firms are headquartered in the U.S. and are members of global networks through which they affiliate with firms in other countries for various business and client service purposes. Registered public accounting firms provide information about those affiliations in their annual reports on PCAOB Form 2. These U.S. firms are inspected annually.
- **Non-U.S. GNF** – These firms are headquartered outside of the U.S. and are member of global networks. Currently all these firms are inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.
- **NAF Annual** – These firms are non-affiliated firms (NAF) that are not part of a network but are inspected annually because they issue more than 100 issuer audit reports per year. Currently all NAF Annual firms are headquartered in the U.S.
- **U.S. NAF Triennial** – These firms are non-affiliated firms that are not part of a network, are headquartered in the U.S., and are inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.

[1] In May 2023 the PCAOB announced it had enhanced its inspection reports with a new section on auditor independence and a range of other improvements that increase transparency by making publicly available more information that is relevant, reliable, and useful for investors and stakeholders. See news release and further detail.

Broker-Dealer Firm Inspections

The PCAOB has performed inspections of firms that audit broker-dealers since the inception of the interim inspection program in 2011. In 2020, 2021, and 2022 we inspected 65, 50, and 50 firms, respectively. For the financial statement aspects of those inspections, we will include certain comparative information in this Spotlight. Please read our **full report** on the broker-dealer inspections, which is published each summer.

- **Non-U.S. NAF** – These firms are non-affiliated firms that are not part of a network, are headquartered outside of the U.S., and are inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.
- **Broker-Dealer** – These firms, which can also be part of an issuer inspection program as described above, perform audits of broker-dealer and are included in this Spotlight where inspection results are comparable. (See the "Broker-Dealer Firm Inspections" box for more.)

I. 2022 INSPECTIONS: OBJECTIVES AND APPROACH

During 2022, our inspection procedures (as more fully discussed in our Spotlight publication, "Staff Overview for Planned 2022 Inspections") focused on repeat problems and higher risk areas, including on anticipated financial reporting and audit risks primarily driven by:

- Increased volatility in financial and commodities markets due to fluctuations in interest rates and inflationary trends.
- Increased initial public offerings (IPOs) and merger and acquisition activities, including transactions with special purpose acquisition companies (SPACs), including de-SPACs.
- Widespread disruption in supply chains.
- Continued negative effects of the COVID-19 pandemic, especially in industries most impacted.
- Audit firm-wide risks, such as heightened degree of staff turnover and auditing in a remote environment, including the risk that auditors will not identify misstatements that could be material.

PCAOB Inspection Procedures

For a full description of what the PCAOB inspects and how those inspections are conducted, please visit our website for information on **PCAOB issuer inspection procedures** and **broker-dealer inspections**.

Target Team Focus in 2022

In 2022, the PCAOB's target team, a group of inspectors who focus on emerging audit risks and issues, focused risks related to IPOs including de-SPAC transactions, external factors that would materially affect a public company's financial statements, and use of audit firms' shared service centers (including the audit firms' designated centers of excellence and other service delivery centers). Please read our **Spotlight on the target team's observations from 2021**. The results of our 2022 and 2023 observations will be available in the Fall.

Figures 2, 3, and 4 present profile information related to our inspection programs over the most recent three-year period to inform the reader of our inspection activities. The figures show how our work was distributed across types of firms, engagements, and industries. The increase in non-U.S. GNF inspections in 2022 primarily relates to inspections that were delayed during the pandemic where the PCAOB was unable to inspect remotely. Figure 4 does not include broker-dealer.

Figure 2 – Number of Firms Inspected by Program, 2020 to 2022

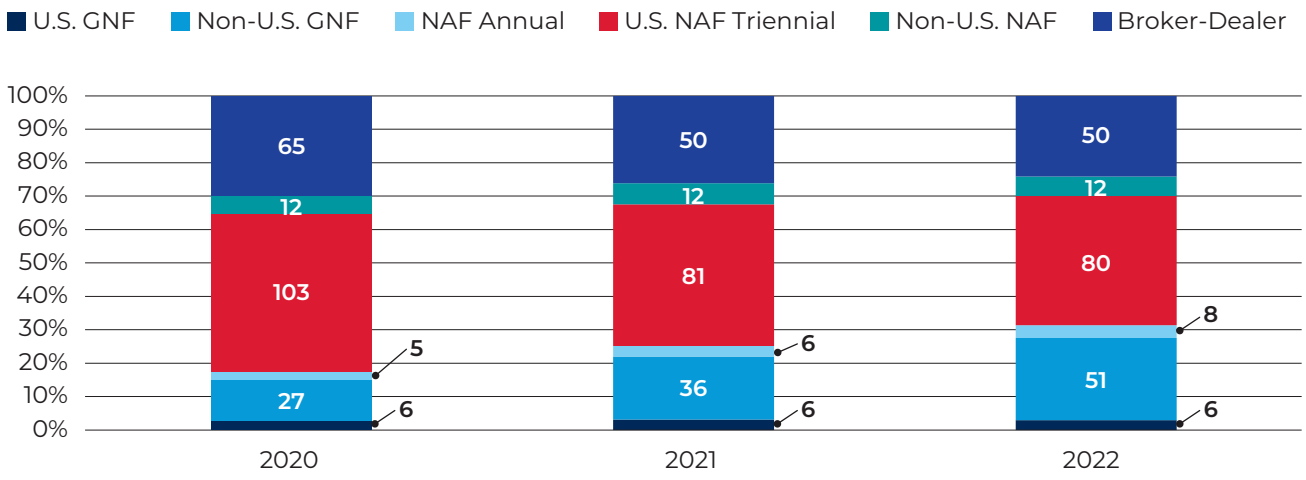


Figure 3 – Engagements Reviewed by Program, 2020 to 2022

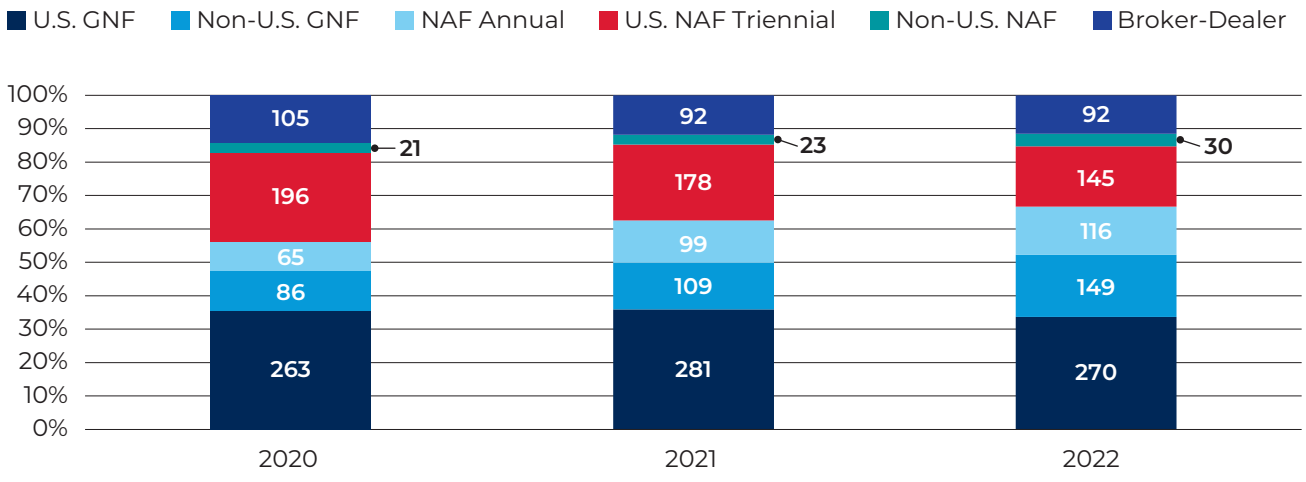
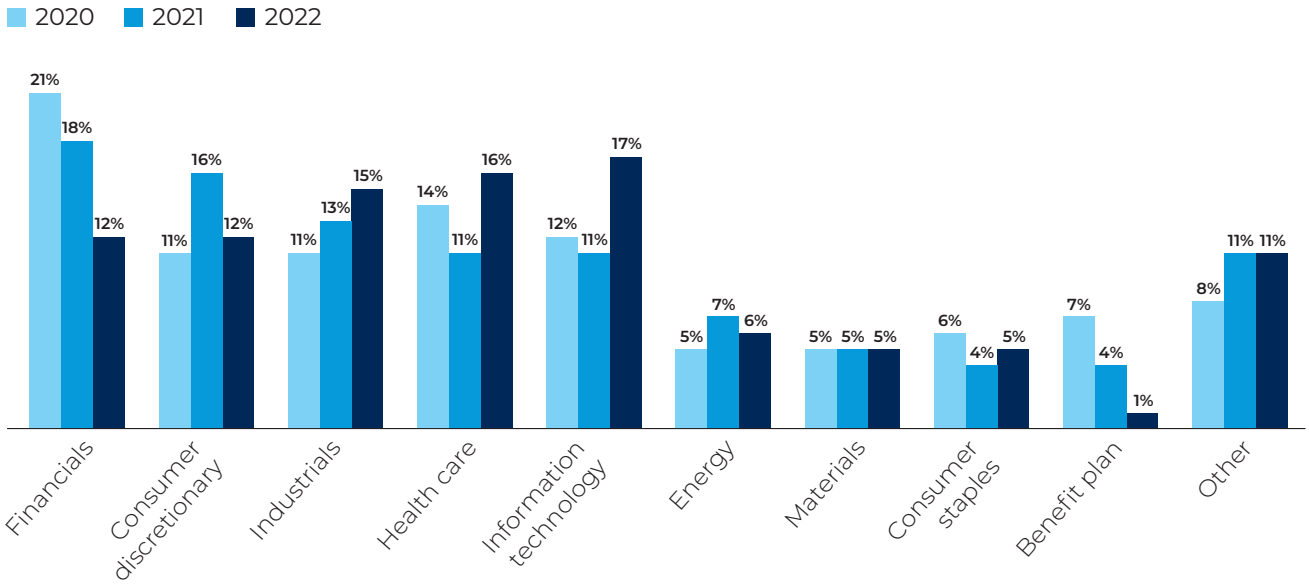
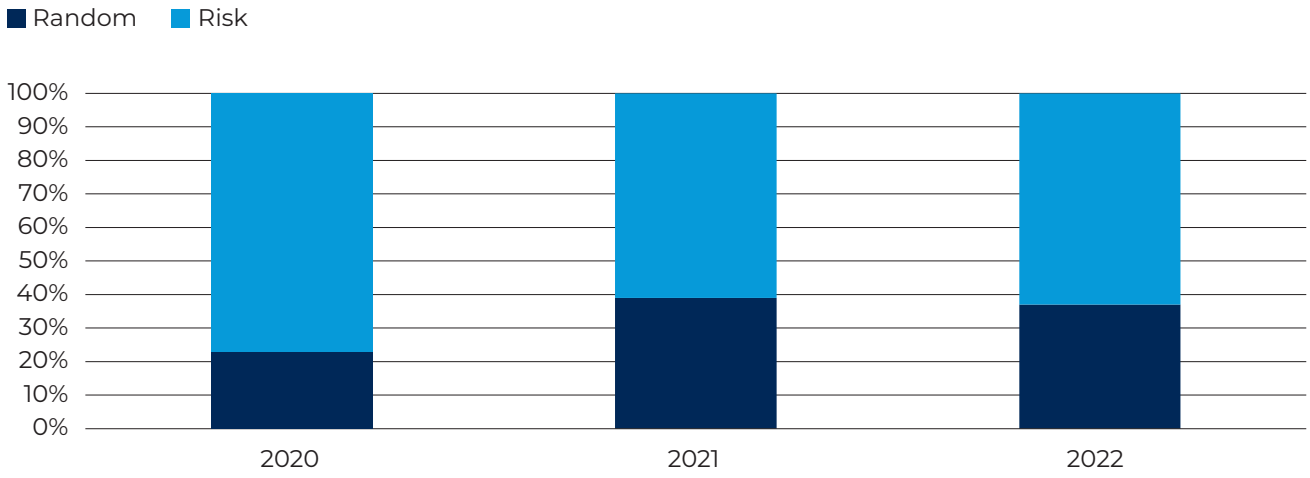


Figure 4 – Audit Engagements Selected by Industry Sector



Annually inspected firms have a larger pool of engagements subject to our inspection, and we use both a risk-based and random-based selection process to select which engagements we will review. We tailor the selection of engagements for review based on the size, nature, structure, and complexity of the audit firm, and we consider several factors when evaluating the engagements we may select for review. Those factors can include economic trends, industry, market capitalization, and prior inspection history.

Figure 5 – Selection Method for Audit Engagements (Annual Firms Only)

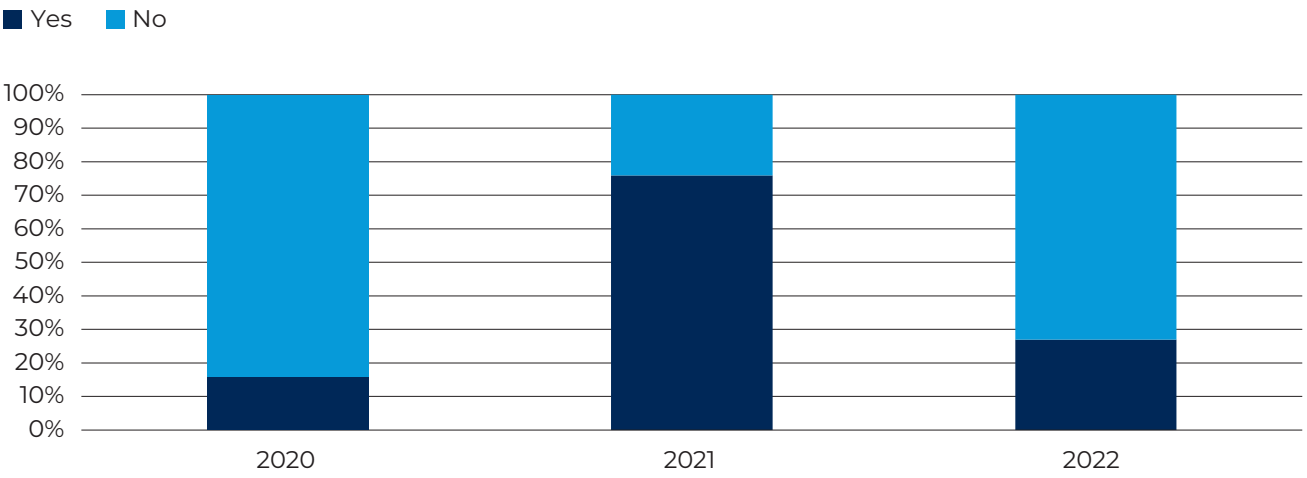


In 2022, 48% of the randomly selected engagements resulted in at least one deficiency, and we expect approximately 26% of those randomly selected engagements will be included in Part I.A. In comparison, 64% of our risk-based selections resulted in at least one deficiency, and we expect approximately 42% of those risk-based selections will be included in Part I.A.

A PCAOB inspection is not designed to review all aspects of a firm's quality control system, to review all of the firm's audits, or to identify every deficiency in the reviewed audits. 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. Audit work related to specific financial statement accounts is an important aspect of our review. The top 10 financial statement accounts included in our inspections are (1) revenue and related accounts, (2) accounts affected by business combinations, (3) inventory, (4) cash and cash equivalents, (5) investment securities, (6) long-lived assets, (7) goodwill and intangible assets, (8) accruals and other liabilities, (9) equity and equity-related transactions, and (10) debt.

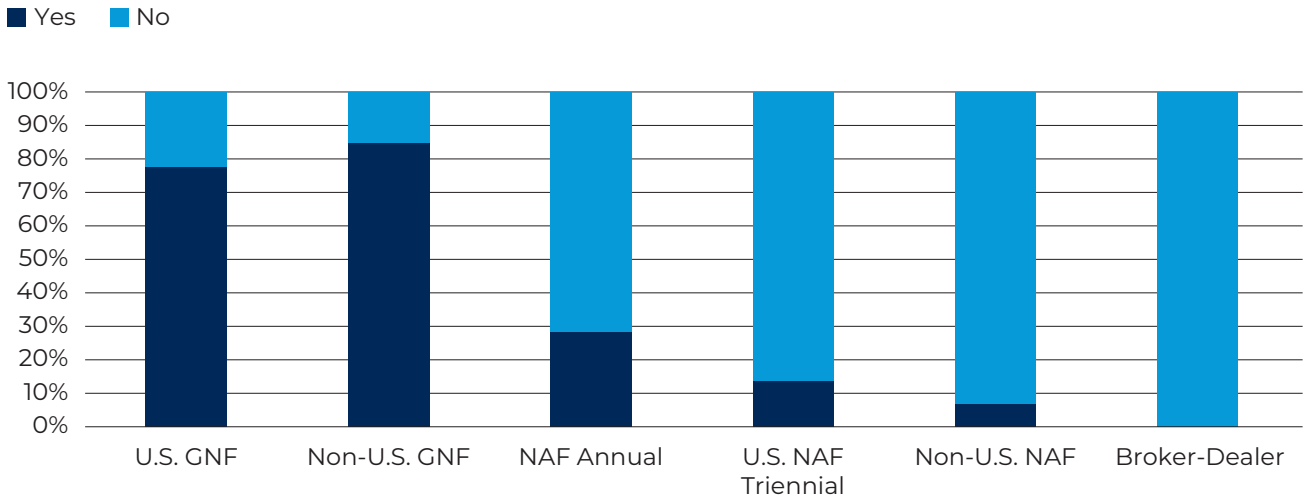
We can also select non-traditional areas. A non-traditional focus area varies by audit firm, has not been frequently reviewed in the past, is an area of audit where a firm has not had a recent quality control criticism, and is subject to a risk of material misstatement. We vary our selection of non-traditional focus areas on a number of engagements each year to observe how areas of an audit that may be less complex and more routine are performed. During 2022 and 2021, 17% and 8%, respectively, of our non-traditional focus areas resulted in a deficiency. These deficiencies are all expected to be in Part I.A of the applicable inspection report and are largely concentrated in the following areas: accruals, cash, debt, deposit liabilities, equity, and expenses.

Figure 6 – Engagement Selections With Non-Traditional Focus Areas (Annual Firms Only)



During 2022 and 2021, for the engagements we reviewed, the mix between integrated audits with ICFR opinions and non-integrated audits (which did not require an ICFR opinion) was 49% and 51% for 2022 and 47% and 53% for 2021, respectively.

Figure 7 – Engagements Subject to ICFR Opinion



Only accelerated filers that are not emerging growth companies and large accelerated filers (as defined by the SEC) are required to provide an auditor's report on ICFR. As such, Figure 7 serves as a rough proxy for the relative size of issuers the firms in each of our programs are auditing. Currently, there are no broker-dealers that are themselves issuers, although some broker-dealers are subsidiaries of issuers. Nevertheless, certain internal controls at broker-dealers may be subject to auditor testing and our review.

We review a variety of focus areas not directly related to financial statement accounts or disclosures. The top 10 are (1) compliance with the auditor's reporting model, (2) evaluation of software audit tools used on the audit, (3) Form AP compliance, (4) fraud considerations considered by the auditor and related audit response, (5) how the engagement team evaluated overall audit findings, (6) communications with the audit committee, (7) how a cybersecurity event impacted the auditor's risk assessment and related audit response, (8) independence, (9) use of other auditors, and (10) related party transactions.

Broker-Dealer Focus Areas

Our areas of inspection focus are similar for broker-dealers but also include specific requirements of a broker-dealer audit, such as supplemental information.

II. COMMON DEFICIENCIES FOUND BY 2022 INSPECTIONS

In 2022, we unfortunately continued to observe deficiencies similar to those identified in prior years. Many of these deficiencies are in areas that are inherently complex and in turn generally include greater risks of material misstatement and hence demand more attention from the auditor. The auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. As

the assessed risk of material misstatement increases, the amount of evidence that the auditor should obtain also increases.

Deficiencies in Auditing ICFR

As noted above, deficiencies in controls testing remain a common occurrence. Despite improvements observed at certain firms, we continue to observe deficiencies related to testing ICFR across firms. Common audit deficiencies in this area include:

- The auditors did not sufficiently evaluate whether controls with a review element selected for testing operated at a level of precision sufficient to prevent or detect material misstatements. In these instances, the auditors did not sufficiently evaluate the review procedures the control owners performed, including the procedure to identify items for follow-up, and the procedures to determine whether those items were appropriately addressed. This type of testing deficiency is the most common when testing management review controls. When evaluating this testing, the staff is looking, in part, at the consideration of the relationship of risk of material misstatement to the evidence obtained when performing the control testing.

- The engagement team did not perform procedures to test the accuracy and completeness of the information produced by the company and used by the auditor as the population for testing user access and change management controls. This failure impacted reliance on important reports used in other controls or in substantive testing.

- The auditors did not identify and test controls that are important to the auditor's conclusions about whether the issuer's controls sufficiently address the assessed risk of misstatement to each relevant assertion. In many cases, the auditors did not identify and test controls over the accuracy and completeness of data used by the control owner in the operation of a control.

These testing failures can be critical errors because the auditor's testing of controls is often used as the basis for reducing the nature, timing, and extent of substantive testing, also known as a control reliance approach. Therefore, any deficiencies in the testing of controls may affect the nature, timing, and extent of substantive testing to obtain sufficient appropriate audit evidence.

Deficiencies in auditing ICFR remain high and it is important that auditors continue to focus on auditor performance in these areas. Staff Audit Practice Alert No. 11 may be helpful to certain firms. An integrated audit of financial statements and ICFR benefits investors because the auditor's reports address both the audited financial statements and the effectiveness of the controls the company uses to produce its financial statements. The auditor performing this work should have a clear understanding of the business and its environment to understand the company activities that might reasonably be expected to have a risk of material misstatement.

Deficiencies in Auditing Financial Statement Areas

Figure 12 below illustrates the deficiencies we have communicated by comment form by financial statement area. The top five categories, in terms of financial statement area, remain relatively consistent over the period, and significant estimates, evidence, and/or data and reports used to support audit conclusions are often a component.

In addition to the top five categories, we have summarized our observations over cryptocurrency transactions, although material cryptocurrency transactions or holdings were not numerous at issuers whose audits were inspected.

Revenue and Related Accounts

Revenue is a frequently selected focus area in our inspections given (1) complexities often associated with revenue recognition accounting policies and practices and (2) the auditing of such policies and practices.

While we see deficiencies related to the auditing of complex contractual obligations and performance measures of revenue testing, concerningly, we most frequently identify deficiencies pertaining to basic auditing principles. Audit firms have put significant resources into training, development of practice aids and guides, and testing templates, as we have observed in their remediation responses. However, we continue to see deficiencies in fundamental auditing, such as:

- Appropriate response to a significant fraud risk.
- Sampling of transactions.
- Confirmation procedures of related receivables.
- Sufficient procedures to test presentation and disclosure.
- Sufficient or appropriate procedures to test the accuracy and completeness of data or reports produced by the company used as evidence in an audit procedure.
- Sufficient or appropriate testing of data used in a software-assisted analysis procedure and/or a sufficient evaluation of the plausibility and predictability of the relationship when performing a substantive analytical procedure.
- Sufficient evaluation of review procedures performed by a control owner when taking a controls reliance approach.

Accounting Estimates

Accounting estimates are found throughout the financial statements. By their nature, accounting estimates, including fair value measurements, generally involve subjective assumptions and measurement uncertainty, making them susceptible to management bias. Some estimates involve complex processes and methods. As a result, accounting estimates are often some of the areas of greatest risk in an audit, requiring additional audit attention and appropriate application of professional skepticism. The challenges of auditing estimates may be compounded by cognitive bias, which could lead auditors to anchor on management's estimates and inappropriately weight confirmatory over contradictory evidence.

We observed deficiencies across a broad range of financial statement accounts and transactions related to accounting estimates. Our most common observations related to business combinations and goodwill and intangible assets, including other long-lived assets. However, we also had observations related to accruals and allowances, derivatives, equity and equity-related transactions, inventory, investment securities, revenue, and in the assessment and conclusions regarding going concern.

Specifically, our observations can be described as:

- No risk assessment procedures performed for an estimate that includes a significant assumption.
- No substantive procedures beyond inquiry.
- Insufficient evaluation of significant assumptions (often a growth rate) and, if applicable, the company's intent and ability to carry out a specific course of action.
- Insufficient evaluation of significant differences and/or conclusions reached

between the work performed by a company's specialist and the auditor-engaged specialist.

- Insufficient testing of data used by an auditor-engaged specialist.

Some deficiencies relate to highly judgmental estimates, but as described above many of our observations include deficiencies in fundamental audit procedures.

Business Combinations

Business combinations, by their nature, impact many accounts and include a broad spectrum of accounting and estimates, including fair value, and many of our observations are included above under ICFR and accounting estimates. We noted instances of:

- Insufficient or no risk assessment procedures related to an acquisition and inappropriate or no basis for a conclusion that no risk exists, resulting in an inappropriate audit response, including no procedures being performed over preliminary purchase accounting.
- Insufficient procedures to evaluate whether significant financial statement disclosures are complete and accurate.
- Insufficient procedures to evaluate the relevance and reliability of a company's specialist's report.
- Insufficient evaluation of auditor-engaged specialist's work to ensure sufficient appropriate evidence has been obtained.
- Insufficient documentation related to the work performed by the auditor-engaged specialist to evaluate the reasonableness of the methods, assumptions, and inputs used to assign values to the assets acquired and liabilities assumed.
- Insufficient or inappropriate evaluation of departures from accounting standards.
- Insufficient evaluation of contradictory evidence.

Inventory

Inventory can often present a heightened risk of material misstatement due to the complexities of determining the cost of inventory and measuring inventory on-hand at a point in time. Common deficiencies identified in auditing inventory included instances where:

- Insufficient procedures were performed to test the existence of inventory, including physical count procedures where the auditor relied on the effectiveness of other controls, such as the accuracy of scales or cycle counts.
- Insufficient or inappropriate procedures were performed to test the accuracy and completeness of issuer-prepared reports used in the auditor's substantive procedures, such as quantities on-hand in excess of estimated future period demands.
- Insufficient or inappropriate procedures were performed to test conversion factors provided by a company's specialist used to determine inventory quantity.
- Insufficient procedures were performed to test that presentation and disclosure, including valuation, are in conformity with the applicable accounting standards.

Long-lived Assets

The valuation of long-lived assets requires considerable judgement and professional skepticism, and an appropriate assessment of the risks of material misstatement at the financial statement level and the assertion level. The process to assess if an impairment exists and, if necessary, to perform valuation is

often complex, including both qualitative and quantitative factors. A specialist is often used by the issuer to model a forecast of revenue, operations, or cash flows used to test for impairment and/or determine fair value.

Among other procedures, PCAOB standards require the auditor to test the accuracy and completeness of company-produced data used by the company's specialist and evaluate the relevance and reliability of data from sources external to the company that are used by the company's specialist. This may include, if there is risk of material misstatement, volumetric information, including underlying nonfinancial data and assumptions, such as those used in extractive industries. Common deficiencies identified in auditing long-lived assets include instances where:

- No or insufficient risk assessment procedures were performed to consider qualitative and/or quantitative factors, including an unsupported conclusion of no risk of material misstatement.
- Sufficient procedures were not performed to use the work of the company's specialist.
- Insufficient or inappropriate evidence was gathered to obtain reasonable assurance about whether material weaknesses existed as of the date of management's assessment.
- Insufficient substantive testing was performed because the firm's substantive procedures were designed based on a level of control reliance that was not supported.
- Insufficient procedures were performed to evaluate the public company's intent and ability, related to carrying out a specific course of action, related to an assumption.

Cryptocurrency Transactions

We continue to focus on identifying public companies that have material digital asset holdings and/or have significant activity related to digital assets. We reviewed cryptocurrency transactions on several audits that met these criteria and had findings on over 65% of the related audits we reviewed. The most common observations include the audit firm failing to:

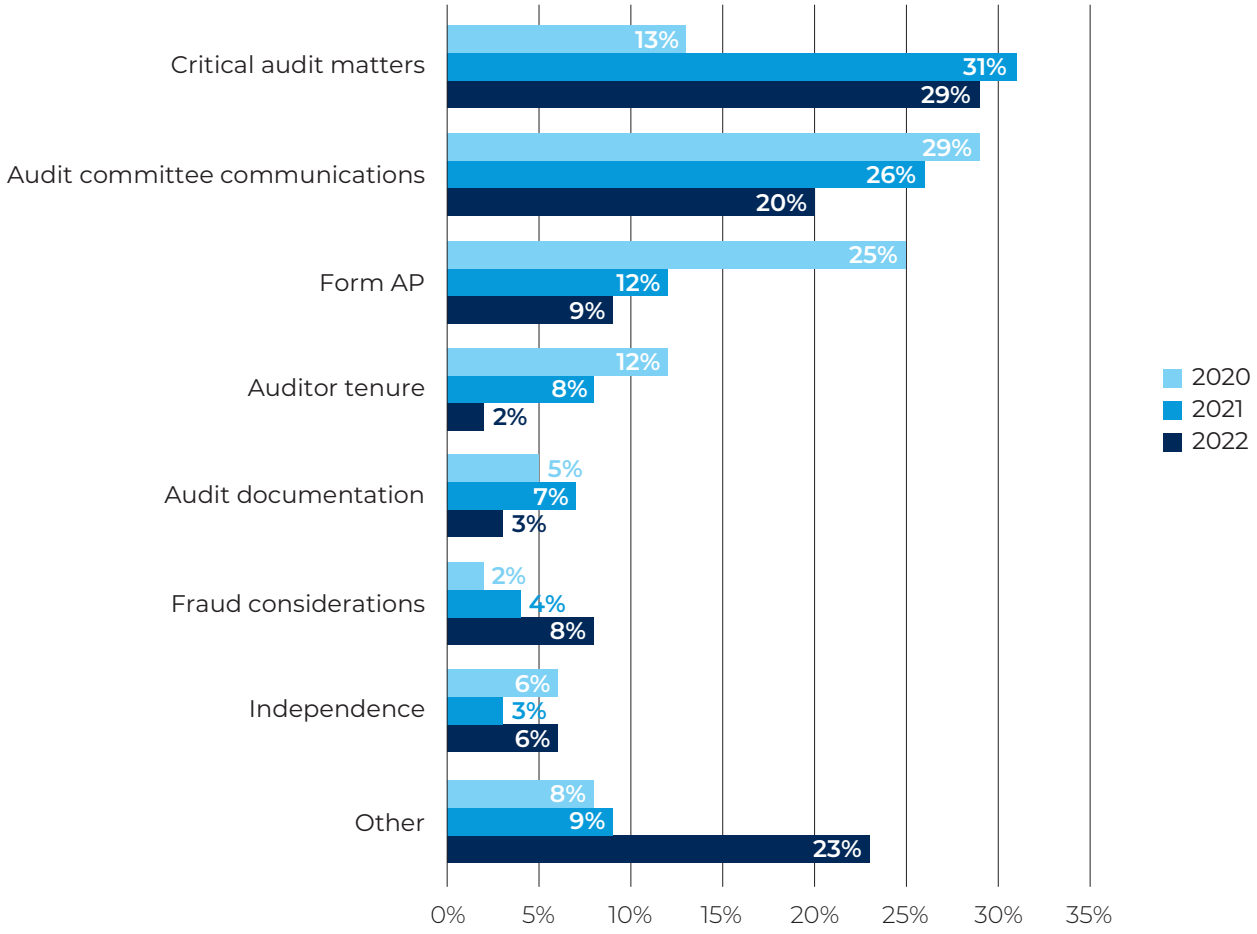
- Evaluate whether the public company's omission or inaccuracies of the disclosures of the relevant accounting framework for revenue was appropriate.
- Perform procedures to assess the appropriateness of mining revenue recognition.
- Perform procedures to evaluate whether the classification of digital assets as current was appropriate.
- Evaluate the relevance and reliability of quantity and pricing information used by the public company to recognize mining revenue and used by the auditor as audit evidence.

See our June 2023 Spotlight, "Inspection Observations Related to Public Company Audits Involving Crypto Assets."

Deficiencies Related to Other PCAOB Standards or Rules

The Rules of the Board also include a variety of topics that can be subject to our inspection activities. Figure 8 below is a summary and three-year comparison of our observations of other PCAOB standards and Rules. Our most common Part I.B deficiencies currently relate to critical audit matters but over time have been related to audit committee communications. The increase in "Other" relates to audit findings, related party, and an entity's ability to continue as a going concern.

Figure 8 – Deficiencies Related to Other PCAOB Standards and Rules



Critical Audit Matters (CAMs)

An auditor's communication of CAMs in the auditor's report is intended to inform investors and other financial statement users about any matters arising from the audit of the financial statements that were communicated or required to be communicated to the audit committee and that relate to accounts or disclosures that are material to the financial statements and involve especially challenging, subjective, or complex auditor judgment, and the auditor's response to those matters.

The deficiencies found by 2022 inspections are primarily related to instances in which auditor procedures to determine whether or not matters were CAMs did not include every matter that was 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. These instances of noncompliance do not necessarily mean that other CAMs should have been communicated in the auditor's report. In limited instances within the triennially inspected firm program, some auditors performed no procedures regarding CAMs.

Auditor Tenure

We also continue to identify deficiencies in auditor reporting of the year the auditor began serving consecutively as the public company's auditor.

Audit Committee Communications

Both the auditor and the audit committee benefit from a meaningful exchange of information throughout the audit to assist in understanding matters relevant to the audit. However, we continue to identify recurring deficiencies in the auditor's communication with the audit committee.

Deficiencies are broadly ranged across all firms and include instances where the auditor did not communicate to the public company's audit committee:

- Certain or (in limited cases) any of the required communications.
- Significant risks identified during the auditor's risk assessment procedures, including fraud risks.
- Overall audit strategy and timing of the audit.
- The auditor's evaluation of, and conclusions about, the qualitative aspects of significant accounting policies and practices of the public company's financial reporting.
- A complete list of material weaknesses identified during the audit prior to the issuance of the auditor's report.
- The auditor's evaluation of the public company's ability to continue as a going concern.
- The uncorrected and corrected misstatements identified by the auditor.
- The engagement team's evaluation of the public company's identification of, accounting for, and disclosure of its relationships and transactions with related parties.

In addition, the auditor in some instances did not provide a copy of the management representation letter to the public company's audit committee.

For the above common deficiencies, in certain cases, documentation did not exist to demonstrate that the required communications, some of which can be orally made, were made prior to the issuance of the auditor's report.

Additionally, several auditors did not inquire of the audit committee about whether the committee is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations.

Form AP

Audits serve a crucial public function in the capital markets. Form AP was adopted to provide investors and other financial statement users with information about engagement partners and accounting firms that participate in audits of public companies. The information is filed on Form AP, *Auditor Reporting of Certain Audit Participants* (Rule 3211) and is available in a searchable database on the Board's website.

Form AP took effect during 2017. For many firms, 2022 was the fifth year of execution, but basic common deficiencies continue to be observed during our inspections.

Our observations during 2022 include:

- Inaccurate information. Over 5% of the Form APs we inspected had inaccurate information. This can be the public company's name, the public company's CIK number, and information about other firms, including their name and level of participation.
- Late filings. The form is due on or before the 35th day after the date the audit report is first included in a document filed with the SEC. Registration statements have an accelerated deadline of 10 days.
- Omitted information. While not as frequent,

we also see omitted information that can include other firms that participated in the audit. For example, one firm had over a thousand Form AP filings with omitted information regarding shared service centers operated by other firms in their affiliation.

Fraud

The auditor should perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud, and designing further audit procedures. An understanding of the public company, its relationships and transactions with related parties, its environment, and its flow of transactions, including how transactions are initiated, authorized, processed, and recorded, better informs the auditor to identify fraud risks and to develop an appropriate audit response.

Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (a) recording inappropriate or unauthorized journal entries throughout the year or at period end or (b) making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidating adjustments, report combinations, and reclassifications. Accordingly, the auditor should design procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

Our observations during 2022 include:

- Auditors did not perform journal entry testing or equivalent procedures.
- Auditors did not perform sufficient procedures to test the completeness of the population used to select journal entries for testing, a fundamental audit step.
- Auditors did not consider the characteristics of potential fraudulent entries or other

Suggested Questions for the Audit Committee

In light of increased inspection findings, the following are suggested questions that audit committees may want to consider in discussions with their independent auditors.

- Has our audit engagement been inspected, and, if so, would you share the results? Were there any audit areas that required significant discussions with the PCAOB that did not result in a comment form?
- Has the engagement partner been inspected on other engagements? If so, what were the results of that inspection?
- What is the audit firm doing to address overall increased inspection findings?

The following question may encourage effective two-way communication to assist in understanding matters relevant to the audit:

- Are there any audit procedures that are unnecessarily complicated or not "straight-forward" because management is not providing clear, supportable information?

Please also read our 2023 Spotlight, "**Audit Committee Resource**."

adjustments in identifying and selecting specific journal entries and other adjustments for testing.

We have observed a growing trend of engagement teams rebutting the fraud risk related to revenue and limiting any fraud testing performed to detect management override of controls. It is important to apply a fraud lens to ensure the risk assessment is appropriately tailored to reflect the dynamic and changing business environment we face today.

III. OBSERVATIONS RELATED TO QUALITY CONTROL SYSTEMS

PCAOB inspection teams conduct quality control reviews to assess a firm's quality control system. This assessment includes evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control. Our process has evolved over the years and is scaled to each firm based on the size, nature, structure, and complexity of the audit firm. This section discusses our issuer program findings in key areas.

A firm's ability to consistently execute high-quality audits necessitates a commitment by senior firm leadership to promote and embrace integrity and audit quality (sometimes referred to as "tone at the top" or firm culture). All of our firm inspections include specific procedures related to understanding the firm's tone at the top and overall effectiveness of the quality control system. These procedures include assessing results of procedures specifically related to a firm's quality control system as well as an analysis of the deficiencies identified in individual audits.

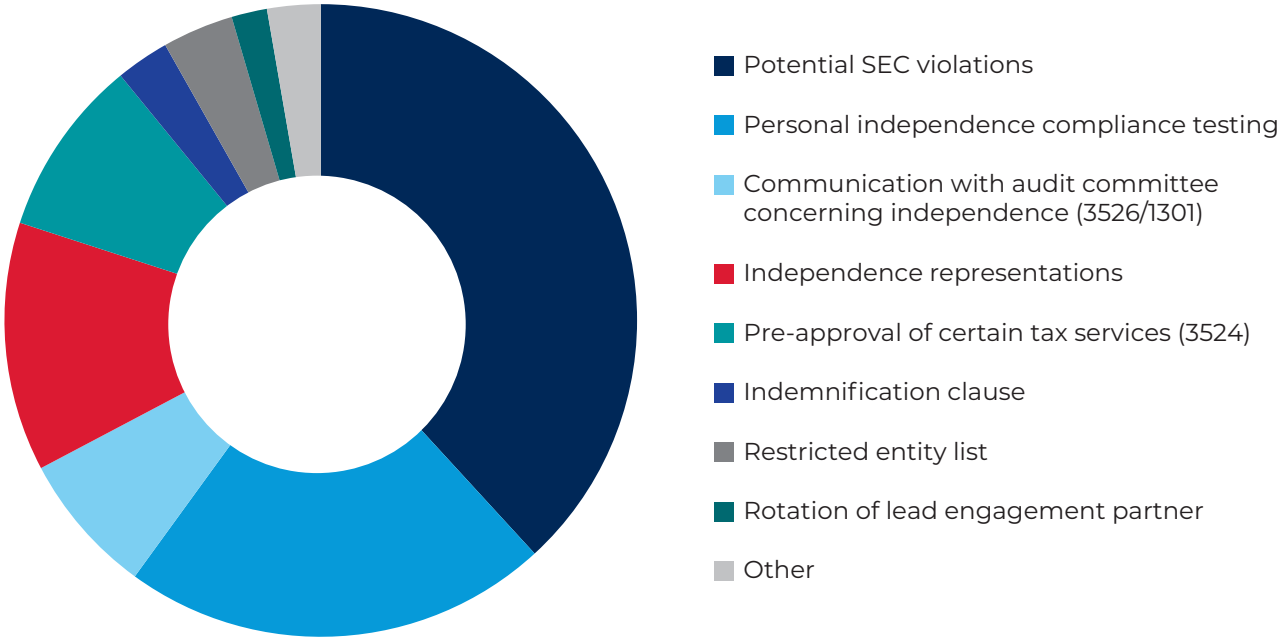
During 2022, we observed an increase in lack of compliance by firm personnel, including partners and/or senior management, with their firm's own policies and procedures. This may raise concerns about firm leadership's commitment to audit quality.

Independence

Independence is a critical element to be addressed by an audit firm's quality control system and remains an area for improvement. Figure 9 below summarizes the areas of our observations, including instances of potential noncompliance with SEC rules or instances of noncompliance with PCAOB rules, regardless of the means of identification of the deficiency (by the PCAOB or reported to us by the firm) during 2022 and is consistent, although with some increases, to 2021. Compliance by all personnel and partners with a firm's process to preserve independence with their public company clients, in fact and in appearance, is fundamental to a strong culture of integrity and audit quality.

In 2022, we continued to identify potential SEC violations of the financial relationship requirements of Rule 2-01 of SEC Regulation S-X. These potential violations, mainly with triennially inspected audit firms, include financial relationships, employment relationships, business relationships, non-audit services, contingent fees, and audit committee administration of the engagement. Some of the annually inspected firms continue to report a high rate of noncompliance by audit firm personnel reporting their financial relationships in accordance with firm policies that could be more restrictive than the SEC or PCAOB independence requirements, in the applicable audit firm's monitoring system. We also observed deficiencies related to PCAOB Rule 3524, *Audit Committee Preapproval of Certain Tax Services*.

Figure 9 – Independence-Related Comments



Engagement Quality Review

We continue to identify deficiencies in the engagement quality review (EQR) in many of our inspections. The deficiencies are not limited to a single type or size of firm, nor are they limited to a specific type of engagement. The deficiencies observed by the PCAOB range from not conducting an EQR at all, to failing to perform an EQR with due professional care.

Our observations in 2022 include:

- EQRs were not performed.
- EQRs performed with due care should have identified and resulted in the engagement teams addressing, before the firm issued its reports, the deficiencies identified by the inspection teams.
- Engagement quality reviewers did not have sufficient competence. Firms should evaluate the experience of an engagement quality reviewer. This may include, but is not limited to, looking at the individual's experience in relevant industries or with applicable accounting, auditing, and financial reporting standards. An engagement quality reviewer with the requisite experience may need to be retained outside of the firm.
- Audit documentation had no evidence identifying the documents reviewed by the engagement quality reviewer.
- Permission was granted to clients to use the audit report before the engagement quality reviewer provided and documented concurring approval.

Monitoring

Firms, based primarily on size and structure, utilize a variety of methods to ensure that the policies and procedures established by the firm are suitably designed and are being effectively applied. Monitoring involves ongoing consideration and evaluation. Many firms' documented system of quality control indicate aspects of the monitoring is performed through

internal inspection procedures, typically after release of their audit report (a post-issuance review program).

Our observations in 2022 include:

- Some firms do not have a system of quality control in place, including a set of policies and procedures to monitor to ensure that their personnel comply with professional standards applicable to their accounting and auditing practice.
- Firms have not performed internal inspection procedures, as their documented system of quality control indicates, or alternative procedures.
- The firms' internal inspection program is not suitably designed and effectively operated because, despite having previously reviewed the same areas of our inspection, deficiencies identified by the inspection team were not identified by the monitoring.

State Practice Qualification Requirements

We observed instances where the audit firm had performed audits of financial statements of public companies in jurisdictions where the audit firm was not registered or licensed to practice.

IV. TRENDS IN AREAS WITH RECURRING DEFICIENCIES, 2020 TO 2022 INSPECTIONS

In our continuing efforts to monitor areas with recurring deficiencies, we analyze comment forms. The results of our analysis illustrate continued similar reasons for the deficiencies discussed below. Firms that have repeated or persistent criticisms should thoughtfully consider the cause and make meaningful changes where appropriate. The inspection staff believes that a firm's analysis of the root cause(s), although not required, may be helpful in determining their appropriate actions to remedy repeated or persistent criticisms from our inspections. The nature and extent of the root cause process will likely differ significantly with a firm's size and structural complexity.

Substantial Progress

Remediation is a critical step in our inspections and our mission-driven efforts to protect investors and improve audit quality. Firms must demonstrate that they have made "substantial progress." A firm need not – and many firms do not – await a final inspection report before beginning to assess the root causes of deficiencies communicated and begin to develop and implement steps before our inspection report is issued. As more fully discussed in our **Staff Guidance** and our Spotlight publication, "**Additional Insights on the Remediation Process**," we consider five criteria when evaluating a firm's remediation efforts: change, relevance, design, implementation, and execution and effectiveness.

During 2022 we observed, what might be characterized broadly as an increase in failures to perform basic audit steps sufficiently or appropriately. For example, there are numerous instances where data and reports used to support audit conclusions were not sufficiently or appropriately evaluated and testing controls with a review element at an adequate level of precision continues to be a challenge.

Trends in Deficiencies in Auditing ICFR

As described in more detail above, deficiencies in auditing ICFR were related to the sufficiency and appropriateness of audit evidence supporting an audit firm's ICFR opinion. These deficiencies represent instances of non-compliance with AS 2201, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, observed in our issuer program.

The three-year data highlights certain areas in ICFR audits that have generated the most comment forms since 2020. Figure 10 illustrates those areas, and Figure 11 illustrates the financial statement audit areas to which our ICFR comments relate.

Figure 10 – Nature of ICFR Auditing Deficiencies

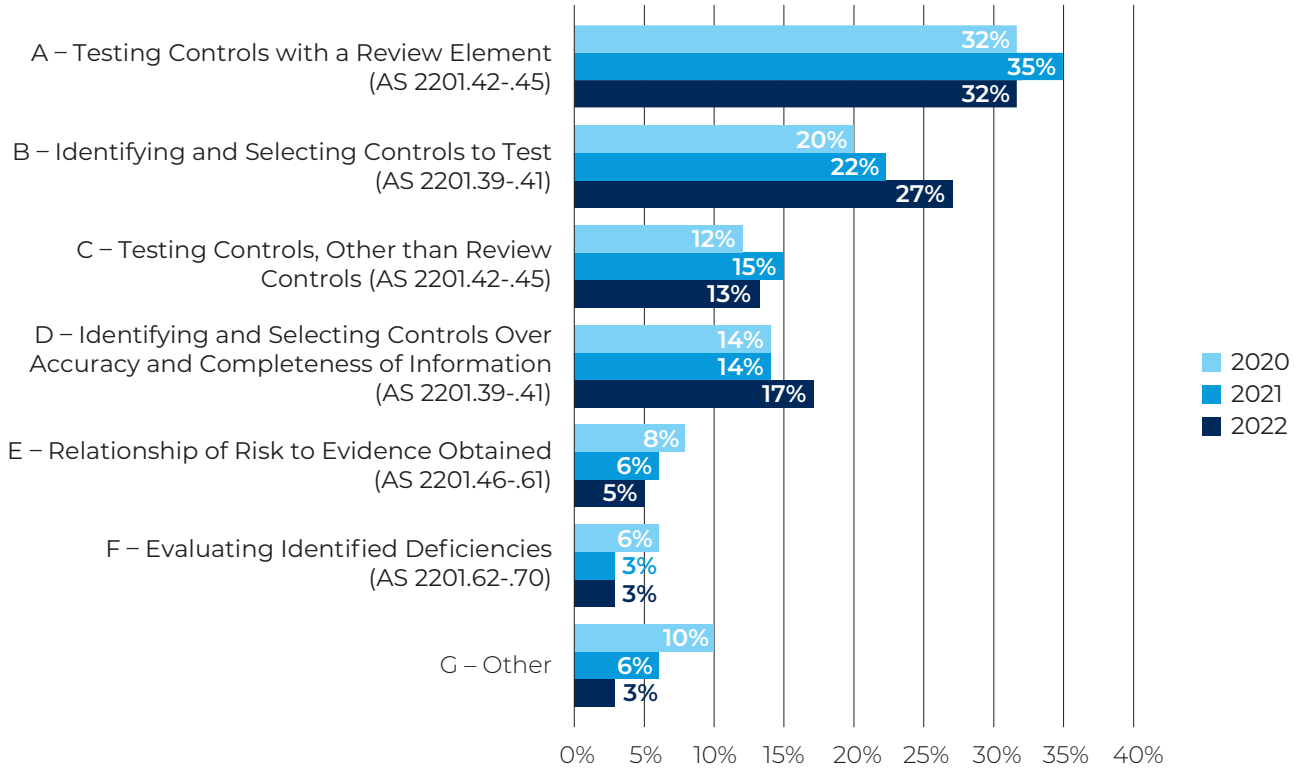
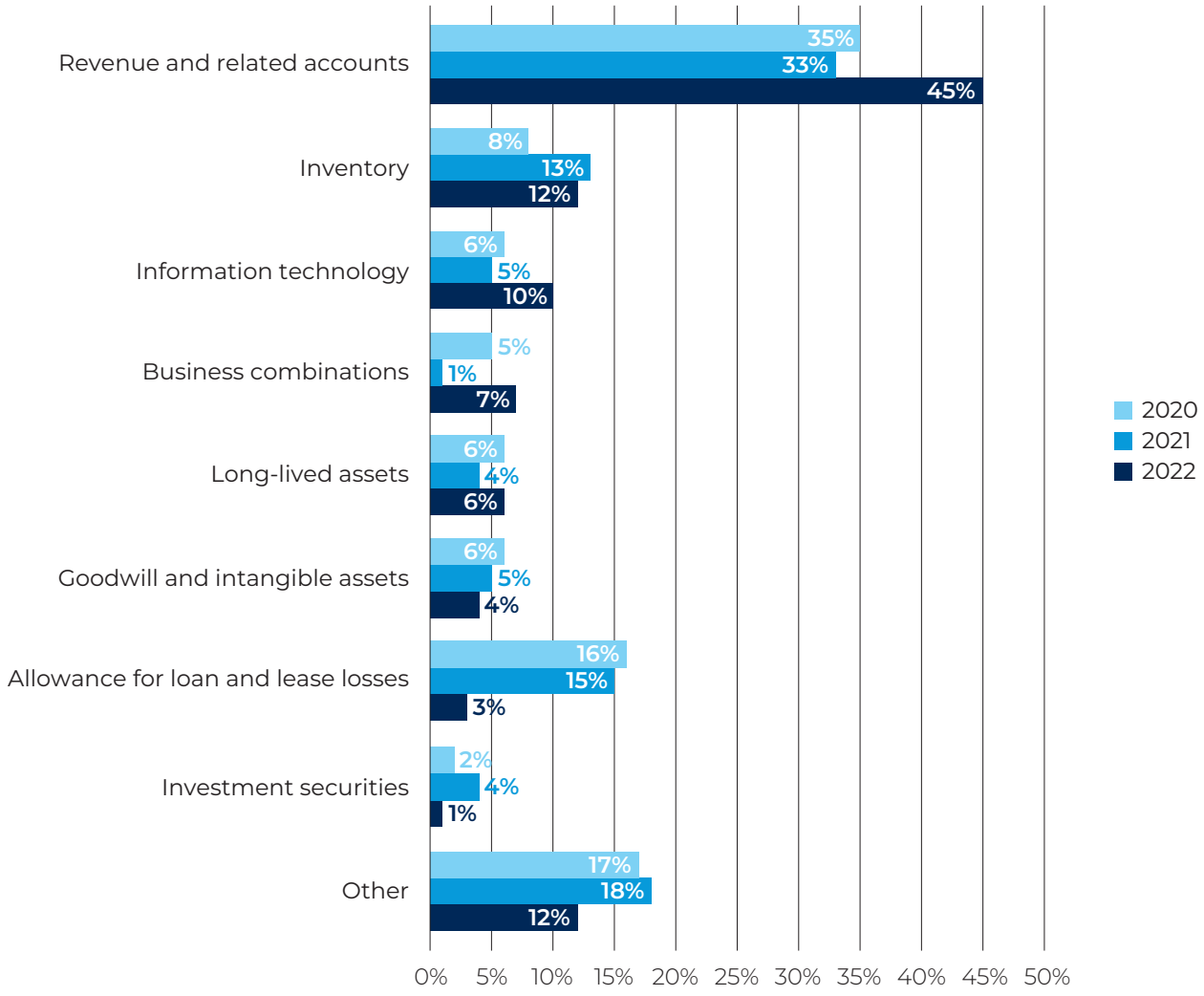


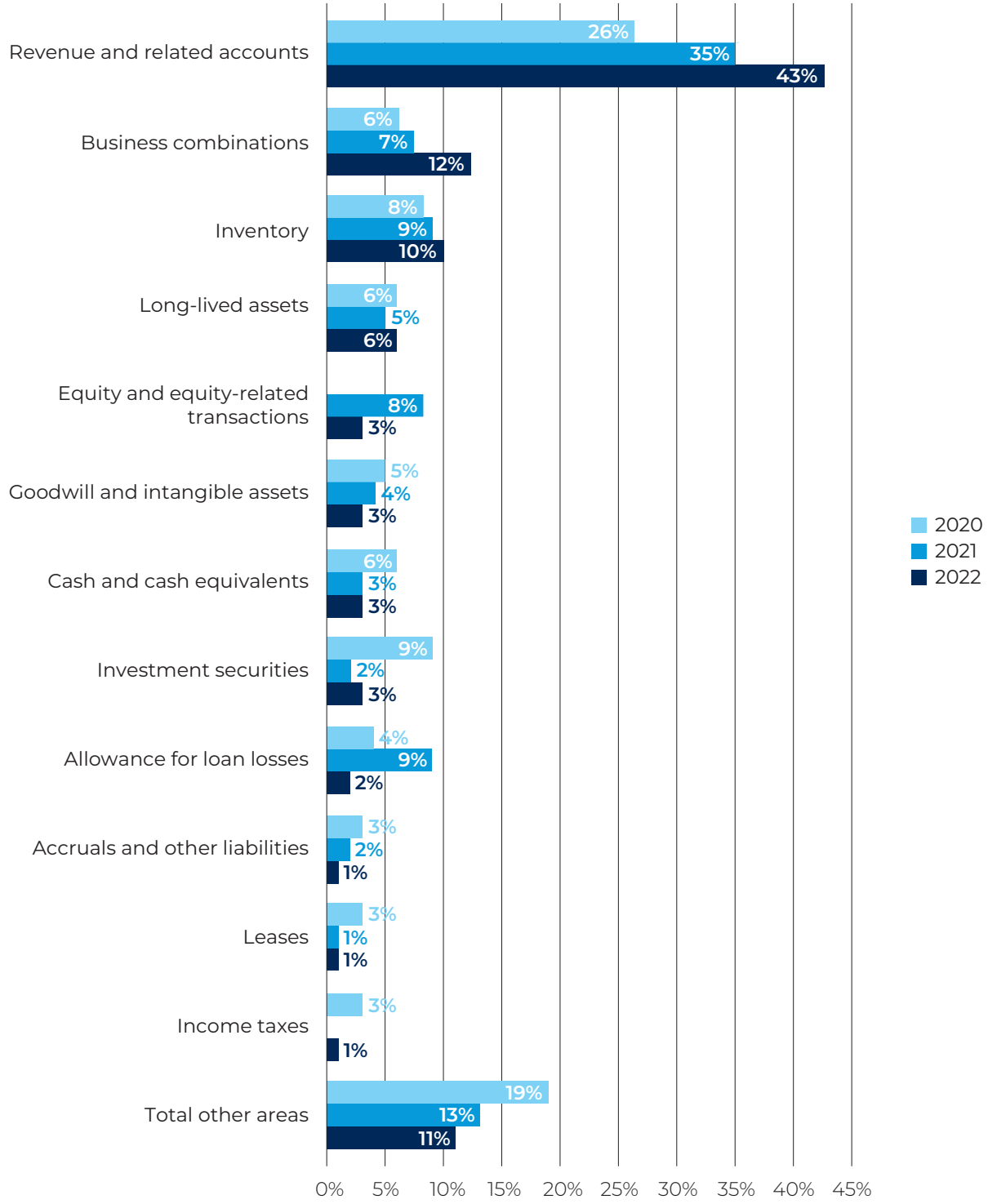
Figure 11 – Deficiencies in Auditing ICFR by Financial Statement Area



Trends in Deficiencies in Financial Statement Audit Areas

Figure 12 below shows the financial statement audit areas across both the issuer and broker-dealer programs that generated the most comment forms on a recurring basis during this period, excluding those that relate to ICFR.

Figure 12 – Common Financial Statement Deficiency Areas, Excluding ICFR



V. GOOD PRACTICES

Our inspectors, through the course of their reviews, see good practices at certain firms, implemented in creative ways for the firm's size and unique structure. The following encapsulates and aggregates our observations and can be helpful to all firms. For example, a specialist in one firm may only perform very specialized assessments in a narrow field of study, but, in a smaller firm, this specialist might be the most experienced person who stays current with new developments through continuing professional education. These good practices are not prescriptive and need to be considered regarding facts and circumstances specific to a firm's practice.

Risk Assessment

Higher-quality audit work was associated with effective risk assessment procedures. For example, audit quality was higher when engagement teams:

- Used clear, concise, and understandable documentation linking risks identified and the audit response.
- Developed a risk assessment that was supported by an in-depth understanding of the issuer and the issuer's business.
- Disaggregated risk assessment at the transaction stream level, assertion level, or account level. For example, one firm assigned likely sources of potential misstatements to elements of an estimate or calculation.
- Tailored risks by appropriately considering varying risks for different components, portfolios, locations, and revenue streams.
- Walkthrough documentation that is robust, including clear, easily understood description(s) of the likely sources of misstatement identified and the linkage to the control tested or audit response.
- Non-perfunctory and timely risk assessment discussions involving all engagement team members.

Use of Practice Aids

Over the years, firms have developed various tools and templates to drive consistency in the application of the auditing standards and firm methodology. These tools and templates, when utilized appropriately, may contribute to audit quality. Some examples include when firms utilized:

- Firm tools that documented a comprehensive understanding and evaluation of risks, controls, and substantive audit evidence obtained.
- Firm risk assessment templates that helped engagement teams better capture and clearly document linkage between likely sources of potential misstatements and the controls to be tested, including for data and data in reports used as evidence (sometimes referred to as IPE or "Information Provided by the Entity").
- Firm templates for testing controls with a review element. (The template drives documentation of sufficient appropriate evidence obtained about the effectiveness of the control owner's activities, particularly over precision, a common inspection finding.)
- Firm templates for testing estimates. One example includes a template that has engagement teams list out individual assumptions/inputs and lists risks by the assumptions/inputs to control and substantive testing approach.

Utilization of Individuals With Specialized Skill or Knowledge

Utilization of auditor-engaged specialists and consultations with subject matter experts may drive audit quality as it allows teams to utilize specialized knowledge and skillsets in certain technical areas of the audit. Examples include:

- Integration and involvement of firm specialists in highly complex and technical audit areas.
- Involvement of appropriate members including specialists in planning meetings, risk assessment, walkthroughs, and controls testing.
- Integration and collaboration between the core engagement team, IT specialists, tax specialists, and valuation specialists.

Supervision and Review

Other observed good practices contributing to audit quality include:

- Supervision and Review – Significant and timely involvement of partners and engagement team members performing supervisory roles during the audit, including the use of milestones.
- Detailed Approach Memos – Some firms have developed concise, top-down practice aids to help facilitate supervision and review.

Tell Us What You Think

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