June 7, 2024

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

Via email: comments@pcaobus.org

Re: **PCAOB Rulemaking Docket Matter No. 041 – Firm and Engagement Metrics**

Dear Members of the Public Company Accounting Oversight Board (PCAOB):

We appreciate the opportunity to comment on the PCAOB's proposal to amend its rules and reporting forms to require the reporting of specified firm-level metrics on new Form FM, *Firm Metrics*, and specified engagement-level metrics on an amended and renamed Form AP, *Audit Participants and Metrics* (Proposal).

We conduct original archival research that examines how staffing leverage is linked with audit quality and the cost of providing audits, which we believe offers insights into the PCAOB's proposed metrics on partner and manager involvement.

In the rest of this letter, we summarize the findings from our research, highlight the connections between our findings and the Proposal, and answer specific questions posed by the PCAOB in the Proposal.

Research Findings

A current version of our research, titled "*Manager Staffing Leverage at the Audit Office and Audit Quality*," can be found at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4856541. Please see our research paper for a full description of our research methodology and findings.

We examine the relation between staffing leverage and audit quality and other measures related to the cost of audits. We measure manager staffing leverage at the audit-office level as the ratio of auditors in the office that are managers and above (i.e., managers, senior managers, principals, partners, and similar) to total auditors. This gives us a measure of the percentage of the auditors in an office that are managers and above. As this measure increases, the availability of managers and above to oversee audits and less experienced staff increases. We prefer measuring at the audit-office level because audit offices maintain control of many relevant staffing decisions (e.g., staffing levels, engagement assignments) that factor into staffing leverage and because audit offices are core functional units of audit firms (e.g., Bills et al. 2016; Christensen et al. 2021). Office level is also the finest level of detail at which we can measure staffing leverage using publicly available data. Our analysis is limited to U.S. audit offices performing audits of public filers.

We find a negative association between manager staffing leverage and restatements, which serve as our primary measure of audit quality. That is, we find that offices with higher ratios of auditors in positions of manager and above to total auditors produce higher audit quality. When we disaggregate manager and above staffing leverage into manager-only leverage versus partner leverage, we find that the associations with our measures of audit quality are limited to manager-only leverage. However, the coefficients between the manager-only leverage and partner leverage are not statistically different from one another. We also find that the relation between manager and above staffing leverage and audit quality varies with client and office characteristics in expected ways. Specifically, the relation is concentrated in important clients, as measured by audit fees, and in complex clients, as measured by accounting reporting complexity based on XBRL tags. With regard to office characteristics, the relation is concentrated in offices with higher levels of growth in audit fees and in offices that are rated better for compensation and career opportunities.

To match the Proposal's firm-level metric, we also measure staffing leverage at the firm level and find that increased manager and above staffing leverage is linked with higher audit quality, consistent with our client-level measures of audit quality. Specifically, manager and above staffing leverage at the firm level is associated with fewer restatements in client-level analyses. Moreover, it is negatively associated with firm-wide measures of audit quality, such as PCAOB inspection findings.

With regard to costs, manager and above staffing leverage is associated with higher audit fees and longer lags between a client's fiscal year-end and audit report date. These findings indicate that higher manager and above staffing leverage comes with some additional costs, such as higher fees and slightly longer audits.

Overall, we conclude that staffing leverage ratios measuring the presence of audit managers and partners to total auditors can serve as salient indicators of audit quality.

Connections Between our Research Findings and the Proposal

Given that staffing leverage ratios can serve as audit quality indicators, we believe requiring their reporting would provide valuable information to investors, audit committee members, and other stakeholders, by allowing them to better assess audit quality. As such, we believe that requiring manager and partner involvement metrics would advance investor protection and promote the public interest by enabling stakeholders to make better-informed decisions, promoting auditor accountability and ultimately enhancing capital allocation and confidence in our capital markets as sought by the Proposal.

Although we use publicly-available data, we note that the collection of these data to measure staffing leverage may be tasking as it involves advanced data collection techniques that are not easily replicable for most investors, audit committees, and other stakeholders. We also note that firm-provided metrics would possibly be more accurate since our data rely on auditors who self-disclose their employment history in their publicly-visible professional profiles and that we are not able to measure staffing leverage at the engagement level because of this.

Response to Question 1: ***Would the proposed metrics, individually or collectively, provide useful information for investors, audit committees, or other stakeholders? Why or why not? How would stakeholders use the metrics?***

We believe the proposed metric on manager and partner involvement will provide useful information to investors, audit committees, or other stakeholders because it would provide a salient indicator of audit quality, according to our research on staffing leverage.

A growing accumulation of academic research supports that auditor human capital inputs to audit production are crucial to audit quality (e.g. Hoopes et al. 2018; Christensen et al. 2021; Gipper et al. 2021). We note that the Proposal regularly cites such research. In this letter, we only attempt to highlight a new finding relevant to the proposed metrics on manager and partner involvement that is not currently well studied using U.S. data.

Response to Question 18: ***Are the proposed descriptions and calculations of the firm-level and engagement-level metrics for partner and manager involvement clear and appropriate? If not, why not?***

The proposed descriptions and calculations for partner and manager involvement are clear. Our research also finds they would likely be useful to investors, audit committee members, and other stakeholders in evaluating audit quality through staffing, a major input to audit production. Thus, we believe they would also be appropriate.

However, we caution that the PCAOB should consider what it is trying to capture with the measure. Focusing on audit hours that directly went into audit engagements would provide the most accurate view of direct audit production. However, it would exclude many auditors in functions that indirectly support audit production. It is common for auditors, especially managers through partners, to serve in support functions through roles such as reviewing new regulator standards and updating a firm's audit methodology in response to new standards. Roles such as these are typically referred to as "national office," "professional practice development," and similar. As currently constructed in the Proposal, such roles, which likely support audit quality, would be excluded from the calculations. Their inclusion could be beneficial in firm-wide measures of manager and partner involvement.

Response to Question 19: ***Would it be helpful to separate the calculations for partner involvement and manager involvement? Why or why not?***

Our research shows there may not be much potential benefit to separating partner involvement from manager involvement. Although we find that the results are statistically significant for manager-only leverage when we disaggregate our staffing leverage measure, the differences in the coefficients on manager-only leverage versus partner-only leverage are not statistically different, indicating that the aggregate measure may be the most meaningful for assessing audit quality.

Response to Question 21: ***Instead of partner and manager involvement, should firms disclose partner and manager hours compared to staff hours on the audit (i.e., a staffing leverage ratio)? If so, why?***

As discussed in the Proposal, it is theorized that manager and partner involvement affects audit quality through their ability to properly oversee the audit and audit personnel, who play an integral role in the audit process. As such, we believe that disclosing a staffing leverage ratio, which scales manager and partner involvement relative to total audit staffing, would communicate additional information on manager and partner involvement beyond solely disclosing manager and partner hours.

We sincerely appreciate the opportunity to comment on the Proposal.

Respectfully,

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