

Inspections Outlook for 2019

The **PCAOB Division of Registration and Inspections** staff is providing this Outlook on objectives and potential focus areas for planned 2019 inspections of audits of issuers and brokers and dealers. This Outlook outlines our ongoing inspections transformation efforts and provides an overview of various areas of inspection focus for 2019. Auditors should consider this information when planning and performing their current and upcoming audits and review of their quality control systems.

Transformation

The PCAOB Division of Registration and Inspections staff (“we”) designs our inspections process to drive improvement in the quality of audit services through a focus on efficient and effective prevention, detection, deterrence, and oversight of firms’ remediation of audit deficiencies. Through a number of interrelated projects, we are currently reevaluating how we plan, conduct, and report on our inspections.

We are considering topics such as the procedures we perform on the review of specific engagements and systems of quality control, our approach to selecting engagements for inspection and areas of focus, and how and what we communicate about our inspections. We are also considering how to make our process forward-looking and how to more effectively consider evolving risks, environmental factors, and the changing needs of our stakeholders. Although some of these projects are long-term, we expect other projects to have an effect on the 2019 inspections cycle. As we revise our approach to inspections, we expect to provide periodic updates of our progress.

Key Areas of Focus

System of Quality Control

A firm’s system of quality control serves as the foundation for executing quality audits. In 2019, we intend to increase our focus on the design and operating effectiveness of firms’ systems of quality control.

We plan to perform procedures such as:

- Analyzing how firms’ systems of quality control promote a culture of audit quality and respond to risks, including by reviewing areas such as the effective design, implementation, and monitoring of the quality control systems; organizational structure; complexity of firms’ practices; and the knowledge and experience of firms’ personnel.
- Identifying and reviewing in greater depth those aspects of firms’ quality control processes that are critical to audit quality, including engagement acceptance and continuance decisions; firms’ internal monitoring programs; engagement performance; and personnel management.
- Understanding if firms design policies and perform procedures to evaluate whether the companies they audit have an appropriate code of conduct, as well as compliance programs to avoid fraud, bribery, corruption, and other violations of law, including inadvertent violations, that may have a direct and material effect on the determination of financial statement amounts.

Overview

- **Transformation**
- **Key Areas of Focus**
 - System of Quality Control
 - Independence
 - Recurring Inspection Deficiencies
 - External Considerations
 - Cybersecurity Risks
 - Software Audit Tools
 - Digital Assets
 - Audit Quality Indicators
 - Changes in the Auditor’s Report
 - Implementation of New Accounting Standards

Independence

Firms are required to be independent of their audit clients. Independence contributes to trust in the quality of audit services. Over the last several years, we have identified recurring deficiencies related to auditor independence, including firms' monitoring procedures failing to identify independence violations. These recurring deficiencies suggest that some firms and their personnel either do not sufficiently understand applicable independence requirements or do not have appropriate controls in place to prevent violations. In 2019, we intend to continue our focus on firm independence matters.

We plan to perform procedures to assess, among other things, how firms:

- ⦿ Maintain their independence in fact and appearance;
- ⦿ Educate their professionals on independence requirements;
- ⦿ Monitor compliance with independence requirements; and,
- ⦿ Assess the impact on independence of non-audit services.

Recurring Inspection Deficiencies

Globally, we continue to identify deficiencies in auditing internal control over financial reporting, revenue recognition, allowance for loan losses, and other accounting estimates, including fair value measurements (e.g., goodwill and intangible assets). Additionally, we continue to identify deficiencies related to assessing and responding to identified risks of material misstatement. We expect firms to continue to take steps to address deficiencies in these areas. For more information on these topics, see [Staff Inspection Briefs](#) and [Annual Report on Inspections of Brokers and Dealers](#).

In 2019, we will continue to review remedial actions in response to past inspection findings and information about the potential root causes of those findings.

We will consider, among other things:

- ⦿ What tools and techniques firms use to identify the causes of deficiencies;
- ⦿ How firms use various root cause analysis approaches;
- ⦿ What actions firms are taking to reduce these types of recurring deficiencies in the future;
- ⦿ What type of actions lead to higher audit quality in these areas of recurring deficiencies; and,
- ⦿ How firms monitor the timing and progress of audit work.

External Considerations

Risks of material misstatement can arise from a variety of sources, including factors external to a company, such as economic conditions. An auditor's risk assessment procedures should continue throughout the audit and include consideration of relevant external factors. We remind auditors to consider whether assessed risks have changed as a result of changes in economic conditions.

We continue to identify deficiencies in auditing:

- Internal Control Over Financial Reporting
- Revenue Recognition
- Allowance for Loan Losses
- Other Accounting Estimates
- Risks of Material Misstatement

Our inspection procedures will include:

- ⦿ Evaluating firms' responses to elevated risks of material misstatement due to external considerations, including assessing how firms adjust the nature, timing, and extent of their audit procedures; and,
- ⦿ Assessing firms' evaluation of audit evidence, including consideration of evidence obtained through external sources, such as industry or economic data, that potentially contradicts management assertions.

Cybersecurity Risks

Cyber incidents and breaches of information systems continue to occur frequently while the complexity of cyber attacks on businesses is constantly evolving. In 2019, we will continue to evaluate the audit procedures firms use to identify and determine whether cyber risks and actual breaches pose risks of material misstatement to companies' financial statements.

Software Audit Tools

Firms continue to develop and use software audit tools. Through our inspections, we have observed firms using these tools for audit engagement management, testing procedures, and risk assessment. We have also observed some use of artificial intelligence. Throughout 2019, we will continue to monitor the use and development of firm software audit tools and will consider whether firms are effectively using these tools and applying due care, including professional skepticism, when they do.

Digital Assets

We will evaluate auditors' responses to risks associated with digital assets (e.g., cryptocurrencies, initial coin offerings, and uses of distributed ledger technology). We also intend to understand firms' client acceptance and retention decisions, resource management, and planned audit procedures in this area. We further will consider whether firms are maintaining their independence while offering new service lines relating to digital assets.

Audit Quality Indicators (AQIs)

As part of our information gathering activities, we plan to consider in 2019 how firms may be using AQIs to monitor their audit work and staff deployment, and whether firms are discussing AQI results with audit committees. Through these efforts, we will seek to enhance discussions on the essential factors that firms may use as part of their monitoring procedures to prevent, detect, deter, and remediate audit deficiencies. During 2019, we will collaborate with those who collect data and conduct research on the quality of audits to develop more thought leadership around AQIs.

Changes in the Auditor's Report

In 2017, the PCAOB adopted a new standard (AS 3101) to enhance the usefulness of the auditor's report. The new standard required changes to the basic elements of the auditor's report, including the disclosure of auditor tenure, which are already in effect. In addition, impending changes will require the auditor to communicate "critical audit matters" arising from the audit of the financial statements that involved, among other things, especially challenging, subjective, or complex auditor judgment, and the response that the auditor had to those matters.

Our inspectors will monitor the evolution of new technologies available to companies and auditors that are affecting current and future audits.

We will monitor firms' implementation activities to understand experiences with pilot testing and dry runs. We also will begin to assess compliance with the new standard for certain audit engagements. We further plan to engage with other regulators in countries that have analogous reporting standards to consider any lessons they learned during implementation.

Implementation of New Accounting Standards

During 2019, we will continue monitoring changes in firms' processes and/or procedures in light of new accounting standards for areas such as revenue recognition (ASC 606 and IFRS 15), lease accounting (ASC 842 and IFRS 16), current expected credit losses (ASC 326), and financial instrument accounting (ASC 815 and IFRS 9). Additionally, we will evaluate how firms have audited the implementation of the new accounting standards that are in effect.

We will focus on those areas that require management judgment and how auditors have addressed the design and operating effectiveness of internal controls after implementation of these new standards, including the need for controls that operate only during the implementation period. We will further evaluate firms' processes related to the auditors maintaining their independence with respect to providing assistance with companies' implementation of the new standards. Finally, we intend to monitor the developments in areas addressed by the audit standard-setting projects for discussion with firms on implementations.

This Outlook highlights some of the factors to be considered by auditors throughout the audit. We plan to conduct and report on our inspection activities, including areas noted in this Outlook, to communicate, as soon as practicable, the nature and significance of our inspection results.

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