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OPINION | COMMENTARY Follow

We Audit the Auditors, and We Found Trouble

PCAOB inspectors are turning up an increasing number of deficiencies. That's bad for investors.

By Erica Y. Williams

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George W. Bush signs a bill at the White House, July 30, 2002. PHOTO: KEVIN LAMARQUE/REUTERS

High-quality audits are essential to the integrity of U.S. capital markets and the protection of investors. As President George W. Bush said when signing the law creating the Public Company Accounting Oversight Board to oversee audits of public companies: "The fundamentals of a free market—buying and selling, saving and investing—require clear rules and confidence in basic fairness. The only risks—the only fair risks—are based on honest information."

It is therefore unacceptable that audit quality is trending down for the second year in a row. A PCAOB report released Monday finds that when inspection reports are finalized later this year, PCAOB inspectors expect that approximately 40% of the audits they reviewed in 2022 will have had one or more deficiencies, in which the audit firm failed to obtain sufficient appropriate evidence to support its opinion. That is up 6 percentage points from 2021, which was 5 points higher than the deficiency rate in 2020.

This means audit opinions were signed without completing the audit work required to verify the financial statements. That is a serious problem at any rate, and 40% is completely unacceptable.

The PCAOB hasn't hesitated to bring enforcement cases against auditors when appropriate. Last year we doubled the number of enforcement orders compared with 2021 and imposed the highest total penalties in history.

At the same time, we will continue conducting inspections to hold audit firms accountable.

Transparency is one of the most powerful tools the PCAOB has to improve audit quality. Sharing our inspection results empowers audit committees and boards of directors—which are responsible for hiring auditors of public companies—to hold audit firms accountable directly.

As part of its efforts to improve transparency, earlier this year the PCAOB began including more information in our public inspection reports than ever before, including information about auditor independence violations. Last week we added more tools on our website to make it easier to compare deficiency rates across audit firms.

We hope boards of directors and audit committees will use PCAOB inspection reports to hold audit firms accountable for high-quality results and ask tough questions on behalf of their investors.

Audit committees should know the deficiency rate of the audit firm they hire and how it compares with other options. They should ask audit firms if the audits of their company have been inspected and, if so, for the results. They should find out whether the specific auditors who are assigned to work with their company have had their audits for other clients inspected and what the results were.

Similarly, investors should engage with investor relations and the audit committees of the companies in which they invest and encourage them to seek out audit firms with quality records.

Ultimately, the responsibility falls on auditors to correct the problems that led to deficiencies in their audits. But accountability from their clients offers a powerful incentive to find solutions. The root causes of increased deficiencies vary from firm to firm, and there is no one-size-fits-all explanation for deteriorating audit quality.

Some firms point to the continuing effects of Covid-19, including the great resignation and heightened competition for talent. Three years after the pandemic began, these challenges are no longer new and firms should have a strategy to meet them.

At the same time, Covid-19 can't simply explain away a 40% deficiency rate. Many of the deficiencies PCAOB inspectors identified have recurred for years, well before the pandemic.

Now is the time for solutions, not excuses.

Investors trust audits to verify the financial reporting that underpins our capital markets. Auditors must deliver quality results worthy of that trust.

Ms. Williams is chairman of the Public Company Accounting Oversight Board.

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