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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 99
March-April 2025

Summary

2024 PCAOB Large Firm Inspection Reports. On March 31, the PCAOB released the 2024 inspection reports for the U.S. affiliates of the global network accounting firms, BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC. In 26 percent of the 2024 engagements that 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. For the Big Four Firms only, the deficient engagement rate was 20 percent – six percent better than the 26 percent rate in 2023. Deloitte's inspection results were the best in the GNF group, followed closely by PwC. BDO experienced the greatest improvement, with its deficient engagement rate falling from 86 percent in 2023 to (a still high) 60 percent in 2024. Three firms had deficient rates above 25 percent -- EY, Grant, and BDO.

Audit committees should discuss their audit firm's inspection report with the engagement partner. Audit committees may 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. If the company's engagement was the basis for an inspection finding, the audit committee should understand the cause of the deficiency and how the auditor plans to remedy it and prevent a recurrence. (more)

How the PCAOB Staff Sees the 2024 Inspection Results. The PCAOB's inspections staff has released Spotlight: Staff Update on 2024 Inspection Activities. This publication is a comprehensive discussion of the PCAOB's 2024 public company audit inspection results. In 2024, the PCAOB inspected 171 registered public accounting firms and reviewed portions of over 800 public company audits. The inspections staff observed "a tangible decrease" in deficiency rates and "a substantial improvement, in the aggregate, among the largest firms." For all 171 inspected firms, the aggregate deficiency rate decreased to 39 percent in 2024, down from 46 percent in 2023. The staff cites four drivers of improvement that affected the 2024 results -- More in-person work; more focused training, especially of less experienced staff; more firm resources dedicated to audit quality; and better supervision and review.

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 preparation for discussion of the firm's inspection with their engagement partner. (more)

SEC Accounting and Auditing Enforcement Slumped in 2024, While PCAOB Enforcement Hit a New High. Three new reports on accounting and auditing enforcement indicate that the SEC and the PCAOB 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. Similarly, in 2024 Enforcement Activity Involving Auditors, the Brattle Group 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." 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.

Despite year-to-year fluctuations, accounting and auditing enforcement are perennial SEC priorities. Enforcement focus on accounting and auditing 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. 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. (more)

BDO on Financial Reporting Implications of Tariffs and Questions Audit Committees Should Ask. BDO has published Economic Uncertainty: Financial Reporting Considerations for Tariffs which discusses reporting and disclosure issues arising from President Trump's program of new tariffs on imports from many countries. BDO's paper addresses tariff-related accounting considerations, financial statement disclosure issues, SEC reporting requirements, internal control implications, effects on auding, and corporate governance impacts. BDO also suggests questions for audit committee consideration concerning the financial statement, disclosure, and audit impacts of tariffs. Tariff policy is unfolding on a daily basis, and audit committees should make sure that management considers the financial reporting and disclosure implications. BDO's audit committee questions are a good starting point. (more)

SEC Takes Another Step Away From Climate Disclosure. The SEC has voted to stop defending the validity of its rules requiring disclosure of climate-related risks and greenhouse gas 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." 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.

It seems likely that the Commission will eventually rescind the climate disclosure rules. However, for public companies and their audit committees, this may not end the need to make GHG emissions and other climate-related disclosures. Many large U.S. companies will be subject to California's climate disclosure requirements. In addition, U.S. companies that are active in the European Union may be required to comply with E.U.'s sustainability disclosure regime, although the E.U. is in the process of narrowing the scope of its requirements (see next item). Mandatory reporting aside, many public companies make climate disclosures voluntarily in response to investor interest in this information. (more)

E.U. is Dialing Dial Back Sustainability Reporting and Due Diligence. The European Commission has proposed legislation that would significantly reduce sustainability reporting under the E.U.'s Corporate Sustainability Reporting Directive and postpone implementation of the requirements for many companies. The proposals 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. 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." In mid-April, the European Parliament approved the EC's "stop the clock proposal" which postpones CSRD reporting and for companies not already reporting. The European Parliament will next consider the balance of the proposals. 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 legislation and considers how changes to E.U. reporting may affect the company. (more)

Another Independence Monitoring Disclosure: PCAOB Makes Public a 2020 EY QC Criticism. On March 12, the PCAOB released a previously nonpublic portion of Ernst & Young's 2020 inspection report. This action indicates that, in the Board's view, the firm did not satisfactorily address the quality control issue discussed in that portion of the report within 12 months of the report date (September 30, 2021). The now-public quality control criticism in EY's 2020 inspection report relates to compliance with the firm's policies for employee financial holdings disclosure. This is the third inspection year for which the PCAOB has found that EY failed to remedy this deficiency. 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. (more)

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 also follow @BlogAuditor on twitter or @the-audit-blog on medium.com.

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

Update Nos. 99-present (March-April 2025 to present) and summaries are available here. Update Nos. 89-98 (March 2024 to February 2025) and summaries are available here. Update Nos. 76-88 (August 2022 to February 2024) and summaries are available here. Update Nos. 60-75 (June 2020 to July 2022) are available here. Update Nos. 49-59 (January 2019 to May 2020) are available here. Updates prior to No. 49 are available on request.

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