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A summary of 10 years of PCAOB research: What have we learned?☆

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ABSTRACT

For the past 10 years, the Public Company Accounting Oversight Board (PCAOB) has operated as an independent overseer of public company audits. Over 70 percent of PCAOB studies have been published since 2010, evidencing the increasing relevance of PCAOB-related research in recent years. Our paper reviews the existing literature on the PCAOB's four primary functions – registration, standard-setting, inspections, and enforcement. In particular, we examine PCAOB registration trends and evaluate the effects of PCAOB registration requirements on the issuer audit market, as well as discuss the relative costs and benefits (e.g., auditor behavior changes, improvements in audit quality, auditor perceptions) of the 16 auditing standards the PCAOB passed in its first 10 years of operation. Further, we summarize the literature's findings on the effects of the PCAOB inspection process on various facets of audit quality. Finally, we analyze the research concerning the PCAOB's enforcement actions to determine how markets have responded to sanctions against auditors and audit firms. We contend that understanding and reviewing the effects of the PCAOB's activities are important to future audit research because of the PCAOB's authority over and oversight of the issuer audit profession. We also identify PCAOB-related research areas that have not been fully explored and propose several research questions intended to address these research areas.

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1. Introduction

On January 6, 2003, the Public Company Accounting Oversight Board (PCAOB) opened its Washington, DC office; three days later, the PCAOB held its first open board meeting, ending more than 100 years of self-regulation at the federal level by the public company audit profession (PCAOB, 2013c; Ernst & Young, 2012). The PCAOB had been established six months earlier with the passage of the Sarbanes-Oxley Act (SOX) to protect the interests of investors and further the public confidence in the preparation of informative, accurate and independent audit reports (U.S. House of Representatives 2002). Researchers, regulators, and practitioners have tried to understand the influence of the PCAOB for over a decade. For example, what impact has the PCAOB inspection process had on the auditing profession and audit quality? How have markets reacted to information disseminated by the PCAOB? How have PCAOB standards influenced auditor behavior? Accordingly, the objective of our paper is to review prior studies related to the four primary functions of the PCAOB (i.e., registration, standard-setting, inspections, and enforcement), synthesize the extant findings, and suggest directions for future research to address unanswered questions.

Over 70 percent of PCAOB studies have been published since 2010, evidencing the increasing relevance of PCAOB-related research in recent years. It is likely that in coming years, PCAOB research will continue to grow and broaden as data on each of the functions of the PCAOB become more available. The possibility exists that, as we learn more about the influence of the PCAOB, many prior conceptions in academic research about the role of auditors, auditors' obligations to their clients, and auditors' responses to external scrutiny may warrant reinvestigation or further exploration. While the breadth of the PCAOB research is fairly diverse, we did identify some common themes. First, the research has concluded that PCAOB regulation drove many small audit firms out of the issuer audit market (DeFond & Lennox, 2011; Read, Dasaratha, & Raghunandan, 2004).¹ However, this does not necessarily imply that auditor exits from the issuer audit market were detrimental, as the auditors that remained appeared to be more independent, of higher quality, and less likely to be the target of PCAOB enforcement actions than the exiting auditors (DeFond & Lennox, 2011).

Second, several papers have highlighted the costs and benefits of the PCAOB standard-setting activities (e.g., Smith, 2012; Wang & Zhou, 2012). For example, while some research supports AS3's increased focus on documentation (e.g., Payne & Ramsay, 2008), other research (e.g., Piercey, 2011) highlight unintended, adverse effects on auditor judgments (e.g., more lenient judgments).

Third, while some research questions the efficacy of the inspection process (e.g., Glover, Prawitt, & Taylor, 2009; Lennox & Pittman, 2010), several studies have contributed empirical evidence to support the position that the PCAOB inspection process has been beneficial to the auditing profession (e.g., DeFond, 2010; Offermanns & Peek, 2011). Specifically, the extant literature contends the market penalizes audit firms for receiving inspection reports containing PCAOB-identified deficiencies (Daugherty, Dickins, & Tervo, 2011) and, over time, the inspection process has appeared to lead to improved audit quality (e.g., Gramling, Krishnan, & Zhang, 2011; Landis, Jerris, & Braswell, 2011).

Fourth, enforcement actions and subsequent penalties borne by auditors that remained in the issuer audit market appeared to be relatively more severe for smaller audit firms (Gilbertson & Herron, 2009). However, enforcement actions levied against firms of all sizes resulted in negative repercussions to both auditors (e.g., auditor retention) and to audit clients (Dee, Lulseged, and Zhang (2011).

Understanding and reviewing the effects of the PCAOB is important to future research because of the PCAOB's authority over the audit profession. The effects of the PCAOB's decisions can have far-reaching implications on how audits are conducted, the pricing of audits, the auditor/client relationship, the consequences of audit failure, and the public's confidence in the auditing profession. As the PCAOB's activities have increased in recent years (e.g., increased standard-setting docket, expanded inspection programs into dealer-broker audits), it is likely that the PCAOB will continue to affect the auditing profession in the coming years. Our review provides a foundation for future research by synthesizing and categorizing this emerging body of research, as well as discussing future

¹ The PCAOB defines a small audit firm as an audit firm that regularly audits 100 or fewer issuers each year; these firms are inspected triennially.

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