

Heads Up

In This Issue:

- Communication Between Audit Committees and Audit Firms Regarding the Inspection Process
- PCAOB Inspection of an Audit Firm
- Inspection Reports and Firms' Responses
- Appendix A — Possible Inspection-Related Questions and Considerations That Audit Committees May Wish to Discuss With Their Audit Firms
- Appendix B — PCAOB Reports Related to the Inspection Process

The release contains four main questions that audit committees may wish to consider asking audit firms about the inspection process.

Information for Audit Committees About the PCAOB Inspection Process

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On August 1, 2012, the PCAOB issued a [release](#)¹ "to assist audit committees in (1) understanding the PCAOB's inspections of their audit firms and (2) gathering useful information from their audit firms about those inspections." The purpose of the release is to provide audit committees with information about the inspection process and the meaning of report findings to "better equip audit committees to engage in meaningful discussion with audit firms about the results of inspections."

Communication Between Audit Committees and Audit Firms Regarding the Inspection Process

The PCAOB has received feedback that audit firms are providing varying amounts of inspection-related information to audit committees and that the nature of the communications may not clearly convey the meaning of the inspection report findings. The release contains four main questions that audit committees may wish to consider asking audit firms about the inspection process:

1. "Was the company's audit selected for PCAOB inspection?"
2. "Did the PCAOB identify deficiencies in other audits that involved auditing or accounting issues similar to issues presented in the company's audit?"
3. "What were the audit firm's responses to the PCAOB findings?"
4. "What topics are included in Part II findings?"

See [Appendix A](#) for additional questions suggested in the release.

Editor's Note: Deloitte is committed to the transparency of the inspection process and to maintaining open and candid dialogue with audit committees regarding PCAOB inspections. See our 2012 transparency report [Committed to Quality](#).

¹ PCAOB Release No. 2012-003, *Information for Audit Committees About the PCAOB Inspection Process*.

PCAOB Inspection of an Audit Firm

Inspection Process

The Sarbanes-Oxley Act of 2002 requires the PCAOB to periodically inspect registered public accounting firms.² The release states that “inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits” and that these inspections include reviews of certain aspects of (1) selected audits and (2) the firm’s system of quality control over its audit processes. The PCAOB generally employs a risk-based approach in selecting engagements for inspection. The release indicates that the risk factors considered by the PCAOB include the following:

- “[T]he nature of the issuer or its industry.”
- “[A]udit issues likely to be encountered.”
- “[M]arket capitalization of the issuer.”
- “[W]hether the issuer has significant operations in certain emerging markets.”
- “[C]onsiderations related to the particular audit firm, practice office, or partner, including prior inspection results.”
- “[A]ny other relevant information that has come to the Board’s attention.”

In inspecting engagements, the PCAOB often focuses on “the most difficult or inherently uncertain areas of financial statements.” Given that the PCAOB selects engagements largely on the basis of the above factors and focuses primarily on difficult audit areas (i.e., not a representative sample), “the Board cautions against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout a firm’s practice.” However, the release encourages audit committees to discuss the findings of such inspections with their audit firms (see [Appendix A](#)).

If the PCAOB inspection team identifies concerns during the inspection of a particular audit, it will furnish the audit firm with written “comment forms” describing the findings. The audit firm will then have the opportunity to provide written responses to the comments as well as any additional relevant information. In addition, the inspection team typically discusses the findings with the audit firm’s engagement team and key leaders to ensure that firm personnel understand the issues outlined in the comment forms.

The PCAOB also will evaluate elements of a firm’s system of quality control. Such elements may include:

- “[P]olicies, procedures, and practices concerning audit performance, training, and compliance with independence requirements.”
- “[C]lient acceptance and retention, and the establishment of policies and procedures.”
- “[T]one at the top’ as it relates to audit quality.”
- “[P]artner management, including evaluation, compensation, admission and discipline.”
- “[U]se of the work performed by foreign affiliates.”
- “[T]he firm’s self-monitoring of its practice through . . . internal inspections and analyses of, and responses to, identified weaknesses.”

The PCAOB generally employs a risk-based approach in selecting engagements for inspection.

² Under paragraph 104(b)(1)(A) of the Sarbanes-Oxley Act.

The release acknowledges that firms may be reluctant to share the details of Part II findings in an inspection report for a number of reasons, including privilege concerns, but encourages audit committees to ask for certain generic information about the findings.

Inspection Reports

The PCAOB will prepare a draft inspection report that is informed by its consideration of the audit firm's responses to matters or findings identified during the inspection process; the draft report may not include all of the criticisms included in the comment forms that were written or may articulate them differently. The staff will provide the draft report to the firm, which will then have the opportunity to respond to it. After evaluating the firm's response, the inspection team will recommend a report to the Board for final issuance. The final report will include the firm's written response to the draft report.

Once the inspection report is issued, the report is transmitted to the SEC as well as to "the accountancy board in any U.S. state where the firm is licensed" as long as "that state board has provided written acknowledgment . . . of the statutory restrictions on disclosure of nonpublic portions of the report." The PCAOB is also permitted to provide nonpublic portions of the report to certain other "domestic regulatory or law enforcement authorities" as long as those authorities adhere to the confidentiality provisions³ of the Sarbanes-Oxley Act.

Inspection Reports and Firms' Responses

The release also describes the types of findings contained in the public portion and nonpublic portion of an inspection report. [Appendix B](#) outlines PCAOB reports related to the inspection process and which portions of those reports are released publicly.

Public Portion of Inspection Reports

The Sarbanes-Oxley Act requires that inspection findings on specific audit engagements be made public. The public portion of the inspection report includes Part I, which describes any audit deficiencies related to individual audit engagements in which the inspection staff found that the auditor failed to gather sufficient audit evidence to support an audit opinion. It also includes the firm's written responses to the draft inspection report, except for any redactions to protect confidential information.⁴

Nonpublic Portion of Inspection Reports

The nonpublic portion of the report includes Part II, which contains findings related to the firm's overall system of quality control and initially is not publicly released. Audit firms that receive comments on their quality control systems in Part II have 12 months⁵ from the report's issuance date to remediate these findings to the PCAOB's satisfaction. If the PCAOB is not satisfied with the firm's remediation efforts, all or portions of Part II of the inspection report may be made public. The PCAOB is otherwise expressly prohibited⁶ from publicly releasing Part II.

The release acknowledges that firms may be reluctant to share the details of Part II findings in an inspection report for a number of reasons, including privilege concerns, but encourages audit committees to ask for certain generic information about the findings. See [Appendix A](#) for specific questions suggested by the PCAOB.

³ Under paragraph 105(b)(5)(B) of the Sarbanes-Oxley Act.

⁴ Under PCAOB AU Section 390.04.

⁵ Under paragraph 104(g)(2) of the Sarbanes-Oxley Act.

⁶ Under paragraph 105(b)(5)(A) of the Sarbanes-Oxley Act.

Appendix A — Possible Inspection-Related Questions and Considerations That Audit Committees May Wish to Discuss With Their Audit Firms

- “[W]as the company’s audit selected for PCAOB inspection?”
- “[D]id the PCAOB identify deficiencies in other audits that involved auditing or accounting issues similar to issues presented in the company’s audit?”
- “[W]hat were the audit firm’s responses to the PCAOB findings?”

The release highlights types of responses that audit committees should “view with skepticism”:

 - “Assertions that characterize criticisms as documentation deficiencies rather than as deficiencies in the performance of procedures to obtain audit evidence.”
 - “Assertions that characterize criticisms as differences in professional judgment.”
 - “Assertions that the firm has addressed the criticisms in accordance with PCAOB standards.”
- “[W]hat topics are included in Part II findings?”

The release indicates that “audit committees may want to ask for certain generic information about the [Part II] findings such as:

 - A. what changes the firm is making to address any quality control deficiencies;
 - B. what is the progress of the quality control remediation process, including a discussion of any submissions the audit firm made to the PCAOB as part of that process;
 - C. the inspected years about which the PCAOB has made a final determination about the firm’s remediation efforts and the nature of that determination; and
 - D. whether the PCAOB has provided initial indications that the audit firm may not have sufficiently remediated any items.”

In addition, audit committees may be interested in the following information during an inspection or when a final inspection report is issued.

- “[W]hether anything has come to the firm’s attention suggesting the possibility that an audit opinion on the company’s financial statements is not sufficiently supported, or otherwise reflecting negatively on the firm’s performance on the audit, and what if anything the firm has done or plans to do about it.”
- “[W]hether a question has been raised about the fairness of the financial statements or the adequacy of the disclosures.”
- “[W]hether a question has been raised about the auditor’s independence relative to the company.”
- “[W]hether any of the matters described in the public portion of an inspection report on the firm, whether or not they involve the company’s audit, involve issues and audit approaches similar to those that arise or could arise in the audit of the company’s financial statements.”
- “[T]o the extent any such similarity exists, 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.”
- “[H]ow issues described by the Board in general reports summarizing inspection results across groups of firms relate to the firm’s practices, and potentially the audit of the company’s financial statements, and how the firm is addressing those issues.”

Appendix B — PCAOB Reports Related to the Inspection Process

Information	Public	Nonpublic
The results of the Board's regular, periodic inspection of a registered public accounting firm:		
Portions of inspection report that describe audit deficiencies related to individual audit engagements in which the inspection staff found that the auditor failed to gather sufficient audit evidence to support an opinion, if applicable; material misstatements identified, if applicable; and the firm's response, if applicable	X	
Part II: Portion of inspection report related to quality control criticisms that a firm addresses to the Board's satisfaction within 12 months after the issuance of the inspection report		X
Part II: Portion of inspection report related to quality control criticisms that a firm does <i>not</i> address to the Board's satisfaction within 12 months after the issuance of the inspection report	X	
General reports, known as " 4010 reports ," that are not firm-specific but that provide information and analysis concerning specific audit issues or a summary and analysis of results from inspections of a specified category of firms over a particular period	X	

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