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# Report of the President

By Chad Stefaniak



Greetings from Columbia, South Carolina!

I hope everyone is settling into the fall semester. Personally, I've always loved the start of fall more than spring—there's just a special buzz to it. Students are full of energy, faculty are hopefully well-rested, and the possibilities feel endless. This fall, I have the privilege of stepping into the role of President of the Auditing Section, and I'm excited to continue the great work we've been doing.

First, I want to thank Jennifer Joe for her fantastic leadership last year. Thanks to her efforts, we're in a great place to keep the momentum going. Our Executive Committee this year is stacked with some amazing individuals. Yi-Jing Wu, a long-time friend, is serving as VP Academic. Margot Cella has retired, but we're fortunate to have James Powell (KPMG) joining us as VP of Practice to help us stay connected to the profession. Steve Perreault remains our Treasurer, and Chad Simon will continue representing us on the Council. Both of them are just stellar people. And I'm thrilled that Marcy Shepardson is stepping in as Secretary, taking the reins from Ken Bills. I'm truly grateful for this incredible team and all they're doing to support the Section.

Beyond the Exec team, I've been blown away by how many members stepped up to serve on our committees. I'll admit, I wasn't exactly looking forward to filling all those spots, but it turned out to be way easier than I expected thanks to everyone's willingness to help out. A special thank you to those who took on roles outside their comfort zones. Your willingness to help out is inspiring!

I also want to extend my gratitude to the AAA and its leadership. I've worked with AAA in various capacities over the years, and I've never had better experiences than I'm having right now. Their responsiveness and support have made my transition into this role so smooth. Yvonne and her team have been incredible partners, and I couldn't be more appreciative.

## Updates about the Section

The Auditing Section is in good shape overall. We have 946 members, which is a little lower than recent years (we've averaged around 1,075), but this aligns with the overall trend in AAA membership.

Financially, we're in great shape thanks to the AAA's new revenue-sharing model with the journals. We have some funds to work with, and I'd love to hear any creative ideas for putting that money to good use. Let's turn your ideas into reality!

### **Introducing PIPEline**

One vision I'm thrilled to announce is a new initiative we'll be launching at AMY 2025—the Pathway into PhD Experience (PIPEline). This program is designed to introduce students and professionals interested in a PhD and academic career to the world of academia. If you didn't catch the email, here's what the program aims to do: After being nominated for the PIPEline program, approximately 10 to 15 individuals will be selected and given them the chance to attend the 2025 Audit Midyear Meeting in Charlotte, NC, with little to no cost. We want to connect these future academics with our community, expose them to cutting-edge audit research, and give them valuable insights into an academic career. We'll cover transportation, hotel, and registration so they can dive into the experience without financial worries.

Thanks again to everyone for your continued support of the Auditing Section. None of this would be possible without you. As President, I'm all ears for your ideas and feedback. Please don't hesitate to reach out—I'd love to hear from you.

I'm looking forward to seeing you all in January. One last shout out, which will also hopefully encourage you to attend the 2025 Audit Midyear. Scott Vandervelde, a Past President of the Auditing Section and current Department Chair at UNC Charlotte, has generously arranged sponsorship of the Friday evening reception, which will be held at the NASCAR Hall of Fame (which is very close to our conference hotel). The reception will surely be one of the more memorable and interactive receptions in recent history (though I don't know if Portland's Bacon Bar will ever be topped)! See you in Charlotte!

Warm regards,

Chad Stefaniak  
University of South Carolina

# PCAOB Update

By Barbara Vanich and Elena Bozhkova

PCAOB Acting Chief Auditor and PCAOB Assistant Chief Auditor

## Introduction

This Update addresses select Public Company Accounting Oversight Board (PCAOB) developments since the Summer 2024 Update that are likely to be of interest to accounting and auditing researchers, educators, and students. The developments include:

- Spotlight on the Integration of Generative Artificial Intelligence in Audits and Financial Reporting
- Report on Inspections of Audits of Broker-Dealers
- PCAOB Scholars for the 2024-2025 Academic Year
- Spotlight on 2023 Inspection Activities and Related Data Charts
- Spotlight on Bank Financial Reporting Audits
- Spotlight on Inspection Observations Related to Auditor Independence
- Spotlight on Observations From the Target Team’s 2023 Inspections
- Meeting of PCAOB Investor Advisory Group (IAG)
- Implementation Resources for New Standards
- Fraud Risk Resources
- Settled Disciplinary Orders

## PCAOB Developments

### Spotlight on Integration of Generative Artificial Intelligence in Audits and Financial Reporting

On July 22, 2024, the PCAOB released a new staff Spotlight publication, “Staff Update on Outreach Activities Related to the Integration of Generative Artificial Intelligence in Audits and Financial Reporting.” The Spotlight highlights staff outreach to audit firms and public companies to understand their perspectives on the integration of Generative Artificial Intelligence (GenAI) in audits and financial reporting.

The Spotlight includes several observations, including that the current integration of GenAI in audits conducted by the firms that the PCAOB staff spoke to appears to be focused primarily on administrative and research activities. However, most audit firms interviewed noted the potential for using GenAI in certain aspects of planning and performing the audit. The outreach also indicated that while some public companies are exploring opportunities to incorporate GenAI in accounting and financial reporting processes, integrating GenAI in these processes appears to be secondary to integrating GenAI in operational and customer-facing areas.

The Spotlight is available at <https://pcaobus.org/documents/generative-ai-spotlight.pdf>.

## Report on Inspections of Audits of Broker-Dealers

On July 25, 2024, the PCAOB released its “Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers.” This year’s report notes that PCAOB staff identified at least one deficiency in 70% of the 103 audit engagements on broker-dealer financial reports reviewed during 2023. In addition to descriptions of deficiencies, the report provides firms with examples of good practices and reminders of certain PCAOB requirements.

These good practices and reminders are focused on topics where deficiencies are persistently high or increasing, and they include the following:

- Auditing considerations regarding use of a service auditor’s SOC 1 report to obtain evidence of the design and operating effectiveness of certain controls at a service organization;
- Testing relevant assertions for investment advisory fee revenue;
- Enhancing procedures for examining journal entries and other adjustments for evidence of possible material misstatement due to fraud; and
- Enhancing focus on required communications to the broker-dealer’s audit committee (or equivalent) and management.

The annual report is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/inspections/documents/2023-broker-dealer-annual-report.pdf?sfvrsn=c66f7e9e\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/inspections/documents/2023-broker-dealer-annual-report.pdf?sfvrsn=c66f7e9e_2).

In addition to the annual report, the PCAOB released a separate publication, “Supplementary Information Related to Audits of Brokers and Dealers.” This supplement provides additional information about firms selected for inspection, audit and attestation engagements for broker-dealers selected for review, and inspection results stratified based on a variety of characteristics. The publication is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/inspections/documents/2023-broker-dealer-supplementary-information.pdf?sfvrsn=3217a5d3\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/inspections/documents/2023-broker-dealer-supplementary-information.pdf?sfvrsn=3217a5d3_2).

## PCAOB Scholars for the 2024-2025 Academic Year

On August 1, 2024, the PCAOB announced that a record 676 students from U.S. colleges and universities were selected to receive a \$15,000 scholarship for the 2024-2025 academic year, up from \$10,000 previously.

The Sarbanes-Oxley Act of 2002 provides that funds from the collection of PCAOB monetary penalties must be used to fund a merit scholarship program for students in accredited accounting degree programs. Scholarship recipients are nominated by their respective institutions, which participate in the PCAOB Scholars Program based on their accreditation and the number of students they graduate with accounting degrees each year. The Scholars Program’s overarching goals are to (1) benefit outstanding students who are likely to become auditors and (2) make a difference to eligible students who might otherwise pursue a different career path.

A description of the program, including information on the nomination process, the selection of nominating institutions, and other details can be found on the PCAOB Scholars Program page at <https://pcaobus.org/about/scholars-program>.

All participating institutions, along with the named PCAOB Scholars, are available at <https://pcaobus.org/news-events/news-releases/news-release-detail/a-record-676-students-named-pcaob-scholars-for-the-2024-2025-academic-year>.

### **Spotlight on 2023 Inspection Activities and Related Data Charts**

On August 15, 2024, the PCAOB released a new staff Spotlight publication, “Staff Update on 2023 Inspection Activities.” The Spotlight provides an overview of staff observations from the 2023 inspections. Staff observed that while overall deficiency rates continued to increase in the aggregate, with 46% of the engagements reviewed having at least one Part I.A deficiency, the aggregate deficiency rate at the Big Four firms has leveled off and there are improvements in the deficiency rates at several of the other annually inspected firms. The Spotlight also explores how outliers influence the overall average, among other observations.

The PCAOB also published new charts on its website illustrating much of the data in the U.S. Global Network Firms (GNFs) and U.S. annual Non-Affiliate Firms (NAFs) inspection reports for the first time as part of ongoing efforts to increase transparency in inspection data and make it easier for stakeholders to understand and compare inspection results both across firms and over time.

The Spotlight is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/staff-update-2023-inspection-activities-spotlight.pdf?sfvrsn=2afb0f25\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/staff-update-2023-inspection-activities-spotlight.pdf?sfvrsn=2afb0f25_2).

The new data charts are available at <https://pcaobus.org/oversight/inspections/global-network-firms-inspection-data> for the U.S. GNFs and at <https://pcaobus.org/oversight/inspections/non-affiliated-firms-inspection-data> for U.S. annual NAFs.

### **Spotlight on Bank Financial Reporting Audits**

On September 9, 2024, the PCAOB released a new staff Spotlight publication, “Bank Financial Reporting Audits.” The Spotlight describes the PCAOB’s inspection response to bank failures in early 2023 and the continued effects of these bank failures on the banking industry and includes an overview of survey responses outlining how dozens of U.S. firms responded to disruptions in the banking industry, including impacts from rising interest rates. It also provides common observations from the PCAOB’s inspection activities, along with a description of good practices at audit firms in key focus areas.

The Spotlight is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/banking-spotlight.pdf?sfvrsn=c3f496ab\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/banking-spotlight.pdf?sfvrsn=c3f496ab_2).

### **Spotlight on Inspection Observations Related to Auditor Independence**

On September 16, 2024, the PCAOB released a new staff Spotlight publication, “Inspection Observations Related to Auditor Independence.” The Spotlight highlights common deficiencies which resulted in the issuance of comment forms, good practices, and other reminders that can help audit firms and their personnel comply with PCAOB and U.S. Securities and Exchange Commission independence standards and rules.

The Spotlight is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/auditor-independence-spotlight.pdf?sfvrsn=7fddcf7b\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/auditor-independence-spotlight.pdf?sfvrsn=7fddcf7b_2).

### **Spotlight on Observations From the Target Team’s 2023 Inspections**

On September 25, 2024, the PCAOB released a new staff Spotlight publication, “Observations From the Target Team’s 2023 Inspections.” The Spotlight provides auditors and other stakeholders with a view into the target team’s observations – including inspection results and good practices – in three focus areas for 2023:

- Significant or unusual events or transactions – The target team worked to gain insights into firms’ methodologies, practices, and execution of audits involving risks posed by significant or unusual events or transactions (e.g., data breaches).
- Crypto assets – As a result of crypto asset market disruptions and the corresponding emerging risks, the target team performed procedures to gather information about certain audits of public companies with material crypto asset activities.
- Multi-location audits – Given geopolitical turmoil (e.g., Russia-Ukraine war) and public companies switching from China-based audit firms to those in the U.S., the target team selected multi-location audits as a focus area in 2023.

The target team also focused on the interim reviews of certain banks in order to provide real-time perspective on important risks, including low capital ratio, significant share price decline, and unrealized loss.

The Spotlight is available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/target-team-2023-inspections-spotlight.pdf?sfvrsn=acf72513\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/documents/target-team-2023-inspections-spotlight.pdf?sfvrsn=acf72513_2).

### **Meeting of PCAOB Investor Advisory Group (IAG)**

On September 26, 2024, the PCAOB held a meeting of the IAG. Agenda topics included:

- PCAOB standard-setting update;
- IAG Presentation to the Board on Audit Committees’ Audit-Related Engagement with Investors;
- IAG Presentation to the Board on Emerging Issues in Audit Firm Ownership Structures and Funding Arrangements;
- IAG Presentation to the Board on Cyber Risk on External Audits; and
- IAG Presentation Regarding IAG Request for Critical Audit Matters.

The recording and related materials for the meeting are available at <https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting-september-2024>.

### **Implementation Resources for New Standards**

The PCAOB staff posted implementation resources for several of the Board's recently completed standard-setting projects. The implementation resources for AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, also include a knowledge check developed by the staff.

The implementation resources are available at <https://pcaobus.org/oversight/standards/implementation-resources-PCAOB-standards-rules>

### **Fraud Risk Resources**

The PCAOB staff developed a webpage to highlight important PCAOB and SEC resources regarding the auditor's consideration of fraud in an audit.

The fraud risk resources are available at <https://pcaobus.org/resources/information-for-audit-firms/fraud-risk-resources>.

### **Settled Disciplinary Orders**

The PCAOB posted numerous settled disciplinary orders that imposed significant monetary penalties and other sanctions.

Settled disciplinary orders are available at <https://pcaobus.org/Enforcement/Decisions/Pages/default.aspx>



## **Have you Seen...?**

**Candice T. Hux, Northern Illinois University**

**Jenny McCallen, University of Georgia**

**Delia Valentine, University of Wisconsin – Milwaukee**

**“Coaching Today’s Auditors: What Causes Reviewers to Adopt a More Developmental Approach” By Lindsay M. Andiola, Joseph F. Brazel, Denise Hanes Downey and Tammie J. Schaefer. *Accounting, Organizations and Society* 112: 101548.**

Audit workpaper review is an important part of firms’ quality control activities. Workpaper review aims to detect potential errors in workpaper preparation while also fostering the development of auditors’ skills and abilities as they progress within the firm. Theory suggests that a developmental review approach can help achieve these objectives. This study examines two environmental factors that may interfere with the effectiveness of the review process – preparer recurrence and preparer office affiliation. Results show that reviewers adopt a less developmental approach when preparers are internationally located (i.e., not local to the same office). Reviewers utilize a more developmental approach when preparers are located locally but only when they are likely to recur. The study further finds that a developmental approach leads to a higher quality audit as evidenced by more review comments that take a “coaching” approach and increased error detection. Taken together, this study suggests that workpaper review as a quality control mechanism may be impaired on global audits but preparer recurrence can improve the review process.

**“Internal Auditing’s Role in Preventing and Detecting Fraud: An Empirical Analysis” By Annika Bonrath and Marc Eulerich. *International Journal of Auditing* 28 (4): 615-804.**

This study explores the role of internal auditing in preventing and detecting fraud, noting that its approach can vary across organizations. Based on a survey of Chief Audit Executives from Germany, Switzerland, and Austria, the research highlights that strong corporate governance significantly enhances the involvement of the internal audit function in fraud prevention. The study also finds that when internal auditors work closely with management, their efforts to prevent and detect fraud increase. Additionally, a technology-based auditing approach improves the ability of internal auditors to identify new risks. The findings highlight ways organizations can bolster fraud protection and show the importance of technology integration to protect against rising fraud risks.

**“When Employees Go to Court: Employee Lawsuits and Talent Acquisition in Audit Offices” By Jade Huayu Chen. *Journal of Accounting Research* 62 (4): 1265-1307.**

This study examines the impact of employee-initiated lawsuits on an audit office’s ability to attract high-quality talent and maintain audit quality. Descriptively, employee lawsuits are prevalent in the United States with 25% of Big 4 audit offices experiencing one from 2005 to 2018. Using a comprehensive data set of individual auditor profiles, results suggest a decline in the quality of new hires following an employee lawsuit and an increase in the likelihood of financial restatements among their clients. The

results are concentrated to offices that are smaller or experiencing high growth and when the lawsuit receives extensive media coverage. Alternatively, larger offices or those offering competitive wages are less affected. Collectively, the results highlight the importance of managing prospective employers' perceptions and maintaining a good employer reputation in competitive labor markets.

**“Competence vs. Independence: Auditors' Connections with Members of Their Clients' Business Community”** By Mark DeFond, Zengquan Li, T.J. Wong and Kaiwen Wu. *Journal of Accounting and Economics* 78 (1): 101702.

Using data from China and focusing on connections within the client's community rather than direct relationships with the client, this study revisits the relationship between auditors' social connections with their clients and audit quality. Intuitively, auditors connected to their clients' community are likely to have access to more information to evaluate their clients' financial reporting. However, connections to members of their clients' business community may threaten auditor independence. Results are consistent with strong local business and government ties enabling auditors to deliver higher quality audits, evident by fewer financial irregularities such as restatements. Additional analysis suggests connected auditors are also more likely to issue going concern opinions and inconsistent with concealing bad news for their client. This suggests that the benefits of certain client connections outweigh the potential risks to auditor independence.

**“Does Auditor Assurance of Client Prosocial Activities Affect Subsequent Reporter-Auditor Negotiations”** By Jeremy Douthit, Steven Kachelmeier and Ben W. Van Landuyt. *Accounting, Organizations and Society* 112: 101550.

Based on psychology research on licensing, the authors posit and find that by engaging in a prosocial activity, such as ESG initiatives, and receiving assurance on that activity, reporters are more likely to engage in aggressive reporting in auditor-reporter negotiations. Specifically, reporters who receive auditor assurance on a prosocial activity specify more aggressive initial negotiation positions. However, this behavior does not lead to increased leniency by the auditor. Experiment one also shows that final outcomes are more biased toward the reporter's value when auditor assurance is collaborative between reporters and auditors. In experiment two, reporter aggressiveness is still observed when prosocial assurance is provided. However, removing the collaborative nature of the prosocial assurance role helps to reduce bias in the final negotiated outcome. This study highlights aggressive reporting as a potential unintended consequence of ESG assurance, particularly when the assurance process is more collaborative.

**“Does Auditor Style Influence Non-GAAP Earnings Disclosure”** By Frank Heflin, Jacqueline Tan, Karen Ton and Jasmine Wang. *Contemporary Accounting Research* 41 (3): 1639-1671.

Given regulator and practitioner concerns about the lack of standardization in non-GAAP reporting, this study examines whether auditor style influences similarity in non-GAAP earnings disclosures. Non-GAAP earnings are a common voluntary corporate disclosure with over 90% of the S&P 500 companies providing non-GAAP metrics in their earnings press releases between 2015 and 2017. Using several measures of disclosure similarity, the results indicate that companies audited by the same auditor are

more likely to disclose non-GAAP earnings in a similar manner. Additional analysis suggests the relationship is driven by Big 4 accounting firms and clients audited by the same audit office with a stronger relationship for larger offices and smaller clients. Importantly, these findings suggest that auditor involvement in unaudited non-GAAP earnings can facilitate similarity in non-GAAP disclosure and improve compliance with SEC requirements.