

PCAOB Audit Regulation in a Historical Perspective: How the Regulatory Structure Has Changed

Kei OKAJIMA

Abstract

This paper reexamines the historical development from the traditional self-regulatory peer review system to the current audit regulation under the PCAOB in terms of regulatory structure. By using the congressional records the paper explores how a new regulatory system was designed, in particular, how the creation of a new regulatory body, namely, the PCAOB, charged with oversight of public companies audits was decided. Further, the paper finds out the structural features of the current regulatory system, and indicates structural flaws appearing in implementing the SOX Act.

Keywords: audit regulation; Public Company Accounting Oversight Board (PCAOB); Sarbanes-Oxley Act; self-regulatory system; Public Oversight Board; public regulation; peer review; PCAOB inspections

1. Introduction

This paper reexamines the historical development from the traditional self-regulatory peer review system to the present audit regulation under the PCAOB in terms of regulatory structure. The structure of the existing PCAOB audit regulation was established by the enactment of the Sarbanes-Oxley Act of 2002, which marked a significant milestone of audit regulatory history.

Audit researchers generally agree that this fundamental transition from self-regulation towards public oversight took place under a “fire-alarm” approach to regulation.¹ It is presumably apparent, as indicated below, that the discussions for regulatory reform proceeded in terms of what type of regulatory structure should be selected in order to restore the public confidence rather than how regulatory system could be improved to overcome the deficiencies or limitations in the previous system.

1 Kinney [2005], pp.104-105; Palmrose [2013], pp.775-776. McCubbins provides the theoretical model of regulatory choices, assuming that Congress choose either of two different policies, a centralized oversight policy (“police-patrols”) or a decentralized oversight policy (“fire-alarms”) (McCubbins and Schwartz [1984]; McCubbins [1985]). According to his works, congressmen tend to prefer a decentralized oversight policy to be more effective and efficient.

Historically, in response to the congressional hearings in the mid-1970s, in 1977 the American Institute of Certified Public Accountants (AICPA), in consultation with the Securities and Exchange Commission (SEC), created a voluntary self-regulatory framework consisting of the SEC Practice Section with an independent Public Oversight Board to oversee the activities of the SECPS (especially, peer review program), and monitor and comment on matters that affect public interest in the integrity of the audit process. The POB was composed of five public members with a broad spectrum of business, professional, regulatory, and legal experience that represent the public interest. Although the SEC had no formal authority over the profession's self-regulation, but it claimed its oversight role to the POB.

The fundamental conception under which the profession's self-regulatory system had sustained for a long time, was the following view of Robert Mautz on self regulation:

Generally, self-regulation is perceived as more equitable than public regulation because the standards to be met are established and enforced by fellow practitioners whose experience provides an understanding of the environment, the risks, the pressures and the possibilities of service that laymen neither comprehend nor understand. Self-regulation, if performed properly, also assures better service to the public because its emphasis is on remedy and improvement and because it is in closer touch with practice, more aware of changing needs, and more responsible to wants of those who use the service than any other form of regulation can be.²

The profession's self-regulatory system had remained unchanged through 2001, but was subject to criticism outside the profession in some occasions. Ultimately, the Enron debacle in 2001 triggered the arguments for structural change of audit regulation.

2. The Enron Scandal and Reform of the Regulation of the Audit Profession

2.1. Background to calls for regulatory reform

Over the years, the regulation of the audit profession had been an enduring concern. Even in the 1980s and in the 1990s several attempts were made to reconsider the existing regulatory system from the viewpoint of improving audit quality, but these proposals did not resulted in a drastic reform of audit regulation.³ However, in the face of fraudulent accounting of the Enron Corporation and consequent audit failure therein, revealed at the end of 2001, Congress and the SEC came to be propelled to take further steps for restoring investor confidence by increasing corporate accountability, strengthening corporate governance, and improving transparency and reliability of audited financial reporting.

2 Mautz [1983], p. 78. See also Public Oversight Board [1984]. Professor Mautz was appointed as POB member in January 1981, and served on the POB for fifteen years.

3 Dingell Hearings [1986]; National Commission on Fraudulent Financial Reporting [1987]. More recently, the 2000 Panel on Audit Effectiveness comprehensively considered the status of self-regulatory system and made various recommendations for strengthening the accounting profession's governance system (see Public Oversight Board [2000], Chapter 6).

During the period between January and April, the House and Senate committees embarked on comprehensive examinations regarding the issues raised by the Enron and other scandals. In the Senate, among others, the Committee on Banking, Housing, and Urban Affairs chaired by Paul Sarbanes held ten hearings with regard to the issues of accounting and investor protection in the period from February 12 to March 21. The issues then considered were divergent, including the integrity of certified financial audits, appropriate accounting principles and auditing standards, the effectiveness of the accounting regulatory oversight system, the importance of auditor independence for the quality of audits, conflicts of interest and the compromise to auditor independence raised by accounting firms' increased offerings of consulting services to audit clients, the completeness of corporate disclosure in SEC filings and shareholder communications, and so forth, but the major theme was on auditing standards and oversight of independent auditors. On the other hand, in the House of Representatives, the Committee on Financial Services chaired by Michael Oxley in response to submission of the Corporation and Accountability, Responsibility, and Transparency bill (H.R.3763; the Oxley Act), held hearings to discuss and consider that bill on March 13, 20, and April 9. Eventually, within a half year, more than thirty related bills were introduced and finally resulted in the enactment of the Sarbanes-Oxley Act, regarded as a legislative milestone.

2.2. Dissolution of the Public Oversight Board

Shortly after revelation of the Enron debacle, SEC Chairman Harvey Pitt made the formal statement as to reform of the regulation of the audit profession, including its proposal for creating a new auditor oversight body, stating in particular:

... there is a need for reform of the regulation of our accounting profession. ... given the enormous – and appropriate – attention being focused on the role of accountants in some of these corporate failures over the last decade, we have taken the initiative to begin the process of restructuring the regulatory system that governs the accounting profession. ... Toward that end, even before Enron's collapse, we called upon the accounting profession to work with us to resolve its vulnerabilities and weaknesses. ... The profession has shown great willingness to work with us to produce a better regulatory system. ... In our vision, this system must at heart be a tough, no-nonsense, fully transparent disciplinary system, subject to independent leadership and governance. In addition, there must be regular monitoring of the ways in which accounting firms perform their responsibilities, and the areas in which either individual firms or the profession as a whole, can improve. ... We initially envision a new body dominated by public members, with two primary components – discipline and quality control. ... We are at the early stages of this proposal, and many details remain to be worked out. The SEC will carefully review this and other proposals regarding a system of public sector regulation to ensure that it addresses our concerns with the current system.⁴

4 Public Statement by SEC Chairman: Regulation of Accounting Profession, January 17, 2002.

After a few days, Chairman Pitt explained, in a responding letter to Charles Bowsher, then Chairman of the POB: “[t]he preliminary proposal, which I introduced last Thursday [i.e. January 17], envisions a Public Accountancy Board *outside the AICPA*. This new Board would have direct involvement, not just oversight, of two important functions: auditor discipline and quality control monitoring. ... Nothing I said on Thursday, or since, was in any way intended to suggest that the POB had no role to play. Indeed, my proposals were intended to strengthen the body that will be our “new” POB, insure its independence from the AICPA, and expand its mandate.”⁵

In the other hand, on 20 January 2002, the POB unanimously resolved termination of its own existence, effective March 31, 2002, “with recognition of the obstacles to achieving this goal [i.e. effective self-regulation].”⁶ Regarding the background behind it, POB Chairman explained in his testimony before the Senate Committee on Banking, Housing Urban Affairs as follows: “[the Pitt’s] plan was worked out in private talks between the SEC and the AICPA and the Big 5 accounting firms, with no input from the POB, which repeatedly had been assured that would be consulted. This new proposal effectively rendered the POB a lame duck. The POB believed it could not oversee the activities of accounting profession under the circumstances, and that it would mislead the public to appear to do so.”⁷ Thus he emphasized that the POB’s decision to voluntarily dissolve itself was taken as “a matter of conscience and principle.”⁸

In addition, Bowsher submitted the POB’s white paper, entitled *The Road to Reform* prior to his hearing before the Senate Banking Committee, wherein the problems inherent in the current self-regulatory system were identified.⁹ First, the funding of the POB was subject to control through the SECPS by major accounting firms. Indeed the POB was compelled to cease its special reviews of public accounting firm’s performances of quality controls about independence to be conducted in early 2000, due to the decision of the SECPS to cut off funding of the POB’s special reviews requested by the SEC. Second, the disciplinary system was not timely and ineffective. As the 2000 Panel on Audit Effectiveness had indicated, disciplinary proceedings were deferred while litigation or SEC regulatory proceedings were in process. This resulted in years of delay and made sanctions not meaningful. Third, monitoring of accounting firms’ practices by the peer review process was broadly viewed as ineffective. So the peer review process lost credibility because it was perceived as being “clubby” and not sufficiently rigorous. Lastly, the peer review team did not examine the work of an audit that was under investigation or in litigation.

Conclusively the POB left the following last message in this paper:

5 Letter from Harvey Pitt to Charles Bowsher dated January 22, 2002, reproduced in Sarbanes Hearings [2002b], p. 994. Italics added. Bowsher was a former Comptroller General of the United States (his terms of office was from 1980 through 1996).

6 Resolution passed by the Public Oversight Board on January 20, 2002, reproduced in Sarbanes Hearings [2002b], p. 961.

7 Bowsher’s testimony, Sarbanes Hearings [2002b], p. 898.

8 Sarbanes Hearings [2002b], p. 973. Decision of the POB to terminate its activities seemed unexpected for Chairman Pitt. On January 31, he commented that “I am very disappointed by the Public Oversight Board’s announcement today that it will not reconsider its January 20 decision to terminate its existence by March 31, 2002.” (Sarbanes Hearings [2002b], p. 995)

9 POB [2002], pp. 981-982.

In the end ... it became very apparent to the POB that real reform will take place only when the Congress requires it through legislative action. ... In the wake of the Enron debacle, the POB, acting as the “conscience and critic” of the profession, strongly believes that *to protect investors and the public, the old system of voluntary self-regulation for the accounting industry must be replaced*. While many will urge that Congress act with caution and that the profession be again given the opportunity to fix the present system with marginal changes, the POB believes it is time to resist the continuation of the status quo and move ahead with fundamental change.¹⁰

Ironically the POB itself, which was charged with oversight role within self-regulatory system of the accounting profession, reached the conclusion that it could not maintain the existing self-regulatory system any more, and therefore it should terminate its own activities and replaced itself with another oversight body. Although the POB was expected to play an independent oversight role, it chose the way of ceasing to its activities (In fact, the POB continued to remain by the end of April).

3. The Sarbanes-Oxley Act of 2002 and the PCAOB

The Sarbanes-Oxley (SOX) Act prescribes creation of the Public Company Accounting Oversight Board (PCAOB) “to provide for more effective oversight of the part of the nation’s accounting industry that audits public companies.”¹¹

The SOX Act designates the PCAOB to be incorporated under the District of Columbia Nonprofit Corporation Act. It is not legally an agency or establishment of the federal government but a private sector corporation. Thus, it is not subject to requirements of the Administrative Procedure Act.¹² Notwithstanding, the PCAOB is situated under the oversight by the SEC. The PCAOB is subject to SEC oversight and review to assure that PCAOB’s policies are consistent with the administration of the federal securities laws, and to protect the rights of accounting firms and individuals to its jurisdiction. And the SEC is also conferred general oversight authority including its approval for the PCAOB rules or other regulations, appointments of PCAOB member, and its budget.

From the beginning of discussions, the opinion that restructure of the regulatory system was necessary predominated, but it was at the last phase of legislative process in June that creation of a new organization as the form of the PCAOB was incorporated in the bill. On June 18, the Senate Banking Committee considered the Public Company Accounting Reform and Investor

10 POB [2002], pp. 991-992. Italics added.

11 *Public Company Accounting Reform and Investor Protection Act of 2002: Report of the Committee on Banking, Housing, and Urban Affairs* (Senate Report 107-205), p. 4. Especially, “Title I reflects significant portions of S. 2004, authored by Senators Dodd and Corzine, as well as the terms of an amendment offered at the Committee’s June 18 mark-up by Senator Enzi, which was adopted by voice vote.”

12 It is arguable that one of the reason that the POB was formally established as a private sector organization was “to release [it] from the administrative burdens of a federal agency.” (Löhlein [2016], p. 29)

Protection bill (S. 2673; the Sarbanes bill) including creation of the PCAOB, and voted 17-4 to report that bill to the Senate for consideration.

Already Senators Christopher Dodd and Jon Corzine, members of the Sarbanes Committee had submitted their bill (S. 2004), which proposed the Independent Public Accounting Board with responsibility of oversight of auditors.¹³ Prior to consideration of the Sarbanes bill, this Dodd-Corzine bill had been the only proposed bill submitted to the Senate regarding auditor oversight body.

In any event, at the Sarbanes Committee's hearings, leading to the enactment of the SOX Act, held during the period from February to March, there was prevalent for the opinion that a drastic change for the self-regulatory system by the accounting profession was needed. For instance, John Briggs, a former POB member and then Chairman and CEO of TIAA-CREF recalled the POB attempting "to oversee a bewildering array of monitoring groups."¹⁴ Also Shaun O'Malley who chaired the 2000 Panel of Audit Effectiveness, testified: "[t]he profession's combination of public oversight and voluntary self-regulation is extensive, Byzantine, an insufficient. The Panel found that the current system of governance lacks sufficient public representation, suffers from divergent views among its members as to the profession's priorities, implements a disciplinary system that is slow and ineffective, lacks efficient communication among its various entities and with the SEC, and lacks unified leadership and oversight."¹⁵

Most of the witnesses supported for creation of a new independent body charged with more effective oversight of the auditors. According to the Senate Report, twenty witnesses emphasized the need for a strong Board to oversee the public companies auditors.¹⁶ Among others, Paul Volcker, former Chairman of the Federal Reserve Board and then Chairman of the Trustees of the International Accounting Standards Committee, argued: "[h]igh-quality standards and improved audit practices should go a long way toward enforcement. However, there are areas where it may be difficult or impossible for any one firm to proceed alone. Hence, there is a need for official regulation. The United States has the framework for regulation and enforcement in the SEC. Over the years, there have also been repeated efforts to provide oversight by industry or industry/public member boards. By and large, I think we have to conclude that those efforts at self-regulation have been unsatisfactory. Thus, experience strongly suggests that governmental oversight, with investigation and enforcement powers, is necessary to assure discipline."¹⁷

And the POB last Chairman Bowsher, as well as a former POB member and with the past career as SEC Commissioner, Aulana Peters, and a former POB member Briggs also made simi-

13 Under SEC oversight, the IPAB shall inspect audit firms annually, review selected audit engagements, and issue a public report on its findings. Public accountants who performed audits must register with the IPAB. The IPAB is similar with the PCAOB under the SOX Act in that it has regulatory authority of promulgating auditing and quality control standards and that its funding is financed by registration fees and annual dues collected from registered firms.

14 Sarbanes Hearings [2002a], p. 376.

15 Sarbanes Hearings [2002b], p. 683.

16 Senate Report 107-205, p. 5.

17 Sarbanes Hearings [2002a], p. 145.

lar recommendations.¹⁸ These POB members emphasized that a new board should be created by statute to be given its authority adequately and firmly. And they shared the view that an organization should not rely on the accounting profession with regard to its funding. Several witnesses including the former POB members testified that in fact by cutting off the fund voluntarily collected the POB has been faced with difficulty in attempting its initiative concerning oversight of the auditors.

However, there were divergent opinions as to whether a newly created body should be private or public.¹⁹ Several witnesses clearly contended that it should be a private sector organization modeled after self-regulatory organizations such as the New York Stock Exchange or the National Association of Securities Dealers, Inc.²⁰ For instance, Robert Glauber, Chairman of the NASD testified: “if properly designed, a new private-sector regulator [could] make a major contribution by tapping industry resources and insights not available to the Government. To get the best of both worlds, however, these advantages should be matched with tough SEC oversight under watchful eye of Congress.”²¹ Conversely, some witnesses had the opinion that Congress should create a new federal governmental body for overseeing the public companies auditors, such as David Walker, the U.S. Comptroller General.²² Comptroller Walker presented the statement at his testimony to the effect that of the alternative structures ((1) a new unit within the SEC, (2) an independent government entity within the SEC, (3) an independent government agency outside the SEC, or (4) a non-governmental private sector entity overseen by the SEC), the GAO favored alternative (2) of creating an independent government entity within the SEC “as having a greater likelihood of success because the new body would be housed within the SEC and there, could receive administrative support from the SEC.”²³

Further, other witnesses agreed that the reform of the status quo of self-regulation system was necessary, but disagreed that Congress created the new regulatory organization, irrespective of whether it was situated in the private or public sector. Typically, former SEC Chairman Richard Breeden remarked: “[w]e have 70 years of experience. We do not need to go and invent another one. We need to invigorate the SEC and make sure it has the tools to do the job. Let’s not reinvent the wheel. Downstream from the SEC, private sector groups can be helpful.”²⁴

18 Peters argued that a new entity should “have a statutorily defined base of authority” (Sarbanes Hearings [2002a], p. 902) and that legislation should “clarify [the entity]’s ability to conduct operations by providing it with a permanent source of funding.” (*Ibid.*, p. 903) Biggs also stated: “We need something better for regulatory body. ... I believe the proposed entity needs more authority. And that authority can come only from Congress.” (Sarbanes Hearings [2002a], p. 377)

19 Nagy [2005], p. 997.

20 Testimonies of Glauber, John Coffee, Jr. (Columbia University of School of Law; Sarbanes Hearings [2002b], pp. 536-537), Joel Seligman (Washington University of School of Law in St. Louis; Sarbanes Hearings [2002b], pp. 532-533), and Michael Sutton (former Chief Accountant of the SEC; Sarbanes Hearings [2002a], pp. 194-195).

21 Sarbanes Hearings [2002b], p. 529.

22 At the hearings of House Committee on Financial Service (April 9, 2002), Walker urged the creation of “an independent statutory Federal Government body to oversee financial audits of public companies.” (Oxley Hearings [2002], p. 136)

23 Letter from GAO Comptroller General Walker to Senator Sarbanes, dated May 3 2002, reproduced in Sarbanes Hearings [2002b], p. 662.

24 Sarbanes Hearings [2002a], p. 37.

Most of them argued with direct regulation by the SEC on the condition that additional funds would be infused into the SEC.²⁵

4. The Structure of the PCAOB Audit Regulation

4.1. The PCAOB's authorities and functions

The SOX Act creates the PCAOB “to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors” (Section 101(a)). To accomplish that mission, under the SOX Act, the PCAOB must conduct four major regulatory functions – (i) registration of public accounting firms, (ii) rulemaking of auditing standards, quality control standards and other professional standards, (iii) periodic inspections of registered firms and (iv) investigations and disciplinary proceedings of registered firms.

(i) Registration of accounting firms

Accounting firms which audit the public companies must register with the Board (Section 102). It is unlawful for an unregistered firm to continue to audit public companies.

(ii) Auditing, quality control, ethics, and independence standards and rules

The PCAOB is authorized to establish or adopt auditing, quality control, ethics standards to be followed by the registered public accounting firms in preparing and issuing audit report (Section 103). These include auditing standards, the rules of conduct, independence standards, the quality control standards, and the attestation standards.

(iii) Inspections of registered accounting firms

The PCAOB are to implement the inspections of the operations of registered firms to assess that the registered firms, its partners, and employees comply with the statute, the PCAOB rules, and the other professional accounting standards (Section 104).²⁶ Initially, firms that audit more 100 public companies are to be inspected each year, and firms that audit 100 or fewer public companies are to be inspected at least every three years. During an inspection, the PCAOB is to review particular audit engagements of a firm, and the firm's general quality control systems and policies.

(iv) Investigations and disciplinary procedures

The PCAOB is given the power to conduct investigations, and bring disciplinary actions concerning public accounting firms or associated person thereof, when not complying with the SOX Act, the PCAOB rules, the SEC rules and other professional standards in regulating the audits of public companies and broker-dealers (Section 105).

25 Testimonies of Robert Litan (Brookings Institutions; Sarbanes Hearings [2002b], p. 874), Walter Schuetze (Chief Accountant of the SEC; Sarbanes Hearings [2002a], p. 208), and Arthur Wyatt (former Chairman of Auditing Standards Executive Committee; Sarbanes Hearings [2002b], p. 745).

26 The Senate Report explicates that “a program of inspections is essential to identify problems in firm procedures, training, and “culture” before those problems can produce audit failures that trigger large investor losses and threaten confidence in the capital markets.” (Senate report 107-25, p. 9)

4.2. The formative days of the PCAOB

Following the enactment of the SOX Act, the PCAOB was incorporated under the District of Columbia Nonprofit Corporation Act in 2002 October. As starting members, Charles Niemeier (former Chief Accountant of the SEC Enforcement Division), Bill Gradison (former Congressman), Kayla Gillan (former general counsel of the CalPERS), and Daniel Goelzer (former General Counsel of the SEC) were appointed and they proceeded with the structural installment of its organization.²⁷ In 2003 April, the SEC formally certified that the Board possessed the capacity to meet the requirements of the SOX Act. Thereafter in 2003 June William McDonough, ex-president of the Federal Reserve Bank of New York was assumed as the first PCAOB Chairman.

In 2004 June, one year after the start of the Board activities, the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises held a hearing to review the developments in the PCAOB. The witness of this day was McDonough alone. At first, Committee Chairman Oxley spoke the words of praise, saying “[i]n his brief tenure, [PCAOB] Chairman McDonough has transformed the board, the centerpiece of Sarbanes-Oxley, into a rigorous, effective and highly respected overseer of public accounting firms. ... The PCAOB has been a vast improvement in accounting industry regulation.”²⁸

The mandatory governmental inspections of registered firms which were introduced as “a very effective tool to restore [public] confidence”²⁹ was ready to commence from the period of 2004 May, and prior to the regular implementation in its fiscal year of 2003 the PCAOB was conducting limited inspections of major four accounting firms. In response to the question of David Scott, a member of the subcommittee, of “how [the inspections was] working, particularly what success it has had in detecting fraud, and making sure that there [was] compliance in terms of professional auditing standards,”³⁰ McDonough explained the situation: “[t]he inspections that we are doing this year will be much more detailed. In the case of the Big Four, we will be looking at about 5 percent of their engagements, and the biggest firm has about 3,600 engagements. So 5 percent is a pretty important statistical sample. In the case of the next lot of firms, we will be looking at about 15 percent. We look at a combination of what looks like high risk clients, very complicated companies, for example ...”³¹ Scott also asked whether the accounting firms were given notice to subject the inspection or it was a surprise inspection, then McDonough replied, “we quiet deliberately want a certain level of surprise in the inspections.”³²

27 Oxley Hearings [2003], p. 6. At this hearing, SEC Chairman Donaldson emphasized how closely the SEC had involved the PCAOB affairs in the startup days. Thus he believed that the “strong PCAOB” was in the process of establishing itself with the close relationships with the SEC.

28 Baker Hearings [2004], p. 3.

29 Baker Hearings [2004], p. 15. PCAOB member Goelzer also referred to the inspection as “the fundamental tool Congress gave to the Board to restore public confidence in audited financial reporting.” (Goelzer [2005])

30 Baker Hearings [2004], p. 14.

31 Baker Hearings [2004], p. 15.

32 *Ibid.*

5. Concluding Remarks

The SOX Act through creation of the PCAOB drastically changed the traditional regulatory structure, which was entirely relied on self-regulation by the accounting profession. The SOX Act, as Professor Kinney indicates, “reverse[d] a pattern of more than 20 years of self regulation.”³³

Previously the audit profession had been regulated mainly via the voluntary peer review process, but the peer reviews were now replaced with the compulsory PCAOB inspections. This *replacement* was made upon the congressional and public distrust of the profession’s peer review, actually implemented in the form of firm-on-firm review.³⁴ Unlike the POB, the PCAOB does not take indirect oversight over the profession’s peer review program, rather the PCAOB directly conducts quality control reviews of registered firms’ audit procedures and practices.

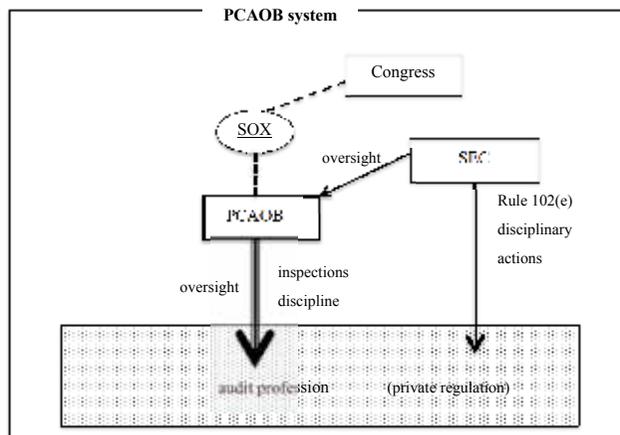


Figure 1 Structure of PCAOB Audit Regulation

³³ Kinney [2005], p. 101.

³⁴ According to the Senate Report concerning the Sarbanes bill, “[v]irtually every witness who addressed the details of auditor oversight agreed on critical need for a regular or comprehensive review, by an independent body of inspectors, of each audit firm’s compliance with audit standards and procedures.” (Senate Report 107-205, p. 9)

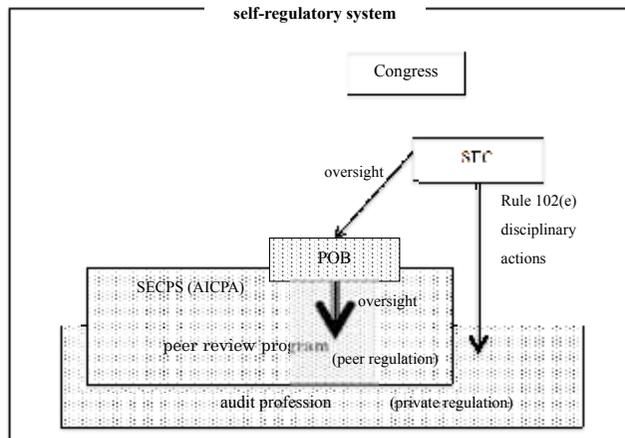


Figure 2 Structure of Traditional Self-Regulatory System

Viewing from the broader perspective, firm-on-firm peer reviews and PCAOB inspections have a commonality in that they are basic instruments through which they assess whether audit firms have developed appropriate quality control policies and procedures, and whether these are implemented in compliance with professional standards.³⁵ Implicitly the PCAOB was created so as to overcome the POB’s inherent defect of being organized within the accounting profession. Therein it was stressed that the PCAOB should be a *strong* and *independent* auditor oversight body, irrespective of private or public. In this context, PCAOB inspections had to be situated as strategically important means of restoring public confidence.

It is certain that “the [profession’s] peer review system lacked independence and enforcement authority invested in the PCAOB by federal laws,” but it should be also acknowledged that “the peer review process *is* not without teeth.”³⁶ “The PCAOB’s decision to discard the strengths of the existing peer review process and use only PCAOB staff in its inspections,” as Professors Glover and others point out, “leads to what we consider the most serious flaw in the PCAOB’s staffing model.”³⁷ They also argue that this made (and still makes) staffing of PCAOB inspectors with sufficient expertise difficult.³⁸ Furthermore, another researcher indicates lack of auditing expertise of the PCAOB itself as a significant structural flaw.³⁹

Thus, to be effective, the expectation that the PCAOB’s activities are ultimately overseen and regulated by the SEC is very fundamental to maintain public trust for the PCAOB’s activities. It should be recognized that SEC oversight over the PCAOB is statutorily authorized, but how the SEC does and will implement that authority remains uncertain. The PCAOB is under

35 Löhlein [2016], pp. 28-29.

36 Glover *et al.* [2009], p. 231. Italics added.

37 *Ibid.*

38 Nonetheless, PCAOB member Goelzer emphasized that because PCAOB inspectors are themselves experienced auditors but are not “peers,” such inspection is more likely to improve the day-to-day quality of auditing (Goelzer [2005]).

39 Kinney [2005], pp. 102-104.

SEC oversight but it is not a unit within the SEC, or an independent government entity within the SEC. This setting itself can bring about crucial deficiencies in the structure of the current audit regulation.

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