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Forum

Are we there yet? Protecting investors by securing a strong auditing profession into the future

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ABSTRACT

In 2008, the U.S. Department of the Treasury's Advisory Committee on the Auditing Profession (ACAP) issued a report with findings and recommendations to address the sustainability and effectiveness of the public company auditing profession. The ACAP report addressed a number of longstanding issues and emerging developments at a critical time in history for the auditing profession and the Public Company Accounting Oversight Board (PCAOB). As the first comprehensive study of the profession since the Sarbanes–Oxley Act of 2002, the report identifies many significant issues for the PCAOB and the profession itself. The report dealt with three primary areas: human capital issues impacting the auditing profession, audit firm structure and finances, and audit firm concentration and competition. The report contains numerous recommendations directed toward regulators, academics, the auditing profession, and other stakeholders. This paper provides updated information about the numerous actions taken on sixteen ACAP recommendations that refer to or involve the PCAOB. Given the amount of effort related to these recommendations, it seems reasonable to ask, "Are we there yet?" But this is not the correct question, because we should never become complacent in thinking that we have made sufficient progress or completed the necessary actions to achieve and maintain high quality auditing. Since the time ACAP report was written, risks to audit quality have changed. The PCAOB continues to focus on areas raised in the ACAP report. While key issues raised in the ACAP report remain relevant, audit firms and audit regulators must be insightful and forward-looking to detect new and emerging risks so that timely actions can be taken to ensure reliable, high quality auditing to support the capital markets and protect investors. Numerous opportunities for future research exist in evaluating the impact of actions taken on the ACAP recommendations, including to what extent the actions have accomplished the original objectives and whether unanticipated consequences have occurred or additional actions might be needed.

As a Board member of the U.S. Public Company Accounting Oversight Board (PCAOB), I spend considerable time and effort analyzing the sustainability and effectiveness of the audit in protecting investors and promoting confidence in the capital markets. I am also acutely aware of the remaining work that needs to be done to attain a resilient and strong profession that achieves those objectives, now and into the future.

The U.S. Department of the Treasury took a snapshot of these issues in a 2008 report by its Advisory Committee on the Auditing Profession (ACAP).

My objective in this paper is to provide a description of the PCAOB's actions related to the ACAP recommendations that refer to or involve the PCAOB, along with contextual information to describe the background and basis for the recommendations. Because it had been years since such an analysis had been conducted,[1] my initial concern in starting this project was that I would find large issue areas within the ACAP recommendations that had yet to be addressed by the PCAOB. In fact, that is not the case. The amount of work conducted by the PCAOB related to the ACAP recommendations is impressive.

In some instances, the PCAOB actions taken differ from what was specifically indicated in a recommendation. It is important to keep in mind that the Committee's recommendations were made at a particular point in time and PCAOB actions have been taken after additional study and

Presentation at the Braden Award Ceremony, October 9, 2015.

[1] In 2010, the PCAOB staff prepared a paper on the status of the PCAOB-related ACAP recommendations of the October 13–14, 2010 Advisory Committee Meeting (Public Company Accounting Oversight Board, 2010c).

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analysis of information that became available based on its regulatory oversight activities.

I am not presenting conclusions about the adequacy of the PCAOB actions in meeting the original intent and objectives of the ACAP recommendations, as such conclusions are better as the subject of research studies or policy debates. In addition, these topics and their impact need to be monitored over time within the context of the dynamic and changing environment of public company auditing. This is not simply a "check the box" exercise after which we can declare actions completed.

Therefore, what I endeavor to do in this paper is to provide information that will be useful to researchers in formulating specific research questions, as well as designing broad analyses related to the state of auditing and the profession now and in the future.

Background

The accounting profession has been studied extensively over recent decades, frequently in response to scandals or other major problems. In 1996, the U.S. General Accounting Office (GAO)[2] issued a two-volume report (General Accounting Office, 1996a, 1996b) that summarized the results of 27 significant studies about the profession that were conducted from 1972 to 1995. The studies highlighted actions and reforms needed in the areas of auditor independence, the auditor's responsibility for detecting fraud, the effectiveness of internal control, and ongoing challenges with accounting and auditing standard setting.

In the years immediately following the issuance of the GAO report, the U.S. capital markets experienced a wave of corporate financial reporting and auditing scandals. A full-blown crisis of restatements and heavy losses in market capitalization began in the late 1990s (General Accounting Office, 2002), followed by a string of corporate failures and financial accounting and auditing scandals. Two infamous companies served as the "bookends" for this string of scandals: Enron and WorldCom (Franzel, 2014). With the demise of their auditor, Arthur Andersen, concentration among the largest audit firms increased, as the number of dominant firms fell from the "Big 5" to the "Big 4."

In response to the many scandals, on July 25, 2002, Congress passed the Sarbanes–Oxley Act of 2002, which President George W. Bush signed into law five days later.[3] The Act dealt with many of the issues identified over the decades as problematic in financial reporting and auditing for public companies.

Among other things, the Act created the PCAOB to oversee the audits of public companies to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. Thus, audits of U.S. public companies and their auditors became subject to regulatory oversight for the first time in history. Previously this segment of the profession was self-regulated.

In 2010, to further promote investor protection, the Dodd–Frank Wall Street Reform and Consumer Protection Act amended the Sarbanes–Oxley Act to, among other things, give PCAOB the explicit authority to oversee the audits of brokers and dealers.

The PCAOB commenced operations in April 2003, and began the process of developing and implementing its statutory responsibilities, which now include:

- registering public accounting firms that audit public companies, brokers, or dealers;
- establishing auditing and other professional standards;
- conducting and reporting on regular inspections of registered public accounting firms that audit public companies, brokers, or dealers; and
- conducting investigations and disciplinary proceedings in cases where auditors may have violated certain provisions of the Act, the rules of the PCAOB and the Securities and Exchange Commission (SEC), and other laws, rules, and professional standards governing the audits of public companies, brokers, and dealers (Public Company Accounting Oversight Board, 2015a, p. 1).

Treasury's advisory committee on the auditing profession

In November 2006, Secretary of the Treasury Henry Paulson Jr. spoke about indicators of both persistent and newly emerging risks in the capital markets, including "questions about the [public company audit] industry's sustainability and effectiveness" (Paulson, 2006, p. C:8). Secretary Paulson articulated growing concerns about the decline in corporate participation in the U.S. stock markets. He highlighted areas of study that provide a "framework to assess our own capital markets" (Paulson, 2006, p. C:3), which included concerns related to public company accounting and auditing.

Secretary Paulson suggested that there was evidence that recent regulatory reforms "may not be healthy" and may be "fundamentally altering the interactions between auditors and corporate management and boards in a number of ways, some of which are not constructive." (Paulson, 2006, p. C:8). He also cited increasing market concentration among audit firms and a high number of corporate financial restatements.

Following additional outreach, Secretary Paulson announced in the spring of 2007 that the Department of the Treasury had developed and was beginning to implement a "capital markets action plan." The first stage of the plan would involve the chartering of "a non-partisan committee to develop recommendations to consider options available to strengthen the [auditing] industry's financial soundness and its ability to attract and retain qualified personnel" (Department of the Treasury, 2007a).

Thus, the Treasury Department established the Advisory Committee on the Auditing Profession ("the Committee") in 2007. The Committee was charged with evaluating the sustainability of a strong and vibrant auditing profession and providing informed advice and recommendations to Treasury. The Committee was organized to study three broad areas:

[2] Now called the Government Accounting Office, the GAO is an independent, nonpartisan agency that works for the U.S. Congress and performs audits and investigations of federal agencies and programs.

[3] Public Law No. 107-204, July 30, 2002.