

SPOTLIGHT

Inspection Observations Related to Auditor Use of Data and Reports

April 2024

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OVERVIEW

Auditors must obtain sufficient and appropriate audit evidence to provide a reasonable basis for their opinion. Sufficiency is the measure of the quantity of audit evidence, and appropriateness is the measure of the quality of the audit evidence. To be appropriate under PCAOB standards, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based.

As noted in previously issued "Staff Update and Preview" Spotlights (2020–2023), PCAOB staff has observed significant and consistent rates of deficiencies related to auditors' evaluation of audit evidence, including information from external sources, and testing of information produced by the company ("IPC") and used in the performance of control activities and substantive testing.

- IPC includes company-produced information such as invoices issued by the company, shipping documents created by the company, and other data and reports from company information technology systems.
- Information received from external sources includes, among other things, purchase orders submitted by customers, shipping records, records from the bank showing cash received from a customer as payment for an invoice, or information produced by a service organization.

Approximately 17% of the total comment forms¹ for each of the 2021 and 2022 inspection cycles contained deficiencies where the auditor did not perform sufficient procedures to test (or sufficiently test controls over) the accuracy and completeness of IPC or other data and reports including information produced by service

Why Is Accuracy and Completeness Necessary?

As auditors receive information from a multitude of sources within the company during an audit, it is important to understand why the accuracy and completeness of that information matter. Accuracy and completeness of information are necessary in the detection of errors, as well as in the detection of fraud.

For example, the auditor testing fixed asset additions for the period needs to ensure he or she has a complete population of the additions, relevant to the system of record being reviewed (e.g., the fixed asset subledger). Without testing completeness of the listing of additions produced by the company, the auditor may not be in a position to detect errors or fictitious additions during his or her substantive testing.

Testing the accuracy of information produced by the company is just as important. For example, if the auditor did not test the accuracy of pension participant data produced by the company that is used by the auditor in his or her substantive procedures, it is possible that he or she may not detect a misstatement in the recorded balance.

¹ A "comment form" is the initial communication to audit firms of observed deficiencies from our inspections. Please refer to [Basics of Inspections](#) for additional information.

organizations. Observations in our comment forms may subsequently result in one or more deficiencies being discussed as findings included in Part I.A of our inspection reports.²

To improve audit quality and assist auditors of public companies and brokers and dealers (“broker-dealers”), this Spotlight highlights recent staff observations on the use of IPC and information from external sources in the audit. Our observations, including common audit deficiencies, good practices, and other reminders, may help auditors understand how the testing of IPC and information from external sources is properly performed.

Confirmations

Information obtained by the auditor directly from external sources, including through confirmation, can be an important source of evidence obtained as part of an audit. Although this Spotlight does not expressly discuss observations related to confirmations, in September 2023, the PCAOB approved a new standard, **AS 2310, The Auditor’s Use of Confirmation**, that will replace the existing auditing standard on the confirmation process. This new standard emphasizes the auditor’s responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. The new standard will apply for audits of financial statements for fiscal years ending on or after June 15, 2025.

What Is Relevance and Reliability?

In accordance with AS 1105, *Audit Evidence*, the **relevance** of audit evidence refers to its relationship to the assertion or to the objective of the control being tested. The relevance of audit evidence depends on: design of the audit procedure used to test the assertion or control, in particular whether it is designed to (1) test the assertion or control directly and (2) test for understatement or overstatement; and the timing of the audit procedure used to test the assertion or control.

The **reliability** of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained. The reliability of information generated internally by the company is increased when the company’s controls over that information are effective. Evidence obtained directly by the auditor is more reliable than evidence obtained indirectly. Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized, or otherwise converted into electronic form, the reliability of which depends on the controls over the conversion and maintenance of those documents.

² Part I.A of our PCAOB inspection reports discusses deficiencies, if any, that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion(s) on the public company’s financial statements and/or internal control over financial reporting (ICFR).

COMMON AREAS OF INSPECTION DEFICIENCIES RELATED TO DATA AND REPORTS

This section summarizes information about deficiencies identified in our 2021 and 2022 comment forms issued to audit firms related to IPC and other audit evidence.

Testing Accuracy and Completeness of IPC

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 1105, <i>Audit Evidence</i>, paragraph .10, when using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:</p> <ul style="list-style-type: none">• Test the accuracy and completeness of the information, or test the controls over the information; and• Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. <p>In accordance with AS 1105.A8, the auditor should also test the accuracy and completeness of company-produced data used by a company's specialist and evaluate the relevance and reliability of data from sources external to the company that are used by the specialist.</p> <p>For broker-dealer audits conducted in accordance with AT No. 1, <i>Examination Engagements Regarding Compliance Reports of Brokers and Dealers</i>, in accordance with paragraph .09, the auditor should obtain an understanding of the broker's or dealer's processes, including relevant controls regarding compliance with the financial responsibility rules. These procedures should include understanding the degree to which the broker's or dealer's compliance depends on the completeness and accuracy of the broker's or dealer's internally generated data.</p>	<p>We have observed deficiencies where the auditor did not perform sufficient procedures to test, or sufficiently test controls over, the completeness of the IPC that was used to make selections for tests of details, such as for a financial account with a significant risk.</p> <p>We also identified deficiencies where the auditor failed to test the accuracy and completeness of the non-financial data prepared by the company and non-financial information used by the company's specialists in developing an estimate, such as reserves in the oil and gas industry or participant data for a pension liability.</p> <p>Additional deficiencies have been identified in tests to evaluate data used in a software-assisted correlation analysis (e.g., an analysis that shows the level of correlation between specified factors).</p> <p>In broker-dealer inspections, we noted deficiencies where the auditor did not test the accuracy and completeness of IPC used by the auditor as part of its compliance procedures as of the broker-dealer's year end.</p>

Considering Relevance and Reliability of Audit Evidence

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 1105.04, the auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.</p> <p>In accordance with AS 1105.06, to be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based.</p> <p>Auditors can also consider PCAOB staff guidance, "Evaluating Relevance and Reliability of Audit Evidence Obtained From External Sources."</p>	<p>We have identified deficiencies where the auditor failed to evaluate the relevance and reliability of non-financial information, such as growth rates, used by the company's specialists in developing an estimate.</p> <p>We noted deficiencies where the auditor did not perform any procedures to evaluate the relevance and reliability of information provided by external parties, such as risk-free rates and equity-risk premiums, that was used in assessing long-lived assets for impairment.</p>

Testing Controls Over IPC Used in the Operation of a Control

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 2201, <i>An Audit of Internal Control over Financial Reporting That is Integrated with an Audit of Financial Statements</i>, paragraph .39, the auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.</p> <p>In accordance with AS 2201.40, there might be more than one control that addresses the assessed risk of misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of misstatement to more than one relevant assertion. It is neither necessary to test all controls related to a relevant assertion nor necessary to test redundant controls, unless redundancy is itself a control objective.</p> <p>Note, Staff Practice Alert 11 says for example, if a control selected for testing uses system-generated data or reports, the effectiveness of the control depends in part on the controls over the accuracy and completeness of the system-generated data or reports. In those situations, supporting a conclusion on the effectiveness of the selected control involves testing both the selected control and the controls over the system-generated data and reports.</p>	<p>We have identified deficiencies where the auditor did not identify and test controls over the accuracy and completeness of data used by the control owner in the operation of a control important to the auditor's conclusions about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.</p>

Assessing Information Used in Expectations for Substantive Analytical Procedures

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 2305, <i>Substantive Analytical Procedures</i>, paragraph .16, before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information. The auditor obtains assurance from analytical procedures based upon the consistency of the recorded amounts with expectations developed from data derived from other sources. The reliability of the data used to develop the expectations should be appropriate for the desired level of assurance from the analytical procedure. The auditor should assess the reliability of the data by considering the source of the data and the conditions under which it was gathered, as well as other knowledge the auditor may have about the data. The following factors influence the auditor's consideration of the reliability of data for purposes of achieving audit objectives:</p> <ul style="list-style-type: none">• Whether the data was obtained from independent sources outside the entity or from sources within the entity;• Whether sources within the entity were independent of those who are responsible for the amount being audited;• Whether the data was developed under a reliable system with adequate controls;• Whether the data was subjected to audit testing in the current or prior year; and• Whether the expectations were developed using data from a variety of sources.	<p>We have repeatedly observed deficiencies where the auditor did not assess the reliability of data (e.g., system generated reports) used to develop its expectation in a revenue substantive analytical procedure.</p>

Assessing Information Produced by a Service Organization

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i>, paragraph .14, if the user auditor decides to use a service auditor's report, the user auditor should consider the extent of the evidence provided by the report about the effectiveness of controls intended to prevent or detect material misstatements in the particular assertions. The user auditor remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the user organization.</p> <p>In accordance with AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i>, paragraph .08, the auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.</p>	<p>We identified deficiencies where the public company used a service organization to process and record revenue transactions. The auditor's approach to substantively test revenue included reliance on controls, including controls over the accuracy and completeness of transaction data that the public company obtained from the service organization. The auditor did not perform any procedures to test the operating effectiveness of complementary user controls at the public company that the service auditor specified should be in place in its service organization control report ("SOC report").</p> <p>We observed deficiencies where the auditor used certain data produced by the public company's benefit plan record keeper in testing participant contributions. The auditor did not perform any procedures that addressed the accuracy and completeness of this data. In this instance, the auditor used the information produced by a service organization and did not test controls over the relevance and reliability of this information or test controls over the accuracy and completeness of this information or data to support the extent of its use.</p>

Auditor Considerations When Using a Service Organization

The auditor may want to consider the following:

- When using information produced by a service organization, did the SOC report cover controls relevant to that information?
- Are there exclusions in the scope of the SOC report?
- Are complementary user entity controls being addressed by the public company or broker-dealer?
- Has the auditor performed procedures to test the complementary user entity controls?
- If the SOC report does not address controls over accuracy and completeness of information produced by the service organization, did the auditor identify and test alternate, compensating, or mitigating controls at the public company or broker-dealer over accuracy and completeness of information produced by the service organization?
- How much time has elapsed since the period covered by the SOC reports compared to the period under audit? Have there been any changes in the controls that may have occurred at the service organization during the period not covered by the SOC report? If so, the auditor may consider obtaining an updated SOC report or if performing other procedures are required.

Testing Supplemental Information Accompanying Audited Financial Statements

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 2701, <i>Auditing Supplemental Information Accompanying Audited Financial Statements</i>, paragraph .04, in performing the audit procedures on supplemental information, the auditor should, among other things, perform procedures to test the completeness and accuracy of the information presented in the supplemental information to the extent that it was not tested as part of the audit of financial statements.</p>	<p>We observed deficiencies where the auditor did not perform, or sufficiently perform, procedures to test the completeness and accuracy of information presented in customer and broker-dealer reserve computations, including information produced by the broker-dealers or the broker-dealers' service organizations used to prepare the computations.</p>

Use of Data by an Auditor-Engaged Specialist

Applicable Standards	Examples of PCAOB Staff Observations
<p>In accordance with AS 1210, <i>Using the Work of an Auditor-Engaged Specialist</i>, paragraph .09, the engagement partner and, as applicable, other engagement team members performing supervisory activities should review the report, or equivalent documentation, provided by the specialist pursuant to paragraph .06d and evaluate whether the specialist's work provides sufficient appropriate evidence, specifically whether:</p> <ul style="list-style-type: none"> • The specialist's work and report, or equivalent documentation, are in accordance with the auditor's understanding with the specialist; and • The specialist's findings and conclusions are consistent with results of the work performed by the specialist, other evidence obtained by the auditor, and the auditor's understanding of the company and its environment. 	<p>We observed deficiencies where the auditor did not sufficiently evaluate the work of the auditor-engaged Specialist and identify that such work did not provide sufficient appropriate audit evidence.</p>

REMINDERS FOR AUDITORS

Audit firms and auditors are encouraged to consider the following reminders:

- It is important for the auditor to clearly identify and document the linkage between the likely sources of potential misstatement and the controls, if applicable, to be tested, including the testing of data and reports that may be used as audit evidence, when planning the audit response.
- It is important for the auditor to understand the sources of data, both internal and external to the public company, to better identify required audit procedures for testing the accuracy and completeness and evaluating the relevance and reliability to be able to use such data as audit evidence.
- If the service auditor's report does not provide audit evidence regarding the accuracy and completeness of information, including reports produced by a service organization, the auditor should perform appropriate procedures for the facts and circumstances.
- It is important for the auditor to identify the sources of the underlying data in reports as well as how the reports are generated, when testing data and reports that may be used as audit evidence.
- If the auditor is using the work of a company's specialist, PCAOB standards require the auditor to test the accuracy and completeness of company-produced data used by the company's specialist and evaluate the relevance and reliability of data from sources external to the company that are used by the company's specialist.

- If the auditor is using the work of an auditor-engaged specialist, PCAOB standards require the auditor to inform the specialist of the work to be performed, which includes establishing and documenting an understanding with the specialist regarding the degree of responsibility of the specialist for testing data produced by the company or evaluating the relevance and reliability of data from sources external to the company.

GOOD PRACTICES

Many audit firms, ranging from large global network firms to sole proprietorships, continue to take steps to improve their processes related to testing data and reports, which we believe positively influence audit quality. Some examples of these good practices we have observed include the following:

- Use of firm risk assessment templates that helped engagement teams capture well-documented linkage between likely sources of potential misstatements and the controls to be tested, including data and reports.
- Integration and collaboration between the core audit engagement team and the information technology engagement team members to understand and document data flows, system interfaces, and the use of data and reports within a process flow.
- Use of a central repository of reports identified during the audit, including a link to the applicable information technology application, the associated testing approach

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for the report, testing of the report, and the testing conclusion.

- Clear communication between the core audit engagement team and auditor-engaged specialists that demonstrates all data being used by the specialist is subjected to testing procedures as appropriate.

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