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# AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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## Summary

**2023 PCAOB Inspections Will Prioritize Fraud, Financial Services, and Crypto.** The PCAOB's inspection staff has released Spotlight: Staff Priorities for 2023 Inspections, its annual preview of the current inspection cycle. The 2023 Spotlight discusses ten areas or audit types that the PCAOB staff will emphasize in 2023 inspections, including how auditors identified and assessed risks of material misstatements due to fraud; audits in the financial services sector that are potentially impacted by risks arising from interest rates, inflation, and uncertainty and volatility in the digital assets markets; and audits of public companies in any industry with material digital assets. PCAOB "target teams", which review specific issues across many audit firms, will focus on risks related to digital assets, first year audits, multi-location audits, and significant or unusual events or transactions. For audit committees, Spotlight provides insight into whether the company's audit might be selected for inspection and into the aspects of the audit that are likely to be reviewed if it is selected. The Spotlight also highlights accounting and auditing challenges to which the committee may want to direct its attention. (more)

**PCAOB Proposes to Expand Auditor Responsibility for Financial Statement Fairness and for Legal Compliance.** The PCAOB has issued two sets of proposed revisions to its auditing standards that, if adopted, could significantly affect the scope of the auditor's work, the range of issues auditors raise with audit committees, and the cost of public company audits. Under proposed AS 1000, General Responsibilities of the Auditor in Conducting an Audit, the auditor would be required to evaluate whether information in the financial statements is presented and classified appropriately and in a manner that is "informative and not misleading to a reasonable investor" and whether transactions and relevant events and conditions are "appropriately recognized, measured, and disclosed in the financial statements." According to the PCAOB, these new requirements would clarify that, in determining whether financial statements are fairly presented, the auditor must go beyond evaluating technical compliance with GAAP.

Another PCAOB proposal would expand the auditor's responsibilities with respect to the audit client's legal compliance. Proposed AS 2405, A Company's Noncompliance with Laws and Regulations, would require auditors to plan and perform audit procedures to (1) identify laws and regulations with which noncompliance could reasonably have a material effect on the financial statements; (2) assess and respond to risks of material misstatement of the financial statements due to noncompliance with those laws and regulations; and (3) identify whether there is information indicating such noncompliance with those laws and regulations has or may have occurred. The auditor would to be required to communicate with management and the audit committee "as soon as practicable" upon becoming aware of information suggesting that legal noncompliance "has or may have occurred" regardless of financial statement impact. (more)

**Accounting Class Actions are Increasing Slowly While SEC Accounting Cases are Skyrocketing.** Cornerstone Research has issued two reports on litigation involving accounting and auditing violations. In its annual report on accounting-related class actions, Accounting Class Action Filings and Settlements—2022 Review and Analysis, Cornerstone finds that class action filings against public companies for alleged accounting violations increased slightly last year but remain low by historical measures. In contrast, Cornerstone's annual report on SEC accounting and auditing enforcement actions finds that number of SEC enforcement cases filed in this area increased sharply in fiscal 2022, although the dollar amount of monetary settlements in such cases dropped. Cornerstone also reports that the SEC is stepping up its focus on individual violators in accounting cases. One or more individuals were named as defendants or respondents in 72 percent of the SEC cases filed in 2022, a marked increase from the 2017 to 2021 average of only 37 percent. Strong internal controls, along with audit committee care and diligence in overseeing the company's financial reporting, can reduce the risk that the company will be exposed to the cost and distraction of litigation over accounting matters. (more)

**Commissioner Uyeda Discusses the SEC's Focus on Accounting**. In a recent speech, SEC Commissioner Mark T. Uyeda discussed the SEC's focus on accounting violations. See Remarks at ICAEW Event – World-Class Regulation: Building Trust and Transparency in International Markets (May 12, 2023). His remarks underscore that the Commission is ramping up enforcement activity involving accounting and auditing -- the same point as is illustrated by Cornerstone's report on 2022 SEC accounting and auditing enforcement (see above). Commissioner Uyeda also emphasized the importance of a strong audit committee as a means of lowering the likelihood that a company will become the target of SEC financial reporting enforcement. (more)

**PCAOB Adds Audit Quality Indicators to its Short-Term Agenda**. On May 16, the PCAOB announced that its staff had posted to the Board's website a revised standard-setting agenda. From an audit committee perspective, the most significant change from the prior agenda is that a project entitled "Firm and Engagement Performance Metrics" has been added to the short-term agenda. PCAOB-sanctioned metrics – sometimes referred to as audit quality indicators – could be useful to audit committees in assessing the performance of their auditor. Audit committees may want to follow the progress of the project as it evolves. (more)

**Pointers on the Audit Committee's Role in Ethics and Compliance Oversight.** As part of its "On the audit committee's agenda" series, the Deloitte Center for Board Effectiveness has released Who's in charge: The audit committee's role in ethics and compliance oversight (April 2023). The paper is a high-level discussion of audit committee oversight of ethics and compliance, particularly issues arising from the committee's statutorily-mandated responsibility for procedures, such as hotlines, for receipt of employee complaints regarding questionable accounting or auditing matters. Themes of the discussion include audit committee consideration of whether it is the proper committee to oversee a particular area of compliance; identifying the greatest ethical and compliance risks; questions to ask management in determining whether the company's policies, processes, and procedures optimally address key risks; and the critical importance of employee communications. (more)

**Avoiding Awkward Silences: FRC Has Conversation Starters for Investor-Audit Committee Dialogue.** The UK's Financial Reporting Council has announced the launch of a web page "aimed at promoting better engagement between investors and audit committees to facilitate better understanding of companies and their approach to financial reporting and internal control." The FRC said that this new resource is intended to assist investors that wish to engage with audit committees and companies on assurance-related topics. The FRC believes that direct conversations with audit committee chairs could provide investors with insights into the company's approach to regulatory issues and other areas of interest to market participants. While the web page is written from a UK perspective, it could be useful to U.S. audit committees in understanding what information concerning the committee's work might be of interest to investors. (more)

**If You Want Assurance Over Your ESG Disclosures, Hire a CPA**. As corporate disclosures regarding ESG matters have increased, more companies are seeking third-party assurance over their ESG disclosures. However, unlike financial statement audits, which must be performed by licensed CPAs, in most jurisdictions there are no legal constraints on who can express an opinion on ESG disclosures. In Corporate decision-making: Why choose a CPA for your ESG assurance needs? (April 2023), the Center for Audit Quality and the Association of International Certified Professional Accountants discuss reasons why companies should choose a CPA as their ESG assurance provider. Among other things, the paper points out that US accounting firms usually apply the AICPA's attestation standards and that those standards have been subjected to due process procedures and are publicly available, allowing disclosure users to evaluate a CPA's assurance report against the standards. Also, CPAs comply with "rigorous and widely recognized" requirements for independence, firm systems of quality control, and subject matter competency. In the view of the CAQ and the Association, non-CPA firms may not be subject to the same credentialing, continuing education, quality control, and oversight. (more)

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

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.