

**Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB's Proposal on *Firm Reporting***

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

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**SUMMARY:** On April 9, 2024, the Public Company Accounting Oversight Board (the Board or PCAOB) issued a request for comment on its proposal *Firm Reporting* (PCAOB 2024). This comment letter summarizes the views of the participating members of the Auditing Standards Committee of the Auditing Section of the American Accounting Association. We commend the PCAOB for its efforts to promote audit firm transparency. Our comments include overall observations and perspectives on the Board's economic analysis.

# **Comments of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB's Proposal on *Firm Reporting***

## **I. INTRODUCTION**

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide feedback on the Public Company Accounting Oversight Board's (PCAOB's) proposal on *Firm Reporting* (PCAOB 2024). This comment letter summarizes the participating committee members' observations on the PCAOB (2024) proposal.<sup>1</sup> Our comment letter is organized as follows: Section II presents a discussion of our overall observations; Section III provides perspectives on the PCAOB's economic analysis; and Section IV offers a conclusion to the comment letter.

## **II. OVERALL OBSERVATIONS**

We commend the PCAOB for its efforts to promote audit firm transparency. Our overall observation with respect to firm reporting is a question about where this ultimately may be headed. Some statements in the Proposal about possible PCAOB use of firms' financial statements give us pause, as we wonder, "Are we moving closer to the PCAOB influencing / controlling audit firms' investing and operating decisions, or even heading toward minimum capital requirements or de facto government auditing?"

First, we highlight the following from page 26 of the Proposal:

This financial information would provide a baseline from which the PCAOB can understand a firm's ability to invest in technology and personnel, and/or generate profit within a specific service line.

This statement could be interpreted as a move toward PCAOB influence over firms' resource allocation decisions. Is this the ultimate intent?

Second, we note the following from page 26:

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<sup>1</sup> We use or adapt certain language from the PCAOB (2024) proposal in our comments.

An assessment of audit firm resources would enable the Board to understand a firm's capacity to withstand risks associated with events such as a firm's break up, court judgments against the firm, or threats to global networks or other affiliates that may require the firm's support.

This statement could be interpreted as a move toward PCAOB requirements for firms to maintain minimum capital levels. Further clarification about the ultimate intent would be helpful.

Third, we consider the following from page 26:

The proposed financial information would inform the PCAOB's inspection function by providing a baseline understanding of a firm's operations, the resources devoted to its audit practice, and its focus and incentives.

It is unclear to us how PCAOB inspections would change in response to this information. Since financial statements will be required for the largest firms that are already required to be inspected annually, it does not seem that this information would result in a change in the frequency of inspections. Is the PCAOB proposing to increase the number of inspection selections, or the intensity of inspections, in response to firm financial statement information?

Finally, the proposal suggests that access to firms' financial statements will inform the PCAOB's efforts in various areas, including "enforcement activities." Does this mean the PCAOB might impose regulatory sanctions on firms that do not make the types of investments the PCAOB desires? We suggest clarifying how firm financial information could inform enforcement activities.

Overall, the firm reporting proposal is one element of increasingly vigorous and costly oversight of public company auditors. With PCAOB registration, standard setting, inspections, enforcement, proposed firm and engagement metrics, and proposed firm reporting, all indications are that PCAOB oversight of the auditing profession is increasing at a rapid rate. While we fully support high quality audits and effective oversight of auditors, we believe that the PCAOB needs to be cognizant of potential risks of over-regulating. For example, over-regulating can have a

detrimental effect on the attractiveness of an auditing career, and on the ability of smaller and midsized firms to maintain active practices within the public company audit marketplace. We encourage the Board to be clear about its ultimate intended degree of influence or even control over the operations of audit firms.

### **III. PERSPECTIVES ON THE ECONOMIC ANALYSIS**

We commend the PCAOB for its efforts to strengthen its evaluation of the economic impacts of its proposals. PCAOB and Securities and Exchange Commission (SEC) policies suggest that an economic analysis is central to the justification of any proposed rule, and therefore it should be presented in any proposal. Further, policies indicate that the PCAOB has the burden of proof on the economic analysis. Thus, we are concerned that there is no numerical economic analysis related to the proposed firm reporting standard, especially its costs and benefits. Of particular concern is that in addition to the missing numerical analysis, certain questions suggest that the PCAOB expects other parties to provide such data. For example, in Question 62, the proposal asks:

Are there any quantifiable costs? If yes, please: (i) identify them; (ii) describe a methodology to quantify them; (iii) explain why the methodology is appropriate and relevant to the proposal; and (iv) direct us to any studies or data on which the methodology relies.

The missing numerical data is of particular concern as the PCAOB has conducted inspections for over 20 years. It is reasonable to expect that the PCAOB has collected a significant amount of data which it has evaluated when selecting and reviewing engagements.<sup>2</sup> Such data could plausibly be used to provide a more complete summary of the baseline required in the economic analysis policies. Further, the inspection program is mature and extensive; it would be surprising if the PCAOB does not already collect the information identified in the current request.

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<sup>2</sup> In 2023, the PCAOB inspected 227 audit firms in 37 jurisdictions, reviewing nearly 900 audit engagements (PCAOB 2023).

Illustrations could be developed that maintain the confidentiality of the issuer yet demonstrate how such information would be used, along with estimates of the related costs. Such illustrations or “field testing” could identify those instances where “context matters” (Ho 2024).

#### **IV. CONCLUSION**

We appreciate the opportunity to provide our perspectives and comments on the PCAOB (2024) proposal, and we commend the PCAOB for its continuing efforts to promote audit quality by enhancing firm reporting. Our comments in this letter included overall observations and perspectives on the Board’s economic analysis.

## REFERENCES

- Ho, C. 2024. *Statement on the Firm and Engagement Metrics Proposal - Helpful or Harmful to Investors?* Washington, DC: PCAOB. <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-the-firm-and-engagement-metrics-proposal---helpful-or-harmful-to-investors>
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