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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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Summary

2023 PCAOB Large Firm Inspection Reports. The PCAOB has released the 2023 inspection reports for the 14 U.S. annually inspected accounting firms, including the U.S. affiliates of the six global network firms. In 34 percent of the engagements it inspected for these six large firms, the PCAOB found one or more Part I.A deficiencies – that is, deficiencies of such significance that the firm did not obtain sufficient evidence to support its opinion. This compares to a 30 percent deficient engagement rate for the six global network firms in 2022. Substantially higher deficiency rates at BDO and Grant were primarily responsible for the increase. For the Big Four firms only, the 2023 deficiency rate was 26 percent – the same as in 2022. To some extent, this reflects Big Four convergence – the two firms with the best records (Deloitte and PwC) experienced some deterioration in their Part I.A deficiency rates, while the other two firms (EY and KPMG) improved somewhat. For the eight annually inspected firms that are not global network members, the deficiency rates ranged from seven percent (Crowe) to 100 percent (B.F. Borgers).

Audit committees should discuss their audit firm’s inspection report with their engagement partner. Audit committees may want to understand how the auditor addressed, or plans to address, engagement deficiencies highlighted in its report and whether the report will result in any changes in audit procedures that could affect the company’s audit. If the company’s engagement was the basis for an inspection finding, the audit committee should understand the cause of the deficiency and how the auditor plans to remedy it and prevent a recurrence. ([more](#))

PCAOB Staff Explains the 2023 Inspection Results. A new PCAOB publication, [Spotlight: Staff Update on 2023 Inspection Activities](#), presents the results of the Boards’s 2023 inspection program and provides staff observations on those results. The [2023 Inspections Spotlight](#) is more comprehensive than prior staff reports on the PCAOB’s annual inspections and includes new information to facilitate comparisons between categories of inspected firms and an understanding of inspection findings.

In 2023, the PCAOB inspected 227 registered public accounting firms and reviewed portions of 793 public company audits and 103 securities broker-dealer audits. Forty-six percent of the public company audits had at least one Part I.A deficiency, up from 40 percent in 2022. Regarding this increase in Part I.A deficiencies, the staff observes that, although overall “negative trends” in deficiencies continued in 2023, “we have begun to see the aggregate deficiency rate at the Big Four firms level off, as well as improvements in the deficiency rates at several of the other annually inspected firms.”

The [2023 Inspections Spotlight](#) provides good background information for audit committees seeking to understand their audit firm’s inspection results and how they fit into the overall context of the 2023 inspections. Committees may want to review the [Spotlight](#) in conjunction with their auditor’s inspection report and as part of their preparation for discussion of the inspection with their engagement partner. ([more](#))

[A Shift in the Winds: Court Rejects SEC’s Use of Internal Control Authority to Police Cybersecurity](#). The SEC’s efforts to use the internal accounting control requirement in the Securities Exchange Act as a lever to regulate public company cybersecurity practices has suffered a setback. In [SEC v. SolarWinds Corp.](#), a federal district court judge held that the provision in the Exchange Act requiring companies to devise and maintain a system of internal accounting controls does not apply to cybersecurity controls. The decision is contrary to the position the SEC took in its recent settlement with R.R. Donnelley & Sons, [discussed](#) in the [July 2024 Update](#). Despite the SEC’s loss, audit committees should be aware that disclosure concerning cybersecurity and cyber breaches is a top SEC enforcement priority and that the Commission will likely be aggressive in enforcing its new cybersecurity disclosure rules. ([more](#))

[CAQ Releases a Resource for Audit Committees on Generative AI Oversight](#). The Center for Audit Quality has published [Audit Committee Oversight in the Age of Generative AI](#), a resource for audit committee members that provides an overview of the use of generative artificial intelligence in financial reporting processes and internal control over financial reporting. The paper includes questions audit committees can ask to understand management’s approach to using genAI in financial reporting and the related risks. The CAQ notes that “As the use of genAI in financial reporting processes and ICFR presents new risks and considerations for companies, audit committees will have an important oversight role to play.” The CAQ’s paper is an excellent primer on genAI and the risk areas that audit committees should consider. The questions it suggests committees discuss with the management and the auditor would be a good starting point for committees seeking to educate themselves on how genAI will impact financial reporting and on the new risks that will arise as it becomes ubiquitous. ([more](#))

[PCAOB Shines a Spotlight on Generative AI in Auditing and Financial Reporting](#). The PCAOB staff has conducted “limited outreach” to audit firms and public companies to understand their perspectives on the use of generative artificial intelligence in financial reporting and auditing. This effort is part of a Board research project to determine whether there is a need for regulatory actions in light of the increased use of technology-based tools in financial statement preparation and auditing. [Spotlight: Staff Update on Outreach Activities Related to the Integration of Generative Artificial Intelligence in Audits and Financial Reporting](#) summarizes the results of this outreach initiative. The [GenAI Spotlight](#) introduces some of the oversight challenges that audit committees will face as genAI is integrated into financial reporting and auditing. ([more](#))

[PCAOB Discloses a Criticism of Deloitte’s Internal Independence Reporting – Again](#). On July 23, the PCAOB released a portion of the previously nonpublic section of [Deloitte & Touche’s 2020 inspection report](#). This action indicates that, in the Board’s view, the firm did not satisfactorily address the quality control issue discussed in that portion of the inspection report within 12 months of the report date. The now-public quality control criticism in Deloitte’s 2020 inspection report relates to compliance with the firm’s policies for employee financial holdings disclosure. This is the third inspection year for which the PCAOB has found that Deloitte failed to remedy this deficiency. ([more](#))

[Is AI One of Your Risks? The Rise of Generative AI In SEC Filings](#), a report issued by Arize AI, finds that in 2024 almost two-thirds of Fortune 500 companies mention artificial intelligence in their annual report on Form 10-K, and more than half have a risk factor citing AI. One hundred eight Fortune 500 companies refer specifically to generative AI in their annual filing. Seventy-five of those companies mention genAI only in their risk factors, nine refer to it only in terms of potential benefits, and 24 discuss both the risks and benefits of genAI. The Arize report includes examples from Fortune 500 filings of several types of risk factor disclosure and of disclosures discussing the benefits or industry implications of genAI. Audit committees may want to consider whether there are material risks associated with either the company or its competitors deploying AI, especially genAI, and, if so, whether those risks are appropriately disclosed. ([more](#))

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The Update's website is www.auditupdate.com.

Update Nos. 89-present (March 2024 to present) and summaries are available [here](#). Update Nos. 76-88 (August 2022 to February 2024) and summaries are available [here](#). Update Nos. 60-75 (June 2020 to July 2022) are available [here](#). Update Nos. 49-59 (January 2019 to May 2020) are available [here](#). Updates prior to No. 49 are available on request.

An index to titles and topics in the Update beginning with No. 39 (July 2017) is available [here](#).