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Audits of ICFR: Update on Issues and Trends

AAA Preconference Workshop: COSO 2013 Framework

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Public Company Accounting Oversight Board

August 6, 2016

Disclaimer

- ❑ The views I express today are mine alone, and do not necessarily reflect the views of the Board, other Board Members, or PCAOB staff.

Current Issues and Trends

- **PCAOB inspection findings and trends related to internal control over financial reporting (ICFR) audits**
- **Data related to ICFR audit opinions and related questions**
- **SEC attention to ICFR**

PCAOB Inspections Focus on ICFR

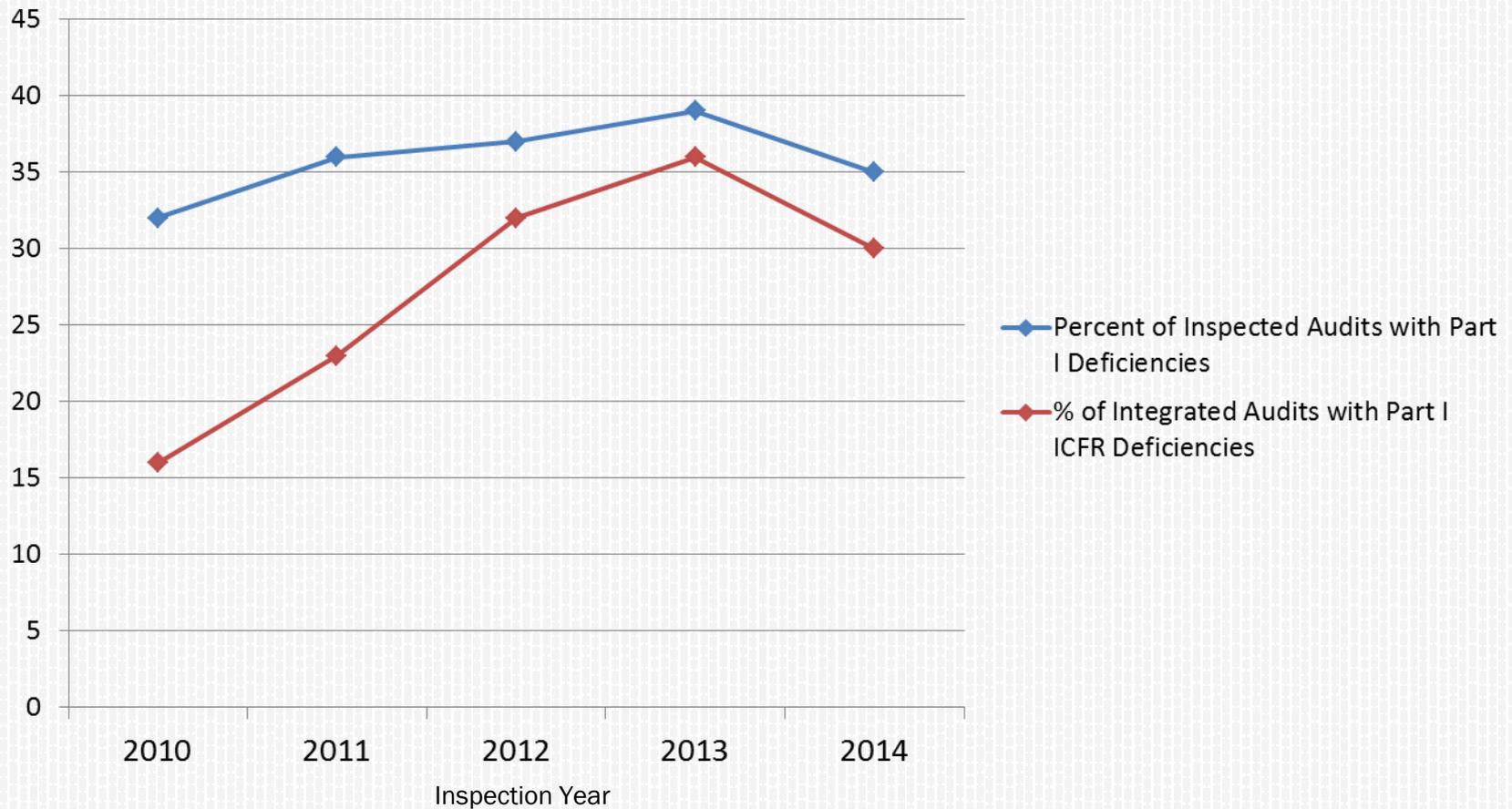
- ❑ Heightened inspections focus on ICFR audits beginning in 2010 inspections cycle
- ❑ *Observations from 2010 Inspections of Domestic Annually Inspected Firms regarding Deficiencies in Audits of Internal Control over Financial Reporting (Dec 10, 2012)*
- ❑ Staff Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting (Oct. 24, 2013)*
<https://pcaobus.org/Standards/Pages/Guidance.aspx>
- ❑ Ongoing discussions with issuers and auditors on actions needed to improve ICFR and ICFR auditing

Inspection Findings Related to ICFR

U.S. Domestic - Big 4 Firms

Inspection Year	Total Audits Inspected U.S. Big Four Firms	Inspected Audits with Part I Deficiencies	Percent of Inspected Audits with Part I Deficiencies	Total Integrated Audits Inspected	Integrated Audits with Part I ICFR Deficiencies	% of Integrated Audits with Part I ICFR Deficiencies
2014	219	76	35%	212	64	30%
2013	219	85	39%	211	76	36%
2012	208	76	37%	197	64	32%
2011	225	80	36%	213	48	23%
2010	250	79	32%	236	38	16%

U.S. Domestic – Big 4 Firms Inspection Findings



Most Frequent ICFR Audit Findings 2013 - 2014

U.S. Domestic - Big 4 Firms

Finding	Comparison of 2014 to 2013
Selecting the appropriate controls to test (AS 5.39)	Similar results
Testing design effectiveness (AS 5.42)	Improvement
Testing the operating effectiveness of the controls (AS 5.44)	Improvement

2015 Inspections of Domestic Big 4 Firms

- ❑ PCAOB's 2015 inspections indicate improvements in the area of auditing ICFR
- ❑ This is part of a larger trend of overall reductions in audits with Part I deficiencies
- ❑ Overall, the most significant and frequent audit deficiencies continue to be in key areas related to
 - ❑ Auditing ICFR
 - ❑ Assessing and responding to risks of material misstatement
 - ❑ Auditing accounting estimates

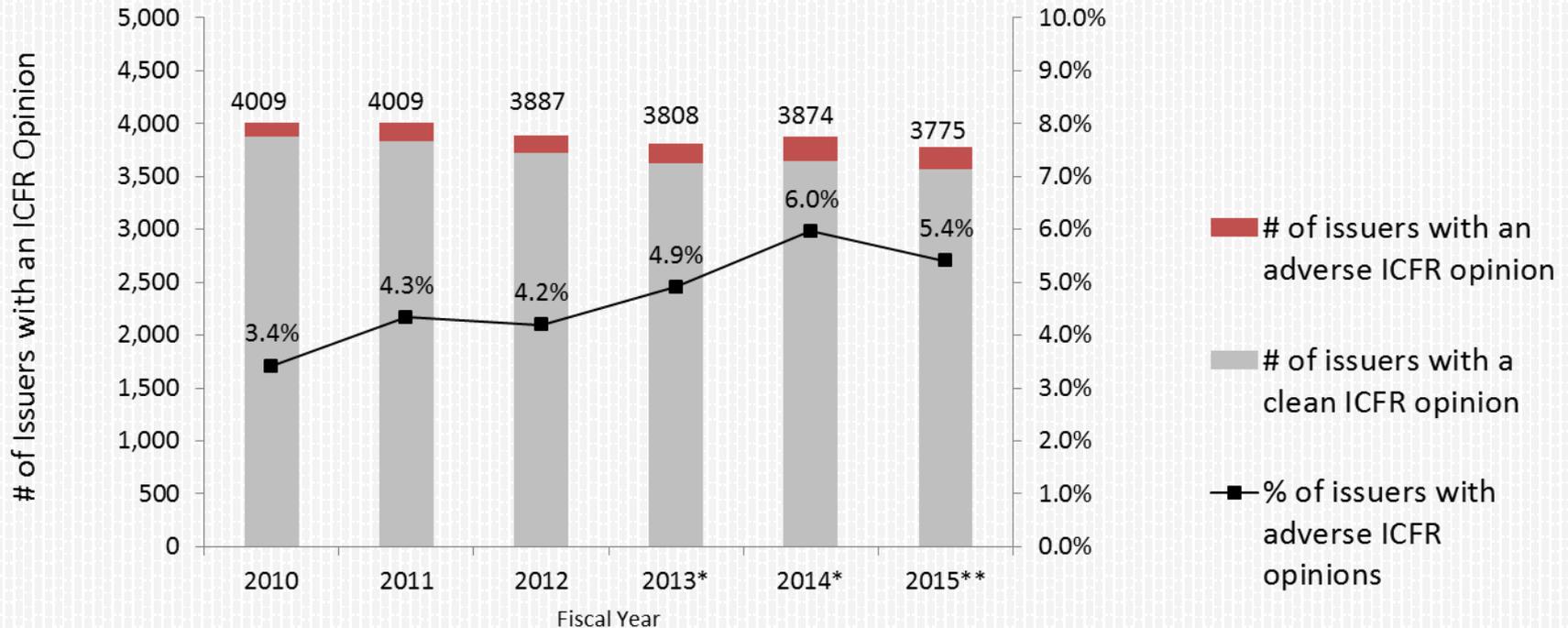
Percentage of Adverse ICFR Opinions 2010 - 2015

Reporting Year	Number of Adverse ICFR Opinions	Total ICFR Opinions	Percentage Adverse Opinions
2010	137	4,009	3.4%
2011	174	4,009	4.3%
2012	163	3,887	4.2%
2013	187	3,808	4.9%
2014	231	3,874	6.0%
2015	204	3,775	5.4%**

**Preliminary count based on filings through July 20, 2016

Data Source: Audit Analytics

ICFR Audit Opinions 2010 - 2015

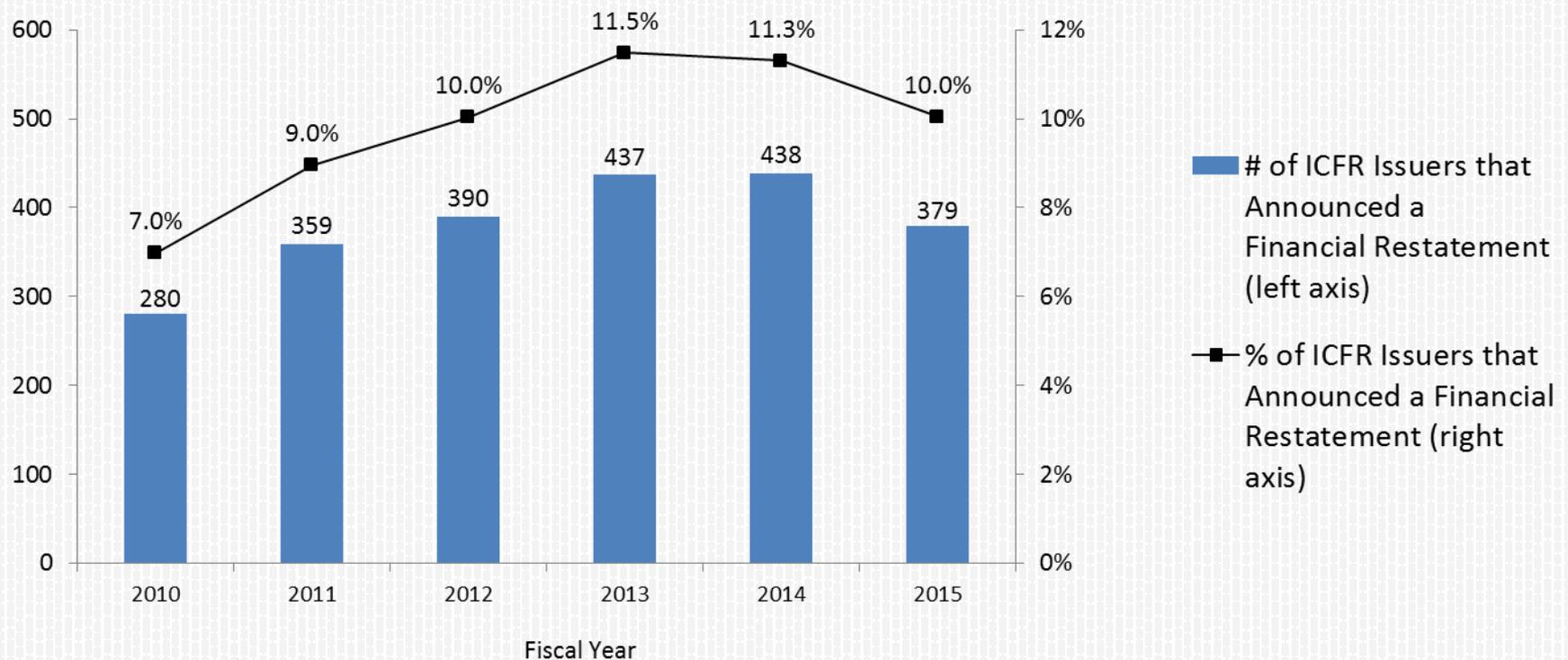


* Revised counts of issuers

** Preliminary counts of issuers

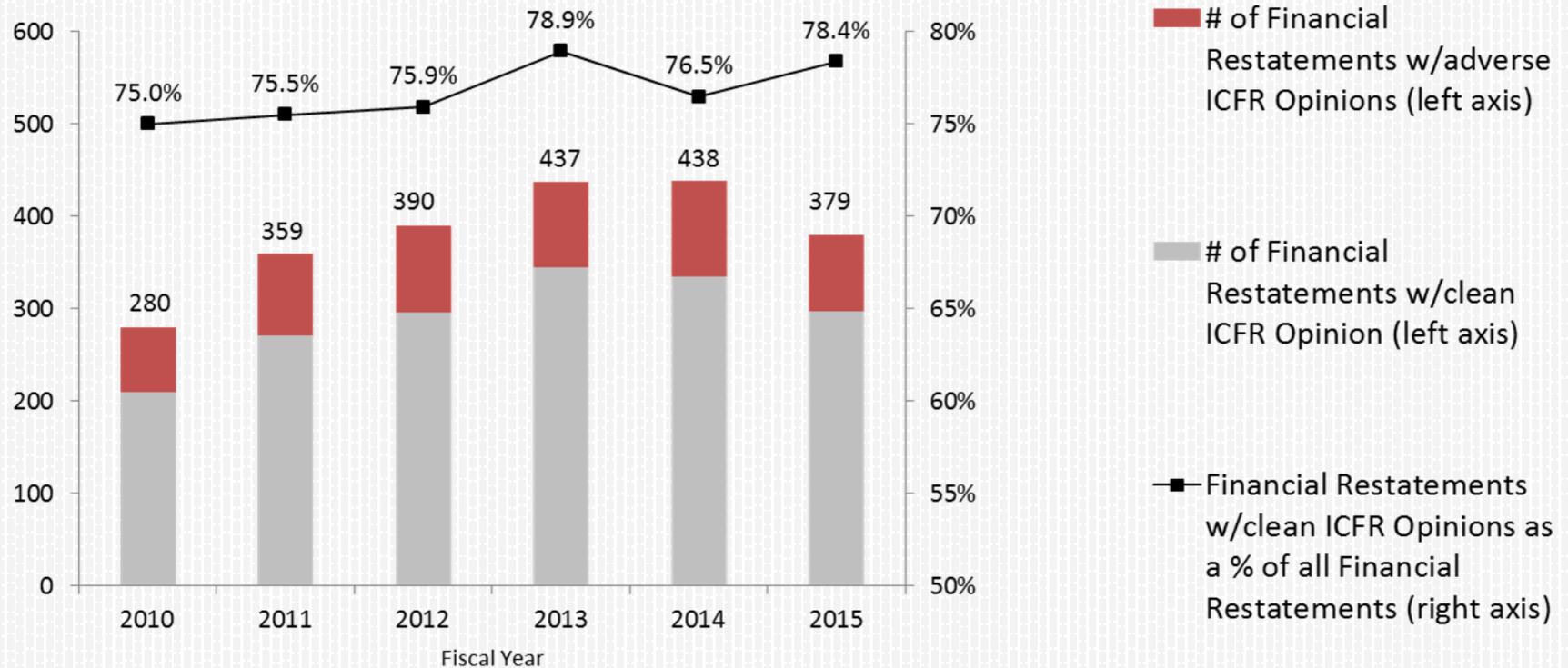
Data Source: Audit Analytics

Financial Restatement Activity of Issuers with ICFR Opinions



Data Source: Audit Analytics

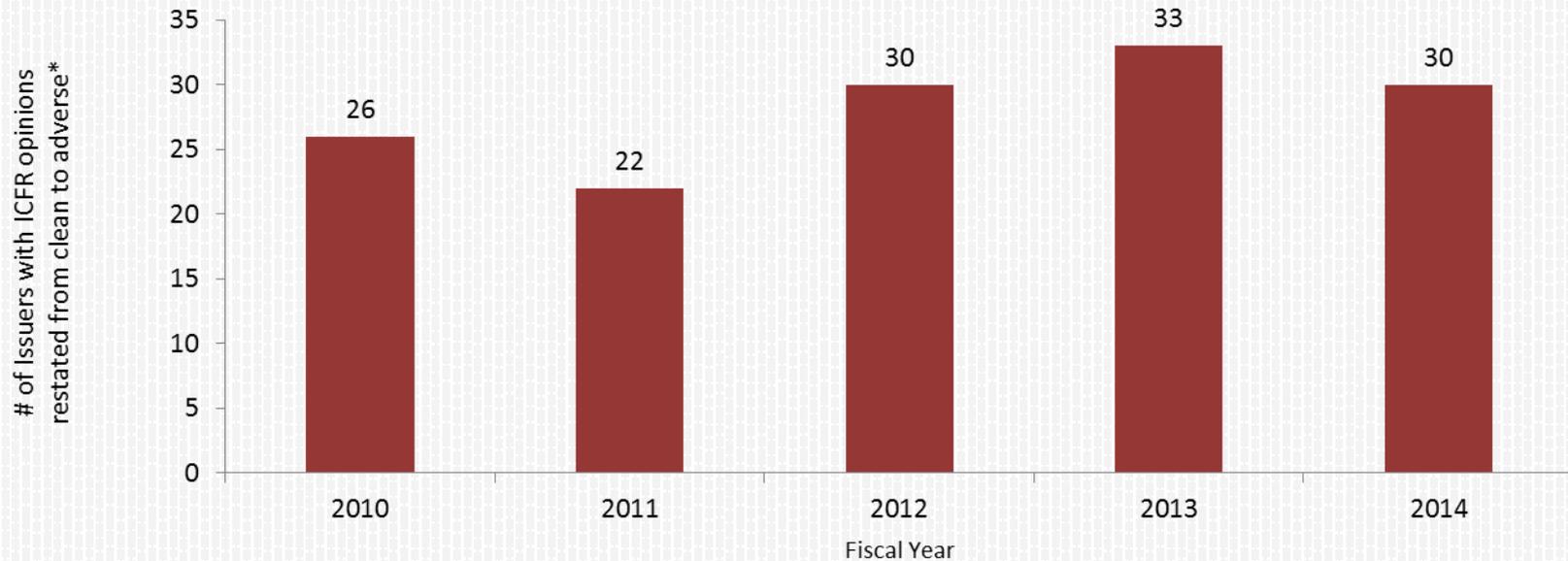
ICFR Opinions of Issuers that Announce Restatements



Note: Data includes non-reliance notifications filed by an issuer on Form 8-K and disclosure of a restatement identified in the issuer's periodic filing.

Data Source: Audit Analytics

Number of ICFR Audit Opinions Restated From “Clean” to “Adverse”



Since it is possible for fiscal year 2015 ICFR opinions to be restated up to the issuance of a fiscal year 2016 opinion, 2015 counts have not been included here.

* Restated ICFR opinions represent issuers which initially received a clean ICFR opinion , and subsequently received an additional ICFR opinion for the same reporting period that was adverse.

Data Source: Audit Analytics

SEC Emphasis on ICFR

Remarks from SEC's Deputy Chief Accountant, Brian Croteau, at AICPA's National Conference on Current SEC and PCAOB Developments

- ❑ 2013 - SEC increasing intensity of focus on ICFR
 - Some of PCAOB's inspection findings related to the audits of ICFR are likely indicators of similar problems with management's evaluations of ICFR
 - Are all material weaknesses being properly identified? It is surprisingly rare to see management identify a material weakness in the absence of a material misstatement.

<https://www.sec.gov/News/Speech/Detail/Speech/1370540472057>

- ❑ 2014 - ICFR: "Where are the material weaknesses?"

<https://www.sec.gov/News/Speech/Detail/Speech/1370543616539>

- ❑ 2015 - "ICFR Reporting Continues to be an area of focus for OCA"

<https://www.sec.gov/news/speech/croteau-2015-aicpa.html>

SEC Charges Company and Executives for Faulty Evaluations of Internal Controls

On March 10, 2016, the SEC instituted settled cease-and-desist proceedings against:

- ❑ The oil company Magnum Hunter Resources Corporation
- ❑ The company's chief financial officer and chief accounting officer
- ❑ The external audit engagement partner
- ❑ A consultant hired to conduct SOX ICFR assessment and internal audit services

due to alleged failures to "properly implement, maintain, and evaluate" ICFR

See SEC Press Release 2016-48, March 10, 2016.