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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 85
October 2023

Summary

SEC Chief Accountant: When Assessing Risk, Look at the Big Picture. SEC Chief Accountant Paul Munter has issued a statement discussing risk assessment. In The Importance of a Comprehensive Risk Assessment by Auditors and Management, Mr. Munter warned that, in some instances, “management and auditors appear too narrowly focused on information and risks that directly impact financial reporting, while disregarding broader, entity-level issues that may also impact financial reporting and internal controls.” He urged taking “a holistic approach” to risk assessment and avoiding the tendency to treat problems as isolated incidents, rather than considering their significance as indicators of financial reporting risk or of weaknesses in internal control over financial reporting. Audit committees may want to discuss with both management and the auditor their reactions to the statement and how it relates to their respective risk assessment procedures. (more)

No Surprises, Please. PCAOB Conversations with Audit Committee Chairs. Audit committee chairs are worried about the impact of the great resignation on their engagement team and on the financial reporting staff at their company. And they don’t like inconsistent or last-minute auditor communications which could lead to surprises during the audit. Those are two of the conclusions that can be drawn from the PCAOB’s annual report on its inspection staff’s discussions with audit committee chairs. The report provides several other insights as to the current views and concerns of audit committee chairs. In addition, an audit committee chair who is contacted by the PCAOB staff as part of an inspection of the company’s auditor may want to review the 2022 Conversations Report and prior reports on these dialogues as a way of preparing for the interview. (more)

California Outflanks the SEC on Climate Disclosure. California has enacted legislature that will require many U.S. companies to disclose their scope 1, 2, and 3 greenhouse gas (GHG) emissions and to prepare an annual climate-related financial risk report. The Climate Corporate Data Accountability Act and the Climate-Related Financial Risk Act are estimated to apply to as many as 10,000 companies that do business in California, including a significant share of SEC reporting companies. The SEC has also proposed extensive climate disclosure requirements, and, in recent Congressional testimony, SEC Chair Gensler suggested that the California law may make it easier for the SEC to act on its proposal. The California legislation serves as a warning that mandatory climate reporting is soon likely to become a reality for most, if not all, public companies. Audit committees should be discussing with management its plans to generate the information to comply with likely disclosure requirements. For example, companies that are not currently collecting GHG emissions information should consider how they will do so and what new controls and procedures will be needed to assure reliability, particularly as to scope 3 emissions. Climate disclosures, voluntary or mandatory, will almost certainly be a fertile source for litigation and regulatory challenge, and audit committees should be making sure that management is preparing to meet these new responsibilities. (more)

E.U. ESG Disclosure Requirements Will Affect Many U.S. Companies. The European Union's Corporate Sustainability Reporting Directive will affect many U.S. companies. To provide basic guidance on the application of the CSRD to companies based in the United States, Deloitte has released #DeloitteESGNow - Frequently Asked Questions About the E.U. Corporate Sustainability Reporting Directive. Audit committees of companies with any level of contact with the E.U. should make sure that management is considering how the CSRD may impact the company. Companies that will be subject to CSRD reporting should begin considering how their controls and disclosure procedures will need to be modified to generate the necessary information and to permit their financial statement auditor, or some other independent third party, to provide the required assurance. Deloitte's Q&A paper provides a good introduction to these complex issues. (more)

Ready or Not: KPMG Finds that Few Companies are Prepared for ESG Assurance. KPMG has released Road to Readiness, the inaugural report on the KPMG ESG Assurance Maturity Index. The Maturity Index, measured on a scale of 0−100, gauges "the relative maturity of a company's ESG reporting program in order to assess its assurance readiness" – that is, readiness to obtain third-party assurance on its ESG reporting. For 2023, KPMG finds that the average ESG assurance readiness score for U.S. companies is 49.4. The report discusses five steps that leading companies are taking to become ESG assurance ready. Third-party assurance requirements for climate disclosures are likely to become mandatory for U.S. public companies in the near future, and other ESG assurance requirements may follow. Audit committees should be discussing with management the steps necessary for the company to become ESG assurance ready. (more)

Ineffective ICFR Ticked Up for the Second Straight Year in 2022. Ideagen Audit Analytics has released SOX 404 Disclosures: A 19-Year Review, its annual analysis of disclosures under Section 404 of the Sarbanes-Oxley Act. AA found that, in FY 2022 the number of companies filing a management assessment that reported ineffective internal control over financial reporting (ICFR) increased for the second straight year – rising from 1,678 in 2021 to 1,740 in 2022, a 4 percent increase. Nearly one quarter (24.4 percent) of public companies reported that their controls were not effective. Since the reporting universe grew, the percentage of companies that filed an adverse ICFR disclosure during FY2022 was however slightly lower than in the prior year. AA also found that the total number of adverse ICFR auditor attestations rose to 257 in FY2022, a 21 percent increase over 2021. The most common internal control issue cited as contributing to ineffective ICFR in management reports was the need for more highly trained accounting personnel. The most common issue cited in adverse auditor reports was information technology, software, and/or security issues.

Oversight of the adequacy of internal control is one of the most fundamental responsibilities of a public company audit committee. Audit committees may want to probe whether frequently cited control weaknesses described in the AA report are affecting their company's controls. (more)

PCAOB Adopts a New Confirmation Standard. The PCAOB has adopted a new standard on the auditor's use of confirmations. See The Auditor's Use of Confirmation, and Other Amendments to PCAOB Standards. Among other things, the new standard provides that the auditor should perform confirmation procedures for cash and cash equivalents held by a third party and for accounts receivable, although it recognizes that there may be situations in which accounts receivable confirmation is not feasible. The new standard requires the auditor to communicate with the audit committee about the auditor's response to significant risks associated with cash or accounts receivable when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by an external source. The new standard also states that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence and limits the use of internal audit in the confirmation process. (more)

Top Technology Risks that Keep Internal Audit Up at Night. Chief audit executives and IT audit leaders see cybersecurity as the top technology risk their companies face over the next year, followed by risks associated with third parties and vendors. Those are among the findings reported in Navigating A Technology Risk-Filled Horizon, the eleventh annual Global Technology Audit Risks Survey conducted by consulting firm Protiviti and The Institute of Internal Auditors. Only 28 percent of respondents identified artificial intelligence and machine learning (including generative AI) as significant threat risk in the coming year, although 54 percent view AI systems as a substantial risk in the next two to three years. Audit committees may want to consider using this report as a basis for discussion with their internal audit head concerning how he or she perceives the company's top technology risks in the near and medium term and what steps can be taken to address such risks in the coming year. (more)

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Updates issued after June 1, 2020, are available here. Updates issued between January 1, 2019, and May 31, 2020, are available here.   An index to titles and topics in the Update beginning with No. 39 (July 2017) is available here.