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# AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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

**In This Update**

**2024 PCAOB Large Firm Inspection Reports**

**How the PCAOB Staff Sees the 2024 Inspection Results**

**SEC Accounting and Auditing Enforcement Slumped in 2024, While PCAOB Enforcement Hit a New High**

**BDO on Financial Reporting Implications of Tariffs and Questions Audit Committees Should Ask**

**On the Update Radar: Things in Brief**

- **SEC Takes Another Step Away From Climate Disclosure**
- **E.U. is Dialing Dial Back Sustainability Reporting and Due Diligence**
- **Another Independence Monitoring Disclosure: PCAOB Makes Public a 2020 EY QC Criticism**

**The Audit Blog**

## 2024 PCAOB Large Firm Inspection Reports

On March 31, the Public Company Accounting Oversight Board released the 2024 inspection reports for the U.S. affiliates of the six global network accounting firms, BDO USA, P.C. (BDO), Deloitte & Touche LLP (Deloitte), Ernst & Young LLP (EY), Grant Thornton LLP (Grant), KPMG LLP (KPMG), and PricewaterhouseCoopers LLP (PwC). In 26 percent of the 2024 engagements the PCAOB inspected for these six large firms, it found one or more Part I.A deficiencies – that is, deficiencies of such significance that it appeared that the firm did not obtain sufficient evidence to support its opinion. This compares to a 34 percent deficient engagement rate for the six firms in 2023. See 2023 PCAOB Large Firm Inspection Reports, August 2024 Update. (In this post, the percentage of inspected engagements in which the staff found one or more Part I.A deficiencies is referred to as the "deficient engagement rate" or DER). For the

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Dan Goelzer is a retired partner of Baker McKenzie, a major international law firm. The SEC appointed him to the Public Company Accounting Oversight Board as one of its founding members, and he served on the PCAOB from 2002 to 2012, including as Acting Chair from 2009 to 2011. Dan was on the Securities and Exchange Commission's staff for 16 years and served as SEC General Counsel from 1983 to 1990. He chaired Deloitte's Audit Quality Advisory Council for eleven years, and, from 2017 to July 2022, was a Sustainability Accounting Standards Board member.

Big Four firms only – Deloitte, EY, KPMG, and PwC -- the 2024 DER was 20 percent – six percent better than the 26 percent DER in 2023.

In a press release announcing the six inspection reports, the Board also announced publication of a staff report, Spotlight: Staff Update on 2024 Inspection Activities, which describes the overall results of the 2024 inspection program in detail. According to that report, for all 171 firms inspected in 2024, the Part I.A DER decreased to 39 percent, down from 46 percent in 2023. The press release also quotes SEC Chair Williams as characterizing the 2024 results as demonstrating "real progress in protecting investors." She urges the audit profession "to build on this momentum." For a summary of the Spotlight report on the 2024 inspections, see How the PCAOB Staff Sees the 2024 Inspection Results in this Update.

This item analyzes the 2024 inspection reports of the six U.S. affiliates of the global network firms (GNFs), compares them to last year's results and to each other, and offers some observations. Audit committees should review their audit firm's inspection report and discuss it with their engagement partner. The information below is intended to provide context for that discussion.

Overview of 2024 Global Network Firm Results

As noted above, in 26 percent of the GNF audit engagements it inspected in 2024, the PCAOB found one or more Part I.A deficiencies. The DER fell for all six firms. BDO experienced the greatest improvement, with its DER falling from 86 percent in 2023 to (a still high) 60 percent in 2024. Three firms had DERs above 25 percent -- EY (28 percent), Grant (48 percent), and BDO (60 percent). See Tables 1 and 2.

Deloitte's inspection results were the best in the GNF group, followed closely by PwC. The Board found deficiencies in nine of the 63 Deloitte audits its inspected (14 percent). In 2023, the Board found deficiencies in twelve (21 percent) of 56 Deloitte engagements inspected. PwC had ten deficient engagements (16 percent), a modest improvement over its 18 percent rate in 2023. At the other end of the spectrum, BDO, as in 2023, had the highest percentage of deficient engagements. The Board found problems with 18 (60 percent) of the 30 BDO audits it inspected, down from 86 percent last year. The 86 percent DER in 2023 appears to be the highest ever experienced by one of these six firms.

Each engagement in Part I.A of an inspection report may contain several audit deficiencies. Therefore, in addition to comparing their DERs, another way of assessing the firms' inspection results is to compare the number of individual audit deficiencies the Board found. See Table 3. Deloitte was also the best performer by this metric, followed by PwC. For Deloitte, the Board inspected 63 engagements and found 20 audit deficiencies – 0.3 deficiencies per inspected engagement and 2.2 deficiencies per engagement in Part I.A. In PwC's report, there were 0.5 deficiencies per inspection and an average of three deficiencies per Part I.A engagement. In contrast, for BDO the comparable numbers were 2.4 deficiencies per inspection and an average of four deficiencies per Part I.A engagement. Grant had 2.2 deficiencies per inspection and 4.5 deficiencies per Part I.A engagement.

In 2024, as in past years, a substantial number of Part I.A deficiencies related to audits of internal control over financial reporting (ICFR). Inspectors found ICFR audit deficiencies in 21 percent of the integrated audits they inspected, down from 27 percent in the 2023 GNF inspections. Similarly, 21 percent of all inspected engagements were found to have a financial statement audit deficiency. Sixty-eight percent of audit engagements described in Part I.A of the 2024 inspection reports of the six GNFs included an ICFR deficiency and 80 percent included a financial statement audit deficiency. AS 2201, An Audit of Internal Control Over Financial Reporting that is Integrated with An Audit of the Financial Statements, was the most frequently cited auditing standard by a wide margin. See Table 4. "Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing" was the most frequently cited audit deficiency. See Table 5.

Part I.B of an inspection report describes instances of non-compliance with PCAOB standards or rules that do not relate directly to the sufficiency or appropriateness of the evidence supporting an audit opinion. The 2024 inspection reports of the six GNFs include 161 Part I.B deficiencies, compared to 149

in 2023. See Table 6. The most-frequently cited PCAOB standard or rule in Part I.B was AS 1301, Communications with Audit Committees, and the most common Part I.B finding was the failure to make one or more required communications to the audit committee. See Tables 7 and 8.

Part I.C of an inspection report describes instances of potential non-compliance with rules related to auditor independence. The 2024 inspection reports of the six GNFs describe 559 instances of potential non-compliance with the independence rules, of which 518 were firm self-reported and 41 were identified by the PCAOB. The most common potential independence issue was a financial relationship with an audit client (e.g., instances where either a partner in the same office as the engagement partner or an individual who provided 10 or more hours of non-audit services to the client had an investment relationship with the client). See Tables 9 and 10. As the PCAOB points out, disclosure in Part I.C of an instance of potential non-compliance with the independence rules does not necessarily mean that the Board or the firm has concluded that the firm was not objective and impartial throughout the audit and professional engagement period. In the 559 instances of apparent non-compliance described in Part I.C of the six reports, if the firm involved was the principal auditor, it evaluated the potential non-compliance and determined that its objectivity and impartiality were not impaired.

Summaries of 2024 Global Network Firm Inspection Reports

Below are summaries of the 2024 inspection reports of each of the six U.S. GNF affiliates:

- BDO USA, P.C. The PCAOB reviewed 30 BDO public company audits, 18 of which were integrated audits of both the financial statements and ICFR. In 18 of the 30 audits (60 percent), the PCAOB identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to BDO's 86 percent DER in 2023. In one of the 18 deficient engagements, the firm's opinion and the public company's report on ICFR effectiveness were determined to be incorrect and were subsequently revised Seven of the 18 engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR; ten included only a financial statement audit deficiency; and one included only an ICFR audit deficiency. The PCAOB described 72 audit deficiencies (2.4 deficiencies per inspection) associated with 82 auditing standards (2.7 standards per inspection) in the 18 engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified 29 instances of noncompliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described five instances it identified of potential non-compliance with independence rules and seven instances the firm identified.

- Deloitte & Touche LLP. The PCAOB reviewed 63 Deloitte public company audits, 50 of which were integrated audits of both the financial statements and ICFR. In nine of the 63 audits (14 percent), the PCAOB staff identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to Deloitte's 21 percent DER in 2023. Five of the nine engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR, two included only a financial statement audit deficiency, and two included only an ICFR audit deficiency. The PCAOB described 20 audit deficiencies (0.3 deficiencies per inspection) associated with 24 auditing standards (0.4 standards per inspection) in the nine engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified 18 instances of noncompliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described 15 instances it identified of potential non-compliance with independence rules and 106 instances that the firm identified.

- Ernst & Young LLP. The PCAOB reviewed 64 EY public company audits, 59 of which were integrated audits of both the financial statements and ICFR. In 18 of the 64 audits (28 percent), the PCAOB staff identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to EY's 37

percent DER in 2023. In two of the 18 deficient engagements, the firm's opinion, and the public company's report, on ICFR effectiveness were determined to be incorrect and were subsequently revised; in one of those audits, the issuer also restated its financial statements, and the firm revised and reissued its report on the financial statements. Eleven of the 18 engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR, four included only a financial statement audit deficiency, and three included only a deficiency in the ICFR audit. The PCAOB described 80 audit deficiencies (1.3 deficiencies per inspection) associated with 86 auditing standards (1.3 standards per inspection) in the 18 engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified 23 instances of non-compliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described eight instances it identified of potential non-compliance with independence rules and 107 instances that the firm identified.

- Grant Thornton LLP. The PCAOB reviewed 27 Grant public company audits, 19 of which were integrated audits of both the financial statements and ICFR. In 13 of the 27 audits (48 percent), the PCAOB staff identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to Grant's 54 percent DER in 2023. Six of the engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR, five included only a financial statement audit deficiency, and two included only an ICFR audit deficiency. The PCAOB described 59 audit deficiencies (2.2 deficiencies per inspection) associated with 60 auditing standards (2.2 standards per inspection) in the 13 engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified eleven instances of noncompliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described five instances it identified of potential non-compliance with independence rules and 105 instances that the firm identified.

- KPMG LLP. The PCAOB reviewed 64 KPMG public company audits, 58 of which were integrated audits of both the financial statements and ICFR. In 13 of the 64 audits (20 percent), the PCAOB identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to KPMG's 26 percent DER in 2023. Seven of the engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR, one included only a financial statement audit deficiency, and five included only an ICFR audit deficiency. The PCAOB described 49 audit deficiencies (0.8 deficiencies per inspection) associated with 53 auditing standards (0.8 standards per inspection) in the 13 engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified 39 instances of noncompliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described no instances it identified of potential non-compliance with independence rules and 49 instances that the firm identified.

- PricewaterhouseCoopers LLP. The PCAOB reviewed 64 PwC public company audits, 54 of which were integrated audits of both the financial statements and ICFR. In ten of the 64 audits (16 percent), the PCAOB staff identified deficiencies of such significance that it appeared that the firm had not obtained sufficient appropriate audit evidence to support its opinion. This compares to PwC's 18 percent DER in 2023. In one of the ten deficient engagements, the issuer concluded that its financial statements included misstatements and should be restated. Three of the engagements in Part I.A included deficiencies related to both the audit of the financial statements and the audit of ICFR, four included only a financial statement audit deficiency, and three included only an ICFR audit deficiency. The PCAOB described 30 audit deficiencies (0.5 deficiencies per inspection) associated with 33 auditing standards (0.5 standards per inspection) in the ten engagements in Part I.A. In Part I.B of the inspection report, the PCAOB identified 41 instances of noncompliance with PCAOB standards or rules that did not relate directly to the evidence the firm obtained to support an opinion. In Part I.C, the Board described eight instances it identified of potential non-compliance with independence rules and 144 instances that the firm identified.

Comparison of Global Network Firm Part I.A Results

Table 1 compares the overall results of the 2024 inspections of the six U.S. affiliates of the GNFs. Table 2, which appeared in 2023 PCAOB Large Firm Inspection Reports, August 2024 Update, compares the results of the 2023 inspections of the six firms.

TABLE 1

2024 INSPECTIONS OF U.S. AFFILIATE OF GLOBAL NETWORK FIRMS
(Reports are dated February 26, 2025, and were released on March 31, 2025)

| Firm | Engagements Inspected | Deficient Engagements Described in Part I.A | Percentage of Inspected Engagements with Deficiencies |
|---|---|---|---|
| BDO | 30 | 18 | 60% |
| Deloitte & Touche | 63 | 9 | 14% |
| Ernst & Young | 64 | 18 | 28% |
| Grant Thornton | 27 | 13 | 48% |
| KPMG | 64 | 13 | 20% |
| PwC | 64 | 10 | 16% |
| Global Network Firm Totals | 312 | 81 | |
| Global Network Firm Averages | 52 | 14 | 26% |

TABLE 2

2023 INSPECTIONS OF U.S. AFFILIATE OF GLOBAL NETWORK FIRMS
(Reports are dated between May 23, 2024, and June 20, 2024, and were released on August 15, 2024)

| Firm | Engagements Inspected | Deficient Engagements Described in Part I.A | Percentage of Inspected Engagements with Deficiencies |
|---|---|---|---|
| BDO | 29 | 25 | 86% |
| Deloitte & Touche | 56 | 12 | 21% |
| Ernst & Young | 59 | 22 | 37% |
| Grant Thornton | 28 | 15 | 54% |
| KPMG | 58 | 15 | 26% |
| PwC | 57 | 10 | 18% |
| Global Network Firm Totals | 287 | 99 | |
| Global Network Firm Averages | 48 | 17 | 34% |

Tables 1 and 2 focus on the percentage of inspected engagements that have at least one audit deficiency. Other indicators of the relative performance of the six firms are the number individual audit deficiencies in each report and the number of citations to auditing standards associated with those deficiencies. These metrics differ from the DER because an engagement included in Part I.A may involve more than one deficiency. Table 3 compares the performance of the six firms based on the number of audit deficiencies in each inspection report and the number of auditing standards associated with those

deficiencies. In some cases, there is an element of judgment in determining the number of deficiencies in a Part I.A engagement description.

TABLE 3

DEFICIENCIES AND ASSOCIATED AUDITING STANDARDS IN PART I.A OF GLOBAL NETWORK FIRM 2024 INSPECTION REPORTS

| Firm | Engagements Inspected | Deficient Engagements | Total Deficiencies | Standards Referenced | Deficiencies Per Inspected Engagement | Standards Referenced Per Inspected Engagement |
|---|---|---|---|---|---|---|
| BDO | 30 | 18 | 72 | 82 | 2.4 | 2.7 |
| Deloitte & Touche | 63 | 9 | 20 | 24 | 0.3 | 0.4 |
| Ernst & Young | 64 | 18 | 80 | 86 | 1.3 | 1.3 |
| Grant Thornton | 27 | 13 | 59 | 60 | 2.2 | 2.2 |
| KPMG | 64 | 13 | 49 | 53 | 0.8 | 0.8 |
| PwC | 64 | 10 | 30 | 33 | 0.5 | 0.5 |
| Global Network Firm Totals | 312 | 81 | 310 | 338 | | |
| Global Network Firm Averages | 52 | 14 | 52 | 56 | 1.0 | 1.1 |

Aggregate Part I.A Data on Auditing Standards, Deficiency Descriptions, and Audit Areas

Auditing standards cited in deficiencies. Table 4 lists the auditing standards most frequently cited as the basis for audit deficiencies in Part I.A of the 2024 GNF inspection reports. Table 4 also shows the percentage of all deficiencies that were based on each auditing standard. The same auditing standard may have been cited multiple times in an engagement described in Part I.A. Table 4 only includes standards cited more than twice.

TABLE 4

AUDITING STANDARDS REFERENCED IN GLOBAL NETWORK FIRM 2024 PART I.A DEFICIENCY FINDINGS

| PCAOB Auditing Standard | Number of Times Standard Cited as Deficiency Basis | Percentage of Total Deficiencies Citing Standard |
|---|---|---|
| AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of the Financial Statements | 159 | 47.0% |
| AS 2301, The Auditor's Response to the Risks of Material Misstatement | 47 | 13.9% |
| AS 1105, Audit Evidence | 45 | 13.3% |
| AS 2501, Auditing Accounting Estimates | 39 | 11.5% |
| AS 2810, Evaluating Audit Results | 12 | 3.6% |
| AS 2315, Audit Sampling | 11 | 3.3% |
| AS 1201, Supervision of the Audit Engagement | 7 | 2.1% |
| AS 2305, Substantive Analytical Procedures | 6 | 1.4% |
| AS 2310, The Confirmation Process | 3 | 0.9% |
| AS 2510, Auditing Inventories | 3 | 0.9% |

Audit deficiencies. In each inspection report, the PCAOB lists the most frequently identified audit deficiencies, divided between the most frequent deficiencies in financial statement (FS) audits and the most frequent deficiencies in ICFR audits. Table 5 aggregates these frequent deficiency lists for the six GNFs. Table 5 also indicates what percentage of the engagements in Part I of the six reports included these deficiencies.

TABLE 5

MOST FREQUENTLY IDENTIFIED AUDIT DEFICIENCIES
IN 2024 GLOBAL NETWORK FIRM INSPECTION REPORTS

| Deficiency Description | Number of Times Deficiency Was Identified | Audit Affected | Share of All Most Frequent Deficiencies |
|---|---|---|---|
| Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing. | 40 | ICFR | 22.6% |
| Did not identify and/or sufficiently test controls over accuracy and completeness of data or reports that the issuer used in the operation of controls. | 32 | ICFR | 18.1% |
| Did not perform sufficient testing related to a significant account or disclosure or to address an identified risk. | 30 | FS | 16.9% |
| Did not sufficiently test an estimate. | 24 | FS | 13.6% |
| Did not identify and test any controls that addressed the risks related to a significant account or relevant assertion. | 23 | ICFR | 13.0% |
| Did not perform sufficient testing of data or reports used in the firm's substantive testing. | 16 | FS | 9.0% |
| Did not obtain sufficient evidence as a result of overreliance on controls (due to deficiencies in testing controls). | 7 | FS | 4.0% |
| Did not sufficiently evaluate the appropriateness of the issuer's accounting method or disclosure for one or more transactions or accounts. | 5 | FS | 2.8% |

Audit/financial statement areas. For each inspection report, the PCAOB lists the audit areas with frequent Part I.A deficiencies. For the six firms, on an aggregate basis, these areas (excluding those cited only once) are:

- Revenue and related accounts – 36 deficiencies.
- Inventory – 12 deficiencies.
- Allowance for credit losses/Allowance for loan losses – 10 deficiencies.
- Business combinations – 7 deficiencies.
- Goodwill and intangible assets – 6 deficiencies.
- Long-lived assets – 4 deficiencies.
- Investment securities – 3 deficiencies.
- Leases – 2 deficiencies.

Global Network Firm Part I.B Results

Part I.B of an inspection report describes instances of non-compliance with PCAOB standards or rules that do not relate directly to the sufficiency or appropriateness of the evidence supporting an audit opinion. In 2024, the PCAOB found an aggregate of 161 such deficiencies, compared to 149 in 2023.

Comparison of firm results. Table 6 presents the number of Part I.B deficiencies for each of the six GNFs and compares each firm's 2024 Part I.B results to its 2023 report. Year-to-year comparisons may provide general insight into Part I.B trends but should be interpreted with caution. It appears that the PCAOB does not review all inspected engagements for every type of Part I.B deficiency. Therefore, the number of Part I.B deficiencies in a firm's inspection report is not directly comparable to the number in other firms' reports or to the number reported in prior years.

TABLE 6

PART I.B DEFICIENCIES: 2024 and 2023 INSPECTIONS OF U.S. AFFILIATE OF GLOBAL NETWORK FIRMS

| Firm | 2024 Part I.B Deficiencies | 2023 Part I.B Deficiencies | Net Change in Part I.B Deficiencies 2022 to 2023 |
|---|---|---|---|
| BDO | 29 | 32 | -3 |
| Deloitte & Touche | 18 | 14 | +4 |
| Ernst & Young | 23 | 22 | +1 |
| Grant Thornton | 11 | 30 | -19 |
| KPMG | 39 | 36 | +3 |
| PwC | 41 | 15 | +26 |
| Global Network Firm Totals | 161 | 149 | +12 |
| Global Network Firm Averages | 26.8 | 24.8 | +2 |

Part I.B auditing standards and rules. Table 7 lists the PCAOB auditing standards and rules most frequently referenced in Part I.B deficiencies in the six reports. Table 7 only includes deficiencies cited more than twice.

TABLE 7

AUDITING STANDARDS AND RULES REFERENCED IN PART I.B OF 2024 GLOBAL NETWORK FIRM REPORTS

| PCAOB Auditing Standard or Rule | Number of Times Cited as Deficiency Basis |
|---|---|
| AS 1301, Communications with Audit Committees | 43 |
| AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of the Financial Statements | 33 |
| AS 2110, Identifying and Assessing Risks of Material Misstatement | 24 |
| AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion | 14 |
| AS 2101, Audit Planning | 11 |
| AS 2401, Consideration of Fraud in a Financial Statement Audit | 8 |
| Rule 3524, Audit Committee Pre-approval of Certain Tax Services | 8 |
| Rule 3211, Auditor Reporting of Certain Audit Participants | 6 |
| AS 1215, Audit Documentation | 5 |

Part I.B deficiencies. An auditing standard or rule may encompass more than one type of deficiency. Table 8 sets forth descriptions of the non-audit deficiencies most frequently described in Part I.B of the 2024 GNF inspection reports. These descriptions are not always consistent across all six reports. For example, some reports disaggregate the types of audit committee communications that were not made, while others combine several types of communication failures in a single deficiency description.

TABLE 8

MOST FREQUENT PART I.B DEFICIENCIES DESCRIBED IN 2024 GLOBAL NETWORK FIRM INSPECTION REPORTS

| Deficiency Description/Auditing Standard or Rule | Number of Times Deficiency Cited |
|---|---|
| Firm did not make one or more required communications to the audit committee related to (1) other accounting firms or persons not employed by the firm that performed audit procedures; (2) corrected or uncorrected misstatements; (3) critical accounting policies and practices; (4) critical accounting estimates; (5) significant unusual transactions; (6) planned use of the work of internal auditors; (7) firm's evaluation of the quality of the issuer's financial reporting; or (8) firm's evaluation of the issuer's ability to continue as a going concern. AS 1301, Communications with Audit Committees | 37 |
| Firm reported in writing to the audit committee that no significant deficiencies were identified during the audit, even though an ICFR audit does not provide assurance that all deficiencies less severe than a material weakness have been identified. AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of the Financial Statements | 20 |
| Firm did not inquire of, or make all required inquiries of, certain members of management, the internal audit function, and/or others in the company about the risks of material misstatement, including fraud risks. AS 2110, Identifying and Assessing Risks of Material Misstatement | 17 |
| Firm did not perform procedures to determine whether all individuals who participated in the audit were in compliance with independence requirements. AS 2101, Audit Planning | 11 |
| Firm did not communicate to management, in writing, all control deficiencies identified during the audit and/or inform the audit committee when such communication had been made. AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of the Financial Statements | 10 |
| Engagement team performed procedures to determine whether or not matters were critical audit matters but did not include a matter that was communicated to the audit committee and that related to accounts or disclosures that were material to the financial statements. AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion | 7 |
| Firm did not describe, in writing and in connection with seeking pre-approval, to the issuer's audit committee the scope and/or fee structure for these services. Rule 3524, Audit Committee Pre-approval of Certain Tax Services | 7 |
| Firm's report on Form AP omitted information or included inaccurate information related to the issuer or to the participation in the audit by other accounting firms. Rule 3211, Auditor Reporting of Certain Audit Participants | 6 |
| Firm, when testing journal entries for evidence of possible material misstatement due to fraud, (1) did not appropriately consider the characteristics of potentially fraudulent journal entries in determining the criteria it used to identify and select journal entries for testing; or (2) identified fraud risk characteristics but did not perform sufficient procedures to identify all journal entries that had those characteristics. AS 2401, Consideration of Fraud in a Financial Statement Audit | 5 |
| Firm did not include all relevant work papers in the final set of audit documentation it was required to assemble. AS 1215. Audit Documentation | 4 |

Global Network Firm Part I.C Results

Part I.C of an inspection report discusses instances of potential non-compliance with SEC or PCAOB auditor independence rules. Part I.C describes both instances of potential noncompliance that the PCAOB identified and instances that the firm self-reported during its inspection. Across the six GNFs, the Board identified 41 instances of potential independence rule noncompliance, 15 of which were at Deloitte. The six firms self-reported 518 such instances, 144 of which were at PwC.

Comparison of firm results. Table 9 presents the Part I.C instances of potential non-compliance with the independence rules for each of the six firms. In reviewing Table 9, readers should be aware that each inspection report contains the following warning:

> "While we have not evaluated the underlying reasons for the instances of potential non-compliance, the number, large or small, of firm-identified instances of potential non-compliance may be reflective of the size of the firm, including the number of non-U.S. associated firms in the global network; the design and effectiveness of the firm's independence monitoring activities; and the size and/or complexity of the issuers it audits, including the number of affiliates of the issuer. Therefore, we caution against making any comparison of these firm-identified instances of potential non-compliance across firms."

TABLE 9

INSTANCES OF POTENTIAL NON-COMPLIANCE WITH INDEPENDENCE RULES IN PART I.C OF GLOBAL NETWORK FIRM 2024 INSPECTION REPORTS

| Firm | PCAOB-Identified Instances | Firm-Identified Instances | Issuers Affected By Firm-Identified Instances | Affected Firm-Identified Issuers As Percent of All Issuers | Non-U.S. Affiliate As Percent of Firm-Identified Instances |
|---|---|---|---|---|---|
| BDO | 5 | 7 | 4 | 2% | Not stated |
| Deloitte & Touche | 15 | 106 | 68 | 3% | 30% |
| Ernst & Young | 8 | 107 | 56 | 4% | 36% |
| Grant Thornton | 5 | 105 | 51 | 1% | 44% |
| KPMG | 0 | 49 | 28 | 3% | 76% |
| PwC | 8 | 144 | 67 | 4% | 33% |
| Global Network Firm Totals | 41 | 518 | 274 | | |
| Global Network Firm Averages | 6.8 | 86.3 | 45.7 | | |

Part I.C deficiencies. Each inspection report describes the most common instances of potential independence non-compliance in the firm-reported cases. Table 10 lists these firm-identified independence issues on an aggregate basis, combined with those identified by the PCAOB. Because the descriptions in each inspection report include only the most common firm-identified instances, Table 10 does not reflect all 559 potential instances of non-compliance.

TABLE 10

COMMON INSTANCES OF POTENTIAL NON-COMPLIANCE WITH INDEPENDENCE RULES IN PART I.C OF 2024 GLOBAL NETWORK FIRM INSPECTION REPORTS

| Potential Non-Compliance/Applicable Rule | Number of Times Potential Non-compliance Cited |
|---|---|
| Financial relationships, including investments in or other financial relationships with audit clients (e.g., instances where either a partner in the same office as the engagement partner or an individual who provided 10 or more hours of non-audit services to the client had a financial relationship with the client). SEC Regulation S-X, Rule 2-01(c)(1) | 233 |
| Failure to obtain audit committee pre-approval of services, including instances related to services provided by non-U.S. firms associated with the auditor without obtaining audit committee pre-approval. SEC Regulation S-X, Rule 2-01(c)(7) | 203 |
| Employment relationships, including instances in which a former employee of the firm was employed at an audit client in an accounting or financial reporting oversight role or a staff-level employee of the firm was also employed by the audit client. SEC Regulation S-X, Rule 2-01(c)(2) | 35 |
| Non-audit services, including instances related to services provided by the firm or by a non-U.S. associated firm, such as performing management functions for an affiliate of the client. SEC Regulation S-X, Rule 2-01(c)(4) | 17 |
| Direct or material indirect business relationship with audit client or with certain persons associated with audit client. SEC Regulation S-X, Rule 2-01(c)(3) | 13 |
| Indemnification clauses, including agreements under which the audit client agreed to indemnify the auditor with respect to certain liabilities arising from the audit. Regulation S-X, Rule 2-01(b) | 7 |
| Unpaid fees for any professional services provided to the audit client more than one year prior to the date of the audit report. PCAOB ET Section 191 | 6 |
| Non-compliance with the SEC's partner rotation requirement. SEC Regulation S-X, Rule 2-01(c)(6) | 2 |

## Audit Committee Takeaways

1. For companies that are audited by one of the six GNF U.S. affiliates, the audit committees may want to consider the following highlights of the six 2024 inspections in preparation for discussing the audit firm's inspection results with the company's engagement partner:

a. If inspection results measure audit quality, then audit is improving at the six global network firms. The overall Part I.A DER (i.e., percentage of inspected engagements included in Part I.A of the inspection report) for the six firms fell from 34 percent in 2023 to 26 percent in 2024. By this measure, all six firms improved their performance in 2024. At the Big Four as a group – DT, EY, PwC, and KPMG – the DER declined to 20 percent from 26 percent in both 2023 and 2022. The number of individual audit deficiencies per inspected engagement also improved substantially, falling almost 40 percent for the six GNFs as a group.

b. While the disparities between the six firms' inspection results are still large, they decreased in 2024. There was a 46 percent difference in DERs between the firm with the lowest rate (Deloitte at 14 percent) and the firm with the highest rate (BDO at 60 percent). While this is a significant difference, it is the smallest gap between the top and bottom firms in at least the past three years and reverses a trend of widening differences. In the 2023 inspections, the gap was 68 percent and in 2022 and 2021 it was 57 percent and 49 percent, respectively. Similarly, the PCAOB found 0.3 deficiencies for every Deloitte audit it inspected and 2.4 deficiencies – eight times more -- for every

BDO audit. But this measure is also going in the right direction: In 2023, the ratio of lowest firm to highest firm deficiencies per inspection was ten to one.

c. ICFR audit deficiencies are still a major driver of audit deficiencies. As in prior years, Auditing Standard No.2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of the Financial Statements, was by far the most frequently cited auditing standard in Part I.A. deficiencies. Forty-seven percent of all deficiencies cited AS 2201, up slightly from 44 percent in the 2023 inspections. In addition, the two most common audit deficiencies in Part I.A of the six firms' reports both related to the ICFR audit: "Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing" and "Did not identify and/or sufficiently test controls over accuracy and completeness of data or reports that the issuer used in the operation of controls." Sixty-eight percent of engagements in Part I.A included at least one ICFR deficiency (compared to 67 percent in 2023).

d. Audit committee communications lapses dominated Part I.B non-audit deficiencies. Part I.B deficiencies increased from 149 in 2023 to 161 2024. As in the past, it is not clear whether this increase reflects more underlying non-audit deficiencies or more PCAOB inspection focus on Part I.B issues. The audit committee communications requirements were the most common source of these deficiencies: Auditing Standard 1301, Communications with Audit Committees, was cited more frequently than any other standard in the descriptions of Part I.B deficiencies. The two most frequent Part I.B deficiencies were failure to make one or more required audit committee communications and reporting to the audit committee that no significant deficiencies were identified during the audit, even though an ICFR audit does not provide assurance that all deficiencies less severe than a material weakness have been identified.

e. Instances of Part I.C. independence-related potential non-compliance increased. In 2024, the six GNFs self-reported 518 instances of potential non-compliance with the independence rules, and the PCAOB uncovered 41 more instances. This compares to 460 self-reported and 24 PCAOB-identified incidences in 2023. The combined 2024 total was 559, up from 484 in 2023. PwC had the highest combined total of Part I.C instances (152) while BDO had the fewest (12). In all instances of non-compliance described in Part I.C where the firm was the principal auditor, it determined that its objectivity and impartiality were not impaired.

f. Failure to obtain audit committee pre-approval of services was a frequent independence issue. The most common Part I.C instance of potential non-compliance with the independence requirements was the existence of a financial relationship, such as an investment in the audit client, with someone who was covered by the SEC's independence rules. However, the second most common type of instance was noncompliance with the requirement for audit committee pre-approval of services, and 33 of the 41 PCAOB-identified instances of potential non-compliance with the independence rules involved noncompliance with the audit committee pre-approval requirement.

2. Audit committees seeking to understand their audit firm's inspection results and how they fit into the overall context of the 2024 inspections may also want to review Spotlight: Staff Update on 2024 Inspection Activities. This publication describes in detail the PCAOB's 2024 public company inspection program and discusses the inspection staff's views of the results. For a summary, see How the PCAOB Staff Sees its 2024 Inspection Activities in this Update.

3. In Spotlight: Staff Update and Preview of 2022 Inspection Observations, the staff suggested that audit committees consider asking these four questions 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? (Although findings decreased in 2024, the committee might want to ask generally what the firm is doing to address deficiencies described in its inspection report.)

- Are there any audit procedures that are unnecessarily complicated or not “straight-forward” because management is not providing clear, supportable information? (While not related to inspection reporting, this question “may encourage effective two-way communication to assist in understanding matters relevant to the audit.)

4. As noted in past Updates, the audit deficiency descriptions and auditing standard deficiency tables could serve as a discussion topic checklist. Audit committees may also 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. Of course, if the company’s engagement was the basis for an inspection finding, the audit committee should understand in depth the cause of the deficiency, the impact on the audit, and how the auditor plans to remedy it and prevent a recurrence.

## How the PCAOB Staff Sees the 2024 Inspection Results

The Public Company Accounting Oversight Board’s inspections staff has released Spotlight: Staff Update on 2024 Inspection Activities (2024 Inspections Spotlight). This publication is a comprehensive discussion of the PCAOB’s 2024 public company audit inspection results. In 2024, the PCAOB inspected 171 PCAOB-registered public accounting firms. In those inspections, the staff reviewed portions of over 800 public company audits. For last year’s staff summary of the 2023 inspections program, see PCAOB Staff Explains the 2023 Inspection Results, August 2024 Update.

The 2024 Inspections Spotlight begins with an Overview discussing key findings and PCAOB efforts to improve audit quality. Following that discussion, the report consists of four sections – 2024 Inspections Approach; Common Deficiencies; Observations Related to Quality Control Systems; and Areas with Recurring Deficiencies, 2022 to 2024 Inspections.

Overview

In 2024, the PCAOB inspections staff observed “a tangible decrease in Part I.A1 deficiency rates” and “a substantial improvement, in the aggregate, among the largest firms.” The 2024 Inspections Spotlight sets out five key highlights of the 2024 inspection results:

- Overall Part I.A Deficiency Rate: For all 171 inspected firms, the aggregate Part I.A deficiency rate decreased to 39 percent in 2024, down from 46 percent in 2023.

- Big Four U.S. Firms: The aggregate Part I.A deficiency rate for the Big Four U.S. firms decreased to 20 percent in 2024, from 26 percent in 2023.

- U.S. Global Network Firms (GNF): The aggregate Part I.A deficiency rate for the six U.S. GNF firms decreased to 26 percent in 2024, from 34 percent in 2023.

- U.S. Non-Affiliated Firms (NAF): The aggregate deficiency rate for the eight annually inspected firms that are not global network members decreased slightly to 52 percent in 2024, compared to 53 percent in 2023.

- Triennial Firms:  The aggregate deficiency rates for NAF triennially inspected firms decreased from 67 percent in 2023 to 61 percent in 2024.  For triennially inspected non-U.S. affiliates of GNF firms, the deficiency rate decreased from 35 percent in 2023 to 26 percent in 2024.

As to the reasons for improved results in 2024, the staff cites four "drivers of improvement":

- More in-person work. Firms continued with policies requiring engagement teams to work on-site together for a portion of their work week.

- More focused training. Firms increased the training of less experienced staff.

- More resources. Firms strengthened national office resources dedicated to audit quality.

- Better supervision and review. Firms implemented programs or policies to increase supervision and review.

The 2024 Inspections Spotlight also discusses steps the PCAOB has taken to improve audit quality. These includes such initiatives as publishing information and actionable recommendations to help firms improve; providing guidance of the remediation of audit quality deficiencies identified in inspection reports; encouraging communication between audit firms and the PCAOB during the remediation process; and engaging directly with audit committees "as we share a common goal of driving quality audits through effective oversight of external auditors."

2024 Inspections Approach

This section discusses how the Board selected firms and engagements for inspection. In 2024, the inspection program emphasized audits of:

- Regional banks and mutual funds with Level 3 investments (i.e., investments that are not valued based on readily available market information) or other specific audit challenges.

- Public companies engaged in mergers and acquisitions or business combinations.

- Public companies in the information technology sector with complex revenue recognition.

- Public companies that require industry-specific or sector-specific accounting.

- Public companies that held significant assets that may have declined in value, such as collateralized commercial real estate debt.

- Public companies with material digital asset holdings or significant digital asset transactions.

For the largest firms, which are inspected annually, most engagements are selected for review based on factors that suggest increased audit risk.  However, the inspection staff also selects some annually inspected firm engagements at random.  In 2024, 18 percent of annual firm audit engagements were random selections, 77 percent were risk-based, and 5 percent were target team selections.  Nineteen percent of the randomly selected engagements resulted in an audit deficiency that was included in Part I.A of an inspection report, while 37 percent of risk-based inspections resulted in a Part I.A deficiency.

In addition to selecting specific engagements for review, the PCAOB deployed a target team to review certain emerging audit risks across many engagements.  In 2024, the target team focused on:

- Initial audits by a successor auditor.

- Risk assessments.

- Auditor assessments of the company's use of artificial intelligence.
- Biotech startups.
- Audit firms' use of shared service centers.
- Cash flow statements, segment reporting, and earnings per share.

For a summary of the Board's most recent discussion of the work of target teams, see 2023 PCAOB Target Team Report: Crypto, Multi-Location Audits, and Significant Transactions, September-October 2024 Update.

Once an engagement is selected, the staff identifies portions of the audit for review. In 2024, considerations that affected focus area selection included:

- Recurring deficiencies.
- Evaluating audit evidence obtained by the auditor.
- Auditor's understanding of the company and its environment.
- Use of other auditors.
- Going concern.
- Critical audit matters.

The staff also selects non-traditional focus areas for review to observe how the auditor performs procedures in areas that are "less complex, and more routine." During 2024, 2023, and 2022, 10 percent, 15 percent, and 14 percent, respectively, of non-traditional focus areas inspected resulted in a Part I.A deficiency, mostly in the areas of accruals, debt, equity, and expenses.

The industry sectors that accounted for the highest percentages of inspected engagements in 2024 were Financials (19 percent), Information Technology (17 percent), Health Care (14 percent), and Industrials (14 percent). The sectors with the fewest inspections were Real estate and Utilities, each of which accounted for one percent of total inspections.

Common Deficiencies

This section discusses examples of common deficiencies in the audit of internal control over financial reporting (ICFR) and in the financial statement audit that result in Part I.A findings. It also discusses frequently identified types of non-compliance with other PCAOB standards and rules that are the basis for Part I.B and I.C deficiencies.

- ICFR audits. Examples of common ICFR audit deficiencies include deficiencies in risk assessment; selecting controls to test; testing of the design effectiveness of controls; testing management review controls; consideration of the impact of the company's information technology on system-generated data and reports; roll-forward of controls tested at an interim date; using the work of internal or other auditors; and evaluating control deficiencies.

- Financial statement audits. The top five financial statement areas in which inspectors have found audit deficiencies are revenue and related accounts; inventory; accounts impacted by business combinations; investment securities; allowance for credit losses; and long-lived assets, goodwill,

and intangible assets. Deficiencies often involved the auditing of accounting estimates, including fair value measurements.

- Non-audit deficiencies. The most common Part I.B deficiencies (i.e., audit deficiencies that do not impact to the sufficiency of the audit evidence) related to audit committee communications and fraud (such as procedures for assessing fraud risk and performing procedures to address the risk of fraud). Critical audit matter reporting and the timely and accurate filing of Form AP were also frequent Part I.B issues for smaller firms. The 2024 Inspections Spotlight discusses these types of noncompliance and provides examples of deficiencies in each area.

- Independence. Deficiencies related to potential noncompliance with independence requirements are reported in Part I.C of an inspection report. This "remains an area for improvement" since the level of deficiencies has been "fairly consistent year-to-year." The most common independence-related inspection comments concerned personal independence compliance testing, non-audit services, and tax services. Potential violations of SEC independence requirements occurred primarily at smaller, triennially inspected firms. Some larger, annually inspected firms reported a high rate of noncompliance by firm personnel with internal reporting requirements for financial relationships. The 2024 Inspections Spotlight notes that a "public company may be particularly interested in their auditor's potential noncompliance with SEC and PCAOB independence rules, as the auditor independence requirements underpin the public company's requirement to file financial statements audited by an independent registered public accounting firm."

Observations Related To Quality Control Systems

Inspections include an assessment of the firm's system of quality control (QC), including an evaluation of whether audit deficiencies indicate a defect in quality controls. If individual QC defects indicate significant deficiencies in the firm's QC system, Part II of the inspection report discusses those systemic issues as a QC criticism.

The 2024 Inspections Spotlight discusses five examples of common QC deficiencies:

- Testing controls -- QC system does not provide reasonable assurance that control testing will comply with Board standards.

- Reliance on data or reports -- QC system does not provide reasonable assurance that the work performed to establish a basis for reliance on issuer-prepared data or reports will comply with Board standards.

- Supervision of the audit -- QC system does not provide reasonable assurance that engagement partner supervisory activities, including reviews of audit work, will comply with Board standards.

- Engagement quality review (EQR) – QC system does not provide reasonable assurance that review procedures performed by engagement quality reviewers will comply with Board standards.

- Policies for financial holdings disclosures. monitoring -- QC system does not provide reasonable assurance that personnel will comply with firm policies and procedures with respect to independence-related requirements (such as reporting of financial relationships or investments).

QC criticisms in Part II of a firm's inspection report and are nonpublic when the report is issued. If the firm fails to satisfactorily remediate the deficiency within one year of the report date, the Board makes the criticism public. In 2024, the Board made remediation determinations related to 101 firm inspection reports and reached a satisfactory determination for approximately 66 percent – and an increase from 60 percent in 2023. QC areas with an unsatisfactory determination most frequently related to EQR, policies for financial holdings disclosures and other independence matters, testing controls, supervision of the audit, and auditor reporting on Form AP of audit participants.

Areas With Recurring Deficiencies, 2022 To 2024 Inspections

The 2024 Inspections Spotlight presents three years of data on the ICFR audit and financial statement audit areas with recurring deficiencies.

- The most frequent ICFR deficiencies in 2024 comment forms were “testing controls with a review element” and “identifying and selecting controls to test.” These areas were also the top ICFR deficiency areas in 2022 and 2023.

- The financial statement areas in which there were the most ICFR deficiencies in 2024 were Allowance for Credit Losses and Long-lived Assets. Last year, Deposit Liabilities, Loans and Related Accounts, and Other Investments were the areas with the most ICFR deficiencies.

- In 2024, financial statement areas that generated the most comment forms (excluding those related to ICFR) were Other Investments, Allowance for Credit Losses, and Equity and Equity-Related Transactions. Other Investments topped this list in each of 2022, 2023, and 2024.

Audit Committee Takeaways

The 2024 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 2024 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.

The discussion in the 2024 Inspections Spotlight of common and recurring deficiencies may also provide insight into issues the PCAOB is likely to focus on in future inspections and into the audit areas most likely to generate deficiencies. Audit committees may want to discuss with their auditor how it plans to address these areas. The Spotlight may also aid audit committees in understanding their auditor’s risk assessment and resource allocation decisions.

## SEC Accounting and Auditing Enforcement Slumped in 2024, While PCAOB Enforcement Hit a New High

Three reports on accounting and auditing enforcement actions indicate that the Securities and Exchange Commission and the Public Company Accounting Oversight Board went in opposite directions in 2024.

“Accounting and auditing enforcement actions plummeted in the last fiscal year of Gary Gensler's tenure as Chair of the Securities and Exchange Commission (SEC) to the lowest number of actions since FY 2021,” according to SEC Accounting and Auditing Enforcement Activity: Year in Review 2024, Cornerstone Research’s annual review of SEC accounting enforcement. On the other hand, in its report on 2024 PCAOB enforcement, Cornerstone finds that the PCAOB “finalized 51 enforcement actions during 2024--the highest number since 2017” and that PCAOB actions “finalized during the first half of 2024 were more than triple the number of Auditing Actions finalized during the first half of 2023.” Public Company Accounting Oversight Board (PCAOB) Enforcement Activity: 2024 Year in Review 2024. Cornerstone also notes that in 2024 the Board assessed a record $35.5 million in monetary penalties. (For a discussion of Cornerstone’s reports on SEC and PCAOB accounting and audit enforcement in 2023, see Cornerstone: Accounting Class Actions and Enforcement Cases Continue Their Upward Trend, April 2024 Update.)

The Brattle Group also reports that “SEC activity was significantly muted in 2024, as the regulator brought only seven actions in 2024, down 50% from 2023 activity and the lowest level during any year in our sample (2018–2024) * * * while the PCAOB imposed record-breaking penalties for the third straight year.” 2024 Enforcement Activity Involving Auditors. Brattle forecasts “a sea change in auditor enforcement

activity" in 2025 as both the SEC and PCAOB, under new leadership, become less aggressive and more focused on traditional enforcement priorities.

All three reports refer to the impact on SEC and PCAOB enforcement of the Supreme Court's June 2024 decision in SEC v. Jarkesy. Jarkesy held that the SEC's use of administrative proceedings to seek financial penalties in an action based on securities fraud charges was unconstitutional. In such cases, the Court decided, the defendant is entitled to a jury trial, which requires that the case be brought in a federal district court, not before an SEC administrative law judge. While Jarkesy involved SEC administrative proceedings, it seems also to preclude much of the PCAOB's administrative enforcement. And, unlike the SEC, the PCAOB does not have the option of bringing enforcement actions in federal court.

Cornerstone: SEC Accounting and Auditing Enforcement

Cornerstone's study of fiscal 2024 SEC accounting and auditing enforcement found that the Commission filed 45 accounting and auditing actions, about half (54 percent) of the number of cases brought in fiscal 2023. In addition, the SEC dismissed six accounting or auditing administrative proceedings following the Jarkesy decision. Despite bringing fewer cases, the SEC's monetary penalties in these types of cases increased: The Commission imposed more than $771 million in total monetary penalties in FY 2024, the highest total since 2021.

Other highlights of Cornerstone's SEC enforcement report include:

- The SEC is shifting from in-house administrative proceedings to actions in federal court. In 2023, the Commission brought 86 percent of its accounting and auditing cases as administrative proceedings, but in 2024 its use of administrative proceedings fell to 62 percent or 28 cases. In all but one of the 28 administrative proceedings, a settlement was announced on the same day as the initiation of the case. As noted above, the SEC dismissed six accounting/auditing administrative proceedings following Jarkesy. Presumably, no contested administrative cases were brought post-Jarkesy.

- The SEC's focus seems to have shifted to foreign respondents. The number of SEC accounting or auditing enforcement actions initiated against U.S. respondents fell by 56 percent in FY 2024, while actions against non-U.S. respondents increased by 18 percent. The 13 actions against non-U.S. respondents was the highest number since 2019.

- Announcements of restatements or material control weaknesses attracted less enforcement attention in 2024. The number of actions referring to announced restatements and/or material weaknesses in internal control dropped to the lowest level in recent years. Of the 45 SEC actions initiated in FY 2024, eight (18 percent ) referred to announced financial statement restatements and six (13 percent) referred to announcements of material weaknesses in internal control. This compares to 42 percent and 38 percent, respectively, in 2023. Five actions (11 percent) referred to both an announced restatement and material weakness in internal control – the second lowest level since FY 2017.

- Revenue recognition and internal accounting control violations were the most common allegations in accounting and auditing enforcement cases. One or both of revenue recognition and internal accounting control violations were alleged in 58 percent of 2024 SEC cases. However, the absolute numbers fell. For example, 22 (49 percent) of 2024 cases alleged internal accounting control violations, compared to 47 cases (56 percent) in 2023. As to other types of violations, the Commission initiated three actions in FY 2024 alleging violations of the auditor independence requirements (down from four such actions in FY 2023), and five actions alleging violations of compensation "clawback" provision of the Sarbanes-Oxley Act (an increase from three such actions initiated in FY 2023).

- The SEC's overall enforcement focus on individuals continued to soften but cases against CEOs and CFOs increased. In 2024, the SEC charged 37 individuals in its accounting/auditing cases. This compares to 59 individual respondents in 2023 and 66 in 2022. The SEC named one or more individuals as defendants or respondents in 24 of the 45 accounting cases it filed (54 percent), and 27 percent of SEC accounting and auditing actions initiated in 2024 involved only individual respondents or defendants. By comparison, in 2023, there were 48 cases in which one or more individuals were charged, and those cases represented 58 percent of total accounting/auditing actions. While there were fewer individual defendants/respondents in 2024, those who were charged tended to hold senior positions. Twenty-five of those charged (67 percent) were a CEO or CFO at the time of the alleged violation.

- Cases involving auditors declined. The SEC changed 11 eleven auditor and audit firm respondents in 2024, half of the 22 auditors and audit firms that were charged in 2023 and lower than the FY2018-2022 average of 25 such defendants or respondents. Three of the 37 individuals in SEC 2024 accounting/auditing cases were auditors (eight percent), compared to 14 of the 59 individuals (24 percent) charged in 2023.

- The monetary cost of settling an accounting case with the SEC rose sharply. The $771 million in total monetary settlements in 2024 was an increase of $188 million over FY 2023. In fiscal 2024, 67 respondents or defendants settled with the SEC. In those settlements, 63 of the settling parties (95 percent) were required to make a monetary payment, up from 86 percent in 2023. Civil penalties accounted for 46 percent of the $771 million the SEC collected. The remaining 54 percent was disgorgement of illegally obtained funds (47 percent) and prejudgment interest (seven percent). In 2024, the average monetary cost per settling respondent was $11.5 million; in 2023 the cost per settling respondent was $4.9 million.

- The SEC made frequent use of officer and director bars and bars from SEC practice. Nineteen (58 percent) of the 33 individuals who settled with the SEC in FY 2024 were prohibited from acting as an officer or director of an SEC-registered company. Eleven of these bars were permanent, and the other eight averaged 6.5 years. Five of the 33 settling parties were denied the privilege of appearing or practicing before the SEC as an accountant. Three of these were permanent bars while the other two were suspensions from practice for an average of 1.5 years.

Cornerstone: PCAOB Enforcement

Cornerstone's report on 2024 PCAOB enforcement finds that the Board publicly disclosed 51 enforcement actions in 2024. (Board enforcement matters are confidential until settled or decided in the Board's favor.) Forty of those actions involved audit performance (Auditing Actions), an 8 percent increase over 2023; non-auditing actions involved such matters as reporting violations or failure to cooperate with a PCAOB inspection or investigation. The Board assessed monetary penalties of $35.5 million – a record for a single year and up 78 percent from 2023. Forty percent of all monetary penalties since the inception of the PCAOB's enforcement program in 2004 were imposed in 2024.

Other highlights of Cornerstone's PCAOB enforcement report include:

- Despite its record 2024 results, PCAOB enforcement slowed following Jarkesy. The 30 Auditing Actions finalized during the first half of 2024 were more than triple the number of Auditing Actions finalized in the first half of 2023. However, the Board only brough ten actions during the second half of 2024. As noted above, the Supreme Court announced its Jarkesy decision on June 27.

- The PCAOB's focus tilted slightly to domestic respondents. Unlike the SEC, the PCAOB's enforcement program focused somewhat more heavily on domestic respondents in 2024. The Board brought 23 Auditing Actions (57 percent of the total) against U.S. respondents grew in 2024, compared to 19 cases (51 percent in 2023.

- PCAOB enforcement targets were split between individuals and firms. For the consecutive year, most PCAOB respondents were firms rather than individuals. Compared to 2023, however, when firms comprised two-thirds of respondents, the proportion was more evenly split in 2024. The Board charged 25 individuals (47 percent of 53 total respondents) and 28 accounting firms (53 percent) in the 40 Auditing Actions disclosed in 2023. In 2023, the Board charged 19 individuals (36 percent of 53 total respondents) and 34 accounting firms (64 percent) in 37 Auditing Actions.

- Firm quality control remained an enforcement priority. In more than half of the 2024 Auditing Actions (52 percent), the PCAOB alleged violations of its quality control (QC) standards, and 15 percent of the 40 Auditing Actions alleged only QC violations. One third of Auditing Actions involved only auditing standards violations (essentially the same as 32 percent in 2023). The Board seems to have an increasing tendency to allege both an underlying violation and a related QC control violation – reflecting the idea that the underlying violation would not have occurred if quality controls had been adequate. QC violations were combined with ethics and independence violations in five percent of Auditing Actions, with auditing standards violations in 12 percent, and with both ethics/independence and audit violations in 20 percent.

- The Board took monetary penalties to a new level (again). As noted above, the PCAOB imposed record monetary penalties of nearly $35.5 million in 2024. Monetary penalties were imposed on all but four of the 53 respondents in cases that were settled or adjudicated in 2024. Monetary penalties imposed on firms were $34.1 million – 96 percent of the total – while individuals paid $1.3 million. The median individual penalty was $45,000 and the median firm penalty was $60,000. Eighty percent of total penalties were levied against non-U.S. firms. The PCAOB imposed a penalty on 92 percent of respondents in 2024, compared to 100 percent in 2023. Five respondents paid almost 90 percent of the total monetary penalties.

- The PCAOB also made extensive use of non-monetary sanctions. Most firm respondents (71 percent) were required to undertake some type of remedial action (e.g., revised quality control procedures or staff training). The Board required eleven percent of firm respondents in 2024 Auditing Actions to retain an independent consultant, down from 15 percent in 2023. Twenty-one percent of firm respondents had their PCAOB registration revoked, either permanently or temporarily.

- Individuals charged by the PCAOB were less likely to be permanently barred from auditing public companies or broker-dealers. Seventy-six percent of individual respondents in 2024 Auditing Actions were barred either permanently or temporarily from auditing public companies or broker-dealers, down over 85 percent in 2023. Eight percent of individual respondents were permanently barred, down from 21 percent in 2023. For the 68 percent that received (or agreed to) bars that included a right to reapply, the average period before the individual could seek to reenter public company auditing was 2.5 years.

Brattle's Perspective

The Brattle Group report analyzes PCAOB and SEC enforcement against public accounting firms and professionals employed by public accounting firms during 2018–2024. In particular, it compares auditor enforcement activity during 2024 to the first two full years of the Williams/Gensler administrations (2022 and 2023) and to activity during 2018–2021. Brattle's findings are generally similar to Cornerstone's although its methodology is somewhat different in that it considers only on cases against auditors, and it provides more regulatory context concerning enforcement developments. Brattle's report is also more focused on comparing PCAOB enforcement to the SEC's auditing cases.

The Brattle report also differs from Cornerstone's papers in that Brattle includes predictions regarding future SEC and PCAOB auditor enforcement. Brattle notes that "the combination of Trump 2.0 and ongoing constitutional challenges * * * will bring a sea change in auditor enforcement activity." Brattle expects Paul Atkins, President Trump's choice to chair the SEC, "to scale back aggressive SEC

enforcement, focus on protecting retail investors, create a more predictable regulatory environment for digital assets, and * * *  continue to focus the SEC's enforcement efforts on systemic audit failures, fraudulent revenue recognition, and egregious disclosure violations." Brattle also notes that Mr. Atkins (who took office at the SEC on April 21) has been a critic of the PCAOB and will likely replace its current leadership with board members "who will take a less aggressive stance on enforcement."

Against this background, Brattle makes five predictions:

- The PCAOB and SEC Will Revert to a Focus on Individual Accountability. Under PCAOB Chair William's and SEC Chair Gensler, both regulators placed a higher focus on charging firms than individuals. For example, under Chair Williams, PCAOB actions involving firm respondents outnumbered actions involving individuals more than two to one. "Under Chair Atkins, we expect to see enforcement by both regulators revert back to a focus on individual accountability."

- Penalties Will Fall and Become More Predictable. The SEC increased financial penalties to record or near-record levels in each of the last three fiscal years. "Under Mr. Atkin's leadership, we predict a significant reduction in monetary sanctions and a return to a more predictable determination of penalties, perhaps akin to a framework on financial penalties articulated by the SEC nearly two decades ago * * *." Similarly, Brattle expects a decline in PCAOB penalties. Even aside from the enforcement philosophy of new board members, constitutional limits on the PCAOB's enforcement powers are likely to put a brake on penalties. "Although it is unclear what drove the change, we note that penalties imposed by the PCAOB post-*Jarkesy* have been significantly muted. Despite bringing a third of its 2024 actions after the June 2024 *Jarkesy* decision, only 2% of its penalties for the year were imposed post-*Jarkesy*."

- Crypto-Related Enforcement Matters Involving Auditors Will Rise. The SEC is expected to be less aggressive in its crypto-related enforcement under Chair Atkins' leadership. However, Brattle anticipates that the resulting increased use of cryptocurrencies will lead to increased crypto-related fraud and that, in turn, will lead to more enforcement activity involving crypto-related fraud. "Auditors are particularly susceptible to such actions due to their requirement under AS 2401, *Consideration of Fraud in a Financial Statement Audit,* to consider fraud in planning and performing the audit."

- PCAOB-Registered Firms in the PRC and Hong Kong Will Remain a Priority. Since 2022, the PCAOB has been able to inspection PRC- and Hong Kong-based accounting firms. Based on these inspections the PCAOB brought five actions against these firms or affiliated individuals. President Trump has issued executives order asserting power over independent agencies such as the SEC and "may view enforcement against Chinese firms (including Chinese audit firms) as another tool in US-China relations toolbox."

- We Will See Fewer "Firsts". Brattle notes that, under Chair Williams, the PCAOB highlighted several enforcement "firsts" in its annual reports. These included "bringing the PCAOB's 'first action for failure to supervise personnel under Section 105(c)(6) of the Sarbanes-Oxley Act,' 'imposing the PCAOB's first sanctions for failing to supervise an unregistered firm,' and 'imposing the PCAOB's first-ever sanctions related to membership in an accounting alliance.'" Brattle expects that, under Chair Atkins, "the SEC and an overhauled PCAOB will focus on more traditional enforcement priorities, such as financial fraud and straightforward violations of SEC and PCAOB rules, with a decreased likelihood of novel legal theories, rulemaking by enforcement, and first-of-their-kind enforcement actions."

## Audit Committee Takeaways

Despite year-to-year fluctuations, accounting and auditing enforcement are perennial SEC priorities. That focus may increase under the new SEC administration, since a back-to-basics approach to enforcement is likely to result in more, not fewer, accounting and financial disclosure cases. The same may be true of

PCAOB actions against auditors, although the future direction of PCAOB enforcement is harder to predict because of uncertainty concerning both who will be leading the Board and because of the constitutional questions that overhang the PCAOB's enforcement program.

Audit committees and financial reporting management should also keep in mind Brattle's prediction that the SEC will step up its focus on individual culpability. As noted above, while the number of individuals charged in SEC accounting cases fell in 2024 and 2023, those that the SEC did charge tended to hold senior positions, such as CEO or CFO. The risk that restatements, internal control material weaknesses, and other accounting-related problems will result in SEC enforcement action against the individuals involved, along with or instead of the reporting company, is likely to remain elevated.

For these reasons, audit committees should not assume that a more business-friendly regulatory climate and a less aggressive enforcement philosophy at the SEC and PCAOB will result in reduced scrutiny of public company financial reporting.

## BDO on Financial Reporting Implications of Tariffs and Questions Audit Committees Should Ask

President Trump's announcement of a program of new tariffs on imports from many countries have resulted in economic and business uncertainty and securities market volatility. Tariffs also have accounting, financial reporting, and disclosure implications for public companies. BDO has published Economic Uncertainty: Financial Reporting Considerations for Tariffs which discusses these reporting and disclosure issues. BDO also suggests questions for audit committee consideration concerning the financial statement, disclosure, and audit impacts of tariffs.

BDO's paper explores six topics:

1. Accounting Considerations. New tariffs may affect revenue recognition, impairment of nonfinancial assets, and income taxes.

- Revenue recognition. Tariffs may affect revenue recognition in a variety of ways, such as by affecting the collectability of contractual consideration or triggering re-negotiation of the terms of revenue-producing contracts to reflect increased costs incurred because of the tariffs.

- Impairments. Tariffs may affect the recoverability of assets, such as property, plant, and equipment and goodwill. Similarly, inventory may need to be written down if costs exceed net realizable value.

- Income taxes. Effects of tariffs, such as goodwill impairments, may impact income tax accounting. Changes to tariffs may also affect transfer pricing calculations.

2. Disclosures. Companies should consider the impact of new tariffs on financial statement disclosure requirements with respect to subsequent events and risks and uncertainties.

- Subsequent events. Financial statements should reflect conditions that existed at the balance sheet date; however, certain events and conditions that arose after the balance sheet date may also need to be disclosed to prevent the financial statements from being misleading. Some tariffs were announced before March 31 (which was the end of a reporting period for many companies), while others were announced on April 2. Companies may therefore need to consider the impact of the subsequent events disclosure requirements (ASC 855) on their financial statements.

- Risks and uncertainties. The accounting standards (ASC 275) also require disclosure of risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term. Risks and uncertainties can stem from the nature of an entity's operations, the use of

estimates in preparing the financial statements, or significant concentrations in an entity's operations. BDO provides this example: "[I]f an entity determines that a change in a tariff that was not known or knowable as of the reporting period end would be a triggering event for a material goodwill impairment in the following period, and that is known or knowable prior to issuing the financial statements, the entity is required to disclose that risk and potential effect."

3. SEC Reporting. Tariffs and their consequences for the company's business may trigger various SEC reporting requirements.

- Regulation S-K. The imposition of new tariffs and company responses to tariffs may require new or modified disclosure under SEC Regulation S-K disclosure rules in Item 101, Description of Business, Item 105, Risk Factors, Item 303, Management's Discussion & Analysis, and Item 305, Quantitative and Qualitative Disclosures About Market Risks. For example, Item 101 disclosure may be required if "[t]ariffs and related market disruptions may cause a registrant to change its overall strategy, operations, customer engagement strategies, or suppliers (such as where it sources its raw materials)."

- Form 8-K. Companies may need to disclose material information related to tariffs in a Current Report on Form 8-K. For example, entering into or modifying a material definitive arrangement with a supplier or customer not in the ordinary course of business would require a Form 8-K filing.

- Non-GAAP measures. Companies that are considering the presentation of financial information that highlights the effects of tariffs should be aware of the SEC's rules and guidance on non-GAAP financial measures. Non-GAAP measures that are based on adjustments for costs that are normal, recurring, cash operating expenses are not allowed. Further, companies are required to explain why a non-GAAP measure is useful to investors and to consider whether the non-GAAP measure is consistent with measures used by management and communicated to the board. However, BDO points out that the impact of tariffs may be disclosed without running afoul of the non-GAAP rules: "[A] registrant may disclose and quantify the effects of the tariffs in one place and separately list those effects without adjusting its GAAP results. For example, a registrant may include a supplemental table that describes each item and includes dollar amounts. While the non-GAAP rules and SEC staff guidance do not apply to such supplemental information, a registrant that presents such a table should consider explaining how and why this information can help investors analyze the registrant's results."

4. Internal Control Over Financial Reporting. Management may need to design and implement new or modified controls to address the complexities and risks associated with tariffs. BDO offers this example: "This could involve revising controls over estimation processes, particularly for estimates related to future cash flows. It is critical that entities do not rely excessively on historical information, and only include information that was known or knowable as of the measurement date." Material ICFR changes must be disclosed.

5. Auditing Considerations. Because of the economic uncertainties arising from the Administration's tariff program, there may be new risks of material misstatement that the auditor must address. Auditors may also encounter increased difficulty in obtaining sufficient appropriate audit evidence.

- New financial reporting risks. BDO notes that the auditor needs to understand how tariffs and resulting economic uncertainty may affect the entity and suggests a series of questions that auditors should ask as part of their audit planning. The auditor also needs to consider "heightened risks of misstatement in specific accounting and disclosure areas, including revenue recognition, valuation of assets, risk disclosures, and subsequent events."

- Obtaining sufficient appropriate audit evidence. Changes in tariffs and resulting economic uncertainty and new financial reporting risks may require auditors to adjust the nature, timing, and

extent of their audit procedures. BDO lists some examples and states that audit procedure adjustments may increase audit effort and cost.

- Effect on the audit report. The PCAOB's rules require audit reports to include a discussion of critical audit matters (CAMs). "The effects of new tariff measures and resulting economic uncertainty on the entity's financial statements and disclosures may lead auditors to identify new CAMs or revise disclosures related to previously identified CAMs."

6. Corporate Governance and Shareholder Considerations. BDO recommends that boards and audit committees work with management, auditors, and advisors to evaluate tariff-related risks and formulate responses. BDO also suggests that shareholders may be interested in how companies "are managing significant challenges and risks, including those to supply chain management, arising from the tariff measures and resulting economic uncertainty and how executives are contingency planning."

- Audit committee oversight. Audit committees should consider the following questions as they engage with management and the auditors:

  a. Do the financial statement disclosures reflect changing risk factors, such as changes in supply chains, pricing decisions, loss of significant customers, and disruptions to production?

  b. Do the financial statement disclosures reflect subsequent events that were known or knowable before issuing the financial statements that users of financial statements will find meaningful and reflective of industry-specific considerations?

  c. Are controls over financial reporting adequate to respond to the effects of tariffs or the resulting economic uncertainty, including the risk of fraud?

  d. Will financial statement deadlines be affected by changes to procedures performed by the entity, its specialists, or the auditors?

  e. Is the committee meeting often enough with management and the auditors to address challenges as they arise?

  f. Is the committee keeping the board apprised of significant matters with respect to risk and disclosure?

- Shareholder questions. Boards should expect shareholder questions about such matters as risk assessment and anticipated effects of tariffs; response to tariffs, including changes in product procurement, customer demand, and earnings; financial reporting and disclosures to tariff convey risks; and industry-specific risk mitigation plans, such as contracts, supply chain, and technology.

## Audit Committee Takeaways

For many companies, operating and strategy issues associated with the new tariff program and the resulting economic uncertainty are major current challenges. As companies struggle with these challenges, consideration of the financial reporting and disclosure implications of tariffs may not be top-of-mind. BDO's paper provides a comprehensive overview of how tariffs may affect reporting and disclosure. Audit committees should focus on how financial reporting management is addressing those issues.
Since tariff policy has the potential to change significantly on a daily basis, audit committees should also ensure that management is monitoring developments and policy changes. As events unfold and companies respond, the audit committee should make sure that management considers the financial reporting and disclosure implications.

## On the Update Radar: Things in Brief

**SEC Takes Another Step Away From Climate Disclosure.** On March 27, the Securities and Exchange Commission voted to stop defending the validity of its rules requiring disclosure of climate-related risks and greenhouse gas (GHG) emissions. The Commission submitted a letter to the court in which challenges to rules are pending, informing it of the decision.

In a press release announcing the vote, Acting Chair Uyeda said, "The goal of today's Commission action and notification to the court is to cease the Commission's involvement in the defense of the costly and unnecessarily intrusive climate change disclosure rules." Commissioner Crenshaw issued a statement attacking the decision: "We do not have license to wholesale abandon agency action simply because the now-constituted Commission would not have supported the rule when it passed." She suggested that the court appoint counsel to "vigorously advocate" in defense of the rules "on behalf of investors, issuers and the markets."

On March 6, 2024, the SEC adopted rules requiring public companies to disclose certain climate-related information, including material Scope 1 and Scope 2 GHG emissions. See SEC Adopts Landmark Climate Change Disclosure Rules, March 2024 Update. Several lawsuits were filed challenging the rules, and the Commission suspended their effectiveness pending the outcome of the cases, which were consolidated in the Court of Appeals for the Eighth Circuit. See SEC Puts its Climate Disclosure Rules on Hold, April 2024 Update.

In January, SEC Chair Gensler and Commissioner Lizarraga resigned, shifting the Commission from a 3-2 Democratic majority to 2-1 Republican control. As described in Acting Chair Asks Court to Pause Challenges to SEC Climate Disclosure Rules, February, 2025 Update, on February 11, Acting SEC Chair Uyeda directed the Commission's appellate litigation team to request that the court suspend consideration of the case while the Commission reconsidered its position. The SEC's March 27 letter to the court states simply that, since its request that the court suspend consideration, "the Commission has determined that it wishes to withdraw its defense of the Rules."

Several state attorneys general have intervened in support of the climate disclosure rules, and it is possible that the litigation will continue without the Commission's participation. Regardless of the future course of the judicial proceedings, it is likely that the SEC will eventually rescind the climate disclosure rules. Recission – or modification – would however presumably require notice-and-comment rulemaking in accordance with the Administrative Procedure Act and could be a lengthy process. A final Commission decision in such a proceeding could itself be subject to review in the federal courts.

As noted in last month's Update, for many companies, the SEC's retreat from climate reporting may not be the end of the need to make GHG emissions and other climate-related public disclosures. Many U.S. companies will be subject to California's climate disclosure requirements. See California Tweaks its Climate Disclosure Law But Reporting Deadlines are Unchanged, November 2024 Update. In addition, U.S. companies that are active in the European Union may be required to comply with its sustainability disclosure regime, although the E.U. is in the process of narrowing the scope of its requirements. See E.U. is Dialing Dial Back Sustainability Reporting and Due Diligence in this Update. Mandatory reporting aside, many public companies make climate disclosures voluntarily in response to investor interest in this information. See What Backlash? ESG Reporting Continues to Grow, September-October 2024 Update.

**E.U. is Dialing Dial Back Sustainability Reporting and Due Diligence.** The European Commission (EC) has proposed legislation that would significantly reduce sustainability reporting under the E.U.'s Corporate Sustainability Reporting Directive (CSRD) and postpone implementation of the requirements for many companies. The proposals – referred to as the omnibus packages -- would also narrow the scope of entities subject to CSRD reporting and potentially exclude many U.S. companies that would otherwise be required to comply with the CSRD and related

requirements. See PwC Explains Audit Committee Responsibilities under the E.U.'s CSRD, May-June 2024 Update and E.U. ESG Disclosure Requirements Will Affect Many U.S. Companies, October 2023 Update. The EC's press release announcing the proposals states that the changes would "remove around 80% of companies from the scope of CSRD, focusing the sustainability reporting obligations on the largest companies which are more likely to have the biggest impacts on people and the environment."

Aspects of the omnibus packages that are of particular significance to non-E.U. companies include:

- Reduce number of entities subject to CSRD reporting. The proposals would limit the scope of CSRD reporting to large E.U. undertakings. A large undertaking is an entity with more than 1,000 employees and either a balance sheet total of at least €25 million or worldwide annual net turnover of €50 million. (Currently, the employee threshold is 250 employees.) Non-E.U. companies would be subject to reporting if they have an annual net turnover of at least €450 million in the E.U. and either an E.U. subsidiary that is required to report or a branch in the E.U. with an annual net turnover of €50 million euros. Currently the turnover threshold for a non-E.U. parent is €150 million.

- Delay implementation of reporting requirements. The omnibus packages also propose a two-year delay in the implementation of CSRD reporting for "second wave" and "third wave" companies. The initial reporting date for the second wave of entities would change from 2025 to 2027 and for third wave of entities from 2026 to 2028. (First wave entities are already subject to reporting.) In very simplified terms, first wave entities are large E.U. or foreign companies that are listed on an E.U. exchange; second wave entities are large undertakings that are not included in the first wave, and third wave entities are smaller listed companies.

- Revise disclosures. The proposals would provide for revisions to the European Sustainability Reporting Standards (ESRS). The ESRS are the reporting standards, rules, disclosures, and metrics that companies must comply pursuant to the CSRD. The EC's proposal envisions substantially reducing the number of "data points" that must be reported and clarifying the requirements.

- Limit value chain reporting. The proposed revisions would also limit the reporting burdens imposed on smaller companies in a reporting entity's value chain. The Corporate Sustainability Due Diligence Directive (CSDDD) requires both E.U. and non-E.U. large companies (as defined above) to conduct due diligence on human rights and environmental impacts throughout their operations, subsidiaries, and value chains. Under the proposals, reporting companies would only be required to apply due diligence measures to the activities of the company, its subsidiaries, and direct business partners. Companies would not be required to obtain information from entities that are not subject to CSRD reporting. The proposals would also delay application of the CSDDD to first wave companies by one year until 2028.

- E.U. Taxonomy (EUT) reporting. The EUT a system for classifying sustainable economic activities. Under the EUT, in-scope companies are required to annually report the share of their business that is within the taxonomy using specific metrics. Under the proposals, mandatory EUT reporting would be limited to entities that are required to comply with the CSRD and have net turnover exceeding €450 million. The proposals would also decrease the information required to be reported.

In mid-April, the European Parliament approved the EC's "stop the clock proposal" which implements the postponement of CSRD reporting and CSDDD due diligence, as described above. The European Parliament will next consider the balance of the proposals and could make changes. If the proposals are adopted, they will then need to be transposed into domestic law of the E.U. member states.

Audit committees of companies that do business in the E.U., directly or through subsidiaries, should make sure that management monitors the progress of the omnibus packages and considers how changes to the scope and requirements of the CSDR ,CSDDD and EUT may affect the company. Thought should also be given to how these changes could impact due diligence information requests from customers or suppliers that are subject to these directives. Since E.U. reporting deadlines and requirements are changing, managements and boards should also evaluate whether the company is investing in controls and disclosure procedures that will need to be modified or may even prove to be unnecessary. The scope and requirements of the CSRD are complex, as are the proposals to modify it, and many companies may potentially be affected by the proposed changes may want to consult professional advisors that specialize in this field.

**Another Independence Monitoring Disclosure: PCAOB Makes Public a 2020 EY QC Criticism.** On March 12, the Public Company Accounting Oversight Board released a previously nonpublic portion of Ernst & Young's 2020 inspection report. Board criticisms of a firm's quality control system appear in Part II of its inspection report, and, under the Sarbanes-Oxley Act, Part II is nonpublic when the report is issued. If the firm does not, in the PCAOB's view, satisfactorily address a quality control criticism within 12 months, the Board makes the criticism public. The quality control deficiency that the Board found in its 2020 inspection of EY and has now made public is identical to a deficiency that the Board found in its 2019 and 2018 EY inspections and has previously made public.

The now-public quality control criticism in EY's 2020 inspection report is that EY's system of quality control did not provide reasonable assurance that EY personnel will comply with the firm's policies and procedures concerning independence-related regulatory requirements. EY conducts periodic audits of a sample of its personnel to monitor compliance with firm independence policies. In the reviews EY conducted during the 12 months ending March 31, 2020, the firm found that 26 percent of managers who were audited had not reported financial relationships that were required to be reported under the firm's policies. The inspection report states:

> "This high rate of non-compliance with the firm's policies, which are designed to provide compliance with applicable independence regulatory requirements, provides cause for concern, especially considering that these individuals are required to certify on a semi-annual basis that they have complied with the firm's independence policies and procedures."

The date of EY's 2020 inspection report is September 30, 2021. Therefore, the PCAOB's disclosure of this portion of the 2020 report indicates that EY failed to persuade the PCAOB that, as of September 30, 2022, it had satisfactorily remediated the deficiency related to compliance with the firm's independence-related reporting policies.

2020 is the third inspection year for which the PCAOB has found that EY failed to remedy this deficiency. On July 11, 2024, the Board made public the same finding EY's 2019 inspection report. See PCAOB Discloses Three 2019 Criticisms of EY's Quality Control, July 2024 Update. On October 17, 2022, the PCAOB made public the same finding in Part II of EY's 2018 inspection report. See PCAOB Gives EY a Partial Fail on 2018 Remediation, September-October 2022 Update. These quality control lapses relate to EY's internal procedures, and there is no indication that they resulted in violations of the SEC's or PCAOB's independence rules.

During the past two year, the Board has made public substantially the same quality control deficiency concerning each of the other three largest firms. See PCAOB Makes Public 2021 Quality Control Criticisms of Deloitte and Grant Thornton, February 2025 Update; PCAOB Discloses a Criticism of Deloitte's Internal Independence Reporting – Again, August 2024 Update; PCAOB Discloses Non-Public Portions of 2018 and 2019 KPMG Inspection Reports, April 2024 Update; and 2019 Inspection PricewaterhouseCoopers LLP (portion of Part II made public on July 13, 2023).

## The Audit Blog

The Audit Blog provides commentary on developments in auditing and financial reporting, auditor oversight and regulation, and sustainability disclosure. The blog is available here. You can follow @BlogAuditor on Twitter or @the-audit-blog on medium.com.

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

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