CPA Practice Advisor

Bad Auditing

The PCAOB secured access last year to inspect registered public accounting firms based in mainland China and Hong Kong.

Jason Bramwell • May. 10, 2023

The head of the Public Company Accounting Oversight Board (PCAOB) said today that its inspectors found significant deficiencies in the audits of U.S.-listed Chinese companies conducted by KPMG's affiliate in mainland China and PwC's member firm in Hong Kong.

These were the PCAOB's very first inspections of Chinese-based audit firms— the audit regulator secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong last year, ending a decades-long stalemate.

Without access to these companies' books, the U.S. could have levied trading bans on

The results of those inspections were released by the PCAOB this morning—and they were not good. In a statement, PCAOB Chair Erica Williams said:

> Both reports show unacceptable rates of Part I.A deficiencies, which are deficiencies of such significance that PCAOB staff believe the audit firm failed to obtain sufficient appropriate audit evidence to support its work on the public company's financial statements or internal control over financial reporting.
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> The PCAOB inspected a total of eight engagements in 2022—four at each of the two firms—including the types of engagements to which People's Republic of China authorities had previously denied access, such as large state-owned enterprises and issuers in sensitive industries.
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> PCAOB inspectors found Part I.A deficiencies in 100% (four of four) of the audit engagements reviewed at KPMG Huazhen and 75% (three of four) of the audit engagements reviewed for PwC Hong Kong.
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> As I have said before, any deficiencies are unacceptable. At the same time, it is not unexpected to find such high rates of deficiencies in jurisdictions that are being inspected for the first time. And the deficiencies identified by PCAOB staff at the firms in mainland China and Hong Kong are consistent with the types and number of findings the PCAOB has encountered in other first-time inspections around the world.

> The fact that our inspectors found these deficiencies is a sign that

> accountable. And the power of transparency applies public pressure for firms to improve.
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> The remediation process is another tool we use to hold firms accountable for fixing deficiencies. By law, public inspection reports do not initially include quality control deficiencies that inspectors find. Instead, firms have one year to remediate those deficiencies. If they don't remediate those deficiencies to the board's satisfaction, we make them public.
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> Finally, where appropriate, our inspectors will refer inspection findings to our enforcement team for possible action. If violations are found, our enforcement staff will not hesitate to recommend sanctions, including imposing significant money penalties and barring bad actors from performing future audits.

Williams added that PCAOB enforcement teams have begun fieldwork for 2023's inspections, which will continue off and on throughout most of the year. She said this is common practice for inspections of PCAOB-registered audit firms around the world.

Those two firms accounted for 40% of the total market share of U.S.-listed companies audited by Hong Kong and mainland China firms, Williams said, and the PCAOB is on track to hit 99% of the total market share by the end of this year.

"So, there is no question that the PCAOB is prioritizing inspections that are the most relevant to investors on U.S. markets—because protecting investors is what this is all about," Williams said.

The full inspection report for KPMG Huazhen can be found here; PwC Hong Kong's