

**Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB’s *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards***

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**SUMMARY:** On March 28, 2023, the Public Company Accounting Oversight Board (the Board or PCAOB) issued a request for comment on its *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (PCAOB 2023). This commentary summarizes the participating committee members’ views on selected questions.

**Note:** The views expressed in this letter are those of the participating members of the Committee and do not reflect an official position of the American Accounting Association. The comments do not necessarily reflect the views of every member.

**Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB’s *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms***

**I. INTRODUCTION**

We are pleased to provide feedback on the PCAOB *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (PCAOB 2023). This commentary summarizes the participating committee members’ views on selected questions.<sup>1</sup>

The PCAOB has adopted a framework to conduct an economic analysis of all new and potential regulations. This framework has “four main elements: (1) the need for the rule, (2) the baseline for measuring the rule impacts, (3) the alternatives considered, and (4) the economic impacts of the rule (and alternatives), including the benefits and costs” (PCAOB 2014).

In this Release, the primary need for the rule is to consolidate/streamline and standardize the general principles and responsibilities of the auditor when conducting an audit (the “foundational standards”). These foundational standards have held “interim” status since the creation of the PCAOB, and more recently issued standards and others in development, or under review, may not conform to the interim standards (e.g., revised independence rules). In addition, the Release includes requirements that consider technology advancement and other changes in the auditing environment. While we commend the PCAOB for its modernizing efforts, as described in some of the responses below, we have some reservations regarding whether alternatives other than the proposal were adequately considered, and we offer some specific suggestions in certain areas.

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<sup>1</sup> We use or adapt certain language from the PCAOB (2023) proposal throughout our response.

## II. RESPONSES TO SELECTED QUESTIONS

**Question 1:** Are the general principles and responsibilities described in the proposal appropriate for audits performed under PCAOB standards? Are there additional principles or responsibilities that are fundamental to the conduct of an audit under PCAOB standards that merit inclusion in the proposed standard and amendments? If so, what are they and how should they be addressed?

The proposed standard speaks to auditors' foundational obligation to protect investors and notes that the audit primarily benefits investors. While we do not object to highlighting the central role of investors, we harbor reservations about the reference in paragraph .15 to auditors being mindful of their role in protecting investors. This encourages auditors to adopt an investor perspective when making judgments, and research highlights that this may be detrimental to audit quality. Altiero, Kang, and Peecher (2022) show that auditors prompted to take an investor perspective are less likely to assess a misstatement as material. Similarly, Dong, Wang, and Chien (2022) highlight that taking an investor perspective can decrease assessed risk of material misstatement.

We therefore encourage the PCAOB to consider redrafting paragraph .15 such that it speaks to the auditor's requirement to comply with applicable professional and legal requirements in conducting an audit *without* reference to auditors keeping in mind their role in protecting investors.

**Question 3:** Are the objectives of the auditor in the proposed standard appropriate? If not, what changes to the objectives are necessary and why?

With reference to the objectives of the auditor, we believe that the proposed standard does not effectively recognize auditor's objectives with regard to communication with the

company (i.e., internal communication with the client). Para .03c speaks of external communication, but the standard is silent on internal communication.

The Sarbanes-Oxley Act expanded and emphasized “the role of audit committees in ensuring the quality of reported financial results. This increased responsibility requires improved and expanded dialogue between audit committees and external auditors” (Cohen, Gaynor, Krishnamoorthy, and Wright 2007, 166). Current audit standards also require a myriad of internal communications by the external auditor. Furthermore, research supports the value of these internal communications which have been shown to reduce audit risk, increase audit quality, and improve audit committee oversight of the audit function (Cohen et al. 2007). We, therefore, encourage the PCAOB to consider expanding paragraph .03c to capture both external and internal communications.

**Question 4:** Are the proposed requirements related to auditor independence clear and comprehensive? If not, why not?

In responding to this question, we refrain from commenting on the various independence principles, rules, and regulations that the provisions in the proposed standard give effect to. Rather, we focus on the clarity and comprehensiveness of the proposed standard.

With reference to auditor independence, we note that the related pronouncements supporting auditor independence have elements of both principles and rules, and that the research on independence rules versus independence principles suggests that a combination of both is likely to be the most effective approach (e.g., Herron and Gilbertson 2004; Church, Jenkins, and Stanley 2018). We believe, therefore, that the provisions of the proposed standard should give effect to both the principles and the rules of the related pronouncements, and to reinforce that

compliance with the rules and regulations is necessary, but not sufficient, to fulfill expectations for auditor independence.

As presently drafted, the proposed standard refers to the principles underlying independence in paragraph .04. However, paragraph .05 speaks to the rules that must be complied with and has the potential to be interpreted as meaning that compliance with such rules is sufficient. We encourage the PCAOB to re-phrase paragraph .05 to be clear that compliance with the rules and regulations of the various authorities, while necessary, is not sufficient to fulfill expectations as to independence. We make similar recommendations in our response to Question 5 relating to ethics.

**Question 5:** Are the proposed requirements related to ethics clear and comprehensive? If not, why not?

In responding to this question, we refrain from commenting on the various current and proposed ethical principles, rules, and regulations that the provisions in the proposed standard give effect to. Rather, we focus on the clarity and comprehensiveness of the proposed standard. With reference to auditor ethics, we note that the related pronouncements supporting an ethical disposition have elements of both principles and rules, and that the research on ethical principles versus ethical rules suggests that a combination of both is likely to be the most effective approach (e.g., Herron and Gilbertson 2004; Church et al. 2018). We believe, therefore, that the provisions of the proposed standard should give effect to both the principles and the rules of the related pronouncements, and to reinforce that compliance with the rules and regulations is necessary, but not sufficient, to fulfill ethical expectations.

As presently drafted, the proposed standard (paragraph .06) speaks to the requirement to comply with applicable ethical requirements, rules, and standards. There is no statement, however, of the broad ethical principles that guide auditor behaviors.

Current ET Section 102 and proposed EI 1000 *Integrity and Objectivity* (see PCAOB 2022a) refer to the broad principles of integrity and objectivity, and we encourage the PCAOB to include an additional paragraph (preceding paragraph .06) noting these broad principles (in a similar manner to that which is done for independence in paragraph .04). In addition, and consistent with our recommendations in response to Question 4, we further encourage the PCAOB to re-phrase paragraph .06 to be clear that compliance with the noted ethical requirements, rules, and standards, while necessary, is not sufficient to support the expected ethical disposition of auditors.

**Question 6:** Are the proposed requirements related to the auditor’s competence clear and comprehensive? If not, why not?

With reference to the research literature, we believe that the proposed requirements related to the auditor’s competence and the means by which auditors develop and maintain competence are comprehensive (e.g., Bonner and Lewis 1990; Tan and Libby 1997; Nelson and Tan 2005; Dierynck, Kadous, and Peters 2023). We do note, however, that the terms “knowledge,” “skill,” and “ability” are broad terms. While capturing the breadth of determinants of competence evidenced in the academic literature, the interpretation of these terms may be such that the particular tacit skills and individual dispositions supporting ability (e.g., confidence, courage, ethics) may not be immediately evident.

We believe that the proposed standard would be strengthened with a clearer recognition of professional competencies (AICPA 2018) and further elaboration in the note accompanying

paragraph .07 to reinforce the breadth of determinants of competence underlying knowledge, skill, and ability.

**Question 7:** Are the proposed requirements and related descriptions of the general principles (i.e., reasonable assurance, due professional care, professional skepticism, and professional judgment), clear and comprehensive? If not, why not??

In responding to this question, we do not speak to the appropriateness of other pronouncements that the provisions in this standard reinforce. Rather, we speak to the clarity and completeness with which the requirements and related descriptions have been captured in the proposed standard.

We agree with the added emphasis in paragraph .09 on supervision and review of work performed. Research has long highlighted the importance of and variation in direction, supervision, and review of audit work (see Rich, Solomon, and Trotman (1997) and Nelson and Tan (2005) for reviews). However, we are concerned that the responsibilities of engagement partners are expressed as being a substitute for, rather than in addition to, the broad principles expressed for all auditors at the beginning of paragraph .09. We encourage the PCAOB to emphasize in paragraph .09 that for engagement partners, the additional activities are in addition to those noted for all auditors.

Moreover, we are concerned that such additional responsibilities are framed as being limited to engagement partners. Direction, supervision, and review are functions that are performed by auditors at different levels of experience, and research highlights that the effectiveness of such work can vary across hierarchical levels (e.g., Ramsay 1994; Harding and Trotman 1999). We encourage the PCAOB to extend the scope of the additional responsibilities

to include engagement partners *and* those auditors performing planning, supervision, and review tasks.

We further note the additional information provided in paragraph .11 on what the auditor's exercise of professional skepticism includes, and express our concern that these descriptions may not be sufficiently comprehensive. We feel that the descriptions in paragraph .11 focus on the evaluation of information with insufficient recognition of the exercise of professional skepticism in first obtaining that information. We note paragraph .10 of proposed QC1000 speaks to both obtaining and evaluating information and that research highlights the merits of focusing on both (e.g., Grenier 2017; Harding and Trotman 2017). We encourage the PCAOB to expand paragraph .11 to focus on both obtaining and evaluating information / evidence.

**Question 11:** Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?

The proposed standard sets out to specify the engagement partner's due professional care responsibilities and the supervision and review of audit documentation and engagements. The standard builds off the existing requirements for engagement partner oversight, including reviewing the subordinates' work (AS 1010.03), being knowledgeable of the standards and client (AS 1015.06), and supervising and reviewing audit documentation (AS 1201.04-.05 and AS 2101.03). The new standards seek to clarify the existing standards, for example, by removing vague language regarding an engagement partner's responsibilities. We agree with the need for clear standards for engagement partner responsibilities because academic research finds substantial evidence that the engagement partner can negatively impact audit quality when they do not follow standards, such as by not promoting the need for professional skepticism, ethical



behaviors, continuing education, etc. (e.g., Dennis and Johnstone 2016; Gissel and Johnstone 2017; Harding and Trotman 2017; Koch and Salterio 2017; Messier and Schmidt 2018; Alberti, Bedard, Bik, and Vanstraelen 2020).

We believe that the amendments made to clarify the engagement partner requirements are generally reasonable and clear; however, as the noted in the Release, the standard could present unintended consequences. For example, we noted that the PCAOB's analysis lacks direct evidence suggesting that engagement partners do not understand their responsibilities or that the firms do not have adequate incentives to help them understand them (also see Question 18 below for evidence of fundamental auditing issues). Instead, the analysis asserts that the proposed language reinforces auditors' existing responsibilities at little cost. As we noted in our response to the proposed quality control standard, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (PCAOB 2022a), a key ingredient of audit quality is the auditing profession's ability to attract and retain talent. We continue to encourage the PCAOB to closely monitor trends in the firms' abilities to attract and retain talent and also to carefully monitor how the PCAOB's regulatory efforts and even public messaging may be affecting the attractiveness of the profession, especially in periods when auditors have many other options for employment. Overly burdensome regulation can create unintended consequences, including the potential for lower audit quality if people leave the profession or if it creates additional, unforeseen costs.

**Question 12:** Are the proposed clarifying amendments related to audit documentation appropriate? If not, why not?

The proposed amendments related to the audit documentation standards are designed to clarify audit documentation supervision and review (AS 1201, AS 1215, and AS 2101), as well

as to accelerate the timeline for completing audit documentation from 45 days to 14 days (AS 1215). As discussed above, we agree that proper supervision of audit documentation from the engagement partner is critical as it relates to ensuring higher audit quality. We further agree with the Release that high quality documentation is important and necessary for enhancing audit quality. However, we encourage the PCAOB to consider new, unintended costs of additional regulations. For example, academic studies find that there can be unintended consequences of additional regulation, including new costs associated with extensive audit documentation, auditors taking a “box-ticking” approach to extensive documentation requirements, and, in-turn, reduced auditor retention (Brivot, Roussy, and Mayer 2018; Boland, Daugherty, and Dickins 2019). Furthermore, some research exists suggesting that before the 2015 inspection cycle, auditors perceived that the PCAOB may be changing auditing standards *within* inspections, specifically regarding documentation (Boland, Brown, and Dickins 2020). We discuss the implications of the accelerated timeline from 45 days to 14 days in more detail within our responses below to Questions 13-15.

**Question 13:** Is the proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention from 45 days to 14 days from the report release date appropriate? If not, why not?

The analysis suggests the rationale for the acceleration is that inspections might begin earlier in the year, yet no alternatives other than accelerating the archival of workpapers are presented. The basis for the proposal is that many, although not all, auditors already comply with the acceleration and that technology exists to accomplish the acceleration. While not a perfect analogy, research investigating the Securities and Exchange Commission’s (SEC) acceleration of

reporting deadlines in the 2000s suggests that accelerating reporting deadlines more quickly than 15 days was costly to issuers regarding misstated financial statements (Bryant-Kutcher, Peng, and Weber 2013; Boland, Bronson, and Hogan 2018; Alsbah 2023). It is likely that the audit firms currently requiring more than 29 days (i.e., proposed 14-day requirement plus 15-day acceleration) would likely incur nontrivial compliance costs.

If some firms already comply with an accelerated timeline, we wonder why accelerating the archival timing is required and furthermore why 14 days is considered an ideal timeline. We encourage the PCAOB to consider alternatives to accelerating inspection scheduling timing for those not meeting the proposed 14-day deadline. We encourage the PCAOB to reconsider adding requirements to audit firms that provide little additional benefit. As noted above, a heavier regulatory hand may impact audit quality by affecting the profession's attractiveness. As noted below, it is also reasonable to believe the size of the firm and/or the complexity of an engagement could influence the ability to meet an accelerated timeline without some unintended consequences (e.g., increased chances for error and/or increased costs). Therefore, we encourage the PCAOB to reconsider the impact of internalizing these new costs and how it could create undue burden for some firms and engagement teams.

**Question 14:** Would firms have difficulty complying with the requirements of AS 1215.16 when filing Form AP within 35 days of the audit report being filed with the SEC in light of the proposed requirement to assemble a complete and final set of audit documentation for retention within 14 days? If so, what are the difficulties? How should the PCAOB address them?

As we indicated in Question 13, the limited research on accelerating reporting deadlines (e.g., audited financial statements) suggests that accelerations greater than 15 days may be problematic.

**Question 15:** Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required?

We are not able to opine on the feasibility of audit firm processes. Larger, more complex engagements could likely take longer. However, such engagements also are likely to have better systems and be more efficient.

**Question 18:** We request comment generally on the baseline for evaluating the economic impacts of the proposed standard. Are there additional factors we should consider? If so, what are they? Is there any evidence that auditors are failing to understand their obligations under today's standards, or that the standards set insufficiently robust expectations and obligations associated with the performance of an audit? If so, please explain.

Regarding evidence of auditors failing to understand their responsibilities under existing standards, we note that research suggests that audit failures often relate to basic areas of audit responsibility. For example, SEC enforcement actions against auditors in fraudulent financial reporting cases most commonly relate to the following deficiencies: "failure to gather sufficient competent audit evidence (73 percent of the cases), failure to exercise due professional care (67 percent), insufficient level of professional skepticism (60 percent), and failure to obtain adequate evidence related to management representations (54 percent)" (Beasley, Carcello, Hermanson,

and Neal 2013, 3). These all reflect foundational failures in the audit process. Contributors to such basic failures appear to be firm disincentives to be skeptical (Brazel, Jackson, Schaefer, and Stewart 2016; Brazel, Gimbar, Maksymov, and Schaefer 2019) and high auditor workloads (Persellin, Schmidt, Vandervelde, and Wilkins 2019). The current shortage of accounting graduates (AICPA 2022; Foley 2022) may exacerbate audit quality issues.

Further, the PCAOB inspection program reveals ongoing issues with audit deficiencies. For example, Prasad and Webster (2022) examine trends in PCAOB inspection reports from 2003 to 2017, with no widespread, obvious improvement in inspection results revealed. Likewise, a recent PCAOB (2022b) staff update highlights the lack of improvement in inspection results from 2019 to 2021, as well as areas of recurring deficiency and an increase in the number of audits with deficiencies in 2021.

Overall, audit deficiencies persist, despite SEC and PCAOB enforcement and many cycles of PCAOB inspections. While we recognize that the PCAOB inspection process may be becoming more rigorous over time, the fact remains that the number of audit deficiencies remains a concern. This suggests that it is important to further improve auditors' understanding of and compliance with foundational auditing principles.

**Question 19:** We request comment generally on the analysis provided above regarding the need for the proposal. Should we consider any additional arguments, academic studies, or sources related to the need for standard setting? If so, please specify.

With respect to the need for clarification of engagement partner review, we would highlight academic research that suggests that audit partners impact the audit. For example, Cameran, Campa, and Francis (2022, 753) find evidence of significant variation in audit outcomes across audit partners for U.K. listed companies and that audit partners are potentially

the “most important auditor-related characteristic in explaining audit quality.” Using Swedish data, Knechel, Vanstraelen, and Zerni (2015) find evidence suggesting that partners have persistent reporting styles. Using U.S. data, Francis, Golshan, and Hallman (2022, 947) find that “audit quality is lower when partners reside farther from their clients,” which is consistent with distance making it harder for partners to understand clients and oversee audit teams. Using data from Taiwan, Aobdia, Lin, and Petacchi (2015) find evidence that suggests variation in the quality of audit partners and that the market responds to audit partner quality. Overall, partners appear to matter for audit quality (see Lennox and Wu (2018) for a review of archival audit partner research).

**Question 20:** Are there additional potential benefits and costs that should be considered? If so, what are they? Please provide relevant data or other reference information.

Please refer to our responses to Questions 11, 12, and 13 above.

**Question 21:** We request comment generally on the potential unintended consequences of the proposal. Are there potential unintended consequences that we should consider? If so, what responses should be considered?

Please refer to our responses to Questions 11, 12, and 13 above.

**Question 23:** What academic studies or data should the Board consider in evaluating the potential benefits and costs of the proposed requirements? Please provide citations and other reference information for such studies and data.

With respect to benefits of accelerating the document completion date, if the PCAOB will more quickly inspect auditors and, thus, more quickly release inspection reports, then there could be market benefits (also see our response to Question 13 above). For example, J. Krishnan, J. Krishnan, and H. Song (2017) find evidence consistent with improvements in audit quality after

PCAOB inspections, and DeFond and Lennox (2017) find internal control audits to improve in the wake of PCAOB inspections. Aobdia (2018) finds increases in auditor effort after PCAOB inspections find audit deficiencies. Also, Shroff (2020) finds evidence consistent with PCAOB inspections ultimately reducing financing frictions, as evidenced by company investment decisions after deficiency-free inspection reports. Of course, these benefits would be contingent on the PCAOB accelerating the public release of inspection reports and ensuring that the content of inspection reports is meaningful.

We appreciate the opportunity to comment on this proposed standard.

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