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**ILLINOIS**  
Gies College of Business

January 31, 2023

Office of the Secretary, PCAOB  
1666 K Street NW  
Washington, DC 20006-2803

RE: Rulemaking Docket Matter No. 046 (PCAOB Release No. 2022-006 Request for Public Comment)

Dear Secretary Brown and PCAOB Board Members:

We appreciate the opportunity to comment on the PCAOB’s Proposed Quality Control Standard (QC 1000) — PCAOB Release No. 2022-006, “A Firm’s System Of Quality Control And Other Proposed Amendments To PCAOB Standards, Rules, And Forms.” As academics with expertise in behavioral research on auditing topics, we believe and hope that we can help inform the Board about academic research relating to the newly proposed quality control standard. We make four recommendations for the Board’s consideration. Our first three recommendations are based on the broad audit and accounting academic literature. Our last set of recommendations are directly based on one of our own studies that examines how audit firms manage their QC systems.

**Recommendations based on the broad audit and accounting literature**

First, we suggest that the Board enrich the **Information and Communication** component of audit firms’ QC systems by explicitly integrating academic audit and accounting studies as a vital source of information. We applaud the Board for reviewing and specifically citing numerous academic studies to support the formulation of Proposed QC 1000 (e.g., in VI Economic Analysis section, at the subsection entitled “Academic literature on quality-threatening behaviors and quality control” [p. 259]). What is missing from QC 1000, however, is encouraging, or even requiring audit firms to inform their QC design, implementation, monitoring, and revision by taking stock of relevant themes and findings documented in academic audit and accounting studies. More than any one study, particular streams of research shine needed and helpful light on both factors that amplify and factors that mitigate judgment bias. Judgment bias often occurs at the subconscious level and has high potential to distort audit engagement team members’ exercise of sound professional judgment and objectivity (e.g., QC1000.47a). As just one example, a stream of peer-reviewed studies demonstrates that, when certain factors are present, audit professionals are **not** objective on average when deciding on the acceptability of client management’s accounting choices or when recommending audit adjustments that would reduce client management’s reported income or assets. This lack of objectivity, often caused by subconscious bias, is a systematic quality risk that endangers attainment of quality objectives. The factors heightening this risk include the existence of higher engagement pressure, more explicit pressure from client management or auditor affinity with management, and when management publicly releases its earnings before the date of audit completion (see, e.g., Kadous et al. 2003; Koch and Salterio 2017;

Bhaskar et al. 2019).<sup>1</sup> By staying current on new developments in the academic audit literature, audit firm's QC leadership will be in a better position to triage newly identified quality risks as well as the specific engagements more susceptible to these risks. It may well be cost-beneficial for QC 1000 to require, or at least to encourage audit firms' QC leaders with staying current on the audit literature; reflecting on emerging findings in this literature; calling for new academic studies proactively that pertain to topical quality objectives, quality risks (including "what could go wrong" as PCAOB Release No. 2022-006 mentions several times), and planned quality responses including remediation processes and potential revisions to their audit training and methodologies. We note that some of the items presented in the illustrative list provided in Appendix B at paragraph .20a are amenable to being empirically investigated to learn more about whether and under what conditions they influence quality risks (e.g., reliance on shared service centers internal or external to the audit firm, dependency on technology).

Second, we suggest that the Board revise QC 1000 to clarify that an indispensable way that audit firms as a whole and their principal executive officers can demonstrate a robust commitment to maintaining and improving their QC systems (see, e.g., QC 1000.14a) is to provide ongoing, meaningful support of scholarly audit and accounting research. Doing so is roughly analogous to institutions and organizations, both governmental and NGO's, being steadfastly committed to research and development activities that have a longer-term payoff. Audit academics, as a result of their training, expertise, and social distance from practitioners and their accompanying pecuniary interests, are well-positioned to produce studies that are in the public interest and help audit firms proactively refine quality objectives, mitigate quality risks, and improve their quality responses, remediation efforts, and QC reporting. Audit firms can do so, for example, by allowing academics access to their audit professionals to conduct well-designed experimental, survey, or interview research projects.<sup>2</sup> What is more, a powerful way to test the effectiveness of efforts to remediate or improve a firm's QC system in real-time would be to implement proposed improvements on an experimental or pilot basis, using some form of random assignment. With this approach, scientifically valid field experiments could be conducted by academics and their results analyzed.<sup>3</sup> Such experimentation should be encouraged in QC 1000 as it is reasonable to

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<sup>1</sup> Kadous, K., J. Kennedy, and M. E. Peecher. 2003. The Effect of Quality Assessment and Directional Goal Commitment on Auditors' Acceptance of Client-Preferred Accounting Methods. *The Accounting Review* 78 (3): 759–778 (<https://doi.org/10.2308/accr.2003.78.3.759>); Koch, C. and S. Salterio. 2017. The Effects of Auditor Affinity for Client and Perceived Client Pressure on Auditor Proposed Adjustments. *The Accounting Review* 92 (5): 117–142 (<https://doi.org/10.2308/accr-51703>); and Bhaskar, L. S., P. E. Hopkins, and J. H. Schroeder. 2019. An Investigation of Auditors' Judgments When Companies Release Earnings Before Audit Completion. *Journal of Accounting Research* 57 (2): 355–390 (<https://doi.org/10.1111/1475-679X.12262>).

<sup>2</sup> We do note that for over a decade, the [Center for Audit Quality](#) (CAQ) has provided numerous helpful opportunities for audit academics to conduct meaningful audit research studies through its [Access to Audit Personnel Program](#) and now inactive [Research Advisory Board Grant Program](#). However, it is our understanding that there currently is a large backlog of unfulfilled studies associated with the Access to Audit Personnel Program. Further, it is almost certainly the case that the set of research questions that have generated enthusiasm and consensus among CAQ advisory board members and CAQ member firms is one that overlaps but does not come close to coinciding perfectly with the set of research questions that one particular audit firm or the PCAOB's Board would want to pursue. We also clarify that part of being "well-designed" for academic research that involves human participants is oversight by appropriate institutional human subjects' review boards

<sup>3</sup> Field experiments are rare in the audit literature, despite holding considerable promise for research in auditing and other accounting contexts (see, e.g., Levitt, S. D. and J. A. List. 2016. Using Field Experiments in Accounting and Finance. *Journal of Accounting Research* 54 (2): 437–475 [<https://doi.org/10.1111/1475-679X.12113>]). If the proposed remediation to quality objectives, risks, and responses were truly proprietary, an audit firm could quarantine the field experiment results for some time, or shared on a limited release basis, such as with the PCAOB or audit

conjecture that some ideas for improving a firm’s QC system might not work as planned. Indeed, the policy resistance literature documents anecdotal and empirical evidence of how a variety of policy innovations ended up having side effects that offset the intended benefits or even worsened matters.<sup>4</sup> A vibrant academic arm of the broader audit profession can help understand and improve audit practitioners’ exercise of professional skepticism and professional judgment.<sup>5</sup>

Third, we recommend that Proposed QC 1000 be modified to clarify the need for QC leaders’ exercise of professional skepticism to embrace the fallibility of audit engagement team members’ and partners’ professional judgment and decision processes. As PCAOB Release No. 2022-006 notes (at, e.g., p. 259), a large number of studies have shown that auditors are susceptible to an array of (often subconscious) biases. Many of these biases make it difficult for audit engagement team members to be objective when assessing and addressing the risk of material misstatement on audit engagements. QC leaders need to be familiar with these studies and thoughtfully reflect on their QC implications for audit practice to help mitigate the likelihood that these biases pose unacceptably large quality risks that trigger avoidable QC deficiencies. At Proposed QC 1000 para. 10 (in Appendix 1 at page A1-4), for example, there is an apt discussion of the need to exercise professional skepticism. This paragraph would be improved if it went on to point out that the exercise of professional skepticism, especially as it pertains to designing, implementing, and improving the firms’ QC systems, involves turning one’s questioning mind towards audit engagement team members’ professional judgment and decision processes.<sup>6</sup>

### **Recommendations based on our recent QC study**

Fourth, our last set of recommendations draws on findings from one of our recent studies titled “[Managing Quality Control Systems: How Audit Firms Experience and Navigate Conflicting Institutional Demands](#).”<sup>7</sup> Although our paper has yet to undergo the rigorous peer-review process at a top academic journal, we have presented it at three refereed conferences. Further, several experts in our field have also reviewed the paper and provided their comments.

The extant academic literature is quite limited but confirms the important role that QC systems play in delivering high audit quality. For example, deficient QC systems are associated with significant adverse consequences for audit firms, including low audit quality, reduced firm

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committee members. Our conjecture is that timely insights from field experiments about many planned improvements to firms’ QC systems would have sufficient public-good spillover value to make more widespread sharing amongst public company audit firms and academics desirable.

<sup>4</sup> For examples outside of auditing, see, e.g., Stermann, J. 2006. Learning from Evidence in a Complex World. *American Journal of Public Health* 96 (3): 505–514 (<https://doi.org/10.2105/AJPH.2005.066043>). For examples in auditing, see, e.g., Altiero, E. B., Y. J. Kang, and M. E. Peecher. 2022. Motivated Perspective Taking: Why Prompting Auditors to Take an Investor’s Perspective Makes Them Treat Identified Audit Differences as Less Material. *Contemporary Accounting Research* 39 (1): 339–370 (<https://doi.org/10.1111/1911-3846.12721>).

<sup>5</sup> We encourage the Board to study the Dutch [Foundation on Audit Research](#) (FAR) and consider the extent to which the Board could adopt or adapt elements of FAR’s purpose, mission and strategy to advance longer term QC 1000 objectives as well as its broader mission of furthering the public interest with regard to independent audit reports.

<sup>6</sup> Theory and empirical evidence suggest that audit effectiveness can improve when engagement team auditors, especially specialists, broaden their exercise of professional skepticism so that it includes asking questions about the quality of their own decision processes and those of others on the audit engagement (see, e.g., p. 33–35 of Bell, T. B., M. E. Peecher, and I. Solomon. 2005. [The 21<sup>st</sup> Century Public Company: Conceptual Elements of KPMG’s Global Audit Methodology](#). *KPMG International* and Grenier, J. 2016. Encouraging Professional Skepticism in the Industry Specialization Era. *Journal of Business Ethics* (<https://doi.org/10.1007/s10551-016-3155-1>).

<sup>7</sup> Hayne, C., M. Peecher, J. Pickerd, and Y.D. Zhou. 2023. [Managing Quality Control Systems: How Audit Firms Experience and Navigate Conflicting Institutional Demands](#). Available at: <https://ssrn.com/abstract=4339512>

profit, and loss of investor confidence in the capital market.<sup>8</sup> However, academic research to date has shed very little light on how accounting firms design and implement changes to their QC systems. As a result, and because several standard setters have recently made or proposed a major overhaul of QC standards, we initiated a study examining how firms change and manage their QC systems. To inform our research, we interviewed 27 assurance service QC leaders from eight major accounting firms in the United States. We conducted our interviews between July 2020 and May 2021. Scholarly research that draws on interviews as its main data collection method is well-accepted in academe and is arguably the only method that enables authors to peer into the minds of expert QC leaders about a timely issue.

Below, we summarize our main findings and then share relevant implications from our study. We first set out to learn from QC leaders what changes audit firms are currently making (or have recently made) to their QC systems, and what changes they would ideally make if they did not face resource constraints. The latter prompt was intended to elicit what more “ideal” QC systems would look like in leaders’ minds and help us identify obstacles that currently prevent audit firms and the profession from moving closer to more ideal QC systems. The most common changes currently underway in firms include (1) enhanced engagement monitoring and use of data analytics, (2) organizational structure changes to enhance QC (e.g., a dedicated ISQM team, independent advisors), and (3) a more proactive approach to identifying QC issues. By contrast, the most commonly described ideal changes include (1) more enhanced engagement monitoring and use of data analytics<sup>9</sup>, (2) human talent-related initiatives such as improved hiring and promotion practices and more optimal staffing of engagements teams, and (3) improved client risk assessment processes. A key finding from our analysis of the gaps between current and ideal changes is that more ideal changes seem to necessitate a more proactive approach to QC change, consistent with the PCAOB’s Proposed QC 1000 standard, whereas the current changes are more reactive in nature. Further, when QC leaders addressed why a gap existed between their firm’s current and the ideal QC changes they wished to pursue, encouragingly, several QC leaders revealed a belief that their firms had most of the resources they needed (time was sometimes an exception), or that they did not feel resource constrained. Table 3 in [our paper](#) provides indicative evidence of the current/ideal changes and comments relating to our gap analysis that the PCAOB may find helpful. We excerpt from quotations we provide in Table 3—relating to an ideal change of human talent and engagement staffing—to provide a sense of respondent’s comments:

**Human Talent/Engagement Staffing:** *On the talent side, how do we get people to senior level faster? And how do we keep them longer? Because as we go through our quality issues and we look at our root cause analyses, many times, failures happen because we lost people, we didn’t have the right continuity, we didn’t have the right skillset. It’s the biggest operational challenge, but it also has a huge impact on quality....*

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<sup>8</sup> See Nagy, A. L. 2014. PCOAB Quality Control Inspection Reports and Auditor Reputation. *Auditing: A Journal of Practice & Theory* 33 (3): 87–104 (<https://doi.org/10.2308/ajpt-50752>) as well as Aobdia, D. 2020. The Economic Consequences of Audit Firm’s Quality Control System Deficiencies. *Management Science* 66 (7): 2883–2905 (<https://doi.org/10.1287/mnsc.2019.3301>).

<sup>9</sup> While the most common current changes and ideal changes both relate to enhanced engagement monitoring and use of data analytics, analysis of the evidence reveals a significant difference between the two. While respondents state that their firms currently perform pre-opinion issuance reviews on selected engagements, they aspire to do these reviews much earlier and on more engagements. Ideally, respondents want “in-flight” monitoring to be implemented in real-time and continuously throughout audit engagements.

To better understand what obstacles besides resource constraints prevent firms from achieving a more ideal QC system, we next examined the challenges that audit firms face in managing and changing their QC systems. One of the most frequently noted challenges is to obtain buy-in and acceptance of QC changes from organizational members. Another major challenge is skepticism about evaluations of the costs and potential benefits associated with a QC change before charting a path forward. A third commonly noted challenge is managing what one might characterize as local/global differences; instances where, for example, local offices have a different perspective from the national office, U.S. firms have a different perspective from member firms outside the U.S., or different perspectives among service lines. QC leaders also felt it was challenging to advance proactive and risk-based changes since they are preoccupied with implementing more reactive QC changes, to measure and monitor QC initiatives in the absence of trustworthy measures, and to manage the extent of change so it was not overly disruptive to organizational members. These six challenges were all perceived by QC leaders to be significant to the process of implementing QC change and, correspondingly, we believe they will continue to test firms as they adopt the PCAOB's Proposed QC 1000 standard. The narrative of our paper includes many quotations directly from QC leaders that help paint a picture of these challenges and Table 4 in [our paper](#) provides additional evidence that may be of interest to the PCAOB. Below we provide two excerpts from the quotations in Table 4—the first relates to the difficulty of obtaining buy-in for QC changes and the second to balancing stability and change:

**Obtaining Buy-In:** *A lot of the questions internally are “Why are we doing that?” and “Is it required by the standards? Show me where it’s required by the standards.” ... You better approach it humbly but also from the vantage point of knowing precisely what the standards require—and know when you’re asking someone to comply with the requirement of the standard versus asking them to go beyond it. If you’re asking them to go beyond it, then you better know why and have a good reason for articulating that.*

**Balancing Stability and Change:** *One of the biggest things that we have to think about and consider is just the annual cycle of our business ... if you’re rolling out changes that are going to be practice-wide, that’s going to affect your client service teams. You got to be very careful with that and make sure that you don’t overwhelm the system.*

Given the challenges that audit firms face managing their QC systems, our study also explores how audit firms attempt to manage these challenges. The most common strategies that audit firms use to navigate changes to their QC systems include the formalization of organizational structure and what we label as scientizing change. The former entails initiatives such as adding a dedicated ISQM team to the firm, changing reporting relationships within the audit practice, or expanding representation in the national office. The latter entails the use of thoughtful lay theories (or stories) to try to legitimize an effortful QC change (e.g., root cause analysis was a common process used to legitimize QC change). QC leaders also described their reliance on persuasion and coercion (“carrots and sticks”), pilot tests and the collection of feedback, adjustments to the frequency and/or timing of change, and extensive negotiation among stakeholders to help ease the otherwise challenging implementation of QC changes. Here again, our paper includes many



quotations from QC leaders to explain the use of these strategies, and Table 5 provides additional evidence. We strongly encourage the Board and others at the PCAOB who will be writing the final QC 1000 to review these tables because they add substantial depth to our findings.

We believe the interview evidence in our paper emphasizes that this is indeed an opportune time for the PCAOB to revise their QC standard. At the same time, our paper identifies several challenges that firms will face in upgrading their QC systems toward a more risk-based and proactive approach. These challenges seem to be relevant as the PCAOB considers “additional potential costs” related to adoption of QC 1000 (**Questions #88** and **#89** in PCAOB QC 1000 proposal). Fortuitously, the collective insights from our research indicate that firms are aware of the need and have an appetite to shift toward a QC system that is grounded in proactively identifying quality objectives and managing quality risks. Nevertheless, our findings indicate that QC leaders expect significant obstacles to achieving this shift and firms are currently preoccupied with adopting more reactive QC changes. Next, we leverage our research findings as a basis for drawing what may facilitate firms’ adoption of a more risk-based and proactive QC approach for the PCAOB’s consideration.

First, our data suggest that the PCAOB may wish to consider providing firms—especially those relatively small in size and reach—with a longer timeline and/or more gradual approach to adoption. The PCAOB’s proposed standard effectively requires at least some audit firms to undertake what will be, in essence, a total overhaul their QC systems. We expect they will face many of the implementation-related challenges uncovered by our research and outlined above. **Question #93** in the QC 1000 proposal asks if the effective date of December 15 of the year after approval by the SEC would create challenges for auditors and, if so, what are the challenges and how should they be addressed? The above summary of our research carefully details six challenges that the PCAOB should be aware of as well as some ways that firms may navigate challenges associated with implementing QC 1000. For example, our data suggest that an overly speedy adoption timeline could create unintended consequences such as disruption to the stability of QC systems and increased difficulty of getting buy-in from organizational members on the proposed QC changes. Our data indicate that firms often use an extended period of time to pilot prioritized QC initiatives and seek feedback from organizational members, strategically influence organizational members to gain buy-in on the QC changes, and stagger the roll-out of QC changes. While some firms have already started to prepare for the implementation of ISQM 1 and SQMS 1, we observed variance across firms in their preparedness for QC changes introduced by recently approved QC standards in our data. This variation is likely to be larger for smaller auditing firms. Thus, a longer timeline and/or more gradual approach to adoption should allow firms to more effectively pilot test and finetune the proposed changes in QC 1000, especially in areas where QC 1000 may differ from IAASB or AICPA QC standards.

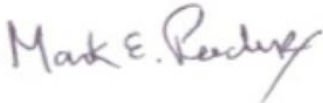
Second, our data reveal the importance of balancing between prescriptiveness and flexibility of the QC standards. **Question #9** in the Proposed QC 1000 asks if there are any additional factors the PCAOB should consider related to the scalability of the standards. Many of the QC leaders in our interviews emphasized the importance of “QC standardization” that would allow firms to apply a consistent level of assurance service quality within their firms and around the globe. More prescriptive language in standards may also allow firms to more effectively persuade or coerce (“carrots or sticks”) their organizational members that the changes “must” occur. But changes made in response to fiat power is not synonymous with an internalized commitment to changes due to perceived merits of the QC change. Thus, it is important to provide flexibility in the QC standards. Our study indicates that flexibility in the standards would enable

firms to tailor their audit approach to “local risks and the environment,” making firms’ QC approaches more scalable. Further, our data show that flexibility in the QC standards would provide firms and their engagement teams with discretion when “they think the quality will be as high or higher by doing it a different way.” Thus, the use of auditors’ professional judgment, empowered by flexibility built into the finalized QC 1000 may well enable firms to effectively implement a more proactive QC approach.

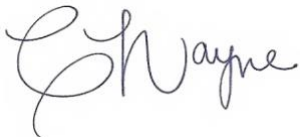
Finally, our study finds that implementing more proactive QC changes can be particularly challenging due to resistance from organizational members as these more proactive QC changes are often not explicitly required in the standards. To that extent, the PCAOB may wish to consider, for example, (1) providing reward-based incentives to encourage firms and engagement teams to go above and beyond the minimum requirements specified in the standards (e.g., privately or publicly acknowledging firms or engagement teams); (2) publishing good QC initiatives observed in practice to inform firms of “best” practice relating to the design and implement of QC changes; and (3) making clarifications that simply complying with the QC standards “to the letter” may not be enough to achieve a sufficiently high level of audit quality in certain circumstances.

We appreciate the PCAOB’s efforts to continue to strengthen the auditing profession by aspiring to help significantly improve audit firms’ quality control systems. We would be pleased to discuss our comments with you or your staff at your convenience.

Respectfully,



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A handwritten signature in black ink, appearing to read 'Yuepin Zhou', written in a cursive style.

Yuepin (Daniel) Zhou  
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