CORPORATE LAW & GOVERNANCE

Reforming the PCAOB

A former member describes the structural defects of this largely unaccountable board.

BY C. CHRISTINA HO

In the early 2000s, the collapses of Enron and WorldCom—two corporate giants whose fraudulent accounting practices destroyed billions in shareholder value—shocked the American public and exposed serious failures in the auditing profession. Enron's auditor, Arthur Andersen, was convicted of obstruction of justice for destroying documents related to Enron, and the firm collapsed. Those scandals revealed that the accounting profession's self-regulatory system had failed to detect or prevent massive fraud.

Congress responded in 2002 with the Sarbanes–Oxley Act, creating the Public Company Accounting Oversight Board (PCAOB) to regulate the auditing of publicly traded companies. The board's job is straightforward: Ensure that auditors of public companies do their work properly so investors can trust the financial statements they read. Every year, auditors examine thousands of companies' financial records and issue opinions on whether those companies' financial statements are accurate. The PCAOB oversees these auditors by setting standards for how audits should be conducted, inspecting audit work, and disciplining companies that fall short.

Congress designed the PCAOB with an unusual structure. Unlike typical government agencies, it is a private nonprofit corporation that can tax all publicly traded companies to fund itself, giving it a virtually unlimited budget with minimal oversight. Unlike industry self-regulatory organizations, the PCAOB is not controlled by the profession it regulates. This unique structure has led to serious problems over the past two decades.

Scholars and legal experts have long critiqued these structural defects, from a 2005 analysis by American Enterprise Institute scholar Peter Wallison to the Supreme Court's 2010 ruling in *Free Enterprise Fund v. PCAOB*. This article offers something those earlier works could not: firsthand experience from inside the organization. Having served as a PCAOB board member for over four years, I have witnessed these structural problems not as theoretical concerns but as operational realities that directly undermine the PCAOB's mission to protect investors.

The governance failures, budgetary excess, standard-setting disconnects, and enforcement overreach documented here are not abstract policy critiques; they are observed patterns from someone who participated in board deliberations, reviewed hundreds of inspection reports, and saw firsthand how concentrated power and lack of accountability led to poor decision-making. This insider perspective provides a more detailed diagnosis of what is broken and, importantly, identifies specific fixes through either legislative action or administrative reforms that the Securities and Exchange Commission and the PCAOB board can implement immediately.

STRUCTURAL DEFECTS OF THE PCAOB

Under Sarbanes–Oxley, PCAOB board members were given "dual layer" tenure protection: They could only be removed by SEC commissioners, who in turn could only be removed by the US president, and in both cases removal had to be for cause. The Supreme Court ruled in *Free Enterprise Fund* that this violated the Constitution's separation of powers by hindering the president's ability to control the executive branch.

While the Court severed the unconstitutional provision and allowed the PCAOB to continue operating, the case exposed fundamental questions about the board's structure. As the Cato Institute argued in its brief supporting the challenge, the PCAOB represents an unprecedented delegation of governmental power to a private entity with the extraordinary ability to tax all public companies to support its operations. This funding mechanism frees the board from the normal constraints that control both government agencies (congressional appropriations) and self-regulatory organizations (industry funding and oversight).

Unchecked spending and mission creep / Wallison (2005) predicted that the PCAOB's unique funding structure would lead

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to runaway spending. That prediction has proven accurate. As he documented, the board was operating at twice the cost per employee of comparable regulatory bodies from its inception, spending over $500,000 per employee in 2004 compared to $200,000 for the National Association of Securities Dealers.

This pattern has continued and accelerated. The PCAOB budget ballooned by 40 percent over the past four years alone. Its 2025 budget, approved by the SEC, exceeded the 2025 budget of the Commodity Futures Trading Commission (CFTC), despite the CFTC having a much broader regulatory scope. The CFTC regulates the US derivatives market, which is worth trillions of dollars and involves tens of thousands of market participants compared to the PCAOB's oversight of approximately 1,500 audit firms. Although the PCAOB adopted a 2026 budget in December 2025 with a 9 percent decrease, that pales in comparison to the 40 percent increase between 2022 and 2025.

The PCAOB's ability to levy fees on over 8,400 public companies provides essentially unlimited funding with no meaningful oversight. Unlike government agencies subject to congressional appropriations or industry self-regulatory organizations funded by their regulated members, the PCAOB faces no natural constraint on spending. The SEC's nominal budget approval authority has proven ineffective as demonstrated by its consistent approval of the PCAOB's ballooning budgets from 2022 to 2025, as well as its approval of proposed standards and rules that lacked unanimous board support, which is unprecedented.

CEO duality problem / The PCAOB's bylaws create a dual role where the board chair also serves as the entity's president and chief executive officer. This concentration of power in one individual has resulted in:

- *weakened oversight* as the chair/CEO controls board meetings and sets agendas,
- *poor decision making* across multiple areas because of excessive authority vested in a single person, and
- inability of other board members to *effectively check* the chair's authority.

This governance structure contradicts best practices and concentrates too much power in one unelected official who is already insulated from meaningful political accountability. A 2021 report commissioned by the SEC on the corporate governance of the PCAOB noted that the board has suffered since its inception from a lack of clarity on the specific role and authority of non-chair board members (Kalorama 2021). Under the PCAOB bylaws, only the chair can call a meeting of the board, essentially giving the chair single-handed power to undermine expert voices, sow distrust in capital markets, and stifle innovation.

Ironically, CEO duality in public companies has faced persistent investor pressure because of its inherent risk of abuse. Yet the PCAOB—charged with overseeing public company auditors—operates under this very governance structure, which would not pass the litmus test for sound corporate governance if the PCAOB itself were a public company.

Standard-setting disconnected from reality / The PCAOB sets the rules that auditors must follow when examining companies' financial statements. These auditing standards determine what procedures auditors must perform, what evidence they must gather, and how they must document their work. The PCAOB's standard-setting staff, while dedicated and talented, largely lack recent public company audit experience. Of the five current board members, only two are certified public accountants with presumed public company reporting and auditing experience. This creates a critical knowledge gap, particularly regarding the use of technology in auditing.

Despite repeated requests from investors and other stakeholders for guidance on emerging technologies, the PCAOB has failed to develop technology-driven standards. For example, auditors increasingly use artificial intelligence and machine learning to analyze massive datasets, identify patterns, and detect anomalies that might indicate fraud or error. AI can review millions of transactions in minutes—something impossible for humans—and can spot unusual patterns that warrant closer examination. Yet the PCAOB has provided no substantive guidance on how auditors should use these powerful tools responsibly, what controls should be in place, or how to validate AI-generated results.

Instead, the PCAOB has focused on process and reporting requirements that impose a compliance-oriented "check-the-box" approach. This means that auditors must follow specific procedural steps and document that they did so, regardless of whether those steps actually improve audit quality. For instance, recent PCAOB standards require auditors to create extensive documentation showing they considered various risks and consulted with specialists, even when an auditor's professional judgment indicates those steps add little value for a particular audit. The emphasis is on proving compliance with prescribed procedures rather than demonstrating that the audit effectively identified material problems in the company's financial statements.

The volume of new procedural requirements was unprecedented under former PCAOB chair Erica William: Five new standards were scheduled to take effect in 2025 alone (though some were later delayed), creating implementation burdens that the PCAOB's economic analyses failed to adequately quantify. These new standards would require audit firms to overhaul their methodologies, retrain thousands of professionals, and update quality control systems, all at significant cost ultimately borne by public companies and their investors.

Inspection program inefficiencies / While the PCAOB's standard-setting function (described above) creates the rules auditors must follow, the inspection function checks whether auditors actually follow those rules. Each year, PCAOB inspectors examine a sample of completed audits—called "audit engagements"—from various firms. An audit engagement is simply the work an auditor performs in examining one company's financial statements for one year. For example, when an auditor examines Apple's 2024 financial statements, that is one audit engagement.

The PCAOB operates under a governance structure that would not pass the litmus test for sound corporate governance if the PCAOB itself were a public company.

The PCAOB's inspection approach focuses heavily on reviewing individual audit engagements rather than firms' overall systems for ensuring quality. In 2024, the PCAOB inspected 232 audit firms and 930 individual audit engagements. This labor-intensive approach may be excessive when the effectiveness of a firm's quality control system could be assessed by reviewing fewer individual audits.

The same "check-the-box" mentality that plagues standard-setting also affects inspections. PCAOB inspectors often identify deficiencies when auditors cannot show they performed specific procedures or documented their work in prescribed ways, even if the auditor reached the correct conclusion about the company's financial statements through other means. This approach has led to artificially inflated deficiency rates, even as the rate of companies restating their financial statements because of errors has declined significantly over the past decade. In other words, actual audit failures (companies having to fix their financial statements) are down, but PCAOB-identified deficiencies are up. This suggests the PCAOB is measuring compliance with procedural documentation requirements rather than whether audits effectively detect material problems.

Focus on minor infractions / Between January 2022 and March

2025, approximately 27 percent of PCAOB enforcement orders involved minor infractions such as failures to comply with reporting requirements. For example, the PCAOB has brought enforcement actions against firms for filing required forms a few days late or failing to properly update their registrations—administrative violations that pose no risk to investors. These minor cases resulted in only 6 percent of total civil money penalties.

By contrast, serious violations that should command enforcement attention include cases in which auditors failed to detect or properly investigate fraud, issued audit opinions on financial statements that were materially misstated, or lacked the independence required to objectively evaluate their clients. These are the violations that led to the Enron and WorldCom disasters. Yet PCAOB enforcement resources are diverted to pursuing administrative paperwork violations.

SEC commissioner Hester Peirce warned in 2022 that the PCAOB's enforcement approach "could devolve quickly into bringing enforcement actions for minor infractions"—a prediction that has proven accurate. The PCAOB's aggressive and at times unreasonable enforcement posture over the past four years has unfairly painted the auditing profession as dishonest and incompetent, making the profession increasingly unappealing and further exacerbating recruitment and retention of talent.

So, how to address these failures and shortcomings?

REFORM OPTION 1: LEGISLATION FOLDING PCAOB INTO THE SEC

The most comprehensive reform would be for Congress to transfer the PCAOB's duties and powers to the SEC. This approach would:

- **Restore Accountability**
  - Place audit oversight under a government agency subject to the Appointments Clause.
  - Subject regulatory authority to congressional appropriations and oversight.
  - Apply the "checks" on PCAOB programs and operations and rulemakings that apply to federal agencies, such as the Administrative Procedure Act and the Paperwork Reduction Act.
- **Improve Efficiency and Reduce Costs**
  - Eliminate duplicative administrative functions between the SEC and PCAOB.
  - Subject PCAOB functions to the same budget constraints as other SEC divisions.
  - Reduce the overall regulatory burden on public companies by streamlining oversight.
- **Enhance Expertise and Coordination**
  - Better integrate audit oversight with the SEC's broader market oversight responsibilities.
  - Improve coordination between audit regulation and other corporate disclosure requirements.
  - Leverage the SEC's existing expertise in securities regulation and enforcement.

Implementation approach / The board could initially serve as an advisory body on developing rules and standards for auditing during a transition period. Within three years, the PCAOB should be fully absorbed into the SEC, with all standard-setting complete and ongoing enforcement handled by the SEC. This would place regulatory authority where it belongs: in a government agency subject to congressional oversight and appropriations.

REFORM OPTION 2: ADMINISTRATIVE REFORMS WITHOUT LEGISLATION

If legislation is not enacted, significant improvements can still be achieved through administrative reforms by the SEC and the new PCAOB board. These reforms include:

End CEO duality / The PCAOB should amend its bylaws to separate the roles of board chair and CEO. Under this reform:

- The chair would continue to lead the board in its policy-making role.
- A new CEO/president position could be created to handle day-to-day management and administration.
- The CEO would be appointed and be removable by the full board.
- Any board member could call board meetings, not just the chair.

While this reform would add an executive salary to the PCAOB budget, this cost could be offset by the recent $1 million in salary reductions for board members and strategic staffing reductions that do not impair the investor protection mission.

Establish a public–private partnership / The PCAOB should exercise its authority under Sarbanes–Oxley to designate a professional group of accountants to formulate technology-driven and other standards for board consideration. This would require SEC approval of a PCAOB rule that:

- designates a qualified group of accountants with recent public company audit experience,
- requires the designated group to be free from conflicts of interest,
- ensures members have expertise in AI and emerging technologies used in auditing, and
- establishes procedures for the group to propose and issue new standards and amendments with a streamlined approval process

This public–private partnership would address the critical knowledge gap in technology-driven auditing and other emerging issues.

Revamp inspections / The PCAOB should shift its inspection program from examining hundreds of individual audit engagements to assessing firms' systems of quality control (QC). As PCAOB Quality Control Standard QC 1000, paragraph .05 states, an "effective QC system protects investors by facilitating the consistent preparation and issuance of informative, accurate, and independent engagement reports."

Under this approach:

- The PCAOB should determine whether a firm's quality control system is effective by reviewing audit firms' organization and operations such as governance and leadership, ethics and independence, engagement performance, and others.
- Once an effective quality control system is confirmed, the PCAOB should reduce the number of individual audits inspected for that firm.
- If a quality control system is found ineffective after limited reviews, the PCAOB should address the systemic issues rather than inspecting numerous additional engagements.
- The PCAOB should focus on root causes and system improvements rather than individual engagement deficiencies.

This would make inspections more efficient and effective from both a timeliness and staffing perspective, while reducing the burden on firms and their audit clients.

Consolidate enforcement into the SEC / The SEC should exercise its authority under Sarbanes–Oxley to fold the PCAOB's enforcement program into the SEC. This would require SEC rulemaking but would better protect investors by:

- redirecting enforcement resources from minor infractions (such as late form filings) to serious violations (such as audit failures involving fraud or material misstatements),
- applying consistent enforcement standards across all securities law violations,
- eliminating duplicative enforcement bureaucracy, and
- ensuring enforcement actions focus on conduct that poses real risks of harm to investors.

WHY REFORM IS URGENT

Regardless of the legislative outcome, PCAOB reform is necessary because the status quo is:

- **Stifling innovation:** The PCAOB's technology-averse standard-setting approach and rigid inspection methodology discourage the responsible use of AI and other technologies that could improve audit quality.
- **Instilling fear:** The aggressive enforcement posture and unreasonable focus on minor infractions paint the auditing profession as dishonest and incompetent, exacerbating talent recruitment and retention problems.
- **Creating barriers to quality:** The "check-the-box" inspection approach measures compliance by whether firms follow procedures rather than by actual audit effectiveness, as evidenced by previously reported increased deficiency rates despite declining financial restatement rates.
- **Imposing unjustified costs:** The PCAOB's unchecked spending and burdensome regulations impose costs on public companies and, ultimately, investors without corresponding improvements in audit quality.

The US capital markets cannot afford to lag on innovation. The current PCAOB structure constricts the use of technology in auditing and fails to adapt to the evolving needs of investors and the auditing profession. This neither protects investors nor improves audit quality.

CONCLUSION

The structural defects of the PCAOB have been apparent since its creation and were partially validated by the Supreme Court's 2010 decision in *Free Enterprise Fund*. The problems identified by Wallison in 2005—unchecked spending, mission creep, and lack of accountability—have only intensified. Recent experience has added new concerns about governance failures, technology aversion, inspection inefficiencies, and misplaced enforcement priorities.

Two viable paths exist for reform. Congressional action to fold the PCAOB into the SEC would provide the most comprehensive solution by restoring constitutional accountability, improving efficiency, and subjecting audit oversight to normal government administrative and oversight mechanisms. Alternatively, certain administrative reforms—ending CEO duality, establishing a public–private partnership for standard-setting, revamping inspections to focus on quality management systems, and consolidating enforcement into the SEC—can significantly improve PCAOB operations without legislative action.

Both the SEC and the new PCAOB board can implement meaningful reforms that will better protect investors, reduce unnecessary costs, encourage innovation, and restore confidence in the audit oversight system. The question is not whether reform is needed, but whether policymakers will act before the structural defects cause further damage to the auditing profession and the capital markets. R

READINGS

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