PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SPOTLIGHT

Observations From the Target Team's 2022 Inspections

December 2023

CONTENTS

Overview 3

Focus Areas for the Target Team in 2022 3

- Traditional IPOs and De-SPAC Transactions 3
    - Observations 4
    - Good Practices 4
- Shared Service Centers 7
    - Observations 8
    - Key Insights 8
- Climate-Related Matters 9
    - Observations 9

OVERVIEW

The PCAOB's Division of Registration and Inspections ("staff" or "we") has a target team consisting of inspectors who focus on emerging audit risks and other topics that the staff believes could have important implications for audits performed by the audit firms we inspect.

The target team executes in-depth reviews across audit firms using information-gathering procedures that extend beyond traditional inspection procedures. This inspection approach has enabled staff to (1) develop observations across audit firms, (2) provide timely insights to inspected audit firms, investors, and other stakeholders, and (3) inform and shape future inspection focus areas.

As part of this ongoing effort, in 2022, the target team focused on inspecting audits of public companies related to three areas:

- First audit engagement post-initial public offering (IPO), including private companies transitioning to a public company through a traditional IPO as well as private operating companies undertaking a business combination with special purpose acquisition companies (SPACs) which are also referred to as de-SPAC transactions;
- Audit firms' use of shared service centers (SSCs) as part of the audit; and
- Climate-related matters in the context of a public company's financial statements.

This Spotlight provides auditors and other stakeholders with a view into the target team's work in 2022, including observations (that include deficiencies that resulted in the issuance of comment forms), good practices, and key insights.

FOCUS AREAS FOR THE TARGET TEAM IN 2022

Traditional IPOs and De-SPAC Transactions

The target team performed reviews of 20 post-IPO audits, across six U.S. Global Network Firms[1] (GNF) where the audit reports for these audits were signed in early 2022 for the 2021 year-end financial statements. The target team selected for review the first post-IPO audit engagement for these newly formed public companies. Sixteen of the 20 audits reviewed were de-SPAC transactions, and the remaining four of the 20 audits reviewed were traditional IPOs. The target team's work included reviews of certain focus areas, as well as the completion of specific inspection procedures, where applicable.

The purpose of the target team's reviews was to gain insights into various aspects of the audit engagements such as the audit firms' client acceptance and continuance processes, independence policies and procedures, staffing, and audit execution (including the nature, timing, and extent of audit procedures performed, supervision, and review). The target team also reviewed the engagement team's fraud procedures on certain audits. The target team's inspection procedures included reviewing:

1. How auditors evaluated potential challenges after becoming a public company that came with new public companies facing their initial year of financial reporting responsibilities and

[1] Global Network Firms – These audit firms are headquartered in the U.S. and are members of global networks through which they affiliate with audit 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. audit firms are inspected annually.

their effect on the audit, including risk assessment and audit execution.

2. How the auditors modified their overall audit strategy and the audit plan for newly identified risks during the course of the audit, including changes due to a revised assessment of the risks of material misstatement or the discovery of a previously unidentified risk of material misstatement.

3. How auditors responded to the public company's first-year internal control over financial reporting (ICFR), if applicable.

4. Whether non-audit services and business relationships presented risks to the auditor's independence as formerly private companies completed their IPOs or transacted with SPACs. How the audit firms identified and addressed those risks.

5. Whether audit firm personnel had the requisite industry knowledge and experience.

6. Whether audit procedures were sufficiently performed to determine whether the financial statement's presentation and disclosure were appropriate.

Observations

The target team identified deficiencies in 20% of the post-IPO audits reviewed. Those audits were of de-SPAC transactions and the deficiencies were related to the revenue focus area.

The target team noted instances where the auditor did not:

- Identify a departure from generally accepted accounting principles in the presentation of deferred revenue.
- Perform procedures to test, or test controls over, the accuracy and completeness of labor hours used as an input to record revenue.
- Perform sufficient substantive procedures to test the reasonableness of the percentage of completion used by the public company to estimate revenue.
- Identify and evaluate the significance of an inconsistency in the description of a transaction in a note disclosure and the description of the transaction in Part I of the public company's annual report filed on Form 10-K.
- Evaluate the specific review procedures that control owners performed to assess the reasonableness of forecasted hours used as an input to record revenue.
- Sufficiently evaluate the severity of a control deficiency to determine whether the deficiency, individually or in combination with other deficiencies, was a material weakness.
- Identify and test controls over the reconciliation of time-and-materials data[2] with the general ledger.
- Identify and test controls over the presentation of deferred revenue.

Good Practices

Throughout their 2022 inspections of IPO audits, the target team observed the following good practices we believe may enhance audit quality:

1. **Use of Specialists** – While the use of specialists was not required by the audit firms' policies, in all of the audits reviewed, engagement teams used auditor-employed

[2] These services are sold on a time-and-materials basis and billed monthly based on actual hours incurred.

valuation specialists in assessing valuation models and related estimates developed by management.

2. **Consultations** – Engagement teams completed consultations with the audit firm's professional practice group on all post-IPO audits reviewed, including instances where a consultation was not required by an audit firm's methodology. Some examples of voluntary consultations included:

    - Evaluation of the technical accounting of tax receivables.
    - Planned audit response to assessed risks of material misstatement for revenue.
    - Evaluating the public company's accounting for reverse mergers and other topics specific to a de-SPAC transaction.
    - Evaluating estimates with subjective assumptions and measurement uncertainty and complex financial instruments resulting from the completion of a de-SPAC transaction.

3. **Use of Technology-Based Audit Tools** – Engagement teams voluntarily used the audit firm's technology-based audit tools ("technology-based tools"). For example:

    - One engagement team used the technology-based tools to perform data analytics for specific revenue streams which identified a material entry to cash that contained a misstatement.
    - On two audits reviewed, a technology-based tool was used to support the risk assessment by processing each journal entry through a series of analytical routines designed to identify specific characteristics of potential fraud. By using this technology-based tool, engagement teams were able to adjust their risk assessment to address specific fraud risk characteristics.

4. **Additional Partner Review** – For two audits reviewed, the engagement teams voluntarily added an additional partner during the audit with relevant industry experience to assist with reviewing fraud risks. This additional partner had relevant industry experience and provided additional supervision and review to help the engagement team with increased workload.

Focus on Fraud Procedures in IPO Audits

In 14 of the 20 post-IPO audits reviewed across the six GNF audit firms, the target team reviewed the engagement teams' consideration of fraud, and although no deficiencies were identified, the following observations and good practices were noted:

Observations

- Engagement teams tested the design and effectiveness of controls over the public companies' whistleblower program with respect to how tips are received, escalated, and resolved.
- No engagement teams identified any fraud risks despite the continuing COVID-19 environment and the related effects of the pandemic, including its impact on engagement teams' fraud risk assessments related to:
  - The public company and its business and operations;
  - The public company's industry, regulatory environment, and other external factors; or
  - The public company's objectives, strategies, and related business risks.
- No engagement team consulted on any audits related to fraud procedures.
- Engagement teams incorporated an element of unpredictability in their audit procedures. Examples included:
  - Expanding fraud inquiries to include individuals outside of the accounting/finance functions that were not inquired of in the prior year.
  - Selecting certain balances below targeted thresholds and obtaining supporting documentation for the balances.

Good Practices

1. **Whistleblower Procedures** – One engagement team placed a call to the whistleblower hotline and evaluated that the call was logged, and the engagement team included this example as part of the discussion during the audit committee meeting.
2. **Use of Auditor-Employed Forensic Specialist** – For nine public companies across four audit firms, engagement teams used auditor-employed forensic specialists as part of their fraud risk assessment and brainstorming activities. For four audit firms, the usage of a fraud or forensic specialist is required if there is a known or strong suspicion of possible fraud, when the public company is a first year publicly traded client, or if the private company is planning an IPO within one year.
3. **Use of Technology-Based Tools**
   - Several engagement teams used technology-based tools in response to identified fraud risks. For example, one engagement team used the audit firm's technology-based tool to risk rate the public companies' revenue transactions processed during the period for the engagement team to select higher risk items to test in response to the revenue-related fraud risks identified.
   - While the audit methodologies at each audit firm reviewed by the target team suggest that engagement teams use the designated technology-based tools for journal entry testing, one audit firm requires that engagement team document their rationale if technology-based tools are not used.

Shared Service Centers

As part of the target team's reviews of 20 post-IPO audits, 16 of those audits included the use of SSCs. The target team performed procedures to increase its understanding of the nature and extent of the usage of SSCs at the four largest U.S. GNFs, including:

- Supervision and review of personnel at the SSCs;
- Quality control systems of the SSCs; and
- SSC personnel utilization (e.g., number of personnel, expertise, and professional experience).

What Are SSCs?

SSC refers to an entity – affiliated with one or more audit firms – that mostly provides resources and services remotely to core engagement teams. SSC personnel traditionally serve in staff or senior associate roles of an engagement team. The services provided are typically more traditional standardized audit procedures, such as testing the mathematical accuracy of schedules prepared by the public company.

SSCs may be based inside and/or outside the U.S. and may or may not be subsidiaries of the U.S. audit firm.

The target team completed site visits of the four GNF audit firms' domestic SSCs during 2022 and performed site visits to SSCs in India for those four audit firms in early 2023. During the site visits, the target team focused on the following:

Planning of Work	Execution of Work	Completion of Work	Quality Control Systems
• Service offerings provided by the SSCs • Acceptance and assignment of work by the SSCs • Instructions and guidance provided to the SSCs • Communications with the U.S. engagement team	• Integration with the U.S. engagement team • Consultations • Use of technology-based tools • Available training, guidance, and resources of the SSCs	• Documentation and submission of deliverables • Supervision and review • Quality of work – checks and balances • Reporting hours	• Oversight and tone at the top • Effects of COVID-19 pandemic and the "great resignation" • Independence • Reporting of tips and complaints • Security • Work performed by other member audit firms • Hiring practices • Monitoring and audit firm requirements • Performance management

Observations

Through their inspections, although no deficiencies were identified, the target team noted the following in this area:

- **Planning of Work**
  - The scope of the audit procedures performed by the SSC was determined by the lead engagement partner.
  - In each of the audits, formal communication and reporting lines were established between the SSC and the U.S. audit firm.
- **Execution of Work**
  - SSC personnel were not prohibited from interacting directly with the public company that they are working on; however, the extent of the SSC personnel's interactions was determined and managed by the U.S. engagement teams and, in most cases, the audit firm required a U.S. engagement team member to be involved in the interaction.
  - SSCs used the audit firm's globally approved technology-based tools to perform audit and support services, and one audit firm has developed a specific tool for use at its SSC only.
- **Completion of Work**
  - None of the audit firms restricted the level of risk of the work performed by the SSC. Further, SSCs performed audit procedures in complex or judgmental areas.
  - Regardless of the nature of the level of work or the related risks, the U.S. engagement team was ultimately responsible for all audit work performed by the SSC.
  - All audit firms restricted SSC resources from serving as the final workpaper reviewer.
- **Quality Control Systems**
  - SSCs were subject to the audit firm's internal inspection processes for the audit of U.S. public companies.
  - Three of the audit firms perform personal independence compliance testing on SSC personnel periodically, which is monitored as a part of the audit firms' quality control system.
  - Some U.S. engagement teams were unclear on whether they were required (or not) to use the SSC.

Key Insights

The target team observed certain practices that we believe may have enhanced audit quality on the engagements reviewed:

1. **Continuity of SCC Personnel** – Larger engagement teams made use of the ability to request specific SSC personnel including maintaining continuity of SSC personnel between years, to enhance quality and build efficiencies.
2. **Additional Review** – Certain audit firms have an additional review process over SSC deliverables to ensure the quality of the work provided to the U.S. engagement teams. For example, one audit firm has a quality review process in place where all workpapers are subject to further quality review performed by an SSC Senior Manager. At another audit firm, there is a quality and continuous improvement team that selects a sample of work requests and performs a review of the associated work deliverables.

3. **Independence** – One audit firm subjects the SSC to the U.S. firm-wide procedure, whereby if time is charged to an audit engagement of a U.S. public company, it is automatically compared against the SSC personnel's holdings in securities, as reported within the audit firm's tracking system.

Climate-Related Matters

Climate-related matters are an area of growing interest for audit firms, investors, regulators, and certain public companies. Therefore, as part of its ongoing information-gathering efforts, the target team selected climate-related matters as a focus area to understand how audit firms are incorporating this emerging topic into their audit work.

The target team reviewed 10 additional audit engagements across five GNF audit firms with a focus on risks of climate-related matters that could materially affect the public company's annual reports filed on Form 10-K. The engagements reviewed are categorized into the following industry sectors: (i) Consumer Discretionary; (ii) Energy; (iii) Industrials (primarily Airlines); and (iv) Materials. Total market capitalization coverage of the public companies selected exceeded $800 billion. The target team's review included climate-related considerations in the audit of the financial statements and related disclosures in or outside of the financial statements such as the public company's separate "sustainability" report. The target team observed the engagement team's risk assessment and audit response. All engagement teams considered the potential impact of climate matters as part of their planning and risk assessment procedures, and consequently, no deficiencies were identified.

Observations

The target team observed the following on the audit engagements reviewed:

- In all 10 audit engagements, the target team noted that all public companies increased the levels of communications of climate-related initiatives through press releases and advertising emphasizing management's focus on climate-related risks and initiatives.
- The target team observed that all five audit firms authored and issued internal guidance highlighting, among other things:
    - The importance of the key assumptions and judgments used by management in both climate-related commitments and in the preparation of the financial statements.
    - Relevant disclosure considerations related to potential impairment of nonfinancial assets; the estimates used by management in determining the estimates useful lives of property, plant, and equipment; the measurement of financial assets; and
    - The importance of estimates in conducting the required going concern assessments.
- All five audit firms provided auditor-employed specialists to assist engagement teams when conducting preliminary risk assessment procedures when the impact of climate-related matters may be material to the financial statements. Some of the professionals that were involved included advisory professionals with climate-related expertise, subject-matter experts within the audit practice, industry groups, and tax professionals.
- For two audit firms across two public companies, engagement teams could

have documented their considerations and conclusions related to climate-related risks, either centrally or in a comprehensive memo. These engagement teams were able to articulate their consideration of climate-related risks during the inspection interviews and reference various locations in the audit files where certain risk assessment procedures were performed.

- All five of the audit firms authored and issued external guidance, including educational material, noting the firm's expertise in climate-related matters.
- One engagement team represented that it had frequent meetings with management and the audit committee to discuss matters related to climate. The engagement team noted that as part of the 2022 audit cycle, matters related to climate were included as a standing agenda item for upcoming audit committee meetings.
- In all 10 of the audit files reviewed, the public companies reported climate-related matters in a separate "sustainability" report.
- One of the 10 public companies used an "integrated reporting" approach, disclosing its climate-related initiatives in Business section (Part I of its annual report filed on Form 10-K).

Stay Tuned and in Touch

During 2023, the target team has been focused on the audits of public companies that include risks related to distributed ledger technology, interim reviews of certain banks, multi-location audits, and significant or unusual events and transactions. Observations from the target team will be shared in future Spotlight documents.

For more perspectives from the PCAOB, including publications on our inspection observations and outlook, visit the **Staff Publications** page on the PCAOB's website. To receive periodic updates, please **join the PCAOB's mailing list**.

The PCAOB welcomes your questions and comments and invites you to fill out a short **reader survey** and/or to contact the staff at **info@pcaobus.org**.