

SPOTLIGHT

Additional Insights on the Remediation Process

February 2023

This document represents the views of the staff of the Division of Registration and Inspections (“inspection staff”) and not necessarily those of the Board. It is not a rule, policy, or statement of the Board.

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OVERVIEW

The Public Company Accounting Oversight Board (the “Board” or PCAOB) oversees the audits of public companies, and certain Securities and Exchange Commission (SEC)-registered brokers and dealers, to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

The PCAOB is committed to promoting compliance with its professional standards and rules. One important means by which the PCAOB does this is through [its inspections program](#), to accurately assess, drive improvement in, and communicate the elements of audit quality.

Section 104(g)(2) of the Sarbanes-Oxley Act (the “Act”) provides that, in connection with the inspection of a public accounting firm registered with the PCAOB, no portion of an inspection report that deals with criticisms of or potential defects in the quality control systems of that firm (“quality control criticisms,” QCCs, or “criticisms”) will be made public if those are addressed by the firm to the Board’s satisfaction within 12 months of the date of the inspection report. Since 2013, when the inspection staff issued [guidance to firms on the remediation process](#) (“Staff Guidance”), the Board has made a substantial number of remediation determinations. This has enabled the inspection staff to develop insights into how firms remedy criticisms in their quality control systems, as well as to identify some emerging trends and challenges related to remediation.

This Spotlight reflects the staff’s current remediation program and the previous Board and Staff Guidance, including the Board’s 2006 release ([PCAOB Release No. 104-2006-077](#)) addressing the process for Board

Remediation is a critical step in our inspections and our mission-driven efforts to protect investors and improve audit quality.

determinations regarding firms’ efforts to address QCCs in inspection reports (“Board Statement”) and Staff Guidance, each of which is available on the PCAOB’s website.

The staff is currently evaluating the Staff Guidance to determine what changes in the Staff Guidance may be needed. Pending the conclusion of that evaluation, the staff is sharing its current observations in this Spotlight.

REMEDICATION: PROCESS AND GUIDANCE

Process

PCAOB inspections of firms are designed to review portions of selected audits of public companies and to evaluate elements of a firm’s quality control system. Each inspection results in a report, specific to the quality control system components of each firm inspected, which may summarize identified deficiencies. QCCs, if any, appear in Part II – Observations Related to Quality Control – of an inspection report. The Act requires that QCCs in Part II of an inspection report remain nonpublic when the report is first issued. The following steps then occur:

1. Consistent with PCAOB Rule 4009, a firm has 12 months from issuance of the inspection report to submit evidence or otherwise demonstrate to the inspection staff that it has taken steps to remediate the QCC.

2. The inspection staff then evaluates the firm's remedial efforts and makes a recommendation to the Board regarding the determination as to whether the firm has remediated the QCC.
3. The Board makes a determination as to whether the firm has remediated, to the Board's satisfaction, each QCC in Part II of the inspection report.
4. Firms have a right under the Act to request review by the SEC within 30 days of receiving notice of an adverse determination by the Board.
5. Unless the SEC overturns the Board determination that a firm did not remediate a QCC to the Board's satisfaction, that QCC will be made public.

This Spotlight discusses the inspection staff's insights regarding step 2 of this process, in which the inspection staff evaluates the firm's remedial efforts and makes a recommendation to the Board.

Guidance

The Act sets out a standard for the Board's remediation determinations that affords the Board substantial discretion. Two documents provide public guidance on how the Board and the inspection staff assess whether a firm has remediated a quality control deficiency to the satisfaction of the Board. These documents are the Board Statement and the Staff Guidance referred to above.¹

The inspection staff refers firms with QCCs in Part II of their inspection reports to these documents when providing their inspection reports, and the inspection staff is available to discuss these documents with firms during their remediation periods.

The Board Statement provides information about the Board's process for determining whether a firm has addressed QCCs to the satisfaction of the Board for purposes of Section 104(g)(2) of the Act.

A favorable remediation determination reflects the Board's assessment that, among other things, a firm has acted in good faith and, consistent with Section 104(g)(2)'s requirement that a firm address QCCs not later than 12 months after the date of the inspection report, "the firm has identified steps suited to the particular objective and is...making reasonable progress in implementing those steps" (footnote omitted).

As noted in the Board Statement: "The Board's process is based on the proposition that each firm knows best how to manage its operations and to define the specific methods by which it can address a particular quality control criticism. This allows each firm to craft effective remedies based on its specific organizational structure and operations."

2013 Staff Guidance

The Staff Guidance provides information for firms that receive a final inspection report that contains any QCC. The document describes certain considerations that the inspection staff has identified as relevant to its recommendations to the Board concerning the sufficiency of firms' remediation efforts.

The Staff Guidance provides the five criteria applied by the inspection staff when evaluating a firm's remediation efforts. These criteria are:

- 1. Change:** Does the remedial step represent a change to the firm's system of quality control that was in effect at the time of the conduct that resulted in the QCC? Depending upon the circumstances,

¹ As mentioned above, the staff is currently evaluating the Staff Guidance, including the five criteria described below that are used by the staff in evaluating firms' remediation efforts. The staff may revise the Staff Guidance as a result of that evaluation. This Spotlight is being issued to provide additional insights pending the completion of that evaluation.

relevant change may involve supplementing or replacing previous guidance, policies, or procedures or taking steps to increase the technical competence and proficiency of the firm's personnel.

- 2. Relevance:** Is the remedial step responsive to, and does it specifically address, the quality control criticism described in the inspection report; and does it help satisfy future compliance with the Board's quality control standards? If the root cause of the underlying quality control criticism is unclear, did the firm perform an appropriate root cause analysis in developing the remedial action?
- 3. Design:** Is the remedial step appropriately designed (either individually or in combination with other actions) to remediate the quality control criticism? Although not stated in the 2013 Staff Guidance, in applying this criterion the inspection staff considers both whether the general design of the action is appropriate and also whether the firm's particular remedial steps, individually or in combination, have a sufficient scope to satisfactorily remediate the criticism.
- 4. Implementation:** To what extent was the remedial step put in operation by the close of the 12-month remediation period? If not fully implemented, has the firm demonstrated an appropriately high level of diligence and serious and substantial progress described in Section 6 below ("PCAOB Expectations on the Timing of Remediation Design and Implementation") in addressing the criticism during the 12-month period? If there is no convincing reason why the action could not have been implemented sooner, it will be viewed as untimely.



The 2013 Staff Guidance provides the five criteria applied by the inspection staff when evaluating the firm's remediation efforts.

- 5. Execution and Effectiveness:** Has the remedial step achieved (or, if sufficient time has not passed to measure results, is it expected to achieve) the proposed effect that it was designed to achieve? If available, what do the subsequent firm monitoring procedures and external inspection results suggest about the effectiveness of the remedial step?

These criteria guide the inspection staff in the evaluation process that underpins its recommendations to the Board. This process takes into account factors such as the size of the firm and the nature and complexity of its practice, so that firms of differing sizes and complexity may achieve the same quality control objective using differing approaches.

ADDITIONAL CONSIDERATIONS RELATED TO REMEDIATION EFFORTS

This Spotlight does not change or replace the Board Statement or Staff Guidance. As the staff continues to evaluate its Staff Guidance, the staff presents the following additional insights – gleaned from the PCAOB's years of evaluating remediation efforts – that firms and others, such as audit committees and investors, should consider.

1. Repeated or Persistent Criticisms Require a New or Enhanced Response

The Staff Guidance emphasizes that, for repeated or persistent criticisms, the inspection staff's "evaluation of current remediation efforts takes into account whether those efforts reflect change. In other words, do the current efforts differ meaningfully from the types of efforts the firm has described in previous remediation submissions but that ultimately do not appear to have sufficiently addressed the deficiency?"

Repeated or persistent criticisms include QCCs that have appeared in inspection reports for multiple years. Under the Staff Guidance, expectations as to what a firm needs to do to meet each criterion are higher with respect to repeat or persistent criticisms.

The Staff Guidance notes that, even if a particular type of remediation step was considered satisfactory in a prior determination, the same type of step – without some meaningful enhancement – may not necessarily be viewed as satisfactory if the particular problem has persisted after there has been sufficient time for the previous efforts to effect improvement.

For each year that the criticism persists, the actual implementation, execution, and tangible results of a firm's remedial steps take on increasing importance in the inspection staff's evaluation. A firm should consider whether the types of actions it is taking to address these longstanding, persistent criticisms are meaningfully different from the types of actions implemented in response to the QCC included in prior inspection reports.

The inspection staff use their experience and judgment in identifying a criticism for the Board as a repeat or persistent QCC at a firm.

A criticism that occurs in Part II of at least two consecutive inspection reports, or that occurs consistently, even if it skips one or two inspection reports, is considered a repeat or persistent criticism.

The inspections staff evaluates similar deficiencies, regardless of how these deficiencies have been categorized in Part II in prior inspection reports. For example, if the year subject to remediation included a QCC related to testing assumptions of estimates, and the prior year included a QCC related to testing assumptions of business combinations, the QCC for the subsequent year would likely count as a recurrence because the underlying deficiency in both instances relates to testing assumptions.

Please see below for further discussion regarding the consideration of subsequent inspection results.

2. The Importance of Root Cause Analysis

The inspection staff believes that a firm's analysis of the root cause(s) of a QCC may be helpful in determining whether an action is relevant and appropriately designed to remediate quality control deficiencies. There may be multiple causes contributing to a given deficiency. The nature and extent of the root cause process will likely differ significantly with a firm's size and complexity. However, as a general matter, the more thoughtful the analysis, the more likely a firm will identify the major causal factors and the greater the likelihood that a firm can design and implement remediation efforts that will be effective in preventing recurrence of similar deficiencies. Firms may also consider performing analyses on audits they deem to be high quality in order to identify characteristics or benchmarks which can then be compared

to, and contrasted with, audits that gave rise to a QCC.

Consistent with the Board Statement's expectation that firms demonstrate that they are "making reasonable progress" to implement remedial steps, a firm need not – and many firms do not – await a final inspection report before beginning to assess root causes of QCCs and beginning to develop and implement remedial steps, which we would consider a good practice.

3. How the PCAOB Considers Subsequent Inspection Results

Consistent with the Staff Guidance, the information considered in the inspection staff's evaluation of a firm's remediation efforts includes evidence of the effectiveness of the firm's actions, if available. This includes results of firm monitoring procedures or evidence from subsequent inspections.

The Staff Guidance further discusses the fact that strong remediation efforts, particularly when accompanied by effective firm monitoring procedures and timely adjustments, can weigh favorably in the inspection staff's recommended remediation determination, even if subsequent inspection results indicate recurrences of the same type of deficiency. However, in other cases, adverse subsequent inspection results without evidence of such strong efforts may result in the inspection staff recommending that the Board determine that a QCC was not satisfactorily addressed.

When evaluating whether a firm's remediation efforts are sufficiently strong to overcome poor subsequent inspection results, the inspection staff considers various factors. Here are three examples:

1. Remediation efforts for QCCs that have persisted over multiple inspection reports are viewed through a more critical lens to be considered as sufficiently strong to overcome poor subsequent inspection results.
2. In connection with repeat or persistent QCCs, certain types of actions, such as training and intra-firm communications alone, may be viewed as insufficiently strong steps to overcome poor subsequent results.
3. If there are design flaws noted within actions, or if they are not sufficient in scope (when viewed both individually and collectively), they may be viewed as insufficiently strong remediation efforts, particularly for repeat or persistent QCCs. Examples might include a QCC on estimates for which the firm's action only addresses a specific type of account, such as inventory, or a QCC regarding personal independence compliance testing for which the firm's action only addresses a portion of the population subject to the testing.

4. How the PCAOB Evaluates the Design of New or Revised Guidance, Tools, or Policies From Firms

For actions such as new or revised guidance or policies, the inspection staff considers the merits of the guidance or policy itself, and (1) the effective date of the guidance or policy, (2) the method of communication and reinforcement to practitioners, and (3) whether a specific group or individual is responsible for execution and/or oversight and monitoring of the new policy/guidance.

For actions such as introduction of a new audit tool (e.g., templates, practice aids, etc.), the inspection staff considers whether use

of the tool is mandatory (where appropriate) and is reflected in the audit work papers. Other considerations include the review requirements for the specific audit tool and related timing for completion (e.g., planning/interim/final).

If a firm leaves to the discretion of its audit professionals whether to use the new guidance or tool, and the guidance or tool is not widely adopted across the firm, inspection staff may not consider the action appropriately designed to address the QCC.

5. What the PCAOB Considers When Evaluating the Design of Training Programs

The inspection staff takes into account various considerations when evaluating training programs employed by firms as steps to attempt to remediate QCCs. Such considerations generally include (1) whether the training is specifically tailored, and provided, to the appropriate levels of professionals within the firm who would be expected to perform or review the audit procedures that resulted in the deficiencies, (2) the extent to which the training is mandatory for the target audience and the related participation, (3) the training delivery method (in-person/webcast/self-study), (4) the quality of the content and the amount of time devoted to the specific QCC with respect to which the training is employed as a remedial step, (5) the content of the training (inclusion of case studies and/or periodic testing during the session) and how it changed from previously provided training, (6) whether there is a post-course assessment and/or the training qualified for continuing professional education (CPE) credit, and (7) the background and qualifications of the course instructors.

When evaluating training programs, the inspection staff also considers a firm's processes for monitoring participation. For example, the inspection staff considers how the firm (1) determines the target audience required to participate in the relevant training, (2) follows up with those who did not participate in mandatory training, (3) advises professionals who did not participate in the mandatory training regarding the required participation alternatives (e.g., make-up session, self-study), and (4) considers a professional's compliance with training requirements in staffing decisions and the firm's performance management process.

6. PCAOB Expectations on the Timing of Remediation Design and Implementation

In developing remediation recommendations for the Board, the inspection staff considers whether a firm approaches its actions with diligence in the pursuit of progress within the 12-month statutory remediation period. The inspection staff generally expects a firm to design and implement appropriate remedial actions no later than the end of the 12-month deadline. However, staff recognizes that, in some cases, the implementation of longer-term remediation plans extending beyond the 12-month deadline is appropriate to address a QCC. In such a circumstance, the inspection staff's assessment of an action may include consideration of not only whether the firm has done all it reasonably could within the 12-month period, but also whether the firm has established reasonable milestones reflecting an appropriately aggressive approach to complete implementation.

If an action has not been fully implemented prior to the 12-month deadline, the inspection

staff may attribute weight to the action only where a firm has shown that its remediation effort is one that, by its nature, could not have been completely implemented within the 12-month period, and it provides evidence of a project plan and steps taken prior to the end of the remediation period. Such evidence might include leadership approval, firm-wide communications, resource commitment, and internal reporting to leadership/project owner.

7. The Value of Ongoing Dialogue

Each firm with a QCC is encouraged to initiate a dialogue with the inspection staff's remediation team (specifically, the team member identified in the inspection report cover letter) as early as possible within the 12-month remediation period. The inspection staff's experience indicates that, the earlier that a firm initiates a dialogue with the inspection staff, the better the firm will be able to adjust its approach, if necessary, to achieve a favorable inspection staff recommendation.

Learn More and Contact the PCAOB

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The PCAOB also welcomes your questions and comments. You can contact the PCAOB at **info@pcaobus.org**, and **we invite you to share your views on this document by filling out our short reader survey**.

The inspection staff expects annually inspected firms to share their preliminary remediation plans in writing with inspection staff within 60 days of any inspection report that includes a QCC and encourages other firms to do so within six months of any such inspection report. Board Guidance is not prescriptive regarding the format of a firm's response.

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