# Responding to the PCAOB in its State of Flux

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***By Ellen Graper***

The Public Company Oversight Board (PCAOB) has been in the headlines again, but for all the wrong reasons. Formed in 2002 to protect investors after the accounting and auditing scandals of the early 2000s, some have questioned the direction the quasi-governmental organization has taken in the past several years.

Given the current landscape at the PCAOB, firms must act more quickly on remedial actions in 2021 than in the past to ensure the remediation staff concludes that the remedial actions are sufficient.

Echoing the SEC's December 2017 action to replace the PCAOB's five-member board with new members, on June 4, 2021, the SEC removed the PCAOB's chairman and announced it would replace the remaining board members.

While the SEC has sought nominations for new Board members, when those members will take office is anyone's guess. Until then, three existing members remain at the Board.

What does this mean for your registered firm? Not much, at least in the short term. The PCAOB continues its inspection and enforcement activity, but its standard-setting activity may not progress until a new Board is in place. But there are actions registered firms should take during this state of flux at the PCAOB.

You've likely noticed that the issuance of both of inspection reports and enforcement orders has decreased significantly over the past three years. Since peaking at 344 inspection reports in 2011, the PCAOB's pace for issuing inspection reports slowed to a trickle of 46 reports in 2020. And since the Sarbanes-Oxley Act dictates the timing of the inspection activity but not the issuance of reports from those inspections, it is clear the PCAOB has a significant backlog of reports to issue from inspections conducted in 2019, 2020, and 2021 to date.

Enforcement actions are not made public when initiated. As such, assessing DEI's current activity level is more challenging as it can take years to settle a DEI investigation. The PCAOB settled 54 orders in 2017, but only 20, 30, and 17 in 2018, 2019, and 2020, respectively.

This slowdown is likely due to a combination of factors: a change in the content and format of inspection reports in 2020 aimed to enhance readability and make information more digestible and accessible to users, extended vacancies in the DEI Director and General Counsel's positions between 2018 and 2019, and a change in the DRI Director position in 2018. These personnel changes were in addition to the overhaul of Board members in late 2017.

This slowdown in report issuance is creating several complications for registered firms. As originally contemplated in the Sarbanes Oxley Act, a firm subject to triennial inspections would complete its cycle of inspection, reporting, and remediation within a three-year period.

The delays in reporting inspection results create an "overlap" of inspection activities from one triennial cycle (inspection, reporting and remediation) to the next. Thus, firms will be conducting audit procedures subject to the next inspection before the Board concludes on the firm's remedial actions from the prior inspection.

Luckily, CPA firms continue to have a 12-month period to remediate quality control ("QC") criticisms from inspection reports before those criticisms are made public. However, overlapping inspection cycles may cause firms to have QC criticisms repeated in reports that were subsequently remediated.

In 2013, the PCAOB issued guidance on "repeated or persistent" criticisms. It has not, however, issued any guidance on how it will evaluate repeated criticisms due to the overlap of inspection cycles.

The delay in issuing inspection reports will likely result in a push to issue more such reports, either just before a new Board is in place or after the Board members have gotten settled. When this push to issue reports occurs, the substantial backlog of reports will create significant strain on the PCAOB staff evaluating firms' remedial actions.

The PCAOB has dedicated inspection staff to evaluate firm remediation submissions. Under normal circumstances, this staff is available to review drafts of remediation submissions and provide feedback to firms with enough time and in enough detail that firms can amend their remedial responses to ensure a more favorable determination from the Board.

When the report floodgates open at the PCAOB, however, more firms will be in their 12-month remediation period concurrently. Moreover, unless the PCAOB substantially increases its remediation staff resources, the allocation of remedial resources available to individual firms will be reduced and firms should expect less feedback and longer timeframes.

Despite these circumstances, public accounting firms should not delay compliance activities and instead, proactively take the following actions:

To the extent you did not perform incremental audit procedures or enhance the work paper documentation in response to the comment forms, perform that work now in compliance with AS 2901, Consideration of Omitted Procedures After the Report Date, and AS 2905, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report. If this documentation was not provided with the comment form responses, the remediation staff expects firms to address the engagement deficiencies as part of the remediation process.

Don't wait for the issuance of the final inspection report to begin remediating QC criticisms included in the draft report. Use the time between the issuance of the draft and final inspection reports to buy your firm additional time address these QC criticisms.

Analyze the root cause of each engagement deficiency noted in the inspection. The engagement deficiencies give rise to the QC criticisms in the final report, so identify relevant root causes and develop actions to address those root causes now.

Provide a draft remediation response to the PCAOB staff early in the remediation period. Feedback from the remediation staff is one of the most important resources available to PCAOB registered firms; don't squander this opportunity.

With the unprecedented backlog in inspection reports, the PCAOB remediation staff will be inundated with questions and draft responses once the report floodgates open. By taking effective remedial actions early in the remediation period, your firm can get ahead of the curve.

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## About the Author

*Ellen Graper, a Partner at StoneTurn, has more than 15 years of experience enhancing and implementing controls for most of the world's registered public accounting firms through her work at the Public Company Accounting Oversight Board (PCAOB).*

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