

# SPOTLIGHT

## The PCAOB's Use of Economic Analysis and Stakeholder Input in Standard Setting

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November 2020

This Spotlight represents the views of PCAOB staff and not necessarily those of the Board. It is not a rule, policy, or statement of the Board.

## OVERVIEW

A core component of the Public Company Accounting Oversight Board's (PCAOB) oversight is setting [standards](#) for firms to follow as they prepare audit reports for public companies and other issuers, and broker-dealers. In setting standards, we follow an evidence-based approach which includes economic analysis. This approach is responsive to the financial reporting and auditing environments, carefully weighs costs, benefits, and potential unintended consequences, and contemplates our mission to protect investors.

This Spotlight outlines how we conduct economic analysis and gather stakeholder input, both before and after our standards take effect. We drafted this Spotlight in response to frequently asked questions we have received this year from audit committee chairs and others who have asked if we perform cost-benefit analysis of our standards.

## ANTICIPATING A STANDARD'S IMPACT

Before issuing a new or revised standard, we seek input from relevant stakeholders and perform an economic analysis.

### The Public Comment Process

Although federal law does not require the PCAOB to use particular rulemaking procedures (e.g., the Administrative Procedures Act), the Board—like other standard setters and U.S. federal agencies—generally follows a notice-and-comment process to develop standards. This process typically involves issuing a proposing release for comment. It can also involve additional steps, such as publishing a

“We must carefully consider relevant research of all types, and use evidence-based principles to inform our decision-making. In other words, we must leverage our strong economic and risk analysis capabilities to facilitate effective policymaking.”

- PCAOB Chairman William D. Duhnke III,  
May 17, 2018

concept release to help determine whether a proposal is needed and what form it might take or issuing a supplemental request for comment to refine an original proposal.

During the standard-setting process, the public can provide input via comment letters, and the Board may also use mechanisms such as roundtables to gather views. Stakeholder comments serve to inform the Board on an array of perspectives regarding proposed standards before voting on whether to adopt them.

The U.S. Securities and Exchange Commission (SEC) has the ultimate authority to approve standards adopted by the PCAOB. In considering whether to approve a new or revised standard, the SEC usually conducts its own notice-and-comment rulemaking process.

## The PCAOB's Approach to Economic Analysis

Our approach to analyzing economic considerations related to new or revised standards addresses four main elements.<sup>1</sup>

### 1. *Describing the Need for the Standard or Rule*

When publishing a proposed or final standard, we describe, as clearly as possible, the need for standard setting and explain how the standard would meet that need.

### 2. *Developing the Baseline and Measuring for Rule Impacts*

To assess the potential economic effects of a new or revised standard, we first establish a baseline against which to measure the potential impacts of the new or revised standard. In other words, we evaluate conditions without the new or revised standard—i.e., the state of the world today—including the economic attributes of the market being regulated.

The baseline analysis discusses the current standards that the new or revised standard will affect, as well as information available regarding the wider range of audit performance and market behavior found in practice.

### 3. *Considering Reasonable Alternatives*

We also consider alternative approaches to solving the stated problem, with the aim of answering three questions. First, why is standard setting preferable to another regulatory approach, such as providing interpretive guidance or enhancing inspection or enforcement efforts? Second, why is the chosen standard-setting approach preferable to other reasonable standard-setting approaches?

Third, what are the key policy choices made by the Board in determining the details of the standard?

### 4. *Analyzing Economic Impacts of the Standard (and Alternatives)*

Finally, we identify the likely economic benefits, costs, competitive effects, and potential unintended consequences of the new or revised standard (and alternatives). To the extent we can, we quantify those variables. We also provide relevant qualitative analyses.

An example of a potential economic benefit could be a reduction in the likelihood of a high-impact event (such as a major audit failure) that could negatively impact investors and/or increase the cost of capital for public companies.

The costs of a standard can be either direct or indirect. Direct costs are those incurred by auditors to comply with the standard. Indirect costs can be incurred by auditors or other affected entities.

## Economic Analysis: Quantitative and Qualitative Inputs

PCAOB economists strive to characterize impacts as accurately as possible, especially in evaluating costs and benefits of the standard. While we rely on economic theory and rigorous quantitative analysis whenever possible, some concepts or phenomena (e.g., audit quality) can be challenging or impossible to fully capture on a quantitative basis. In such cases, qualitative information—such as feedback collected through interviews or surveys—also serves as a critical input for economic analysis.

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<sup>1</sup> Further information about the purpose, scope, timing, and process for conducting economic analysis is available in the PCAOB [Staff Guidance on Economic Analysis in PCAOB Standard Setting](#).

## REVIEWING RESULTS

We continue to perform economic analysis after the Board adopts (and the SEC approves) the new or revised PCAOB standards. One approach is through a [post-implementation review program](#) where we gather and analyze information regarding implementation of the standard. Post-implementation reviews complement the prospective economic analysis presented in our releases. With the benefit of more data, post-implementation reviews allow for a second look at the overall effects of a rule or standard (including costs and benefits) and provide an additional opportunity for external engagement.

We review adopted standards in several ways, including:

- *Analyzing Public and Nonpublic Data.* PCAOB economists apply econometric analyses and other empirical methods to large-sample data sets (e.g., stock market returns or PCAOB inspection findings). [Working papers](#) and [white papers](#) discussing these analyses are available on our website.
- *Conducting Surveys.* We conduct surveys to collect quantitative and qualitative information from relevant stakeholders—for example, audit engagement partners, audit firms, or investors—regarding auditors' implementation of our standards.
- *Interviewing Stakeholders.* We conduct structured interviews with stakeholders to hear firsthand about the impact of standards. These interviews can take place on a regular basis (e.g., the PCAOB's ongoing conversations with audit committee chairs) or as part of more focused analysis of a particular standard.

- *Reviewing Economic Literature.* In addition to conducting its own research, our Office of Economic and Risk Analysis reviews the relevant work of academic researchers on the economic impact of auditing and audit regulation on capital markets.

### Post-Implementation Review and Interim Analysis

The objective of a PCAOB post-implementation review program is to look back at significant rulemakings to evaluate the overall effect of the standard, after a reasonable period of time has passed.

In some cases, we may perform an “interim analysis” to provide insight into the initial impacts of new auditing requirements at key points in the implementation process. While preliminary, interim analyses help inform the broader and more comprehensive post-implementation review. Interim analyses can also provide early evidence of significant costs, benefits, or unintended consequences associated with new requirements.

We publicly share the results of our post-implementation reviews and interim analysis **on our website**.

## CASE STUDY: UPDATING THE AUDITOR'S REPORT

In 2017, the PCAOB adopted, and the SEC approved, a revised standard for the auditor's report. The revised standard includes a requirement for the auditor to determine and communicate critical audit matters (CAMs) in the auditor's report. Here's how we have used and will continue to use economic analysis and stakeholder input related to CAMs.

### Stakeholder Engagement and Analysis during the Standard-Setting Process

Starting in 2011, we offered the public several opportunities to [review and comment](#) on possible changes to the auditor's reporting model, including issuing a concept release describing potential changes to auditor reporting and issuing a proposing release. After considering comments on the proposed standard, the Board sought further public comment on a re-proposed standard.

Consideration of changes to the auditor's reporting model also involved conducting an extensive economic analysis, which began before the Board issued a proposed standard for public comment. The [adopting release for the final rule](#) contains a comprehensive discussion of economic considerations, including the need for the rulemaking, the baseline, costs, benefits, potential unintended consequences, and possible alternatives.

### Evaluating the New CAMs Requirements

We adopted a phased implementation approach for CAMs. The Board required auditors to communicate CAMs (1) for audits of large accelerated filers for fiscal years ending on or after June 30, 2019 and (2) for audits of all other companies to which the requirements apply for fiscal years ending on or after December 15, 2020.

### Interim Analysis

During the comment process prior to adoption, some commenters raised concerns about the impact of CAMs requirements on stakeholders in the financial reporting process. For example, how would identifying CAMs affect the workload of engagement teams? Would CAMs lead to reduced communication between audit committees and auditors? Would investors find CAMs useful? PCAOB economists considered these concerns when preparing the economic analysis presented in the release accompanying the final standard. The SEC asked the Board to perform an interim analysis of the standard between the relevant effective dates as part of the Board's efforts to monitor implementation of CAMs.

To support the interim review of CAMs, PCAOB economists pursued several avenues of research after the initial implementation of CAMs, including conducting:

- Surveys of audit firms and engagement partners to gain insights into how audit firms had prepared for CAMs and how CAMs had affected their work;
- Surveys of investors to gather information about their awareness, perceptions, and use of CAMs;

- Structured interviews with audit committee chairs and financial statement preparers to understand their experiences with initial implementation of CAMs; and
- Analysis of public and nonpublic data sources to investigate the impact of initial CAMs implementation on audit hours, audit fees, time to issue audit reports, and the capital markets.

We presented the results of this work in an October 2020 [Interim Analysis Report](#) and two staff white papers focused specifically on [stakeholder outreach](#) and [econometric analysis](#).

### Post-Implementation Review

Our interim review, however, was only the first step in analyzing the standard after its implementation. We are currently working on a comprehensive post-implementation review to evaluate the overall effect of the standard on the audit profession, public companies, and the capital markets. We expect to complete our post-implementation review in 2024.

## We Want to Hear from You

So we can continue to improve our external communications and provide information that is timely, relevant, and accessible, we want your views on this document. We invite you to fill out **our survey**, which should take no more than two minutes to complete.

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