

July 2, 2024

By email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SECURITIES AND EXCHANGE COMMISSION [Release No. 34-100277; File No. PCAOB-2024-02] Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on A Firm's System of Quality Control and Related Amendments to PCAOB Standards

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of US public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by US public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, US public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of US public company auditors and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the final standard (Final Standard or Adopting Release) adopted by the Public Company Accounting Oversight Board (PCAOB or the Board) on May 13, 2024 (File No. PCAOB 2024 – 02) and filed with the Securities and Exchange Commission (SEC or Commission) on May 24, 2024, in Release No. 34-100277.

As we have consistently stated – including in encouraging the Board to move forward expeditiously with updating the US quality control standard to, in part, bring it up to date with the international standard – we believe that a firm's quality control system is foundational to audit quality and that an effective quality control system is important to strengthening auditing practices and continuously improving audit quality. We also support the Board's efforts to modernize existing auditing standards, and in particular quality control standards. We have supported this effort since responding to the PCAOB's Concept Release on QC 1000 dated December 17, 2019, and Proposed Standard dated November 18, 2022.¹ Unfortunately, we have specific concerns and questions about the Final Standard, particularly the new External Quality Control Function (EQCF), that we believe requires further consideration by the PCAOB before a final quality

¹ In addition to supporting the PCAOB's efforts to update its quality control standard, we supported the IAASB's efforts, including our July 1, 2019, comment letter to the IAASB on its updated quality control standard and our efforts to support firms' implementation of the international requirements.



CENTER FOR AUDIT QUALITY
555 13th Street NW, Ste 425 E
Washington, DC 20004

(202) 609-8120
www.thecaq.org



control standard can be approved by the SEC. Our comment letter focuses specifically on our concerns related to this new EQCF requirement.

It is our understanding that the Commission shall approve a PCAOB proposed rule if it finds that the rule is:

1. Consistent with the requirements of the Sarbanes-Oxley Act (SOX) and the securities laws; or
2. Necessary or appropriate in the public interest or for the protection of investors.²

Given our concerns related to the new EQCF requirement, as described further below, we believe that the Final Standard fails to satisfy these criteria. While we are supportive of a modernized quality control standard, we do not believe it is appropriate for the SEC to approve the Final Standard until the PCAOB has revised the standard to eliminate the concerns described in this letter, including obtaining additional public input and conducting further analysis. We write this letter very reluctantly and after careful thought and consideration, as we are enthusiastic for a modernized quality control standard to move forward. With certain key modifications, we believe an effective and balanced quality control standard can be achieved.

The CAQ has a unique perch in the financial reporting ecosystem. We witness day in and day out the profession's commitment to high quality audits and the professional standards and rules that underpin the consistent delivery of high-quality audits. Over the last eight years, we have had the privilege of convening our membership to support 16 comment letter responses to the PCAOB. In that same time, we have also worked with our member firms to support the implementation of five final PCAOB rules and related standards. It is through these efforts we have observed leaders from our member firms carefully consider the questions and concerns they are facing with respect to a proposed or final standard. At the heart of their questions and concerns is a desire to help auditors "do the right thing" to best support the profession in executing high quality audits. If we thought the questions and concerns described in this letter could be addressed solely through implementation, we would not be raising them in this comment letter to the SEC.

The Final Standard Introduces a New Requirement that Was Never Exposed and Is Inconsistent with SOX and the Securities Laws

Our primary concern related to the EQCF requirement is that it was not exposed for public comment, and, as a result, stakeholders did not have the opportunity to provide input or pose clarifying questions that would have ultimately strengthened and clarified the requirement to be included in the Final Standard.

² 15 U.S.C. § 7217(b)(3).



We believe that due process, particularly the opportunity for stakeholders to provide input on the requirements of a proposed standard prior to finalization, is essential to developing high quality and practical auditing standards. As Chair Williams stated at PCAOB Forum for Auditors of Small Businesses and Broker-Dealers in Chicago, “Once we’ve proposed a new or amended standard or rule, we look for more perspective through the public comment process... This input is incredibly valuable for us, and it shows up in our rules and standards.”³ We fully agree with this sentiment but unfortunately, the EQCF requirement in the Final Standard did not benefit from the public comment process.

Based on the proposal, stakeholders could not have anticipated that the EQCF was an alternative to the proposed requirement that the PCAOB was considering. The proposal required that a firm have an independent oversight function for the *audit practice* that would be in a position to exercise independent judgment with regard to *quality control matters*. The proposal further indicated that the requirements “would not specify how the firm would establish its governance structure or assign authority.”⁴

The scope of the independent oversight function in the Final Standard was changed significantly, requiring the EQCF to have responsibilities for *evaluating the judgments made and the related conclusions* reached by the firm when *evaluating and reporting on the effectiveness of its quality control system*. This is contrary to what was included in the proposal which was intended to provide firms with flexibility to establish their own governance structures.

Had this requirement been exposed for public comment, or had we been able to anticipate the direction the PCAOB would take in the Final Standard, we would have raised concerns and questions that were not mentioned in our comment letter to the PCAOB in response to the proposal. For example, in order for the EQCF to have sufficient information to evaluate the firm’s conclusions about the effectiveness of its quality control system, firms will likely need to share with the EQCF nonpublic quality control criticism(s) included by statute in the nonpublic Part II of the PCAOB inspection reports, including the related analysis by the firm of the nature and severity of such matters. While the Final Standard does not specifically require firms to share such information, it is unclear how the EQCF could have sufficient information to evaluate the firm’s significant judgments and conclusions about the effectiveness of its system of quality control without it.⁵ This raises a question as to whether creating an oversight function that would compel firms to provide such information to an external party⁶ would be inconsistent with SOX and the related

³ [PCAOB Chair Williams Remarks at PCAOB Forum for Auditors of Small Businesses and Broker-Dealers in Chicago | PCAOB \(pcaobus.org\)](#)

⁴ [QC Proposal November 17 2022 - FINAL \(pcaobus.org\)](#) page 98.

⁵ Moreover, it is not clear as to how the PCAOB inspections division would view this matter without sufficient guidance from the PCAOB as part of its standard setting and comment process.

⁶ The Final Standard is clear that the EQCF should be fully external and independent of the firm.



Congressional intent, which was clear the quality control criticisms are to remain nonpublic (unless they are not sufficiently addressed within 12 months). It appears that the EQCF requirement may undermine the privilege that such information is afforded by SOX. We do not believe that this matter, and the PCAOB's authority to compel such disclosure, have been sufficiently evaluated in the Adopting Release and need to be given further consideration before the SEC considers approving the Final Standard.

In addition, we have further questions and concerns regarding:

1. The documentation requirements to demonstrate the EQCF's evaluation of the firm's conclusions.
2. The extent of information the EQCF would need to be provided to enable them to satisfy their oversight requirements.
3. The liability for those serving in the EQCF role, which could cause those who are otherwise qualified to be unwilling to perform this role, and other matters which we are still in the process of evaluating.

The lack of public comment on the EQCF requirement leaves many important questions unanswered and without appropriate consideration in the Adopting Release. We believe that the matters identified above, and others that may be posed by other stakeholders, need to be evaluated and remedied before the SEC considers approving the Final Standard. As such, we encourage the SEC to direct the PCAOB to re-propose a standard that addresses the concerns noted above, with further exposure of the proposed changes and dialogue to enable a clear understanding of what is expected and promote successful implementation of this important standard. As noted above, we do not believe that these substantial open questions can be addressed via implementation guidance, particularly the need for third parties to serve in the EQCF roles and the need for regulatory Board-level certainty in these matters.

Engagement and Dialogue Needed for Successful Implementation

In addition to the above, successful implementation of an updated final standard (that has remedied the issues described above) is extremely important. We have found that being able to engage with the Board after a standard is final but before it is effective is helpful for successful implementation. We have greatly appreciated the PCAOB's willingness in the past to work with the members of the profession, including meeting with CAQ task forces, as doing so allows for an ongoing dialogue on implementation. This dialogue has been instrumental in permitting the profession to share specific feedback on various implementation issues and questions and enabling the PCAOB staff to provide helpful clarification through guidance about the intent of the standards after they were finalized and before the effective date. We urge the Board to continue such engagement after the SEC has approved an updated final quality control standard to support consistent successful implementation across firms and in conjunction with the international quality control standard, which was implemented effective December 15, 2022. This will ultimately promote audit quality and investor protection.



The CAQ appreciates the opportunity to comment on the Final Standard, we look forward to future engagement and we encourage the Commission and PCAOB Board to proactively seek out engagement with auditors, audit committee members and investors on these topics. As the Commission continues to gather feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Dennis McGowan (dmcgowan@thecaq.org), Vanessa Teitelbaum (vteitelbaum@thecaq.org), or Erin Cromwell (ecromwell@thecaq.org).

Sincerely,

A handwritten signature in black ink that reads "Dennis J. McGowan".

Dennis McGowan, CPA
Vice President, Professional Practice
Center for Audit Quality

cc:

PCAOB

Erica Y. Williams, Chair
George R. Botic, Board member
Christina Ho, Board member
Kara M. Stein, Board member
Anthony C. Thompson, Board member
Barbara Vanich, Chief Auditor
Martin C. Schmalz, Chief Economist

SEC

Honorable Gary Gensler, Chair
Caroline A. Crenshaw, Commissioner
Jaime Lizárraga, Commissioner
Hester M. Peirce, Commissioner
Mark T. Uyeda, Commissioner
Paul Munter, Chief Accountant