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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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Summary

[PCAOB Proposes Engagement Metrics and Audit Firm Operational and Financial Reporting.](#)

On April 9, the PCAOB issued for public comment two proposals that would significantly expand the disclosures that accounting firms must make regarding their performance of audit engagements and their operational and financial condition. A primary objective of these new disclosures would be to aid audit committees in their oversight. The [Firm and Engagement Metrics](#) proposal would require PCAOB-registered firms that audit large accelerated filers and accelerated filers to publicly report eleven metrics relating to specific audit engagements or the firm's overall audit practice. The [Firm Reporting](#) proposal would require annual disclosure of certain information regarding fees earned, firm governance, network arrangements, and cybersecurity, among other things. Audit committees should consider whether they would find the engagement performance metrics and firm information that the PCAOB is proposing to require useful in their work and consider expressing their views to the PCAOB. The comment period on both proposals runs until June 7. ([more](#))

[Why Are Accounting Errors Increasing? Glass Lewis Has Answers and a Warning for Audit Committees.](#)

In a recent blog post, [Why Are Accounting Errors on the Rise at U.S. Public Companies?](#), proxy and corporate governance advisory firm Glass Lewis offers reasons for what it sees as a rise in financial reporting issues. The chief causes Glass Lewis identifies are SPAC merger companies with limited financial reporting experience, a shortage of qualified accountants, and the increasing scope of audit committee responsibilities. The firm emphasizes that, despite the burdens and challenges audit committees face, it is prepared to recommend proxy votes against audit committee members who are not fulfilling their core duties. Glass Lewis recommends that public companies review their board's structure and the breakdown of responsibilities assigned to committees to make sure that the board can meet investor expectations regarding the oversight of new subjects such as cybersecurity and ESG, without undermining its effectiveness in more traditional areas such as financial reporting oversight. ([more](#))

[PCAOB Discloses Non-Public Portions of 2018 and 2019 KPMG Inspection Reports.](#)

The PCAOB has made public several previously nonpublic portions of KPMG's 2018 and 2019 inspection reports. The now-public material relates to testing controls, supervision of the audit, and compliance with firm policies concerning disclosures of financial relationships. The Board's decision to make these quality control criticisms public indicates that, in the Board's view, KPMG had not satisfactorily remediated them within 12 months of the inspection report dates. Audit committees of KPMG clients may want to discuss with their engagement partner how the firm is addressing these matters, what changes the firm has made since the PCAOB's determination that the deficiencies had not been remediated, and how the company's audit might be affected. ([more](#))

[Cornerstone: Accounting Class Actions and Enforcement Cases Continue Their Upward Trend.](#) Cornerstone Research has issued three reports on litigation involving accounting and auditing violations. Together, these reports indicate that these cases are increasing, as are the costs of resolving them. In its annual report on accounting-related class actions, [Accounting Class Action Filings and Settlements—2023 Review and Analysis](#), Cornerstone finds that the number of class action filings against public companies for alleged accounting violations increased 10 percent last year compared to 2022. The dollar value of accounting class action settlements rose 11 percent, even though the number of settlements fell. Cornerstone's annual analysis of SEC accounting and auditing enforcement cases, [SEC Accounting and Auditing Enforcement Activity—Year in Review: FY 2023](#), reports that the SEC brought 83 accounting and auditing enforcement actions in FY 2023, a 22 percent increase from FY 2022 and the highest number of actions initiated since FY 2019. Cornerstone also reports that the PCAOB expanded its auditing enforcement activity to the highest level since 2017 and that PCAOB monetary penalties set a record. See [PCAOB Enforcement Activity—2023 Year in Review](#). Despite this environment, strong internal controls, along with audit committee care and diligence in overseeing the company's financial reporting, can reduce the risk that the company or its senior management will be exposed to the cost and distraction of litigation over accounting matters. ([more](#))

[Unredacted: KPMG's 2022 Inspection Report.](#) On April 26, the PCAOB made public the complete [KPMG 2022 PCAOB inspection report](#). The version of the 2022 KPMG report that the PCAOB released in February was redacted to omit the discussion of one of the KPMG engagements the PCAOB inspected in 2022. The company involved in that engagement is referred to in the unredacted report as Issuer N. The complete version of the 2022 KPMG report describes 16 engagements, including Issuer N's, in which 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. Overall, the PCAOB found deficiencies in 30 percent of the 54 KPMG audits it inspected in 2022.

Neither the PCAOB nor KPMG have made any public statements concerning the reason for the original redaction or the subsequent release of the unredacted report. The likely explanation is that KPMG exercised its right under the Sarbanes-Oxley Act to appeal the PCAOB's deficiency finding as to Issuer N's audit to the SEC. Under the SEC rules, the PCAOB may release only the portions of an inspection report that are not subject to appeal while an appeal is pending. After the release of the redacted report, the SEC presumably concluded that the PCAOB's finding concerning Issuer N was correct, and the Board then released the full report, including the description of the Issue N deficiency. ([more](#))

[SEC Puts its Climate Disclosure Rules on Hold.](#) The SEC has [issued an order](#) staying its rules requiring public companies to disclose certain climate-related information, including material Scope 1 and Scope 2 GHG emissions. The effect of the stay order is to suspend the effectiveness of the new rules pending judicial review of their validity. The Commission adopted the climate rules on March 6 and was almost immediately sued, both by parties alleging that the rules exceed the Commission's authority and by those asserting that the rules do not go far enough. In its order, the Commission stated that the stay would "facilitate the orderly judicial resolution of those challenges" and avoid "regulatory uncertainty if registrants were to become subject to the Final Rules' requirements during the pendency of the challenges to their validity." The litigation, including any efforts to seek review in the U.S. Supreme Court, is likely to continue for several years. Despite the stay, it would be prudent for companies to continue to make plans to implement the new rules. ([more](#))

[EY Has Q1 Suggestions for Audit Committees.](#) The EY Center for Board Matters has issued [How audit committees can prepare for 2024 Q1 reporting](#). The EY Center's paper addresses five topics of interest to audit committee members: Risk management, changes to internal audit standards, accounting and disclosures, investor views on risks, and SEC rulemaking and reporting considerations. The paper includes a series of questions that audit committees could consider asking in their discussions with management, compliance personnel, and internal and external auditors. These questions fall under three headings: Risk management-related inquiries; accounting, disclosures, and other financial reporting-related inquiries; and inquiries to auditors. ([more](#))

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

Update Nos. 89-present (March 2024 to present) 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](#).