

LOOK WHO'S TALKING: DUE PROCESS AND THE PCAOB.

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Abstract: Formed to reduce the practicing auditor's influence on auditing standards, the Public Company Accounting Oversight Board (PCAOB) fundamentally changed how public company auditing standards are created. Using comment letters submitted to the PCAOB and the Security and Exchange Commission (SEC) since 2002, we document broad participation by key constituencies, including auditors, as measured by signatories. While we find both auditors and financial statement preparers submit more comment letters than financial statement users, neither individually dominates the public due process. While auditors and preparers participate at similar levels, auditors are consistent in their participation across all PCAOB audit standard settings. Preparers' participation is more targeted to specific standards. We also examine and do not find support for the SEC's claim that the PCAOB spends more time pursuing disclosure standards at the expense of audit performance standards. Our findings suggest the PCAOB generates input from a broad constituency, with no single interest dominating. Contrary to SEC concerns, our findings suggest PCAOB standards are focused on performance, not disclosure.

Data Availability: Data are available from public sources identified in the paper.

Key Words: Auditing standard; standard setting; PCAOB; due process

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I. Introduction

The Public Company Accounting Oversight Board (PCAOB) was established in response to accounting and auditing failures of the early 2000s. Its charge is to oversee public company auditors and thereby protect investors (SOX, 2002). Because the lack of auditor independence was thought to be central to the failures (Nagy, 2004; Anantharaman, 2012), the PCAOB was given discretion in developing and enforcing its oversight. Breaking with the regulatory tradition of the Securities and Exchange Commission (SEC), the prior auditing regulator, the PCAOB kept standard writing responsibilities.¹ In addition, the PCAOB restricted the role of accountants in standard setting by limiting their representation on the Board to two of five members. These changes shifted the institutional structure under which public company auditing standards were created in the United States. In this paper, we develop and test exploratory hypotheses regarding participation in public company auditing standard setting under the PCAOB regime as a basis for framing the discussion about the content of standards issued.

The PCAOB has broad responsibilities beyond auditing standard setting. The PCAOB issues rules and standards for ethics and independence, quality control, inspections, registration, and PCAOB procedural matters. Every rule and standard provides an opportunity for due process. We restrict our study to auditing standards as those are the standards the PCAOB uses to evaluate auditors. In addition, several studies examine how and when auditors participate in *accounting* standard setting (Haring, 1979; Brown, 1981; Puro, 1984; Allen, Ramanna, & Roychowdhury, 2012; Gipper et al., 2013). However, few studies exist about who participates in

¹ The SEC had delegated all auditing standard setting to Auditing Standards Board (ASB), a committee of the American Institute of Certified Public Accountants (AICPA) and its predecessors. ASB still issues auditing standards for nonpublic company, nonprofit, and governmental audits.

auditing standard setting (Willekens & Simunic, 2007; Ye & Simunic, 2013). We seek to fill this apparent gap in the literature.

Positive accounting theory (R. L. Watts, 1986; R. L. Watts & Zimmerman, 1978) predicts auditors and preparers will participate the most in auditing standard setting. Ramanna (2015) identifies accounting and auditing standard setting as “thin political markets.” He asserts the topics in thin political markets are so complex that only a limited number of experts (e.g., auditors) are equipped to understand potential consequences and to contribute to the proposed regulation. However, Simunic and Ye’s (2013) analytical model suggests auditors’ and users’ (investors) interests are aligned. As such, we hypothesize and test for significant participation differences between three key constituency groups: auditors, preparers, and users.

Our population of participants incorporates 1,802 signatories for 18 different auditing standard related items on the PCAOB’s docket. We use signatories instead of submitted letters as the number of signatures captures more completely encompasses all participating voices. We leverage Jorissen et al.’s (2012) study of the International Accounting Standards Board to create the constituency groupings to place the participants in auditing standard setting in a broader context of standard setting participation more globally, and broadly for accountants.

Similar to Jorissen et al. (2012), we limit our study to the formal measures of participation due to the difficulty of documentation of informal methods (e.g., conferences, news articles and opinion pieces, academic research, etc.). We find that auditors, as measured by signatures, do not dominate the public due process.² We note that while auditors participate more than users, there is not support for statistically different participation between auditors and

² In a similar paper, William and Wilder (2015), study the influence of auditors on PCAOB auditing standard setting. Their sample is limited to 16 specific constituents (eight auditing firms, four state societies and four other organizations). In contrast, our paper documents the participation of more than 500 organizations.

preparers and between preparers and users. These results reflect the fact that when a hot issue is debated, everyone speaks, and other times, almost everyone is quiet.

After identifying key constituencies, we look at the nature of the auditing standards generating comment letters. SEC Commissioner Daniel Gallagher questioned the nature of the PCAOB priorities about auditing standard setting when commenting on the 2015 PCAOB budget (Rapoport 2015). SEC Chief Accountant James Shnurr identified two areas in which the PCAOB could improve: setting standards faster and focusing efforts on audit performance (Tysiac 2014). The PCAOB has undertaken several projects to improve the transparency of the audit; however, remarks from SEC personnel suggest the focus should move back to audit performance (Schnurr, 2014; Rapoport, 2015). Thus, our study looks at the relationship between the topic of the auditing standard (disclosure or performance)³ and the intensity of constituent response as measured by signatures on comment letters. Further, we explore the impact of the response on how long it takes for a proposed standard to be finalized. For auditing standards, using a test of differences in medians and a duration model, we do not find support for the idea that disclosure standards take longer to finalize.

We document a broad constituency participates in the public due process of PCAOB standard setting; however, the majority of participants only speak a single time. In the spirit of independence from the auditing profession, the PCAOB solicits input so that no one constituency dominates the standard setting process. It is not surprising that financial statement users (investors) submit roughly 6% of the comment letters as they are represented on the Board and the advisory group, setting the standards agenda. Auditors outside the biggest eight firms rely on

³ As discussed in the next section, we define disclosure standards as standards, final or proposed, focused on required communication to the user of the audit opinion report. We define performance standards as standards, final or proposed, focused on specific audit procedures (e.g., observe inventory) or aides in the conduct of the audit (e.g., codification of standards).

their representatives (twelve state societies of Certified Public Accountants (CPA's) participated in addition to the AICPA and the Center for Audit Quality).

The paper is organized as follows. Section 2 describes standard setting and due process at the PCAOB and develops the hypotheses. Section 3 explains the research framework and describes our data. Section 4 presents empirical results, and Section 5 concludes. Appendix 1 provides a listing of PCAOB docket items and identifies the successive auditing standard, when applicable. It defines the items classified as performance-related; the dates relevant to our study; and the number of signatures on submitted comment letters by regulator.

II. Background and hypotheses development

According to sociology theory, standards and rules are set in three distinct phases: proclamation, implementation and resulting enforcement (Nagy, 2004). Standard setting by implementation is not easily observable by parties outside of practicing public company auditors. Although the PCAOB engages in a robust enforcement program, specifically through their inspections and disciplinary functions, we limit our study to the proclamation phase of standard setting.

Standard Setting and Due Process

In the early 1900s, the AICPA (the professional association of CPAs) and the leading accounting firms produced reports, books, and pamphlets documenting current best practices. Beginning in 1934, the SEC required the standards governing the measurement (attestation) of financial information be in accordance with generally accepted accounting (auditing) principles (standards), known as GAAP (GAAS). General acceptability was understood to mean the procedures and practices used by most of those in public practice. The SEC delegated both accounting and auditing standard setting to the AICPA and reserved the right to reject standards

considered inadequate to protect investors. AICPA committees and task forces developed early standards and the general membership voted their approval. Before the vote, trade publications discussed the issue or problem and proposed practices to address the problem.

In responses to the New Deal legislation and a changing political environment, Congress passed the Administrative Procedures Act (APA) in 1946. Congress was concerned the growing number of executive branch departments were issuing potentially burdensome regulations that were not consistent with congressional intent (McNollgast, 1999). The APA's purpose was to provide executive agencies (including the SEC) guidance on how to make rules. Thus, the APA introduced *due process* into executive branch rulemaking. These rulemaking procedures provide opportunities to block undesirable rules before implementation as they are difficult to undo after implementation (McNollgast, 1999). As shown in Figure 1, and in compliance with the APA, the SEC publishes proposed rules in the Federal Register, opening a public comment period (usually 30 to 60 days).

[Insert Figure 1 here]

In addition to the proposed rule, the public notice includes a discussion of the problem or issue the SEC hopes the rule will address. At the end of the public comment period, the SEC reviews the comment letters. Based on the comment letters, the SEC has three alternatives: issue the rule as final, adjust the proposal and send out for more comments, or abandon the rule. The final step in issuing the rule is publication in the Federal Register. The publication identifies the effective date of the rule, the text of the final rule, discussion of the issue or problem, and addresses issues identified in the comment letters. Comment letter issues are either incorporated into the final rule or discussed why the issues are not relevant.

As the delegated accounting and auditing standard setter, the AICPA formed internal committees⁴, who adopted a comment letter process similar to that of the APA. As these committees were not part of the public regulatory system, they made efforts to reach out to constituents outside the accounting and auditing professions. Before 1973, the AICPA committees relied on board members' active participation in the field (i.e., practicing accountants and auditors), supplemented by task forces focused on specific issues as well as users and their needs. In 1973, accounting standard setting moved to the independent FASB and board membership expanded to include more representatives from the user community. To prevent potential conflicts of interest or "regulatory capture,"⁵ these board members are full-time employees of the FASB. Auditing standard setting remained under the AICPA's ASB committee. Unlike the FASB, the ASB limited its board membership to active public accountants who served part-time terms. The ASB determined the insights from active practicing accountants allowed the ASB to respond quickly to issues, outweighing the potential "regulatory capture" concerns (AICPA, 1978).

When forming the PCAOB, Congress was concerned contemporaneous accounting failures and frauds⁶ were due to the "clubby" (Anantharaman, 2012; POB, 2002) relationships between the auditors and firm management. They believed this relationship dominated the auditors' professional responsibilities to the user and investor communities, noting the self-regulating arrangement of the ASB did not prevent these frauds (Nagy, 2004). To shield the

⁴The Committee on Accounting Procedure (1936 – 1959) and the Accounting Principles Board (1959 – 1973) created accounting standards and are the predecessors to the Financial Accounting Standards Board (FASB) (1973 – present). Public company auditing standards were created by the Committee on Auditing Procedure (1939 – 1972), the Auditing Standards Executive Committee (1972 - 1978) and the Auditing Standards Board (ASB) (1978 – 2002).

⁵ Regulatory capture theory argues that the regulated entities capture the regulator and create benefits for the regulated entities *because* of government intervention (Stigler, 1971). An example of regulatory capture is the efforts to increase competitors' barriers to entry, such as requiring Uber drivers to comply with regulations governing taxi drivers.

⁶ Examples of these more significant accounting failures and frauds include Enron, Worldcom, Xerox, Sunbeam, Waste Management, Adelphia, Tyco, HealthSouth, and Global Crossing,

PCAOB from politics and strengthen independence from the auditing community, the PCAOB is a quasi-public organization or “subsidiary” of the SEC (Nagy, 2004; Kinney Jr, 2005; Palmrose, 2013). Coates (2007; 2013) describes the PCAOB as a regulatory innovation: an institution granted regulatory authority without normal Congressional constraints.⁷

While the PCAOB is free from many laws that apply to the SEC⁸, it does follow SEC practices when issuing new auditing standards. These practices include issuing a draft, asking for comment, and publishing the final standard with comment letter analyses. In addition, the PCAOB’s funding, mainly fees paid by companies listed on US markets, is outside the regular Congressional budget process (Palmrose, 2013).

[Insert Figure 2 here]

The SEC provides oversight by appointing the PCAOB board members; authorizing the budget and approving PCAOB standards, including issuing an exposure draft; asking for comment; and publishing the final standard with rationale. The SEC also reserves the right to inspect PCAOB operations, consider audit firm requests for interim review of PCAOB inspection reports and Board remediation determinations, and hear appeals of PCAOB enforcement findings (Palmrose, 2013). To protect against pressure from special interests, and similar to the SEC and FASB, the board consists of five full-time board members with staggered terms. However, unlike the FASB, auditors are a minority of the board, resulting in trained attorneys forming the majority of the board (Kinney Jr, 2005).^{9,10} Designed to prevent

⁷ See Nagy (2004) for a complete discussion of the PCAOB’s powers and responsibilities.

⁸ Coates and Srinivasan (2013) note that the PCAOB “enjoys broad immunity from private lawsuits, and its communications are sheltered behind a regulatory privilege, making them generally not subject to ordinary discovery in lawsuits against audit firms.” Coates (2007) observes the PCAOB is also exempt from “such ... laws requiring open meetings, public disciplinary hearings and administrative procedures, public access to records (... inspection and disciplinary reports), and some ‘revolving door’ laws regulating post-PCAOB employment by PCAOB employees.”

⁹ While board members may be professionals in their respective disciplines, they are not professional accountants or auditors. Williams (2014) notes that while accounting is involved with measurement, the measurement’s precision

regulatory capture, it also removes an important source of expertise in the cost-effective regulation of the auditing profession (Kinney Jr, 2005; Palmrose, 2013). This arrangement forms an institutional bias against accountants' and auditors' participation in the due process of establishing auditing standards under the PCAOB regime.

Participation in Standard Setting

Who participates?

Before creating the ASB, the Special Committee of the AICPA to Study the Structure of the Auditing Standards Executive Committee (1978) recommended limiting the standard setting board membership to auditors. They noted critics of auditors' performance "had little to say about the auditing standards themselves or the means by which they have been formulated" (AICPA, 1978). They inferred that there is "less scope for outsiders to contribute to discussions of auditing than to discussions of accounting, and there is little interest in the subject outside the ranks of the profession" (AICPA, 1978). This assessment is consistent with Ramanna's (2015) description of "thin political markets." In thin political markets, regulators are reliant on a small number of experts who are also the special interests groups subject to the resulting regulation. These regulatory situations may give rise to charges of regulatory capture.

Congressional investigations in 1978 and 1985¹¹ were early signs of non-auditor constituents. In response, the ASB expanded the advisory groups and task forces to better

is ambiguous at best. As noted in Footnote 7, the implication is that individuals without a similar professional background may have difficulty regulating auditors.

¹⁰ Two, and only two, board members must be or have been certified accountants (CPAs), and a CPA chairperson may not have practiced for at least five years prior to Board appointment (Kinney Jr, 2005; Palmrose, 2013). Glover et al. (2009) assert the nonexpert model would be "absurd" in other, analogous organizations, such as the Federal Drug Administration, American Medical Association or the Financial Accounting Standards Board, and question its existence in regulating auditors.

¹¹ Representative Moss and Senator Metcalf held hearings in the aftermath of accounting failures in the early and mid-1970s. They recommended the SEC assume auditing standard setting to increase independence from auditing firms. The Dingell hearings in 1985, also focused on auditor independence, were a result of audit failures associated with the Savings and Loan crisis. (Clikeman 2009)

capture these other constituencies' voices. After the early 2000s accounting failures, auditing standard setting moved to the newly-created PCAOB. For the first time, auditors' participation in the auditing standard setting for publicly held companies was restricted as the practicing auditors no longer controlled the entity responsible for enacting new auditing standards.¹² We argue that the shift in institutional structure impacts the auditors' dominance in the auditing standard setting process, affecting their incentives to participate in the formal comment letter setting process under the PCAOB regime.

However, regulation theory (Stigler, 1971) assumes that auditors follow their economic interests, either by representing themselves or their clients, supporting the continued participation of auditors in the standard setting process. Any potential auditing standard could directly impact the auditors' responsibilities. Therefore, the auditors might participate frequently and with high volumes of respondents in the formal comment letter process, more than any other constituency. As such, we hypothesize, in the null:

H1: There is no difference between auditors' and the remaining constituencies' participation in the auditing standard setting process.

Existing research describes the participants' activities in the accounting standard setting process at the national and international levels (R. Watts, 1977; R. L. Watts & Zimmerman, 1978).¹³ Further studies examined various constituents' participation in international accounting standard setting (Jorissen et al., 2012, 2013; Bamber & McMeeking, 2015). Relying on Sutton (1984), Jorissen et al. (2012) finds that preparers of financial statements take part more in the comment letter process of accounting standard setting as compared to users. They assert accounting standards affect preparers' wealth, for better or worse, more than the user of such statements who can diversify the effect of any one standard across multiple investments.

¹² The ASB continued to set auditing standards for private companies and nonprofit.

¹³ See Gipper et al. (2013) for a complete review.

Similarly, relying on Mian and Smith (1990), Jorissen et al. (2012) find that users prefer as much disclosure as possible, as long as they do not directly bear the cost burden.

In a similar juxtaposition, we expect that preparers and users are positioned differentially for auditing standards setting participation. The PCAOB was established to protect investors by ensuring the integrity of the audit of publicly held companies (SOX 2002). That mission assumes the PCAOB board represents the users of audited financial statements. Consistent with the mission, users are represented on the PCAOB board and related advisory groups. But, it is an empirical question about who, other than auditors, engages in auditing standard setting.

The experience of the ASB (AICPA, 1978) suggests that auditors continue to have an economic interest in auditing standard setting. This economic interest is analogous to those of preparers in accounting standard setting. Audited financial statements are a joint work product of the auditor and the audited firm (preparer). We expect the preparer to have a significant interest in the auditing standards. New standards potentially impact the preparer/auditor interaction directly, for example, requiring preparers to provide the auditors with more information, or indirectly through fee increases due to added auditor work. We propose that economic incentives support the idea of auditors' interests aligning with preparers.

In contrast, using an analytic model, Ye and Simunic (2013) find the interests of the users of the statements (i.e., investors) and their auditors are aligned. In other words, users and auditors match the need for audit with the effort needed to reach an agreed quality. The model implies that users and auditors could be active participants in the standard setting process in a similar fashion.

Based on these two potential constituency alignments with auditors, we propose our second set of hypotheses allowing for the empirical testing of the participation of auditors,

preparers, and users. Prior to testing for differences in participation between the key parties, we first test for the existence of an association among constituencies and participation in public company auditing standard setting:

H2A: Auditors, preparers, and users similarly participate in the audit standard setting process.

H2B: Auditors and preparers differentially participate in the audit standard setting process.

H2C: Auditors and users differentially participate in the audit standard setting process.

H2D: Preparers and users differentially participate in the audit standard setting process.

The nature of the standard and time to completion

As discussed above, the SEC has oversight responsibility for the PCAOB, including approval of proposed standards and rules. SEC Chief Accountant James Schnurr argues that PCAOB standard setting takes too long and that the most effective way to improve audit quality is through “standards that directly address auditor performance” (Schnurr, 2014). Relatedly, SEC Commissioner Daniel Gallagher expressed concern the “PCAOB’s limited standard-setting resources have been focused too heavily on disclosure projects” (Rapoport, 2015). The implications of these SEC concerns are twofold: (1) audit performance standards improve audit quality,¹⁴ and (2) disclosure standards take longer to finalize.

According to the PCAOB website, the “PCAOB aims to improve audit quality” (PCAOB, 2015). DeAngelo (1981) defines audit quality to “be the market-assessed joint probability that a given auditor will both (a) discover a breach in the client's accounting system, and (b) report the

¹⁴ We leave this implication for future research to address.

breach.” Measurement of audit quality has been difficult.¹⁵ While the PCAOB has undertaken a project that seeks to identify indicators of audit quality,¹⁶ it has not been explicitly connected to the nature of existing or proposed auditing standards (e.g., disclosure versus performance).

As our study examines the participation in the auditing standard setting process, we focus on the second implication of the SEC’s concerns: disclosure standards take longer than performance standards to finalize. The SEC suggests disclosure standards may result in more participation from constituents. This increased participation, in the form of comment letters and likely multiple proposed standards, increases the time it takes to issue a final auditing standard. Schnurr (2014) notes that international auditing standard setting bodies have successfully and quickly passed performance standards addressing similar topics that have long been on the PCAOB agenda. It is an empirical question whether standard category impacts the time to issue for standards, and so our final hypothesis is:

H3: There is no difference in the time to finalization between audit disclosure and performance standards.

III. Research Framework and Data

In this section, we describe the data collection and classification process, outline the variables of interest, and propose statistical tests to address our hypotheses.

Data

Our study captures all participants involved in the PCAOB auditing standard setting process. We download copies from the PCAOB website of all comment letters (3,155) for the 40 PCAOB rulemaking agenda items (dockets) through June 2015. We also gather, from the SEC website, comment letters (184) related to those 40 items. Consistent with Larson & Herz (2013),

¹⁵ See Francis (2011), DeFond and Zhang (2014), and Christensen et al. (2014) for a review of the academic literature and various measures.

¹⁶ See Docket 41, released for comment on June 30, 2015.

we identify every party who signed each comment letter. We identify as a “signatory” each individual signature, with or without an organizational connection, representing one instance of participation in the comment letter process. Comment letters signed as the organization (i.e., not an individual) also represent one instance of participation and are also identified as a signatory. We capture each signatory to ensure complete representation of all participants as there may be multiple signatories on a letter representing different organizations.¹⁷ Anecdotally, standard setters view the comments from the consistent commenter differently than a unique contributor who speaks only to one standard. Following Jorissen et al. (2012, 2013), and defined in Table 1, we classify each comment letter signatory into one of the following constituency groups: accounting profession, preparer, stock exchange, government,

[Insert Table 1 here]

standard setter, individuals, academics, user, and other. In sum, constituency groups submitted 3,339 comment letters, representing 4,039 signatories, to the PCAOB and the SEC.

Classifying signatories is subjective. Thus, one author and several research assistants individually and independently classified each comment letter for the main category classification. First classifications agreed for around 94% of the signatories. The other author determined the final classification for those disputed signatories. A few signatories (less than 1% of the population) fit multiple categories. As a result, the authors discussed the classification rationale and agreed on each signatory assignment.¹⁸

¹⁷ Individuals from multiple organizations often write and sign a single comment letter. These individuals may come from different constituency groups; for example, multiple representatives from academia and preparers sign comment letter 41, docket item 37. To more fully consider participation rates, we construct our main variable based on the summation of signatory participation. This is in contrast to accounting standard setting participation literature who assign constituency grouping by the affiliation of first signature (e.g. (Jorissen, Lybaert, Orens, & van der Tas, 2012)).

¹⁸ We read a sample of the comment letters to determine that a signatory appears to respond from a similar perspective to multiple issues. Each signatory’s constituency group classification remains stable for our analyses.

Although the PCAOB has 40 docket items, we restrict our testing to auditing standards identified by the PCAOB’s own classification (see Rulemaking Releases & Comments page).¹⁹ Our final population for examining auditing standard participation, as detailed in Table 2, is 1,802 signatories, 1,666 PCAOB and 136 SEC. Table 4 details the number of constituency group signatories and reflects that auditors (37%) and preparers (31%) have the highest overall participation rates. For a graphical representation of the overall breakdown between signatory categories, refer to Figure 3.

[Insert Table 2 here]

[Insert Figure 3 here]

As noted above, some SEC personnel and commissioners (Rapoport, 2015; Schnurr, 2014) identify PCAOB auditing standards as related to disclosure or auditing performance. We define disclosure standards as a standard, final or proposed, focused on required communication to the user of the audit opinion report. We define performance standards as standards, final or proposed, focused on specific audit procedures (e.g., observe inventory) or aides in the conduct of the audit (e.g., codification of standards). Since the PCAOB adopted the ASB’s auditing standards as interim measures, we do not require that performance standards introduce new procedures. Each author independently sorted the auditing-related items on the PCAOB rule docket into these two categories. In addition, two other individuals knowledgeable about auditing sorted the items into the two categories. The docket item’s final categorization was a majority consensus. Of the 19 docket items, representing 18 issued and one transitional auditing standard, 13 (68%) are categorized as performance. Appendix 1 reflects each auditing standard docket number’s classification as either disclosure or performance.

Moreover, this is not a significant issue for our analyses as the majority of signatories (over 75%) respond to a single issue.

¹⁹ The webpage address is: <http://pcaobus.org/Rules/Rulemaking/Pages/default.aspx>.

Methodology

The main variable for our first two sets of hypotheses is the summation of the number of signatories for each included constituency by docket item.²⁰ Thus, for each of the following tests, the number of observations equals the number of PCAOB auditing standard related docket items commented on, by each constituency group, during the period from inception to June, 2015. For example, for docket item 4, 24 comment letters (signed by 28 individuals or businesses) were submitted, of which 13 signatories were auditor related. As we do not assume that comment letters signatories' participation follows a normal distribution, we use non-parametric statistical analyses, including Wilcoxon and Kruskal-Wallis tests. To address H1, we compare the auditor participation by docket item to the participation by all other constituencies combined. To address H2A, we compare the number of the signatories from the users, auditors, and preparers by docket item to discover if they participate in auditing standard setting differentially. We use post estimation tests to further examine the relationship among the three key constituency groups to test H2B-H2D. Statistically significant results would indicate support for a differential participation between the examined constituency groups.

To investigate if the standard type plays a role in the time to issuance, our third set of hypotheses, we use a duration model, allowing us to incorporate proposed (unissued) standards with comment letters on file.²¹ We examine the time from the first placement on the PCAOB rulemaking docket until the standard is finally issued. To estimate how long it takes for a specific audit standard to be issued, we define the critical event as an issued standard any time

²⁰ Since the PCAOB allows for multiple comment periods for certain docket items (e.g., concept release, proposed rule, repropounded rule, etc.), it is possible that a specific individual/organization has multiple signatory counts within a particular item.

²¹ While infrequent within accounting research, economics and finance literature have used the duration models to examine bank failures, plant failures, and other events (Tveteras & Eide, 2000)(e.g. Henebry 1996; Lane, Looney, & Wansley 1986).

between the PCAOB's inception and June 30, 2015. We examine if the probability an auditing standard will be issued later varies by standard type. The dependent variable is the time to issuance of an auditing standard, t . The Cox model is:

$$H(t|X, B) = h_0(t) \exp(X'\beta)$$

where X is a vector of the independent variables assumed to affect the probability of the standard being issued and the β vector contains the regression coefficients. The main strength of the Cox model is that no distributional assumptions are required to model the initial hazard function, h_0 .

Our independent variables are: auditing standard type (*Disc*), the number of signatories (*Signatures*), spread of the signatories between constituencies (*Wide Representation*), and if the standard is the first in a particular area (*First*). *Disc* is an indicator variable valued at one if identified as a disclosure related item, otherwise zero. *Signatures* measures the volume of respondents whose comments need to be addressed and incorporated by the PCAOB and the SEC before a standard is finalized. *Wide Representation* represents the number of different constituency groups from which the signatories belong. Finally, the *First* variable is an indicator variable representing the initial auditing standards that allowed for the transition from the ASB to the PCAOB regime for public company auditors (e.g., the first two Auditing Standard items (number 4 and 8) added to the PCAOB Rulemaking Docket). Our focus is the regression coefficient on *Disc* to test H3, which we predict to be significantly different than one.

IV. Empirical Results

Descriptive results

Although 1,802 signatories, representing more than 570 organizations, participate in PCAOB auditing standard setting, only the Big 4 firms and Grant Thornton submit comment letters for each of the 18 auditing standard items. It is interesting to note the remaining three of

the “next 4” do not submit comments on 15% or more of the proposed auditing standards. Table 3 lists organizations submitting comments on at least half of the auditing standards. After CPA firms or related entities, the American Accounting Association (AAA)²² participates most often in the auditing standard setting process, commenting on 11 auditing standards. The first government related entity, the US Government Accountability Office, submitted or signed 10 comment letters, for just over half of the auditing standards.

[Insert Table 3 here]

To place the audit standard participation in context, no single entity or individual provides a comment on each PCAOB rulemaking agenda item (40). Overall, the Big 4 audit firms, led by Deloitte, provide comments (37) on the most PCAOB items (e.g., rules, inspections, etc.). Grant Thornton completes the top five with responses (30), seven fewer than Deloitte. The top international participant, Institut der Wirtschaftsprüfer, a non-profit organization of public auditors and firms, provides comments on 20 different items. Cynthia Fornelli, Executive Director of the Center for Audit Quality, an auditor-related organization, is the individual with the most signatures on comment letters. Chris Barnard, an unaffiliated actuary, submitted comment letters for the most issues, 6 fewer than Fornelli.

[Insert Table 4 here]

Table 4 details comment letter signatories submitted, by constituency, to the PCAOB and the SEC. The audit profession and financial statement preparers are the dominant constituencies within the audit standard setting. The activity by the related associations of auditors or accountants (e.g., New York Society of CPAs) and preparers (e.g., National Association of Corporate Directors, US Chamber of Commerce, etc.) is consistent with the primary participators actively voicing their viewpoints through multiple channels.

²² The AAA is an association of accounting academics.

In Table 5, we identify the total number of signatories by constituent group for each docket item. The auditors' participation appears to be more consistent than the other key constituency groups. The auditing standard docket item relating to changes to the auditor's report (number 34) elicited the most comments from preparers, auditors, and users. Intriguingly, if we separate preparers further into management (e.g., chief financial officer, chief accounting officer, etc.), governance (e.g., audit committee members or chair), internal audit, or compliance (e.g., head of internal audit, compliance personnel) in untabled results, we see variation in preparer participation. For example, governance and management represent preparers for auditor rotation (docket item number 37), while internal audit or compliance signatories represent preparers for AS2 and AS5 (docket items number 8 and 21). Finally, while auditor rotation (docket item number 37) drew the most management related signatories, the second most management signatories link to the auditor's report, item 34. This varied participation is consistent with self-interested behavior within the preparer community.

[Insert Table 5 here]

Results

Based on the distribution of auditor signatories as detailed in Table 5, we examine the auditor participation compared to all other signatories. We do not find support for differential participation on audit standard items (Wilcoxon $z = -0.6905$, p value 0.9798) and are unable to reject H1. These results are consistent with the auditors failing to dominate the public comment letter process for auditing standards as measured by the volume of signatories.

Table 6 presents the results for testing the participation amongst specific key constituencies in the auditing standard setting. We do find support for H2A, differential participation amongst auditors, preparers, and users (Kruskal-Wallis $\chi^2 = 15.452$, p value 0.0008). Consistent with Jorissen et al. (2012), we expand our users to include academics and individuals

and expand preparers to include the other constituency. Table 6 Panel B presents the expanded constituency results with no change in inference.

[Insert Table 6 here]

Panel C, table 6 details the post-estimation testing we perform with adjustments to the required significance for the multiple comparisons. We pairwise compare auditors', preparers', and users' participation in the auditing standard setting process. We fail to find statistical support for differential participation between auditors and preparers (H2B), and between preparers and users (H2D). We find statistical support for differential participation between auditors and users (test statistic value =3.93, p-value<.0167) supporting H2C. In supplemental, untabulated analyses, we examine the auditor participation and preparer combined participation compared to all other signatories and find support for differential participation on audit standard items.²³ Collectively, these results indicate that auditors do not dominate the signatory participation for auditing standard setting in the PCAOB regime. Our evidence supports the idea that the auditors are aligned with the preparers with the formal comment letter process. Together, the auditors and preparers are to be the most significant voices in the formal comment letter phases of auditing standard setting. It appears that users rely on the PCAOB to advocate for their constituency. Interestingly, using a t test, constituency groups do not vary in participation across regulators (t value= 0.55, p value= 0.5942). This finding supports our decision to combine each docket item signatories, irrespective of the regulator, PCAOB or SEC.

[Insert Table 7 here]

[Insert Table 8 here]

²³ We also combine the auditor and user constituencies together to compare their participation with all other signatories and fail to find any significant difference in participation (Wilcoxon z= -0.4330, p value 0.6650).

Tables 7 and 8 address H3, the length of time it takes to issue final standards. As noted above, we test this hypothesis two ways, a Wilcoxon test of medians and a Cox hazard model. Table 7 details the results of the test of medians. While the median time to issue both performance and disclosure auditing standards is the same (312 days), contrary to SEC concerns, both the mean and maximum number of days is longer for the performance standards than disclosure standards. However, as of June 2015, more disclosure auditing standards remain unissued compared to a single performance standard. If we exclude the transitional auditing performance standard (the one standard without any comment letters associated with its issuance), the minimum days for performance standards becomes 198, the median is 337, and the mean is 539 days (untabulated). In order to test whether the perception holds across the entire docket, we expand our classification of disclosure and performance across all items; Table 7 details our results. We fail to find support for differences in the median times to issue amongst all the PCAOB Rulemaking Docket items (Z value=0.1226, p value .9024).

Recall, we use the Cox model to determine if it takes longer to issues disclosure auditing standards, relative to performance auditing standards. Consistent with our test of medians, as detailed in Table 8 Panel A, we do not find support for H3. Except the *First* variable, the control variables are also insignificant. The regression coefficient on *First* indicates that standards were more likely to be issued (e.g., reach the end of the process faster) if the standard is one of the initial items the PCAOB issues in a particular area. In supplemental, untabulated tests, this regression coefficient remains significant if we restrict the *First* variable to only docket item 4 (Compliance with Auditing and Related Professional Practice Standards - Advisory Groups). This is consistent with the view that PCAOB develops the initial standards in an area but doesn't always have much momentum for moving subsequent items to completion, reflective of the

PCAOB examining its standard setting process for potential improvements (Tysiac 2015; Cohn 2015). Overall, these results fail to support the view that the PCAOB is issuing one standard type over another. We check for violations of the proportionality assumption underlying the Cox model (Box-Steffensmeier & Zorn 2001). Table 8 Panel B provides no evidence there is a violation of this assumption. The small sample size leads to low power with our test (approximately 22%), thus providing a cautionary note to our results interpretation.

V. Conclusion

Formed in response to accounting and auditing standards, the PCAOB created structures to limit the influences of auditors in the creation of auditing standards. These limits included user dominated advisory councils and limited representation on the PCAOB Board itself. We test whether the influence of the auditors continues to dominate the audit standard setting process. Focusing on the formal, public due process, we identify comment letter signatories by constituency group. As a single comment letter may be signed from individuals from different entities, the signatory represents the full breadth of formal participation. We find that while auditors and preparers participate at similar levels, neither dominates the process. While users participate least in the formal due process, it is likely due to their participation in the informal portion of setting standards, when the agenda is being set and the details of the standard are being proposed. We also find the constituents participate differently based on the proposed standard. Auditors participate at a consistent level across all standards, while preparers participate more opportunistically. Preparers participate in large number but on only a few items, while users participation is somewhere in between.

The SEC, the federal agency responsible for the PCAOB, expressed concern that the PCAOB priorities were not focused on the audit quality improvement. They cited a focus on disclosure related standards at the expense of audit standards focused on the conduct of the audit

itself (performance standards). An additional concern was that disclosure standards take longer to finalize. We find twice as many auditing performance standards were initiated and adopted than disclosure standards. When we expand to the entire rulemaking docket, we find less than a third of all docket items are disclosure. We conduct two tests for length of time to finalize a standard. We compare median times to completion and a duration test. Neither test supports the SEC concerns: audit disclosure standards do not take longer to finalize than audit performance standards.

Our study should be of interest to regulators, researchers, and other standards setting constituencies. Understanding who responds to proposed standards may provide insight in the crafting of new standards. The “lumpy” preparers’ response to standards regarding testing internal controls and auditor report revisions (docket items 8, 21, and 34) is consistent with preparers responding to standards in their economic self-interest. With the exception of auditor rotation (docket 37) and audit partner signature (docket 29), on a docket basis, disclosure standards generate less participation than audit performance standards. This study should help the SEC in its oversight over the PCAOB and the PCAOB in developing its standard setting priorities. The expanded definition of constituency should aid researchers in developing new questions about the constituent participation effectiveness.

Appendix 1

PCAOB Docket Item	AS No.	Performance	Title	First Date Formally Appeared	Date Passed	Comment Letter Signatories		
						PCAOB	SEC	Total
4		Y	Compliance with Auditing and Related Professional Practice Standards - Advisory Groups	4/16/2003	10/31/2003	26	2	28
8	2	Y	Auditing Standard No. 2 - An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements	10/7/2003	6/17/2004	238	36	274
9		Y	Rule Regarding Certain Terms Used in Auditing and Related Professional Practice Standards	10/7/2003	9/8/2004	16	5	21
10	1		Auditing Standard No. 1 - References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board	11/12/2003	5/14/2004	9	6	15
12	3	Y	Auditing Standard No. 3 - Audit Documentation and Amendment to Interim Auditing Standards	11/12/2003	8/25/2004	47	9	56
14		Y	Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2	3/9/2004	11/17/2004	11	2	13
16		Y	Temporary Transitional Rule Relating to PCAOB Auditing Standard No. 2	11/30/2004	12/3/2004	0	0	0
18	4		Auditing Standard No. 4 – Reporting on Whether a Previously Reported Material Weakness Continues to Exist	3/31/2005	2/6/2006	43	6	49

Comment Letter Signatories

PCAOB Docket Item	AS No.	Performance	Title	First Date Formally Appeared	Date Passed	PCAOB	SEC	Total
21	5	Y	Auditing Standard No. 5 – An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements	12/19/2006	7/27/2007	209	44	253
23	6		Auditing Standard No. 6 – Evaluating Consistency Of Financial Statements and Conforming Amendments	4/3/2007	9/16/2008	11	3	14
25	7	Y	Auditing Standard No. 7 – Engagement Quality Review and Conforming Amendment to the Board’s Interim Quality Control Standards	2/26/2008	1/15/2010	73	9	82
26	8-15	Y	Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards	10/21/2008	12/23/2010	59	2	61
28		Y	Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards	4/14/2009		59	0	59
29			Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits	2/16/2005		161	0	161
30	16	Y	Auditing Standard on Communications with Audit Committees and Related Amendments to PCAOB Standards	3/29/2010	12/17/2012	97	6	103

PCAOB Docket Item	AS No.	Performance	Title	First Date Formally Appeared	Date Passed	Comment Letter Signatories		
						PCAOB	SEC	Total
34			Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments	6/21/2011		503	0	503
36	17	Y	Auditing Standard on Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards	7/12/2011	2/12/2014	11	3	14
38	18	Y	Auditing Standard on Related Parties and Related Amendments to PCAOB Auditing Standards	2/28/2012	10/21/2014	66	3	69
40			Proposed Framework for Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Auditing Standards and Rules	3/26/2013		27	0	27
Total						1,666	136	1,802

This table summarizes the 19 auditing standard related items on the PCAOB rulemaking docket as of June 2015. This table identifies the 13 items we classify as performance related while the remaining standards are disclosure related.

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Figure 1
Securities and Exchange Commission Rulemaking

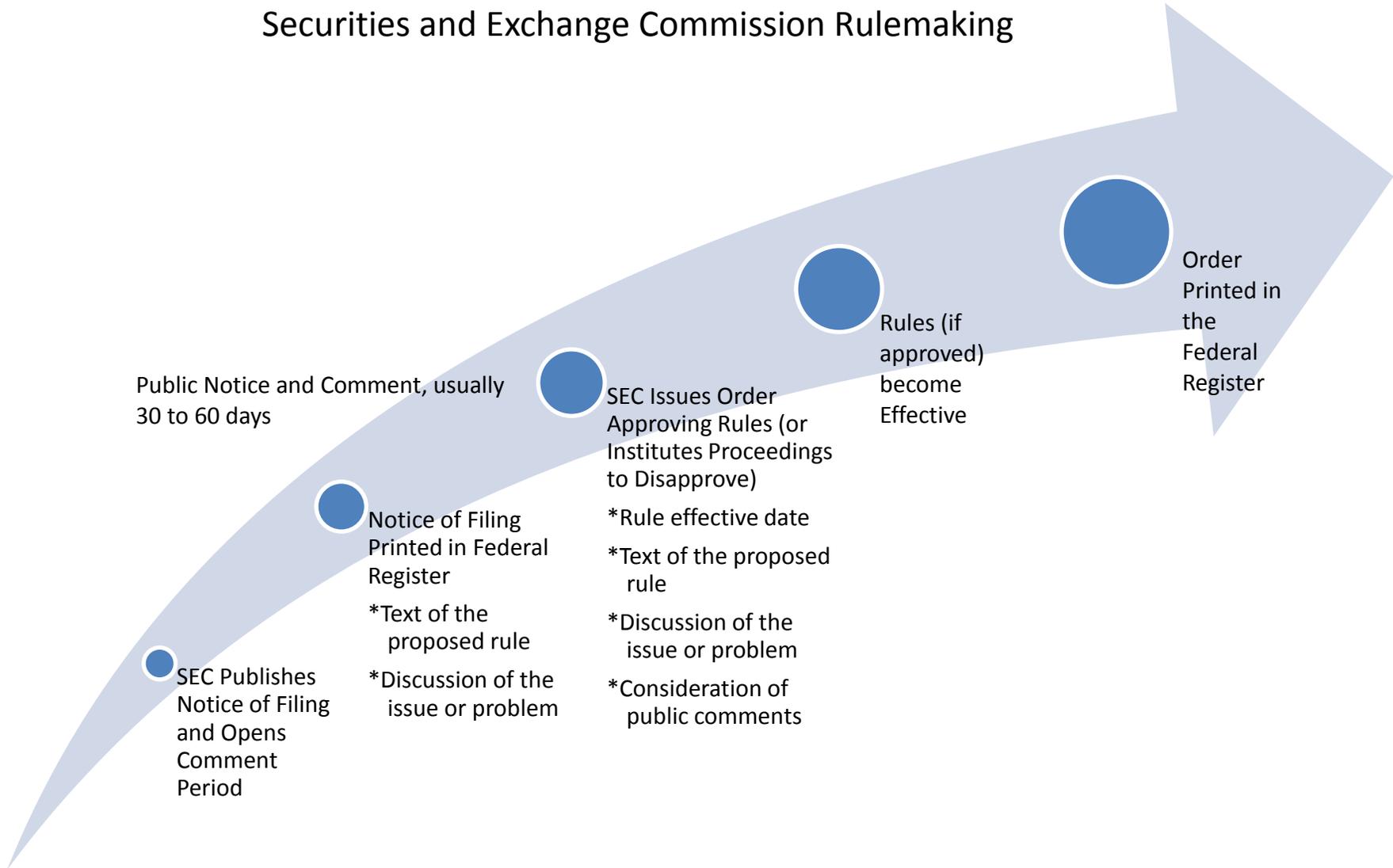


Figure 2 Public Company Accounting Oversight Board Rulemaking

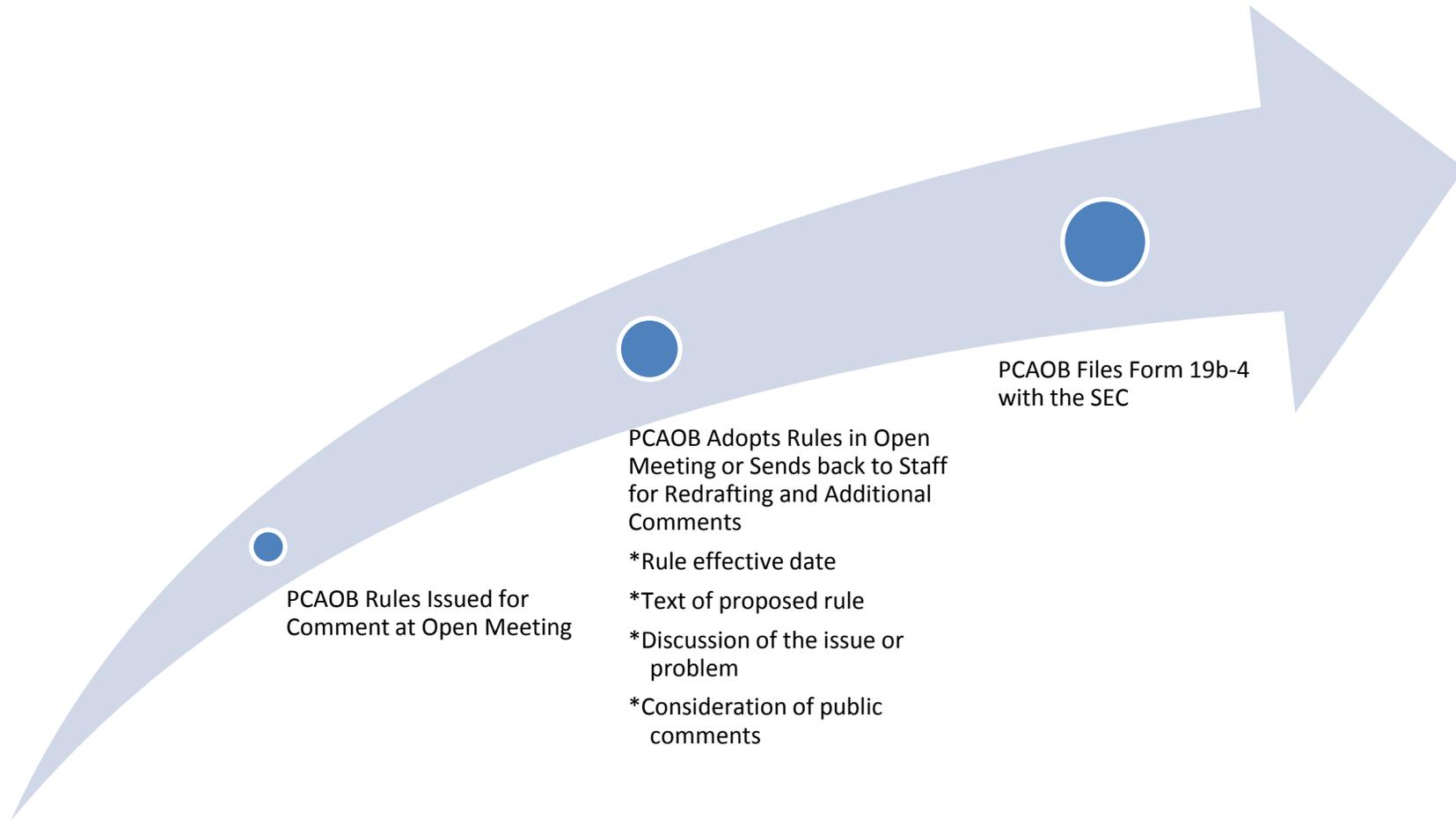


Figure 3 - Main Constituency Group Participation in Auditing Standard Setting

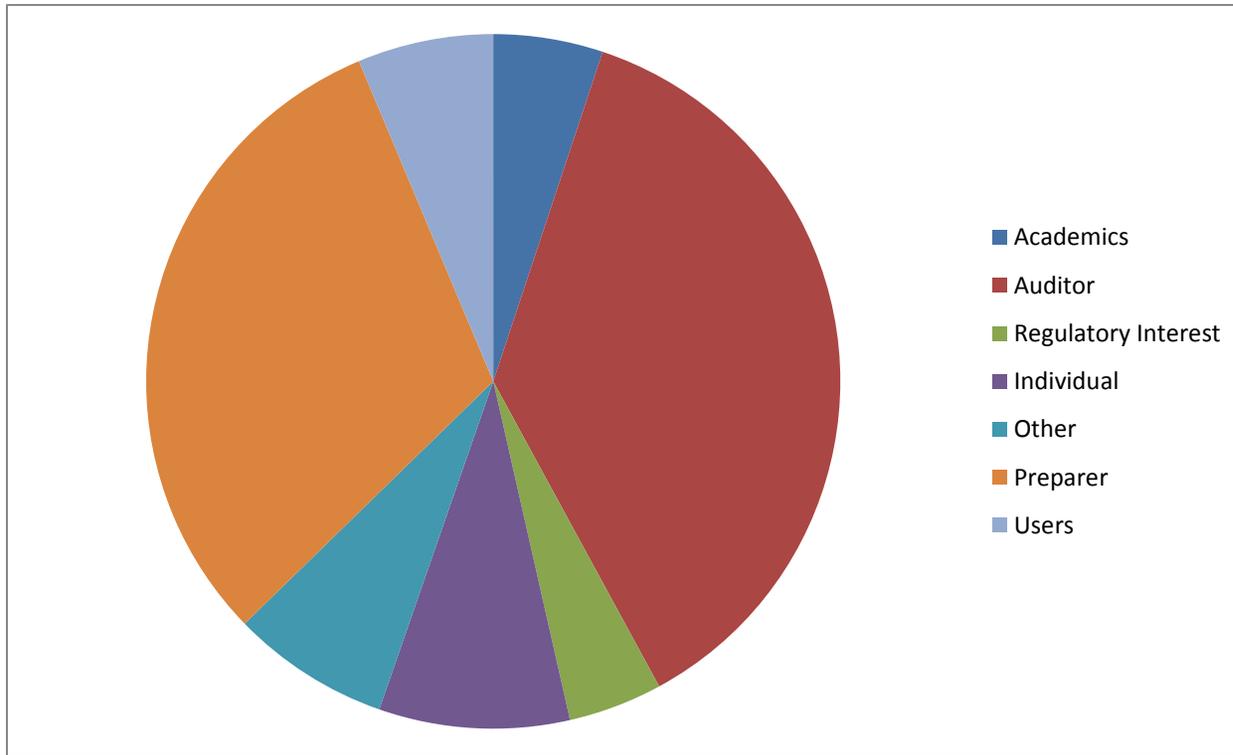


Table 1 – Constituency Definition

Constituency Group	Description
<i>Audit Firms</i>	Any entity or individual that provides audit and tax services to clients
<i>Auditor Related Associations</i>	Any entity or individual writing on behalf of an entity comprised of CPA's or the equivalent internationally (e.g. chartered accountants) including state societies
Auditor	
<i>Companies</i>	All public companies and other companies or individuals writing from the preparer perspective
<i>Preparer Related Associations</i>	All entities or individuals writing on behalf of an entity that are comprised of preparer individuals or representing preparer interests along industry lines
Preparers	
<i>Government</i>	Any entity or individual affiliated with a governmental unit at a state or federal (or equivalent level for internationally based entities)
<i>Standard Setter</i>	Any entity or individual that sets standards that other groups must follow
<i>Stock Exchange</i>	Any entity or individual that is connected to a stock exchange
Regulatory Interest	
Academics	Any individual affiliated with an institution of higher education or any institute of higher learning
Individual	A person not writing on behalf of an organization
Users	Any entity or individual that would be a user of audited financial statements including an investor
Other	Any entity or individual that does not belong in a category above including lawyers, consultants, actuaries, and broker dealers

This table defines the classification of signatories into constituency groupings used to test our hypotheses.

Table 2 – Population Description

	PCAOB	SEC
Comment Letters	3,155	184
Signatories	3,841	198
Less: Not linked to a PCAOB rulemaking item		(1)
Less: Related to non-auditing standard PCAOB rulemaking items	(2,175)	(61)
Final Population	1,666	136

This table provides the breakdown of signatories for PCAOB auditing issues between the PCAOB and SEC relating to auditing and non-auditing standard PCAOB rulemaking items.

Table 3 – Organizational Input

Organization	Input into Auditing Standards
Deloitte	18
EY	18
Grant Thornton	18
KPMG	18
PricewaterhouseCoopers	18
BDO	15
New York State Society of CPAs	15
Crowe Horwath LLP	13
McGladrey LLP	13
Texas Society of Certified Public Accountants	13
Institut der Wirtschaftsprüfer	12
American Accounting Association	11
Center for Audit Quality	11
Institute of Chartered Accountants in England and Wales	11
Illinois CPA Society	10
US Government Accountability Office	10
California Public Employees' Retirement System	9

This table lists the organizations that actively participate in auditing standard setting process. Out of the 18 auditing standard docket items, the input number details the total number of items when each organization signed at least one letter.

Table 4 – Overall Participation in Auditing Standard Items by Constituency Group

Constituency Group	Number of Signatories		SEC	% of SEC	Total	% of Participation Overall
	PCAOB	% of PCAOB				
Auditor	<i>Audit Firms</i>	295		51		
	<i>Auditor Related Associations</i>	297		23		
		592	36%	74	54%	666
Preparers	<i>Companies</i>	400		21		
	<i>Preparer Related Associations</i>	120		17		
		520	31%	38	28%	558
Regulatory Interest	<i>Government</i>	67		1		
	<i>Standard Setter</i>	8		1		
	<i>Stock Exchange</i>	2		0		
		77	5%	2	1%	79
Academics	90	5%	2	1%	92	5.1%
Individual	155	9%	5	4%	160	8.9%
Users	108	6%	6	4%	114	6.3%
Other	124	7%	9	7%	<u>133</u>	7.4%
Total by Type of Issue	<u>1666</u>		<u>136</u>		1,802	

This table summarizes the distribution of the comment letter signatories by constituency group for auditing standards by regulator.

Table 5 – Constituency Participation by Docket Item

Docket Item	Number of Signatories			Summation of Key Constituencies	Total Signatories
	Auditors	Preparers	Users		
4	13	4	1	18	28
8	50	143	13	206	274
9	16	0	0	16	21
10	15	0	0	15	15
12	37	0	1	38	56
14	13	0	0	13	13
18	22	4	10	36	49
21	44	108	17	169	253
23	12	0	1	13	14
25	51	20	1	72	82
26	40	4	2	46	61
28	47	2	1	50	59
29	73	11	18	102	161
30	60	17	6	83	103
34	97	234	36	367	503
36	12	0	1	13	14
38	43	11	6	60	69
40	21	0	0	21	27
	666	558	114	1,338	1,802

This table provides the signatory detail by auditing standard docket item. The auditor, preparer, and user constituencies are defined in Table 1. Appendix A details the name of each docket item. We test and fail to find support for differential participation between auditors and all other constituency groups (Wilcoxon z= -0.6905, p value 0.4899).

Table 6 - Krushkal-Wallis Test Results

Panel A - Main Results

χ^2	15.462	
DF	2	
Pr> χ^2	0.0008	***

Panel B - Supplemental Results

χ^2	6.5292	
DF	2	
Pr> χ^2	0.0764	*

Panel C

Comparison Constituency	Difference	Standard Error	Critical Test Statistic
Auditors vs Users	17.56	4.47	3.93 *
Auditors vs Preparers	7.19	4.8	1.5
Preparers vs Users	10.36	5.05	2.05

This table presents an analysis for signatory participation in PCAOB auditing standard setting process for all audit standard setting items as reflected in Table 5. Panel A reports the results for the Kruskal-Wallis test for the participation among key signatory groups -- auditors, preparers and users as defined in Table 1. Panel B reports the results after expanding the preparers to include others and users to include academics and individuals, as defined in Table 1. Panel C details the results of an application of the Dunn (1964) test. We use a Bonferonni correction to establish our level of required significance. ***, **, and * reflect 1, 5, and 10% significance level for a two tailed test, respectively.

Table 7 – Test of Medians

PCAOB Docket Items	Number of Issues	Time to Issue				Number In Progress
		Minimum	Median	Mean	Maximum	
Auditing Standards						
<i>Disclosure</i>	6	184	312	343	532	3
<i>Performance</i>	13	4	312	495	994	1
Other Docket Items						
<i>Disclosure</i>	6	140	247	451	1347	1
<i>Performance</i>	9	168	291	452	946	2
Total	40					8
Difference in Medians across all Disclosure Items						
			Z	0.1226	p	0.9024

This table summarizes the PCAOB issues by type and the duration (in days) to issue for the docket numbers that have resulted in an approved SEC order. We classify an item as related to disclosure if it is focused on required communication to the user of the audit opinion report in the report or other PCAOB based communication e.g. form, and performance if it requires an individual to do something in connection with the execution of an audit or inspection. The separation between Auditing Standards and others relies on the PCAOB's self-classification of items on their website. The number in progress indicates those that were not issued as of June 30, 2015. We fail to find support for a statistical difference between the median time to issue for the issued audit performance and disclosure standards for auditing standards alone ($Z=-.500$, $p=0.6171$).

Table 8 – Duration Model on Time to Final Standard

Panel A

Variable	Hazard Rate	z value	Prob>z	
Disclosure Standard	0.6339	-0.62	0.536	
First	11.1611	3.21	0.001	***
Signatures	0.9943	-1.52	0.128	
Wide Representation	0.5266	-1.01	0.311	
Log pseudolikelihood	-31.0138			
Prob> χ^2	0.009			
Number of observations	19			

This table reports the hazard ratio results from equation (1). Variables are: Disclosure Standard equals 1 if the PCAOB rule relates to disclosure and 0 otherwise; First equals 1 if the issue was the first audit standard items on the docket, and 0 otherwise; Signatures is the count of the number of respondents on the comment letters for the PCAOB and SEC public comment periods for the issue; and, Wide Representation equals 1 if the signatories come from at least 5 different constituencies as reflected in Table 1. *, **, *** Indicate significance at the 0.10, 0.05, and 0.01 levels, respectively using two-tailed test. Robust standard errors are used.

Panel B

Variable	ρ	χ^2	Prob> χ^2
Disclosure Standard	-0.0891	0.14	0.713
First	0.1250	0.15	0.698
Signatures	-0.1247	0.16	0.687
Wide Representation	0.0394	0.02	0.880
Global Test		0.56	0.967

This table reports the Schoenfeld residuals to test the proportionality assumption underlying the Cox model. We fail to find evidence that we are violating the assumption.