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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 53
July 2019

This Update summarizes recent developments relating to public company audit committees and their oversight of financial reporting and of the company's relationship with its auditor.

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More PCAOB Advice for Audit Committees on CAMs

On July 11, the Public Company Accounting Oversight Board released two documents and a video providing information about the new requirement for auditors to include a discussion of critical audit matters (CAMs) in their audit reports. This follows the release in May of guidance to assist auditors in drafting their CAM discussions. See PCAOB Staff Dives into CAM Reporting, May-June 2019 Update. One of the newly-issued papers, Critical Audit Matters: Insights for Audit Committees, is intended specifically for audit committees and includes sample questions that audit committees may wish to consider asking their auditor regarding CAM disclosure.

As described in earlier Updates (see, e.g., PCAOB Staff Issues New Guidance on CAM Reporting, March, 2019 Update), beginning for large accelerated filers with fiscal years ending on or after June 30, the auditor's report must include a discussion of CAMs identified during the audit. A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment.

Insights for Audit Committees begins with a discussion of the basics of CAM disclosure, including the definition, effective dates, exceptions to the CAM requirement, and the period covered by CAMs. The most useful part of this background is a decision tree that can be used to determine if a matter that arises in an

audit is a CAM. Insights for Audit Committees then discusses twelve FAQs of interest to audit committees. Examples of these questions and the PCAOB's responses include:

- Does the audit committee have a role in determining and approving CAM communications? No. CAMs are the sole responsibility of the auditor. The auditor is, however, required to provide the audit committee with a draft of the audit report, including the CAMs. In that context, "the auditor could discuss with management and the audit committee the treatment of any sensitive information."

- Are CAMs expected to be the same each year? No. The auditor must determine CAMs based on the current period financial statements audit. "Depending on the circumstances, some matters may be considered CAMs each year, while others may not." For example, a new accounting standard might be a CAM in the first year of implementation, but not in subsequent years.

- If a public company experiences a significant event, such as a cybersecurity breach, will that be a CAM? Not necessarily. The CAM requirements are principles-based, and their application depends on the facts and circumstances. "When auditors evaluate such events for purposes of determining CAMs, they will consider the impact the event had on the audit. This will largely depend on the nature and extent of the audit response required to address any affected accounts and/or disclosures."

- What is the relationship between CAMs and a company's disclosures regarding critical accounting estimates? Critical accounting estimates disclosure in MD&A may overlap with CAMs but is not the same. "[T]he source of CAMs is broader than just critical accounting estimates because the source of CAMs includes all matters communicated or required to be communicated to the audit committee." Conversely, not all critical accounting estimates discussed in MD&A will be CAMSs.

- What is the interaction between CAMs and company disclosures outside of the financial statements? In the description of a CAM, the auditor is required to refer to the relevant financial statement accounts or financial statement disclosures. Disclosures outside of the financial statements may, however, also relate to the CAM. In describing a CAM, the auditor is generally not expected to provide information about the company that has not been made publicly available by the company. In this context, "[i]nformation a company has made publicly available includes all means of public communication, whether within or outside the financial statements, including SEC filings, press releases, and other public statements."

One of the FAQ responses describes the PCAOB's plans to monitor CAM implementation. (SEC Chairman Clayton urged the PCOAB to undertake post-implementation review in a statement at the time of SEC's approval of the CAM rules.) The PCAOB's monitoring will have three aspects:

- Once CAM reporting begins, the Board will perform an "interim analysis" to assess stakeholders' experiences and results. This will include interviews, surveys, and other outreach (including to audit committee members) to learn about stakeholders' experience with CAMs.

- In the second half of 2019, the PCAOB's inspection program will review CAMs in large accelerated filer audit reports. The staff expects to issue a report of its observations.

- After full implementation in December 2020, the PCAOB will conduct a review to analyze the effectiveness of the CAM requirement. As part of that review, the Board will "reevaluate costs and benefits of the new standard, including any unintended consequences."

Insights for Audit Committees also includes five examples of questions audit committees may want to consider asking their auditor regarding CAM implementation:

- What has the audit firm done to prepare for the identification and communication of CAMs in the auditor's report?

- Does the audit firm have a methodology, practice aids, or other training available to its auditors?

- Has the audit firm done any dry runs? If so:

  - What did the audit firm learn as a result of the dry runs?

  - Were there any matters considered to be "close calls," but ultimately not identified as a CAM during the firm's dry run? What was the thought process behind the final determination?

- Were our CAMs similar or different from our industry peers? What is the nature of the differences (or similarities)?

- Has the audit team discussed with management how and by whom any investor or stakeholder question regarding CAMs will be addressed?

Along with Insights for Audit Committees, the PCAOB released Critical Audit Matters: Insights for Investors. That document explains the CAM requirement from an investor perspective, although some content is the same as that in the audit committee paper. Insights for Investors discusses the function of the auditor's report and the origins of the CAM requirement, describes the basics of CAM reporting, and includes a list of FAQs similar to the list in the audit committee insights document. The PCAOB also released a short video in which the Board's Deputy Director of External Affairs highlights the insights papers.

Comment: While it does not break any new interpretive ground, Insights for Audit Committees is a short, understandable overview of some of the basic issues that audit committees should be aware of regarding CAM reporting. The three guidance statements issued in March, particularly The Basics, provide a somewhat more detailed analysis. Reviewing those papers, along with Insights for Audit Committees, would be useful for audit committee members who are still coming up to speed on CAM reporting (see PCAOB Staff Issues New Guidance on CAM Reporting, March 2019 Update). The sample questions in Insights for Audit Committees are also useful as a catalyst for a dialogue with the auditor about CAM implementation.

PCAOB Staff Provides Guidance on Auditor Independence Communications with Audit Committees

On June 3, the PCAOB staff issued guidance on how an auditor should communicate with the audit committee when the audit firm has identified a violation of the independence rules but has concluded that the firm can nonetheless continue as the company's auditor. The guidance, Rule 3526(b) Communications with Audit Committees Concerning Independence, lays out disclosures that the auditor must make to the audit committee in these circumstances to comply with the PCAOB's rules regarding annual communication of independence matters.

The general auditor independence standard in the SEC's rules is that the Commission "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement." In addition to this general standard, the SEC's rules contain a detailed, non-exclusive, set of specific circumstances that are inconsistent with independence. The PCAOB's rules incorporate the SEC's independence rules and add some additional requirements.

The PCAOB also requires that auditors make certain independence-related disclosures to client audit committees. Under PCAOB Rule 3526(b), the auditor of a public company must at least annually:

1. Describe, in writing, to the audit committee all relationships between the audit firm (or affiliates) and the audit client (or persons in financial reporting oversight roles at the client) that, as of the date of the communication, may reasonably be thought to bear on independence.

2. Discuss with the audit committee the potential effects of the relationships described on the firm's independence.

3. Affirm to the audit committee, in writing, that, as of the date of the communication, the firm is "independent in compliance with" the SEC and PCAOB auditor independence rules.

4. Document the substance of its discussion with the audit committee.

The specific circumstances in the SEC's independence rule that compromise independence are complex, and audit firms occasionally discover technical violations. In many of these situations, the firm and the client audit committee conclude that the firm is still capable of exercising objective and impartial judgment and meets the reasonable investor test in the SEC's general independence standard. According to the staff guidance, these situations typically have four attributes:

- The firm addressed the underlying reasons for the violation. The audit firm analyzed the facts and circumstances of the violation and addressed (or is addressing) those circumstances. Based on its analysis, the firm determined that, despite the violation, it was capable of exercising objective and impartial judgment related to all issues encompassed within the audit and that a reasonable investor with knowledge of all relevant facts and circumstances would reach the same conclusion.

- The firm communicated the matter to the audit committee.

- The audit committee separately evaluated the firm's determination. The guidance notes that the audit committee "has an important role in representing the interests of the audit client's investors in this regard, particularly with respect to the 'reasonable investor' portion of the analysis."

- The audit committee and the firm agreed to continue the audit engagement.

A question that arises in this scenario is how the audit firm should comply with the requirement in Rule 3526(b) that it represent to the audit committee that it is "independent in compliance" with the SEC and PCAOB rules. The new staff guidance provides that the firm should:

a. Summarize for the audit committee each violation that existed during the year.

b. Summarize for the audit committee the firm's analysis of why, for each violation, the firm concluded that its objectivity and impartiality have not been impaired, and why the firm believes that a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the firm was capable of exercising objective and impartial judgment.

c. If more than one violation existed during the year, provide the audit committee with a separate analysis of why, notwithstanding all of the violations taken together, the firm concluded that its objectivity and impartiality with respect to all audit issues have not been impaired, and why the firm believes that a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the firm was capable of exercising objective and impartial judgment.

d. Engage in dialogue with the audit committee regarding the violations and the firm's analyses.

e. Document the substance of the firm's discussions with the audit committee.

If the audit firm takes these steps, it may affirm to the audit committee that, except for the violations expressly identified, the firm would be independent in compliance with the rules. The guidance suggests that a firm "may choose" to use the following language:

> "We have concluded that our objectivity and impartiality with respect to all issues encompassed within our engagement has not been impaired, and we believe that a reasonable investor with knowledge of

> all relevant facts and circumstances would conclude that we are capable of exercising objective and impartial judgment on all issues encompassed within our engagement. Except for the violation(s) expressly identified and discussed with you [and as set forth above/in separate communications dated XX/XX/XXXX], the Firm would be independent in compliance with Rule 3520."

It is important to recognize that this guidance, while helpful, is quite narrow. The guidance is not a cure for independence lapses and addresses only the audit committee communication requirements in PCAOB Rule 3526(b). Compliance with guidance still leaves auditors and audit committees with the underlying – and more difficult – question of whether the SEC would agree that the auditor is independent. The guidance states that, whether there was a violation of the independence criteria of the PCAOB or the SEC and whether it has been ameliorated, "is a matter for the Firm and the audit committee to consider and with respect to which, in certain circumstances, the Firm and the audit committee may decide to consult with SEC staff concerning their conclusions."

<u>Comment</u>: If an auditor independence issue arises, the audit committee should of course expect the audit firm to follow the procedures and make the disclosures outlined in the new PCAOB guidance. As noted, however, compliance with those procedures does not relieve the audit committee of its responsibility to reach its own decision regarding the audit firm's ability to exercise objective and impartial judgment. How the audit committee should proceed when it learns of a violation of the auditor independence rules, and how the SEC's reasonable investor test applies to a particular situation, are frequently difficult judgment calls. The large accounting firms employ independence specialists who are familiar with the interpretations of the SEC's rule and with the SEC staff's attitudes and likely reactions. While the engagement team would be expected to consult these experts and inform the audit committee of their conclusions, in many cases it will be prudent for the audit committee to also consult its own counsel.

BDO Releases Audit Committee Self-Evaluation Tool

Accounting firm BDO USA has released an updated tool, Audit Committee Self-Assessment, to assist audit committees in evaluating their performance. The listing standards of the New York Stock Exchange require audit committees to conduct an annual performance evaluation and, even for non-NYSE companies, an annual self-evaluation is a common (and desirable) practice. BDO states that its tool "is designed to assist in strategic improvements and identification of ongoing goals for the audit committee as a basis for good governance practice."

The self-assessment tool consists of statements or issues regarding committee performance arranged under twelve topics. The twelve assessment areas are: composition; committee management; culture; onboarding and continuing education; audit committee chair; communications; consideration of risk; oversight of financial reporting; oversight of internal control over financial reporting; oversight of internal audit; oversight of external auditors; and overall assessment. For each of the statements under a given topic, one of six responses (including not applicable) can be selected, ranging from strongly disagree to strongly agree. The assessment form includes space for the committee to describe an action step and an estimated completion date for performance improvements. There is also an opportunity for free-form text comments.

BDO notes that the self-assessment could be customized to reflect specific attributes of the organization or to include additional items. As to process, BDO states that the "audit committee chair would generally compile the results, which may be obtained from individual committee members on a confidential basis, but should also contemplate feedback from other key stakeholders such as the board, internal and external audit, and management."

<u>Comment</u>: As noted above, an audit committee self-evaluation is a best practice, and most audit committees perform such an evaluation annually. There are a variety of tools and checklists available to assist in this effort. BDO's list of topics and issues is quite comprehensive, and could serve as a good starting point, although committee chairs may want to add or delete topics based on the specific characteristics of the committee, such as the responsibilities in the committee's charter. BDO's approach of going beyond evaluation and identifying areas for improvement, action steps, and a timetable is also worth considering.

Protiviti Finds that SOX Compliance Costs are Down, Hours are Up, and Technology is Slowly Taking Over

On June 24, consulting firm Protiviti released the 2019 edition of its annual survey of Sarbanes-Oxley Act compliance costs, Benchmarking SOX Costs, Hours and Controls. (The 2018 survey is summarized in SOX Compliance Requires More Hours Than Ever, and the Cause May Lie in Reporting Changes or at the PCAOB, August-September 2018 Update.) As described in the executive summary, key findings of the 2019 survey are:

- SOX compliance costs are trending down. Most surveyed companies reported slightly lower internal SOX compliance costs, although overall costs remain significant. For many organizations, external audit costs rose.

- Overall SOX compliance hours continue to rise, with some variations. The upward trend in compliance hours reflects the fact that "the cumulative time internal teams and external auditors invest in compliance activities is determined by a range of 'beyond-SOX' factors, including knock-on effects from PCAOB inspections, the adoption of new accounting standards, internal technology implementations, process changes and more."

- The use of automated controls testing is increasing, as is interest in deploying advanced technologies to enhance SOX compliance efficiency. Protiviti predicts that '[a]s these plans are executed, it appears likely that more companies will reduce the costs and hours dedicated to SOX compliance while simultaneously strengthening the control environment."

- More organizations are leveraging outside resources. "There has been a substantial increase among companies using co-source providers for SOX compliance activities related to process and IT controls."

- Cyber security continues to influence SOX efforts. Nearly half of surveyed organizations had to issue a cyber security disclosure in their most recent fiscal year. About 20 percent of those companies reported a substantial increase in cyber security-related SOX compliance hours.

Protiviti and AuditBoard, a cloud-based platform that offers audit management and compliance solutions, surveyed 693 audit, compliance and finance professionals at public companies during the first quarter of 2019. The survey was conducted online. The most common titles held by respondents were audit manager, finance manager, chief audit executive, audit director, and finance director. About two-thirds of the non-financial services organizations in the survey (67 percent) had $1 billion or more in annual revenue.

Internal Compliance Costs

As noted above, compliance costs declined marginally for most companies.

- The average annual internal cost of SOX compliance for the largest public companies (large accelerated filers) declined in the 2019 survey to $1.309 million from $1.339 million in the prior year. For the next tier of public companies (accelerated filers), average annual internal costs averaged $989,300, down slightly from $997,000 in the prior survey.

- For smaller companies (non-accelerated filers), costs averaged $734,200, up significantly from $560,700 last year. As in prior surveys, the highest compliance costs – $1.339 million – were incurred by emerging growth companies (EGCs – certain recently-public companies with revenues of less than $1 billion). EGC SOX costs were down marginally from $1.392 million in the 2018 survey. Non-accelerated filers and EGCs are generally not required to engage their auditor to provide an opinion on the effectiveness of the company's internal control over financial reporting.

On an industry basis, companies in the technology and consumer products/retail sectors had the highest internal SOX compliance costs ($1.436 and $1.412 million, respectively). In the 2018 survey, healthcare and financial services lead the list.

External Audit Fees

External audit fees rose for most companies. Fifty-six percent of large accelerated filers, and 49 percent of accelerated filers, reported that their external audit fee increased in fiscal 2018, while less than 15 percent of each of these filer groups reported a decrease. For non-accelerated filers, 67 percent reported an increase, and only 5 percent reported a decrease. For emerging growth companies, 55 percent reported an audit fee increase, while 16 percent said their audit fee decreased.

Hours Devoted to SOX Compliance

While internal compliance costs fell slightly, significant percentages of companies reported that hours devoted to SOX compliance increased. For all companies in the survey, 51 percent said that their total hours increased in FY 2018, and 59 percent of those reported increases of 10 percent or more. Fifteen percent of respondents said their SOX compliance hours fell, and 34 percent said they were constant. Non-accelerated filers were the least likely to report an increase in compliance hours – only 36 percent of these companies said that they compliance hours were higher in fiscal 2018 than in the prior year.

External Auditor Reliance on Company Testing

Protiviti asked respondents what percentage of their control testing the external auditor relied on. For large accelerated filers, the overall percentage of controls on which the auditor relied was 44 percent. The percentage-of-controls-relied on was almost the same for accelerated filers – 43 percent overall. In contrast, for non-accelerated filers and ECGs the overall reliance percentages were 29 percent and 37 percent respectively.

Technology Tools

Protiviti notes that, while the absolute numbers are still small, more organizations are employing advanced technology, such as robotic process automation and machine learning, as part of their SOX compliance. Correspondingly, over 60 percent of respondents reported that their external auditor uses technology tools as part of control testing. (For example, 47 percent of companies in the survey said that their auditor employs data analytics in SOX compliance, an increase from 27 percent last year.)

Respondents were asked which technology tools their organization used in SOX Section 404 compliance. The five most frequently reported tools were:

- Data analytics (41 percent, up from 30 percent last year).

- Automated process approval workflow tools (e.g., expense report approval process) (38 percent, up from 31 percent last year).

- Access controls/user provision/segregation of duties review tools (36 percent, up from 30 percent last year).

- Automated reconciliation tools (28 percent, down from 29 percent last year).

- Continuous controls monitoring (28 percent, up from 27 percent last year).

SOX Compliance Benefits

Fifty-seven percent of public company respondents believed that one of the “primary benefits” of their organization’s SOX compliance process was improved internal control over financial reporting. Last year,

67 percent said that ICFR had "significantly" or "moderately" improved since internal control auditing became required. Other primary benefits of SOX compliance cited by respondents in 2019 were:

- Enhanced understanding of control design and control operating effectiveness (51 percent).
- Continuous improvement of business processes (47 percent).
- Compliance with SEC rules (46 percent).
- Increased reliance by external audit on the work of internal audit. (43 percent).
- Ability to better identify duplicate of superfluous controls (43 percent).
- Improvements in company culture, specifically related to risks and controls (36 percent).

Comment: SOX compliance has imposed significant costs on companies of all sizes, and the impact on non-accelerated filers and ECGs has been substantial, given their more limited resources. Protiviti survey respondents have, however, consistently also reported that SOX compliance has created value in the form of stronger and more reliable controls. Costs now seem to be leveling off, or even declining, at least for the largest companies. Protiviti foresees greater cost reductions in the future as more companies implement advanced technology as part of their SOX compliance. Audit committees may want to explore with management whether it is taking advantage of these opportunities. Also, as noted in SOX Compliance Costs and Audit Fees Continue to Rise, August 2016 Update, audit committees may want to consider Protiviti's view that there are opportunities to convert SOX compliance costs into an investment in more effective and efficient financial reporting and information-gathering processes.

Disclosing an SEC Financial Fraud Investigation Depresses Long Term Stock Prices and Shortens CEO Tenure, even if No Charges are Brought

A challenge faced by a company under non-public SEC investigation is whether to publicly disclose the investigation before the company knows whether it will result in any charges. There are no firm rules on whether investigations must be disclosed. The decision is inherently a judgment call and depends on an assessment of materiality after considering the costs and consequences of the investigation, the issues underlying the inquiry, the likelihood and potential impact of any eventual SEC enforcement proceeding, and other factors. It is frequently assumed that transparency is the more conservative approach and that, in the long run, the market rewards candor.

A recent paper by David H. Solomon, of Boston College's Carroll School of Management, and Eugene Soltes, of Harvard Business School, casts doubt on these assumptions. In Is "Not Guilty" the Same as "Innocent"? Evidence from SEC Financial Fraud Investigations, Professors Solomon and Soltes conclude:

- Even if no charges are ultimately filed, companies that voluntarily disclose an SEC financial fraud investigation have "significant negative returns, underperforming non-sanctioned firms that stayed silent by 12.7% for a year after the investigation begins."
- Disclosing in a "more prominent manner" (e.g., in a press release as distinguished from an SEC filing) is associated with worse returns.
- A CEO whose company discloses an investigation is 14 percent more likely to "experience turnover" within two years than a CEO whose company opts to remain silent, regardless of the outcome of the SEC investigation.

The authors observe that their “results are consistent with transparency about bad news being punished, rather than rewarded, by financial and labor markets.”

Solomon and Soltes obtained information from the SEC on investigations conducted between 2002 and 2005. This data was then filtered to focus on financial fraud investigations involving publicly-traded companies – a total of 618 investigations of 587 companies. The study reports that only 25 percent of these investigations -- 156 inquiries -- resulted in SEC public enforcement actions.

The study compares the companies that disclosed the investigation with those that did not and finds evidence that both the company and the CEO incur significant costs as a result of disclosure, regardless of SEC enforcement outcome. “Our results are consistent with the notion that being known to have faced allegations of fraudulent conduct and being found “not guilty” is considerably worse than if investors never know about the allegations at all. Put differently, whatever rewards firms may gain from transparency seem to be outweighed by the costs of revealing bad news.”

The authors suggest that one potential reason why disclosure may be detrimental, “even over long horizons and after controlling for investigation outcomes,” is what they refer to as limited investor attention. Investors may not pay much attention to the details of financial reporting issues “without the dramatic information that the SEC has become involved” since an “SEC investigation colors perceptions of the firm in a negative light, even if the subsequent investigation does not lead anywhere.” Conversely, the fact that the SEC closed its investigation without bringing an action may not be disclosed (or, even if it is, may attract much less attention than the original disclosure).

With respect to the impact of disclosure of an investigation on the CEO, the study hypothesizes that boards may react to the public pressure from disclosure by terminating the CEO “to deflect blame from themselves.” The study finds that investigation disclosure has greater negative effects on CEO tenure than does an SEC sanction imposed on the CEO. “This suggests that boards react negatively to the existence of an investigation, but they react considerably more to the public revelation of the investigation.”

The authors conclude by recommending that the SEC establish a rule for the disclosure of investigations. “A clear regulatory or legal ruling one way or the other – that disclosure is always mandated (either by the firm or by the SEC itself), or that firms will face no legal sanction or liability for failing to disclose the investigation – would seem beneficial.”

Comment: The circumstances which lead to SEC financial fraud investigations vary widely, as do the pros and cons of voluntary disclosure. The Solomon and Soltes research, while intriguing, should not be a factor in deciding whether to disclose an investigation. The paper does, however, underscore how seriously the markets are likely to take news of a financial fraud investigation. The audit committee needs to treat such a matter equally seriously.

PCAOB 2017 Inspections Status Report

On June 27, the PCAOB made publicly available the Report on 2017 Inspection of BDO USA, LLP. During the 2017 inspection cycle, the PCAOB reviewed 23 BDO issuer audits. In nine of those audits (39 percent), the PCAOB staff identified deficiencies of such significance that it appeared to the inspection team that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to BDO’s 75 percent deficiency rate in 2016. Seven of the nine engagements described in Part I of the report included deficiencies related to both the audit of the financial statements and the audit internal control over financial reporting (ICFR). One of the nine engagements included only an ICFR audit deficiency, and one included only a financial statement audit deficiency. (It is not clear from the report whether the engagement which included only a financial statement deficiency was an integrated audit of both the financial statements and ICFR or a financial statement only audit.)

The PCAOB has now released the public portion of the 2017 inspections reports with respect to the U.S. affiliate of five of the six global network accounting firms. (The Global Networks are described on the PCAOB’s website.) No 2017 report has yet been issued for the U.S. affiliate of Ernst & Young Global. The

table below summarizes the results of the 2017 inspections of the firms for which inspection reports are available.

2017 Inspections of U.S. Affiliates of Global Networks (Reports Made Publicly Available in 2019)

Firm	Report Date	Engagements Inspected	Part I Deficiencies*	Percentage
BDO	June 20, 2019	23	9	39%
Deloitte & Touche	December 20, 2018	55	11	20%
Grant Thornton	March 21, 2019	34	6	18%
KPMG	January 24, 2019	52	26	50%
PwC	February 28, 2019	55	13	24%

* The PCAOB describes deficiencies that are included in Part I of an inspection report as "of such significance that it appeared to the inspection team that the firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion."

After the PCAOB has made the 2017 inspection reports for the U.S. affiliate of all six global networks available, the Update will present an overview of the PCAOB's inspection findings concerning these firms.

Comment: Audit committees should discuss the results of the firm's most recent PCAOB inspection with their engagement partner. If the company's audit is mentioned in either the public or nonpublic portion of the inspection report, the audit committee should understand the reasons for the reference to the audit and how it will affect the engagement in the future. If the company's audit is not cited in the report, the audit committee should explore with the auditor how deficiencies identified in other audits might have affected the company's audit and how changes in the firm's procedures might affect future audits. Audit committees should also understand how the firm intends to remediate quality control deficiencies described in the nonpublic portion of the report.

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Prior Updates issued after January 1, 2019 are available here.