Will SEC Pressure Shift the PCAOB's Standard-Setting Priorities?

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by Soyoung Ho

For much of the PCAOB's 12 years of existence, it had a largely cooperative working relationship with the SEC.

By 2014, the cooperation had badly frayed. At the AICPA's yearly December Conference on Current SEC and PCAOB Developments in Washington, the recently installed SEC chief accountant, James Schnurr, publicly criticized the PCAOB for its slow progress on standards related to audit quality.

"I have questioned what might be the root cause or causes with respect to the PCAOB standard-setting process," Schnurr said.

Schnurr later said the SEC was "supportive of the PCAOB's work on the many important projects on its standard-setting agenda."

Long before the differences between the two regulators flared into the open, it was clear that SEC officials were frustrated with the PCAOB's work on some rules that had stirred up a harsh backlash from the major audit firms. Entering into 2014, it became clear that the project the audit firms objected to the most, the plan to write a standard imposing a mandatory rotation of audit firms, had come to a standstill.

A second effort to publicly identify the lead audit partner on a client engagement is moving forward, but it has taken several years because of the audit profession's opposition. The PCAOB plans to ask for an extra round of public comments on the December 2013 proposal in Release No. 2013-009,*Improving Transparency Through Disclosure of the Engagement Partner and Certain Other Participants in the Audit.* Auditors are concerned the rule may lead to a heightened exposure to shareholder lawsuits if disclosed in the auditor's report, and the PCAOB believes that some of the risk can be eased by having the disclosure made separately on a new form created specifically for the disclosure rule.

Schnurr called the separate disclosure form "a good idea" because it balances the different views on the issue.

The PCAOB also hopes to move closer to a final standard based on the 2013 proposal in Release No. 2013-005,*Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments.* It's expected that expanded auditor reports will include a discussion of the "critical audit matters" that were uncovered during the review the client's financial reports.

Investors supported the PCAOB projects to get auditors to increase the amount of information they publicly disclose, and as the projects developed, they drew from a long history of staff research. In 2008, the Treasury Department's Advisory Committee on the Auditing Profession (ACAP) recommended that the PCAOB require the engagement partner's signature on the auditor's report to improve accountability among audit firms. The panel also said the PCAOB should expand the auditor report section of regulatory filings to make it more useful for investors. Some panel members believed the measures would promote audit quality.

But audit firms have never endorsed the rotation and have successfully sought to weaken the disclosure projects, despite becoming subject to similar rules overseas.

The criticism SEC staffers lobbed at the PCAOB largely reflected the audit firms' frustrations and had the backing of SEC Chair Mary Jo White, who told *Accounting & Compliance Alert* that the audit regulator needed to focus more effort on standards related to the specifics of audit work.

PCAOB Chairman James "Doty has said that it's something that should be speeded up along with the other undertakings they have," White said.

"The issue really has been one of whether they are working on the right projects," said Dennis Beresford, a former FASB chairman and now a professor of accounting at the University of Georgia. "Some of the people at the SEC questioned whether they were spending too much [time on disclosure projects.] Those are not what some call nuts and bolts of basic auditing type activity."

When the PCAOB was established by the Sarbanes-Oxley Act of 2002, it adopted the existing AICPA standards on an interim basis with the intent of reviewing each standard for permanent adoption, revision, or replacement.

“They’ve kind of gotten away from that process [and] never really completed that task,” said Daniel Goelzer, a partner with Baker & McKenzie LLP and an original member of the PCAOB until 2012, including 18 months as acting chairman.

Still, the PCAOB has plenty of support for its initiatives.

“You could easily argue the big improvement that’s necessary now is improving transparency and communication,” said Douglas Carmichael, a former chief auditor with the PCAOB and now a professor at Baruch College. “I haven’t seen any good reason stated why it would be important not do those and do particular performance standards.”

Moreover, Carmichael doesn’t believe auditors and their clients are clamoring for updated performance standards, and he doesn’t think the PCAOB has been particularly slow in updating them because the board needed time after its formation to get established. In 2010, the board published a series of eight standards in Release No. 2010-004,*Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards,* which were necessary before it could proceed on to the performance standards.

“It takes time for people to assimilate those things in practice,” Carmichael said. “You don’t want to inundate auditors with changes in performance standards.”

Goelzer believes that the recurring problems in audit work uncovered in the PCAOB’s inspections would be addressed if the audit performance standards are updated. But others, including Joseph Carcello, an accounting professor at the University of Tennessee in Knoxville, and a member of the PCAOB’s Investor Advisory Group, believe the problems uncovered in the inspections have more to do with poor compliance with existing standards and not a weakness in the standards themselves.

Carcello believes the tension between the SEC and the PCAOB is nothing new, and that there were some previous rulemaking disagreements between the agencies that had a major effect on financial reporting and auditing.

“It just came out in the open now,” he said.

After the PCAOB published Auditing Standard (AS 2) AS No. 2,*An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements,* to establish the requirements for complying with Section 404(b) of Sarbanes-Oxley, it was frequently criticized for issuing a standard that forced auditors to undertake an excessive amount of work and imposed heavy costs on clients. By 2007, the SEC amended its Section 404 guidance, and the PCAOB replaced AS 2 with AS 5,*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.* In the eight years since AS 5 was issued, auditor complaints about Section 404(b) compliance have largely died down.

How the SEC and PCAOB ultimately address the standards for audit work still has to be determined.

When Sarbanes-Oxley established the PCAOB, it also gave the SEC authority to appoint its members, approve its budget, and approve all its standard-setting decisions.

“Ultimately the SEC has to bless whatever the PCAOB comes up with, and the two agencies don’t always see eye-to-eye,” Carcello said. “I think that slows it down.”