ABSTRACT

We survey 170 inspectors, representing 27% of the inspection staff, from auditor public oversight boards (POBs) in 20 countries to understand whether, how, and why auditors change auditing practices in response to POB oversight. We find that a large majority of POB inspectors believe that auditors frequently respond to inspector feedback. In terms of how auditors respond, inspectors report that they observe changing audit procedures and quality control systems, increasing documentation, conducting firm-wide training, increasing audit effort, increasing scrutiny of management estimates, and modifying the audit-quality review process. In terms of why auditors respond, the inspectors perceive that the primary drivers are POB enforcement capabilities, the perceived authority of the POBs, auditors’ desire for a ‘deficiency-free inspection report, and that POBs have a culture conducive for detecting auditing deficiencies. We ask questions in additional areas to support (or not) other theories in the literature. Overall, the survey data indicate that POB oversight leads auditors to change some auditing practices and procedures and that the changes occur primarily because the POBs have authority and enforcement capabilities.
1. Introduction

Over the past two decades, several countries have changed their approach to oversee the auditing profession, moving from a system of self-regulation to one where an independent regulator oversees auditors. Specifically, many countries have established public oversight boards (POBs) that are independent of the auditing profession in terms of their primary funding source and the composition of their governing body. These POBs are typically responsible for setting standards, conducting periodic auditor inspections to monitor audit quality, and enforcement. Several recent studies examine whether changes in auditor regulatory oversight affect proxies for audit quality, primarily focusing on the Public Company Accounting Oversight Board (PCAOB) in the U.S. The evidence suggests that PCAOB inspections improve audit quality and confer economic benefits to clients of PCAOB-inspected auditors. However, there is little evidence on whether POBs established by other countries affect audit quality (Carson et al. (2017) is an exception that we discuss more below). More importantly, prior research, including that on the PCAOB, provides no evidence related to how or why auditor public oversight improves audit quality. In other words, the extant literature for the most part has studied outcomes after the POB (particularly the PCAOB) is established and infers that inputs into the audit process changed but does not provide direct evidence of input changes.

In this paper, we provide descriptive evidence on whether, how, and why POB inspections affect auditor behavior by conducting a survey of 170 audit inspectors employed by POBs in 20 participating countries. First, we gather basic data on the characteristics of POB inspectors (their education, their experience, etc.). Second, we examine whether inspections by POBs affect auditor

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1 For example, Nagy (2014), Lamoreaux (2016), Krishnan et al. (2017), DeFond and Lennox (2017), Gipper et al. (2017) and Aobdia (2018) find that PCAOB inspections improve audit quality (broadly defined) for companies directly regulated by the U.S. Securities and Exchange Commission (SEC). Westermann et al. (2018) provide evidence from a survey of auditors that audit firms undertake costly actions to address PCAOB deficiencies. Aobdia and Shroff (2017), Fung et al. (2017) and Shroff (2019) find that PCAOB international inspections have positive spillover effects on non-U.S. companies.
behavior. Third, we examine how and why auditors respond to POB inspections. A typical inspection involves an examination of the audit work papers for several audit engagements and an evaluation of the auditors’ quality control systems. Further, the typical inspection process entails face-to-face interactions between inspectors and auditors during the inspection fieldwork (i.e., when inspectors visit the local offices of auditors). As a result, POB inspectors directly observe the effect of their inspections on auditing procedures and practices over time, making survey data uniquely suitable to provide descriptive details of how and why inspections affect audit processes and quality, and contribute to the extant archival studies that investigate the effects of POBs.²

In terms of how auditors respond, the questions we ask inquire about what actions inspectors observe auditors taking in response to inspections. We also go further and ask what effect (if any) do inspections have on the relationship between auditors and their clients, and also within members of an audit engagement team. In addition, we ask about inspector perceptions regarding the likelihood that auditors respond to POB inspections by gaming the system (e.g., tampering archived audit work papers) to obtain more favorable outcomes from their inspections.

In terms of why auditors respond to POB inspectors, it is important to recall that prior to establishing a POB, the auditing profession in several countries was self-regulated. The financial scandals in the early 2000s raised concerns about the effectiveness of auditor self-regulation and replaced the self-regulation approach to auditor oversight with public oversight. In theory, regulatory solutions have several limitations and need not be superior to self-regulation. For example, regulators typically get their authority from laws written by politicians and funding from either taxpayers or the regulated profession (i.e., audit firms). Thus, the typical public regulator is, to some degree, answerable to politicians and could come under pressure from them to be lax in their oversight of auditors. In addition, it is plausible that regulators are “captured” and controlled

² We are cognizant that surveys have important limitations. We discuss these later in the paper.
by the regulated entities (e.g., Stigler, 1971) and advance the interest of the regulated entities (auditors in our context), rather than the public interest. Furthermore, regulatory bodies typically cannot compensate their staff as well as the private sector, which affects the ability of regulators to attract and retain talent. Finally, it is not clear why a public regulator would have stronger incentives to advance the public interest and improve audit quality compared to auditors conducting peer-reviews. In other words, it is not clear how one incentivizes POB employees to inspect the work of auditors any more thoroughly than what would be accomplished in an approach where the auditing profession self-regulates. Thus, while the weight of the empirical evidence in the extant literature suggests that POB (specifically, the PCAOB) inspections improve audit quality, it is not clear why this is the case given the theoretical limitations of a regulatory approach to oversee auditors. As such, we are unaware of any evidence, even of descriptive nature, providing insights into why POBs have been effective at improving audit quality.

Again, survey data are uniquely suited to answering this question. Testing why POB inspections affect audit quality using archival data is difficult because such a test requires data on either: (1) the internal workings of POBs, such as employee incentives plans, promotion criteria, inspection approaches, governance structures, etc. as well as similar data on the alternative oversight approach that the POB replaces, and/or (2) changes in regulatory approaches that encompass several different POB characteristics (so one can design tests to infer which POB characteristic(s) improves audit quality, though this method would still infer input changes from observed output changes). Although survey data cannot be used to draw causal inferences regarding why POB oversight is effective, the data are useful to gain descriptive insights based on the perception of a group of people closely involved with POB oversight – POB inspectors. In addition to asking inspectors why they perceive auditors to change behavior in response to POB oversight, we ask POB inspectors about their incentives and on-the-job experiences related to both
public oversight as well as self-regulation (in instances where inspectors had experience with both systems) to provide a more complete picture of why POBs seem to ‘work’ and to mitigate some response biases (that we discuss below).³

The data about inspector characteristics reveal that almost all inspectors have a degree in accounting and experience working as an auditor at a Big-N firm. The majority of the inspectors held a title of “manager” or “senior manager” at their prior audit firm employer. None of the inspectors in our sample are less than 26 years of age and none of them went to work for the POB directly following their education. These descriptive statistics suggest that the typical inspector has significant experience performing audits and working at an audit firm.

To examine whether POB inspections affect auditor behavior, we ask inspectors to indicate (on a 5-point (0 to 4) Likert scale) the frequency with which they observe auditors changing audit procedures and quality control systems in response to POB feedback. Our data reveal that 78% of the inspectors observe that auditors “frequently” or “very frequently” (rating of 3 or 4 on the scale) adjust general audit procedures (and 69% respond similarly about quality control systems) as a result of the inspections. We also find that 46% of inspectors observe that auditors “frequently” or “very frequently” change culture or the tone at the top in response to inspection feedback. Inspector perceptions regarding the frequency with which auditors change tone at the top is significantly lower than the frequency with which they perceive firms to change audit procedures and quality control systems; yet the number of inspectors that believe changes in culture occur is non-trivial.

In terms of how auditors respond, our POB-inspector-survey data reveal that auditors “frequently” or “very frequently” respond to inspection feedback by increasing documentation (86%), conducting firm-wide training (83%), increasing the amount of audit/testing effort (64%),

³ Approximately 34% (17%) of the inspectors in our sample have experience conducting and/or receiving peer-reviews (inspections by professional organizations).
increasing scrutiny of management estimates (64%) and changing the audit-quality review process (62%). Consistent with inspections having weaker effects on audit firm culture and tone at the top (relative to audit procedures), the survey responses suggest that inspectors perceive fewer auditors to respond to POB inspections by changing compensation policies for engagement managers (12%) or engagement partners (30%) and changing controls over auditor independence (38%).

Recent anecdotes indicate that auditors may respond to POB inspections by gaming the inspection system and obtaining confidential information about upcoming inspections. To understand how pervasive such gaming is perceived to be, we ask inspectors about the frequency with which they believe that auditors (1) “fix” archived audit files to prepare them for inspections and (2) inappropriately obtain confidential information about upcoming inspections. Only 8% of the survey respondents indicate that auditors “Never” (rating = 0) tamper with closed/archived files before inspections. However, 48% provide a rating of one (on a zero-to-four scale), suggesting such behavior is rare. When asked whether auditors inappropriately obtain confidential information about upcoming inspections, 33% responded “Never” (rating = 0) and another 48% provided a rating of one; yet over 5% responded that such behavior occurs more often than not.

In terms of why auditors respond, we first ask inspectors directly about their opinions on why audit firms respond to inspector feedback (using a 5-point Likert scale). Two responses received significant support from majority of the inspectors. Specifically, 80% of the inspectors “agreed” or “strongly agreed” that auditors do not want the inspection report to contain criticisms of their audit procedures, and 74% “agreed” or “strongly agreed” that auditors respond to inspector feedback to reduce the risk of enforcement actions and fines. In comparison, significantly fewer

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4 For example, KPMG U.S. recently settled a case with the SEC in which KPMG admitted to improperly obtaining and using confidential information from former PCAOB employees in an effort to improve the results of their PCAOB inspection. See: https://www.sec.gov/litigation/admin/2019/34-86118.pdf
inspectors perceive that auditors respond to inspector feedback because auditors believe the suggestions improve audit quality (59%) or that auditors do not what to upset the inspectors (27%).

We also asked the converse – what do the inspectors think are the reasons why auditors do not respond to the feedback received during inspections. The three reasons to which the highest percentage of inspectors “agreed” or “strongly agreed” that auditors do not respond are when: (1) audit partners believe that the deficiencies identified by inspectors relate to one-off mistakes (57%), (2) the costs of implementing the suggestions are too high (46%), and (3) auditors see little benefit to them from implementing the suggestions (45%).

When asked to compare the strengths/weaknesses of POB inspections and peer reviews, we find that 80% of the inspectors “agreed” or “strongly agreed” that POB inspectors have greater authority than peer-reviewers, 76% of the inspectors “agreed” or “strongly agreed” that POB inspectors have greater enforcement options than peer-reviewers, and 73% of the inspectors “agreed” or “strongly agreed” that the culture and environment at POBs is more conducive for detecting auditing deficiencies than that at audit firms conducting peer-reviews. These views are significantly stronger among the subset of inspectors that have experience conducting peer-reviews and/or being peer-reviewed. The questions comparing POB inspections and inspections by professional organizations (e.g., AICPA, ICAEW) yield similar responses. These questions and responses suggest that auditors respond due to the authority and enforcement capabilities of the POBs in general, but do not respond when costs of doing so are deemed too high or that the underlying problem is not pervasive.

Finally, to provide insights into other aspects of the functioning of POBs, we asked inspectors about the primary benefits and costs of working at the POB (to infer why they chose to work at the POB) and their long-term career objectives. On the one hand, it is plausible that inspectors seek employment at a POB to gain knowledge and experience about the functioning of
the POB, and to build social ties at the POB, with the goal of returning to the private sector equipped with a greater ability to perform well during regulator inspections and reduce regulatory risk for their private-sector employer. On the other hand, it is plausible that inspectors seek employment at a POB because they believe in the regulator’s mission, prefer the work-life balance offered at the POB (relative to that in the private sector), dislike the private-sector environment, etc. If the typical inspector seeks employment at a POB with a goal of returning to the private sector, POB inspections are less likely to be effective at improving audit quality because inspectors might have incentives to be lax in their inspection and enforcement effort to curry favor with prospective employers.

The survey data suggest that the primary benefits of working as a POB inspector, and thus the reason why inspectors work at a POB, are that the job: (1) is an opportunity to influence audit practice (with 87% of the respondents “agreeing” or “strongly agreeing” with this statement) (2) satisfies an intrinsic interest in improving audit quality (86%) and (3) provides good work-life balance (82%). We find little support for the conjecture that inspectors seek employment at a POB to gain knowledge about the functioning of the POB and subsequently improve their career prospects in the private sector. Specifically, 37% of the respondents “agreed” or “strongly agreed” that a benefit of working at the POB was improved career prospects at an audit firm later in their career. Further, even though 59% (27%) of the inspectors believe that it would be “easy” or “very easy” for a POB inspector to find a job at Big-Four audit firm at the senior manager (partner) level, such movement between audit firms and POBs does not appear to be the norm. For example, less than 17% of the inspectors “agreed” or “strongly agreed” that audit firms frequently approach the current inspection staff for employment and less than 12% of the inspectors “agreed” or “strongly agreed” that inspectors frequently approach the audit firms for employment. In sum, inspector responses suggest that the majority of the inspectors working at a POB are motivated to improve
audit quality because of an innate interest in serving the profession rather than a pecuniary interest or a desire to return to the private sector for higher pay. However, we recognize that inspector responses to these questions might be biased towards answers that make them look more altruistic.

Aside from inspectors’ innate motivation to exert effort and “do the right thing,” the data reveal that inspectors have weak performance related incentives (at least compared to what one might expect in the private sector). For example, only 5% of the inspectors “agreed” or “strongly agreed” that receiving a competing job offer is an important determinant of promotions, and almost half of the surveyed inspectors “agreed” or “strongly agreed” that inspectors are rarely asked to leave their job due to poor performance. Our data also reveal a lack of uniformity in inspector perceptions regarding the existence of formal programs to evaluate auditor inspection quality, suggesting that formal evaluations of inspectors’ performance in conducting inspections might not be an important determinant of promotion. Rather, we find that the majority of the inspectors “agreed” or “strongly agreed” that promotions are determined based on feedback from the inspection team leader (76%) and the availability of promotion opportunities (73%). Finally, we find the number of deficiencies detected during inspections is not an important determinant of promotion. This result implies that inspectors do not perceive to be rewarded for identifying a larger number of deficiencies during inspections, which is contrary to the perceptions held by U.S. auditor partners about the PCAOB inspectors’ incentives (Houston and Stefaniak 2013).

Our paper contributes to the literature on regulation and auditing in two ways. Specifically, this is the first study (to our knowledge) to provide insight into how and why POBs improve audit quality and compare a system of public oversight to self-regulation. Prior research entirely focuses on examining the consequences of the shift from self-regulation to public oversight on the audit market (e.g., Lennox and Pittman 2010; DeFond and Lennox 2011; Aobdia and Shroff 2017), audit quality (e.g., Lamoreaux 2016; Fung et al. 2017; Gipper et al. 2017; Krishnan et al. 2017; Aobdia
2018), and external financing and investment (Shroff 2019). Other studies compare the inspection reports prepared by peer-reviewers and POB inspectors to infer differences in the information content of these reports (e.g., Anantharaman 2012). We build on these studies by providing new descriptive insights into how auditors respond to the feedback received during POB inspections and why inspectors perceive POBs to be effective at changing auditor behavior.

Our paper is also related to prior studies that survey and interview practicing auditors. Daugherty and Tervo (2010) survey triennially inspected U.S. audit firms and find that the responding firms evaluated the inspection process favorably in terms of “appropriate constructive criticism, engagement selection, inspection time devoted to engagements, and inspectors’ knowledge, conduct, and appropriate focus.” However, they go on to indicate that audit firms disagreed that PCAOB inspections are an improvement over the prior peer-review process and that “A number [of auditors] viewed inspections as failing to enhance audit quality or investor confidence.” Houston and Stefaniak (2013) survey partners at larger U.S. audit firms about their perceptions of PCAOB inspections and internal quality reviews (IQRs). 5 Houston and Stefaniak (2013) report that audit partners think that IQRs are better than PCAOB inspections along most dimensions the authors examine (e.g., inspector/reviewer knowledge about audit methods, fairness, focus on improving audit quality, timeliness of feedback, etc.). Johnson et al. (2018) interview 20 U.S. auditors about their experience with PCAOB inspections and find that auditors place great importance on achieving clean inspection reports and spend significant resources to increase the likelihood of positive inspection outcomes. However, auditors generally do not have much trust in the PCAOB. Finally, Westermann et al. (2018) survey 55 U.S. auditors and former auditors of varying rank and interview eight auditors. They find that auditors generally perceive the PCAOB inspection process to have improved audit quality, albeit at a very high cost (implying

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5 Houston and Stefaniak (2013) indicate that “An IQR is an internal quality control mechanism employed by larger audit firms to assess compliance with auditing standards and firm methodologies while performing engagements.”
that costs of PCAOB inspections exceed its benefits). For example, Westermann et al. (2018) state that U.S. auditors believe that “Passing an inspection is so important, that auditors…have resorted to impression management strategies and “functionally stupid” work practices.” Overall, much of the results from surveys and interviews of U.S. auditors is critical of PCAOB inspections.

POB inspectors and auditors are perhaps the two most informed groups of economic agents with knowledge regarding how and why audit firms change behavior in response to POB oversight. Yet, the perceptions of these agents regarding the value of POB oversight and their inspection experiences are likely to differ because (1) it is one group’s job it to identify mistakes in the other group’s work and (2) inspectors and auditors self-select into these roles and thus are inclined to believe that what they are doing is valuable/correct. As such, our survey of POB inspections complements prior studies surveying auditors by providing another point of view that can help us understand whether, how, and why POB oversight affects auditor behavior.6

Our analyses are based on survey data and thus it is important to caveat that our data and results are subject to the general limitations of this method. We attempt to mitigate biases related to survey data by taking multiple steps that we discuss below. In addition, in many instances, our inferences are based on responses triangulated across multiple questions. However, despite these efforts, we recognize that there could be a systematic tendency of respondents to obscure the truth or to be unconsciously biased on particular questions, which could affect our results. Another important caveat is that we ask inspectors about whether, how, and why they perceive inspections to affect auditor behavior. Given that inspectors are choosing to work at a POB, their views could

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6 Some other benefits of surveying POB inspectors rather than auditors include: (1) POB inspectors’ perceptions are based on their inspection experiences from a broad cross-section of audit firms and audit engagements while individual auditors are likely to have had relatively idiosyncratic experiences based on when their engagement was selected for a POB inspection; (2) a survey of POB inspectors enables us to collect facts about the internal workings of POBs, the incentive structures, etc., which we know relatively much less about. And (3) the vast majority of POB inspectors have prior experience being an auditor and thus can relate to both the job as an inspector and auditor; whereas, auditors typically do not have experience working at a POB. Of course, there are disadvantages of surveying POB inspectors as well, which is why we believe our evidence complements that in prior studies surveying auditors.
be favorably biased about the effectiveness of POBs. We recognize this potential bias and are careful to word questions to mitigate the effect of such a bias but we caveat that the results should be interpreted carefully as the responses represent the views of regulators.

The rest of the paper proceeds as follows. Section 2 describes our sample and survey methodology. Sections 3 to 6 present the descriptive statistics and results. Section 7 concludes.

2. Survey methodology and sample

We developed an initial survey instrument based on a review of the auditing literature related to the PCAOB inspections and the American Institute of Certified Public Accountants (AICPA) peer-reviews, as well as the literature on the economics of regulation. We solicited feedback from several academic researchers, regulators, and a survey design consultant on the survey content and design. We used preliminary drafts of the survey to conduct beta tests to seek feedback on the clarity of questions and to estimate the time it would take for inspectors to complete the survey. The final draft of the survey contained 37 questions of varying length, and some questions with subparts. The paper version of the survey was 23 pages long; however, all responses were completed using the online version of the survey, which can be accessed from this link: [https://survey.qualtrics.com/jfe/form/SV_1yO2tbo7NRf4ztP](https://survey.qualtrics.com/jfe/form/SV_1yO2tbo7NRf4ztP).  

We initially reached out to and obtained permission from senior staff at the Authority for the Financial Markets (AFM) in the Netherlands, Independent Regulatory Board for Auditors (IRBA) in South Africa, and Financial Reporting Council (FRC) in the U.K. to survey the inspectors working at these POBs. Subsequently, we also received consent to survey the inspectors at the Dubai Financial Services Authority (DFSA). These approvals were obtained between December 2017 and March 2018, at which point, we reached out to IFIAR to broadcast a

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7 We also had an MIT accounting PhD student take the survey; she completed it in approximately 40 minutes.
participation request to all their members. IFIAR sent out an email to all its members on April 13, 2018 providing a description of our study and requesting members to contact us for more information. IFIAR’s email prompted 14 additional POBs to participate in our study (from a total of 52 member organizations as of 2018). A senior staff member of the AFM also mentioned our study in a Committee of European Auditing Oversight Bodies (CEAOB) plenary meeting, as a result of which Romania’s POB, the ASPAAS, agreed to participate in our study (the ASPAAS is the only non-IFIAR member that participated in our study). On January 10, 2019 the PCAOB agreed to inform their Division of Registration and Inspections (DRI) staff about the survey and allowed them the opportunity to choose to participate.

We requested the 20 participating POBs to provide the email addresses of all the staff employed by them who conduct inspections. Twelve of the 20 POBs provided us email addresses of all their inspection staff. Of the remaining eight POBs, four asked inspectors to volunteer and provided us the email addresses of only those inspectors who volunteered. The PCAOB asked interested DRI staff to contact the researchers if they were interested in participating the survey. Finally, the Switzerland POB randomly selected one-third of their inspectors to participate, the Czech Republic POB selected the senior most volunteer, and the Portuguese POB selected only the senior inspectors. In total, we obtained email addresses of 208 inspectors.

We emailed the first invitation to participate in the survey to 163 inspectors on May 23, 2018. We sent four reminders (May 30, June 6, June 13, and June 27). On June 20, we emailed our contact person at each POB and asked them encourage their inspection staff to complete the survey. We closed the survey on July 6. Since we PCAOB inspectors were informed of the survey at a later date, we re-opened the survey for the PCAOB inspectors on January 17, 2019. Forty-five PCAOB inspectors contacted us and expressed interest in taking the survey in response to internal emails sent within the PCAOB informing all DRI staff about our study. We sent reminders to the
PCAOB inspectors that volunteered to take the survey on February 12th, 19th, 26th and March 21st, after which we closed the survey.

A total of 176 inspectors accessed the survey from a total 208 inspectors that received invitations to participate. Six respondents either completed less than 25% of the survey or simply clicked through the entire survey without answering any of the questions; we exclude these observations from our sample. Thus, we obtain 170 usable responses from our survey. Table 1 lists the POBs (and the countries to which they belong) that participated in our survey, along with the number of inspectors that each of the POBs employ, the number of inspectors whose contact information we received, and the number of inspectors that responded to the survey. 8

One approach to compute the response rate is to take the ratio of the number of usable responses (170) to the number of survey recipients (208), which gives us response rate of 82%. However, part of the explanation for such a high response rate is because we coordinated with POBs and inspectors’ prior willingness to answer the survey was determined by the POB before we sent the survey out.9 Another approach is to use the total number of inspectors employed at the participating POBs (635) as the denominator, which yields a response rate of 26.8%. Both approaches yield response rates that compare very favorably to prior studies.10, 11

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8 It is worth noting that there some heterogeneity in the role of an audit inspector across POBs. In some instances, the inspection staff at the POB strictly focuses on inspections (and related tasks) but nothing else. In other instances, some employees participate in inspections as well as other activities such as enforcement. In our correspondence with the senior members of each POB (who served as our contact), we indicated that we are surveying the employees responsible for conducting inspections, and as such, spend much of their time conducting inspections.

9 This as a condition requested from them. They limited the number of their inspectors that we could survey.

10 A third approach to compute response rates (which we do not have the data implement) is to compare the number of usable responses to the total number of inspectors that work in all POBs that are IFIAR members. In terms of POBs, one could compute a rate as 19 POBs from IFIAR in our sample to the 52 total POBs or a rate of almost 37% (plus we have Romania which is not a member of IFIAR).

11 For example, Daugherty and Tervo (2010) report a responses rate of 32% in a survey of triennially inspected audit firms. Houston and Stefaniak (2013) received a response rate of 9% in a survey of audit partners of large firms. Johnson et al. (2018) and Westermann et al. (2018) do not report response rates in their studies. Other studies, unrelated to auditing, that report response rates are Graham et al. (2014, 2017) with 26% in a survey of tax directors, Graham et al. (2005) and Dichev et al. (2013) with under 9% response rates in surveys of CEOs and CFOs.
There are limitations to survey research. First, there is a possible selection issue if certain types of inspectors choose to respond to the survey and certain types of inspectors do not respond. Indeed, this may be particularly acute if the POBs chose certain types of inspectors that we were allowed to survey and excluded some particular type that we could not survey. In contrast to some other research settings where the responder could be compared to the non-responder or to the typical Compustat firm (e.g., Graham et al. 2014), we have no such luxury in this setting because our data are the only data on POB inspectors that exist. As a precaution, we re-do our analyses using responses from the subset of POBs that allowed us to survey their entire inspection staff and verify that our inferences are unchanged. In addition, the high response rate, to some extent, mitigates these concerns. However, we recognize that some concerns could remain.

It is also possible that respondents did not understand our questions (either because we did not write the question clearly, language differences between us and the respondents, or any number of other factors). There is no way to completely eliminate these issues. However, we tried to prevent serious problems by (1) having many academics read the survey instrument before we administered it to the inspectors, (2) hiring a survey consultant to review the instrument (both the online functioning and the content of the questions), (3) having several senior staff from multiple POBs read the instrument and provide feedback to us about the content of the questions, and (4) encouraging the use of Google Translate in the online survey via a function in Qualtrics if the respondent had trouble with the English language.

Another concern is that respondents may not answer truthfully, they may randomly answer just to finish the survey, or they may answer in a way that “looks good” for the POB for whom they work. Again, there is no way to avoid these issues entirely. To mitigate the concerns, we promised complete confidentiality and stated that the responses would not be shown to the respondents’ boss and that we would present data in such a way that no individual inspector or
even separate countries’ POBs would be identifiable. We analyze the responses and corroborate them across questions and we do not see evidence of respondents answering randomly. In addition, it took the median inspector 42.5 minutes to complete the survey and several inspectors completed the survey over two or more days, suggesting that they did not rush through the task.

Finally, for questions where we list a set of statements in a grid and ask the respondent to rate the extent to which they agree/disagree with each statement in the grid, we randomized the ordering of statements (excluding the ‘other’ option) that the respondent saw on the grid. The intent with such randomization is to avoid any response bias due to the ordering of the possible responses (e.g., the respondent only reads the first few). In addition, when the grids had ten or more statements for the inspectors to agree/disagree with, we included a follow up question asking the respondent to rank the two statements that he/she perceived to be the most important from the subset of statements the respondent “strongly agrees” with. The purpose of such a follow up question was to have a rank ordering of importance of the statements in the event that a respondent strongly agreed with many of the statements. We also allowed respondents to skip every question in the survey and indicated this option in the survey instructions. Thus, if inspectors did not want to answer any particular question, they could move forward without answering the question. In addition, we always included an “other” factor where the respondent could write in text to supply their own answer in the event we were not aware of all possible important issues for a question.

3. Descriptive statistics and inspector characteristics

We first collect information about the educational backgrounds, prior audit and non-audit experience, and average POB employment duration of the typical POB inspector. These data are provided in Table 2. Survey responses reveal that the vast majority of inspectors have significant accounting education, such as a degree in accounting (roughly 51%) and/or a certification such as the CPA or CPA equivalent (roughly 79%). That inspectors have an education in accounting
should come as no surprise. We find that majority of the inspectors have worked at their POB for three or more years and that none of them are under the age of 25 (the majority being older than 36). In addition, all POB inspectors had some prior work experience following their education and before joining the POB. We also find that the vast majority (almost 83%) of the respondents worked in an audit role at a Big-N accounting firm. The majority of inspectors reached the title of manager or senior manager in the audit firm they worked at. Approximately 77% of the inspectors were hired from an audit firm and 11% were hired from another government agency. These background characteristics suggest that POB inspectors have significant audit experience.

The data reveal that 41.4% of inspectors perform inspections of all the Big-4 auditors and 80.6% (36.5%) of the inspectors perform at least 5 (11) inspections of Big-4 and non-Big 4 auditors per year. Just under 34% of the inspectors in our sample have some experience with auditor peer-reviews and just under 17% have some experience with inspections conducted by auditor professional organizations.

4. Effect of inspections on auditor behavior

4.1. Do inspections affect auditor behavior?

A number of studies examine the effect of POB inspections on proxies for audit and financial reporting quality. For example, Lamoreaux (2016) and Krishnan et al. (2017) find that non-U.S. companies cross-listed in the U.S. observe an improvement in audit quality (measured using several approaches) following the threat of a PCAOB inspection and actual PCAOB inspections. Gipper et al. (2017) find that equity investors’ responses to earnings news (i.e., ERCs) increases following the introduction of the PCAOB inspection regime (also see Carcello et al. 2011). DeFond and Lennox (2017) and Aobdia (2018) link the content of PCAOB inspection reports to subsequent changes in audit quality. These studies suggest that U.S. auditors respond to
PCAOB inspections by changing auditing practices. Fung et al. (2017) and Shroff (2019) find that PCAOB inspections not only affect the audits of companies regulated by the U.S. SEC but also affect the audits of non-U.S. companies, which lead to greater access to external capital and increased investment. All of the above archival evidence relates to the effect of PCAOB inspections on audit markets and auditor behavior. Carson et al. (2017) is the only study we are aware of that examines whether non-U.S. POB inspections affect audit quality proxies. They find that the commencement of inspections across POBs of 36 countries is associated with audit quality improvements, consistent with the findings in the U.S. setting. Considering that most countries had some form of self-regulation approach to auditor oversight prior to the introduction of POB inspections, the evidence in prior studies can be interpreted as suggesting that POB inspections are more effective at improving audit quality compared to a self-regulation approach.

While the archival studies are carefully done, these studies typically compare audit quality proxies pre- vs. post-POB establishment and thus are subject to some important limitations (that prior studies recognize). Specifically, it is difficult to identify the effect of POB inspections because the creation of a POB is often confounded by other factors that affect audit quality (e.g., Sarbanes-Oxley Act in the U.S., the adoption of IFRS outside the U.S., concurrent enforcement changes). Prior studies are clever in using research design features such as staggered adoption dates and cross-listed firms. However, problems remain because most proxies for audit quality are slow to respond to any treatment (Leuz and Wysocki 2016). In addition, the counterfactuals in such tests are still based on observing audit quality in companies with different auditors and fundamental characteristics and then inferring that the audit inputs must have changed (but with no evidence on inputs or which inputs). We ask questions in our survey to obtain information specifically about the inputs to the audit process.
We first ask about the frequency with which the inspector responder observes auditors reacting in a variety of ways. Figure 1 presents the data. We find that 78.2% (68.5%) of the inspectors say that auditors “frequently” or “very frequently” change or adjust audit procedures (quality control systems) at inspected clients in future engagement because of feedback from inspectors. In addition, 60.6% of inspectors say that auditors “frequently” or “very frequently” change audit procedures at clients that were not inspected because of inspections (and the feedback received) at other clients. The presence of such spillover effects from inspected to non-inspected audit engagements is important because most POBs do not inspect all audit engagements of an auditor, in part due to resource constraints, and rely on such spillover effects to exist. Further, prior archival studies examining the effect of PCAOB inspections on audit quality typically assume the existence of such spillovers (e.g., Aobdia and Shroff 2017, Fung et al. 2017, Gipper et al. 2017). We also find that 46.1% of the inspectors say that the auditor “frequently” or “very frequently” changes the “tone at the top” as a result of inspection feedback. While this is a lower percentage than the factors discussed above, this is a non-trivial number of inspectors to state that such a large shift in an audit firm occurred after a POB inspection. In sum, the inspectors’ responses suggest a strong belief that auditors frequently make changes to audits processes, and to a lesser degree audit firm culture, in response to the feedback received from POB inspections.

4.2. How do inspections affect auditor behavior?

4.2.1 Effect on audit processes

We attempt to dig further by asking what actions in particular the inspectors have observed auditors taking in response to POB inspection feedback. We listed 12 potential actions each with a 5-point Likert scale that ranged from 0 (strongly disagree) to 4 (strongly agree). The data are presented in Figure 2. The greatest consensus where inspectors stated that they “agree” or “strongly
agree” is for auditors increasing documentation of audit procedures (85.7%). The next most common auditor behavior, according to the inspectors, is conducting firm-wide training (82.7%). Other actions include increasing the amount of audit and testing efforts (64.4%), increasing scrutiny of management estimates (64.0%), changing the audit quality review process (62.1%), changing audit check lists (56.0%), and changing procedural manuals (55.6%). Of note is that seven of the actions listed in the survey, garnered agreement by more than 50% of inspectors. To the extent, changes in audit and testing effort, greater scrutiny of management estimates, etc. lead to increases in audit fees, our evidence is consistent with prior archival studies showing that PCAOB inspections lead to increases in audit fees (e.g., Aobdia 2018, 2019). Our evidence extends prior archival research by providing insights into what input changes in the audit process lead inspections to result in higher audit fees.

Figure 2 also shows that relatively few inspectors “agree” or “strongly agree” that auditors respond to inspection feedback by changing compensation policies for engagement managers (11.7%) or engagement partners (29.8%) or changing controls over auditor independence (37.9%). As such, the responses to questions in both Figure 1 and 2 suggest that auditors are less likely/willing to change overall audit firm culture and independence relative to making procedural changes such as documentation and training; however, the latter sometimes do occur.

4.2.2 Do auditors try to game the inspection system?

Another plausible manner in which auditors could respond to POB inspections and oversight is by finding ways to circumvent the purpose of the inspections and game the system. For example, the SEC recently alleged that two former PCAOB officials had left the PCAOB to

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12 We also note that twelve respondents rated the “Other” option but only two filled-in the text portion of the question describing what “Other” meant. One respondent strongly agreed that auditors focus “specifically in the areas reported at the inspection” and the other respondent strongly disagreed (i.e., rated zero) that auditors change “Culture and remuneration.”
work at KPMG and that these officials made unauthorized disclosures of PCAOB plans for inspections of KPMG audits. The SEC went on to allege that these unauthorized disclosure enabled the (now former) KPMG partners to analyze and revise audit work papers in an effort to avoid negative inspection findings by the PCAOB. We use our survey to understand whether the recent KPMG-PCAOB scandal is a one-off occurrence or whether it is more pervasive but undetected.

We directly ask inspectors whether they believe auditors misbehave or try to game the inspection process by (1) tampering closed/archived audit files to “fix” them for an inspection, and/or (2) whether auditors inappropriately obtain confidential information related to upcoming inspections. These data are presented in Figure 3. The scale for this question was a 5-point Likert scale where 0 = “Never” and 4 = “Very Often.” The data reveal that inspectors think that there is a non-trivial amount of ‘fixing’ audit files in preparation for an inspection. We find that 7.9% choose the rating of 0, meaning “Never,” and 4.3% responded by clicking 4 on the scale for “Very Often.” Another 14.6% of respondents answered 3, indicating more often than not. The interpretation of these data depends on one’s priors, of course. If one’s prior is that closed audit files are never supposed to be tampered with before an inspection, then the low percentage of inspectors that answered “Never” and the 18% and roughly 5% that answered “Often” and “Very Often” may seem surprising and important.

The data about how often auditors obtain confidential information about upcoming inspections is similar in the sense that not all, or even a majority, respond that such behavior never occurs. While fewer inspectors (relative to the percentage that said audit files are fixed) answer that auditors receive information about the inspection in advance, receiving information about the inspection in advance is more egregious behavior than fixing a file. Again, whether the responses are surprising or not depends on one’s priors. The data reveal that 5.5% of the respondents answer
that auditors “Often” or “Very often” inappropriately obtain confidential information about upcoming inspections (rating = 3 or 4). 32.9% respond that this “Never” occurs (rating = 0) and 47.6% respond that obtaining inappropriate information happens rarely (rating = 1).

A caveat to these results is that they are from the inspector’s perspective. We cannot be sure whether inspectors just perceive that auditors are taking these actions to avoid detection of poor audit quality and that the reality is something different or whether the inspectors’ beliefs are consistent with reality. Nonetheless, these responses provide the perspective of one set of agents that are very close to the auditing and inspection process, and thus we believe the views of inspectors can guide future research that further explores the extent to which there is malfeasance in POBs and the auditing industry.

4.2.3 Effect of inspections on relationships within the engagement team

To better understand the effect of POB inspections on audit practice, we ask inspectors about whether the inspection process affects relationships within engagement teams as well as the auditor-client relationship. Inspectors typically have face-to-face interactions with members of the audit engagements they inspect, and thus are able to learn when clients give auditors push back for requesting more information (e.g., see the August 2012 “Guide to PCAOB Inspections” by the Center for Audit Quality). Similarly, face-to-face interactions with engagement teams give the inspectors a chance to infer the effect of inspections on the relationships within engagement team members. However, we recognize that inspectors do not directly observe changes in the auditor-client relationship or the relationships within engagement teams and thus might be unaware about how inspections affect these relationships.

Figure 4 presents the results. In Panel A, we find that 54.3% (44.0%) of the inspectors believe that the inspection process increases tension in the relationships between the engagement
partner and engagement manager (auditor and client). However, consistent with inspectors not observing, and thus not knowing, how inspections affect the above relationships, we find that almost a third of the inspectors indicate that they do not know whether the inspection process affects relationships between the engagement partner and manager or between auditor and client.

In Panels B and C, we present data from questions where we ask about why inspections increased tension in the relationship, conditional on the respondents indicating that the inspections increase tension in the relationships between engagement team members and auditors and clients in the previous question. The majority of our respondents believe that the need to ask clients for more information and increased skepticism of management estimates are the two primary causes for the increased tension in these relationships.

5. Understanding the reasons why auditors respond to inspection feedback

The evidence in the previous sections and that in much of the archival literature suggests that the introduction of POB inspections improves audit quality (though admittedly the cost versus benefit analyses is not examined). However, the field to date has been unable to provide any insights into why POB inspections affect audit quality. To gain insights into why POB oversight affects audit quality/practice, we ask inspectors their perceptions regarding (1) why auditors do and do not respond to inspection feedback and (2) the strengths/weaknesses of POB oversight relative to self-regulation. Because POB oversight replaced the self-regulation approach to oversee auditors, comparing the strengths and weaknesses of these approaches can help us infer the reasons why POB oversight has led to an improvement in audit quality.

5.1. Why do inspections affect auditor behavior?

Figure 5 presents the data regarding why auditors respond according to the inspectors. We begin by asking inspectors the following question: “Considering circumstances where audit firms
DO respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms respond to inspector feedback.” The two reasons that garnered the highest amount of consensus are: (1) Auditors/engagement partners do not want the inspection report to contain criticisms of their audit procedures (79.9% of inspectors “agreed” or “strongly agreed”) and (2) auditors/engagement partners respond to inspector feedback to reduce the risk of current/future enforcement actions and/or fines (74.2%). Relatively fewer inspectors (but still a majority) “agreed” or “strongly agreed” that auditors respond to the inspection report because the audit partners believe that the changes suggested by the inspectors improve audit quality (57.4%), while 26.5% say a response is because audit partners do not want to upset the inspectors and 6.2% say it is because responding enables auditors to charge a higher fee. Thus, inspectors perceive that much of the motivation to respond to inspection feedback is that the auditors do not want to be publicly criticized or to be fined for doing something ‘wrong’ in the opinion of the POB; in other words, the disclosure and enforcement strength of the POB (we investigate this further below).

That 57% agree that at least some motivation for auditors making changes is because auditors think inspectors’ feedback will improve audit quality is in contrast to the evidence in some surveys of U.S. auditors regarding PCAOB inspections. For example, Westermann et al. (2018) report that U.S. auditors perceive passing an “inspection is so important, that auditors…have resorted to impression management strategies and “functionally stupid” work practices (e.g., excessive documentation, a decrease in critical thinking as a result of a “box ticking” approach to auditing).” It is plausible that inspectors perceive responses to their feedback differently than
auditors do, but archival results are consistent with inspector perceptions that inspection feedback improves audit quality.\textsuperscript{13}

Figure 6 presents data for the same research question but the data are responses to where we asked the survey question in the alternative form: “Considering circumstances where audit firms DO NOT respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms do NOT respond to inspector feedback.” Only one factor we listed attracted more than half of the inspected auditors saying they “agreed” or “strongly agreed” with auditors’ motivations. In our sample, 56.8\% of the inspectors said they “agreed” or “strongly agreed” that auditors do not respond to inspector feedback because the auditor believes the mistake identified is a one-off mistake and thus not pervasive enough to need remedied in a larger sense. In terms of the next most common responses, the data reveal that inspectors “agreed” or “strongly agreed” that auditors do not respond to inspector feedback because: (1) auditors believe the costs of implementing the suggestions are too high (46.0\% of respondents), (2) the auditor sees little benefit to the audit firm by responding (45.1\% of respondents), (3) the “tone at the top” at the audit firm is to place commercial interests above the quality of their audits (41.9\% of respondents), (4) the auditor believes that the changes suggested by inspectors do not improve audit quality (40.6\% of respondents), (5) the auditor’s attitude towards regulation is negative (39.8\% of respondents), and (6) clients are unwilling to pay the higher fee to compensate the auditor (39.0\% of respondents).

In sum, as viewed by the inspectors, the main incentive for auditors to respond to inspector feedback is that the auditors do not want to be subject to enforcement action from the POB and do not want inspector criticisms to be publicly disclosed. These results are important because they

\textsuperscript{13} We verify that our inferences are unchanged if we restrict the sample to the perceptions of just the PCAOB inspectors (untabulated).
provide insight into why POBs might be more effective than self-regulation at improving audit quality – POBs have enforcement strength. In addition, several POBs are still prohibited from publicly disclosing their inspection findings at the individual auditor-level. Our result that the disclosure of inspection reports is one of the most important tools to induce changes in auditor behavior potentially sheds light on which POBs are more versus less effective at improving audit quality and potentially guides policymakers if the goal is to induce auditors to change behavior.

We find that a majority of inspectors “agreed” or “strongly agreed” that changes are most likely observed in cases where auditors think the feedback improves audit quality. The main reasons auditors do not respond to POB feedback are if the problem that arose is not pervasive and in cases where responding would be very costly (and not compensated).

5.2. Comparing POB inspections and peer-reviews

An alternative way to understand why POB oversight improves audit quality (as prior studies find and we corroborate) is to ask inspectors their perceptions about the relative strengths and weaknesses of auditor inspection programs conducted by POBs versus inspections conducted by auditors themselves through peer-reviews and by staff for professional organizations for auditors (e.g., the ICAEW in the UK, SAICA in South Africa, the AICPA in the U.S.). Prior to establishing POBs to oversee auditors, the auditing profession in several countries was self-regulated. In a self-regulation system, organizations created and funded by the auditing profession (e.g., the AICPA) set standards, perform inspections, and monitor compliance with professional norms and standards. In this approach, audit firms are inspected either by their peers (through peer-reviews) or by staff employed by the professional organization. A primary drawback of a self-regulation system, where auditors conduct peer-reviews to oversee each other, is that auditors lack the incentives to fault their peers. Specifically, auditors have little-to-no consequence for conducting lax peer-reviews, but could incur some cost by disciplining their peers during such
reviews, if their peers retaliate. Further, there is no higher rank authority between the reviewer and reviewee in a peer-review system and limited enforcement options. The accounting scandals in the U.S. in the early 2000s led several academics and practitioners to criticize the peer-review process as being “toothless” (Coffee 2001) and “incestuous” (Williams 2002). On the other hand, however, auditors are perhaps the most qualified to evaluate the quality of work done by their peers.

By contrast, oversight by a POB could be more independent than a self-regulation system if the POB does not depend on the auditing profession for funding and if the governing bodies of the POBs are not all current auditors.¹⁴ Importantly, POBs can impose sanctions if audit firms fail to comply with the minimum standards for audit quality. Further, given that the external damage from an accounting fraud is potentially large, a public regulator can increase the total amount of enforcement (even if the fines from enforcement actions do not cover enforcement costs) to deter many potential violators (Polinsky 1980; Polinsky and Shavell 2000).

However, there are several limitations of a public regulatory approach to oversee auditors. Specifically, public regulatory oversight can often suffer from the same agency problems as that between auditors, clients, and investors (Stigler 1971; Peltzman et al. 1989). For example, an important concern with public regulators is that they are susceptible to “capture” by the powerful players in the industry (e.g., the Big-4 auditors). Further, depending on the regulator’s source of funding, it could come under political pressure that undermines its effectiveness. While POBs across the world are designed to be independent of the accounting profession to address the above issues, it is debatable as to whether such independence in form has achieved its goal. In addition, the independence in form has raised other issues. Specifically, critics contend that POB inspectors

¹⁴ This is typically the case (see IFIAR 2010). IFIAR is the International Forum of Independent Audit Regulators. It was established in 2006 and is comprised of audit regulators from 52 jurisdictions (as of 2018). Their stated mission is to serve the public interest and enhance investor protection by improving audit quality globally.
do not have the in-depth expertise, or incentives to update their expertise, that practicing auditors have (Palmrose 2006; Glover et al. 2009). Thus, it is possible, the critics claim, that the POB approach to oversight has sacrificed expertise for independence (see Lennox and Pittman (2010) and DeFond (2010) for a discussion). As such, neither approach to auditor oversight strictly dominates the other in a theoretical sense (see Leuz and Wysocki 2008; Minnis and Shroff 2017).

Prior archival studies examine the effect of self-regulation and public oversight on audit outcomes with the goal of comparing the benefits and costs of these oversight approaches. For example, Hilary and Lennox (2005) examine whether peer-review reports provide clients with credible information about differences in auditor quality. They find that receiving ‘clean’ peer-review reports increases auditor market share, while receiving negative peer-review reports decreases auditor market share. Casterella et al. (2009) find that peer-review findings predict audit failure, which they interpret as peer-review reports serving as a credible signal of audit quality. These studies suggest that peer-review reports serve an information role, such that the consumers of audited financial statements (e.g., investors) can learn about differences in auditor quality by reading peer-review reports. However, we are unaware of prior studies that compare the strengths and weaknesses of these approaches to oversee auditors, as it relates to audit quality improvements.

We asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by auditors themselves through a peer-review program.” Figure 7 shows that the most common responses of agree or strongly agree are for the reasons (1) POBs and/or POB inspectors have greater authority than the auditors conducting peer reviews (79.9% of inspectors “agreed” or “strongly agreed”), (2) POBs have stronger enforcement options (76.4%), (3) the culture and environment at POBs is more conducive for detecting auditing deficiencies
(73.0%), and (4) peer reviews are more likely to have conflicts of interest than POB inspectors (67.9%). Recall that these answers are consistent with what we found in the previous section (Figure 5) when we asked about POBs in an absolute sense (not relative to prior regimes). If auditors respond to a threat of enforcement and the POBs have greater authority and enforcement capabilities (as reported in Figure 7), a POB inspection should lead to more response on the part of the auditor relative to peer review, thus a more ‘effective’ method of auditor review.

There is relatively less agreement among inspectors for some other factors that could make POB inspections more effective than peer-review, though some of the following still have a majority or large minority of inspectors agreeing. For example, 53.2% of the respondents “agreed” or “strongly agreed” that auditors have weaker incentives to detect audit deficiencies than POB inspectors and 49.1% “agreed” or “strongly agreed” that the POB’s approach to select audit engagements is better than that used by peer-reviewers. In summary, we interpret the results in Figure 7 as suggesting that inspectors do not necessarily believe that they are better suited or more capable of detecting audit failures than auditors conducting peer-reviews. Rather, it is the authority, enforcement power, and POB culture that are the most important strengths of POB oversight relative to self-regulation and peer-reviews.

We find similar results comparing POB inspectors to inspections conducted by a professional organization, but with a somewhat weaker consensus (lower percentage of inspectors agreeing or strongly agreeing). We asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by staff from a professional organization for auditors (e.g., the ICAEW in the UK, CICA in Canada, AICPA in the US).” Figure 8 presents the results. The statements that received the most consensus in terms of inspectors agreeing or strongly agreeing are: (1) POBs and/or POB inspectors have greater authority than the professional
organization inspectors (69.0% of inspectors “agreed” or “strongly agreed”), (2) POBs have stronger enforcement options (66.7%), (3) the culture and environment at POBs is more conducive for detecting auditing deficiencies (58.1%), (4) professional organization inspectors are more likely to have conflicts of interest than POB inspectors (e.g., because prof. org. get funding from audit firms) (42.3%), and (5) the scope of a typical POB inspection is broader than that of a typical inspection conducted by professional organizations (42.3%). These answers are similar to what we found above (in Figures 7 and 5) and the inferences are largely the same. That is, greater enforcement capability, authority, and organizational culture make POBs more effective than oversight approaches based on self-regulation.

6. Other insights into the functioning of POBs and timing of responses to inspections

6.1. Inspector incentives

We ask inspectors questions about why they sought employment at a POB, how the POB experience contributes to their long-term career goals, the criteria used by POBs to evaluate/promote inspectors, inspectors’ outside opportunities and economic incentives to work at a POB (e.g., promotion at POB, greater promotion opportunities in the private sector). Our objective is to understand the economic incentives and social preferences that motivate POB inspectors to advance the public interest by improving audit quality and trust in public markets. Such motivation could be driven by self-interest (Stigler 1971) or benevolence (Pigou 1938).

6.1.1 Why do inspectors seek employment at a POB?

We asked survey respondents to rate the extent to which they agree or disagree with several statements about the advantages and disadvantages of their job. The purpose of this question is to understand why inspectors seek employment at a POB. On the one hand, it is plausible that POB employment is desirable because such experience helps advance an inspector’s private sector career prospects. On the other hand, it is plausible that POB employment allows inspectors to
continue working in the audit industry in a less stressful environment than that in the private sector. Figure 9, Panel A (B) presents the results related to the benefits (drawbacks) of a POB job. We find that 87.0% of the inspectors “agreed” or “strongly agreed” that a benefit of their job at the POB is that it is an opportunity to influence audit practice, while 85.8% “agreed” or “strongly agreed” that a benefit of their POB job is that it provides them a way to satisfy their intrinsic interest in improving audit quality and that. In addition, 72.0% of the inspectors “agreed” or “strongly agreed” that a benefit of their job at the POB is that it provides them a way to satisfy their intrinsic interest in advancing the regulator’s mission (which is to protect investors and improve audit quality) and 68.0% “agreed” or “strongly agreed” that a benefit of their job at the POB is that it provides inspectors “learning opportunities.” Finally, 61.9% (60.7%) “agreed” or “strongly agreed” that a benefit of their job at the POB is that it is an opportunity to serve a broader set of stakeholders (investors).

There is also considerable support for the idea that working at a POB is less stressful and provides inspectors with better work-life balance than a job in the private sector. For example, 81.5% of the inspectors indicate that a benefit of working at the POB is that it provides “Good work-life balance” and 64.7% indicate that a benefit of their POB job is that it comes with “less pressure/stress than a private sector job.” Relatedly, 59.5% of the inspectors “agreed” or “strongly agreed” that a benefit of their POB job is that it has more “job security and less personal risk” than a private sector job.

We find relatively less support for the idea that inspectors view their job at the POB as helping them advance their future career prospects in the private sector. For example, 37.3% (16.1%) of the inspectors “agreed” or “strongly agreed” with the statement that a benefit of their POB job is that it improves career prospects in the private sector at audit firms (outside audit firms). Only 8.9% “agreed” or “strongly agreed” with the statement that a benefit of working at the POB is that promotions are easier at POBs than in the private sector.
Figure 9, Panel B shows that there is greater dispersion in inspectors’ perceptions regarding the disadvantages of a POB job. The only disadvantage of a POB job that a majority of inspectors perceives is that the POB job comes with few promotion opportunities. Specifically, 78.7% of the inspectors “agreed” or “strongly agreed” with the statement that a drawback of their job at the POB is that it comes with a “limited or more difficult promotion process.” Other perceived drawbacks of a POB job that some inspectors “agreed” or “strongly agreed” with are, the POB job comes with (1) interferences through governance structures (41.3% “agreed” or “strongly agreed”), (2) confrontation/conflict with auditors (38.5%), (3) poor compensation/benefits (35.5%), (4) political interferences while conducting my job (31.9%), and (5) a negative perception of working at a POB (30.2%). Overall, the survey responses in Figure 9 suggest that POB inspectors are largely motivated to work at a POB because of an intrinsic interest in auditing and better work-life balance. As such, these survey responses do not suggest that current or future monetary incentives are a primary determinant of their behavior at POBs.

6.1.2 Employee movement between audit firms and POBs

To explore further, we examine whether there is a revolving door between POBs and audit firms. In regulator settings, an oft-stated incentive for workers to seek employment with a regulator is that the regulatory experience improves one’s private-sector career prospects by enhancing expertise related to regulatory compliance and/or developing social networks within the regulatory organization, which might help extract future favors from regulators. To understand whether the incentives associated with a revolving door motivate inspectors to seek employment at a POB, we ask inspectors how easy or difficult it is for them to secure a private sector job once they decide to leave the POB, and whether inspectors perceive there to be much employee rotation between the POB and audit firms. To some degree, revolving doors are natural in any regulatory setting because regulators require industry expertise to monitor regulated entities, and regulated entities need
experience and knowledge about regulatory processes to reduce regulatory risk and compliance costs. Thus, whether revolving doors enhance or compromise regulatory effort boils down to the reasons why there are worker flows between regulators and the private sector, which we try to investigate with our survey instrument.

Figure 10 shows that 63.9% (59.4%) of the survey respondents believe it is “easy” or “very easy” for them to secure a senior manager-level position at a non-Big-4 (Big-4) audit firm when they are ready to leave the POB. Similarly, 38.0% (27.1%) of the survey respondents believe it is “easy” or “very easy” for them to secure a partner-level position at a non-Big-4 (Big-4) audit firm when they are ready to leave the POB. In untabulated analyses, we condition the responses to this question based on inspectors’ prior audit firm experience. We find that the responses to this question are very similar for inspectors that were at a manager-level position or below and those there at a senior manager-level or above. The only statistically and economically significant difference in responses is that 45.2% of the inspectors who had reached a senior manager-level in their prior experience at an audit firm indicated that it would be “easy” or “very easy” for them to find a partner-level position at a non-Big-4 firm compared to 33.3% for inspectors whose highest position at an audit firm was manager. These responses suggest that inspectors perceive their POB experience as valuable to audit firms.

In Figure 11, we examine whether inspectors, in practice, observe much movement of POB employees to-and-from audit firms. First, we find that only 8.6% of the inspectors “agreed” or “strongly agreed” with the statement that audit firms encourage their current employees to accept jobs at a POB with the goal of hiring them back in the future. Second, we find that 16.5% of the inspectors “agreed” or “strongly agreed” with the statement that audit firms frequently approach current inspection staff for possible future employment opportunities and even fewer inspectors (11.6%) “agreed” or “strongly agreed” that POB inspectors frequently approach audit firms for possible future employment opportunities. These responses provide little support for the idea that
inspectors seek employment at a POB to bolster their private sector auditing careers through a revolving door between POBs and audit firms.

To explore further, we devised survey questions to understand why POBs inspectors sought employment at a POB in the first place. Specifically, we ask inspectors how their experience working at the POB contributes to their long-term career goals. Figure 12 presents the results. We find that 77.8% of the inspectors indicate that their experience working at the POB will help them achieve their long-term goal of “serving the profession.” Aside from “serving the profession,” there is little consensus about any of the other long-term purposes of working at a POB, among the responding inspectors. The responses to this question also indicate that few inspectors join the POB with the goal of improving their career prospects in the private sector. For example, only 24.7% (22.4%) of the inspectors “agreed” or “strongly agreed” that their experience working at the POB will help them achieve their long-term goal of moving to a non-Big-Four (Big-Four) audit firm. Similarly, only 16.9% of the inspectors “agreed” or “strongly agreed” that their experience working at the POB will help them achieve their long-term goal of “gaining experience to earn (faster) promotions at an audit firm.” These responses suggest that POB inspectors may not seek employment at a POB with a primary goal of improving their future career prospects at audit firms. Overall, the responses to three related questions paint a consistent picture: POB inspectors do not seem motivated to work at a POB to improve career prospects at audit firms; rather, the primary motivation appears to be an interest in serving the profession and having better work-life balance.

6.1.3 Inspector evaluation and promotion criteria

Next, we ask inspectors a series of questions to understand the formal and informal incentives provided by POBs to encourage inspectors to exert effort. Specifically, we asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Promotions of inspectors at the POB I work at are influenced by…” and provided
statements for them to evaluate. Figure 13 presents the results. We find that the most commonly agreed upon criteria for promotions at POBs are qualitative in nature (e.g., feedback of team leader, perceptions related to emotional intelligence and work ethic, etc.) and the availability of promotion opportunities. Specifically, 75.6% of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by feedback from the inspection team leader. And 61.6% (61.2%) of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by qualitative perceptions of held by senior staff related to behavioral/emotional intelligence (work ethic) of inspectors. Finally, 72.9% of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by the availability of promotion opportunities.

Interestingly, we find that inspectors do not agree that the number of deficiencies identified during inspections is a primary contributor to promotion prospects. For example, only 13.5% (12.8%) of the inspectors “agreed” or “strongly agreed” that promotions are influenced by the number of engagement (quality control) deficiencies detected during inspections. The evidence in surveys of auditors suggests a belief among auditor partners in the U.S. that PCAOB inspectors are rewarded for identifying deficiencies. For example, Houston and Stefaniak (2013) report that “several partners noted [in response to open-ended questions in their survey] that their PCAOB inspectors were “adversarial” and had a “gotcha psyche…trying to build their career by findings issues,”…” Our survey responses of POB inspectors from the U.S. and other countries suggest that such is not the case (and in untabulated analyses we verify that perceptions of non-U.S. inspectors are similar to that of PCAOB inspectors with respect to this question). As such, our results can be interpreted as U.S. auditors being misinformed about POB inspector incentives (again, subject to the caveat that the inspectors in our sample are answering honestly).

We also ask inspectors if the POB they work at has a program to evaluate the quality of inspections (see Figure 14, Panel A). Survey responses reveal that 56.0% indicate that there is a formal program to evaluate inspections, 25.9% indicate that that is an informal inspection
evaluation program, 1.8% believe there are both formal and informal programs to evaluate inspections and 16.3% indicate that there is no program to evaluate inspection quality. The lack of consensus among inspectors regarding the existence of an inspection evaluation program is revealing in its own right. Specifically, if some inspectors are unaware of the existence of a program to evaluate inspections or if inspectors perceive a formal inspection program to be an informal one, it suggests that such evaluation programs are perhaps not systematic and do not have much consequence.\textsuperscript{15} Overall, the responses to the above question suggest that inspectors are not provided strong economic incentives (e.g., compensation and career progression) to exert effort and conduct thorough inspections. Going back to a response in Figure 11, we find that 47.2% of the inspectors “agreed” or “strongly agreed” with the statement that inspectors are rarely asked to leave their job due to poor performance. Similarly, the responses to the question in Figure 13 (determinants of POB promotions) suggests that inspectors are rarely promoted because they receive a competing job offer from the private sector or other government agency (with only 4.9% of the inspectors “agreeing” or “strongly agreeing” with this statement). Thus, the responses across three questions paint a uniform picture about the lack of economic/financial incentives to conduct high quality inspections. Rather, regulators seem to rely on inspectors’ innate interest in auditing and sense of service to the profession to motivate them.

Finally, we ask inspectors about the criteria used by their POB to evaluate inspection quality (conditional on the inspector responding that their POB has a formal and/or informal program to evaluate inspections). Figure 14, Panel B presents the results. The two primary methods used to evaluate inspection quality that majority of the inspectors “agreed” or “strongly agreed” with are (1) reviewing auditors’ written responses to inspection findings (63.5%) and (2)

\textsuperscript{15} In untabulated analyses, we verify that there is significant within-POB heterogeneity in perceptions regarding the existence and form of inspection evaluation programs. In other words, we verify that the dispersion in beliefs about the evaluation of inspection programs is not explained by cross-sectional differences across the 20 POBs in our sample.
conducting internal reviews (56.2% “agreed” or “strongly agreed”). The result that POBs evaluate inspection quality by taking into account feedback from auditors suggests that POBs do care about auditor perceptions of their inspection findings. Relatedly, an important but smaller fraction of inspectors “agreed” or “strongly agreed” with the statement that POBs evaluate inspection quality by: (1) reviewing feedback (besides the written responses) from inspected auditors about inspections (40.9%), (2) reviewing auditors’ informal response to inspection findings (37.0%) and (3) reviewing complaints from inspected auditors about inspections (28.7%). 42.6% (35.6%) of the inspectors “agreed” or “strongly agreed” that POBs evaluate inspection quality by noting instances where auditing errors resulted in companies restating financial statements (facilitated fraud), which were unidentified during inspections.

6.2. When do inspections affect auditor behavior?

Prior archival studies make different assumptions about when the effect of POB inspections manifest as changes in audit quality. Lamoreaux (2016) finds that the threat of a PCAOB inspection affects audit quality for non-U.S. companies cross-listed in the U.S. (i.e., auditors change engagement practices in anticipation of an inspection). Carson et al. (2017) find that the commencement of inspections at the country-level leads to changes in audit quality. Krishnan et al. (2017) find that audit quality proxies change once the inspection fieldwork is complete, and Gipper et al. (2017) find that ERCs increase both, after the inspection fieldwork is complete as well as after the inspection report is publicly disclosed. Finally, Aobdia and Shroff (2017), DeFond and Lennox (2017), and Shroff (2019) find that changes in auditor market share, the issuance of internal control weakness, and changes in client investment in response to PCAOB inspections occur after the disclosure of the auditors’ inspection reports.

The mechanism through which POB inspections are purported to affect auditor behavior and market outcomes (e.g., auditor market share, ERCs, client investment, etc.) is different across
different studies, and thus the effects of POB inspections on these outcome variables do not have to manifest at the same time. For example, Krishnan et al. (2017) predict audit proxies to change after the inspection fieldwork under the assumption that inspectors inform auditors about their finding at the end of their fieldwork, which leads to subsequent improvements in audit quality. Gipper et al. (2017) predict that ERCs increase when the inspection fieldwork occurs and after the disclosure of inspection reports because investors learn about POB inspections at these times. We use our survey to better understand when auditors are perceived to make changes to engagement-specific practices in response to inspection feedback. This information can help further our understanding of the mechanism through which inspections affect auditor behavior and guide future archival research in their choice of research design; specifically, when POB inspections are most likely to affect the researchers’ dependent variable of interest. To that end, we ask inspectors when they observe auditors making changes to engagement-specific practices in response to the inspectors’ feedback.

Figure 15 presents the results. 73.3% of the inspectors believe auditor change behavior immediately following the completion of inspection fieldwork; 47.9% believe that auditors change behavior only after the inspection report is disclosed to the public or the auditees’ stakeholders; 22.4% believe that auditor change behavior in anticipation of an inspection, and 19.4% believe that auditors change behavior during the inspection fieldwork.16 Thus, our survey responses suggest that archival tests are likely to be more successful in detecting the effects of POB inspections on audit quality when they examine the periods after the inspection fieldwork is complete and even more so after the inspection report is made public.

16 The responses do not add up to a 100% because respondents could choose multiple options regarding when auditors change behavior in response to inspections.
7. Conclusions

The introduction of auditor Public Oversight Boards (POBs) to oversee the work done by auditors is perhaps one of the most significant changes in audit regulation across several countries in decades. Thus, understanding whether, how, and why auditor oversight by a public regulator serves to improve audit quality is an important question. Several recent archival studies suggest that PCAOB inspections in the U.S. help improve audit quality by replacing the peer-review approach to auditor oversight. However, there is little evidence on whether POB inspections outside the U.S. improve audit quality, and no evidence on how and why POB inspections improve audit quality relative to self-regulation. The lack of evidence regarding how and why POBs improve audit quality is likely because such questions are difficult to test using archival methods. To fill-in these gaps in the literature, we survey the inspection staff from POBs across 20 countries, representing 27% of the inspection staff at these POBs, about their perceptions regarding whether, how and why auditors respond to POB inspections. Survey data are uniquely suited to provide descriptive insight into how and why POB inspections affect audit quality because inspectors have face-to-face interactions with several auditors during the inspection fieldwork and thus, can directly observe the effect of their inspections on auditing procedures and practices over time.

We find a large majority of inspectors believe that auditors frequently respond to POB inspections by changing both audit and engagement procedures as well as audit firm culture (albeit to a lesser degree). These results are consistent with archival evidence, suggesting that PCAOB inspections improve audit quality. We then go further by asking inspectors what specific actions have they observed auditors taking in response to POB inspections/oversight. We find that more than 50% of the inspectors perceive that auditor respond to POB inspections by (1) increasing documentation, (2) conducting training, (3) increasing the amount of audit and testing efforts, (4) increasing scrutiny of management estimates, (5) modifying the audit-quality review process, (6) changing audit check lists, and (7) changing procedural manuals. Further, we find that inspectors
believe auditors, in some instances, respond to POB inspections by misbehaving and trying to game the inspection process by tampering closed/archived audit files to “fix” them for an inspection and/or by inappropriately obtaining confidential information related to upcoming inspections. Such behavior occurs but not often.

In terms of why, the main incentive for auditors to respond to inspector feedback is that the auditors do not want to be subject to enforcement action from the POB and do not want inspector criticisms to be publicly disclosed. Our evidence suggests that inspectors do not necessarily believe that they are better suited or more capable of detecting audit failures than auditors conducting peer-reviews. Rather, the evidence suggests that it is the authority, enforcement power, and POB culture that are the most important strengths of POB oversight both in an absolute sense and relative to self-regulation and peer-reviews.

In responses to other questions in our survey, we find little support for the conjecture that inspectors seek employment at POBs primarily to gain experience and earn faster promotion (or higher future compensation) in the private sector, after their POB stint. Rather, inspectors seek employment at a POB for greater work-life balance and because of their innate interest in auditing. Overall, this paper contributes to the literature on auditor oversight and regulation by conducting, for the first time, a comprehensive survey of the inspection staff of POBs.

We conclude by reiterating that there are limitations of survey data. Importantly, surveys measure beliefs, which may not always coincide with the truth. Further, inspectors could potentially provide explanations that they think we or their employer wants to hear, rather than state their true beliefs. Finally, it is plausible that the responses of inspectors we could survey are not representative of the inspectors we could not survey. We take several steps to mitigate the above concerns but recognize that they cannot be eliminated. Despite these limitations, this paper provides unique information about how POBs function and affect the auditing industry.
References


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<th>Method to Select Participating Inspectors</th>
<th>Regulator Name</th>
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Notes: This tables presents our sample composition. * signifies that we have only an approximate estimate of number of inspectors that work at the public oversight board. Further, our survey focuses on POB employees that spend much of their time conducting inspections (but not necessarily spend a 100% of their time performing inspections).
### Table 2
Characteristics of POB inspection staff

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<th>Inspector Background</th>
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<td><strong>Experience IMMEDIATELY preceding POB employment (N=170)</strong></td>
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**Notes:** This table presents descriptive information regarding the backgrounds of POB inspection staff.
Figure 1
Do POB inspections affect auditor behavior?

In your opinion, how frequently/infrequently do audit firms…

- Change/adjust general audit procedures for the inspected clients’ future audit engagements as a result of the feedback received during inspections? (N=165) 78.2%
- Change/adjust their quality control systems as a result of the inspection feedback and process? (N=165) 68.5%
- Change/adjust general audit procedures for the future audit engagements for clients that were not inspected as a result of the feedback received during inspections of other clients’ engagements? (N=165) 60.6%
- Change culture or the “tone at the top” as a result of the inspection feedback and/or process? (N=165) 46.1%

Notes: This figure presents the responses to the survey question “In your opinion, how frequently/infrequently do audit firms…” This question is followed by four statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Very infrequently” and a rating of 4 labeled “Very frequently.” The respondents could select a rating for each of the four statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the frequency rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 2
How do auditors respond to POB inspections?

Auditors typically respond to feedback received during inspection by…

- Increasing documentation of audit procedures (N=161) 85.7%
- Conducting firm-wide training (N=162) 82.7%
- Increasing the amount of audit and testing efforts (N=160) 64.4%
- Increasing scrutiny of management estimates (e.g., the allowance for… 64.0%
- Changing the audit quality review process (N=161) 62.1%
- Changing the audit check lists (N=159) 56.0%
- Changing the procedural manuals (N=160) 55.6%
- Removing lower quality audit partners from public company and/or… 39.4%
- Changing controls over auditor independence (N=161) 37.9%
- Changing compensation policies for engagement partners (N=161) 29.8%
- Changing materiality thresholds (N=159) 17.0%
- Changing compensation policies for engagement managers (N=162) 11.7%

Notes: This figure presents the responses to the survey question “Auditors typically respond to feedback received during inspection by…” This question is followed by twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 3
Do auditors try to ‘game’ the inspections?

In your opinion, how often do auditors...

- Tamper with closed/archived audit files to “fix” the files for an inspection? (N=164)
- Inappropriately obtain confidential information about upcoming inspections? (N=164)

Notes: This figure presents the responses to the survey question “In your opinion, how often do auditors…” This question is followed by the two statements: “Tamper with closed/archived audit files to “fix” the files for an inspection?” and “Inappropriately obtain confidential information about upcoming inspections?” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Never” and a rating of 4 labeled “Very Often.” The respondents could to select a rating for both statements. This figure presents the percentages of respondents that selected each number on the rating scale for both statements below the question.
Figure 4
Consequences of inspections on auditing relationships

Panel A: Do inspections affect tension in the auditor-client relationship and the relationship within audit engagement teams?

In your opinion, how do inspections by the POB you work at affect the tension in the relationships between…

- They increase tension: 54.3% (Engagement Partners & Engagement Managers), 44.0% (Auditors & Clients)
- I do not know: 31.7% (Engagement Partners & Engagement Managers), 30.7% (Auditors & Clients)
- They have no effect: 11.6% (Engagement Partners & Engagement Managers), 21.1% (Auditors & Clients)
- They decrease tension: 2.4% (Engagement Partners & Engagement Managers), 4.2% (Auditors & Clients)
Panel B: Why do inspections affect tension in the auditor-client relationship?

POB inspections increase tension in the relationship between auditors and clients because inspections...

- Require audit firms to ask their clients for more information (N=72) - 79.2%
- Increase skepticism of management estimates in financial statements (N=72) - 76.4%
- Serve as an excuse for auditors to question managers and request more information (N=72) - 63.9%
- Increase audit fees (N=72) - 52.8%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Panel C: Why do inspections affect tension in the relationship within audit engagement teams?

**POB inspections increase/decrease tension in the relationship between engagement partners and engagement managers because inspections...**

- Require audit firms to ask their clients for more information (N=91) - 69.2%
- Increase skepticism of management estimates (N=91) - 62.6%
- Cause engagement partners and managers to blame each other for deficiencies identified during inspections (N=91) - 62.6%
- Serve as an excuse for auditors to question company managers (N=89) - 38.2%
- Increase audit fees (N=88) - 29.5%
- Cause changes in compensation policies (N=90) - 27.8%

Notes: Panel A in this figure presents the responses to the following two survey questions: “In your opinion, how do inspections by the public oversight body you work at affect the tension in the relationships between auditors and clients?” and “In your opinion, how do inspections by the public oversight body you work at affect the tension in the relationships between engagement partners and engagement managers?” These questions are followed by four mutually exclusive options: “They increase tension,” “They decrease tension,” “They have no effect,” and “I do not know.” The figure in panel A presents the percentages of respondents that checked each options. Panels B and C present responses to the questions “POB inspections increase tension in the relationship between auditors and clients because inspections...” and “POB inspections increase/decrease tension in the relationship between engagement partners and engagement managers because inspections...” These questions are followed by several statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the statements as well as the “Other” option. Panel B and C in this figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the questions in Panel A. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements below the questions in Panels B and C were randomized (excluding the “Other” option).
**Figure 5**

*Inspections perceptions regarding why auditors respond to inspection feedback*

<table>
<thead>
<tr>
<th>Statement</th>
<th>Percentage of inspectors that &quot;Agreed&quot; or &quot;Strongly agreed&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors/engagement partners do not want the inspection report to contain criticisms of their audit procedures (N=164)</td>
<td>79.9%</td>
</tr>
<tr>
<td>Auditors/engagement partners respond to inspector feedback to reduce the risk of current/future enforcement actions and/or fines (N=163)</td>
<td>74.2%</td>
</tr>
<tr>
<td>Auditors/engagement partners believe that the changes suggested by inspectors improves audit quality (N=162)</td>
<td>58.6%</td>
</tr>
<tr>
<td>Auditors/engagement partners do not want to upset the inspectors (N=162)</td>
<td>26.5%</td>
</tr>
<tr>
<td>Responding to the feedback enables auditors to charge their clients a higher fee (N=162)</td>
<td>6.2%</td>
</tr>
</tbody>
</table>

*Notes:* This figure presents the responses to the survey question “Considering circumstances where audit firms DO respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms respond to inspector feedback.” This question is followed by five statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the five statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 6
Inspections perceptions regarding why auditors do NOT respond to inspection feedback

To what extent do you agree/disagree with the following statements about why audit firms do not respond to inspector feedback

- Audit partners believe that the deficiencies identified by the inspectors are one-off mistakes and thus do not require remediation across other engagements (N=162)
- They believe the cost of implementing the inspectors’ suggestions is too high (N=161)
- They see little benefit to them (the audit firm) from implementing the inspectors’ suggestions (N=162)
- Their “tone at the top” is to place commercial interests above the quality of their audits (N=160)
- They believe that the changes suggested by inspectors do not improve audit quality (N=160)
- Their attitude towards regulation is negative (N=161)
- Clients are unwilling to pay the incremental audit fees that would be required if the auditor were to implement the changes proposed by inspectors (N=159)
- They agree with the inspectors’ approach/feedback but believe that their clients would not like the proposed changes in audit procedures (N=159)
- They do not care about inspectors’ feedback in general (N=160)

Percentage of inspectors that "Agreed" or "Strongly agreed"
Figure 6 – continued

Notes: This figure presents the responses to the survey question “Considering circumstances where audit firms DO NOT respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms do not respond to inspector feedback.” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the nine statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 7
Comparing POB inspections and peer-reviews

Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by auditors themselves through a peer-review program:

- POBs and/or POB inspectors have greater authority than the auditors conducting peer reviews (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 79.9%

- POB inspectors typically have enforcement options available if auditors fail to comply with their rules, which makes them more effective than peer-reviewers (N=157)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 76.4%

- The culture and environment at POBs is more conducive for detecting auditing deficiencies than that at audit firms conducting peer-reviews (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 73.0%

- Peer-reviewers are more likely to have conflicts of interest than POB inspectors (e.g., because peer-reviewers will be evaluated by the same set of peers) (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 67.9%

- Auditors have weaker incentives to find audit deficiencies at peer firms than a POB inspector (N=158)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 53.2%

- POB’s approach to select audit engagements for review allows for better detection of audit deficiencies than the approach used by peer-reviewers (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 49.1%

- The scope of a typical POB inspection is broader than that of typical peer-review (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 44.7%

- POB inspectors are more likely come under political pressure than peer-reviewers (N=158)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 26.6%

- POB inspectors have relatively fewer resources to conduct a thorough inspection than peer-reviewers (N=159)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 24.5%

- POB inspectors are not as informed about the best practices in auditing relative to peer-reviewers (N=158)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 8.9%

- POB inspectors face greater conflicts of interest than peer-reviewers (e.g., because POB inspectors aspire to eventually work in the private sector) (N=158)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 6.3%

- POB inspectors are more likely be influenced by the auditors they inspect than peer-reviewers (N=157)
  - Percentage of inspectors that "Agreed" or "Strongly agreed": 4.5%
Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by public oversight bodies versus inspections conducted by auditors themselves through a peer-review program.” This question was preceded by the statement “Peer-reviews are a system where one auditor reviews/inspects the audit practices, procedures, and/or quality control systems of another auditor. Answer this question based on your opinion irrespective of whether your country has or had a peer-review regime.” And this question is followed by twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 8
Comparing POB inspections and reviews by professional bodies

Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by staff from a professional organization for auditors:

- POBs and/or POB inspectors have greater authority than the professional organization inspectors (N=155) - 69.0%
- POB inspectors typically have enforcement options available if auditors fail to comply with their rules, which makes them more effective than prof. org. inspectors (N=156) - 66.7%
- The culture and environment at POBs is more conducive for detecting auditing deficiencies than that at professional organizations conducting inspections (N=155) - 58.1%
- Professional organization inspectors are more likely to have conflicts of interest than POB inspectors (e.g., because prof. org. get funding from audit firms) (N=156) - 42.3%
- The scope of a typical POB inspection is broader than that of a typical inspection conducted by professional organizations (N=156) - 42.3%
- Professional organization inspectors have weaker incentives to find audit deficiencies at audit firms than POB inspectors (N=156) - 26.9%
- Professional organization inspectors are more likely to come under political pressure than POB inspectors (N=156) - 19.2%
- POB inspectors have relatively fewer resources to conduct a thorough inspection than professional organization inspectors (N=156) - 16.7%
- POB inspectors are not as informed about the best practices in auditing relative to professional organization inspectors (N=156) - 6.4%
- A prof. organization's approach to select audit engagements for review allows for better detection of audit deficiencies than the approach used by POB inspectors (N=156) - 4.5%
- POB inspectors face greater conflicts of interest than prof. org. inspectors (e.g., because POB inspectors aspire to eventually work in the private sector) (N=157) - 4.5%
- POB inspectors are more likely be influenced by the auditors they inspect than professional organization inspectors (N=156) - 3.2%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by public oversight bodies versus inspections conducted by staff from a professional organization for auditors (e.g., the ICAEW in the UK, CICA in Canada, AICPA in the US).” This question was followed by the instruction to “Answer this question based on your opinion irrespective of whether your country has or had a regime where professional bodies conduct auditor inspections” as well as twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Panel A: Advantages of POB inspector job

A benefit of my job at the public oversight body is that it provides me…

- An opportunity to influence audit practice (N=169) - 87.0%
- A way to satisfy my intrinsic interest in improving audit quality (N=169) - 85.8%
- Good work-life balance (N=168) - 81.5%
- A way to satisfy my intrinsic interest in advancing the regulator’s mission (N=168) - 72.0%
- Learning opportunities (N=169) - 68.0%
- An opportunity to serve a broad set of stakeholders (N=168) - 61.9%
- Less pressure/stress than a private sector job (N=170) - 64.7%
- An opportunity to serve investors (N=168) - 60.7%
- More job security and less personal risk (N=168) - 59.5%
- A sense of authority (N=168) - 45.2%
- Improved career prospects in the private sector at audit firms (N=169) - 37.3%
- Improved career prospects in the private sector outside of audit firms (N=168) - 16.1%
- Different retirement age than that for private sector jobs (N=167) - 13.8%
- An easier path to promotion than that in the private sector (N=169) - 8.9%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Panel B: Disadvantages of POB inspector job

**A drawback of my job at the public oversight body is that it comes with…**

- Limited or more difficult promotion process (N=169) - 78.7%
- Interference through governance structures (N=167) - 41.3%
- Confrontation/conflict with auditors (N=169) - 38.5%
- Poor compensation and benefits (N=169) - 35.5%
- Political interference while conducting my job (N=166) - 31.9%
- A negative perception associated with working at a POB (N=169) - 30.2%
- Travel requirements (N=167) - 24.6%
- Performance requirements that are different from my initial expectations (N=169) - 22.5%
- Uncertainty regarding POB funding (N=168) - 22.0%

Notes: Panel A in this figure presents the responses to the survey question “A benefit of my job at the public oversight body is that it provides me…” This question is followed by fourteen statements and an option to write-in an answer in a row labeled “Other (please describe).” Panel B in this figure presents the responses to the survey question “A drawback of my job at the public oversight body is that it comes with…” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the questions in the two panels. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
In your opinion, how easy/difficult is it for inspectors working at a POB to find the following types of jobs when they are ready to leave their position at the POB

- Senior manager-level position at a non-Big-Four audit firm (N=166): 63.9%
- Senior manager-level position at a Big-Four audit firm (N=165): 59.4%
- Middle management position at a private sector company (e.g., in internal audit function or accounting team) (N=126): 50.0%
- Partner-level position at a non-Big-Four audit firm (N=166): 38.0%
- Senior management position at a private sector company (e.g., in internal audit function or accounting team) (N=165): 35.2%
- Partner-level position at a Big-Four audit firm (N=166): 27.1%

Notes: This figure presents the responses to the survey question “In your opinion, how easy/difficult is it for inspectors working at a public oversight body to find the following types of jobs when they are ready to leave their position at the POB?” This question is followed by six statements. The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Very easy” and a rating of 4 labeled “Very difficult.” The respondents could to select a rating for each of the six statements. This figure presents the percentages of respondents that gave a rating of 0 or 1 for each statement below the question. Note that we reorder the responses for presentation purposes to be in ascending order of the rating scale. On the survey instrument, however, the statements were randomized.
Figure 11
Inspector perceptions of movement of employees between POBs and audit firms

Please rate the extent to which you agree/disagree with the following statements about the movement of employees in and out of POB

- Audit firms are more likely to hire a POB inspector if he/she is a former employee of that audit firm (N=164) 48.8%
- POB inspectors are rarely asked to leave their job because of poor performance (N=163) 47.2%
- Audit firms frequently approach the current inspection staff for possible future employment opportunities at their firms (N=164) 16.5%
- POB inspectors frequently approach audit firms for possible future employment opportunities at the audit firms (N=164) 11.6%
- Audit firms encourage current employees to accept jobs at the POB with the goal of hiring back such employees in the future (N=163) 8.6%

Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the movement of employees in and out of public oversight body.” This question is followed by five statements. The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the five statements. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized.
Figure 12
Why do inspector seek employment at POBs

Notes: This figure presents the responses to the survey question “My experience working at the POB will help me achieve my long-term goal of…” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the nine statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
POB promotion criteria as perceived by inspectors

Figure 13

Promotions of inspectors at the POB I work at are influenced by...

- Feedback from inspection team leader (N=164) 75.6%
- The availability of promotion opportunities (N=166) 72.9%
- Qualitative perceptions held by senior staff related to behavior/emotional intelligence of inspectors (N=164) 61.6%
- Qualitative perceptions held by senior staff related to work ethic of inspectors (N=165) 61.2%
- Seniority by duration of employment at POB (N=166) 49.4%
- Feedback from other inspection team members (besides the team leader) (N=165) 46.1%
- Qualitative perceptions held by senior staff related to moral values of inspectors (N=165) 41.8%
- Conducting formal evaluations of inspections in which an inspector participates (N=165) 37.6%
- The ability of the inspector to diffuse tension with auditors during inspections (N=164) 28.7%
- Seniority by age (N=165) 23.6%
- Positive feedback from auditors about inspections (N=165) 20.0%
- The number of engagement deficiencies detected during inspections (N=163) 13.5%
- The number of quality control deficiencies detected during inspections (N=164) 12.8%
- Complaints from auditors about inspection work (N=164) 7.9%
- Receiving competing job offers from the private sector or other government agencies (N=164) 4.9%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Notes: This figure presents the responses to the survey question “Promotions of inspectors at the public oversight body I work at are influenced by…” This question is followed by fifteen statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the fifteen statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Panel A: Do POBs evaluate inspection quality?

**Figure 14**

How do POBs evaluate inspection quality?

*Does the POB you work at have programs to evaluate the quality of auditor inspections? (N=166)*

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage of Inspectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, there is a formal evaluation process</td>
<td>56.0%</td>
</tr>
<tr>
<td>Yes, there is an informal evaluation process</td>
<td>25.9%</td>
</tr>
<tr>
<td>No</td>
<td>16.3%</td>
</tr>
<tr>
<td>Yes, there is formal and informal evaluation process</td>
<td>1.8%</td>
</tr>
</tbody>
</table>
Panel B: Criteria to evaluate inspections

The POB evaluates auditor inspection quality by…

- Reviewing an auditor’s written response to inspection findings (N=137) 63.5%
- Conducting internal reviews (N=137) 56.2%
- Noting instances where auditing errors resulted in companies restating financial statements, which were unidentified during inspections (N=136) 42.6%
- Reviewing feedback from inspected auditors about inspections (N=137) 40.9%
- Reviewing an auditor’s informal response to inspection findings (N=135) 37.0%
- Conducting cold reviews to corroborate inspection findings (N=136) 35.6%
- Noting auditing errors that facilitated fraud, which were unidentified during inspections (N=135) 32.4%
- Reviewing complaints from inspected auditors about inspections (N=136) 28.7%
- Obtaining feedback from other stakeholders such as company board of directors, investors, etc. (N=136) 16.2%

Notes: Panel A in this figure presents the responses to the survey question “…does the public oversight body you work at have programs to evaluate the quality of auditor inspections?” This question is followed by three options: “Yes, there is a formal evaluation process,” “Yes, there is an informal evaluation process,” and “No.” Respondents could select one or both of the “Yes…” options or the “No” option. Panel A presents the percentages of respondents that checked each options below the question. Panel B in this figure presents the responses to the survey question “The POB evaluates auditor inspection quality by…” This question appears in the online survey instrument only if the inspector responded “Yes…” to the question in Panel A. The question in Panel B is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the nine statements as well as the “Other” option. Panel B in this figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 15
When do auditors respond to POB inspections?

In your opinion, when do auditors change their engagement-specific audit practices in response to the inspections? (N=165)

- Immediately after the inspection is complete: 73.3%
- After the inspection report is made available to the public or their clients’ stakeholders (e.g., the board of directors): 47.9%
- Before the actual inspection (i.e., in anticipation of the inspection): 22.4%
- During the inspection: 19.4%

Notes: This figure presents the responses to the survey question “In your opinion, when do auditors change their engagement-specific audit practices in response to the inspections?” This question is followed by four statements and an option to write-in an answer in a row labeled “Other (please describe). The respondents could check all options that apply. This figure presents the percentages of respondents that checked each statements below the question. Note that we reorder the responses for presentation purposes to be in descending order of the percentage of respondents that checked each statement. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
We survey 170 inspectors, representing 27% of the inspection staff, from auditor public oversight boards (POBs) in 20 countries to understand whether, how, and why auditors change auditing practices in response to POB oversight. We find that a large majority of POB inspectors believe that auditors frequently respond to inspector feedback. In terms of how auditors respond, inspectors report that they observe changing audit procedures and quality control systems, increasing documentation, conducting firm-wide training, increasing audit effort, increasing scrutiny of management estimates, and modifying the audit-quality review process. In terms of why auditors respond, the inspectors perceive that the primary drivers are POB enforcement capabilities, the perceived authority of the POBs, auditors’ desire for a ‘deficiency-free inspection report, and that POBs have a culture conducive for detecting auditing deficiencies. We ask questions in additional areas to support (or not) other theories in the literature. Overall, the survey data indicate that POB oversight leads auditors to change some auditing practices and procedures and that the changes occur primarily because the POBs have authority and enforcement capabilities.
1. Introduction

Over the past two decades, several countries have changed their approach to oversee the auditing profession, moving from a system of self-regulation to one where an independent regulator oversees auditors. Specifically, many countries have established public oversight boards (POBs) that are independent of the auditing profession in terms of their primary funding source and the composition of their governing body. These POBs are typically responsible for setting standards, conducting periodic auditor inspections to monitor audit quality, and enforcement. Several recent studies examine whether changes in auditor regulatory oversight affect proxies for audit quality, primarily focusing on the Public Company Accounting Oversight Board (PCAOB) in the U.S. The evidence suggests that PCAOB inspections improve audit quality and confer economic benefits to clients of PCAOB-inspected auditors. However, there is little evidence on whether POBs established by other countries affect audit quality (Carson et al. (2017) is an exception that we discuss more below). More importantly, prior research, including that on the PCAOB, provides no evidence related to how or why auditor public oversight improves audit quality. In other words, the extant literature for the most part has studied outcomes after the POB (particularly the PCAOB) is established and infers that inputs into the audit process changed but does not provide direct evidence of input changes.

In this paper, we provide descriptive evidence on whether, how, and why POB inspections affect auditor behavior by conducting a survey of 170 audit inspectors employed by POBs in 20 participating countries. First, we gather basic data on the characteristics of POB inspectors (their education, their experience, etc.). Second, we examine whether inspections by POBs affect auditor

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1 For example, Nagy (2014), Lamoreaux (2016), Krishnan et al. (2017), DeFond and Lennox (2017), Gipper et al. (2017) and Aobdia (2018) find that PCAOB inspections improve audit quality (broadly defined) for companies directly regulated by the U.S. Securities and Exchange Commission (SEC). Westermann et al. (2018) provide evidence from a survey of auditors that audit firms undertake costly actions to address PCAOB deficiencies. Aobdia and Shroff (2017), Fung et al. (2017) and Shroff (2019) find that PCAOB international inspections have positive spillover effects on non-U.S. companies.
behavior. Third, we examine *how* and *why* auditors respond to POB inspections. A typical inspection involves an examination of the audit work papers for several audit engagements and an evaluation of the auditors’ quality control systems. Further, the typical inspection process entails face-to-face interactions between inspectors and auditors during the inspection fieldwork (i.e., when inspectors visit the local offices of auditors). As a result, POB inspectors directly observe the effect of their inspections on auditing procedures and practices over time, making survey data uniquely suitable to provide descriptive details of *how* and *why* inspections affect audit processes and quality, and contribute to the extant archival studies that investigate the effects of POBs.\(^2\)

In terms of *how* auditors respond, the questions we ask inquire about what actions inspectors observe auditors taking in response to inspections. We also go further and ask what effect (if any) do inspections have on the relationship between auditors and their clients, and also within members of an audit engagement team. In addition, we ask about inspector perceptions regarding the likelihood that auditors respond to POB inspections by gaming the system (e.g., tampering archived audit work papers) to obtain more favorable outcomes from their inspections.

In terms of *why* auditors respond to POB inspectors, it is important to recall that prior to establishing a POB, the auditing profession in several countries was self-regulated. The financial scandals in the early 2000s raised concerns about the effectiveness of auditor self-regulation and replaced the self-regulation approach to auditor oversight with public oversight. In theory, regulatory solutions have several limitations and need not be superior to self-regulation. For example, regulators typically get their authority from laws written by politicians and funding from either taxpayers or the regulated profession (i.e., audit firms). Thus, the typical public regulator is, to some degree, answerable to politicians and could come under pressure from them to be lax in their oversight of auditors. In addition, it is plausible that regulators are “captured” and controlled

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\(^2\) We are cognizant that surveys have important limitations. We discuss these later in the paper.
by the regulated entities (e.g., Stigler, 1971) and advance the interest of the regulated entities (auditors in our context), rather than the public interest. Furthermore, regulatory bodies typically cannot compensate their staff as well as the private sector, which affects the ability of regulators to attract and retain talent. Finally, it is not clear why a public regulator would have stronger incentives to advance the public interest and improve audit quality compared to auditors conducting peer-reviews. In other words, it is not clear how one incentivizes POB employees to inspect the work of auditors any more thoroughly than what would be accomplished in an approach where the auditing profession self-regulates. Thus, while the weight of the empirical evidence in the extant literature suggests that POB (specifically, the PCAOB) inspections improve audit quality, it is not clear why this is the case given the theoretical limitations of a regulatory approach to oversee auditors. As such, we are unaware of any evidence, even of descriptive nature, providing insights into why POBs have been effective at improving audit quality.

Again, survey data are uniquely suited to answering this question. Testing why POB inspections affect audit quality using archival data is difficult because such a test requires data on either: (1) the internal workings of POBs, such as employee incentives plans, promotion criteria, inspection approaches, governance structures, etc. as well as similar data on the alternative oversight approach that the POB replaces, and/or (2) changes in regulatory approaches that encompass several different POB characteristics (so one can design tests to infer which POB characteristic(s) improves audit quality, though this method would still infer input changes from observed output changes). Although survey data cannot be used to draw causal inferences regarding why POB oversight is effective, the data are useful to gain descriptive insights based on the perception of a group of people closely involved with POB oversight – POB inspectors. In addition to asking inspectors why they perceive auditors to change behavior in response to POB oversight, we ask POB inspectors about their incentives and on-the-job experiences related to both
public oversight as well as self-regulation (in instances where inspectors had experience with both systems) to provide a more complete picture of why POBs seem to ‘work’ and to mitigate some response biases (that we discuss below).³

The data about inspector characteristics reveal that almost all inspectors have a degree in accounting and experience working as an auditor at a Big-N firm. The majority of the inspectors held a title of “manager” or “senior manager” at their prior audit firm employer. None of the inspectors in our sample are less than 26 years of age and none of them went to work for the POB directly following their education. These descriptive statistics suggest that the typical inspector has significant experience performing audits and working at an audit firm.

To examine whether POB inspections affect auditor behavior, we ask inspectors to indicate (on a 5-point (0 to 4) Likert scale) the frequency with which they observe auditors changing audit procedures and quality control systems in response to POB feedback. Our data reveal that 78% of the inspectors observe that auditors “frequently” or “very frequently” (rating of 3 or 4 on the scale) adjust general audit procedures (and 69% respond similarly about quality control systems) as a result of the inspections. We also find that 46% of inspectors observe that auditors “frequently” or “very frequently” change culture or the tone at the top in response to inspection feedback. Inspector perceptions regarding the frequency with which auditors change tone at the top is significantly lower than the frequency with which they perceive firms to change audit procedures and quality control systems; yet the number of inspectors that believe changes in culture occur is non-trivial.

In terms of how auditors respond, our POB-inspector-survey data reveal that auditors “frequently” or “very frequently” respond to inspection feedback by increasing documentation (86%), conducting firm-wide training (83%), increasing the amount of audit/testing effort (64%),

³ Approximately 34% (17%) of the inspectors in our sample have experience conducting and/or receiving peer-reviews (inspections by professional organizations).
increasing scrutiny of management estimates (64%) and changing the audit-quality review process (62%). Consistent with inspections having weaker effects on audit firm culture and tone at the top (relative to audit procedures), the survey responses suggest that inspectors perceive fewer auditors to respond to POB inspections by changing compensation policies for engagement managers (12%) or engagement partners (30%) and changing controls over auditor independence (38%).

Recent anecdotes indicate that auditors may respond to POB inspections by gaming the inspection system and obtaining confidential information about upcoming inspections. To understand how pervasive such gaming is perceived to be, we ask inspectors about the frequency with which they believe that auditors (1) “fix” archived audit files to prepare them for inspections and (2) inappropriately obtain confidential information about upcoming inspections. Only 8% of the survey respondents indicate that auditors “Never” (rating = 0) tamper with closed/archived files before inspections. However, 48% provide a rating of one (on a zero-to-four scale), suggesting such behavior is rare. When asked whether auditors inappropriately obtain confidential information about upcoming inspections, 33% responded “Never” (rating = 0) and another 48% provided a rating of one; yet over 5% responded that such behavior occurs more often than not.

In terms of why auditors respond, we first ask inspectors directly about their opinions on why audit firms respond to inspector feedback (using a 5-point Likert scale). Two responses received significant support from majority of the inspectors. Specifically, 80% of the inspectors “agreed” or “strongly agreed” that auditors do not want the inspection report to contain criticisms of their audit procedures, and 74% “agreed” or “strongly agreed” that auditors respond to inspector feedback to reduce the risk of enforcement actions and fines. In comparison, significantly fewer

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4 For example, KPMG U.S. recently settled a case with the SEC in which KPMG admitted to improperly obtaining and using confidential information from former PCAOB employees in an effort to improve the results of their PCAOB inspection. See: [https://www.sec.gov/litigation/admin/2019/34-86118.pdf](https://www.sec.gov/litigation/admin/2019/34-86118.pdf)
inspectors perceive that auditors respond to inspector feedback because auditors believe the suggestions improve audit quality (59%) or that auditors do not what to upset the inspectors (27%).

We also asked the converse—what do the inspectors think are the reasons why auditors do not respond to the feedback received during inspections. The three reasons to which the highest percentage of inspectors “agreed” or “strongly agreed” that auditors do not respond are when: (1) audit partners believe that the deficiencies identified by inspectors relate to one-off mistakes (57%), (2) the costs of implementing the suggestions are too high (46%), and (3) auditors see little benefit to them from implementing the suggestions (45%).

When asked to compare the strengths/weaknesses of POB inspections and peer reviews, we find that 80% of the inspectors “agreed” or “strongly agreed” that POB inspectors have greater authority than peer-reviewers, 76% of the inspectors “agreed” or “strongly agreed” that POB inspectors have greater enforcement options than peer-reviewers, and 73% of the inspectors “agreed” or “strongly agreed” that the culture and environment at POBs is more conducive for detecting auditing deficiencies than that at audit firms conducting peer-reviews. These views are significantly stronger among the subset of inspectors that have experience conducting peer-reviews and/or being peer-reviewed. The questions comparing POB inspections and inspections by professional organizations (e.g., AICPA, ICAEW) yield similar responses. These questions and responses suggest that auditors respond due to the authority and enforcement capabilities of the POBs in general, but do not respond when costs of doing so are deemed too high or that the underlying problem is not pervasive.

Finally, to provide insights into other aspects of the functioning of POBs, we asked inspectors about the primary benefits and costs of working at the POB (to infer why they chose to work at the POB) and their long-term career objectives. On the one hand, it is plausible that inspectors seek employment at a POB to gain knowledge and experience about the functioning of
the POB, and to build social ties at the POB, with the goal of returning to the private sector equipped with a greater ability to perform well during regulator inspections and reduce regulatory risk for their private-sector employer. On the other hand, it is plausible that inspectors seek employment at a POB because they believe in the regulator’s mission, prefer the work-life balance offered at the POB (relative to that in the private sector), dislike the private-sector environment, etc. If the typical inspector seeks employment at a POB with a goal of returning to the private sector, POB inspections are less likely to be effective at improving audit quality because inspectors might have incentives to be lax in their inspection and enforcement effort to curry favor with prospective employers.

The survey data suggest that the primary benefits of working as a POB inspector, and thus the reason why inspectors work at a POB, are that the job: (1) is an opportunity to influence audit practice (with 87% of the respondents “agreeing” or “strongly agreeing” with this statement) (2) satisfies an intrinsic interest in improving audit quality (86%) and (3) provides good work-life balance (82%). We find little support for the conjecture that inspectors seek employment at a POB to gain knowledge about the functioning of the POB and subsequently improve their career prospects in the private sector. Specifically, 37% of the respondents “agreed” or “strongly agreed” that a benefit of working at the POB was improved career prospects at an audit firm later in their career. Further, even though 59% (27%) of the inspectors believe that it would be “easy” or “very easy” for a POB inspector to find a job at Big-Four audit firm at the senior manager (partner) level, such movement between audit firms and POBs does not appear to be the norm. For example, less than 17% of the inspectors “agreed” or “strongly agreed” that audit firms frequently approach the current inspection staff for employment and less than 12% of the inspectors “agreed” or “strongly agreed” that inspectors frequently approach the audit firms for employment. In sum, inspector responses suggest that the majority of the inspectors working at a POB are motivated to improve
audit quality because of an innate interest in serving the profession rather than a pecuniary interest or a desire to return to the private sector for higher pay. However, we recognize that inspector responses to these questions might be biased towards answers that make them look more altruistic.

Aside from inspectors’ innate motivation to exert effort and “do the right thing,” the data reveal that inspectors have weak performance related incentives (at least compared to what one might expect in the private sector). For example, only 5% of the inspectors “agreed” or “strongly agreed” that receiving a competing job offer is an important determinant of promotions, and almost half of the surveyed inspectors “agreed” or “strongly agreed” that inspectors are rarely asked to leave their job due to poor performance. Our data also reveal a lack of uniformity in inspector perceptions regarding the existence of formal programs to evaluate auditor inspection quality, suggesting that formal evaluations of inspectors’ performance in conducting inspections might not be an important determinant of promotion. Rather, we find that the majority of the inspectors “agreed” or “strongly agreed” that promotions are determined based on feedback from the inspection team leader (76%) and the availability of promotion opportunities (73%). Finally, we find the number of deficiencies detected during inspections is not an important determinant of promotion. This result implies that inspectors do not perceive to be rewarded for identifying a larger number of deficiencies during inspections, which is contrary to the perceptions held by U.S. auditor partners about the PCAOB inspectors’ incentives (Houston and Stefaniak 2013).

Our paper contributes to the literature on regulation and auditing in two ways. Specifically, this is the first study (to our knowledge) to provide insight into how and why POBs improve audit quality and compare a system of public oversight to self-regulation. Prior research entirely focuses on examining the consequences of the shift from self-regulation to public oversight on the audit market (e.g., Lennox and Pittman 2010; DeFond and Lennox 2011; Aobdia and Shroff 2017), audit quality (e.g., Lamoreaux 2016; Fung et al. 2017; Gipper et al. 2017; Krishnan et al. 2017; Aobdia
2018), and external financing and investment (Shroff 2019). Other studies compare the inspection reports prepared by peer-reviewers and POB inspectors to infer differences in the information content of these reports (e.g., Anantharaman 2012). We build on these studies by providing new descriptive insights into how auditors respond to the feedback received during POB inspections and why inspectors perceive POBs to be effective at changing auditor behavior.

Our paper is also related to prior studies that survey and interview practicing auditors. Daugherty and Tervo (2010) survey triennially inspected U.S. audit firms and find that the responding firms evaluated the inspection process favorably in terms of “appropriate constructive criticism, engagement selection, inspection time devoted to engagements, and inspectors’ knowledge, conduct, and appropriate focus.” However, they go on to indicate that audit firms disagreed that PCAOB inspections are an improvement over the prior peer-review process and that “A number [of auditors] viewed inspections as failing to enhance audit quality or investor confidence.” Houston and Stefaniak (2013) survey partners at larger U.S. audit firms about their perceptions of PCAOB inspections and internal quality reviews (IQRs). Houston and Stefaniak (2013) report that audit partners think that IQRs are better than PCAOB inspections along most dimensions the authors examine (e.g., inspector/reviewer knowledge about audit methods, fairness, focus on improving audit quality, timeliness of feedback, etc.). Johnson et al. (2018) interview 20 U.S. auditors about their experience with PCAOB inspections and find that auditors place great importance on achieving clean inspection reports and spend significant resources to increase the likelihood of positive inspection outcomes. However, auditors generally do not have much trust in the PCAOB. Finally, Westermann et al. (2018) survey 55 U.S. auditors and former auditors of varying rank and interview eight auditors. They find that auditors generally perceive the PCAOB inspection process to have improved audit quality, albeit at a very high cost (implying

5 Houston and Stefaniak (2013) indicate that “An IQR is an internal quality control mechanism employed by larger audit firms to assess compliance with auditing standards and firm methodologies while performing engagements.”
that costs of PCAOB inspections exceed its benefits). For example, Westermann et al. (2018) state that U.S. auditors believe that “Passing an inspection is so important, that auditors…have resorted to impression management strategies and “functionally stupid” work practices.” Overall, much of the results from surveys and interviews of U.S. auditors is critical of PCAOB inspections.

POB inspectors and auditors are perhaps the two most informed groups of economic agents with knowledge regarding how and why audit firms change behavior in response to POB oversight. Yet, the perceptions of these agents regarding the value of POB oversight and their inspection experiences are likely to differ because (1) it is one group’s job it to identify mistakes in the other group’s work and (2) inspectors and auditors self-select into these roles and thus are inclined to believe that what they are doing is valuable/correct. As such, our survey of POB inspections complements prior studies surveying auditors by providing another point of view that can help us understand whether, how, and why POB oversight affects auditor behavior.6

Our analyses are based on survey data and thus it is important to caveat that our data and results are subject to the general limitations of this method. We attempt to mitigate biases related to survey data by taking multiple steps that we discuss below. In addition, in many instances, our inferences are based on responses triangulated across multiple questions. However, despite these efforts, we recognize that there could be a systematic tendency of respondents to obscure the truth or to be unconsciously biased on particular questions, which could affect our results. Another important caveat is that we ask inspectors about whether, how, and why they perceive inspections to affect auditor behavior. Given that inspectors are choosing to work at a POB, their views could

6 Some other benefits of surveying POB inspectors rather than auditors include: (1) POB inspectors’ perceptions are based on their inspection experiences from a broad cross-section of audit firms and audit engagements while individual auditors are likely to have had relatively idiosyncratic experiences based on when their engagement was selected for a POB inspection; (2) a survey of POB inspectors enables us to collect facts about the internal workings of POBs, the incentive structures, etc., which we know relatively much less about. And (3) the vast majority of POB inspectors have prior experience being an auditor and thus can relate to both the job as an inspector and auditor; whereas, auditors typically do not have experience working at a POB. Of course, there are disadvantages of surveying POB inspectors as well, which is why we believe our evidence complements that in prior studies surveying auditors.
be favorably biased about the effectiveness of POBs. We recognize this potential bias and are careful to word questions to mitigate the effect of such a bias but we caveat that the results should be interpreted carefully as the responses represent the views of regulators.

The rest of the paper proceeds as follows. Section 2 describes our sample and survey methodology. Sections 3 to 6 present the descriptive statistics and results. Section 7 concludes.

2. Survey methodology and sample

We developed an initial survey instrument based on a review of the auditing literature related to the PCAOB inspections and the American Institute of Certified Public Accountants (AICPA) peer-reviews, as well as the literature on the economics of regulation. We solicited feedback from several academic researchers, regulators, and a survey design consultant on the survey content and design. We used preliminary drafts of the survey to conduct beta tests to seek feedback on the clarity of questions and to estimate the time it would take for inspectors to complete the survey. The final draft of the survey contained 37 questions of varying length, and some questions with subparts. The paper version of the survey was 23 pages long; however, all responses were completed using the online version of the survey, which can be accessed from this link: https://survey.qualtrics.com/jfe/form/SV_1yO2tbo7NRf4ztP.7

We initially reached out to and obtained permission from senior staff at the Authority for the Financial Markets (AFM) in the Netherlands, Independent Regulatory Board for Auditors (IRBA) in South Africa, and Financial Reporting Council (FRC) in the U.K. to survey the inspectors working at these POBs. Subsequently, we also received consent to survey the inspectors at the Dubai Financial Services Authority (DFSA). These approvals were obtained between December 2017 and March 2018, at which point, we reached out to IFIAR to broadcast a

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7 We also had an MIT accounting PhD student take the survey; she completed it in approximately 40 minutes.
participation request to all their members. IFIAR sent out an email to all its members on April 13, 2018 providing a description of our study and requesting members to contact us for more information. IFIAR’s email prompted 14 additional POBs to participate in our study (from a total of 52 member organizations as of 2018). A senior staff member of the AFM also mentioned our study in a Committee of European Auditing Oversight Bodies (CEAOB) plenary meeting, as a result of which Romania’s POB, the ASPAAS, agreed to participate in our study (the ASPAAS is the only non-IFIAR member that participated in our study). On January 10, 2019 the PCAOB agreed to inform their Division of Registration and Inspections (DRI) staff about the survey and allowed them the opportunity to choose to participate.

We requested the 20 participating POBs to provide the email addresses of all the staff employed by them who conduct inspections. Twelve of the 20 POBs provided us email addresses of all their inspection staff. Of the remaining eight POBs, four asked inspectors to volunteer and provided us the email addresses of only those inspectors who volunteered. The PCAOB asked interested DRI staff to contact the researchers if they were interested in participating the survey. Finally, the Switzerland POB randomly selected one-third of their inspectors to participate, the Czech Republic POB selected the senior most volunteer, and the Portuguese POB selected only the senior inspectors. In total, we obtained email addresses of 208 inspectors.

We emailed the first invitation to participate in the survey to 163 inspectors on May 23, 2018. We sent four reminders (May 30, June 6, June 13, and June 27). On June 20, we emailed our contact person at each POB and asked them encourage their inspection staff to complete the survey. We closed the survey on July 6. Since we PCAOB inspectors were informed of the survey at a later date, we re-opened the survey for the PCAOB inspectors on January 17, 2019. Forty-five PCAOB inspectors contacted us and expressed interest in taking the survey in response to internal emails sent within the PCAOB informing all DRI staff about our study. We sent reminders to the
PCAOB inspectors that volunteered to take the survey on February 12\textsuperscript{th}, 19\textsuperscript{th}, 26\textsuperscript{th} and March 21\textsuperscript{st}, after which we closed the survey.

A total of 176 inspectors accessed the survey from a total 208 inspectors that received invitations to participate. Six respondents either completed less than 25\% of the survey or simply clicked through the entire survey without answering any of the questions; we exclude these observations from our sample. Thus, we obtain 170 usable responses from our survey. Table 1 lists the POBs (and the countries to which they belong) that participated in our survey, along with the number of inspectors that each of the POBs employ, the number of inspectors whose contact information we received, and the number of inspectors that responded to the survey.\textsuperscript{8}

One approach to compute the response rate is to take the ratio of the number of usable responses (170) to the number of survey recipients (208), which gives us response rate of 82\%. However, part of the explanation for such a high response rate is because we coordinated with POBs and inspectors’ prior willingness to answer the survey was determined by the POB before we sent the survey out.\textsuperscript{9} Another approach is to use the total number of inspectors employed at the participating POBs (635) as the denominator, which yields a response rate of 26.8\%. Both approaches yield response rates that compare very favorably to prior studies.\textsuperscript{10, 11}

\textsuperscript{8} It is worth noting that there some heterogeneity in the role of an audit inspector across POBs. In some instances, the inspection staff at the POB strictly focuses on inspections (and related tasks) but nothing else. In other instances, some employees participate in inspections as well as other activities such as enforcement. In our correspondence with the senior members of each POB (who served as our contact), we indicated that we are surveying the employees responsible for conducting inspections, and as such, spend much of their time conducting inspections.

\textsuperscript{9} This as a condition requested from them. They limited the number of their inspectors that we could survey.

\textsuperscript{10} A third approach to compute response rates (which we do not have the data implement) is to compare the number of usable responses to the total number of inspectors that work in all POBs that are IFIAR members. In terms of POBs, one could compute a rate as 19 POBs from IFIAR in our sample to the 52 total POBs or a rate of almost 37\% (plus we have Romania which is not a member of IFIAR).

\textsuperscript{11} For example, Daugherty and Tervo (2010) report a responses rate of 32\% in a survey of triennially inspected audit firms. Houston and Stefaniak (2013) received a response rate of 9\% in a survey of audit partners of large firms. Johnson et al. (2018) and Westermann et al. (2018) do not report response rates in their studies. Other studies, unrelated to auditing, that report response rates are Graham et al. (2014, 2017) with 26\% in a survey of tax directors, Graham et al. (2005) and Dichev et al. (2013) with under 9\% response rates in surveys of CEOs and CFOs.
There are limitations to survey research. First, there is a possible selection issue if certain types of inspectors choose to respond to the survey and certain types of inspectors do not respond. Indeed, this may be particularly acute if the POBs chose certain types of inspectors that we were allowed to survey and excluded some particular type that we could not survey. In contrast to some other research settings where the responder could be compared to the non-responder or to the typical Compustat firm (e.g., Graham et al. 2014), we have no such luxury in this setting because our data are the only data on POB inspectors that exist. As a precaution, we re-do our analyses using responses from the subset of POBs that allowed us to survey their entire inspection staff and verify that our inferences are unchanged. In addition, the high response rate, to some extent, mitigates these concerns. However, we recognize that some concerns could remain.

It is also possible that respondents did not understand our questions (either because we did not write the question clearly, language differences between us and the respondents, or any number of other factors). There is no way to completely eliminate these issues. However, we tried to prevent serious problems by (1) having many academics read the survey instrument before we administered it to the inspectors, (2) hiring a survey consultant to review the instrument (both the online functioning and the content of the questions), (3) having several senior staff from multiple POBs read the instrument and provide feedback to us about the content of the questions, and (4) encouraging the use of Google Translate in the online survey via a function in Qualtrics if the respondent had trouble with the English language.

Another concern is that respondents may not answer truthfully, they may randomly answer just to finish the survey, or they may answer in a way that “looks good” for the POB for whom they work. Again, there is no way to avoid these issues entirely. To mitigate the concerns, we promised complete confidentiality and stated that the responses would not be shown to the respondents’ boss and that we would present data in such a way that no individual inspector or
even separate countries’ POBs would be identifiable. We analyze the responses and corroborate them across questions and we do not see evidence of respondents answering randomly. In addition, it took the median inspector 42.5 minutes to complete the survey and several inspectors completed the survey over two or more days, suggesting that they did not rush through the task.

Finally, for questions where we list a set of statements in a grid and ask the respondent to rate the extent to which they agree/disagree with each statement in the grid, we randomized the ordering of statements (excluding the ‘other’ option) that the respondent saw on the grid. The intent with such randomization is to avoid any response bias due to the ordering of the possible responses (e.g., the respondent only reads the first few). In addition, when the grids had ten or more statements for the inspectors to agree/disagree with, we included a follow up question asking the respondent to rank the two statements that he/she perceived to be the most important from the subset of statements the respondent “strongly agrees” with. The purpose of such a follow up question was to have a rank ordering of importance of the statements in the event that a respondent strongly agreed with many of the statements. We also allowed respondents to skip every question in the survey and indicated this option in the survey instructions. Thus, if inspectors did not want to answer any particular question, they could move forward without answering the question. In addition, we always included an “other” factor where the respondent could write in text to supply their own answer in the event we were not aware of all possible important issues for a question.

3. Descriptive statistics and inspector characteristics

We first collect information about the educational backgrounds, prior audit and non-audit experience, and average POB employment duration of the typical POB inspector. These data are provided in Table 2. Survey responses reveal that the vast majority of inspectors have significant accounting education, such as a degree in accounting (roughly 51%) and/or a certification such as the CPA or CPA equivalent (roughly 79%). That inspectors have an education in accounting
should come as no surprise. We find that majority of the inspectors have worked at their POB for three or more years and that none of them are under the age of 25 (the majority being older than 36). In addition, all POB inspectors had some prior work experience following their education and before joining the POB. We also find that the vast majority (almost 83%) of the respondents worked in an audit role at a Big-N accounting firm. The majority of inspectors reached the title of manager or senior manager in the audit firm they worked at. Approximately 77% of the inspectors were hired from an audit firm and 11% were hired from another government agency. These background characteristics suggest that POB inspectors have significant audit experience.

The data reveal that 41.4% of inspectors perform inspections of all the Big-4 auditors and 80.6% (36.5%) of the inspectors perform at least 5 (11) inspections of Big-4 and non-Big 4 auditors per year. Just under 34% of the inspectors in our sample have some experience with auditor peer-reviews and just under 17% have some experience with inspections conducted by auditor professional organizations.

4. Effect of inspections on auditor behavior

4.1. Do inspections affect auditor behavior?

A number of studies examine the effect of POB inspections on proxies for audit and financial reporting quality. For example, Lamoreaux (2016) and Krishnan et al. (2017) find that non-U.S. companies cross-listed in the U.S. observe an improvement in audit quality (measured using several approaches) following the threat of a PCAOB inspection and actual PCAOB inspections. Gipper et al. (2017) find that equity investors’ responses to earnings news (i.e., ERCs) increases following the introduction of the PCAOB inspection regime (also see Carcello et al. 2011). DeFond and Lennox (2017) and Aobdia (2018) link the content of PCAOB inspection reports to subsequent changes in audit quality. These studies suggest that U.S. auditors respond to
PCAOB inspections by changing auditing practices. Fung et al. (2017) and Shroff (2019) find that PCAOB inspections not only affect the audits of companies regulated by the U.S. SEC but also affect the audits of non-U.S. companies, which lead to greater access to external capital and increased investment. All of the above archival evidence relates to the effect of PCAOB inspections on audit markets and auditor behavior. Carson et al. (2017) is the only study we are aware of that examines whether non-U.S. POB inspections affect audit quality proxies. They find that the commencement of inspections across POBs of 36 countries is associated with audit quality improvements, consistent with the findings in the U.S. setting. Considering that most countries had some form of self-regulation approach to auditor oversight prior to the introduction of POB inspections, the evidence in prior studies can be interpreted as suggesting that POB inspections are more effective at improving audit quality compared to a self-regulation approach.

While the archival studies are carefully done, these studies typically compare audit quality proxies pre- vs. post-POB establishment and thus are subject to some important limitations (that prior studies recognize). Specifically, it is difficult to identify the effect of POB inspections because the creation of a POB is often confounded by other factors that affect audit quality (e.g., Sarbanes-Oxley Act in the U.S., the adoption of IFRS outside the U.S., concurrent enforcement changes). Prior studies are clever in using research design features such as staggered adoption dates and cross-listed firms. However, problems remain because most proxies for audit quality are slow to respond to any treatment (Leuz and Wysocki 2016). In addition, the counterfactuals in such tests are still based on observing audit quality in companies with different auditors and fundamental characteristics and then inferring that the audit inputs must have changed (but with no evidence on inputs or which inputs). We ask questions in our survey to obtain information specifically about the inputs to the audit process.
We first ask about the frequency with which the inspector responder observes auditors reacting in a variety of ways. Figure 1 presents the data. We find that 78.2% (68.5%) of the inspectors say that auditors “frequently” or “very frequently” change or adjust audit procedures (quality control systems) at inspected clients in future engagement because of feedback from inspectors. In addition, 60.6% of inspectors say that auditors “frequently” or “very frequently” change audit procedures at clients that were not inspected because of inspections (and the feedback received) at other clients. The presence of such spillover effects from inspected to non-inspected audit engagements is important because most POBs do not inspect all audit engagements of an auditor, in part due to resource constraints, and rely on such spillover effects to exist. Further, prior archival studies examining the effect of PCAOB inspections on audit quality typically assume the existence of such spillovers (e.g., Aobdia and Shroff 2017, Fung et al. 2017, Gipper et al. 2017). We also find that 46.1% of the inspectors say that the auditor “frequently” or “very frequently” changes the “tone at the top” as a result of inspection feedback. While this is a lower percentage than the factors discussed above, this is a non-trivial number of inspectors to state that such a large shift in an audit firm occurred after a POB inspection. In sum, the inspectors’ responses suggest a strong belief that auditors frequently make changes to audits processes, and to a lesser degree audit firm culture, in response to the feedback received from POB inspections.

4.2. How do inspections affect auditor behavior?

4.2.1 Effect on audit processes

We attempt to dig further by asking what actions in particular the inspectors have observed auditors taking in response to POB inspection feedback. We listed 12 potential actions each with a 5-point Likert scale that ranged from 0 (strongly disagree) to 4 (strongly agree). The data are presented in Figure 2. The greatest consensus where inspectors stated that they “agree” or “strongly
agree” is for auditors increasing documentation of audit procedures (85.7%). The next most common auditor behavior, according to the inspectors, is conducting firm-wide training (82.7%). Other actions include increasing the amount of audit and testing efforts (64.4%), increasing scrutiny of management estimates (64.0%), changing the audit quality review process (62.1%), changing audit check lists (56.0%), and changing procedural manuals (55.6%). Of note is that seven of the actions listed in the survey, garnered agreement by more than 50% of inspectors.12 To the extent, changes in audit and testing effort, greater scrutiny of management estimates, etc. lead to increases in audit fees, our evidence is consistent with prior archival studies showing that PCAOB inspections lead to increases in audit fees (e.g., Aobdia 2018, 2019). Our evidence extends prior archival research by providing insights into what input changes in the audit process lead inspections to result in higher audit fees.

Figure 2 also shows that relatively few inspectors “agree” or “strongly agree” that auditors respond to inspection feedback by changing compensation policies for engagement managers (11.7%) or engagement partners (29.8%) or changing controls over auditor independence (37.9%). As such, the responses to questions in both Figure 1 and 2 suggest that auditors are less likely/willing to change overall audit firm culture and independence relative to making procedural changes such as documentation and training; however, the latter sometimes do occur.

4.2.2 Do auditors try to game the inspection system?

Another plausible manner in which auditors could respond to POB inspections and oversight is by finding ways to circumvent the purpose of the inspections and game the system. For example, the SEC recently alleged that two former PCAOB officials had left the PCAOB to

12 We also note that twelve respondents rated the “Other” option but only two filled-in the text portion of the question describing what “Other” meant. One respondent strongly agreed that auditors focus “specifically in the areas reported at the inspection” and the other respondent strongly disagreed (i.e., rated zero) that auditors change “Culture and remuneration.”
work at KPMG and that these officials made unauthorized disclosures of PCAOB plans for inspections of KPMG audits. The SEC went on to allege that these unauthorized disclosure enabled the (now former) KPMG partners to analyze and revise audit work papers in an effort to avoid negative inspection findings by the PCAOB. We use our survey to understand whether the recent KPMG-PCAOB scandal is a one-off occurrence or whether it is more pervasive but undetected.

We directly ask inspectors whether they believe auditors misbehave or try to game the inspection process by (1) tampering closed/archived audit files to “fix” them for an inspection, and/or (2) whether auditors inappropriately obtain confidential information related to upcoming inspections. These data are presented in Figure 3. The scale for this question was a 5-point Likert scale where 0 = “Never” and 4 = “Very Often.” The data reveal that inspectors think that there is a non-trivial amount of ‘fixing’ audit files in preparation for an inspection. We find that 7.9% choose the rating of 0, meaning “Never,” and 4.3% responded by clicking 4 on the scale for “Very Often.” Another 14.6% of respondents answered 3, indicating more often than not. The interpretation of these data depends on one’s priors, of course. If one’s prior is that closed audit files are never supposed to be tampered with before an inspection, then the low percentage of inspectors that answered “Never” and the 18% and roughly 5% that answered “Often” and “Very Often” may seem surprising and important.

The data about how often auditors obtain confidential information about upcoming inspections is similar in the sense that not all, or even a majority, respond that such behavior never occurs. While fewer inspectors (relative to the percentage that said audit files are fixed) answer that auditors receive information about the inspection in advance, receiving information about the inspection in advance is more egregious behavior than fixing a file. Again, whether the responses are surprising or not depends on one’s priors. The data reveal that 5.5% of the respondents answer
that auditors “Often” or “Very often” inappropriately obtain confidential information about upcoming inspections (rating = 3 or 4). 32.9% respond that this “Never” occurs (rating = 0) and 47.6% respond that obtaining inappropriate information happens rarely (rating = 1).

A caveat to these results is that they are from the inspector’s perspective. We cannot be sure whether inspectors just perceive that auditors are taking these actions to avoid detection of poor audit quality and that the reality is something different or whether the inspectors’ beliefs are consistent with reality. Nonetheless, these responses provide the perspective of one set of agents that are very close to the auditing and inspection process, and thus we believe the views of inspectors can guide future research that further explores the extent to which there is malfeasance in POBs and the auditing industry.

4.2.3 Effect of inspections on relationships within the engagement team

To better understand the effect of POB inspections on audit practice, we ask inspectors about whether the inspection process affects relationships within engagement teams as well as the auditor-client relationship. Inspectors typically have face-to-face interactions with members of the audit engagements they inspect, and thus are able to learn when clients give auditors push back for requesting more information (e.g., see the August 2012 “Guide to PCAOB Inspections” by the Center for Audit Quality). Similarly, face-to-face interactions with engagement teams give the inspectors a chance to infer the effect of inspections on the relationships within engagement team members. However, we recognize that inspectors do not directly observe changes in the auditor-client relationship or the relationships within engagement teams and thus might be unaware about how inspections affect these relationships.

Figure 4 presents the results. In Panel A, we find that 54.3% (44.0%) of the inspectors believe that the inspection process increases tension in the relationships between the engagement
partner and engagement manager (auditor and client). However, consistent with inspectors not observing, and thus not knowing, how inspections affect the above relationships, we find that almost a third of the inspectors indicate that they do not know whether the inspection process affects relationships between the engagement partner and manager or between auditor and client.

In Panels B and C, we present data from questions where we ask about why inspections increased tension in the relationship, conditional on the respondents indicating that the inspections increase tension in the relationships between engagement team members and auditors and clients in the previous question. The majority of our respondents believe that the need to ask clients for more information and increased skepticism of management estimates are the two primary causes for the increased tension in these relationships.

5. Understanding the reasons why auditors respond to inspection feedback

The evidence in the previous sections and that in much of the archival literature suggests that the introduction of POB inspections improves audit quality (though admittedly the cost versus benefit analyses is not examined). However, the field to date has been unable to provide any insights into why POB inspections affect audit quality. To gain insights into why POB oversight affects audit quality/practice, we ask inspectors their perceptions regarding (1) why auditors do and do not respond to inspection feedback and (2) the strengths/weaknesses of POB oversight relative to self-regulation. Because POB oversight replaced the self-regulation approach to oversee auditors, comparing the strengths and weaknesses of these approaches can help us infer the reasons why POB oversight has led to an improvement in audit quality.

5.1. Why do inspections affect auditor behavior?

Figure 5 presents the data regarding why auditors respond according to the inspectors. We begin by asking inspectors the following question: “Considering circumstances where audit firms
DO respond to feedback received during inspections, to what extent do you agree/disagree with
the following statements about why audit firms respond to inspector feedback.” The two reasons
that garnered the highest amount of consensus are: (1) Auditors/engagement partners do not want
the inspection report to contain criticisms of their audit procedures (79.9% of inspectors “agreed”
or “strongly agreed”) and (2) auditors/engagement partners respond to inspector feedback to
reduce the risk of current/future enforcement actions and/or fines (74.2%). Relatively fewer
inspectors (but still a majority) “agreed” or “strongly agreed” that auditors respond to the
inspection report because the audit partners believe that the changes suggested by the inspectors
improve audit quality (57.4%), while 26.5% say a response is because audit partners do not want
to upset the inspectors and 6.2% say it is because responding enables auditors to charge a higher
fee. Thus, inspectors perceive that much of the motivation to respond to inspection feedback is
that the auditors do not want to be publicly criticized or to be fined for doing something ‘wrong’
in the opinion of the POB; in other words, the disclosure and enforcement strength of the POB (we
investigate this further below).

That 57% agree that at least some motivation for auditors making changes is because
auditors think inspectors’ feedback will improve audit quality is in contrast to the evidence in some
surveys of U.S. auditors regarding PCAOB inspections. For example, Westermann et al. (2018)
report that U.S. auditors perceive passing an “inspection is so important, that auditors…have
resorted to impression management strategies and “functionally stupid” work practices (e.g.,
excessive documentation, a decrease in critical thinking as a result of a “box ticking” approach to
auditing).” It is plausible that inspectors perceive responses to their feedback differently than
auditors do, but archival results are consistent with inspector perceptions that inspection feedback improves audit quality.\textsuperscript{13}

Figure 6 presents data for the same research question but the data are responses to where we asked the survey question in the alternative form: “Considering circumstances where audit firms DO NOT respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms do NOT respond to inspector feedback.” Only one factor we listed attracted more than half of the inspected auditors saying they “agreed” or “strongly agreed” with auditors’ motivations. In our sample, 56.8% of the inspectors said they “agreed” or “strongly agreed” that auditors do not respond to inspector feedback because the auditor believes the mistake identified is a one-off mistake and thus not pervasive enough to need remedied in a larger sense. In terms of the next most common responses, the data reveal that inspectors “agreed” or “strongly agreed” that auditors do not respond to inspector feedback because: (1) auditors believe the costs of implementing the suggestions are too high (46.0% of respondents), (2) the auditor sees little benefit to the audit firm by responding (45.1% of respondents), (3) the “tone at the top” at the audit firm is to place commercial interests above the quality of their audits (41.9% of respondents), (4) the auditor believes that the changes suggested by inspectors do not improve audit quality (40.6% of respondents), (5) the auditor’s attitude towards regulation is negative (39.8% of respondents), and (6) clients are unwilling to pay the higher fee to compensate the auditor (39.0% of respondents).

In sum, as viewed by the inspectors, the main incentive for auditors to respond to inspector feedback is that the auditors do not want to be subject to enforcement action from the POB and do not want inspector criticisms to be publicly disclosed. These results are important because they

\textsuperscript{13} We verify that our inferences are unchanged if we restrict the sample to the perceptions of just the PCAOB inspectors (untabulated).
provide insight into why POBs might be more effective than self-regulation at improving audit quality – POBs have enforcement strength. In addition, several POBs are still prohibited from publicly disclosing their inspection findings at the individual auditor-level. Our result that the disclosure of inspection reports is one of the most important tools to induce changes in auditor behavior potentially sheds light on which POBs are more versus less effective at improving audit quality and potentially guides policymakers if the goal is to induce auditors to change behavior.

We find that a majority of inspectors “agreed” or “strongly agreed” that changes are most likely observed in cases where auditors think the feedback improves audit quality. The main reasons auditors do not respond to POB feedback are if the problem that arose is not pervasive and in cases where responding would be very costly (and not compensated).

5.2. Comparing POB inspections and peer-reviews

An alternative way to understand why POB oversight improves audit quality (as prior studies find and we corroborate) is to ask inspectors their perceptions about the relative strengths and weaknesses of auditor inspection programs conducted by POBs versus inspections conducted by auditors themselves through peer-reviews and by staff for professional organizations for auditors (e.g., the ICAEW in the UK, SAICA in South Africa, the AICPA in the U.S.). Prior to establishing POBs to oversee auditors, the auditing profession in several countries was self-regulated. In a self-regulation system, organizations created and funded by the auditing profession (e.g., the AICPA) set standards, perform inspections, and monitor compliance with professional norms and standards. In this approach, audit firms are inspected either by their peers (through peer-reviews) or by staff employed by the professional organization. A primary drawback of a self-regulation system, where auditors conduct peer-reviews to oversee each other, is that auditors lack the incentives to fault their peers. Specifically, auditors have little-to-no consequence for conducting lax peer-reviews, but could incur some cost by disciplining their peers during such
reviews, if their peers retaliate. Further, there is no higher rank authority between the reviewer and reviewee in a peer-review system and limited enforcement options. The accounting scandals in the U.S. in the early 2000s led several academics and practitioners to criticize the peer-review process as being “toothless” (Coffee 2001) and “incestuous” (Williams 2002). On the other hand, however, auditors are perhaps the most qualified to evaluate the quality of work done by their peers.

By contrast, oversight by a POB could be more independent than a self-regulation system if the POB does not depend on the auditing profession for funding and if the governing bodies of the POBs are not all current auditors.\textsuperscript{14} Importantly, POBs can impose sanctions if audit firms fail to comply with the minimum standards for audit quality. Further, given that the external damage from an accounting fraud is potentially large, a public regulator can increase the total amount of enforcement (even if the fines from enforcement actions do not cover enforcement costs) to deter many potential violators (Polinsky 1980; Polinsky and Shavell 2000).

However, there are several limitations of a public regulatory approach to oversee auditors. Specifically, public regulatory oversight can often suffer from the same agency problems as that between auditors, clients, and investors (Stigler 1971; Peltzman et al. 1989). For example, an important concern with public regulators is that they are susceptible to “capture” by the powerful players in the industry (e.g., the Big-4 auditors). Further, depending on the regulator’s source of funding, it could come under political pressure that undermines its effectiveness. While POBs across the world are designed to be independent of the accounting profession to address the above issues, it is debatable as to whether such independence in form has achieved its goal. In addition, the independence in form has raised other issues. Specifically, critics contend that POB inspectors

\textsuperscript{14} This is typically the case (see IFIAR 2010). IFIAR is the International Forum of Independent Audit Regulators. It was established in 2006 and is comprised of audit regulators from 52 jurisdictions (as of 2018). Their stated mission is to serve the public interest and enhance investor protection by improving audit quality globally.
do not have the in-depth expertise, or incentives to update their expertise, that practicing auditors have (Palmrose 2006; Glover et al. 2009). Thus, it is possible, the critics claim, that the POB approach to oversight has sacrificed expertise for independence (see Lennox and Pittman (2010) and DeFond (2010) for a discussion). As such, neither approach to auditor oversight strictly dominates the other in a theoretical sense (see Leuz and Wysocki 2008; Minnis and Shroff 2017).

Prior archival studies examine the effect of self-regulation and public oversight on audit outcomes with the goal of comparing the benefits and costs of these oversight approaches. For example, Hilary and Lennox (2005) examine whether peer-review reports provide clients with credible information about differences in auditor quality. They find that receiving ‘clean’ peer-review reports increases auditor market share, while receiving negative peer-review reports decreases auditor market share. Casterella et al. (2009) find that peer-review findings predict audit failure, which they interpret as peer-review reports serving as a credible signal of audit quality. These studies suggest that peer-review reports serve an information role, such that the consumers of audited financial statements (e.g., investors) can learn about differences in auditor quality by reading peer-review reports. However, we are unaware of prior studies that compare the strengths and weaknesses of these approaches to oversee auditors, as it relates to audit quality improvements.

We asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by auditors themselves through a peer-review program.” Figure 7 shows that the most common responses of agree or strongly agree are for the reasons (1) POBs and/or POB inspectors have greater authority than the auditors conducting peer reviews (79.9% of inspectors “agreed” or “strongly agreed”), (2) POBs have stronger enforcement options (76.4%), (3) the culture and environment at POBs is more conducive for detecting auditing deficiencies
(73.0%), and (4) peer reviews are more likely to have conflicts of interest than POB inspectors (67.9%). Recall that these answers are consistent with what we found in the previous section (Figure 5) when we asked about POBs in an absolute sense (not relative to prior regimes). If auditors respond to a threat of enforcement and the POBs have greater authority and enforcement capabilities (as reported in Figure 7), a POB inspection should lead to more response on the part of the auditor relative to peer review, thus a more ‘effective’ method of auditor review.

There is relatively less agreement among inspectors for some other factors that could make POB inspections more effective than peer-review, though some of the following still have a majority or large minority of inspectors agreeing. For example, 53.2% of the respondents “agreed” or “strongly agreed” that auditors have weaker incentives to detect audit deficiencies than POB inspectors and 49.1% “agreed” or “strongly agreed” that the POB’s approach to select audit engagements is better than that used by peer-reviewers. In summary, we interpret the results in Figure 7 as suggesting that inspectors do not necessarily believe that they are better suited or more capable of detecting audit failures than auditors conducting peer-reviews. Rather, it is the authority, enforcement power, and POB culture that are the most important strengths of POB oversight relative to self-regulation and peer-reviews.

We find similar results comparing POB inspectors to inspections conducted by a professional organization, but with a somewhat weaker consensus (lower percentage of inspectors agreeing or strongly agreeing). We asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by staff from a professional organization for auditors (e.g., the ICAEW in the UK, CICA in Canada, AICPA in the US).” Figure 8 presents the results. The statements that received the most consensus in terms of inspectors agreeing or strongly agreeing are: (1) POBs and/or POB inspectors have greater authority than the professional
organization inspectors (69.0% of inspectors “agreed” or “strongly agreed”), (2) POBs have stronger enforcement options (66.7%), (3) the culture and environment at POBs is more conducive for detecting auditing deficiencies (58.1%), (4) professional organization inspectors are more likely to have conflicts of interest than POB inspectors (e.g., because prof. org. get funding from audit firms) (42.3%), and (5) the scope of a typical POB inspection is broader than that of a typical inspection conducted by professional organizations (42.3%). These answers are similar to what we found above (in Figures 7 and 5) and the inferences are largely the same. That is, greater enforcement capability, authority, and organizational culture make POBs more effective than oversight approaches based on self-regulation.

6. **Other insights into the functioning of POBs and timing of responses to inspections**

6.1. **Inspector incentives**

We ask inspectors questions about why they sought employment at a POB, how the POB experience contributes to their long-term career goals, the criteria used by POBs to evaluate/promote inspectors, inspectors’ outside opportunities and economic incentives to work at a POB (e.g., promotion at POB, greater promotion opportunities in the private sector). Our objective is to understand the economic incentives and social preferences that motivate POB inspectors to advance the public interest by improving audit quality and trust in public markets. Such motivation could be driven by self-interest (Stigler 1971) or benevolence (Pigou 1938).

6.1.1 **Why do inspectors seek employment at a POB?**

We asked survey respondents to rate the extent to which they agree or disagree with several statements about the advantages and disadvantages of their job. The purpose of this question is to understand why inspectors seek employment at a POB. On the one hand, it is plausible that POB employment is desirable because such experience helps advance an inspector’s private sector career prospects. On the other hand, it is plausible that POB employment allows inspectors to
continue working in the audit industry in a less stressful environment than that in the private sector. Figure 9, Panel A (B) presents the results related to the benefits (drawbacks) of a POB job. We find that 87.0% of the inspectors “agreed” or “strongly agreed” that a benefit of their job at the POB is that it is an opportunity to influence audit practice, while 85.8% “agreed” or “strongly agreed” that a benefit of their POB job is that it provides them a way to satisfy their intrinsic interest in improving audit quality and that. In addition, 72.0% of the inspectors “agreed” or “strongly agreed” that a benefit of their job at the POB is that it provides them a way to satisfy their intrinsic interest in advancing the regulator’s mission (which is to protect investors and improve audit quality) and 68.0% “agreed” or “strongly agreed” that a benefit of their job at the POB is that it provides inspectors “learning opportunities.” Finally, 61.9% (60.7%) “agreed” or “strongly agreed” that a benefit of their job at the POB is that it is an opportunity to serve a broader set of stakeholders (investors).

There is also considerable support for the idea that working at a POB is less stressful and provides inspectors with better work-life balance than a job in the private sector. For example, 81.5% of the inspectors indicate that a benefit of working at the POB is that it provides “Good work-life balance” and 64.7% indicate that a benefit of their POB job is that it comes with “less pressure/stress than a private sector job.” Relatedly, 59.5% of the inspectors “agreed” or “strongly agreed” that a benefit of their POB job is that it has more “job security and less personal risk” than a private sector job.

We find relatively less support for the idea that inspectors view their job at the POB as helping them advance their future career prospects in the private sector. For example, 37.3% (16.1%) of the inspectors “agreed” or “strongly agreed” with the statement that a benefit of their POB job is that it improves career prospects in the private sector at audit firms (outside audit firms). Only 8.9% “agreed” or “strongly agreed” with the statement that a benefit of working at the POB is that promotions are easier at POBs than in the private sector.
Figure 9, Panel B shows that there is greater dispersion in inspectors’ perceptions regarding the disadvantages of a POB job. The only disadvantage of a POB job that a majority of inspectors perceives is that the POB job comes with few promotion opportunities. Specifically, 78.7% of the inspectors “agreed” or “strongly agreed” with the statement that a drawback of their job at the POB is that is comes with a “limited or more difficult promotion process.” Other perceived drawbacks of a POB job that some inspectors “agreed” or “strongly agreed” with are, the POB job comes with (1) interferences through governance structures (41.3% “agreed” or “strongly agreed”), (2) confrontation/conflict with auditors (38.5%), (3) poor compensation/benefits (35.5%), (4) political interferences while conducting my job (31.9%), and (5) a negative perception of working at a POB (30.2%). Overall, the survey responses in Figure 9 suggest that POB inspectors are largely motivated to work at a POB because of an intrinsic interest in auditing and better work-life balance. As such, these survey responses do not suggest that current or future monetary incentives are a primary determinant of their behavior at POBs.

6.1.2 Employee movement between audit firms and POBs

To explore further, we examine whether there is a revolving door between POBs and audit firms. In regulator settings, an oft-stated incentive for workers to seek employment with a regulator is that the regulatory experience improves one’s private-sector career prospects by enhancing expertise related to regulatory compliance and/or developing social networks within the regulatory organization, which might help extract future favors from regulators. To understand whether the incentives associated with a revolving door motivate inspectors to seek employment at a POB, we ask inspectors how easy or difficult it is for them to secure a private sector job once they decide to leave the POB, and whether inspectors perceive there to be much employee rotation between the POB and audit firms. To some degree, revolving doors are natural in any regulatory setting because regulators require industry expertise to monitor regulated entities, and regulated entities need
experience and knowledge about regulatory processes to reduce regulatory risk and compliance
costs. Thus, whether revolving doors enhance or compromise regulatory effort boils down to the
reasons why there are worker flows between regulators and the private sector, which we try to
investigate with our survey instrument.

Figure 10 shows that 63.9% (59.4%) of the survey respondents believe it is “easy” or “very
easy” for them to secure a senior manager-level position at a non-Big-4 (Big-4) audit firm when
they are ready to leave the POB. Similarly, 38.0% (27.1%) of the survey respondents believe it is
“easy” or “very easy” for them to secure a partner-level position at a non-Big-4 (Big-4) audit firm
when they are ready to leave the POB. In untabulated analyses, we condition the responses to this
question based on inspectors’ prior audit firm experience. We find that the responses to this
question are very similar for inspectors that were at a manager-level position or below and those
there at a senior manager-level or above. The only statistically and economically significant
difference in responses is that 45.2% of the inspectors who had reached a senior manager-level in
their prior experience at an audit firm indicated that it would be “easy” or “very easy” for them to
find a partner-level position at a non-Big-4 firm compared to 33.3% for inspectors whose highest
position at an audit firm was manager. These responses suggest that inspectors perceive their POB
experience as valuable to audit firms.

In Figure 11, we examine whether inspectors, in practice, observe much movement of POB
employees to-and-from audit firms. First, we find that only 8.6% of the inspectors “agreed” or
“strongly agreed” with the statement that audit firms encourage their current employees to accept
jobs at a POB with the goal of hiring them back in the future. Second, we find that 16.5% of the
inspectors “agreed” or “strongly agreed” with the statement that audit firms frequently approach
current inspection staff for possible future employment opportunities and even fewer inspectors
(11.6%) “agreed” or “strongly agreed” that POB inspectors frequently approach audit firms for
possible future employment opportunities. These responses provide little support for the idea that
inspectors seek employment at a POB to bolster their private sector auditing careers through a revolving door between POBs and audit firms.

To explore further, we devised survey questions to understand why POBs inspectors sought employment at a POB in the first place. Specifically, we ask inspectors how their experience working at the POB contributes to their long-term career goals. Figure 12 presents the results. We find that 77.8% of the inspectors indicate that their experience working at the POB will help them achieve their long-term goal of “serving the profession.” Aside from “serving the profession,” there is little consensus about any of the other long-term purposes of working at a POB, among the responding inspectors. The responses to this question also indicate that few inspectors join the POB with the goal of improving their career prospects in the private sector. For example, only 24.7% (22.4%) of the inspectors “agreed” or “strongly agreed” that their experience working at the POB will help them achieve their long-term goal of moving to a non-Big-Four (Big-Four) audit firm. Similarly, only 16.9% of the inspectors “agreed” or “strongly agreed” that their experience working at the POB will help them achieve their long-term goal of “gaining experience to earn (faster) promotions at an audit firm.” These responses suggest that POB inspectors may not seek employment at a POB with a primary goal of improving their future career prospects at audit firms. Overall, the responses to three related questions paint a consistent picture: POB inspectors do not seem motivated to work at a POB to improve career prospects at audit firms; rather, the primary motivation appears to be an interest in serving the profession and having better work-life balance.

6.1.3 Inspector evaluation and promotion criteria

Next, we ask inspectors a series of questions to understand the formal and informal incentives provided by POBs to encourage inspectors to exert effort. Specifically, we asked inspectors to indicate their level of agreement on a 5-point Likert scale (0 – 4) for the following question: “Promotions of inspectors at the POB I work at are influenced by…” and provided
statements for them to evaluate. Figure 13 presents the results. We find that the most commonly agreed upon criteria for promotions at POBs are qualitative in nature (e.g., feedback of team leader, perceptions related to emotional intelligence and work ethic, etc.) and the availability of promotion opportunities. Specifically, 75.6% of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by feedback from the inspection team leader. And 61.6% (61.2%) of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by qualitative perceptions of held by senior staff related to behavioral/emotional intelligence (work ethic) of inspectors. Finally, 72.9% of the inspectors “agreed” or “strongly agreed” that inspector promotions are influenced by the availability of promotion opportunities.

Interestingly, we find that inspectors do not agree that the number of deficiencies identified during inspections is a primary contributor to promotion prospects. For example, only 13.5% (12.8%) of the inspectors “agreed” or “strongly agreed” that promotions are influenced by the number of engagement (quality control) deficiencies detected during inspections. The evidence in surveys of auditors suggests a belief among auditor partners in the U.S. that PCAOB inspectors are rewarded for identifying deficiencies. For example, Houston and Stefaniak (2013) report that “several partners noted [in response to open-ended questions in their survey] that their PCAOB inspectors were “adversarial” and had a “gotcha psyche…trying to build their career by findings issues,”…”. Our survey responses of POB inspectors from the U.S. and other countries suggest that such is not the case (and in untabulated analyses we verify that perceptions of non-U.S. inspectors are similar to that of PCAOB inspectors with respect to this question). As such, our results can be interpreted as U.S. auditors being misinformed about POB inspector incentives (again, subject to the caveat that the inspectors in our sample are answering honestly).

We also ask inspectors if the POB they work at has a program to evaluate the quality of inspections (see Figure 14, Panel A). Survey responses reveal that 56.0% indicate that there is a formal program to evaluate inspections, 25.9% indicate that that is an informal inspection
evaluation program, 1.8% believe there are both formal and informal programs to evaluate inspections and 16.3% indicate that there is no program to evaluate inspection quality. The lack of consensus among inspectors regarding the existence of an inspection evaluation program is revealing in its own right. Specifically, if some inspectors are unaware of the existence of a program to evaluate inspections or if inspectors perceive a formal inspection program to be an informal one, it suggests that such evaluation programs are perhaps not systematic and do not have much consequence.\(^\text{15}\) Overall, the responses to the above question suggest that inspectors are not provided strong economic incentives (e.g., compensation and career progression) to exert effort and conduct thorough inspections. Going back to a response in Figure 11, we find that 47.2% of the inspectors “agreed” or “strongly agreed” with the statement that inspectors are rarely asked to leave their job due to poor performance. Similarly, the responses to the question in Figure 13 (determinants of POB promotions) suggests that inspectors are rarely promoted because they receive a competing job offer from the private sector or other government agency (with only 4.9% of the inspectors “agreeing” or “strongly agreeing” with this statement). Thus, the responses across three questions paint a uniform picture about the lack of economic/financial incentives to conduct high quality inspections. Rather, regulators seem to rely on inspectors’ innate interest in auditing and sense of service to the profession to motivate them.

Finally, we ask inspectors about the criteria used by their POB to evaluate inspection quality (conditional on the inspector responding that their POB has a formal and/or informal program to evaluate inspections). Figure 14, Panel B presents the results. The two primary methods used to evaluate inspection quality that majority of the inspectors “agreed” or “strongly agreed” with are (1) reviewing auditors’ written responses to inspection findings (63.5%) and (2)

\(^{15}\) In untabulated analyses, we verify that there is significant within-POB heterogeneity in perceptions regarding the existence and form of inspection evaluation programs. In other words, we verify that the dispersion in beliefs about the evaluation of inspection programs is not explained by cross-sectional differences across the 20 POBs in our sample.
conducting internal reviews (56.2% “agreed” or “strongly agreed”). The result that POBs evaluate inspection quality by taking into account feedback from auditors suggests that POBs do care about auditor perceptions of their inspection findings. Relatedly, an important but smaller fraction of inspectors “agreed” or “strongly agreed” with the statement that POBs evaluate inspection quality by: (1) reviewing feedback (besides the written responses) from inspected auditors about inspections (40.9%), (2) reviewing auditors’ informal response to inspection findings (37.0%) and (3) reviewing complaints from inspected auditors about inspections (28.7%). 42.6% (35.6%) of the inspectors “agreed” or “strongly agreed” that POBs evaluate inspection quality by noting instances where auditing errors resulted in companies restating financial statements (facilitated fraud), which were unidentified during inspections.

6.2. When do inspections affect auditor behavior?

Prior archival studies make different assumptions about when the effect of POB inspections manifest as changes in audit quality. Lamoreaux (2016) finds that the threat of a PCAOB inspection affects audit quality for non-U.S. companies cross-listed in the U.S. (i.e., auditors change engagement practices in anticipation of an inspection). Carson et al. (2017) find that the commencement of inspections at the country-level leads to changes in audit quality. Krishnan et al. (2017) find that audit quality proxies change once the inspection fieldwork is complete, and Gipper et al. (2017) find that ERCs increase both, after the inspection fieldwork is complete as well as after the inspection report is publicly disclosed. Finally, Aobdia and Shroff (2017), DeFond and Lennox (2017), and Shroff (2019) find that changes in auditor market share, the issuance of internal control weakness, and changes in client investment in response to PCAOB inspections occur after the disclosure of the auditors’ inspection reports.

The mechanism through which POB inspections are purported to affect auditor behavior and market outcomes (e.g., auditor market share, ERCs, client investment, etc.) is different across
different studies, and thus the effects of POB inspections on these outcome variables do not have to manifest at the same time. For example, Krishnan et al. (2017) predict audit proxies to change after the inspection fieldwork under the assumption that inspectors inform auditors about their finding at the end of their fieldwork, which leads to subsequent improvements in audit quality. Gipper et al. (2017) predict that ERCs increase when the inspection fieldwork occurs and after the disclosure of inspection reports because investors learn about POB inspections at these times. We use our survey to better understand when auditors are perceived to make changes to engagement-specific practices in response to inspection feedback. This information can help further our understanding of the mechanism through which inspections affect auditor behavior and guide future archival research in their choice of research design; specifically, when POB inspections are most likely to affect the researchers’ dependent variable of interest. To that end, we ask inspectors when they observe auditors making changes to engagement-specific practices in response to the inspectors’ feedback.

Figure 15 presents the results. 73.3% of the inspectors believe auditor change behavior immediately following the completion of inspection fieldwork; 47.9% believe that auditors change behavior only after the inspection report is disclosed to the public or the auditees’ stakeholders; 22.4% believe that auditor change behavior in anticipation of an inspection, and 19.4% believe that auditors change behavior during the inspection fieldwork.16 Thus, our survey responses suggest that archival tests are likely to be more successful in detecting the effects of POB inspections on audit quality when they examine the periods after the inspection fieldwork is complete and even more so after the inspection report is made public.

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16 The responses do not add up to a 100% because respondents could choose multiple options regarding when auditors change behavior in response to inspections.
7. Conclusions

The introduction of auditor Public Oversight Boards (POBs) to oversee the work done by auditors is perhaps one of the most significant changes in audit regulation across several countries in decades. Thus, understanding whether, how, and why auditor oversight by a public regulator serves to improve audit quality is an important question. Several recent archival studies suggest that PCAOB inspections in the U.S. help improve audit quality by replacing the peer-review approach to auditor oversight. However, there is little evidence on whether POB inspections outside the U.S. improve audit quality, and no evidence on how and why POB inspections improve audit quality relative to self-regulation. The lack of evidence regarding how and why POBs improve audit quality is likely because such questions are difficult to test using archival methods. To fill-in these gaps in the literature, we survey the inspection staff from POBs across 20 countries, representing 27% of the inspection staff at these POBs, about their perceptions regarding whether, how and why auditors respond to POB inspections. Survey data are uniquely suited to provide descriptive insight into how and why POB inspections affect audit quality because inspectors have face-to-face interactions with several auditors during the inspection fieldwork and thus, can directly observe the effect of their inspections on auditing procedures and practices over time.

We find a large majority of inspectors believe that auditors frequently respond to POB inspections by changing both audit and engagement procedures as well as audit firm culture (albeit to a lesser degree). These results are consistent with archival evidence, suggesting that PCAOB inspections improve audit quality. We then go further by asking inspectors what specific actions have they observed auditors taking in response to POB inspections/oversight. We find that more than 50% of the inspectors perceive that auditor respond to POB inspections by (1) increasing documentation, (2) conducting training, (3) increasing the amount of audit and testing efforts, (4) increasing scrutiny of management estimates, (5) modifying the audit-quality review process, (6) changing audit check lists, and (7) changing procedural manuals. Further, we find that inspectors
believe auditors, in some instances, respond to POB inspections by misbehaving and trying to
game the inspection process by tampering closed/archived audit files to “fix” them for an
inspection and/or by inappropriately obtaining confidential information related to upcoming
inspections. Such behavior occurs but not often.

In terms of **why**, the main incentive for auditors to respond to inspector feedback is that the
auditors do not want to be subject to enforcement action from the POB and do not want inspector
criticisms to be publicly disclosed. Our evidence suggests that inspectors do not necessarily believe
that they are better suited or more capable of detecting audit failures than auditors conducting peer-
reviews. Rather, the evidence suggests that it is the authority, enforcement power, and POB culture
that are the most important strengths of POB oversight both in an absolute sense and relative to
self-regulation and peer-reviews.

In responses to other questions in our survey, we find little support for the conjecture that
inspectors seek employment at POBs primarily to gain experience and earn faster promotion (or
higher future compensation) in the private sector, after their POB stint. Rather, inspectors seek
employment at a POB for greater work-life balance and because of their innate interest in auditing.
Overall, this paper contributes to the literature on auditor oversight and regulation by conducting,
for the first time, a comprehensive survey of the inspection staff of POBs.

We conclude by reiterating that there are limitations of survey data. Importantly, surveys
measure beliefs, which may not always coincide with the truth. Further, inspectors could
potentially provide explanations that they think we or their employer wants to hear, rather than
state their true beliefs. Finally, it is plausible that the responses of inspectors we could survey are
not representative of the inspectors we could not survey. We take several steps to mitigate the
above concerns but recognize that they cannot be eliminated. Despite these limitations, this paper
provides unique information about how POBs function and affect the auditing industry.
References


<table>
<thead>
<tr>
<th>Country</th>
<th>Employed by Regulator*</th>
<th>Received Survey Invite</th>
<th>Usable responses</th>
<th>Method to Select Participating Inspectors</th>
<th>Regulator Name</th>
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<td><strong>Total</strong></td>
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<td><strong>208</strong></td>
<td><strong>170</strong></td>
<td><strong>Volunteers</strong></td>
<td><strong>Public Company Accounting Oversight Board</strong></td>
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</table>

*Notes: This table presents our sample composition. * signifies that we have only an approximate estimate of number of inspectors that work at the public oversight board. Further, our survey focuses on POB employees that spend much of their time conducting inspections (but not necessarily spend a 100% of their time performing inspections).*
**Table 2**  
Characteristics of POB inspection staff

<table>
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<tr>
<th>Inspector Background</th>
<th>%</th>
<th>n</th>
<th>Inspector Background</th>
<th>%</th>
<th>n</th>
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<td><strong>Education (N=168)</strong></td>
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<td></td>
<td><strong>Experience IMMEDIATELY preceding POB employment (N=170)</strong></td>
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<td>CPA or CPA equivalent</td>
<td>79.2</td>
<td>133</td>
<td>Big-N audit firm</td>
<td>64.7</td>
<td>110</td>
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<td>Degree in Accounting</td>
<td>50.6</td>
<td>85</td>
<td>Non-Big-N audit firm</td>
<td>10.6</td>
<td>18</td>
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<td>Degree in Economics</td>
<td>16.7</td>
<td>28</td>
<td>Non-audit role in audit firm</td>
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<td>3</td>
</tr>
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<td>Degree in Law</td>
<td>1.8</td>
<td>3</td>
<td>Accounting team of company</td>
<td>4.1</td>
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<td>No Accounting Education</td>
<td>11.3</td>
<td>19</td>
<td>Internal audit team of company</td>
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<td>4</td>
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<td><strong>Age (N=169)</strong></td>
<td></td>
<td></td>
<td><strong>Experience with peer-review program (N=169)</strong></td>
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<tr>
<td>25 or younger</td>
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<td>0</td>
<td>Joined immediately after graduation</td>
<td>0.0</td>
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<tr>
<td>Between 26 and 35</td>
<td>32.5</td>
<td>55</td>
<td>Other</td>
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<td>Between 36 and 40</td>
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<td>Between 41 and 45</td>
<td>22.5</td>
<td>38</td>
<td>Conducted peer-review</td>
<td>16.0</td>
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<td>Between 46 and 55</td>
<td>22.5</td>
<td>38</td>
<td>Reviewed by peer-firm</td>
<td>17.8</td>
<td>30</td>
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<td>Older than 55</td>
<td>3.6</td>
<td>6</td>
<td>Conducted cross-reviews for GNF</td>
<td>19.5</td>
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<td><strong>Duration of employment at POB (N=170)</strong></td>
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<td>No experience</td>
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<tr>
<td>Less than one year</td>
<td>8.8</td>
<td>15</td>
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<tr>
<td>One to two years</td>
<td>24.1</td>
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<td>Conducted inspections</td>
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<tr>
<td>Three to five years</td>
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<td>35</td>
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<tr>
<td>Six to ten years</td>
<td>31.2</td>
<td>53</td>
<td>Was inspected</td>
<td>9.5</td>
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<tr>
<td>More than ten years</td>
<td>15.3</td>
<td>26</td>
<td>No experience</td>
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<td></td>
<td><strong>Highest position at audit firm</strong></td>
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<td>Audit role at Big-N firm (N=164)</td>
<td>82.9</td>
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<td>Partner (N=158)</td>
<td>7.0</td>
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<td>Non-audit role at Big-N firm (N=144)</td>
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<td>31</td>
<td>Director (N=158)</td>
<td>5.7</td>
<td>9</td>
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<tr>
<td>Audit role at non-Big-N firm (N=140)</td>
<td>40.7</td>
<td>57</td>
<td>Senior manager (N=158)</td>
<td>39.9</td>
<td>63</td>
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<td>Non-audit role at non-Big-N firm (N=132)</td>
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<td>Manager/Asst. manager (N=158)</td>
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<tr>
<td>No audit firm experience (N=170)</td>
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<td>Other (N=170)</td>
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<td><strong>No. of Big-4 inspections performed per year (N=169)</strong></td>
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<td></td>
<td><strong>No of inspections performed per year (N=170)</strong></td>
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<td>14.2</td>
<td>24</td>
<td>None</td>
<td>9.4</td>
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<td>One</td>
<td>7.1</td>
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<td>Less than five</td>
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<td>Two</td>
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<td>Five to ten</td>
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<td>14.2</td>
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<td>Four or more</td>
<td>41.4</td>
<td>70</td>
<td>More than twenty</td>
<td>9.4</td>
<td>16</td>
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**Notes:** This table presents descriptive information regarding the backgrounds of POB inspection staff.
Figure 1
Do POB inspections affect auditor behavior?

In your opinion, how frequently/infrequently do audit firms...

- Change/adjust general audit procedures for the inspected clients’ future audit engagements as a result of the feedback received during inspections? (N=165) - 78.2%
- Change/adjust their quality control systems as a result of the inspection feedback and process? (N=165) - 68.5%
- Change/adjust general audit procedures for the future audit engagements for clients that were not inspected as a result of the feedback received during inspections of other clients’ engagements? (N=165) - 60.6%
- Change culture or the “tone at the top” as a result of the inspection feedback and/or process? (N=165) - 46.1%

Notes: This figure presents the responses to the survey question “In your opinion, how frequently/infrequently do audit firms…” This question is followed by four statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Very infrequently” and a rating of 4 labeled “Very frequently.” The respondents could select a rating for each of the four statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the frequency rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 2
How do auditors respond to POB inspections?

Auditors typically respond to feedback received during inspection by…

- Increasing documentation of audit procedures (N=161) 85.7%
- Conducting firm-wide training (N=162) 82.7%
- Increasing the amount of audit and testing efforts (N=160) 64.4%
- Increasing scrutiny of management estimates (e.g., the allowance for… 64.0%
- Changing the audit quality review process (N=161) 62.1%
- Changing the audit check lists (N=159) 56.0%
- Changing the procedural manuals (N=160) 55.6%
- Removing lower quality audit partners from public company and/or… 39.4%
- Changing controls over auditor independence (N=161) 37.9%
- Changing compensation policies for engagement partners (N=161) 29.8%
- Changing materiality thresholds (N=159) 17.0%
- Changing compensation policies for engagement managers (N=162) 11.7%

Notes: This figure presents the responses to the survey question “Auditors typically respond to feedback received during inspection by…” This question is followed by twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 3
Do auditors try to ‘game’ the inspections?

In your opinion, how often do auditors...

Notes: This figure presents the responses to the survey question “In your opinion, how often do auditors…” This question is followed by the two statements: “Tamper with closed/archived audit files to “fix” the files for an inspection?” and “Inappropriately obtain confidential information about upcoming inspections?” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Never” and a rating of 4 labeled “Very Often.” The respondents could to select a rating for both statements. This figure presents the percentages of respondents that selected each number on the rating scale for both statements below the question.
Figure 4
Consequences of inspections on auditing relationships

Panel A: Do inspections affect tension in the auditor-client relationship and the relationship within audit engagement teams?

In your opinion, how do inspections by the POB you work at affect the tension in the relationships between...

- They increase tension: 54.3%
- I do not know: 31.7%
- They have no effect: 11.6%
- They decrease tension: 2.4%

Engagement Partners & Engagement Managers (N=164)  Auditors & Clients (N=166)
Panel B: Why do inspections affect tension in the auditor-client relationship?

**Figure 4 – continued**

POB inspections increase tension in the relationship between auditors and clients because inspections...

- Require audit firms to ask their clients for more information (N=72) - 79.2%
- Increase skepticism of management estimates in financial statements (N=72) - 76.4%
- Serve as an excuse for auditors to question managers and request more information (N=72) - 63.9%
- Increase audit fees (N=72) - 52.8%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Panel C: Why do inspections affect tension in the relationship within audit engagement teams?

**POB inspections increase/decrease tension in the relationship between engagement partners and engagement managers because inspections…**

- Require audit firms to ask their clients for more information (N=91) - 69.2%
- Increase skepticism of management estimates (N=91) - 62.6%
- Cause engagement partners and managers to blame each other for deficiencies identified during inspections (N=91) - 62.6%
- Serve as an excuse for auditors to question company managers (N=89) - 38.2%
- Increase audit fees (N=88) - 29.5%
- Cause changes in compensation policies (N=90) - 27.8%

Notes: Panel A in this figure presents the responses to the following two survey questions: “In your opinion, how do inspections by the public oversight body you work at affect the tension in the relationship between auditors and clients?” and “In your opinion, how do inspections by the public oversight body you work at affect the tension in the relationship between engagement partners and engagement managers?” These questions are followed by four mutually exclusive options: “They increase tension,” “They decrease tension,” “They have no effect,” and “I do not know.” The figure in panel A presents the percentages of respondents that checked each options. Panels B and C present responses to the questions “POB inspections increase tension in the relationship between auditors and clients because inspections…” and “POB inspections increase/decrease tension in the relationship between engagement partners and engagement managers because inspections…” These questions are followed by several statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the statements as well as the “Other” option. Panel B and C in this figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the questions in Panel A. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements below the questions in Panels B and C were randomized (excluding the “Other” option).
Figure 5
Inspections perceptions regarding why auditors respond to inspection feedback

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<th>Statement</th>
<th>Percentage of Inspectors Agreeing</th>
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<tr>
<td>Auditors/engagement partners do not want the inspection report to contain criticisms of their audit procedures (N=164)</td>
<td>79.9%</td>
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<tr>
<td>Auditors/engagement partners respond to inspector feedback to reduce the risk of current/future enforcement actions and/or fines (N=163)</td>
<td>74.2%</td>
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<td>Auditors/engagement partners believe that the changes suggested by inspectors improves audit quality (N=162)</td>
<td>58.6%</td>
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<tr>
<td>Auditors/engagement partners do not want to upset the inspectors (N=162)</td>
<td>26.5%</td>
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<tr>
<td>Responding to the feedback enables auditors to charge their clients a higher fee (N=162)</td>
<td>6.2%</td>
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</tbody>
</table>

Notes: This figure presents the responses to the survey question “Considering circumstances where audit firms DO respond to feedback received during inspections, to what extent to do you agree/disagree with the following statements about why audit firms respond to inspector feedback.” This question is followed by five statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the five statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 6
Inspections perceptions regarding why auditors do NOT respond to inspection feedback

To what extent do you agree/disagree with the following statements about why audit firms do not respond to inspector feedback

Audit partners believe that the deficiencies identified by the inspectors are one-off mistakes and thus do not require remediation across other engagements (N=162) 56.8%

They believe the cost of implementing the inspectors’ suggestions is too high (N=161) 46.0%

They see little benefit to them (the audit firm) from implementing the inspectors’ suggestions (N=162) 45.1%

Their “tone at the top” is to place commercial interests above the quality of their audits (N=160) 41.9%

They believe that the changes suggested by inspectors do not improve audit quality (N=160) 40.6%

Their attitude towards regulation is negative (N=161) 39.8%

Clients are unwilling to pay the incremental audit fees that would be required if the auditor were to implement the changes proposed by inspectors (N=159) 39.0%

They agree with the inspectors’ approach/feedback but believe that their clients would not like the proposed changes in audit procedures (N=159) 29.6%

They do not care about inspectors’ feedback in general (N=160) 21.3%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Notes: This figure presents the responses to the survey question “Considering circumstances where audit firms DO NOT respond to feedback received during inspections, to what extent do you agree/disagree with the following statements about why audit firms do not respond to inspector feedback.” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the nine statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 7
Comparing POB inspections and peer-reviews

Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by auditors themselves through a peer-review program:

- POBs and/or POB inspectors have greater authority than the auditors conducting peer reviews (N=159) - 79.9%
- POB inspectors typically have enforcement options available if auditors fail to comply with their rules, which makes them more effective than peer-reviewers (N=157) - 76.4%
- The culture and environment at POBs is more conducive for detecting auditing deficiencies than that at audit firms conducting peer-reviews (N=159) - 73.0%
- Peer-reviewers are more likely to have conflicts of interest than POB inspectors (e.g., because peer-reviewers will be evaluated by the same set of peers) (N=159) - 67.9%
- Auditors have weaker incentives to find audit deficiencies at peer firms than a POB inspector (N=158) - 53.2%
- POB’s approach to select audit engagements for review allows for better detection of audit deficiencies than the approach used by peer-reviewers (N=159) - 49.1%
- The scope of a typical POB inspection is broader than that of typical peer-review (N=159) - 44.7%
- POB inspectors are more likely come under political pressure than peer-reviewers (N=158) - 26.6%
- POB inspectors have relatively fewer resources to conduct a thorough inspection than peer-reviewers (N=153) - 24.5%
- POB inspectors are not as informed about the best practices in auditing relative to peer-reviewers (N=158) - 8.9%
- POB inspectors face greater conflicts of interest than peer-reviewers (e.g., because POB inspectors aspire to eventually work in the private sector) (N=158) - 6.3%
- POB inspectors are more likely be influenced by the auditors they inspect than peer-reviewers (N=157) - 4.5%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by public oversight bodies versus inspections conducted by auditors themselves through a peer-review program.” This question was preceded by the statement “Peer-reviews are a system where one auditor reviews/inspects the audit practices, procedures, and/or quality control systems of another auditor. Answer this question based on your opinion irrespective of whether your country has or had a peer-review regime.” And this question is followed by twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 8
Comparing POB inspections and reviews by professional bodies

Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by POBs vs. inspections conducted by staff from a professional organization for auditors:

- POBs and/or POB inspectors have greater authority than the professional organization inspectors (N=155) - 69.0%
- POB inspectors typically have enforcement options available if auditors fail to comply with their rules, which makes them more effective than prof. org. inspectors (N=156) - 66.7%
- The culture and environment at POBs is more conducive for detecting auditing deficiencies than that at professional organizations conducting inspections (N=155) - 58.1%
- Professional organization inspectors are more likely to have conflicts of interest than POB inspectors (e.g., because prof. org. get funding from audit firms) (N=156) - 42.3%
- The scope of a typical POB inspection is broader than that of a typical inspection conducted by professional organizations (N=156) - 42.3%
- Professional organization inspectors have weaker incentives to find audit deficiencies at audit firms than POB inspectors (N=156) - 26.9%
- Professional organization inspectors are more likely to come under political pressure than POB inspectors (N=156) - 19.2%
- POB inspectors have relatively fewer resources to conduct a thorough inspection than professional organization inspectors (N=156) - 16.7%
- POB inspectors are not as informed about the best practices in auditing relative to professional organization inspectors (N=156) - 6.4%
- A prof. organization's approach to select audit engagements for review allows for better detection of audit deficiencies than the approach used by POB inspectors (N=156) - 4.5%
- POB inspectors face greater conflicts of interest than prof. org. inspectors (e.g., because POB inspectors aspire to eventually work in the private sector) (N=157) - 4.5%
- POB inspectors are more likely be influenced by the auditors they inspect than professional organization inspectors (N=156) - 3.2%
Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the relative strengths and weaknesses of auditor inspections conducted by public oversight bodies versus inspections conducted by staff from a professional organization for auditors (e.g., the ICAEW in the UK, CICA in Canada, AICPA in the US).” This question was followed by the instruction to “Answer this question based on your opinion irrespective of whether your country has or had a regime where professional bodies conduct auditor inspections” as well as twelve statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the twelve statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 9
Advantages and disadvantages of working at a POB as an inspector

Panel A: Advantages of POB inspector job

A benefit of my job at the public oversight body is that it provides me…

- An opportunity to influence audit practice (N=169) 87.0%
- A way to satisfy my intrinsic interest in improving audit quality (N=169) 85.8%
- Good work-life balance (N=168) 81.5%
- A way to satisfy my intrinsic interest in advancing the regulator’s mission (N=168) 72.0%
- Learning opportunities (N=169) 68.0%
- An opportunity to serve a broad set of stakeholders (N=168) 61.9%
- Less pressure/stress than a private sector job (N=170) 64.7%
- An opportunity to serve investors (N=168) 60.7%
- More job security and less personal risk (N=168) 59.5%
- A sense of authority (N=168) 45.2%
- Improved career prospects in the private sector at audit firms (N=169) 37.3%
- Improved career prospects in the private sector outside of audit firms (N=168) 16.1%
- Different retirement age than that for private sector jobs (N=167) 13.8%
- An easier path to promotion than that in the private sector (N=169) 8.9%

Percentage of inspectors that "Agreed" or "Strongly agreed"
Panel B: Disadvantages of POB inspector job

A drawback of my job at the public oversight body is that it comes with…

<table>
<thead>
<tr>
<th>Disadvantage</th>
<th>Percentage of inspectors who agreed or strongly agreed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited or more difficult promotion process</td>
<td>78.7%</td>
</tr>
<tr>
<td>Interference through governance structures</td>
<td>41.3%</td>
</tr>
<tr>
<td>Confrontation/conflict with auditors</td>
<td>38.5%</td>
</tr>
<tr>
<td>Poor compensation and benefits</td>
<td>35.5%</td>
</tr>
<tr>
<td>Political interference while conducting my job</td>
<td>31.9%</td>
</tr>
<tr>
<td>A negative perception associated with working at a POB</td>
<td>30.2%</td>
</tr>
<tr>
<td>Travel requirements</td>
<td>24.6%</td>
</tr>
<tr>
<td>Performance requirements that are different from my initial expectations</td>
<td>22.5%</td>
</tr>
<tr>
<td>Uncertainty regarding POB funding</td>
<td>22.0%</td>
</tr>
</tbody>
</table>

Notes: Panel A in this figure presents the responses to the survey question “A benefit of my job at the public oversight body is that it provides me…” This question is followed by fourteen statements and an option to write-in an answer in a row labeled “Other (please describe).” Panel B in this figure presents the responses to the survey question “A drawback of my job at the public oversight body is that it comes with…” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the questions in the two panels. Note that the statements were randomized (excluding the “Other” option).
Figure 10
Inspector perceptions of the ease with which they can secure a job at an audit firm

In your opinion, how easy/difficult is it for inspectors working at a POB to find the following types of jobs when they are ready to leave their position at the POB?

- Senior manager-level position at a non-Big-Four audit firm (N=166) - 63.9%
- Senior manager-level position at a Big-Four audit firm (N=165) - 59.4%
- Middle management position at a private sector company (e.g., in internal audit function or accounting team) (N=126) - 50.0%
- Partner-level position at a non-Big-Four audit firm (N=166) - 38.0%
- Senior management position at a private sector company (e.g., in internal audit function or accounting team) (N=165) - 35.2%
- Partner-level position at a Big-Four audit firm (N=166) - 27.1%

Notes: This figure presents the responses to the survey question “In your opinion, how easy/difficult is it for inspectors working at a public oversight body to find the following types of jobs when they are ready to leave their position at the POB?” This question is followed by six statements. The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Very easy” and a rating of 4 labeled “Very difficult.” The respondents could select a rating for each of the six statements. This figure presents the percentages of respondents that gave a rating of 0 or 1 for each statement below the question. Note that we reorder the responses for presentation purposes to be in ascending order of the rating scale. On the survey instrument, however, the statements were randomized.
Figure 11
Inspector perceptions of movement of employees between POBs and audit firms

Notes: This figure presents the responses to the survey question “Please rate the extent to which you agree/disagree with the following statements about the movement of employees in and out of public oversight body.” This question is followed by five statements. The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the five statements. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized.
Figure 12
Why do inspector seek employment at POBs

My experience working at the POB will help me achieve my long-term goal of…

- Serving the profession (N=167): 77.8%
- Moving up the ranks within the POB (N=167): 30.5%
- Staying productive after retiring from the private sector (N=165): 27.3%
- Moving to a Big-Four auditing firm (N=166): 24.7%
- Moving to a non-Big Four auditing firm (N=165): 22.4%
- Securing other government jobs (N=165): 17.6%
- Gaining experience to earn (faster) promotions at an audit firm (N=166): 16.9%
- Moving to the private sector in a non-auditing role (N=167): 15.6%
- Moving into politics (N=166): 3.6%

Notes: This figure presents the responses to the survey question “My experience working at the POB will help me achieve my long-term goal of…” This question is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could select a rating for each of the nine statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
**Figure 13**

*POB promotion criteria as perceived by inspectors*

Promotions of inspectors at the POB I work at are influenced by...

- Feedback from inspection team leader (N=164) 75.6%
- The availability of promotion opportunities (N=166) 72.9%
- Qualitative perceptions held by senior staff related to behavior/emotional intelligence of inspectors (N=164) 61.6%
- Qualitative perceptions held by senior staff related to work ethic of inspectors (N=165) 61.2%
- Seniority by duration of employment at POB (N=166) 49.4%
- Feedback from other inspection team members (besides the team leader) (N=165) 46.1%
- Qualitative perceptions held by senior staff related to moral values of inspectors (N=165) 41.8%
- Conducting formal evaluations of inspections in which an inspector participates (N=165) 37.6%
- The ability of the inspector to diffuse tension with auditors during inspections (N=164) 28.7%
- Seniority by age (N=165) 23.6%
- Positive feedback from auditors about inspections (N=165) 20.0%
- The number of engagement deficiencies detected during inspections (N=163) 13.5%
- The number of quality control deficiencies detected during inspections (N=164) 12.8%
- Complaints from auditors about inspection work (N=164) 7.9%
- Receiving competing job offers from the private sector or other government agencies (N=164) 4.9%

*Percentage of inspectors that "Agreed" or "Strongly agreed"*
Notes: This figure presents the responses to the survey question “Promotions of inspectors at the public oversight body I work at are influenced by…” This question is followed by fifteen statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the fifteen statements as well as the “Other” option. This figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Panel A: Do POBs evaluate inspection quality?

**Does the POB you work at have programs to evaluate the quality of auditor inspections? (N=166)**

- Yes, there is a formal evaluation process: 56.0%
- Yes, there is an informal evaluation process: 25.9%
- No: 16.3%
- Yes, there is formal and informal evaluation process: 1.8%
Panel B: Criteria to evaluate inspections

The POB evaluates auditor inspection quality by…

- Reviewing an auditor’s written response to inspection findings (N=137) 63.5%
- Conducting internal reviews (N=137) 56.2%
- Noting instances where auditing errors resulted in companies restating financial statements, which were unidentified during inspections (N=136) 42.6%
- Reviewing feedback from inspected auditors about inspections (N=137) 40.9%
- Reviewing an auditor’s informal response to inspection findings (N=135) 37.0%
- Noting auditing errors that facilitated fraud, which were unidentified during inspections (N=135) 35.6%
- Conducting cold reviews to corroborate inspection findings (N=136) 32.4%
- Reviewing complaints from inspected auditors about inspections (N=136) 28.7%
- Obtaining feedback from other stakeholders such as company board of directors, investors, etc. (N=136) 16.2%

Notes: Panel A in this figure presents the responses to the survey question “…does the public oversight body you work at have programs to evaluate the quality of auditor inspections?” This question is followed by three options: “Yes, there is a formal evaluation process,” “Yes, there is an informal evaluation process,” and “No.” Respondents could select one or both of the “Yes…” options or the “No” option. Panel A presents the percentages of respondents that checked each options below the question. Panel B in this figure presents the responses to the survey question “The POB evaluates auditor inspection quality by…” This question appears in the online survey instrument only if the inspector responded “Yes…” to the question in Panel A. The question in Panel B is followed by nine statements and an option to write-in an answer in a row labeled “Other (please describe).” The survey provides a 5-point Likert rating scale ranging from 0 to 4 with a rating of 0 labeled “Strongly disagree” and a rating of 4 labeled “Strongly agree.” The respondents could to select a rating for each of the nine statements as well as the “Other” option. Panel B in this figure presents the percentages of respondents that gave a rating of 3 or 4 for each statement below the question. Note that we reorder the responses for presentation purposes to be in descending order of the agreement rating. On the survey instrument, however, the statements were randomized (excluding the “Other” option).
Figure 15
When do auditors respond to POB inspections?

In your opinion, when do auditors change their engagement-specific audit practices in response to the inspections? (N=165)

- Immediately after the inspection is complete: 73.3%
- After the inspection report is made available to the public or their clients’ stakeholders (e.g., the board of directors): 47.9%
- Before the actual inspection (i.e., in anticipation of the inspection): 22.4%
- During the inspection: 19.4%

Notes: This figure presents the responses to the survey question “In your opinion, when do auditors change their engagement-specific audit practices in response to the inspections?” This question is followed by four statements and an option to write-in an answer in a row labeled “Other (please describe). The respondents could check all options that apply. This figure presents the percentages of respondents that checked each statements below the question. Note that we reorder the responses for presentation purposes to be in descending order of the percentage of respondents that checked each statement. On the survey instrument, however, the statements were randomized (excluding the “Other” option).