

## Current affairs in audit

### **US Public Company Audit Oversight Board Inspections**

As the PCAOB was devising its inspection program in 2003, only a limited inspection was made of the big four auditing practices in United States. The areas covered by the PCAOB Inspections included

- Tone at the top;
- Practices for partner evaluation, compensation, promotion, and assignment of responsibility;
- Independence implications of non-audit services; business ventures, alliances and arrangements; and commissions and contingent fees;
- Client acceptance and retention;
- The firm's internal inspection program;
- Practices for establishment and communication of audit policies, procedures and methodologies, including training; and
- The supervision by U.S. audit engagement teams of the work performed by foreign affiliates on foreign operations of U.S. audit clients.

Source: PCAOB, 2004, p.2

In reviewing a firm's tone at the top the PCAOB is assessing whether actions "by the firm's leadership demonstrate a commitment to audit quality and compliance with..." relevant regulations confronted by US auditors (PCAOB, 2004, p.4).

The inspections by the US PCAOB could be summarised as including "detailed scrutiny of firm's working papers, partner pay, independence, quality control and discipline" (Buffini, 2004, p.52). Given that a finding on audit negligence can only be reached by examining audit workpapers, the most significant point relating to these inspections is that they examine the workpapers.

To gain some indication of the type of inspection made by the PCAOB we shall discuss some details of the inspection of Deloitte Touché.

PCAOB staff selected 16 audit engagements of Deloitte Touche to review (p.3). The areas reviewed included “revenues, reserves or estimated liabilities, related party transactions, supervision of work performed by foreign affiliates, the assessment of risk by the audit team, and journal entries and adjustments” (p.3). Potential adjustments to the client’s financial statements that had been identified during the audit but not recorded in the financial statements were also reviewed. The chair of each client’s audit committee was interviewed and communications between the audit firm and the audit committee was also reviewed (p.3).

As a result of these inspections eight Deloitte’s and Touche client’s restated their balance sheets to reclassify revolving lines of credit from long term liabilities to current liabilities (p.16).

Deloitte and Touché reply to the inspection was included in the report and they wished that the report be balanced by including references to the reviewers identifying Deloitte’s and Touché use of best practices. However Deloitte and Touché response shows that the inspection process overcomes one of the problems of out-of-court settlements where problems in the audit process are publicly identified and that assurance is given that problems arising out of the inspections will be rectified.

D&T is committed to conducting the highest quality audits and to prompt and effective response to constructive criticism. ... We believe that improvement of audit quality should be the primary objective of an inspection process and that conclusions reached from such a process should be assimilated into the audit process through remedial action such as changes to audit methodologies, policies and procedures, or through additional training of our partners and our staff.

## References

Public Company Accounting Oversight Board, 2004, *Report on 2003 Limited inspection of Deloitte & Touché LLP*, August 26, [www.pcaobus.org/Inspections](http://www.pcaobus.org/Inspections)

Buffini Fiona, 2004, “Big four audit firms face rule changes”, *The Australian Financial Review*, 1 October, p.52