WEATHERHEAD SCHOOL OF MANAGEMENT
CASE WESTERN RESERVE UNIVERSITY

Department of Accountancy

10900 Euclid Avenue
Cleveland, Ohio 44106-7235

Phone 216.368.8895
Fax 216.368.6244

http://weatherhead.case.edu/acct

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Via email to comments@pcaobus.org

Office of the Secretary, PCAOB
1666 K Street, NW
Washington D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 46 A Firm's System of Quality Control and other proposed amendments to PCAOB standards, rules and forms

Dear Secretary Brown and Members of the PCAOB:

We appreciate the opportunity to provide feedback to the Board regarding the proposed quality control standards. We are accounting professors at Case Western Reserve University. We teach auditing and conduct research in the areas of auditor judgment and decision making, auditor communications, and audit regulation.

Overall, we support the Board's efforts to update the quality control standards and we agree with the risk-based approach to quality control as well as the emphasis on firm governance and tone at the top. While we support a requirement for firms to perform an annual evaluation of their quality control systems, we have concerns about the selective disclosure of that evaluation.

The PCAOB Proposes to amend AS 1301, *Communications with Audit Committees*, to require firms to discuss the conclusion of the firm's most recent annual evaluation of its QC system along with planned and implemented remedial actions. It is our understanding that the PCAOB is prohibited, by statute, from disclosing a firm's quality control deficiencies unless or until that firm fails to remediate those deficiencies within 12 months. Moreover, the PCAOB has often acknowledged the statutory limitations (i.e. the Sarbanes-Oxley Act) in providing firm-specific information to audit committees and urged audit committees to seek more PCAOB inspection information directly, and voluntarily, from their auditors[1]. If the PCAOB cannot provide QC information to audit

[1] For example, Board Member Steve Harris suggested audit committees "be more aggressive in asking their auditors some fundamental questions about the results of the PCAOB inspections" (https://pcaobus.org/news-events/speeches/speech-detail/statement-on-reproposed-auditing-standard-related-to-communications-with-audit-committees_372).

committees directly, we are surprised that the PCAOB believes it can compel audit firms to provide such information to audit committees.

If the PCAOB is permitted under SOX to compel firms to disclose quality control information to audit committees, we would expect the PCAOB could also compel disclosure of such information to the public. If firm quality control information can be communicated to audit committees, we believe it should also be communicated to the public. Professor Carlisle's paper, "The effect of small audit firms' failure to remediate the PCAOB's quality control criticisms on audit market segmentation," published in the Journal of Accounting and Public Policy (https://doi.org/10.1016/j.jaccpubpol.2022.106989) is relevant to this issue. This paper finds that small audit firms that remediate QC criticisms identified in Part II of the inspection report do improve their audit quality, whereas those who fail to remediate QC criticisms do not improve their audit quality. The voluntary nature of remediation creates two market segments, those who provide higher audit quality (those who remediate) and those who provide lower audit quality (those who do not remediate). Importantly, the public disclosure of unremediated QC criticisms appears to allow clients who have a lower demand for audit quality to select a lower quality auditor. Given these findings, we have concerns that the selective disclosure of an annual QC evaluation to only the audit committee may have unintended consequences for the public markets as companies will have more information regarding the quality of their auditors than individual investors. Given the importance of strong QC to audit quality, we believe the public should also be provided this information, particularly in situations in which an audit firm has a weak QC system.

In summary, we urge the PCAOB to consider requiring firms to provide the same QC information (i.e. annual evaluation and remedial actions) to the public that it proposes to firms to provide to audit committees.

Thank you for the opportunity to comment on the proposed standard. If you have any questions, please contact Melissa at 216-368-3724 or John at 216-368-8895.

Sincerely,

/s/ Melissa Carlisle
Melissa Carlisle, PhD, CPA
Assistant Professor

/s/ John D. Keyser
John D. Keyser, PhD, CPA
Assistant Professor

Enclosure

Responses to Specific Questions

61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

We support the proposed requirement for firms to report their annual QC evaluations to the PCAOB. If firms evaluate their QC systems, it is appropriate for their regulator to receive that information. The annual evaluation should help firms to continually improve their quality controls and reporting their evaluations to the PCAOB will hold them accountable to a continuous improvement process.

70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? Why or why not?

We believe that the requirement to disclose the results of the annual evaluation and remedial actions to audit committees are appropriate. However, we question why this same information would not also be provided to investors and other users of financial statements.