



via email: rule-comments@sec.gov

Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street NE, Washington, DC 20549-1090

Reference: Release No. 34-100277; File No. PCAOB-2024-02

Dear Office of the Secretary:

BDO USA, P.C. (BDO) welcomes the opportunity to comment to the U.S. Securities and Exchange Commission (SEC or Commission) in connection with the Commission's consideration of the recently adopted quality control standard, QC 1000, *A Firm's System of Quality Control* (the standard or QC 1000) of the Public Company Accounting Oversight Board (PCAOB).

We support the PCAOB's efforts to enhance systems of quality control of accounting firms registered with the PCAOB. We also agree with the PCAOB that an effective system of quality control protects investors by facilitating the consistent preparation and issuance of informative, accurate, independent, and compliant engagement reports, which enhance the confidence of investors and other market participants in the information firms report on. We wish also to express our unequivocal commitment to protecting the interests of the investing public by having an effective quality control system in place that not only focuses on accountability but is also proactive, risk-based, and has a feedback loop for continuous improvement in the performance of quality audits.

While we write to express our general support for QC 1000, we have concerns with certain elements of the PCAOB's rulemaking process and therefore, certain areas in the standard that we discuss in this letter. We urge the SEC to consider the views expressed in this letter and respectfully recommend that QC 1000 not be approved by the SEC at this time. Instead, we recommend that the SEC require the PCAOB to conduct deeper economic analysis and re-propose the standard, specifically in the areas discussed.

Economic Analysis:

The PCAOB's position is that the costs to implement the standard will not exceed the benefit to investors or that the impact that certain provisions, individually and in aggregate, would have on firms our size and smaller would not be unduly burdensome. These costs would ultimately be passed on to issuers and investors. We believe the economic analysis should be expanded to ensure that any costs incurred are fully aligned with at least commensurate increases in audit quality, particularly for firms of our size. As a part of that economic analysis, we believe there should be further consideration of the potential impact of this new standard on the competitive landscape of firms outside the U.S, where applicable.

Certain examples of these requirements include:



1. **EQCF:** QC 1000, as adopted, includes a new requirement for PCAOB registered public accounting firms that issue audit reports with respect to more than 100 issuers annually to implement an external quality control function (EQCF) as a part of the firm’s governance structure. More specifically, the requirement states that the EQCF should “at a minimum, evaluat[e] the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system.” In the adopting release, the Board analogizes the EQCF function to that of an engagement quality reviewer.

The PCAOB’s Concept Release, *Potential Approach to Revisions to PCAOB Quality Control Standards*, dated December 17, 2019¹, acknowledged that the “largest firms have appointed independent directors or have established *equivalent* or *alternative* means to external oversight and that [s]uch roles have *varying* levels of authority, responsibility and influence that may or may not be within the firm’s QC system.” The Board’s 2022 proposing release on QC 1000 repeated this description (paraphrased) by using these generalized assumptions of varying practices. Commenters asked for more clarity and as a result, appearing to be based on the generalized assumptions of varying practices, concluded on a requirement that was vastly different than that proposed and that of current practice. Despite these generalized assumptions of varying practices in this area, the PCAOB’s economic analysis implies that the “[c]osts, as well as the associated benefits, could be attenuated for U.S. GNFs by the fact that *all*² of the U.S. GNFs, indicate, as of the 2020 inspection cycle, that they already have a governance structure that includes a non-employee.” It does not provide substantive analysis to justify the costs, benefits and unintended consequences as it appears to be based on the lowest common denominator.

In addition, when the 2022 proposing release described the role as an oversight function with regard to matters related to the QC system and stated that:

“[t]he requirement we are proposing would not specify how the firm would establish its governance structure or assign authority, other than having at least one person in an oversight role who would be in a position to exercise independent judgment with regard to QC matters”,

we viewed that description as relatively close to the manner in which firms, such as ours, are using independent advisors as part of an audit quality oversight function and therefore had limited commentary on the proposed requirement. The final requirement, which has expanded the professional obligations and responsibilities of that role, including potential to be subject to Sarbanes-

¹ See PCAOB Release 2019-003.

² On May 16, 2022, BDO, a US GNF, announced the establishment of a newly formed Audit Quality Advisory Council that included a non-employee. See press release at <https://www.bdo.com/insights/press-releases/bdo-enhances-commitment-to-audit-quality>.



Oxley Act section 105(c)(6)³, *Failure to Supervise*⁴, and PCAOB Rule 3502, *Responsibility Not to Contribute to Violations* (as amended),⁵ now impose additional liability costs for those professionals who would serve. The new EQCF requirement may limit the number of qualified professionals available because they will now be subject to personal liability.

We also believe the Commission should closely evaluate whether the requirement of disclosure of highly confidential firm information (including QC deficiencies presented in Part II of a PCAOB inspection report) to an EQCF could result in waiver of the statutory and regulatory protections afforded firms under the Sarbanes-Oxley Act, and if so whether this new requirement falls sufficiently within the PCAOB's mandate.

- 2. Roles / Organizational Structures:** We agree with the emphasis of accountability through requirements of specified roles and responsibilities. However, as noted in our comment letter to the proposed standard, we continue to believe the mandate that only one person be assigned to the ethics and independence areas collectively, to be overly prescriptive and not appropriately scalable for firms of our size. Our ethics and independence functions are currently led by separate individuals due to the unique skills and expertise required by each functional area. We do not believe the economic analysis performed to date is sufficient to support the conclusion that this requirement essentially to modify firm's organizational structures will serve the interests of investors by improving audit quality. We recommend the Commission require the PCAOB to conduct further economic analysis to understand the costs, benefits, and unintended consequences associated with this requirement.

³ Under Section 105(c)(6) of Sarbanes-Oxley, if an associated person of a registered public accounting firm violates any provision of law, rules, or standards referenced in Section 105(c)(6), the PCAOB may impose sanctions on the firm or its supervisory persons if the Board finds that there was a failure reasonably to supervise that associated person with a view to preventing such a violation.

⁴ See page 123 in the PCAOB's adopting release, which states: "We do not believe that the EQCF would be a "supervisory person" under Sarbanes-Oxley Section 105(c)(6) solely by virtue of having evaluated the significant judgments made and related conclusions reached by the firm when evaluating and reporting on the effectiveness of the firm's QC system. *However, depending on the nature and degree of their responsibility, ability, or authority to affect the conduct of the firm's associated persons, as established by the firm, the EQCF could be subject to Sarbanes-Oxley Section 105(c)(6).*" [emphasis added]

⁵ See PCAOB Rule 3502, *Responsibility Not to Contribute to Violations* (as amended). The PCAOB recently adopted to amend Rule 3502 in certain ways, including by changing the standard of conduct for associated persons' contributory liability from recklessness to negligence. See Amendments to Rule 3502, PCAOB Rel. No. 2024-008 (June 12, 2024).



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- 3. Fixed Annual Evaluation Date:** Similar to our comments on this point in our response letter to the proposed standard, the fixed annual evaluation date of September 30 does not give adequate time to complete the majority of the calendar year end inspections typically conducted during an inspection cycle, perform root cause episodic and systemic analyses to identify QC deficiencies, design and implement remedial responses and monitor the effectiveness of those actions all prior to September 30. Even in the case of limited inspection findings, to attempt to accomplish all these activities within that timeframe would require significantly more resources without a commensurate level of benefits to audit quality as compared to a model that would allow for flexibility in the annual evaluation date. Finally, this prescriptive requirement will cause firms to either change their ISQM 1 evaluation date or conduct two separate evaluations each year with significant increased costs that could have limited benefit to the investing public.
- 4. Design-Only Model for Inactive Registrants:** Further, we echo the statement made by Board Member Ho on this topic – specifically, her positions that the: 1) “Design-Only [element of the final standard] appears to be inconsistent with SOX”, 2) “Design-Only [of the final standard] appears to be inconsistent with what PCAOB has told congress”, and 3) “Economic analysis erroneously dismissed the impact of design-only on competition.” We also believe that at least for PCAOB registered firms within a global network that do not have active issuer audit practices, the requirement that they have at the ready a design-only system of quality control that complies with the requirements of the standard is unduly burdensome, costly, and contrary to the long-term interests of investors. We are concerned that this mandate may drive some PCAOB registered public accounting firms from the market, thereby potentially limiting competition on a global basis.

Finally, similar to concerns raised in our response to the proposed standard, we are concerned with whether the current statutory and regulatory framework and the PCAOB’s processes and controls will provide adequate confidentiality protections relating to information required on Form QC. Information provided to the PCAOB through inspection procedures is protected under the confidentiality provision of Section 105(b)(5)(A) of the Sarbanes-Oxley Act; however, such confidentiality protections do not appear to apply to information contemplated by QC 1000 to the extent provided through the PCAOB’s special reporting process such as Form QC. While PCAOB Rule 2203A(c) states the intention of the PCAOB that it will not make a filed Form QC or the contents thereof public, we note the absence of such information falling within the statutory protections provided under Section 105(b)(5)(A) of the Sarbanes-Oxley Act. Any release of information in Form QC could be at odds with the provisions of the Sarbanes-Oxley Act and PCAOB rules strictly protecting the confidentiality of PCAOB Part II findings and firms’ remedial efforts. We understand that the law on protection of information provided to the PCAOB in the manner proposed by this Rule is not well-developed and are concerned with whether highly sensitive business and competitive information relating to a firm’s assessment of its system of quality control will be immune from civil litigation and therefore not subject to production in civil litigation or other legal process. Given that uncertainty, we believe that any information required by the Release should be submitted by firms to the PCAOB only through the inspections process. The PCAOB's response to this issue in its release



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ultimately appears to acknowledge that it cannot guaranty the confidentiality it promised under the proposed rule, outside of Section 105(b)(5)(A).

As stated above, we respectfully request that the SEC not approve the standard and instead require the PCAOB to conduct a substantive economic analysis, where indicated, and re-propose QC 1000, specifically on the points called out in this letter.

We appreciate your consideration of our comments and recommendations and would be pleased to discuss them with you at your convenience. Please direct any questions to Lillian Ceynowa, National Managing Principal, Audit Quality (lceynowa@bdo.com) or John Rod, National Managing Principal, Quality Management (JRod@bdo.com).

Respectfully submitted,

BDO USA, P.C.

cc:

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