The Audit Blog

Save the PCAOB!

[Dan Goelzer]

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By Dan Goelzer

The House Financial Services Committee has voted to include a provision in the 2025 budget reconciliation bill that would abolish the PCAOB and re-assign its functions to the SEC. In my view, this is an ill-considered idea that will jeopardize audit quality and do nothing to reduce the deficit.

The PCAOB, mainly through its inspection program, has been the catalyst for major improvements in public company auditing. The Sarbanes-Oxley Act created the PCAOB in 2002 to stem the crisis in investor confidence in financial reporting that followed the dramatic collapses of Enron, WorldCom, and other financial reporting failures. Sarbanes-Oxley was a bipartisan effort that passed the Senate unanimously and with only three negative votes in the House. The PCAOB has done the job it was created to perform. During the 20-plus years that the Board has been operating, restatements have declined, accounting firms have become more focused on audit quality, and significant breakdowns in audited financial reporting have become far rarer.

It is doubtful that the Board's functions could be performed as effectively if they become SEC responsibilities. Audit quality and public company auditor oversight are sufficiently important to our capital markets that they should be the responsibility of an organization that has those issues as its exclusive focus. The SEC already has a broad range of responsibilities and limited resources. Under the current structure, the SEC oversees the PCAOB — essentially it can control everything the Board does — without having to invest its own resources to perform the day-to-day work of audit oversight. Under the merger proposal, the SEC would lose this ability to use regulatory leverage and instead become the frontline audit regulator. The result is likely to be dilution of both audit oversight and of the SEC's ability to perform its other investor protection responsibilities.

Even if the SEC could eventually re-create inspections and standard-setting functions comparable to the PCAOB's current programs, it would take several years and there would be considerable disruption and lack of continuity along the way. Just building a staff with the necessary expertise could be a challenge. ***It's doubtful that most PCAOB personnel would transfer to the Commission and keep doing their jobs at lower government pay rates — even if the SEC had the budget to hire them.*** PCAOB inspectors are themselves experienced auditors and, given the talent shortage plaguing the profession, there is considerable demand for their skills.

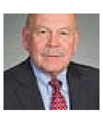
Inspections of foreign accounting firms that audit companies with securities trading in the U.S. are one example of an important PCAOB function that is working well now but would have to be rebuilt by the SEC at considerable cost. After years of effort and frustration, the PCAOB, in 2022, signed a Statement of Protocol Agreement with the Chinese Securities Regulatory Commission and the Ministry of Finance permitting the Board to inspection auditing firms in China and Hong Kong. **The PRC is sensitive to the idea of another**

government acting within its territory, and one key to the SOP Agreement was that the inspectors sent to China would be PCAOB employees, not employees of the U.S. government. The Chinese are not likely to permit the SEC to simply step into the PCAOB's shoes and continuing performing inspections in China. Other countries also may want to renegotiate the memorandum of understanding with the PCAOB under which they permit inspections on their soil. ***After switching the inspection function to the SEC, it could take years to simply restore the foreign inspection program to its current status***.

While there would be many downsides to transferring the PCAOB's functions to the SEC, it's hard to think of advantages. There seems to be a notion that the transfer would save money and reduce the deficit, but the opposite is the case. **The PCAOB is funded through assessments paid by the largest public companies and by fees paid by accounting firms*****. It doesn't receive any taxpayer funding.*** The SEC, on the other hand, like other government agencies, receives an annual appropriation from Congress. Therefore, the effect of merging the PCAOB into the SEC is to require taxpayers to start paying the costs of audit oversight, which are now borne by large companies and accounting firms. In short, it would increase, not decrease, the deficit.

The idea behind including the merger in the 2025 budget reconciliation bill apparently is that the PCAOB will turn over to the Treasury its unused funds when it goes out of business. But that would be a one-time payment, at the expense of the need for future appropriations in perpetuity to support the SEC's ability to do the work that the PCAOB now does. **This makes no fiscal sense.**

Folding the PCAOB's functions into the SEC is a bad idea, from both the standpoint of investor protection and deficit reduction. At the very minimum, it would be a major realignment of the securities regulatory structure. It should be the subject of debate and consideration. **The PCAOB should not be abolished without Congressional hearings and public input** simply to generate a minor windfall in 2025 budget. Investors and the public deserve better.



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