Audit Regulation – The Necessary Oversight vs. the Risks of Overreach

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Abstract: This paper examines the development and effects of audit oversight from self-regulation to independent public oversight models. The paper aims to assess whether strengthened regulatory frameworks improve audit quality or risk excessive regulatory intervention. The study is based on a comparative analysis of the US and the EU oversight models before and after the introduction of public oversight, a review of prior empirical literature, and an examination of inspection findings. The findings indicate that public oversight has enhanced accountability and certain aspects of audit quality. However, the results also suggest that intensified oversight alone does not ensure higher audit quality and may increase compliance pressures. Finally, the paper concludes that effective audit oversight requires an ongoing, balanced approach that safeguards the public interest without compromising professional judgment or the value of the audit profession.

Key Words: audit oversight, audit regulation, audit quality

1. INTRODUCTION

Historical evidence demonstrates that the market values auditing independently of legal mandates (Wallace, 1980). However, today, auditing operates within a highly regulated environment, where both the demand for audits and the manner in which audits are performed are shaped by an extensive set of rules and oversight mechanisms. A series of high-profile accounting and auditing failures at the beginning of the 21st century prompted legislators and regulators to introduce stricter requirements to strengthen audit quality and restore public trust. One of the most notable examples is the Sarbanes–Oxley Act (SOX) in the United States (US), which fundamentally reshaped audit oversight. Similarly, the European Union's (EU) 2006 and 2014 audit reforms (Directive 2006/43/EC, Directive 2014/56/EU, Regulation 537/2014) represent another major stream of audit oversight enhancements. Over the past decade, this regulatory landscape has expanded significantly worldwide, moving auditing from self-regulation and non-public oversight to extensive public oversight models (Zaman Groff and Hočevar, 2009; Löhlein, 2016; Elshandidy et al., 2021; Gisbert et al., 2025; Carson et al., 2026). Globalization and the growing integration of financial markets accelerated this development, with many jurisdictions closely following the public oversight model first introduced in the US (Carson et al., 2026).

However, audit scandals persisted despite stringent regulations (e.g., Lehman Brothers in 2008 post-SOX and Wirecard in 2020 after the EU's 2014 audit reforms), indicating that auditors may still fail to deliver adequate audit quality and/or regulators may lack resources or independence to intervene effectively. Moreover, a recent proposal to dissolve the Public Company Accounting Oversight Board (PCAOB) in the US and transfer its responsibilities to the Securities and Exchange Commission (SEC) has prompted renewed reflection on the adequacy of current oversight structures and practices (Harris et al., 2025; Barr-Pulliam et al., 2025). While regulatory intervention aims to strengthen accountability, critics warn that the politicization of auditing regulation and overly rigid regulation may turn auditing into a purely compliance-based exercise, ultimately undermining the delicate professional judgment that is essential for detecting complex risks in modern business environments (Glover et al. 2009; Dowling et al., 2018). As a result, the search for an ideal type of oversight systems remains ongoing, raising the critical question: where is the boundary between effective oversight and excessive regulatory intervention?

The goal of this research is to examine whether enhanced regulatory frameworks have led to improved audit quality. Methodologically, this paper investigates the evolution of US and EU audit oversight models, drawing upon empirical findings and comparative analysis of inspection results. A comparison of regulatory models, their evolution, and related empirical findings is valuable for understanding challenges of different oversight models and assessing whether and how oversight can be balanced against the risk of overreach, particularly in efforts to standardize or harmonize auditing standards and practices within an increasingly globalized economy.

2. FROM NON-PUBLIC TO PUBLIC OVERSIGHT MODELS

In the US, before the introduction of the Sarbanes–Oxley Act in 2002, as well as in Europe before the 2006 regulatory reforms, the audit profession operated largely under a system of self-regulation (Zaman Groff and Hočevar, 2009; García Osma et al., 2017; Elshandidy et al., 2021; Gisbert et al., 2025). Self-regulation means that the profession is internally governed, standards are set by national boards influenced by auditors, and oversight is handled by professional bodies. This model rests on the idea that both audit firms and their professional bodies must safeguard their reputation to remain viable (Arruñada, 1999). In this system, quality control relied on peer review or internal professional mechanisms rather than on an external regulator.

In the EU, several oversight models coexisted alongside self-regulation before public oversight was introduced in 2006. These included systems with well-established governmental public oversight that adopted new audit regulations to update oversight bodies' responsibilities, as well as models featuring either mixed public-professional structures or unclearly defined systems (García Osma et al., 2017). Table 1 outlines the main oversight models before the audit reforms and the establishment of independent public oversight.

Table 1: Main oversight models prior to the introduction of public oversight

Oversight model pre-POB	Description	Country Examples	Notes on Inspection / Quality Control Mechanisms
Self-regulation by the auditing profession	Audit oversight was carried out by professional bodies; quality control relied on peer review or internal professional mechanisms rather than an external regulator.	US, Australia, Denmark, France, Ireland, the Netherlands, the UK	Peer review systems were common (e.g., professional associations run inspection programs). These systems often provided some monitoring but lacked independent enforcement authority.
Government oversight	Audit oversight was carried out directly by a state agency rather than the profession.	Finland	The state typically sets licensing, registration, and inspection requirements.
Mixed system (shared oversight between profession and government)	Oversight responsibilities were divided between professional bodies and public authorities.	Germany, Italy, Spain	Mixed systems sometimes included professional self-inspection plus government approval or review of findings.
No oversight system before public oversight	No formal audit oversight or inspection system existed before reforms introduced a POB.	Austria	Absence of peer review or regulatory inspection meant little structured quality control.

Source: The table is based on García Osma et al. (2017), Carson et al. (2026).

While self-regulation balances between protecting the public interest and defending the profession, its power ultimately depends on sustaining public trust, or at least avoiding strong public pressure for an alternative model. However, the EU's shift to an independent public oversight model for auditing was driven not only by audit failures and corporate scandals but also by the need to harmonize oversight mechanisms across member states (García Osma et al., 2017; Gisbert et al., 2025). The harmonization gained further reach through the amended audit Directive (2014/56/EU) and Regulation (537/2014), which expanded oversight bodies' inspection and sanctioning powers while clarifying specific requirements for statutory auditors and audit firms of Public-Interest Entities (PIEs). However, the audit oversight market in the EU is still fragmented, undermining the performance of oversight bodies (Gisbert et al., 2025).

Oversight activities generally include the registration of statutory auditors and audit firms, the development of standards, inspections, and enforcement actions (Abernathy et al., 2013; Gisbert et al., 2025). Oversight models differ in how these functions are delegated to professional bodies or exercised by independent regulators, and in their application to private vs. public company audits (US) or non-PIE vs. PIE audits (EU). Also, the US follows a centralized model via the PCAOB for public companies, while the EU utilizes a decentralized approach through national regulators and the Committee of European Auditing Oversight Bodies (CEAOB). In the EU, audit oversight coordination began with the European Group of Auditing Oversight Bodies (EGAOB) in 2006, which was replaced by the CEAOB in 2016 to strengthen EU-wide supervision. Still, one of the major criticisms of the current audit oversight model in the EU is that the EU needs stronger, harmonized oversight. Currently,

no single EU-wide authority exists, national norms vary, and the CEAOB coordinates without enforcement power. It is also suggested that new reforms could expand the European Securities and Markets Authority (ESMA) mandate or give CEAOB direct enforcement to ensure consistent quality across Member States. Table 2 briefly compares US and EU oversight models following the introduction of independent public oversight.

Table 2: Public oversight models in the US and EU

Key Activity	**US** **Non-public audits**	**US** **Public audits**	**EU** **Non-PIE audits**	**EU** **PIE audits**
Primary Oversight Body	AICPA (self-regulation) via peer review programs	PCAOB (under SEC supervision)	NCAs* though some tasks may be delegated to professional bodies	NCAs*, coordinated by CEAOB
Registration/ Approval	Extensive delegation to State Boards (profession not licensing)	None delegated - PCAOB registration required	Partial to extensive delegation permitted	None/very limited; competent authority retains
Education	Extensive delegation	Partial, SEC/PCAOB oversight only	Partial to extensive delegation allowed	Partial authority; oversees conditions.
Standard-setting	AICPA (ASB) sets standards	PCAOB sets standards	Primarily based on ISA	Primarily based on ISA
Quality assurance	AICPA Peer Review - extensive delegation	PCAOB inspections; none delegated	Partial to extensive delegation	None delegated for PIE
Inspection	Peer reviewers - extensive delegation	PCAOB conducts inspections	Partial delegation under authority	None delegated
Inspection Frequency	Every 3 years	Annual if >100 issuers; Triennial if ≤100 issuers	At least every 6 years for non-PIE auditors	At least every 3 years for auditors of PIEs
Enforcement	Shared: State Boards + AICPA discipline	PCAOB+SEC enforce; none delegated	Partial delegation possible	None delegated

Source: Authors' own work based on Accountancy Europe Reports (https://accountancyeurope.eu/publications/public-audit-oversight/); Carson et al. (2024); Gisbert et al. (2025).

Abbreviations: AICPA- American Institute of Certified Public Accountants, ASB – Accounting Standards Board; PCAOB - Public Company Accounting Oversight Board, SEC- Securities and Exchange Commission; NCA - National Competent Authority, CEAOB - Committee of European Auditing Oversight Bodies, ISA – International Standards on Auditing, PIE – Public Interest Companies.

* Across Europe, the organisation of audit oversight varies considerably. In some countries, audit oversight is carried out by an autonomous public authority dedicated exclusively to supervising statutory auditors and audit firms. In others, responsibility lies with a government ministry (most often the Ministry of Finance). A third group of countries assigns audit oversight to a broader financial or market supervisory authority that also regulates other sectors.

Table 2 shows that US oversight is characterized by centralization, regulatory uniformity, and strict separation from the profession, whereas the EU model emphasizes multilevel governance, harmonization rather than uniformity, and proportional regulation. However, there are considerable national differences in organizational status and funding sources across NCAs. The US framework draws a sharp line between public and private company audits, with only the former subject to federal oversight. The EU, in contrast, extends statutory oversight to all statutory audits but applies stricter requirements to PIEs, thereby embedding differentiation within a single regulatory architecture. These structural differences not only shape inspection practices and enforcement intensity but also affect broader dynamics such as the consistency of audit standards, the degree of public-interest protection, and the balance between regulatory control and professional autonomy.

While the PCAOB oversight is cohesive, there are major differences across EU Member States in how audit oversight bodies conduct inspections, collect data, and impose sanctions. Inspection methodologies vary in

scope, depth, frequency, and risk orientation. Some NCAs follow a rules-based approach focused on detailed compliance, while others take a principles-based approach that considers professional judgment and context (Accountancy Europe, 2025). Report-finalization practices also differ, particularly in how much auditor feedback is allowed and incorporated. Sanctioning approaches likewise vary. Some authorities emphasize corrective, educational measures, while others rely more heavily on punitive penalties or public reprimands. These national models reflect differing legal and institutional frameworks rather than a need for a single EU approach. Transparency also varies significantly. Some countries publish firm-level inspection results, including for PIE audits, while others release only aggregated national findings, and publication may be limited to national languages (Accountancy Europe, 2025; Gisbert et al., 2025).

3. KEY INSIGHTS FROM LITERATURE

The effect of public audit oversight and inspection activities on audit quality has been extensively researched over the last two decades, mostly in the US under the PCAOB. Although findings are mixed, studies consistently show that the establishment of independent oversight bodies and their inspection activities have, at least partially, improved audit quality (e.g., DeFond and Lennox, 2017; Krishnan, Krishnan, and Song, 2017; Acito et al., 2018; Gipper et al., 2020; Shroff, 2020; Christensen et al., 2022; Lamoreaux, 2023; Constance et al., 2025; Mnif and Bouassida, 2026). For example, Carson et al.'s (2026) study examines the effect of multiple public oversight bodies on audit quality using a large international sample (including the US) over 20 years using a difference-in-differences research approach. They document that the creation of public oversight bodies and their characteristics are associated with improvements in selected audit quality measures. However, the magnitude and consistency of these improvements depend heavily on research design features and the proxies used for audit quality.

This sensitivity reflects a broader challenge in audit oversight research. Namely, audit quality is not directly observable (DeFond and Zhang 2014; Francis, 2024), so causal inferences about the effects of oversight on audit quality using imperfect proxies remain ambiguous. Moreover, regulatory trajectories are shaped by complex and interrelated dynamics, such as technological advancements, funding constraints, institutional capacity, evolving rules, and political shifts (Hermanson et al., 2025; Palmer, 2025), making it extremely difficult to isolate the causal impact of regulation itself.

Hanlon and Shroff (2022), drawing on a large-scale survey of 170 inspectors from 20 countries, find that public oversight boards prompt auditors to enhance quality control and documentation. The authors documented that a vast majority of inspectors believe that auditors frequently adjust their procedures as well as the audit firm culture as a result of the inspections. Inspectors are perceived as having greater authority than peer reviewers, making them more effective in enhancing audit processes and quality.

However, a key criticism of current oversight regimes is the heightened pressure they create, which can diminish the appeal of auditing careers. Auditors often view regulation as a source of stress, distrust, and antagonism (Johnson et al., 2014; Hermanson et al., 2016). Heightened regulatory requirements also raise compliance costs that disproportionately burden smaller audit firms, while restrictions on non-audit services may limit beneficial knowledge spillovers between audit and advisory work, potentially undermining audit efficiency and effectiveness. Moreover, concerns about overregulation manifesting in a “check-the-box” compliance culture, reduced professional judgment, and declining attractiveness of the auditing profession suggest structural tensions between regulatory ambitions and practical realities (Westermann et al., 2019; Harris et al., 2025). While early studies such as Glover, Prawitt, and Taylor (2009) focus on the behavioral and practical consequences of public audit inspections, highlighting concerns around documentation-driven audits and inspector expertise, later work (e.g., Dowling et al., 2018) provides a broader institutional explanation. For example, Dowling et al. (2018) argue that these outcomes are not merely unintended side effects but stem from oversight bodies’ need to legitimize their authority, which systematically promotes bureaucratization and compliance-oriented audit practices. Together, these studies suggest that audit oversight reshapes not only audit procedures but also the nature of professional judgment and autonomy. Francis (2025), analyzing broader regulatory dynamics, emphasizes the inherent trade-off between societal demands for high audit quality and the economic realities of audit production. He explains the rationale for audit regulation and its resulting frictions, pointing to market failures from positive externalities in audit quality. High-quality audits benefit the wider economy (e.g., by enhancing investor confidence and market stability), yet firms alone underprovide them without regulation, as they won't fully bear the societal costs.

Overall, the literature reveals a complex interplay between regulatory oversight and overreach. Public audit oversight improves audit quality but creates trade-offs like higher costs, "check-the-box" compliance, reduced judgment, and career stress. The regulators must carefully balance these tensions to avoid undermining public oversight's core goals.

4. KEY INSPECTION FINDINGS AND EMERGING TRENDS

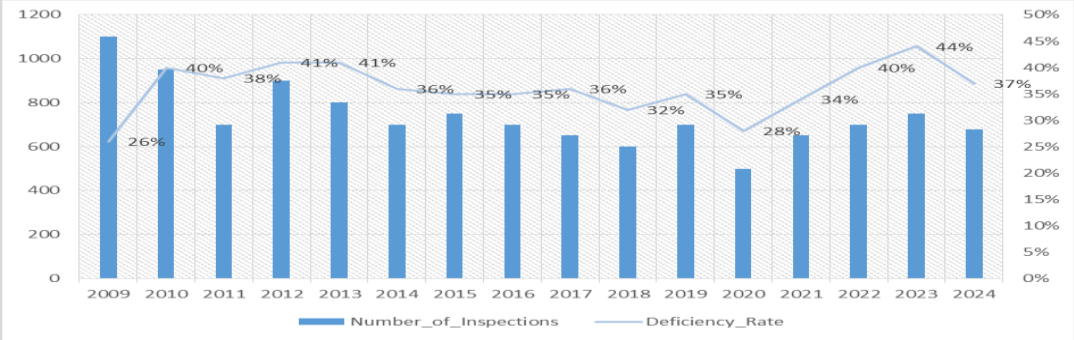
While public oversight bodies perform multiple activities (see Table 2), their most critical activity connected with audit quality is external quality control through inspections. This section examines key inspection findings from EU National Competent Authorities (NCAs) regarding PIE auditors, PCAOB reports on public company auditors, and the global inspection surveys conducted by IFIAR.

While inspection data offers valuable insights into audit quality, it does not serve as a direct measure of audit quality. For example, Constance et al. (2025) show that PCAOB-identified deficiencies predict future misstatements across an audit firm's entire portfolio (i.e., both inspected and uninspected engagements). Specifically, an auditor's failure to understand a client's accounting procedures is the most damaging factor for reporting quality. Still, such measures remain imperfect proxies because they are often lagging and noisy, as they may reflect documentation shortcomings or differences in professional judgment rather than underlying audit quality. Inspections typically focus on procedural adherence to standards, which does not suggest that there are undetected material misstatements in the financial report. In contrast, audit quality measures typically focus on whether an auditor has correctly identified and reported material misstatements in financial statements (Knechel and Ghandar, 2021). Moreover, the selective nature of inspections limits their interpretive power (Aobdia et al., 2025). As a result, while inspection outcomes are informative, they should be viewed as one component of a broader assessment of regulatory impact rather than a definitive measure of audit quality.

The results of inspection findings reported by CEAOB and submitted by Member State authorities for the 2019 to 2021 period demonstrate that NCAs reviewed 737 PIE audit files, yielding an average of 2.6 findings per file. Additionally, firm-wide procedures were conducted on 361 audit firms and sole practitioners auditing PIEs, leading to an average of 3.5 findings per audit firm. Compared to the prior findings, which were predominantly related to deficiencies within audit firms' internal quality control systems, recent findings indicate that the majority of deficiencies are now identified within the PIE audit engagement files, demonstrating insufficient audit procedures performed and/or evidence obtained (European Commission, 2024). Approximately two-thirds of NCAs reported that their recommendations to implement mitigation measures and remedies for addressing these deficiencies had been satisfactorily executed. In five instances, NCAs engaged in discussions with regulatory colleges and within the CEAOB Inspections Subgroup regarding whether specific shortcomings, primarily related to the overall quality of audit firms' internal control systems, should be classified as systemic risks. However, the outcome of these discussions was negative (European Commission, 2024).

In contrast to CAEOB inspection data, which spans a short trend and stems from heterogeneous institutional and oversight frameworks, the PCAOB inspection data offers a longer trend and is more informative. Figure 1 provides PCAOB inspection data deficiency trend (Type 1.A deficiency rate - failed to obtain sufficient appropriate audit evidence).

Figure 1: PCAOB Inspections Deficiency Rate Trend



Source: Authors' own work based on PCAOB data (https://pcaobus.org/oversight/inspections/firm-inspection-reports) and Palmer (2025).

The figure illustrates the trajectory of Type 1.A audit deficiency rates over 16 years, showing a marked rise from the post-COVID low of 28% in 2020 to 44% in 2023. Post-COVID inspections show a rapid rise from 28% (2020) to 40–44% (2022–2023). Although preliminary indications suggest a potential reversal beginning in 2024, the recent three-year increase of 8 percentage points remains substantial relative to the long-term mean deficiency rate of 36% (SD = 4.77). Notably, the 28% rate in 2020 represents the second-lowest point in the entire series, surpassed only by the initial 2009 value. Taken together, the data reveal a distinctly non-monotonic pattern, with no evidence of a sustained downward trend in deficiency rates over time. However, the changes in deviation rate may also reflect changes in inspection scope and philosophy, implying that methodology (not only audit quality) shapes observed deficiency patterns.

Finally, we analyze inspection data from the International Forum of Independent Audit Regulators (IFIAR) global survey. The IFIAR was established in 2006 and unites regulators from 52 jurisdictions. It promotes audit quality through knowledge sharing, inspection coordination, and comparative surveys. Table 3 presents the IFIAR five-year data on inspection findings.

Table 3: IFIAR Inspection data trends

	2020	2021	2022	2023	2024
Panel A: Audit Insepction Findings					
Member Firms Inspected	131	128	152	159	135
Listed PIE Audits Inspected	898	893	905	886	763
Listed PIE Finding Rate (at least one finding)	301	267	234	282	275
Listed PIE Finding Rate	34%	30%	26%	32%	36%
Number of SIFI* audits inspected	14	12	13	21	7
SIFI Finding Rate	52%	43%	33%	46%	32%
Panel B: Insepction Theme					
Internal Control Testing	173	203	150	206	221
Accounting Estimates, including Fair Value Measurement	190	158	147	149	131
Adequacy of Financial Statement Presentation and Disclosure	95	71	95	75	81
Audit Sampling	48	43	60	58	71
Revenue Recognition	96	78	71	58	66
Audit Report	28	47	52	54	62
Risk Assessment	36	37	33	39	49
Group Audits	50	22	37	37	29
Use of Experts and Specialists	19	19	25	33	25
Audit Committee Communications	31	30	28	31	22
Substantive Analytical Procedures	15	23	26	30	20
Fraud Procedures	18	19	19	30	20
Inventory Procedures	21	16	13	19	16
Adequacy of Review and Supervision	30	19	24	18	13
Related Party Transactions	18	11	12	14	12
Engagement Quality Control Review	15	7	18	13	7
Going Concern	8	14	22	8	3
Total findings	891	817	832	872	848

Source: Authors' own work based on IFIAR Survey of Inspection Findings (2025). IFIAR Members submitting inspection findings n=42. *SIFI-Systemically Important Financial Institutions.

The IFAIR data also demonstrate non-monotonic deficiency patterns, with the Listed PIE finding rate falling from 34% (2020) to 26% (2022) before rising again to 36% (2024). This rebound is consistent with global volatility rather than linear improvement. SIFI audits show even higher and more variable deficiency rates (33–52%), reflecting persistent challenges in high-risk, systemically important audits. Thematically, findings remain concentrated in internal controls, accounting estimates, disclosures, sampling, and revenue recognition, reaffirming long-observed structural weaknesses in complex audit areas.

Aggregate data from IFIAR, CEAOB, and the PCAOB suggests that intensifying oversight does not yield a proportionate increase in audit quality. Rather, the findings indicate that 'audit quality' remains a moving target, as inspection priorities continually shift across areas such as substantive testing, risk assessment, and internal controls. In this context, Knechel and Ghandar (2021) emphasize that inspection findings may generate counterproductive feedback loops. Regulators may tighten standards in response to recurring findings, even when findings result from random errors or judgment differences rather than systemic deficiencies. This can expand compliance burdens, increase audit costs, and potentially shift emphasis away from audit risk and professional judgment toward procedural box ticking.

5. CONCLUSION

This paper examined the evolution, effectiveness, and tensions surrounding contemporary audit oversight, drawing on regulatory developments, inspection trends, and academic literature from the US, the EU, and global oversight bodies. Across jurisdictions, the introduction of independent public oversight fundamentally reshaped the audit environment, replacing long-standing self-regulation with statutory supervision designed to strengthen accountability, enhance audit quality, and restore public trust following major corporate failures.

The evidence reviewed demonstrates that reforms such as the U.S. Sarbanes–Oxley Act and the EU's 2006 and 2014 audit reforms have yielded important improvements in audit quality. However, the relationship between oversight intensity and audit outcomes remains ambigous. Inspection data from PCAOB, CEAOB, and IFIAR show fluctuating deficiency rates over time, reflecting methodological shifts, selective sampling, and persistent execution challenges rather than continuous quality improvements. This reinforces a central theme in the literature: audit quality is inherently difficult to measure, and regulatory indicators often capture procedural compliance rather than the substantive assurance valued by financial statement users.

Overall, the findings point to a global audit oversight system that is indispensable yet imperfect. Regulation plays a necessary role in correcting market failures and aligning audit quality with societal expectations, but its effectiveness depends on balancing prescriptive requirements with flexible, risk-based, and outcome-oriented approaches. Future reforms must therefore navigate this equilibrium carefully. Strengthening public oversight should not come at the cost of diminishing professional autonomy, innovation, or market competition. As technological, economic, and institutional environments continue to evolve, oversight models must adapt accordingly, pursuing audit quality not as compliance with detailed procedures, but as the delivery of reliable, decision-useful assurance that supports capital markets and public confidence.

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