

IN THE TEETH OF OPPOSITION: IMPROVING PUBLIC COMPANY AUDITING STANDARDS IN THE UNITED STATES

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INTRODUCTION

Auditors are in the honesty business. Colonel Arthur H. Carter, President of the New York State Society of Certified Public Accountants, sold the auditing profession's trustworthiness in his testimony before the Senate Committee on Banking and Currency as Congress deliberated the Securities Act of 1933:

SENATOR ALBEN BARKLEY: You audit the controllers?

COLONEL ARTHUR H. CARTER: Yes, the public accountant audits the controller's account.

SEN. BARKLEY: Who audits you?

COL. CARTER: Our conscience.¹

The initial draft of the Securities Act of 1933 required financial statement audits only upon the Federal Trade Commission's request.² At the urging of the accounting profession, Congress amended the legislation to extend the independent audit requirement to all financial statements filed for registration.³ However, some suggested government employees—not private auditors—should perform the newly required audits.⁴ Ultimately, Congress determined that the private auditing profession held the competence and trustworthiness necessary to perform such audits, thanks in large part to Col. Carter's testimony.⁵

Congress trusted the auditor's conscience for nearly seventy years following the enactment of the Securities Acts. However, a wave of accounting scandals in the late-1990s and early-2000s led Congress to question the sufficiency of the auditor's conscience as the sole safeguard against auditor malfeasance and misfeasance.⁶

The creation of the Public Company Accounting Oversight Board ("PCAOB") through Congress' enactment of the Sarbanes-Oxley Act of 2002 ("SOX") marked a significant departure from this tradition of self-regulation.⁷ Among other responsibilities, SOX granted the PCAOB with

¹ JOHN L. CAREY, *THE RISE OF THE ACCOUNTING PROFESSION 184-87* (1969).

² *Id.* at 184.

³ *Id.* at 184.

⁴ *Id.* at 186-87.

⁵ *Id.* at 185-91.

⁶ See William H. Donelson, Chairman, Sec. & Exch. Comm'n, *Testimony Concerning Implementation of the Sarbanes-Oxley Act of 2002* (Sept. 9, 2003).

⁷ Charles D. Niemeier, Board Member, Pub. Co. Acct. Oversight Bd., *Independent Oversight of the Auditing Profession: Lessons from U.S. History* (Nov. 8, 2007).

standard-setting authority over auditing standards for public companies.⁸ Congress intended for this approach to resolve perceived industry capture of auditing standards; however, the PCAOB's standard-setting model has proven ineffective and detrimental to the auditing profession.⁹

Congress designed the PCAOB to consist primarily of non-experts. This approach attempted to disentangle auditing standards from the auditing profession. Yet, the non-expert model has resulted in sluggish and ineffective standard-setting. The PCAOB initially adopted the auditing standards issued by the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA") on an interim basis. However, most of the interim standards have yet to be replaced over twenty years later. Additionally, the PCAOB's failure to include an evergreen provision in the adoption of the AICPA standards effectively froze the interim standards in time as of the interim adoption in April 2003. Consequently, many of the auditing standards for public company audits are woefully outdated.

Where the PCAOB has displaced interim standards, empirical evidence suggests the overly prescriptive PCAOB standards result in less efficient audits that incentivize less competent auditors. Moreover, the political motivations of the PCAOB subject the standard-setting process to undue political pressures. The net impact of the PCAOB's standard-setting authority threatens the quality of auditing standards and, as a result, the integrity of capital markets in the United States.

This note proposes that Congress should incentivize the creation of an independent, private auditing standard-setting organization, the Public Auditing Standards Board ("PASB"). The newly minted PASB could rely upon the success of the Conceptual Framework developed by the Financial Accounting Standards Board ("FASB") to avoid industry capture and evade political influence. In doing so, Congress could eviscerate the resulting friction of the PCAOB's standard-setting authority on the auditing profession.

Part I of this note provides background information on auditing standards in the United States and the development of the PCAOB. Part II identifies the specific issues of the PCAOB's standard-setting process that negatively impact auditors' fieldwork. Part III proposes that Congress should incentivize the creation of an independent, private standard-setting authority structured after FASB's Conceptual Framework to resolve the issues presented in Part II.

⁸ See Donelson, *supra* note 6.

⁹ *Id.*

I. AUDITING IN THE UNITED STATES

A brief survey of core auditing principles is essential to contextualize the issues inherent within the PCAOB's standard-setting authority as identified in Part II. Moreover, the history of auditing standards in the United States demonstrates the technical development of industry guidance that served the auditing profession without government oversight for a vast majority of the profession's existence.

A. WHAT IS AN AUDIT?

A financial statement audit is designed to provide reasonable assurance that an entity's financial statements are free of material misstatement.¹⁰ The auditor's reasonable assurance is expressed through the auditor's final work product—the audit opinion.¹¹ This opinion states whether the auditor believes the financial statements are presented fairly, in all material respects.¹² An auditor's opinion reflects the exercise of professional judgment, which encompasses all aspects of an audit—from engagement acceptance, to materiality determination, through substantive and concluding procedures.¹³ The exercise of professional judgment drives the nature, timing, and extent of audit procedures.¹⁴ Ultimately, the auditor's opinion is an expression of professional judgment.

Audit evidence collected through the performance of audit procedures serves as the auditor's reasonable basis for the audit opinion.¹⁵ The auditor must design and perform audit procedures in accordance with applicable auditing standards.¹⁶ In the United States, auditors commonly comply with two different auditing standards, depending upon the nature of the engagement.

Audits of privately held companies generally comport with Generally Accepted Auditing Standards (“GAAS” or “AICPA standards”) as issued by the Audit Standards Board (“ASB”) of the American Institute of Certified Public Accountants (“AICPA”)¹⁷, while audits of publicly traded companies must conform to the standards issued by the PCAOB

¹⁰ PROFESSIONAL STANDARDS § 200.04 (AM. INST. OF CERTIFIED PUB. ACCTS. 2021), <https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00200.pdf>, [https://perma.cc/M4CD-D7A2].

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at § 700A.32(b).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at § 700A.31, 42.

(“PCAOB standards”).¹⁸ The history of auditing standards in the United States demonstrates the industry-led approach that preceded the modern duel-standard regime.

B. BRIEF HISTORY OF AUDIT STANDARDS IN THE UNITED STATES

Professional auditing literature in the United States evolved throughout the twentieth century from an informal, modest collection of nonauthoritative guidelines to a robust set of professional standards, the adherence to which is mandated by law. The profession’s earnest attempts at formulating a reliable and consistent set of auditing standards represents a feat of intellectual and technical ingenuity. More importantly, the profession’s history reflects the well-founded basis for expert-led technical standard setting that existed decades prior to the PCAOB’s creation.

1. Early Audit Literature (1892-1917)

Nonauthoritative practical field guides provided the first form of auditing standards in the United States and England.¹⁹ Lawrence Dicksee—an English accountant and professor—offered one of the earliest and most influential examples of such field guides in his 1892 publication, *Auditing: A Practical Manual for Auditors*.²⁰ An American edition was published shortly thereafter by American accountant and attorney, Robert Montgomery, in 1905.²¹

Although this publication was a step toward uniform auditing standards, Montgomery emphasized in his Preface to the American edition that Dicksee’s auditing principles were not intended for strict application.²² Rather, Dicksee and Montgomery sought to provide auditors with general guidance based upon their own auditing experiences.²³ Montgomery doubted the viability of overly-prescriptive auditing standards, considering the unique risks and characteristics of each engagement.²⁴

Montgomery published his own auditing guidance in 1912, shortly after publishing the American edition of Dicksee’s *Auditing*.²⁵ Montgomery largely framed his *Auditing Theory and Practice* from the American Edition

¹⁸ PUB. CO. ACCT. OVERSIGHT BD., PCAOB RELEASE NO. 2003-006, ESTABLISHMENT OF INTERIM PROFESSIONAL AUDITING STANDARDS (Apr. 18, 2003).

¹⁹ CAREY, *supra* note 1, at 100–01.

²⁰ *Id.* at 101.

²¹ LAWRENCE R. DICKSEE, *AUDITING: A PRACTICAL MANUAL FOR AUDITORS* (Robert H. Montgomery ed., Am. ed. 1905) (1892).

²² *Id.* at 7–8.

²³ *Id.*

²⁴ *Id.*

²⁵ ROBERT H. MONTGOMERY, *AUDITING THEORY AND PRACTICE* (6th ed. 1940).

of Dicksee's *Auditing*, later becoming known as "Montgomery's *Auditing*."²⁶

2. Industry-led Publications (1917-1939)

The American Institute of Accountants ("AIA")—a predecessor to the modern AICPA—provided auditors with the first government-endorsed accounting guidance.²⁷ Notably, this new guidance was far more prescriptive in nature, a departure from Dicksee's and Montgomery's earlier literature.²⁸

In 1917, the AIA published a memorandum on balance sheet audits at the request of the Federal Trade Commission ("FTC").²⁹ The Federal Reserve Board subsequently republished the memorandum in pamphlet form under the title, *Uniform Accounting: a tentative proposal submitted by the Federal Reserve Board*.³⁰ AIA published another iteration of the pamphlet the following year under a new title, *Approved methods for the preparation of balance sheet statements*.³¹ The content of the pamphlets remained largely the same between each edition, providing auditors with a set of general and prescriptive account-specific guidelines intended to provide formulated and standardized methods for balance sheet audits.³²

In 1929, the AIA formed a special committee tasked with updating the guidance offered in the earlier pamphlet series.³³ The resulting AIA's *Verification of Financial Statement* responded to the many criticisms of the earlier pamphlet series.³⁴ Most notably, the 1929 pamphlet suggested that the nature and extent of audit procedures should be tailored based upon the auditor's professional judgment of the firm-specific risk inherent in individual engagements.³⁵ This risk-based approach diverged from the rigid application of auditing methods suggested by the earlier pamphlet

²⁶ See generally *id.*

²⁷ AUDITING STANDARDS BD., AM. INST. OF CERTIFIED PUB. ACCTS., AUDITING, ATTESTATION AND QUALITY CONTROL STANDARDS SETTING ACTIVITIES: OPERATING POLICIES 1, <https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/asb/downloadeddocuments/asb-operating-policies.pdf> [https://perma.cc/7MKC-KYGW].

²⁸ *Id.* at 2.

²⁹ *Id.* at 18.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

series.³⁶ The 1929 pamphlet was later republished in 1936 with modest modifications, including a name change to *Examination of Financial Statements by Independent Public Accountants*.³⁷

A few short months following the issuance of the 1929 pamphlet, the American economy suffered the Great Crash of 1929 and the early beginnings of the Great Depression.³⁸ The reverberations of the sudden economic hardship echoed well into the early-1930s, culminating in the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934 (collectively “the Securities Acts”).³⁹ The Securities Acts required all publicly offered and traded securities be accompanied by audited financial statements on an initial and periodic basis, respectively.⁴⁰

The new financial reporting regulations imposed by Congress fueled expectations that independent audits should foster the fair presentation of financial statements in accordance with the meaning and intent of the Securities Acts’ audit requirements.⁴¹ In turn, regulators pressed the profession to develop more reliable, authoritative accounting and auditing standards to fulfill these expectations.⁴² The auditing profession soon responded to these calls.

3. Statements on Auditing Procedures (1939-1947)

The AIA began issuing Statements on Auditing Procedures (“SAPs”) in 1939.⁴³ The SAPs were issued by the AIA’s Committee on Auditing Procedures, largely in response to calls from regulators and other stakeholders for strengthened standards.⁴⁴ The newly issued SAPs were intended to provide auditors with supplemental guidance in the exercise of professional judgment.⁴⁵ The AIA did not intend to provide an

³⁶ *Id.*; compare FED. RSRV. BD., VERIFICATION OF FINANCIAL STATEMENTS at *vi* (1929) (suggesting a tailored approach), with FED. RSRV. BD., APPROVED METHODS FOR THE PREPARATION OF BALANCE SHEET STATEMENTS 5–6 (1918) (suggesting a uniform approach).

³⁷ AUDITING STANDARDS BD., *supra* note 27, at 18.

³⁸ See generally Maury Klein, *The Stock Market Crash of 1929*, 75 BUS. HIST. REV. 325 (2001).

³⁹ See Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 337-39 (1988).

⁴⁰ Securities Act of 1933 § 19(b)(2), 15 U.S.C. § 77s; Securities Exchange Act of 1934 § 15(b)(13)(E)(iv)(II), 15 U.S.C. § 78o.

⁴¹ See CAREY, *supra* note 1, at 199–202 (discussing the early tensions between SEC Chairman, James Landis, and leadership of the AIA).

⁴² *Id.*

⁴³ AUDITING STANDARDS BD., *supra* note 27, at 19.

⁴⁴ *Id.*

⁴⁵ *Id.*

exhaustive or prescriptive body of auditing techniques.⁴⁶ Rather, the profession continued to rely upon the nonauthoritative, yet largely influential auditing field guides, such as Dicksee's *Auditing* and Montgomery's *Auditing*, in tandem with the SAPs.⁴⁷

SAP No. 1, "Extensions of Auditing Procedure," painted a picture of the conceptual foundations of the auditing profession as they existed in 1939.⁴⁸ The conclusions in SAP No. 1 were based on the "experience and tradition" of the profession as developed mostly in the preceding four decades.⁴⁹ SAP No. 1 significantly influenced later SAPs and the structural outline of auditing standards, even as they exist today.⁵⁰ AIA issued twenty-four SAPs within the first decade following SAP No. 1.⁵¹ The AIA published "Codification of Statements on Auditing Procedure" in 1951 to consolidate the first twenty-four SAPs, which served as a central guidance resource for auditors in the field.⁵²

4. Statements of Auditing Standards and the Era of GAAS (1947-2002)

Shortly after the creation of SAPs, the SEC required auditors of publicly traded companies to comply with "generally accepted auditing standards," or "GAAS."⁵³ Although the auditing profession made significant strides toward providing consistent auditing guidelines through the issuance of SAPs in the years prior, the profession had not yet defined "generally accepted auditing standards" that would satisfy the SEC's new requirement.⁵⁴ In response, the AIA undertook yet another project designed to promulgate generally accepted auditing standards.

In 1947, the AIA published a brochure, *Tentative Statement of Auditing Standards—Their Generally Accepted Significance and Scope*.⁵⁵ The 1947 brochure effectively created two categories of auditing guidance. First, the SAPs, which the AIA continued to issue after the creation of GAAS, guided auditors as to what *acts* should be performed in an audit.⁵⁶ Second, the newly created GAAS established *standards of quality* in the performance of auditing procedures.⁵⁷ The AIA continued to issue SAPs and refined

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 20.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

GAAS into the 1950s.⁵⁸ The AIA later codified GAAS and all prior SAPs in SAP No. 33, which was published in 1963.⁵⁹

The AIA issued twenty-one additional SAPs following SAP No. 33.⁶⁰ In 1972, the AICPA—successor to the AIA—combined all effective SAPs into the newly created Statements on Auditing Standards (“SASs”).⁶¹ Twenty-two additional SASs were issued through 1978, when the AICPA created the modern Auditing Standards Board (“ASB”).⁶² The AICPA vested sole standard-setting authority in the ASB.⁶³ The ASB continued to issue SASs into the late 1990s.⁶⁴ However, massive accounting frauds and audit failures at Enron, WorldCom, and other publicly traded companies upended the status-quo of industry-led auditing standards at the turn of the last millennium.

5. Modern Auditing Standards (2002-Present)

Much ink has been spilled over the audit failures that precipitated Congress’ enactment of the Sarbanes-Oxley Act of 2002 (“SOX”). Many observers attribute this fraud phenomenon to lax auditing standards and independence requirements.⁶⁵ Others point to the “perverse” incentive structure of corporate executives and auditors alike.⁶⁶ Regardless of what led to the accounting improprieties, the political revolt that followed ushered in a world of change to the accounting and auditing profession—namely through the enactment of SOX and the creation of the PCAOB.

Congress passed SOX on July 25, 2002, with a unanimous Senate vote of 99-0 and a nearly unanimous vote in the House of 423-3.⁶⁷ This bipartisan legislation represented the most significant overhaul of the United States’ financial regulatory schema since the New Deal-era

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* at 19–20.

⁶³ *Id.* at 20.

⁶⁴ *Id.*

⁶⁵ See Grant Madsen, *BYU Fraud Expert Dissect Causes of Enron, WorldCom Scandals*, BYU MARRIOTT SCH. OF BUS. (Jun. 4, 2004), <https://marriott.byu.edu/emba/news/article?id=195> [https://perma.cc/6MBW-S7GD].

⁶⁶ See generally Steven Toms, *Financial Scandals: A Historical Overview*, 49 ACCT. BUS. RSCH. 477 (2019).

⁶⁷ Richard B. Schmitt et al., *Corporate-Oversight Bill Passes, Smoothing Way for New Lawsuits*, WALL ST. J. (Jul. 26, 2002, 11:59 PM), <https://www.wsj.com/articles/SB1027614152831614080> [https://perma.cc/82FY-4XCF].

Securities Acts.⁶⁸ Within the first title of SOX, Congress created the PCAOB in just sixty-five words.⁶⁹ Congress intended for the PCAOB to serve as a vigilant overseer of public company auditors. Among other responsibilities, the PCAOB administers registration for public accounting firms that audit public companies⁷⁰, inspects independent audits for compliance with professional standards⁷¹, and investigates alleged violations of securities law relating to the preparation and issuance of audit reports.⁷²

Congress also granted the PCAOB with authority to establish standards for public company audits.⁷³ This marked a significant departure from the industry-led standard-setting process, which had been refined for over one-hundred years. However, as discussed in Part II, the PCAOB standards have failed to live up to the promises of the Sarbanes-Oxley Act of 2002.

II. INHERENT FLAWS WITHIN THE PCAOB'S STANDARD-SETTING AUTHORITY

Congress intended for the PCAOB's standard-setting authority to avoid alleged conflicts inherent within the industry-led AICPA standards.⁷⁴ Observers have criticized the close relationship between the Auditing Standards Board—the board that issues the AICPA standards—and the auditing profession.⁷⁵ The profession directly funds the ASB, and many ASB members are closely associated with large public accounting firms.⁷⁶ Critics suggest the profession's influence over the ASB seeps into AICPA auditing standards, which results in biases in favor of auditors over users of the financial statement.⁷⁷ In response to these claims, which exploded in the aftermath of massive audit failures near the turn of the millennium, Congress granted the independent, non-expert PCAOB with standard-setting authority over public company audit engagements.⁷⁸ However, such authority, and the execution thereof, are flawed for many reasons.

⁶⁸ See Niemeier, *supra* note 7.

⁶⁹ Sarbanes-Oxley Act of 2002 § 101(a), 15 U.S.C. § 7211.

⁷⁰ *Id.* at § 102.

⁷¹ *Id.* at § 104.

⁷² *Id.* at § 105.

⁷³ *Id.* at § 103.

⁷⁴ Gary Gensler, Chair, Sec. & Exch. Comm'n, Prepared Remarks at Center for Audit Quality "Sarbanes-Oxley at 20: The Work Ahead" (Jul. 27, 2022).

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

First, the PCAOB's failure to tether interim standards to AICPA's amendments, coupled with the board's inaction to modernize the interim standards, resulted in the industry's capture of the PCAOB standards, which is precisely what Congress sought to avoid. Second, the PCAOB's non-expert model stymies the Board's standard-setting capabilities and competencies. Third, the quality and implementation of the standards the Board has issued cause significant friction in auditors' fieldwork. Fourth, the Board's emphasis on enforceability of standards results in less efficient audits and less competent auditors. Finally, the political nature of the Board post-*Free Enterprise Fund* needlessly politicizes auditing standards. Simply stated, the PCAOB's standard-setting authority has resulted in ineffectual standards that frustrate the important work of public company auditors.

A. FOREVER INTERIM STANDARDS

The inaugural PCAOB members viewed their standard-setting authority as a mandate from Congress to establish public company auditing standards.⁷⁹ Prior to SOX, public and private audits were performed under the same set of AICPA auditing standards—GAAS.⁸⁰ For the sake of continuity, the PCAOB adopted the AICPA auditing standards *as they existed in April 2003*, with the goal of gradually promulgating independent PCAOB standards to replace the interim standards.⁸¹

Critics of the “interim approach” note the PCAOB's failure to include an evergreen provision in the interim adoption standards.⁸² Such language could incorporate by reference the AICPA standards on an interim basis.⁸³ Consequently, the interim standards would mirror the modern AICPA standards, as amended by the ASB.⁸⁴ Thus, an auditor could rely upon AICPA standards for all public engagements unless the PCAOB displaced the AICPA standard.⁸⁵ The U.S. Government Accountability Office

⁷⁹ Am. Inst. Certified Pub. Acct., *One on One: The PCAOB Chairman and the JofA*, J. ACCNT., Dec. 1, 2003.

⁸⁰ See AUDITING STANDARDS BD., *supra* note 27, at 21.

⁸¹ *Interim Standards*, PUB. CO. ACCT. OVERSIGHT BD. (May 4, 2022), <https://pcaobus.org/oversight/standards/standard-setting-research-projects/interim-standards> [<https://perma.cc/VY5B-2F8V>].

⁸² Steven M. Glover et al., *Audit Standard Setting and Inspection for U.S. Public Companies: A Critical Assessment and Recommendations for Fundamental Change*, 23 ACCT. HORIZONS 221, 223 (2009).

⁸³ See e.g., U.S. GOV'T ACCOUNTABILITY OFF., GAO-21-368G, GOVERNMENT AUDITING STANDARDS 22 (2021), <https://www.gao.gov/assets/720/713761.pdf> [<https://perma.cc/NJ2J-R5CX>].

⁸⁴ Glover, *supra* note 82.

⁸⁵ See *id.*

adopted this approach for the Yellow Book, which encompasses government auditing standards issued by the GAO.⁸⁶ However, under the current interim approach, auditors must comply with legacy AICPA standards as they existed in April 2003, where the PCAOB has failed to displace the interim standard.⁸⁷

Peculiar unintended consequences arise. In areas of an audit engagement where the PCAOB has failed to issue a PCAOB standard, an auditor of a public company must perform procedures in accordance with AICPA standards as they existed in April 2003.⁸⁸ Auditing capabilities and technologies have matured significantly since April 2003.⁸⁹ Unfortunately, many of the standards that largely drive the nature and extent of public company auditors' fieldwork have remained the same.⁹⁰

The PCAOB indirectly ceded leadership in auditing standards back to the profession by failing to issue new standards.⁹¹ While the PCAOB failed to produce meaningful improvements to public company auditing standards in the Board's early existence, the Auditing Standards Board ("ASB") and the International Auditing and Assurance Standards Board ("IAASB") maintained an ambitious agenda.⁹² Because the PCAOB failed to proactively issue auditing standards, accounting firms largely based their audit methodology on the highest quality standards available—the industry-led ASB and IAASB standards.⁹³ Consequently, many aspects of the industry-led standards are incorporated on public engagements.⁹⁴ Where the PCAOB failed to act, the industry took a leadership role in standard-setting, and firms took direction from the industry-led standards.⁹⁵ The PCAOB's inaction defeated Congress' intent for the PCAOB to rescue auditing standards from industry capture.

B. NON-EXPERT MODEL

Critics of the AICPA standards argued that public company auditing standards in the United States were captured by the auditing industry, namely by the Big Five public accounting firms that were significant

⁸⁶ See U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 83.

⁸⁷ Glover, *supra* note 82.

⁸⁸ See *id.*

⁸⁹ See e.g., Ken Tysiac, *Embracing Technology in the Audit*, J ACCT., Feb 1, 2022.

⁹⁰ Gensler, *supra* note 74.

⁹¹ Glover, *supra* note 82, at 224–25.

⁹² *Id.* at 224.

⁹³ *Id.* at 225.

⁹⁴ *Id.*

⁹⁵ *Id.*

financial supporters of the AICPA prior to SOX's enactment.⁹⁶ The political fallout following the epidemic of audit failures at the turn of last millennium drove Congress to decouple public company auditing standards from the auditing profession.⁹⁷ SOX attempted to achieve this policy aim largely through the PCAOB's non-expert model.⁹⁸

Congress intended for the PCAOB to consist primarily of non-CPAs or individuals who lacked accounting and auditing expertise critically relevant to the PCAOB's standard-setting authority.⁹⁹ PCAOB board members are, by design, political appointees intended to serve as objective overseers of the auditing profession.¹⁰⁰ A vast majority of current and former board members did not have any public accounting experience prior to their tenure.¹⁰¹ Observers have noted the lack of technical experience at certain PCAOB's staff positions.¹⁰²

Auditing standards are hyper-technical.¹⁰³ The history of auditing standards in the United States demonstrates the arduous and laborious path the industry traveled before it arrived at a set of authoritative standards.¹⁰⁴ The AICPA standards in effect as of April 2003—the date of the PCAOB's interim adoption—were developed over the course of a rich, one-hundred-year history that demonstrates the profession's progress and maturity.¹⁰⁵ More significantly, industry experts, accounting education, and technical training of auditors continuously improved the practice of the standards along the way.¹⁰⁶

To be sure, the standard-setting process of the AICPA's ASB lacks meaningful independence from the auditing industry; however, the technical expertise of the ASB and the stakeholders that contribute to the issuance of the AICPA standards ensures technically sound auditing standards.¹⁰⁷ The lack of expertise within the PCAOB is a feature of the organization, not a bug. The political accountability and oversight of the

⁹⁶ See Gensler, *supra* note 74. The “Big Five” public accounting firms consisted of Arthur Andersen, LLP, Deloitte & Touche, LLP, PricewaterhouseCoopers, LLP, KPMG, LLP and Ernst & Young, LLP. *Big Five Accounting Firms*, BIG 4 ACCT. FIRMS, <https://big4accountingfirms.com/big-5-accounting-firms/> [https://perma.cc/B986-KGLE] (last visited Oct. 1, 2023). Arthur Andersen, LLP dissolved following the Enron collapse, leaving the modern “Big Four” public accounting firms. *Id.*

⁹⁷ Gensler, *supra* note 74.

⁹⁸ Glover, *supra* note 82, at 225–26.

⁹⁹ Sarbanes-Oxley Act of 2002 § 101(e)(2), 15 U.S.C. § 7211.

¹⁰⁰ Glover, *supra* note 82, at 225.

¹⁰¹ *Id.*

¹⁰² *Id.* at 225–26.

¹⁰³ *Id.* at 225.

¹⁰⁴ See *supra* Part I.B.

¹⁰⁵ See *supra* Part I.B.

¹⁰⁶ See *supra* Part I.B.

¹⁰⁷ See *supra* Part I.B.

auditing industry may be well served by an independent organization. Yet, the technical nuances of auditing standards should not be left in the hands of neophytes.

The PCAOB's failure to adequately maintain auditing standards for public company audits represents a significant negative consequence of the PCAOB's non-expert model. The causes of the PCAOB's failure to issue modern auditing standards is certainly multi-faceted, and the lack of accounting and auditing expertise within the PCAOB represents just one of the many flaws that drive the dysfunction of the PCAOB's standard-setting process. A logical consequence of the non-expert model is best demonstrated in the lack of productivity and criticized quality of the PCAOB standards.

C. STANDARD-SETTING PRODUCTIVITY AND QUALITY

Twenty-eight of the fifty-five current PCAOB standards—over half—are holdover interim standards frozen in time as of April 2003.¹⁰⁸ The PCAOB has failed to fully promulgate modern auditing standards since the Board's inception in the early 2000s.¹⁰⁹ Consequently, auditors of public companies are required to adhere to many archaic standards.¹¹⁰

The substantive quality and procedural rollout of PCAOB standards has faced criticism since the PCAOB's early beginning.¹¹¹ AS No.1, the PCAOB's first standard-setting action, merely adopted the AICPA's auditing standards on an interim basis.¹¹² As previously discussed in Section II. A, the interim standard approach remains in effect. However, the PCAOB's first novel standard, AS No. 2, did not survive the criticism and controversy it created.¹¹³

The PCAOB designed AS No. 2 to provide guidance for audits of public companies' internal controls over financial reporting ("ICFR") as required under Section 404 of SOX.¹¹⁴ The PCAOB released AS No. 2 in March 2004, and the SEC approved the standard in June 2004 with an effective date for fiscal years ending on or after November 15, 2004.¹¹⁵ Auditors were required to implement the standard in the same fiscal year of the standard's release and SOX's Section 404 implementation of

¹⁰⁸ Soyoung Ho, *Chair Erica Williams Discusses PCAOB Priorities*, THOMSON REUTERS (Jun. 10, 2022), <https://tax.thomsonreuters.com/news/chair-erica-williams-discusses-pcaob-priorities/> [<https://perma.cc/TMA8-H4BA>].

¹⁰⁹ Gensler, *supra* note 74.

¹¹⁰ *See* Glover, *supra* note 82, at 227.

¹¹¹ *Id.*

¹¹² *Id.* at 228.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.*

ICFR.¹¹⁶ AS No. 2 required auditors to conduct an unprecedented degree of detailed testing over internal controls.¹¹⁷ Practitioners deemed many of the prescriptive procedures unnecessary and overly burdensome.¹¹⁸ Audit firms desperately sought clarified guidance from the PCAOB, to no avail.¹¹⁹

Although the PCAOB eventually released a nonauthoritative publication series in response to industry concerns, *Staff Questions and Answers on AS No. 2*, the PCAOB offered very little in terms of interpretive guidance for AS No. 2.¹²⁰ Rather, the PCAOB publicly blamed “auditors’ misimpressions” for the friction AS No. 2 created.¹²¹ This blame-shifting narrative drove observers to note the political motivations of the PCAOB.¹²² That is, because the PCAOB is a politically appointed body, the PCAOB is incentivized to avoid responsibility for its failures. This criticism grew following the severance of the for-cause removal protection for members of the PCAOB following the *Free Enterprise Fund* decision.¹²³ Ultimately, the PCAOB replaced AS No. 2 with a less stringent AS No. 5 just three years after the effective date of AS No. 2 in 2007.¹²⁴ Unfortunately, the most recent PCAOB strategic plan suggest a more aggressive, prescriptive standard-setting agenda that harkens back to the blunders of AS No. 2.¹²⁵

Many stakeholders have also criticized the Board’s failure to collaborate with the ASB or the International Auditing and Assurance Standards Board (“IAASB”), an international auditing standard-setter.¹²⁶ The ASB and the IAASB have publicly committed toward convergence of the two standards.¹²⁷ Conversely, the PCAOB continues to issue standards independent of the ASB and IAASB convergence project.¹²⁸ Although one explanation of the PCAOB’s resistance toward convergence may lie in the

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.* at 229.

¹²³ See *infra* Part II.E.

¹²⁴ Glover, *supra* note 82, at 229.

¹²⁵ PUB. CO. ACCT. OVERSIGHT BD., STRATEGIC PLAN 2022-2026 10 (Nov. 18, 2022) [hereinafter STRATEGIC PLAN 2022-2026] https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2cc4b6a_4/ [https://perma.cc/V4ME-LTF7].

¹²⁶ Glover, *supra* note 82, at 227.

¹²⁷ *Id.*

¹²⁸ See *e.g.*, PUB. CO. ACCT. OVERSIGHT BD., PCAOB RELEASE NO. 2022-006, A FIRM’S SYSTEM OF QUALITY CONTROL AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS, RULES AND FORMS (Nov. 18, 2022).

Board's statutory mandate¹²⁹, this explanation reinforces the detrimental design of the PCAOB's role as a non-expert, independent overseer tasked with the issuance of technical industry standards. The benefit of independent oversight forsakes the quality of auditing standards under the current PCAOB model.

D. HYPER-STRINGENT STANDARDS

The PCAOB's most recent strategic plan includes an objective that expressly seeks to adopt auditing standards that enhance the PCAOB's ability "to enforce the standards and inspect for compliance."¹³⁰ Subtlety in the language of standards significantly impacts an auditor's requirements and inspectors' ability to enforce rigid standards.¹³¹ For example, substituting "the auditor *should*" with "the auditor *shall*" replaces an auditor's professional judgement with a mandatory, unconditional responsibility.¹³² This minutia of the language used in standard setting significantly impacts the nature and extent of auditors' fieldwork.¹³³ The PCAOB's strengthening of enforceability will likely result in more prescriptive audit requirements, incrementally replacing auditor judgment currently exercised on an engagement-specific basis.¹³⁴ However, empirical evidence suggests more stringent auditing standards may result in higher audit costs with lower auditor competency, thereby reducing audit quality.¹³⁵

Researchers from the University of Chicago and University of Minnesota developed a model to analyze the impact of the PCAOB's more stringent standards.¹³⁶ The researchers observed that more stringent standards restrict auditors' exercise of professional judgment.¹³⁷ The

¹²⁹ See Letter from Deloitte & Touche, LLP to Elizabeth Murphy, Secretary, Sec. & Exch. Comm'n (Oct. 18, 2010), <https://www.sec.gov/comments/pcaob-2010-01/pcaob201001-2.pdf> [<https://perma.cc/K9AA-P89F>].

¹³⁰ See STRATEGIC PLAN 2022-2026, *supra* note 125.

¹³¹ See PUB. CO. ACCT. OVERSIGHT BD., RULE 3101, CERTAIN TERMS USED IN AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS (2004) (discussing differences in professional requirements signaled by "should" and "shall").

¹³² *Id.*

¹³³ *Id.*

¹³⁴ See e.g. Soyoung Ho, *Regulator Proposes Sweeping Reforms to Quality Control Standards for Audit Firms*, THOMSON REUTERS (Nov. 18, 2022), <https://tax.thomsonreuters.com/news/regulator-proposes-sweeping-reforms-to-quality-control-standards-for-audit-firms/> [<https://perma.cc/U2A2-V7P7>].

¹³⁵ See Pingyang Gao & Gaoqing Zhang, *Auditing Standards, Professional Judgment, and Audit Quality*, 94 *Acct. Rev.* 201, 213 (2019), https://carlsonschool.umn.edu/sites/carlsonschool.umn.edu/files/2018-10/v1_2017.5.29.pdf [<https://perma.cc/N986-7PJG>].

¹³⁶ *Id.* at 202.

¹³⁷ *Id.* at 213.

model suggests that more prescriptive standards that require less professional judgment result in greater “compliance mentality” that may prevent misaligned auditor misconduct, such as fraud. However, the researchers found that auditors’ decreasing exercise of professional judgment may indirectly lower professional expertise.¹³⁸

The less often auditors are required to exercise professional judgment, the less expertise is developed.¹³⁹ Meanwhile, the extent of auditing procedures is greater under more stringent standards, which results in more onerous, costly, and time-consuming engagements.¹⁴⁰ The researchers concluded that more stringent standards may result in less efficient audits performed by less qualified practitioners, which lowers overall audit quality.¹⁴¹

The PCAOB’s renewed focus on enhancing the enforceability of auditing standards suggests a trend toward hyper-stringent standards.¹⁴² Although this approach may promote the PCAOB’s enforcement mandate, the quality of auditing standards and audit quality may suffer. The unintended consequences of more stringent auditing standards as identified by empirical research highlights yet another example of the harmful combination of the PCAOB’s oversight role and its standard-setting responsibility.

E. POLITICAL MOTIVATIONS OF THE PCAOB

To ensure the apolitical nature of the PCAOB, Congress provided board members with for-cause removal protection.¹⁴³ However, the Supreme Court severed the removal protection of PCAOB members in *Free Enterprise Fund* after the Court found the double layer of for-cause removal protection unconstitutional.¹⁴⁴ Following this decision, the Board has experienced a tumultuous cycle of politically motivated terminations throughout the last half-decade. Consequently, the dysfunction of the PCAOB’s standard-setting authority have been exacerbated in recent years.

1. An Opened Door

Commentators and legal scholars identified several suspect constitutional issues inherent in the structure of the PCAOB shortly after

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² See STRATEGIC PLAN 2022-2026, *supra* note 125.

¹⁴³ *Id.*

¹⁴⁴ *Free Enter. Fund v. Public Co. Acct. Oversight Bd.*, 561 U.S. 477, 514 (2010).

its creation.¹⁴⁵ The for-cause removal protection granted by Congress to the PCAOB's board members represented one such challenge. The United States Supreme Court ultimately held that the board members' double for-cause protection violated the Separation of Powers principle.¹⁴⁶ Because the officers charged with oversight of the PCAOB—SEC Commissioners—also enjoyed for-cause removal protection, the additional layer of protection for PCAOB members interfered with the President's oversight of inferior officers.¹⁴⁷ The Court severed the for-cause removal protection from the remainder of the Sarbanes-Oxley Act, and spared the PCAOB from total elimination.¹⁴⁸

The abrogation of the for-cause removal protection permits the SEC to remove PCAOB board members for any reason, including those of a political nature.¹⁴⁹ The erosion of the PCAOB's political independence created a pendulum swing of cyclical board terminations.¹⁵⁰ As executive administrations have come and gone, so too have the leaders of the PCAOB. The resulting political whiplash of the PCAOB's strategy threatens the quality and productivity of public company auditing standards in the United States.

2. Cyclical Board Terminations

On August 11, 2017, shortly after the revelation of a scandal involving the theft of inspection schedule by a departing PCAOB employee, SEC Chairman Jay Clayton announced a search to appoint new PCAOB board members to fill certain seats left by resigned and term-limited board members.¹⁵¹ In December 2017, the SEC Chairman further announced that all board seats would be filled by new appointees.¹⁵² This action marked the first time in the PCAOB's history that the SEC either removed

¹⁴⁵ Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status* 80 NOTRE DAME L. REV. 975, 1029–60 (2005) (discussing early criticisms of the PCAOB).

¹⁴⁶ *Free Enterprise Fund v. Public Co. Accounting Oversight Bd*, 561 U.S. 477, 484, 492–508 (2010).

¹⁴⁷ *Id.* at 484.

¹⁴⁸ *Id.* at 508–10.

¹⁴⁹ See e.g., *infra* Section II.E.2.

¹⁵⁰ See e.g., *infra* Section II.E.2.

¹⁵¹ Press Release, Sec. & Exch. Comm'n, James R. Doty, Chairman of the Public Company Accounting Oversight Board, Agrees to Remain in Place for Search and Transition Period for New Board Members (Aug. 11, 2017), <https://www.sec.gov/news/public-statement/clayton-statement-pcaob-2017-08-11> [<https://perma.cc/TXL7-CYVT>].

¹⁵² Press Release, Sec. & Exch. Comm'n, Statement on Appointment of New PCAOB Board Members (Dec. 12, 2017), <https://www.sec.gov/news/public-statement/clayton-2017-12-12> [<https://perma.cc/3R6P-EPMX>].

a sitting PCAOB member or refused to reappoint a PCAOB board member who sought a second term.¹⁵³

The newly seated PCAOB Chairman, William Duhnke, served as a longtime staffer to Republican Senator Richard Shelby and staff director and general counsel to the Republican-led U.S. Senate Rules Committee.¹⁵⁴ Critics noted that Duhnke lacked any relevant experience in securities law, financial reporting, or regulatory administration.¹⁵⁵ Consequently, many argued Duhnke was a political appointee chosen for his anti-regulatory approach that, critics suggested, threatened the operational efficacy of the PCAOB.¹⁵⁶ Others noted that no previous member of the PCAOB worked for a Big Four firm, while two of the five new appointees had prior Big Four experience.¹⁵⁷

Although the SEC did not formally release its rationale for the shakeup at the PCAOB, many observers believed the newly appointed PCAOB members were selected because of their alignment with the Trump Administration's broader deregulatory policy.¹⁵⁸ Others pointed to the aforementioned inspection schedule scandal as evidence that the PCAOB needed a change in leadership.¹⁵⁹ Regardless of the political motivations to remove and replace the entire PCAOB, this move marked a departure in the manner PCAOB members were previously selected and retained.

A choir critical of the newly appointed PCAOB members grew quickly under Chairman Duhnke's leadership. Among chief complaints against the PCAOB following the 2017 appointments, the most common pertained

¹⁵³ Dave Michaels, *Government Cleans House at Audit Regulator*, WALL ST. J. (Dec. 12, 2017, 6:59 PM) <https://www.wsj.com/articles/government-cleans-house-at-audit-regulator-1513110178> [<https://perma.cc/RHM5-WU6K>].

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ Arthur Levitt, *The S.E.C.'s Clayton Turns Oversight Political*, N.Y. TIMES OPINION (Oct. 24, 2019), <https://www.nytimes.com/2019/10/24/opinion/clayton-sec-pcaob.html>.

¹⁵⁷ Michaels, *supra* note 153.

¹⁵⁸ Soyoung Ho, *Former SEC Officials Urge Chair Gensler not to Buckle Under Political Pressure When Picking Members of Audit Regulator*, THOMSON REUTERS (Sept. 21, 2021), <https://tax.thomsonreuters.com/news/former-sec-officials-urge-chair-gensler-not-to-buckle-under-political-pressure-when-picking-members-of-audit-regulator/> [<https://perma.cc/4LZF-BTPZ>].

¹⁵⁹ Kellie Mejdich, *Progressives Tell SEC Chair to Fire Trump-era Audit Board*, POLITICO (May 17, 2021, 10:04 AM), <https://www.politico.com/news/2021/05/17/progressives-sec-chair-trump-audit-board-488988> [<https://perma.cc/UX3H-Y33H>]; Francine McKenna, *U.S. Audit Regulator Fails to Hold Public Meetings as Required by Bylaws*, MARKETWATCH (Sept. 19, 2019, 11:15 AM), <https://www.marketwatch.com/story/us-audit-regulator-fails-to-hold-public-meetings-as-required-by-bylaws-2019-09-19> [<https://perma.cc/9CW2-A45H>].

to the relaxation of regulations and a decline in enforcement actions.¹⁶⁰ Observers noted that the PCAOB under Duhnke's leadership held few open meetings and ended the Investor Advisory Group and Standing Advisory Group, which served as stakeholder advocacy groups within the PCAOB.¹⁶¹ Others criticized a shift in PCAOB policies under Duhnke that were "too friendly" to accounting firms.¹⁶²

Defenders of the PCAOB argued that Duhnke and other board members took quick action to remedy the PCAOB's organizational flaws, which enabled the theft of insider information used in the inspection scandal.¹⁶³ Duhnke's PCAOB also undertook efforts to modernize the PCAOB's standards on audit quality control and began efforts to establish a permanent broker-dealer inspections program.¹⁶⁴ Others highlighted a decline in audit deficiencies identified in PCAOB inspections, which suggested an improvement in overall audit quality under Duhnke's leadership.¹⁶⁵ Despite such efforts, Duhnke's performance would soon face even greater public scrutiny following a whistleblower report that raised serious allegations of retaliation and misconduct at the PCAOB under Chairman Duhnke's leadership.

On October 15, 2019, the Wall Street Journal reported on whistleblower complaints filed with the SEC in mid-2019, alleging the PCAOB chairman instituted a "culture of fear", among other grievances.¹⁶⁶ According to the whistleblower reports written by a group of PCAOB employees, internal strife among PCAOB staff and board

¹⁶⁰ Cydney Posner, *Blog: SEC Removes Duhnke as PCAOB Chair*, JD SUPRA (Jun. 7, 2021), <https://www.jdsupra.com/legalnews/blog-sec-removes-duhnke-as-pcaob-chair-2535655/> [<https://perma.cc/5QFT-BLEZ>].

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ Amanda Iacone, *KPMG Scandal Leads to Enhanced U.S. Oversight of Risk, Compliance*, BLOOMBERG LAW (Oct. 18, 2018, 3:16 PM), <https://news.bloomberglaw.com/securities-law/kpmg-scandal-leads-to-enhanced-us-oversight-of-risk-compliance> [<https://perma.cc/3YAS-CEJZ>].

¹⁶⁴ Mark Maurer, *U.S. Regulator to Put the Spotlight on Audit Quality in 2020*, WALL ST. J. (Dec. 27, 2019, 6:00 AM), https://www.wsj.com/articles/u-s-regulator-to-put-the-spotlight-on-audit-quality-in-2020-11577444401?mod=article_inline [<https://perma.cc/YTM4-3VZZ>].

¹⁶⁵ Kellie Mejdrieh, *SEC Fires Republican Audit Watchdog After Push from Warren, Sanders*, POLITICO (Jun. 5, 2021, 08:26 AM), <https://www.politico.com/news/2021/06/04/sec-fires-republican-watchdog-491939> [<https://perma.cc/GDP9-GK3A>].

¹⁶⁶ Dave Michaels & Jean Eaglesham, *Audit Watchdog Plagued by Internal Strife, Whistleblower Claims*, WALL ST. J. (Oct. 15, 2019, 11:10 AM), <https://www.wsj.com/articles/audit-watchdog-plagued-by-internal-strife-whistleblower-claims-11571152206> [<https://perma.cc/394D-9AEH>].

members alike drove many of the regulator's top leaders out of the organization.¹⁶⁷

Duhnke continued his service at the PCAOB until a change in leadership at the SEC occurred following the election of President Joseph Biden in 2020.¹⁶⁸ Chairman Jay Clayton resigned from the SEC shortly following the election of President Biden.¹⁶⁹ President Biden nominated former Obama-era regulator, Gary Gensler, as Clayton's replacement in early 2021.¹⁷⁰ Observers noted Gensler's progressive bend toward topics such as investor protection regulations and disclosures related to environmental, social, and governance ("ESG") issues contrasted starkly with Clayton's deregulatory approach.¹⁷¹ Chairman Gensler was sworn into office as SEC Chairman on April 17, 2021.¹⁷² Progressive leaders soon called on Chairman Gensler to dismiss PCAOB chairman Duhnke.¹⁷³

Senators Elizabeth Warren and Bernie Sanders sent Chairman Gensler a letter just over one month into his tenure at the SEC, calling for the immediate removal of all five PCAOB members.¹⁷⁴ The letter alleged former SEC Chairman Clayton "appointed partisan cronies with a

¹⁶⁷ *Id.*

¹⁶⁸ Posner, *supra* note 160.

¹⁶⁹ Press Release, Sec. & Exch. Comm'n, Statement of SEC Chairman Jay Clayton Regarding the Conclusion of His Tenure (Dec. 23, 2020), <https://www.sec.gov/news/public-statement/clayton-2020-12-23> [<https://perma.cc/22LZ-4EZH>].

¹⁷⁰ Katanga Johnson, *U.S. Senate Votes 53-45 to Confirm Gary Gensler as Biden's SEC Chief*, REUTERS (Apr. 14, 2021, 12:43 PM), <https://www.reuters.com/business/finance/us-senate-votes-53-45-confirm-gary-gensler-bidens-sec-chief-2021-04-14/> [<https://perma.cc/T8F7-TBDL>].

¹⁷¹ Soyoung Ho, *SEC Chairman Jay Clayton Resigns*, THOMSON REUTERS (Dec. 28, 2020), <https://tax.thomsonreuters.com/news/sec-chairman-jay-clayton-resigns/>, <https://perma.cc/5N8M-LQM4> [<https://perma.cc/WCB4-2XJT>]; Mark Maurer, *SEC Removes Chairman of Audit Watchdog*, WALL ST. J. (Jun 4, 2021, 8:13 PM), <https://www.wsj.com/articles/sec-removes-chairman-of-audit-watchdog-11622838205> [<https://perma.cc/7HAQ-UALH>].

¹⁷² Press Release, Sec. & Exch. Comm'n, Gary Gensler Sworn in as Member of the SEC (Apr. 17, 2021), <https://www.sec.gov/news/press-release/2021-65> [<https://perma.cc/6XPZ-E4F5>].

¹⁷³ Letter from Elizabeth Warren, U.S. Senator, and Bernard Sanders, U.S. Senator, to Gary Gensler, Chair, SEC (May 25, 2021), <https://www.warren.senate.gov/imo/media/doc/Letter%20to%20Gensler%20on%20PCAOB.pdf> [<https://perma.cc/K4ES-77RQ>]; *see also* Mejdrich, *supra* note 155 (discussing letter from progressive advocacy groups calling on the SEC to "install five new PCAOB board members fully committed to high standards in American public firm auditing").

¹⁷⁴ Letter from Elizabeth Warren, U.S. Senator, and Bernard Sanders, U.S. Senator, to Gary Gensler, Chair, Sec. & Exch. Comm'n (May 25, 2021), <https://www.warren.senate.gov/imo/media/doc/Letter%20to%20Gensler%20on%20PCAOB.pdf> [<https://perma.cc/6RGS-M5V6>].

deregulatory agenda and little relevant experience, rewarding them with one of the highest-paying jobs in government.”¹⁷⁵ The letter continued, “these appointments have compromised the PCAOB’s independence, weakened its expertise, and reinforced perceptions of its capture by industry.”¹⁷⁶

The senators pointed to the PCAOB’s sharp decline in enforcement actions under Duhnke and the PCAOB’s adoption of “weakened” auditor independence rules.¹⁷⁷ To corroborate the overall theme of the letter, the senators pointed to the 2019 whistleblower complaint and a 2019 report published by the Project on Government Oversight that outlined perceived regulatory deficiencies within the PCAOB.¹⁷⁸ The letter concluded by calling for the removal of the sitting board members and appointment of individuals with a “demonstrated commitment to the interests of investors and the public.”¹⁷⁹ Chairman Gensler soon responded to the calls for change at the PCAOB.¹⁸⁰

On June 4, 2021, the SEC announced the removal of Chairman Duhnke from the PCAOB and its intention to replace all sitting PCAOB members with new appointees.¹⁸¹ This decision marked the second time within a four-year period that the SEC replaced all members of the PCAOB.¹⁸² Republicans quickly pointed out the apparent political influence in the SEC’s decision to dismiss the board members.¹⁸³ The minority Republican SEC commissioners released a joint statement, calling the decision to dismiss Duhnke a “hasty and truncated decision-making process” which set a “troubling precedent for the commission’s ongoing oversight of the PCAOB and for the appointment process.”¹⁸⁴ Representative Patrick McHenry, the ranking member of the House Financial Services Committee, rebuked the move and vowed to “hold Mr. Gensler accountable for this decision.”¹⁸⁵ Representative McHenry

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*; see David S. Hilzenrath & Nicholas Trevino, *How an Agency You’ve Never Heard of Is Leaving the Economy at Risk*, PROJECT ON GOV’T ACCOUNTABILITY, (Sept. 5, 2019), <https://www.pogo.org/investigation/2019/09/how-an-agency-youve-never-heard-of-is-leaving-the-economy-at-risk#77009> [<https://perma.cc/Z74L-2SU8>].

¹⁷⁹ Warren, *supra* note 174.

¹⁸⁰ *Id.*

¹⁸¹ Press Release, Sec. & Exch. Comm’n, SEC Announces Removal of William D. Duhnke III from the Public Company Accounting Oversight Board; Duane M. DesParte to Serve as Acting Chair (Jun. 4, 2021), <https://www.sec.gov/news/press-release/2021-93> [<https://perma.cc/Y3TY-MH53>].

¹⁸² Mejdrich, *supra* note 165.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

accused the SEC as treating the PCAOB as a “political football” and suggested that lawmakers should consider whether the PCAOB should exist as an entity separate from the SEC.¹⁸⁶

The SEC appointed PCAOB board member, Duane DesParte as acting chairman until replacements were seated.¹⁸⁷ The SEC ultimately voted to retain DesParte as a board member; however, the remaining four seats were filled by new appointees.¹⁸⁸ Erica Williams, a former SEC staffer and Obama administration alumna, was appointed chairperson in late 2021.¹⁸⁹ Other appointees included a law professor and former senate staffer, a corporate executive and former Treasury official, and the executive director of the Commodity Futures Trading Commission.¹⁹⁰

3. Impact on PCAOB Performance

A disturbing pattern has emerged. Every change in presidential administration since the *Free Enterprise Fund* decision corresponds with a decision by the SEC to dismiss sitting PCAOB members. Republicans publicly supported Chairman Doty’s replacement with Chairman Duhnke in 2017 following the inspection schedule scandal. Democrats, in turn, suggested that this removal needlessly politicized the PCAOB. Democrats argued the PCAOB board members had nothing to do with the scandal, rather Republicans were merely leveraging the issue to replace thorough regulators with political appointees focused on deregulation.

Just four years later, the roles were reversed. Democrats, now with control of the SEC, dismissed Chairman Duhnke, following allegations that his relaxed approach to oversight “neutered” the PCAOB.¹⁹¹ Moreover, Democrats pointed to whistleblower allegations and advocacy reports on the ineffectiveness of the PCAOB to defend the SEC’s decision. Republicans, for their part, called the dismissals “politically motivated.”

The frequent leadership changes within the PCAOB resulted in dramatic shifts in strategic goals and policy priorities over the last half decade.¹⁹² A strong indicator of this pattern is evident in the strategic plans

¹⁸⁶ *Id.*

¹⁸⁷ Press Release, Sec. & Exch. Comm’n, SEC Appoints New Chairperson and Board Members to the Public Company Accounting Oversight Board (Nov. 8, 2021), <https://www.sec.gov/news/press-release/2021-228> [<https://perma.cc/3SHZ-GH6E>].

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ See Warren, *supra* note 174.

¹⁹² See generally Dan Goelzer, *The Housecleaning at the PCAOB: Why it Matters*, MEDIUM: THE AUDIT BLOG (Jul. 6, 2021), <https://medium.com/the-audit-blog/the-housecleaning-at->

published by the PCAOB. Chairman Duhnke's last strategic plan covered 2020 through 2024.¹⁹³ This plan entailed a collaborative approach toward "oversight" of public company audits, largely through an emphasis on stakeholder engagement.¹⁹⁴

In contrast, the PCAOB under Williams' tenure has taken a "bold" approach toward investor protection.¹⁹⁵ The board released a proposed five-year strategic plan covering 2022 through 2026 in August 2022.¹⁹⁶ Unlike Duhnke's previous strategic plan, Williams' proposal describes the PCAOB's mission to "regulate" as oppose to "oversee" public company audits.¹⁹⁷ The plan outlines four goals designed to achieve the PCAOB's mission to "protect investors and further the public interest" through the *regulation* of public company audits.¹⁹⁸

More specifically, the PCAOB's standard setting agenda shifted between board leadership. Under Duhnke, the PCAOB sought to update audit quality control standards, which had not been revised since the PCAOB adopted the AICPA standards on an interim basis as they existed in April 2003.¹⁹⁹ Although the PCAOB released a concept release on a proposed update to the quality control standards, the SEC dismissed Duhnke before the board formally adopt a final updated standard.²⁰⁰ The

the-pcaob-why-it-matters-6da6bdc2eed, [https://perma.cc/4U8W-QRVU] (noting the implementation of new policies following the recent appointments to the Public Company Accounting Oversight Board and its Chair).

¹⁹³ See PUB. CO. ACCT. OVERSIGHT BD., STRATEGIC PLAN 2020-2024 1–3 (2020) [hereinafter Strategic Plan 2020-2024] https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2020-2024.pdf?sfvrsn=776073d3_4 [https://perma.cc/7PF8-QA7H] (showing the last strategic plan published by Chairman Duhnke and the Public Company Accounting Oversight Board).

¹⁹⁴ *Id.*

¹⁹⁵ STRATEGIC PLAN 2022-2026, *supra* note 125.

¹⁹⁶ *Id.* at 7–11.

¹⁹⁷ Compare STRATEGIC PLAN 2020–2024, *supra* note 193, at 5 (explaining the Board's approach to regulate public companies under Chairman Duhnke) with STRATEGIC PLAN 2022–2026 *supra* note 125, at 3 (explaining the Board's improved approach to under Chairman Williams).

¹⁹⁸ STRATEGIC PLAN 2022-2026, *supra* note 125, at 3.

¹⁹⁹ PCAOB Issues Quality Control Concept Release, PUB. CO. ACCT. OVERSIGHT BD. (Dec. 17, 2019), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-issues-quality-control-concept-release_719 [http://perma.cc/4UXV-QTM7].

²⁰⁰ Soyoung Ho, *In Response to Investor Demand, PCAOB to Consider Adding Audit Quality Indicator Project to Agenda*, THOMSON REUTERS (Aug. 5, 2022), <https://tax.thomsonreuters.com/news/in-response-to-investor-demand-pcaob-to-consider-adding-audit-quality-indicator-project-to-agenda/> [https://perma.cc/X42J-D7UJ].

PCAOB under Williams shifted toward a standard-setting agenda with an emphasis on the enforceability of such standards.²⁰¹

As the philosophy of standard-setters ebbs and flows, so too may the requirements of public company auditors. Changes in PCAOB leadership will generate needless friction in public company audits. Such changes have been driven by political motivations rather than a deliberative, consistent appointment process. If the current trend toward politization of the PCAOB continues, the board's focus may teeter between "enhanced regulation" under democrat administrations and "collaborative oversight" under republican administrations.

Each political bent may creep into PCAOB audit standards as the board drafts standards with an emphasis on enforceability or with a deference to auditor judgement, respectively. Likewise, each iteration of the PCAOB could modify audit standards in a manner that best suits the current board philosophy. Such inconsistency will create great uncertainty for public company auditors as the focus and philosophy of standard setting vacillates between administrations. Similarly, PCAOB staff would be caught between a rock and a hard place as they serve dueling visions with each change in administration.²⁰²

III. INCENTIVIZE A FASB MODEL

Congress should incentivize the creation of an independently funded Public Auditing Standards Board ("PASB"). In doing so, Congress may forgo the negative consequences of the current PCAOB's standard-setting authority while avoiding the industry's capture of auditing standards that Congress sought to curb with the creation of the PCAOB.

A. FASB'S CONCEPTUAL FRAMEWORK

The accounting profession and the SEC oversaw FASB's formation in 1973 in response to calls from stakeholders for more uniform, consistent accounting standards.²⁰³ Since its formation, FASB's standards, collectively referred to as generally accepted accounting principles ("GAAP"), have served as authoritative standards for both private and public companies in the United States.²⁰⁴ Congress and the SEC viewed FASB as the

²⁰¹ See STRATEGIC PLAN 2022–2026, *supra* note 125, at 3–4.

²⁰² See generally David E. Lewis, *Presidential Appointments and Personnel*, 14 ANN. REV. POL. SCI. 47 (2011) (discussing presidential appointments' impact on policy output of government agencies).

²⁰³ *About the FASB*, FIN. ACCT. STANDARDS BD., <https://www.fasb.org/info/facts> [<https://perma.cc/D4MN-TD7Z>] (last visited Jan. 15, 2023).

²⁰⁴ *Id.*

authoritative standard-setter for public companies shortly following FASB's formation in 1973.²⁰⁵

The SEC previously vested accounting standard-setting authority in the Accounting Principles Board (“APB”) of the AICPA; however, pressure to improve accounting principles proved too much for the part-time APB.²⁰⁶ Perhaps the biggest nudge to improve private standard-setting came from the SEC's threat to issue its own accounting standards for public companies in 1970.²⁰⁷ In response, the AICPA formed the Wheat Committee in 1971 to study an alternative standard-setting body.²⁰⁸ The Wheat Committee recommended the formation of the Financial Accounting Foundation, which would oversee a subsidiary organization responsible for issuing accounting standards—FASB.²⁰⁹

One legal scholar described FASB as “a private standard-setter that simultaneously maintains its independence and achieves institutional stability while operating in a politicized context, *in the teeth of opposition* from its own constituents” (emphasis added).²¹⁰ The success of FASB's organizational model is remarkable. A private organization—mostly composed of accountants and former auditors—responsible for issuing accounting standards has largely maintained its independence from public and private influence alike.²¹¹ Although FASB has periodically faced allegations of politization and industry capture, Congress and the SEC have allowed FASB to retain accounting standard-setting authority for over forty years because of its ability to maintain independence.²¹²

²⁰⁵ Robert K. Herdman, Chief Accountant, Sec. & Exch. Comm'n, Testimony Concerning the Role of the SEC and the FASB in Establishing GAAP (May 14, 2002), <https://www.sec.gov/news/testimony/051402tsrkh.htm> [<https://perma.cc/3B2Q-4AD3>].

²⁰⁶ Stephen A. Zeff, *The Wheat Study on Establishment of Accounting Principles (1971-72): A Historical Study*, 34 J. ACCT. PUB. POL'Y 146, 147–50 (2015).

²⁰⁷ *Id.* at 149.

²⁰⁸ *Id.* at 151.

²⁰⁹ *Id.* at 172.

²¹⁰ William Wilson Bratton, *Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board*, 48 B.C. L. REV. 5, 8 (2007).

²¹¹ *Id.* at 7.

²¹² See e.g., Shana Clor-Proell & Brian White, *Congress Should Leave Accounting Standards to FASB*, ACCOUNTING TODAY: OPINION (May 18, 2020, 4:04 PM), <https://www.accountingtoday.com/opinion/congress-should-leave-accounting-standards-to-fasb> [<https://perma.cc/7YAE-F6PN>] (expressing how Congress and the Securities and Exchange Commission have allowed authority to remain with the FASB); but see Lynn E. Turner, *Repairing the US Financial Reporting System*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 17, 2021), <https://corpgov.law.harvard.edu/2021/06/17/repairing-the-us-financial-reporting-system/> [<https://perma.cc/33ES-W68E>] (criticizing FASB's lack of investor representation).

FASB sufficiently evades regulatory capture and political infiltration thanks to certain aspects of the organization's governance design. FASB's development of the "Conceptual Framework" was among the organization's first actions.²¹³ FASB initially designed the Conceptual Framework to channel the Board's future decision making.²¹⁴ Although it remains unclear whether the Conceptual Framework achieves its original purpose to channel FASB's decision making, the Conceptual Framework does make clear that FASB's standards are primarily designed to benefit the users of the financial statements, not the preparers.²¹⁵ In doing so, FASB created a healthy tension between its own interests and those of financial reporting managers.²¹⁶

Critics of FASB argue the organization maintains the conceptual framework to diffuse criticism and downplay suspicions of industry capture rather than to solely improve accounting standards.²¹⁷ The argument follows that FASB's resources are directed toward the development of unproductive and even deceptive conceptual frameworks, away from the development of reliable accounting standards.

This alleged practice of "conceptual veiling" is best demonstrated by FASB's modification to the Conceptual Framework in 2010, which removed the fundamental principle of "reliability" from the Conceptual Framework in exchange for "faithful representation."²¹⁸ Critics suggest FASB's primary motivation for the change was industry pressure to further enable fair market value accounting in lieu of the traditional, more conservative cost-method approach.²¹⁹

However, FASB and its proponents claim the change was motivated by a colloquial misinterpretation of the "reliability" principle as synonymous with principles of objective and precise measurement. FASB claims the initial intent of the "reliability" principle was more akin to the notion of "faithful representation", or information that is "complete, neutral and free from error."²²⁰

Regardless of FASB's motivation for changes to the Conceptual Framework, empirical evidence suggest FASB has largely maintained its

²¹³ Bratton, *supra* note 210, at 9.

²¹⁴ *Id.*

²¹⁵ FIN. ACCT. STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 1 at 1 (1978).

²¹⁶ *Id.*

²¹⁷ See Karthik Ramanna, *Unreliable Accounts: How Regulators Fabricate Conceptual Narratives to Diffuse Criticism*, SOC. SCI. RSCH. NETWORK (July 5, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3222559 [<https://perma.cc/6BWG-SNRQ>].

²¹⁸ *Id.* at 6, 8.

²¹⁹ *Id.* at 6–7.

²²⁰ *Id.* at 19–20.

independence both from political influence and industry capture.²²¹ Proponents of the “conceptual veiling” theory fail to recognize the peripheral benefits of conceptual narratives. Even if FASB’s Conceptual Framework fails to channel the decisions of the accounting standard-setter, the secondhand benefits significantly outweigh the perceived waste or negative “veiling” of the board’s ineffectiveness elsewhere.²²² The healthy tension between FASB and managers that is created by the Conceptual Framework’s core focus on the users of the financial statements strikes an appropriate balance between responsiveness to stakeholders’ concerns and independence from political influences and industrial capture.

Although this tension between FASB and preparers resulted in some political reversals of FASB’s decisions through Congressional or SEC action, the organization avoids allegations of industry capture.²²³ When preparers oppose a decision made by the FASB, they may petition Congress or the SEC to displace FASB in a particular area; however, the political influence remains in the political arena rather than amidst the standard-setting process.

Philosophical alignment with the SEC provides another benefit of the Conceptual Framework’s privileging of financial statement users over financial statement preparers.²²⁴ The SEC’s mission closely resembles FASB’s Conceptual Framework in that they both share an emphasis on the protection of users of the financial statements.²²⁵ This common focus provides FASB with “institutional stability, if not political invulnerability.”²²⁶

Independent, reliable funding is perhaps the most important feature of FASB’s structure that enables the standard-setter to maintain independence. Congress established the Accounting Support Fee to provide independent and recurring funding for FASB and the PCAOB.²²⁷ In doing so, auditing and accounting standard-setters are not dependent upon the accounting profession for funding, which is a departure from the status quo prior to Congress’ enactment of SOX.²²⁸

²²¹ See Bratton, *supra* note 210, at 25.

²²² Ramanna, *supra* note 217, at 8.

²²³ Bratton, *supra* note 210, at 9.

²²⁴ *Id.*

²²⁵ *Compare Our Goals*, SEC. & EXCH. COMM’N, <https://www.sec.gov/our-goals#:~:text=The%20SEC's%20long%2Dstanding%20tripartite,capital%20formation%2E2%80%94remains%20our%20touchstone> [<https://perma.cc/2UF2-W6GY>] (last visited Jan. 15, 2023), *with* FIN. ACCT. STANDARDS BD., *supra* note 215.

²²⁶ Bratton, *supra* note 210, at 9.

²²⁷ Sarbanes-Oxley Act of 2002 § 109(d)–(e), 15 U.S.C. § 7219.

²²⁸ *Id.*

B. PUBLIC AUDITING STANDARDS BOARD

Congress should incentivize the creation of a public company auditing standard-setting body to accompany FASB (accounting standards) and the AICPA's ASB (private company auditing standards). The FAF is well situated to expand its role as the parent organization of independent standard-setting bodies. The FASB model, as operated under the auspices of the FAF, has served the accounting profession, regulators, and the investing public for over forty years without permitting significant political or professional influence. Moreover, the FAF's mission (1) "to establish and improve *financial accounting and reporting* standards to provide useful information to investors and other users of financial reports" and (2) "to educate stakeholders on how to most effectively understand and implement those standards" aligns well with the purposes and mission of an independent *auditing* standard-setter.

Independence is a bedrock principle of auditing. Consequently, critics may argue that FAF's role in establishing accounting standards would prevent the FAF from independently establishing auditing standards through a subsidiary board, like PASB. Although auditor independence is largely focused on independence between the auditor and audit clients, the independence of the standards themselves may be compromised by a common parent organization. Consequently, Congress may incentivize the creation of an independent organization to oversee PASB. In fact, FAF was established to enable the creation of FASB.²²⁹ Although the FAF presents an efficient route for the creation of PASB, the independence between accounting standards and auditing standards may be better served through the creation of an independent organization to oversee PASB.

Regardless of whether the FAF oversees PASB, the auditing standard-setter should adopt a guiding set of principles, like FASB's Conceptual Framework, that leverage the expertise of its members while maintaining independence from industry capture and political influence. PASB should focus its standard-setting activity on the interests of audit committees, investors, creditors, and other users of the financial statements rather than the interests of the auditor and the accounting profession. Such a framework could mitigate the likelihood of regulatory capture and political influence.

To further incentivize the creation of PASB, Congress could amend the Sarbanes-Oxley Act to enable the SEC's adoption of PASB's standards. Section 108 of the Sarbanes Oxley Act may serve as a template for such a provision as Congress delegated and reinforced FASB's

²²⁹ *About the FAF*, FIN. ACCT. FOUND., <https://www.accountingfoundation.org/aboutfaf> [https://perma.cc/AXM5-Z3UQ] (last visited Jan. 15, 2023).

authority to develop accounting standards for public issuers through Section 108.²³⁰ Moreover, Congress provided FASB with independent funding from Accounting Support Fees collected by public filers in accordance with Section 109 of the Sarbanes-Oxley Act.²³¹ FASB and the PCAOB currently share funding generated by the Accounting Support Fee.²³²

To ensure PASB's financial independence, Congress could redirect a portion of the accounting support fee from the PCAOB to the newly created PASB. If Congress chose to retain the PCAOB for inspection and enforcement purposes, the accounting support fee may be split among the PCAOB, FASB, and PASB. Alternatively, if Congress chose to dissolve the PCAOB's inspection and enforcement responsibilities into the SEC, FASB and PASB may share the accounting support fee. Additional funding may be necessary to accounting for the SEC's increased role in public company auditing oversight; however, the forgone duplicity of the current regime presents great cost-saving opportunities that may offset any increased cost to the SEC.

CONCLUSION

“A man's conscience and his judgment is the same thing; and as the judgment, so also the conscience, may be erroneous.”²³³ To be sure, auditors' conscience and professional judgment should be trusted. Just as society relies upon engineers to design bridges and doctors to cure disease, public accountants have proven themselves as reliable, trustworthy experts in assurance services. However, history has demonstrated that these qualities alone are insufficient to ensure reliable public company audits. An appropriate balance must be struck between protecting investors, avoiding industry capture, and evading political influence.

The current structure of the PCAOB has proven too flawed and malleable for Congress to entrust with auditing standard-setting authority. The lack of expertise and unproductivity of the PCAOB's standard-setting authority has indirectly resulted in industry capture of public company auditing standards that Congress sought to avoid. Moreover, the overly prescriptive nature of standards the PCAOB has issued threatens the quality of public company auditing in the United States. The patterns of politically motivated, wholesale dismissal of the PCAOB at the behest of the SEC has further created uncertainty and pendulum swings in the PCAOB's standard-setting philosophy. The resulting friction in the

²³⁰ Sarbanes-Oxley Act of 2002 § 108, 15 U.S.C. § 7218.

²³¹ *Id.* at § 109.

²³² *Id.*

²³³ THOMAS HOBBES, *LEVIATHAN* 311–12 (Lerner Publishing Group, Inc. 2018) (1651).

auditors' fieldwork risks the integrity of auditing standards and, as a result, the integrity of capital markets.

In response, Congress should incentivize the creation of a private, independent standard-setting authority, the Public Auditing Standards Board. By leveraging the success of FASB's Conceptual Framework, PASB could avoid industry capture and evade political influence while serving the best interests of financial statement users.

