

The PCAOB Urges Audit Committees to Ask Auditors Tough Questions about PCAOB Inspections

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In response to concerns that audit firms were either declining to provide important information or downplaying the results of PCAOB inspections, the PCAOB recently issued a [report](#) about how an audit committee can enhance discussions with auditors about PCAOB inspections to support the committee's oversight role.

By law, the PCAOB may not disclose the nonpublic portion of an inspection report or other nonpublic inspection information, or compel an audit firm to make the disclosure to an audit committee. Because of these legal restrictions, an audit committee would not even know whether a PCAOB inspection report found deficiencies in the committee's own company or the very audit that it oversees. The only way for an audit committee to obtain this information is by asking the auditors.

With respect to the nonpublic portions of inspection reports, the key recommendation made by the PCAOB is that an audit committee may wish to ask the audit firm to let them know if the company's audit is selected for review in a PCAOB inspection, and if so, for the committee to be kept informed about the areas of review and any concerns raised. More ominously, the release notes that the PCAOB "routinely" communicates inspection information to the SEC, on an issuer-specific basis, which the PCAOB would have first discussed with the audit firm. If a company's audit is the subject of an inspection, an audit committee may also want to inquire about the possibility that the firm's audit opinion is not sufficiently supported, whether questions have been raised about the fairness of the financial statements, the adequacy of the disclosures or the auditor's independence.

Even if a company's own audit was not the subject of an inspection, an audit committee may want to find out whether the report identified deficiencies in other audits that involved auditing or accounting issues similar to issues presented in the company's audit, and if so, whether and how the firm has become comfortable that the same or similar deficiencies either did not occur in the audit of the company's financial statements or have been remedied.

The PCAOB's clear intent that audit committees take seriously their inspection reports is evident even as they describe how the audit committee should understand the public portions of the inspection reports and the audit firms' responses to those findings. If a public inspection report describes a deficiency, it means that the inspection staff believes that the audit firm did not have a sufficient basis for forming an audit opinion and concluding there were no material misstatements. The PCAOB indicates that audit committees should "view with skepticism" audit firms' responses that assert that criticisms by the PCAOB consist of nothing more than documentation deficiencies or differences in judgments, since the PCAOB has already considered and rejected those explanations. If an audit firm determines that the deficiencies have been addressed in accordance with PCAOB standards, the audit committee should seek additional detail due to the broad nature of such a response.

In terms of issues related to a firm's quality control, an audit committee may wish to ask about changes the firm has been making to its policies and procedures to address those deficiencies, since they may implicate the company's own audit or in order to reduce such a possibility. In addition, the audit committee may want to be kept apprised of the status of the remediation process and ongoing discussions with the PCAOB.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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