PwC and KPMG criticised over audits

PwC and KPMG failed to adequately review how certain clients valued mortgage-related securities in 2010, an auditing watchdog has said.

The Public Company Accounting Oversight Board's findings from an annual inspection revealed that years after the financial crisis both auditing firms were not adequately challenging companies' valuations of certain assets when the market for them dried up.

Monday's findings focus, in part, on controls over fair value accounting, which requires US companies to mark certain assets to their market price. When a security is no longer tradable, companies are allowed to use other inputs to help derive a value. During the financial crisis, banking lobbyists pressed the Securities and Exchange Commission to relax accountingrules over fair value accounting, which they said were exacerbating troubles at big banks.

The board reviewed 71 audits completed by PwC in 2010 and 52 audits done by KPMG in 2010.

KPMG failed in seven audits of firms' fair value "to obtain sufficient appropriate audit evidence to support its audit opinions", the board said.

In three of those audits, KPMG obtained multiple prices from third parties but used the price closest to its client's price when it was testing the fair value measurements and failed to evaluate "the significance of differences between the other pricesobtained and the issuer's prices".

The board found that PwC also failed to evaluate the differences between other prices obtained and the ones four clientsused.

In addition, in auditing two clients' valuation of hard-to-value assets, including certain mortgage-related assets, PwC attempted to independently evaluate the clients' prices but used the same third party company the client used.

PwC also obtained certain financial information about these instruments as of a date nine months before the issuer's year end and used it in evaluating the issuer's estimate of fair value at year end. The firm, however, failed to support its assumption that no changes had occurred that affected this financial information.

KPMG said: “We conducted a thorough evaluation of the matters identified in the draft report and addressed the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures.”

PwC said compliance with the board’s standards “has been and remains the top priority for our practice”. It said it was “committed to addressing each of the issues identified in the report in a diligent, conscientious and thoughtful manner”.

(Financial Times)