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## Examine the available evidence: Was the Duhnke PCAOB captured?

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## ABSTRACT

The Public Company Accounting Oversight Board (PCAOB) was created in 2003 after Congress passed the Sarbanes-Oxley Act of 2002. The mission of the Board is to serve the public interest through regulation of accounting firms who audit public companies. Regulatory agencies are susceptible to regulatory capture whereby the agency serves the interests of the regulated industry rather than the public interest. In 2017, the Securities Exchange Commission appointed five new members, including Chairman Duhnke, to the PCAOB. This paper applies [Carpenter's \(2014b\)](#) model to evaluate whether the PCAOB was captured during the Duhnke chairmanship. The susceptibility of the PCAOB to regulatory capture is important because the effectiveness of the capital markets depends on trust in financial statement audits. The available evidence is consistent with a “weak” capture conclusion. During the Duhnke Board’s tenure, there was diminished activity in the areas of inspection, standard-setting, and enforcement.

## 1. Introduction

After multiple financial statement frauds culminated in the failures of Enron and WorldCom, Congress stepped in and enacted the Sarbanes-Oxley Act of 2002 (SOX) ([Arnold & de Lange, 2004](#)). SOX has been referred to as “the single most important piece of legislation embracing corporate governance since the U.S. securities laws of the 1930s” ([Riotta, 2008, p. 960](#)). Title I of SOX establishes the Public Company Accounting Oversight Board (PCAOB or the Board), a quasi-governmental regulatory agency, to oversee public company auditing “in order to protect the interests of investors” and to “further the public interest” ([U.S. House of Representatives, 2002](#)).

The PCAOB fulfills its mission to “protect investors and further the public interest” by registering public accounting firms, inspecting audits performed by registered firms, establishing standards and rules for audits, investigating potential violations of its rules, and taking disciplinary actions when investigations provide evidence that violations have occurred. Through its regulatory efforts, the PCAOB serves as a counterweight to the pressures accounting firms face to under-audit (e.g., client satisfaction, firm profitability). These regulatory activities place time, cost and other burdens on the regulated firms. For example, PCAOB inspections can create a high level of anticipatory anxiety and stress for auditors as well as financial consequences for adverse findings ([Westermann, Cohen, & Trompeter, 2019](#); [Johnson, Keune, & Winchel, 2019](#)). Moreover, PCAOB disciplinary orders can impair firms’ ability to attract and retain clients ([Boone, Khurana, & Raman, 2015](#)). Thus, while investors and the public are served when the PCAOB

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vigorously pursues its mission, registered firms bear the costs. In other words, public accounting firms may benefit from a less vibrant PCAOB.

Capture occurs when a regulatory agency serves the interests of the regulated industry as opposed to those of the public. In 2018, the SEC replaced the entire 5-member PCAOB who, in turn, terminated seven of the eight senior staff. The nearly complete turnover of the Board and senior staff raises an important question: was the new PCAOB, led by Chairman William Duhnke, captured by the public accounting industry? This question is important for several reasons. First, the PCAOB was created in order to restore investor confidence in the audit profession. A perception that the PCAOB has been captured could impair that confidence, raising the cost of capital for firms and diminishing liquidity for investors. Also, [Stigler \(1971\)](#) suggests that the problem of regulation is to identify the conditions where the regulated industry is able to use regulation for its own purposes. [Carpenter and Moss \(2014\)](#) call for research into the circumstances under which mechanisms for regulatory capture are successful. Senator Sheldon Whitehouse suggests, “regulatory capture isn’t getting the attention it deserves” (US Senate, 2011).

Using [Carpenter’s \(2014b\)](#) framework, this paper defines the public interest in the context of PCAOB regulation, examines evidence of the intent and actions of the public accounting profession to influence PCAOB regulation, and investigates whether there was a shift away from the public interest and towards the interest of the accounting firms during the Duhnke Chairmanship. The evidence reflects diminished efforts in all three of the PCAOB’s primary areas of responsibility: inspections, standard-setting, and enforcement. Despite the safeguards imposed by Congress and the founding Board members, the evidence shows that the PCAOB is susceptible to regulatory capture through the appointment of board members.

This paper contributes to research on regulatory oversight of auditors ([Lamoreaux, 2022](#)). It also contributes to the public interest literature by demonstrating the Achilles heel of the PCAOB, the potential for the Securities Exchange Commission (SEC) to appoint members who are hostile to, or even merely indifferent to, the PCAOB’s investor protection mission. It is a duty of research to alert the public to such concerns ([Riotta, 2008](#)). This paper also contributes to the regulatory capture literature by demonstrating how, despite the unique structure of the PCAOB, it is nevertheless susceptible to regulatory capture.

## 2. Background and methodology

### 2.1. The mission of the PCAOB

SOX has two provisions that are specifically focused on the public accounting profession: the creation of the PCAOB and limitations on the provision of non-audit services ([Cullinan, 2004](#)). The mission of the PCAOB was established by Congress in SOX:

There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to 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. ([U.S. House of Representatives, 2002](#)).

In order to fulfill its mission, SOX vests the PCAOB with three key authorities. The first is the authority to register firms and inspect their work. A public accounting firm cannot perform an audit of an issuer or broker dealer unless it is registered with the PCAOB. Any firm that is registered with the PCAOB and performs an audit of one or more issuers or broker dealers is subject to PCAOB inspection. The PCAOB also has the authority to establish the standards that apply to the work performed by registered accounting firms. Finally, the PCAOB has the authority to initiate investigations of potential violations of its standards and levy sanctions for those who engage in such misconduct. The PCAOB fulfills its purpose when it discharges these three duties to the benefit of the public interest.

### 2.2. Regulatory capture

Whenever the public is harmed by a business activity, a common Congressional response has been to establish a regulatory agency or commission to protect the public from future harm. For example, the Interstate Commerce Commission (ICC) was created by Congress in 1887 to address the concerns of farmers and commercial shippers about railroad pricing and safety ([Huntington, 1952](#)). Since then, Congress has established myriad regulatory bodies to oversee various aspects of the U.S. economy. Regulatory agencies are created to protect the public interest in areas of the economy where private and public interests diverge. Congress established the PCAOB in 2002 when it appeared that the public accounting industry was prioritizing self-interest (e.g., client retention) over the public interest (e.g., professional skepticism, objectivity, and independence in the performance of public company audits).

The effectiveness of regulatory agencies rests on a foundation of “dispassionate expertise” ([McCraw, 1975, p. 161](#)). The regulated industry is generally an important source of expertise. The PCAOB’s inspection staff is comprised of former auditors. Registered accounting firm personnel frequently serve on the PCAOB’s advisory groups. Moreover, registered firms provide suggestions to PCAOB rule-making through comment letters and participation at public roundtables.

Unfortunately, regulatory agencies are susceptible to the undue influence of the industries they are established to oversee. For example, the ICC’s decisions increasingly favored the railroad industry, rather than consumers, beginning in the 1920s ([Huntington, 1952](#)). There is a common assertion that regulatory agencies ultimately become captured by the industries they were created to regulate ([Bernstein, 1955; Bernstein, 1972; McCraw, 1975; Stigler, 1971](#)).

[Posner \(2014, p. 49\)](#) describes capture as the “subversion of regulatory agencies by the firms they regulate.” [Shapiro \(2012, p. 224\)](#) suggests capture has occurred “when agencies consistently adopt regulatory policies favored by regulated entities.” These descriptions

address the actions of the captured regulator, but not the efforts of the regulated industry to capture the regulator. [Rex \(2020\)](#) and [Carpenter and Moss \(2014\)](#) emphasize the role of regulated entities in regulatory capture. Capture is evidenced by “regulators consistently favoring the preferred policies of targets of regulation, resulting from an exercise of power by the regulated industry” ([Rex, 2020, p. 273](#)). [Carpenter and Moss \(2014, p. 13\)](#) define regulatory capture as “the result or process by which regulation, in law or application, is consistently or repeatedly directed away from the public interest and toward the interest of the regulated industry, by the intent and action of the industry itself.”

Early regulatory capture research focused on “entry-barrier” capture in which regulated industries influenced their regulators to impose regulations that would impede the entry of new competitors to the industry. [Stigler \(1971\)](#) hypothesized that any industry with sufficient political power to capture would use that power to erect barriers to entry. In other words, the regulated industry uses the state’s power of coercion to prevent new competitors from entering the market and thereby, to increase the profitability of incumbent market participants.

[Bernstein \(1955\)](#) theorized a regulatory life cycle to explain how regulatory agencies become captured over time. In the beginning, during [Bernstein’s \(1955\)](#) “youth stage,” the regulatory agency vigorously pursues its mission with strong public and Congressional support, but also in the face of strong opposition from the regulated industry. Over time, as the agency matures, the coalition of public support for the regulator dissipates while the regulated industry continues to oppose regulatory actions. Eventually the regulator reaches “debility and decline” and becomes passive in its regulatory efforts. The regulator is ultimately replaced by a new regulator or the industry reverts to self-regulation.

In contrast to Bernstein’s view that agencies initially serve the public interest and become captured over time, [Kolko \(1963\)](#) argued that industries control regulation from the start, as Congress drafts legislation creating a regulator and authorizing its powers, to protect their industry. He theorized that big business favored the creation of regulatory agencies for the purpose of eliminating competition after the merger movement failed to achieve that purpose.

More recently, capture research deviates from the entry-barrier concept in two distinct ways. First, there is not necessarily a dichotomy in which a regulatory body is either captured (i.e. strong capture) or it is not. Instead, [Carpenter and Moss \(2014\)](#) suggest that there is a continuum of regulatory capture whereby regulated industries exercise varying degrees of influence over their regulators. “Strong capture” is an extreme condition where it is in the public interest to eliminate or replace the regulator. However, there are circumstances where the regulated industry has some degree of influence over the regulator, but the regulator is still fulfilling its mission to a meaningful, although attenuated, extent. In conditions of “weak capture,” the regulator continues to serve the public interest because the public is better off than if there was no regulation ([Carpenter & Moss, 2014](#)).

Early regulatory capture research focused on the efforts of regulated industries to strengthen regulation as a barrier to entry. However, it has been observed that some regulated industries use their influence to weaken, not strengthen, regulation ([Posner, 2014](#)). [Carpenter \(2014a\)](#) uses the term “corrosive capture” to describe the situation that exists when regulated firms use their influence to weaken regulation, making it less onerous or less expensive.

The PCAOB may be susceptible to corrosive capture due to the adverse impact of its regulatory actions (e.g., inspections, standard-setting, enforcement) on registered firms’ profitability. For example, PCAOB inspections are costly for registered firms. Engagement teams selected for inspection spend significant amounts of time preparing for the inspection, responding to inspector questions, and remediating any identified deficiencies ([Johnson et al., 2019](#)). Moreover, poor inspection results can lead to client loss ([Abbott, Gunny, & Zhang, 2013; Acito, Hogan, & Mergenthaler, 2018; Aobdia, 2018; Daugherty & Tervo, 2010](#)) as well as employee turnover ([Daugherty & Tervo, 2010](#)). The PCAOB can also impose new standards that are costly for firms to implement or conduct investigations that require firms to pay legal fees to defend. Since PCAOB regulation is costly to firms, they benefit financially from weaker PCAOB regulation. Thus, the firms have incentives to weaken PCAOB regulation, making the PCAOB subject to corrosive capture.

### 2.3. Methodology

#### 2.3.1. Data

The PCAOB fulfills its mission when it registers firms, inspects those firms, sets standards, and enforces those standards through investigations and disciplinary actions. The approach taken in this paper is to examine the level of activity in each of the PCAOB’s main functional areas: inspections, standard-setting, and enforcement and to compare those levels of activity during Chairman Duhnke’s tenure to the period immediately preceding (i.e. Chairman Doty’s tenure).

The data is derived primarily from information available on the PCAOB’s website. PCAOB annual reports contain summary data including the number of registered firms, number of firms inspected, enforcement activity, and the budget. Inspection finding data was hand collected from each firm’s annual inspection report. Qualitative data was hand collected from the PCAOB’s annual strategic plan, standard setting agenda and Board member speeches. Open meetings of the SEC to approve the PCAOB’s budget were transcribed by the author. Lobbying expenditure information was hand collected from the lobbying disclosure online database of the United States Congress. Consistent with [Dwyer and Roberts \(2004\)](#), political contributions were obtained from the Center for Responsive Politics website.

#### 2.3.2. Model for measuring agency capture

[Carpenter \(2014b\)](#) develops a model for measuring agency capture. The model begins with a conception of the public interest. The concept of public interest is necessary because it is the benchmark for evaluating the actions of the regulator. This paper uses the PCAOB’s mission as outlined in its enabling legislation (i.e. SOX) to define the public interest.

According to [Carpenter \(2014b, p. 62\)](#), “valid capture diagnoses require intent.” In order to conclude that a regulator has been

captured, there must be evidence that the regulated industry attempted to influence the regulatory process. Evidence of these attempts can include, for example, political contributions and lobbying efforts.

Finally, it is necessary to show that the regulator's policy choices have shifted away from the public interest and towards the interest of the industry. While regulatory capture can result from corruption, it can also result from a principled philosophical view in favor of reduced regulation (Shapiro, 2012). Capture may result from inaction:

Regulatory capture is reflected in a surplus of passivity and reactivity, and a deficit of curiosity and creativity. It is evidenced by a body of commission decisions or non-decisions – about resources, procedures, priorities, and politics, where what the regulated entity wants has more influence than what the public interest requires. The active verb 'capture' signals an affirmative effort, to take someone captive. But the noun 'capture,' and the passive verb form 'to be captures,' signal a state of being. One can enter that state through one's own actions or inactions. One can allow oneself to be captured. One can assist, and sustain, one's own captivity" (Hempling, 2014, p. 25).

### 3. Defining the public interest

In order to evaluate whether the PCAOB has been captured (i.e. has shifted its focus from the public interest to private interests), it is first necessary to define the public interest (Carpenter, 2014b). Defining the public interest provides a standard for the capture evaluation (Dellaportas & Davenport, 2008). The public interest serves as the counterfactual for analysis of regulatory action (Carpenter, 2014b). In other words, regulatory capture exists to the extent that there is deviation between the actions actually taken by the PCAOB and those actions that would be taken if the PCAOB were free of regulatory capture.

A straightforward definition of the public interest does not exist (Baudot, Roberts, & Wallace, 2017; Shapiro, 2012). It is a concept that has been the subject of much debate (Paisey & Paisey, 2020; Willmott, 1990). McCraw (1975) suggests that it is an "undefinable construct." Dellaportas and Davenport (2008) suggest that the concept is understood well enough at the policy level, but not at the operating level. At the operating level, the public interest is ambiguous and subject to a variety of interpretations (Dellaportas & Davenport, 2008; Killian & O'Regan, 2020).

Financial statement audits serve the public interest by facilitating an efficient allocation of resources in the US economy. In a capitalist society, companies achieve profitability only if they produce the products and services demanded by the public. Companies that are profitable, or expected to be profitable, can attract capital necessary to produce desired products and services. When an unprofitable company fraudulently reports profitable results, it attracts capital that otherwise would be allocated to a profitable company. In other words, fraudulent financial reporting violates the public interest because it results in a misallocation of economic resources. By deterring and detecting financial reporting fraud, auditors serve the public interest.

Financial statement audits serve the public interest when they are performed by competent professionals who perform their work diligently and objectively. However, since financial statement audits are a credence good, auditors have incentives to act in their own self-interest (Causholli & Knechel, 2012). By setting high-quality standards, inspecting auditors' work, and disciplining auditors who fail to exercise due care, the PCAOB serves as a counterweight to auditors' self-interest to under-audit. The PCAOB's regulation of auditors ultimately enhances the efficient allocation of economic resources in the United States.

The view that the PCAOB serves the public interest is also consistent with the presumption that Congress acted in the public interest when it passed the PCAOB's enabling legislation (Shapiro, 2012). SOX passed by votes of 423-3 and 99-0 in the House and Senate, respectively. Moreover, SOX is "a law passed in the public interest based on public demand" (Canada, Kuhn, & Sutton, 2008, p. 988). In passing SOX, Congress determined that additional regulation would serve the public interest (Riotta, 2008). Thus, the PCAOB can be said to be acting in the public interest when its actions are consistent with the goals that Congress set when it passed SOX.

The mission of the PCAOB, as described in its enabling legislation (i.e. SOX), is to protect investors through the oversight of public company auditing. The Dodd Frank Act expanded the PCAOB's mission to include oversight of audits of broker dealers. The PCAOB fulfills its mission and serves the public interest by performing the duties outlined in SOX: registering public accounting firms, setting rules and standards for the performance of public company and broker dealer audits, inspecting the audits performed by registered firms, conducting investigations of potential wrongdoing, and disciplining registered firms who fail to comply with its rules and standards. In other words, the PCAOB is acting in the public interest when it is actively engaged in inspection, standard-setting, and enforcement activities. When the PCAOB reduces its efforts in one or more of these aspects of its mission, it is acting contrary to the public interest.

### 4. Actions of the public accounting firms

In order to conclude that the PCAOB was captured during the Duhnke chairmanship, it is necessary to demonstrate that the public accounting profession took action to influence the PCAOB (Carpenter, 2014b). This condition is met, for example, when there is an attempt to lobby or otherwise influence the views of the regulator. Registered firms can attempt to influence the PCAOB directly through meetings and the comment letter process. This type of influence is generally in the public interest, because it provides the PCAOB with access to the firms' expertise and perspectives about the impacts of potential or proposed regulatory action.

The regulated firms can also influence the PCAOB indirectly through involvement in federal political activities (Baudot et al., 2017). Two forms of federal political activities are congressional campaign contributions and lobbying efforts on Capitol Hill (Baudot et al., 2017). Dwyer and Roberts (2004) examine political contributions and find that recipients tend to be sympathetic to the viewpoints of their benefactors. Baudot et al. (2017) find that the accounting profession engages in lobbying activities in order to

protect its professional jurisdiction, sustain its socio-economic status, and retain its authority. Extant research evidences the power of the accounting lobby and the attempts it has made to influence legislation (Canada et al., 2008; Roberts, Dwyer, & Sweeney, 2003). Knechel and Park (2022) find a negative relationship between audit firm political connections and the severity of PCAOB inspection findings.

The accounting profession has been shown to exert significant effort to influence legislation in its favor (Roberts et al., 2003). One of its tactics has been to make significant campaign contributions through political action committees (PACs) (Dwyer & Roberts, 2004). Before it was even established, the profession opposed the PCAOB's enabling legislation (Canada et al., 2008) and made significant campaign contributions in the period leading to its enactment (O'Connell, 2004). Over the four most recent congressional campaign cycles, the Big Four firms' PACs collectively spent over \$35 million in campaign contributions while the other annually inspected firms' PACs contributed approximately \$2.5 million (see Table 1, Panel A). The aggregate contributions by the Big 4 PACs increased each cycle from \$7.3 million for the 2014 elections to \$10.0 million for the 2020 cycle.

The accounting profession spends significant amounts every year to lobby Congress on various matters including its oversight of the PCAOB. Windsor and Warming-Rasmussen (2009) suggest that the PCAOB is susceptible to such efforts. Between 2013 and 2020, the Big Four firms collectively spent nearly \$94 million in lobbying activities (see Table 1, Panel B for amounts spent by each firm and Panel C for descriptions excerpted from the reports). The other annually inspected firms collectively spent \$6.9 million on lobbying during that same period. There is evidence that these lobbying efforts have been successful. For example, after the Big Four lobbied against the PCAOB's consideration of mandatory firm rotation, the House of Representatives passed a bill that would prevent the PCAOB from imposing such a requirement (Keyser, 2021).<sup>2</sup> Moreover, the Big Four continue to lobby against public disclosure of PCAOB enforcement activities prior to resolution. Although several bills have been introduced to make PCAOB enforcement actions public, such legislation has not yet been enacted.

In order to conclude that the PCAOB was captured, Carpenter's (2014b) model requires evidence that the public accounting firm intended, and took action, to influence the PCAOB, directly or indirectly. The available evidence affirms that the public accounting firm has attempted to influence the PCAOB indirectly through its influence on Congress. The publicly available information reveals that the firms contribute significant amounts to congressional campaigns and invest heavily in lobbying activities, and thus, that the firms have taken action to influence the regulatory activities of the PCAOB.

## 5. Policy shift

The third condition for regulatory capture is a shift in regulatory policy away from the public interest and towards the interest of the regulated industry. The PCAOB could be accused of capture if it fails to perform one or more of its functions (e.g. inspection, standard-setting, enforcement) as Congress intended (Shapiro, 2012). Since it is in the interest of registered firms to avoid rigorous inspections and exacting standards, any reductions in these activities by the PCAOB serves those private interests and not the public interest (Rex, 2020). Using the PCAOB's activities under Chairman James Doty (i.e. 2011–2018) as a benchmark, reductions in inspection, standard-setting, and enforcement activities below the benchmark is evidence of capture.<sup>3</sup> This section describes the publicly available evidence in each of these three areas.

### 5.1. The benchmark for measuring shift

James R. Doty commenced his tenure as chairman of the PCAOB in January 2011. Jay Hanson and Lewis Ferguson also joined the Board at that time. They came to the PCAOB with clear intentions to act in the public interest. At the March 16, 2011 meeting of the PCAOB's Investor Advisory Group, Doty explained that they did not intend to be passive in their role as PCAOB members:

... you don't do something like this unless you intend to make a difference. It is our purpose in serving on this Board, and I speak, I know, for every board member, that we intend to make a difference, a positive difference in the grave issues that face us in our securities regime (PCAOB, 2011, p. 11)

During Doty's tenure, the PCAOB used all of its statutory powers – inspections, standard-setting, and enforcement - in the pursuit of the public interest. Chairman Doty defended the PCAOB's rigorous inspection process, as he explained to the SEC in 2013, "It should not trouble the public or the audit profession that we are hard graders. It should comfort the public that we are hard graders" (SEC, 2013). Under Doty, the PCAOB's standard-setting agenda was active with projects including broad disclosure matters including the auditor reporting model and audit firm transparency as well as audit performance standards such as related party transactions and significant unusual transactions. The enforcement division was also active under Doty. The PCAOB faced opposition from the public accounting profession throughout Doty's tenure (Ackerman & Rapoport, 2016).

On December 12, 2017, the SEC announced the appointment of five new PCAOB members (SEC, 2017). The appointment was

<sup>2</sup> The PCAOB never proposed a rule to require MFR. Instead, the Board issued a concept release to solicit feedback about ways to enhance auditor independence, objectivity, and professional skepticism. The concept release requested feedback specifically about whether MFR would be a viable alternative. Successful lobbying efforts resulted in Congress acting before the PCAOB made its own determination about the viability of MFR. The PCAOB's deliberative standard-setting process was disrupted through these efforts.

<sup>3</sup> The use of the Doty Board as a benchmark does not imply that the Doty Board acted entirely in the public interest. By establishing the Doty Board as the benchmark, it is possible to examine whether the PCAOB's activities increased or decreased under the Duhnke Board.

**Table 1**  
Campaign Contributions and Lobbying Expenditures.

<b>Panel A: Congressional Campaign Contributions<sup>1</sup></b>					
<b>Big 4:</b>					
Year	Deloitte	EY	KPMG	PwC	Total
2014	\$ 2,274,900	\$ 2,217,218	\$ 1,071,034	\$ 1,710,660	\$ 7,273,812
2016	2,609,168	2,553,432	1,387,044	2,133,847	8,683,491
2018	3,123,926	2,652,637	1,347,968	1,954,561	9,079,092
2020	3,037,381	2,948,544	1,779,071	2,269,329	10,034,325
	<b>\$ 11,045,375</b>	<b>\$ 10,371,831</b>	<b>\$ 5,585,117</b>	<b>\$ 8,068,397</b>	<b>\$ 35,070,720</b>
<b>Other Annually Inspected Firms:</b>					
Year	BDO	Crowe	Grant Thornton	RSM	Total
2014	\$ 14,800	\$ 44,785	\$ 367,600	\$ 28,350	\$ 455,535
2016	22,554	82,797	537,588	29,154	672,093
2018	52,158	109,839	470,852	27,007	659,856
2020	131,158	0	477,489	81,045	689,692
	<b>\$ 220,670</b>	<b>\$ 237,421</b>	<b>\$ 1,853,529</b>	<b>\$ 165,556</b>	<b>\$ 2,477,176</b>
<b>Panel B: Lobbying Expenditures<sup>2</sup></b>					
<b>Big 4</b>					
Year	Deloitte	EY	KPMG	PwC	Total
2013	\$ 2,840,000	\$ 2,430,000	\$ 1,820,000	\$ 4,200,000	\$ 11,290,000
2014	2,600,000	2,050,000	2,480,000	3,740,000	10,870,000
2015	2,630,000	2,210,000	1,900,000	3,995,000	10,735,000
2016	2,130,000	1,660,000	2,150,000	3,850,000	9,790,000
2017	2,490,000	3,380,000	1,990,000	4,040,000	11,900,000
2018	2,980,000	3,920,000	2,390,000	4,110,000	13,400,000
2019	4,060,000	3,330,000	2,700,000	3,975,000	14,065,000
2020	3,430,000	2,230,000	2,280,000	3,970,000	11,910,000
	<b>\$ 23,160,000</b>	<b>\$ 21,210,000</b>	<b>\$ 17,710,000</b>	<b>\$ 31,880,000</b>	<b>\$ 93,960,000</b>
<b>Other annually inspected firms:</b>					
Year	BDO	Crowe	Grant Thornton	RSM	Total
2013	\$ 0	\$ 120,000	\$ 740,000	\$ 0	\$ 860,000
2014	0	100,000	740,000	0	840,000
2015	0	24,000	500,000	100,000	624,000
2016	0	96,000	570,000	177,000	843,000
2017	0	114,000	790,000	300,000	1,204,000
2018	0	120,000	600,000	340,000	1,060,000
2019	0	120,000	250,000	470,000	840,000
2020	0	120,000	170,000	345,000	635,000
	<b>\$ 0</b>	<b>\$ 814,000</b>	<b>\$ 4,360,000</b>	<b>1,732,000</b>	<b>6,906,000</b>
<b>Panel C: Descriptions of Lobbying Activities</b>					
The following descriptions are excerpted from lobbying reports filed by the Big 4 accounting firms:					
<ul style="list-style-type: none"> <li>• “H.R. 3503 – To amend the Sarbanes-Oxley Act of 2002 to make Public Company Accounting Oversight Board disciplinary proceedings open to the public, issues regarding PCAOB disciplinary proceedings.”</li> <li>• “PCAOB’s mandatory firm rotation concept release.”</li> <li>• “S.1084 PCAOB Enforcement Transparency Act of 2015, general issues regarding disciplinary proceedings before the PCAOB.”</li> <li>• “S. 610 PCAOB Enforcement Transparency Act of 2017, general issues before the PCAOB.”</li> <li>• “General issues and regulation of accounting.”</li> <li>• “S. 1256 PCAOB Enforcement Transparency Act of 2019, general issues regarding PCAOB disciplinary proceedings.”</li> <li>• “General issues related to reform of the Public Company Accounting Oversight Board.”</li> <li>• “Revision of Sarbanes-Oxley rules on disclosure of disciplinary proceedings.”</li> <li>• “Mandatory audit firm rotation.”</li> <li>• “Any legislation prohibiting the Public Company Accounting Oversight Board from mandating the automatic rotation of a public company’s independent external auditors.”</li> <li>• “any language attempting to require the Public Company Accounting Oversight Board to hold its disciplinary proceedings in public, and any other provisions pertaining to the PCAOB or its oversight.”</li> <li>• “Monitoring of Congress’s oversight of the Public Company Accounting Oversight Board’s regulatory power”</li> <li>• “Monitoring for legislation pertaining to oversight of the accounting industry generally.”</li> <li>• “Accounting related issues.”</li> <li>• “Support for existing Sarbanes-Oxley provisions regarding the disclosure of disciplinary proceedings.”</li> </ul>					

<sup>1</sup> Congressional campaign contribution information obtained from [opensecrets.org](https://www.opensecrets.org).

<sup>2</sup> Lobbying expenditure information obtained from <https://disclosurespreview.house.gov/>.

extraordinary for several reasons. First, the appointment of James G. Kaiser was the first time a Big Four partner was appointed to the Board. Second, the SEC terminated Board member Lewis Ferguson whose term had not yet expired. Finally, the new chairman, William Duhnke, lacked prior experience as a regulator, having spent much of his career as a staff member in the United States Senate.<sup>4</sup> When the Doty board was replaced, one journalist wrote, “The era of radical transparency at the country’s main audit regulator is over” (Michaels, 2017).

## 5.2. Key positions unfilled

The Duhnke Board took over in January 2018. A few months later in May, the Board announced the departures of the directors of all three of the PCAOB’s major divisions as well as other key executives. The departures of Helen Munter, the Director of Registration and Inspections and Chief Auditor Martin F. Baumann were announced on May 18 and 22, respectively (PCAOB, 2018a; 2018b). Claudius Modesti was the PCAOB first Director of Enforcement and Investigations. His departure was announced on May 29 (PCAOB, 2018c). All three of these key positions at the PCAOB remained unfilled until George Botic was named Director of Registration and Inspections on November 1, 2018 (PCAOB, 2018d). Megan Zietsman was named Chief Auditor a little over a month later on December 13, 2018 (PCAOB, 2018e). The Director of Enforcement and Investigations position remained open for another year until Patrick Bryan was named on December 17, 2019 (PCAOB, 2019c). The failure to fill these key positions in a timely manner may have contributed to the reduced activity in each of the areas of the PCAOB’s mission.

## 5.3. Inspections

It is a widely held view that the PCAOB’s most important function is the inspection of registered firms, which supplanted the peer review process. In 2013, SEC Commissioner Luis Aguilar said, “The inspection program is the heart of the PCAOB’s mission” (SEC, 2013). In 2012, then-PCAOB Chairman James Doty described the centrality of the PCAOB’s inspection process:

The heart and soul of [the Sarbanes-Oxley Act], is the engagement with the firms in both the planning and the execution of the inspection process, the reporting and then the remediation. To the extent that there is engagement with the firms in those areas, you have your greatest opportunity to improve the audit and to improve the firm (SEC, 2012).

Despite the auditing profession’s claims that the PCAOB’s inspection process is ineffective (Johnson et al., 2019), research results are consistent with inspections improving audit quality (e.g., Carcello, Hollingworth, & Mastrolia, 2011; Defond & Lennox, 2017).

Inspection activity declined in several important ways under the Duhnke Board. The Board conducted fewer inspections, reported inspection findings less timely, found fewer deficiencies, and shifted the focus of inspections toward identification of “best practices.” Reduced efforts in the inspection program is important evidence suggestive of regulatory capture.

### 5.3.1. The number of inspections performed

SOX requires the PCAOB to conduct annual inspections of firms that audit more than 100 issuers and triennial inspections of firms that audit less than 100 issuers. During the first seventeen years of the PCAOB’s existence, it conducted an average of 215 inspections per year (see Table 2). For the most recent years (2018–2020), the annual average is only 185. The decline does not appear to be pandemic-related: the PCAOB conducted 160, 175, and 219 inspections in 2018, 2019, and 2020, respectively. Despite conducting more inspections in 2020 compared to the two preceding years, the PCAOB inspected approximately 23 % (17) fewer firms than it planned during 2020 as a result of the global pandemic (Brown, 2020c). The PCAOB’s annual reports provide no explanation for the below average number of inspections conducted in 2018 and 2019 relative to prior years. Since the vast majority of registered firms are inspected triennially, Panel C of Table 1 shows that the PCAOB conducted 54 fewer inspections during the 2018–2020 period compared to the 2015–2017 period.<sup>5</sup>

The purpose of the inspection process is to provide registered firms with feedback about compliance with PCAOB standards and an opportunity to remediate identified deficiencies. The PCAOB’s failure to perform inspections in a timely manner benefits the registered firms who avoid or delay inspections and are contrary to the public interest because it allows potential deficiencies to go undetected.

### 5.3.2. Public reporting of inspection results

The PCAOB encourages audit committees to use inspection reports as they select and oversee their external auditors. In 2012, the Board issued a document to provide information to audit committees about the inspection process to assist them in their auditor

<sup>4</sup> All of the previous PCAOB chairmen had experience as regulators. William J. McDonough was the President of the Federal Reserve Bank of New York at the time he was appointed to the PCAOB. Mark Olson was a member of the Federal Reserve Board of Governors. James Doty had been the SEC’s General Counsel during the George H.W. Bush administration.

<sup>5</sup> Many registered firms do not perform issuer audits. The PCAOB does not inspect registered firms if they performed no issuer audits during the preceding three years. A portion of the reduction in inspections could be a reduction in the number of firms performing issuer audits. Commencing in 2018, the PCAOB stopped reporting the number of registered firms who actually performed issuer audits. From 2011 to 2017, approximately 27% of registered firms performed issuer audits. Since the number of registered firms decreased 135 from 1,390 in 2017 to 1,255 in 2020, it is reasonable to expect a decrease in the number of inspections to be 27% of 135 or 36. The reduction of 54 is 18 more than expected, which is approximately equal to the 17 inspections PCAOB Member Brown mentioned were planned but not performed in 2020.

**Table 2**  
PCAOB Inspection Reports.

Panel A: Inspections and inspection report backlog								
Year	Registered Firms	Firms Subject to Inspection <sup>1</sup>	Inspections Completed <sup>2</sup>	Reports Issued	Cumulative Inspections	Cumulative Reports	Backlog	
2004	735	594	99	4	99	4	95	
2005	1,423	838	281	172	380	176	204	
2006	1,591	790	172	206	552	382	170	
2007	1,738	762	236	170	788	552	236	
2008	1,828	772	255	259	1,043	811	232	
2009	1,874	743	287	214	1,330	1,025	305	
2010	2,349	696	254	220	1,584	1,245	339	
2011	2,397	683	213	344	1,797	1,589	208	
2012	2,388	676	253	257	2,050	1,846	204	
2013	2,363	648	228	257	2,278	2,103	175	
2014	2,319	617	219	258	2,497	2,361	136	
2015	2,201	599	215	218	2,712	2,579	133	
2016	2,107	573	198	215	2,910	2,794	116	
2017	2,013	532	195	190	3,105	2,984	121	
2018*	1,925	535	160	153	3,265	3,137	128	
2019*	1,862	NR <sup>4</sup>	175	104	3,440	3,241	199	
2020	1,796	NR <sup>4</sup>	219	46	3,659	3,287	372	
			<b>3,659</b>	<b>3,287</b>				

  

Panel B: Average inspections performed by time period		
	Inspections	Reports
Average 2004–2010 (pre-Doty)	248	207
Average 2011–2017 (Doty)	217	248
Average 2018–2020 (Duhnke)	185	101
Overall average	215	193

  

Panel C: Inspections performed by triennial period	
Period	Inspections
2006–2008	663
2009–2011	754
2012–2014	700
2015–2017	608
2018–2020	554

<sup>1</sup> This column lists the number of registered firms, as of the beginning of the year, that performed at least one issuer or broker dealer audit and would, therefore, be subject to inspection. The number of firms is obtained from the PCAOB annual reports.

<sup>2</sup> The inspections completed and reports issued information was obtained from the PCAOB annual reports available on the PCAOB website at <https://pcaobus.org/about/annual-report>. The number of inspections completed in 2018 and 2019 are approximate because the PCAOB did not disclose the exact numbers in the annual reports for those years. The approximate numbers were derived from the Staff Inspection Previews for those years (PCAOB 2019a, 2018f).

<sup>3</sup>NR stands for “not reported.” Beginning with the 2018 annual report, the PCAOB stopped reporting the number of registered firms that did not audit any issuers or broker dealers.

oversight responsibility (PCAOB, 2012). Empirical evidence suggests that audit committees use inspection reports in the selection and retention of external auditors (e.g., Abbott et al., 2013; Acito et al., 2018; Aobdia, 2018; and Daugherty et al., 2011). For example, Acito et al. (2018) find that companies tend to switch from auditors with higher deficiency exposure to auditors with lower deficiency exposure. Thus, timely release of inspection reports is helpful to audit committees in their audit oversight function and, ultimately, the public interest.

When James Doty became PCAOB Chairman in 2011, there was a significant backlog of inspection reports. The Board worked to reduce the backlog and in 2014, Chairman Doty reported to the SEC that the backlog had been cleared (SEC, 2014). Table 2 shows that the backlog of inspection reports increased significantly from 121 when Chairman Duhnke arrived in January 2018 to 372 as of December 31, 2020. It appears that the slow-down in issuances of inspection reports began before the global pandemic in 2019 when the PCAOB issued only 104 inspection reports. A backlog of inspection reports benefits registered firms with high deficiency rates because they can attract and retain clients that might be less willing to hire a low quality auditor. Since the backlog results in less timely information to audit committees who hire the auditors as well as investors who rely on audit reports, the increased backlog is consistent with a shift from the public interest to that of the regulated firms.

Although inspection reports were issued in a less timely manner by the Duhnke Board, it made improvements to the reports it did issue. Inspection report readability was improved the streamlining of content, utilization of charts and graphs, elimination of technical and boilerplate language, and reference to a separate document for general inspection information (PCAOB, 2020c). The new inspection reports also provide comparative information for deficiencies identified in the previous two years. The updated inspection reports should be more useful to audit committees who oversee auditors, consistent with the public interest.

### 5.3.3. Inspection findings

During the Duhnke Chairmanship, the PCAOB appeared to soften its criticisms of firms in their inspection reports. The PCAOB has been reporting both the number of audits with significant deficiencies and the total number of audits inspected for each firm since 2009. The inspection findings for the annually inspected firms are presented in Panel A of [Table 3](#). Overall, comparing deficiency rates under Chairman Duhnke to those under Chairman Doty, they are down 14 % ( $p = 0.002$ ) and 12 % ( $p = 0.026$ ) for the Big 4 and annually inspected non-Big 4 firms, respectively (see [Table 3](#), Panel C). When the averages for the final three years of Doty's term are compared to the first three years of Chairman Duhnke's term, the average deficiency rates drop 9 % ( $p = 0.051$ ) and 6 % ( $p = 0.276$ ) for the Big 4 and second Tier, respectively.

There are many potential explanations for the decline in the deficiency rates, some of which are consistent with regulatory capture and others that are not. One possibility is that the Board changed its view about what constitutes a deficiency. The PCAOB has not clearly defined "deficiency," leaving that determination to the discretion of inspection teams ([Ege, Knechel, Lamoreaux, & Maksymov, 2020](#)). It is possible that the Board has raised the threshold for what constitutes an audit deficiency with the result that fewer deficiencies are reported in the inspection reports. However, there is no evidence to support this potential explanation.

Another potential explanation for the decline in deficiencies relates to the approach to selecting engagements for inspection. The PCAOB announced in 2021 that has shifted its method of selecting audits for inspection to select fewer audits based on risk and more based on random selection (PCAOB, 2021a).<sup>6</sup> To the extent that random selection makes inspection selections less predictable, this approach may enhance the inspection process in forming a view of the overall audit quality of a firm. An approach that reduces the overall deficiency rate clearly benefits the public accounting firms. Auditors place a high priority on receiving clean inspection reports ([Johnson et al., 2019](#)).

A third potential capture-related explanation for the decline in deficiency rates is a change in the allocation of inspection resources away from finding deficiencies and toward identification of "best practices" discussed more fully in the next section ([Section 5.3.4](#)). To the extent inspectors allocate time to these efforts, they can devote less attention to deficiency identification.

There is also at least one non-capture explanation for the decline in deficiency rates. The firms may have remediated their quality controls so that the true deficiency rate has declined, reflecting higher audit quality in the public interest. [Church and Shefchik \(2012\)](#) suggest that if PCAOB inspections are useful, there should be a decline in findings over time. They document a downward trend in inspection findings from 2004 to 2009. Also, the Director of Registrations and Inspections, George Botic, worked in the Inspections Division under the Doty Board and continues to serve in his role under the Williams Board.

If the firms have remediated their quality controls in areas of prior audit deficiencies, it does raise a question about why the PCAOB would not have altered the inspection scope to investigate new areas that have not previously been inspected. Despite declining deficiency rates in historically high deficiency rate areas, there has not been a significant change in the list of the most frequently identified audit deficiencies (see [Table 3](#), Panel D). Since 2014, the PCAOB has identified the most common deficiencies for each of the Big 4 firms. One deficiency appears in every report for every firm for the years 2014–2020: "Failure to sufficiently test the design and/or operating effectiveness of controls that the firm selected for testing."

In summary, there has been a decline in the deficiency rates for most annually inspected firms. However, it is unclear whether the decline results from regulatory capture or effective remediation by the registered firms.

### 5.3.4. Shift in objective of inspections to "best practices"

The PCAOB conducted its initial inspections of the Big 4 accounting firms in 2003. The preface in each inspection report explained that the purpose of inspections is to provide the firms with "unflinching candor" about areas in need of improvement. Consistent with the stated purpose, inspection reports identify audit deficiencies, but provide no information about exceptionally good audit work or "best practices." The firms would have preferred an approach that was more "balanced." In the written response to its 2003 inspection report, PwC expressed concern that by concentrating on "a relatively few number of identified issues," the inspection report failed to adequately convey the true state of audit quality in their firm ([PCAOB, 2004b](#)). Deloitte urged the PCAOB to include "best practices" in the inspections reports based on its belief "that a more balanced report would give the public a more accurate picture of the results of the inspection" ([PCAOB, 2004a](#)).

Contrary to the preferences of accounting firms for more balanced inspection reports, the PCAOB continued to communicate only audit deficiencies until 2018 when the Duhnke Board was appointed. In a 2018 speech, Chairman Duhnke explained that the board planned to "take a more balanced approach to communicating, by publishing not only those audit deficiencies we observe, but also those behaviors and practices we observe that promote or enhance audit quality" ([Duhnke, 2018](#)). The decision to describe "best practices" in inspection reports represents a shift toward the stated interests of the accounting profession. Assuming a fixed inspection budget, allocation of time to identification of "best practices" will necessarily reduce the time allocated to discovering audit deficiencies.

### 5.3.5. Summary – Inspections

It is in the public interest for the PCAOB to conduct thorough, rigorous, and timely inspections of registered firms while registered firms benefit from less rigorous inspections. Under the Duhnke Board, there were fewer inspections conducted and the Board fell behind in the release of inspection reports. The Duhnke Board altered the scope of inspections in ways that are consistent with the

<sup>6</sup> It is not clear whether the PCAOB utilized more random selections in the 2018–2020 inspections.

**Table 3**  
Inspection Report Findings.

Panel A: Deficiency percentages for the annually inspected firms								
	BDO	Crowe	Deloitte	EY	Grant	KPMG	PwC	RSM
2009	24 %	15 %	21 %	9 %	13 %	13 %	12 %	21 %
2010	26 %	62 %	46 %	21 %	29 %	23 %	39 %	47 %
2011	39 %	62 %	42 %	36 %	37 %	23 %	43 %	50 %
2012	55 %	50 %	25 %	49 %	65 %	35 %	40 %	44 %
2013	65 %	38 %	29 %	50 %	56 %	48 %	33 %	31 %
2014	77 %	36 %	21 %	36 %	32 %	55 %	30 %	47 %
2015	52 %	21 %	24 %	29 %	41 %	41 %	23 %	33 %
2016	67 %	33 %	24 %	27 %	24 %	43 %	21 %	47 %
2017	39 %	19 %	20 %	31 %	18 %	50 %	24 %	73 %
2018	48 %	7 %	12 %	26 %	25 %	37 %	25 %	29 %
2019	42 %	50 %	10 %	18 %	23 %	29 %	30 %	20 %
2020	54 %	27 %	4 %	15 %	17 %	26 %	2 %	47 %

  

Panel B: Comparison of Deficiency rates under Doty and Duhnke							
	Doty	Duhnke	Difference	Doty's Last 3 years	Duhnke	Difference	
Deloitte	27%	9%	-18%	23%	9%	-14%	
EY	37%	20%	-17%	29%	20%	-9%	
KPMG	42%	31%	-11%	45%	31%	-14%	
PwC	31%	19%	-12%	22%	19%	-3%	
BDO	56%	48%	-8%	53%	48%	-5%	
Crowe	37%	28%	-9%	25%	28%	3%	
Grant Thornton	39%	22%	-17%	27%	22%	-5%	
RSM	46%	32%	-14%	51%	32%	-19%	

  

Panel C: Statistical Analysis of Deficiency Rates						
Deficiency Rate	Doty	Duhnke	Difference	Mann-Whitney Z-Statistic	p-value	
Overall	39%	26%	-13%	-3.350	<0.001	
Big 4	34%	20%	-14%	-2.922	0.002	
Tier 2	45%	32%	-12%	-1.949	0.026	

  

Deficiency Rate	Doty's Last 3 years	Duhnke	Difference	Mann-Whitney Z-Statistic	p-value
Overall	35%	26%	-9%	-1.619	0.053
Big 4	29%	20%	-9%	-0.606	0.051
Tier 2	38%	32%	-6%	-1.675	0.276

  

Panel D: Most Frequently Identified Big 4 Firm Audit Deficiencies								
Description of the Deficiency	2014	2015	2016	2017	2018	2019	2020	
Failure to sufficiently test the design and/or operating effectiveness of controls that the firm selected for testing.	100%	100%	100%	100%	100%	100%	100%	
Failure to sufficiently test controls over, or sufficiently test, the accuracy and completeness of issuer-produced data or reports.	100%	50%	50%	25%	100%	25%	75%	
Failure to identify and test any controls that addressed the risks related to a particular account or assertion.	75%	50%	25%	75%	75%	100%	75%	
Failure to perform sufficient testing related to an account or significant portion of an account or to address an identified risk.	75%	0%	25%	0%	75%	100%	50%	
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate	100%	75%	100%	75%	100%	100%	50%	
Failure to perform substantive procedures to obtain sufficient evidence as a result of relying too heavily on controls (due to deficiencies in testing controls).	0%	25%	0%	25%	75%	75%	75%	

The information for Table 3 is derived from the individual inspection reports on the PCAOB's website at <https://pcaobus.org/oversight/inspections/firm-inspection-reports>.

preferences of the accounting firms (i.e. reporting best practices). The Duhnke Board did, however, improve the readability of inspection reports. Also, the deficiency rates declined under the Duhnke Board compared to the Doty Board, which might be the result of effective regulation or regulatory capture.

#### 5.4. Standard-Setting

SOX permits the PCAOB to establish its own auditing, independence, and quality control standards or to adopt the standards of another standard setter such as the AICPA's Auditing Standards Board (Keyser, 2015). Prior to SOX, the AICPA's auditing standards applied to all financial statement audits of public and privately held companies in the United States. The accounting profession lobbied the PCAOB to allow the AICPA to continue to set auditing standards (SEC Historical Society, 2021). The PCAOB decided to set the standards itself, in part, due to the perception that the AICPA's Auditing Standards Board would subordinate the public interest to that of the accounting firms (Carmichael, 2014).

The Board was concerned it risked public perception that it had been captured if it chose not to set the standards itself (Harvey, 2019). Founding Board member Dan Goelzer explained that this decision was to avoid capture concerns:

I don't think it was ever really a serious, or a close, issue for us. We felt that we had to do the standard setting ourselves, or again, risk the perception that we were being captured by, or ceding authority to, the profession that we had been assigned to regulate. So, yes, we decided to set the standards ourselves (Harvey, 2019).

The PCAOB can serve the public interest by establishing high quality auditing standards (Dellaportas & Davenport, 2008).

#### 5.4.1. Standard-Setting Agenda

As shown in Table 4, the PCAOB has been active in setting auditing standards since it commenced operations. Early in the PCAOB's existence, the Board's standard-setting function was focused on creating standards on auditing ICFR, audit documentation, and engagement quality review. The Board's first standard-setting priority after adopting its interim standards was to establish standards for audits of internal control over financial reporting (ICFR) so that auditors could fulfill their obligations under SOX Section 404. Auditing Standard No. 2 was proposed on October 7, 2003 and finalized on March 9, 2004. Prior to Duhnke's term that began in January 2018, the Board issued new auditing standards on important matters including audit documentation, engagement quality reviews, risk assessment, communications with audit committees, and auditing related party transactions and significant unusual transactions.<sup>7</sup> The PCAOB also revised the auditor's reporting model to include disclosure of Critical Audit Matters.

The Duhnke board inherited a standard-setting agenda and a research agenda, each with four projects (See Table 5). Two of the standard-setting projects, auditing estimates and use of a specialist, were proposed by the Doty Board in 2017 following several years of research and stakeholder feedback and finalized by the Duhnke board in December 2018. The Duhnke Board removed several projects (e.g., going concern, other information, and noncompliance with laws and regulations) from their respective agendas in 2020 (PCAOB, 2020a).<sup>8</sup> The quality control project was transferred from the research agenda to the standard-setting agenda and a concept release was issued in 2019 (PCAOB, 2019b). The other projects, supervision of other auditors and data and technology remained on the agendas throughout the Duhnke Board term.

The Duhnke PCAOB added just two projects to its agenda during his tenure. One relates to evidence obtained through the use of new technologies. The other involved amendment of the PCAOB's independence requirements to align with the SEC's amendments to Rule 2-01 of Regulation S-X. The Duhnke PCAOB made no progress on updating of interim standards.

At its inception, the Board was immediately faced with the need for standards and adopted as its interim standards, the extant standards of the AICPA's Auditing Standards Board (ASB), U.S. Generally Accepted Auditing Standards (GAAS) (PCAOB, 2003). When the PCAOB first adopted the AICPA standards in 2003, the staff recommended that all of the interim standards should be revised (Gradison, 2014). During Duhnke's tenure, there were no standard-setting efforts to update any of the standards carried over from U.S. GAAS in 2003. Although many interim standards have yet to be updated, the PCAOB's standard-setting agenda contained only two projects (i.e. quality control standards and supervision of other auditors) at the end of Duhnke's tenure, neither of which relates to updates of interim standards.

A few years before Duhnke's arrival at the PCAOB, it issued a proposed standard related to the supervision of other auditors for comment on July 29, 2016 (PCAOB, 2016). In response to stakeholder feedback, the PCAOB revised its proposal and issued a supplemental request for comment on September 26, 2017 (PCAOB, 2017). A new standard was not issued during the Duhnke Chairmanship. The PCAOB's delay in issuing a final standard is curious given that inspectors continued to find deficiencies in the audit work of component auditors that were not identified by the lead auditors (PCAOB, 2016). After Chairman Duhnke left the PCAOB, the Board issued a supplemental request for comment on this project on September 28, 2021 (PCAOB, 2021c) and a final standard on June 21, 2022 (PCAOB, 2022a).

The limited standard setting agenda during Duhnke's tenure favors the regulated firms who are not compelled to incur the costs to adopt new standards (e.g., updating firm policies, developing tools and guidance, and training auditors to comply). A sign of capture is when a regulatory agency lacks vision and priorities (Hempling, 2014). Moreover, the failure to update standards that were identified as deficient more than fifteen years earlier does not serve the public interest.

#### 5.4.2. Dissolution of Advisory Groups

The PCAOB's Standing Advisory Group (SAG) was established in 2003, shortly after the Board commenced operations. The purpose of the SAG was to provide advice and make recommendations to the Board. The PCAOB established the Investor Advisory Group (IAG) in 2010 "to provide a forum for the Board to obtain the views of, and advice from, the broad investor community on auditor oversight matters affecting investors" (Harris, 2010). The Investor Advisory Group met annually from 2011 until 2018. The PCAOB held no meetings of its advisory groups (i.e. the Standing Advisory Group and the Investor Advisory Group) in 2019 or 2020. Board member Brown (2020b) expressed his concern, "Neither group has had an opportunity to publicly weigh in on the decisions to remove from the agendas the very projects they asked us to include. Nor have they had an opportunity to address whether the PCAOB should emphasize the standard-setting priorities of an international body rather than the priorities that they recommend." At the same time the Board eliminated this source of investor feedback, it worked to enhance its outreach to, and feedback from, the preparers of financial

<sup>7</sup> In 2015, the Board reorganized its auditing standards into a single, integrated numbering system, using a topical structure.

<sup>8</sup> Two of the projects, going concern and noncompliance with laws and regulations, were added back to the standard-setting agenda after the Duhnke Board was replaced.

**Table 4**  
Auditing Standards Issued by the PCAOB Since Inception.

Reference	Description	First Proposed	Finalized
AS No. 1	References to PCAOB standards	11/12/2003	12/17/2003
AS No. 2	Audits of Internal Control Over Financial Reporting	10/7/2003	3/9/2004
AS No. 3	Audit Documentation	11/21/2003	6/9/2004
AS No. 4	Material Weakness Remediation	3/31/2005	7/26/2005
AS No. 5	Audits of Internal Control Over Financial Reporting (supersedes AS 2)	12/19/2006	5/24/2007
AS No. 6	Consistency of Financial Statements	4/3/2007	1/29/2008
AS No. 7	Engagement Quality Review	2/28/2008	7/28/2009
AS No. 8–15	Risk assessment standards	10/21/2008	8/5/2010
AS No. 16	Communications with Audit Committees	3/29/2010	8/15/2012
AS No. 17	Broker and Dealer Supplemental Information	7/12/2011	10/10/2013
AS No. 18	Related parties	2/28/2012	6/10/2014
Codification	Codification of Auditing Standards	3/26/2013	1/31/2015
N/A	Transparency of engagement partner and other firms involved in the audit	10/11/2011	12/15/2015
AS 3101	Auditor Reporting Model	8/13/2013	6/1/2017
AS 2501	Auditing Accounting Estimates	6/1/2017	12/20/2018
AS 1210	Auditor's Use of the Work of Specialists	6/1/2017	12/20/2018

The information in this table is derived from information available on the PCAOB's website (<https://www.pcaobus.org>).

**Table 5**  
Standard-Setting and Research Agendas.

Panel A: Standard-setting (SS) and Research Agendas as of December 31, 2017		
Agenda	Project	Status
SS	Auditing Accounting Estimates	Standard finalized in 2018
SS	The Auditor's Use of the Work of Specialists	Standard finalized in 2018
SS	Supervision of Audits involving other auditors	Remains on SS agenda
SS	Going Concern	Removed in 2020
Research	Quality control standards	Moved to SS agenda
Research	Use of data and technology	Remains on agenda
Research	Auditor's role regarding other information	Removed in 2020
Research	Noncompliance with laws and regulations	Removed in 2020
Panel B: Standard-setting (SS) and Research Agendas as of May 29, 2021		
Agenda	Project	Status
SS	Quality control standards	Concept release issued 12/17/2019
SS	Supervision of other auditors	Request for comment 9/26/2017
SS	Auditor independence	New rules finalized 11/19/2020
Research	Data and technology	Remains on agenda
Research	Audit Evidence	Added in 2020

Information to prepare this table are derived from the PCAOB website (<https://pcaobus.org/oversight/standards/research-standard-setting-projects>).

The standard-setting agenda as of December 31, 2007 was obtained from the PCAOB website at [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/standards/documents/q42017dec-standard-setting-agenda.pdf?sfvrsn=de46aa96\\_0](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/standards/documents/q42017dec-standard-setting-agenda.pdf?sfvrsn=de46aa96_0). The removal of the going concern standard setting project and the other information and noncompliance research projects are disclosed in the PCAOB's 2020 annual report (PCAOB 2020a).

statements (Duhnke, 2019). In other words, the PCAOB shifted its focus from obtaining feedback from the beneficiaries of inspections to the targets.

On March 29, 2021, Chairman Duhnke announced that the Investor Advisory Group and Standing Advisory Group had been abolished and a new Standards Advisory Group would be established (Duhnke, 2021). Shortly after Duhnke's departure, the PCAOB announced it was revisiting the decision to disband its advisory groups (PCAOB, 2021b). On January 31, 2022, the PCAOB announced the creation of the Investor Advisory Group and the Standards and Emerging Issues Advisory Group (PCAOB, 2022b).

#### 5.4.3. Standards that favor the regulated profession

With the exception of the two Doty-era projects (i.e. auditing estimates and use of specialists) that were completed in 2018, the only project completed by the Duhnke board related to auditor independence. The final standard relaxed PCAOB independence rules to help registered firms maintain compliance. The PCAOB completed this project quickly, skipping the normal comment letter process, and finalized the rule changes on November 19, 2020 (PCAOB, 2020b). Board member J. Robert Brown, Jr. voted against the rule changes. He explained his rationale at the time of the vote:

Today, however, the Board is rolling back the auditor independence rules of the PCAOB without conducting its own economic or policy analysis. The approach effectively cedes away much of the PCAOB's distinct and separate authority over independence

**Table 6**  
PCAOB Enforcement Activities.<sup>1</sup>

Panel A: PCAOB Disciplinary Orders by Year and Three-Year Period <sup>2</sup>							
Year	Chairman <sup>3</sup>	Disciplinary Orders		Individuals		Registered Firms	
		Number	Percent Of Total	Number	Percent Of Total	Number	Percent Of Total
2005	McDonough	4	1.2%	5	1.9%	3	1.3%
2006	Olson	3	0.9%	3	1.1%	3	1.3%
2007	Olson	9	2.8%	10	3.7%	5	2.1%
2008	Olson	4	1.2%	5	1.9%	3	1.3%
2009	Goelzer	6	1.8%	7	2.6%	5	2.1%
2010	Goelzer	9	2.8%	9	3.4%	4	1.7%
2011	Doty	10	3.0%	8	3.0%	12	5.0%
2012	Doty	11	3.4%	12	4.5%	7	3.0%
2013	Doty	17	5.2%	13	4.9%	14	5.9%
2014	Doty	25	7.6%	7	2.6%	21	8.9%
2015	Doty	46	14.0%	27	10.1%	38	16.1%
2016	Doty	58	17.7%	45	16.9%	33	14.0%
2017	Doty	59	18.0%	52	19.5%	43	18.2%
2018	Duhnke	20	6.1%	19	7.1%	13	5.5%
2019	Duhnke	30	9.1%	27	10.1%	19	8.1%
2020	Duhnke	17	5.2%	18	6.7%	13	5.5%
		<b>328</b>	<b>100.0%</b>	<b>267</b>	<b>100.0%</b>	<b>236</b>	<b>100.0%</b>
Period		Orders		Individuals		Firms	
2015–2017		163		124		114	
2018–2020		67		64		45	
Panel B: Sanctions Imposed by the PCAOB							
<i>Nature of Sanctions Imposed</i>							
	Doty 2015–2017			Duhnke 2018–2020			
<i>Firms:</i>							
Censure and civil monetary penalty	55	48.2%		25	55.6%		
Censure, penalty, and revocation	33	28.9%		8	17.8%		
Censure and revocation	24	21.1%		5	11.1%		
Civil monetary penalty and revocation	0	0.0%		3	6.7%		
Civil monetary penalty only	0	0.0%		2	4.4%		
Revocation of registration only	0	0.0%		2	4.4%		
Censure only	2	1.8%		0	0.0%		
Enforcement actions against firms	<b>114</b>	<b>100%</b>		<b>45</b>	<b>100.0%</b>		
<i>Individuals:</i>							
Censure and bar/suspension	70	58.3%		25	39.0%		
Censure, penalty, and bar/suspension	33	25.0%		19	29.7%		
Penalty and bar/suspension	0	0.0%		8	12.5%		
Suspension or bar	0	0.0%		5	7.8%		
Censure and civil monetary penalty	3	2.5%		3	4.7%		
Civil monetary penalty only	0	0.0%		2	3.1%		
Censure only	18	14.2%		1	1.6%		
None of these <sup>4</sup>	0	0.0%		1	1.6%		
Enforcement actions against individuals	<b>124</b>	<b>100.0%</b>		<b>64</b>	<b>100.0%</b>		
<i>Civil Monetary Penalties</i>							
	Doty 2015–2017			Duhnke 2018–2020			
	n	Mean	Median	n	Mean	Median	
Annually inspected firms	2	\$1,250,000	\$1,250,000	6	\$335,833	\$350,000	
Triennially inspected firms	86	\$134,802	\$10,000	32	\$65,221	\$15,000	
Individual auditors	36	\$19,722	\$10,000	31	\$16,613	\$10,000	
<i>Revocation of Firm Registrations</i>							
	Doty 2015–2017			Duhnke 2018–2020			
Number of Years	Number	Percent of Total		Number	Percent of Total		
Unspecified <sup>5</sup>	9	7.9%		2	4.4%		
1	14	12.3%		2	4.4%		
2	16	14.0%		8	17.8%		
3	8	7.0%		3	6.7%		
5	5	4.4%		2	4.4%		

(continued on next page)

Table 6 (continued)

<i>Revocation of Firm Registrations</i>				
Number of Years	Doty 2015–2017		Duhnke 2018–2020	
	Number	Percent of Total	Number	Percent of Total
Permanent	5	4.4%	1	2.2%
Not revoked	57	50.0%	27	60.1%
	114	100.0%	45	100.0%

  

<i>Suspensions and Bars of Individuals</i>				
Number of Years	Doty 2015–2017		Duhnke 2018–2020	
	Number	Percent of Total	Number	Percent of Total
Unspecified <sup>5</sup>	10	8.1%	2	3.1%
1	37	29.8%	20	31.3%
1.5	1	0.8%	0	0.0%
2	28	22.6%	26	40.6%
3	13	10.5%	5	7.8%
5	12	9.7%	3	4.7%
Permanent	2	1.6%	1	1.6%
Not suspended or barred	21	16.9%	7	10.9%
	124	100.0%	64	100.0%

  

<b>Panel C: Frequent Enforcement Violations</b>				
Description	Doty 2015–2017		Duhnke 2018–2020	
	Number	Percent of Total Violations <sup>7</sup>	Number	Percent of Total Violations <sup>7</sup>
<i>Enforcement Actions Against Firms:</i>				
Quality control deficiencies	15	13.2%	17	37.8%
Due care and professional skepticism	26	22.8%	14	31.1%
Sufficient appropriate audit evidence	24	21.1%	12	26.7%
Failure to file administrative reports with the PCAOB	27	23.7%	10	22.2%
Failure to have an engagement quality review	28	24.6%	9	20.0%
Independence violations	39	34.2%	5	11.1%
<i>Enforcement Actions Against Individuals</i>				
Due care and professional skepticism	43	34.7%	34	53.1%
Sufficient appropriate audit evidence	39	31.5%	25	39.1%
Contributing to a firm's violation of PCAOB standards	44	35.5%	18	28.1%
Failure to perform sufficient audit procedures	21	16.9%	14	21.9%
Failure to adequately document audit work	5	4.0%	8	12.5%
Non-cooperation with PCAOB inspection or investigation	34	27.4%	3	4.7%

<sup>1</sup> The data for this table was hand collected from the publicly available disciplinary actions available on the PAOB website (i.e. <https://www.pcaobus.org>).

<sup>2</sup> The total number of individuals and firms named in enforcement actions exceeds the total number of enforcement actions because the PCAOB frequently name multiple parties in a single enforcement action. For example, they might name both a firm and the partners and other employees involved in the investigation.

<sup>3</sup> The individual listed as chairman is the individual who was the PCAOB chairman on the final day of the calendar year.

<sup>4</sup> The individual in this case was restricted with regard to activities (e.g., performing certain partner responsibilities) for a period of time.

<sup>5</sup> The PCAOB generally identifies the time period after which an individual may request termination of the bar. When the PCAOB does not specify a time period, the individual may request termination at any time.

<sup>6</sup> This table presents the most frequent enforcement actions reported during the relevant three-year period.

<sup>7</sup> The denominator for this statistic is the total number of enforcement actions issued during the three-year period. The denominators for enforcement actions against registered firms are 114 and 45 for Doty and Duhnke, respectively. The denominators for enforcement actions against individuals are 124 and 64 for Doty and Duhnke, respectively.

standards. The majority does so without public input or discussion ... The majority's action are [sic] inconsistent with what Congress intended, does not meet the expectations of investors, the public, and audit committees, and fails to address the needs of the PCAOB in overseeing auditor independence ... This unprecedented approach should trouble audit firms, investors, and the public. The PCAOB is obligated to act in the public interest. This is not a choice. The mission is set out in the statute with unmistakable clarity. The PCAOB cannot simultaneously claim to adhere to this mission while failing to communicate with, and seek input from, investors and the public. (Brown, 2020a).

Board member Brown's comments suggest that, in adopting the independence rule changes without public comment, the PCAOB failed to act in the public interest.

#### 5.4.4. Summary – Standard-Setting

Since its inception, the PCAOB has maintained an active and ambitious standard-setting agenda. During Chairman Duhnke's

tenure, the PCAOB removed several projects from its agenda and added only two, one of which eased the independence rules applicable to registered firms. The Duhnke PCAOB also suspended meetings with its advisory groups and eventually disbanded them altogether.

### 5.5. Enforcement activity

The PCAOB has the power to enforce its standards through disciplinary action with sanctions that include censure, civil monetary penalties, limitation on activities, revocation of firm registration, suspensions and bars of individual auditors from association with a registered firm, and “any other appropriate sanction provided for in the rules of the Board” (U.S. House of Representatives, 2002). Sanctions levied by the PCAOB have had direct effects on the firms involved (e.g., Boone, Khurana, and Raman, 2015; 2017) and their clients (Dee, Lulseged, & Zhang, 2011). PCAOB sanctions have also been shown to lead to increased quality of audits performed by non-sanctioned auditors in certain circumstances (Lamoreaux et al., 2022). An effective enforcement program is, therefore, in the public interest.

There is evidence of a shift in the PCAOB’s exercise of its investigation and disciplinary authorities during the Duhnke term. First, the number of resolved enforcement actions declined dramatically during this time. As shown on Table 6, Panel A, the annual number of enforcement actions increased from 4 in 2005 to 52 in 2017. The Doty Board completed 163 disciplinary orders in its final years (2015–2017) compared to 67 by the Duhnke Board (2018–2020).<sup>9</sup> Enforcement actions against individuals dropped from 48 in 2017 to 19 in 2018. The PCAOB completed 13 enforcement actions against registered firms in 2018, compared to 43 in 2017.

There was also a shift in terms of the sanctions imposed by the PCAOB for wrong-doing (see Table 6, Panel B). Whereas the Doty Board censured every firm and individual involved in a disciplinary action, the Duhnke Board did not. Moreover, the mean (median) monetary penalty for annually inspected firms was \$335,833 (\$350,000) during Duhnke’s term compared to \$1,250,000 (\$1,250,000) levied in the final three years of the Doty Board. The average penalty levied on triennially inspected firms decreased from \$134,802 to \$65,221 while the median increased by \$5,000 to \$15,000. Mean fines assessed to individual auditors declined slightly from \$19,722 (\$10,000) to \$16,613, while the median remained \$10,000.

During the three years 2015–2017, firms subject to PCAOB enforcement were barred from practice for at least one year 42.1 % of the time, compared to 35.5 % of the time under Duhnke. Firms had their registration permanently revoked 2.2 % of the time under Duhnke, compared to 4.4 % during the final three years of the Doty Board. For individual auditors subject to disciplinary action, the evidence is mixed. The Duhnke Board was more likely to suspend or bar an individual auditor from practice (89.1 % of the time compared to 83.1 % during 2015–2017), and just as likely (i.e. 1.6 %) to issue a permanent ban.

The nature of the violations did not change dramatically under the Duhnke Board compared to those issued under prior boards. Panel C of Table 6 shows the most frequent violations under the Duhnke Board and the PCAOB during 2015–2017. Similar violations that occurred frequently prior to the Duhnke Board were identified during the Duhnke tenure. For example, the most frequently occurring violation against individual auditors during the three years preceding the Duhnke Board, “Failure to exercise due care and professional skepticism,” is present in 53.1 % of the enforcement actions occurring under the Duhnke Board. It appears that the Duhnke Board focused less enforcement efforts in the area of auditor independence (34.2 % versus 11.1 %) and non-cooperation with PCAOB inspections and investigations (27.4 % versus 4.7 %).

The decline in enforcement actions resolved under Duhnke and the reductions in the severity of sanctions are consistent with a degree of regulatory capture. SOX provided the PCAOB with the power of investigations and disciplinary action, and those powers were used less under the Duhnke board than they were previously under the Doty Board. The shift from the public interest (strong enforcement) to the private interest of the accounting firms (fewer investigations and weaker sanctions) supports the capture hypothesis. However, the public remains better off with the PCAOB as regulator (versus self-regulation by the profession) because the Duhnke PCAOB continued to focus enforcement activities on the auditors’ responsibilities to exercise due care, professional skepticism, and to obtain sufficient appropriate audit evidence.

## 6. Summary and concluding comments

Congress established the PCAOB to regulate the public accounting profession and thereby, to serve the public interest. The PCAOB serves the public interest by establishing robust performance standards, conducting rigorous inspections, investigating noncompliance with its rules and standards, and imposing sanctions on violators. PCAOB regulation is costly to the regulated firms.

As a regulatory body, the PCAOB is susceptible to regulatory capture. Regulatory capture occurs when a regulatory agency serves the interests of the regulated industry rather than the public interest. This paper employs Carpenter’s (2014b) model to evaluate whether the PCAOB was captured during the Duhnke Chairmanship. For purposes of this paper, the public interest is served when the PCAOB uses its authority to conduct inspections, sets rules and standards for audits of public companies, investigates violations of its rules, and disciplines auditors and firms found to be in violation of its rules and standards.

The paper provides evidence of the intent and actions of the public accounting firms to influence the PCAOB indirectly through campaign contributions and lobbying efforts. Evidence is presented that, during the 2018–2020 timeframe, the PCAOB’s activities attenuated in all three areas of its responsibility. The PCAOB conducted fewer inspections and identified fewer deficiencies in the

<sup>9</sup> The PCAOB has not disclosed in its annual report, since 2017, how many investigations are currently in progress.

inspections it did perform. The PCAOB's standard-setting and enforcement activities were also curtailed. The Duhnke Board did not simply change its approach to regulation by allocating more effort in one area and less in another, it reduced efforts in all areas. This reduced level of activity benefitted regulated firms to the detriment of investors. The conclusion is that the PCAOB was captured during Chairman Duhnke's tenure.

Shapiro (2012) describes multiple ways that regulatory agencies can become captured. First, an agency can become captured as a result of its enabling legislation. Second, rulemaking ossification occurs when Congress or the President impose procedural requirements that make it difficult to establish new rules. Third, an agency can become captured through insufficient funding. Finally, regulatory agencies can be captured through the appointment of "hostile" administrators. The reduced activity of the PCAOB from 2018 to 2020 suggests that majority of the new members appointed to the PCAOB in 2018 may have been less zealous for the PCAOB's mission than prior members. This suggests that the PCAOB was captured through this fourth mechanism, appointment of "hostile" administrators who are philosophically opposed to government regulation and attempt to reduce or weaken it.

A conclusion that the PCAOB was captured during the Duhnke Chairmanship does not imply that it should be dissolved or replaced. Capture is not a dichotomy whereby a regulator acts completely in the interest in the public interest or completely in the private interest. There are degrees of regulatory capture (Carpenter & Moss, 2014). The Duhnke PCAOB was weakly captured. In other words, it continued to serve the public interest, but to a lesser extent than if it had fully embraced its mission. The accounting profession faced less stringent (e.g. fewer inspections, fewer deficiencies, reduced enforcement), less costly (e.g., lower average penalties for misconduct, fewer new standards) regulation under the Duhnke Board, but it remained subject to inspections, standards, and potential enforcement. Moreover, the new Board can choose to impose more stringent regulation. The PCAOB can alternate between serving the public interest and being captured (or move along the capture continuum) as its members change (Davis, 1962).

One of the weaknesses of democracy is the potential for public institutions to be captured by private interests (Novak, 2013). Despite the efforts of Congress to provide appropriate checks and balances in the design of the PCAOB, it remains susceptible to capture through the appointment of members who are hostile or passive with respect to the mission. Time will tell if the PCAOB can be restored to a public interest focus now that a new board has been appointed.

## Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

## Data availability

Data will be made available on request.

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