



August 16, 2024

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

Via email to rule-comments@sec.gov

**Re: File No. PCAOB-2024-02
Proposed Rules on A Firm’s System of Quality Control and Related
Amendments to PCAOB Standards**

Dear Ms. Countryman:

This letter is being submitted by the Public Company Accounting Oversight Board (“PCAOB” or “Board”) in response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing.¹

QC 1000 is an integrated, risk-based standard applicable to all PCAOB-registered firms’ quality control (“QC”) systems. It would replace the PCAOB’s current QC standards, which were developed and issued by the American Institute of Certified Public Accountants before the PCAOB was established. QC 1000 emphasizes accountability, firm culture and the “tone at the top,” and firm governance; addresses changes in the audit practice environment, including the role of firm networks and other auditors and the evolving use of technology; broadens responsibilities for monitoring and remediation of deficiencies to create a more effective ongoing feedback loop driving continuous improvement; and requires a rigorous annual evaluation of the firm’s QC system and related reporting to the PCAOB, certified by key firm personnel, to underscore the importance of the annual evaluation of the QC system, reinforce individual accountability, and support PCAOB oversight. The framework of QC 1000 has commonalities with other international and domestic standards for firm QC systems, though with certain differences as appropriate. The PCAOB believes that building on a well-understood basic framework, appropriately tailored to address our legal and regulatory environment and our investor protection mandate, will enable firms to implement and comply with QC 1000 more effectively and leverage work they have already done when designing, implementing, and operating a QC system under QC 1000.

¹ See Securities Exchange Act Release No. 100277 (June 5, 2024), 89 FR 49588 (June 11, 2024) (Notice of Filing of File PCAOB-2024-02) (“Proposal”).

The PCAOB believes QC 1000 strikes the right balance between a risk-based approach to QC—which should drive firms to proactively identify and manage the specific risks associated with their practice—and a set of mandates, including required risk assessment and other QC-related processes, quality objectives, and quality responses—which should assure that the QC system is designed, implemented, and operated with an appropriate level of rigor.

The proposed rules were published for public comment in the Federal Register on June 11, 2024.² On July 1, 2024, and again on August 13, 2024, the Commission designated a longer period for action on the proposed rules.³ The Commission received 18 comment letters on the proposed rules.

Below, the PCAOB responds to the material aspects of the comments received, some of which appear to rest on misunderstandings of the proposed rules.

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I. The External Quality Control Function

Overview and Background

Paragraph 28 of QC 1000 would require firms that issue audit reports with respect to more than 100 issuers during the prior calendar year to incorporate into their governance structure an External Quality Control Function (“EQCF”). A firm’s EQCF would be composed of one or more persons who are not partners, shareholders, members, other principals, or employees of the firm and do not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system. Such individuals should have the experience, competence, authority, and time necessary to enable them to carry out the responsibilities assigned to the EQCF by the firm. QC 1000 would not prescribe the responsibilities of the EQCF, except to provide that the EQCF’s responsibilities should include, at a minimum, evaluating the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of the firm’s QC system.⁴ Like all persons performing QC

² See *supra* footnote 1.

³ See Securities Exchange Act Release No. 100451 (July 1, 2024), 89 FR 55993 (July 8, 2024); Securities Exchange Act Release No. 100724 (Aug. 13, 2024), ___ FR ____ (forthcoming).

⁴ See generally *A Firm’s System of Quality Control and Other Amendments to PCAOB Standards, Forms, and Rules*, PCAOB Release No. 2024-005 (May 13, 2024) (“Final Release”), at 118.

functions under QC 1000, those in the EQCF role would be required to exercise due professional care in performing their duties.⁵

The PCAOB believes that independent external oversight of a QC system is essential to driving audit quality in firms with large issuer audit practices. Those firms’ consistent performance of audits in compliance with professional and legal requirements is pivotal to the protection of investors and other market participants, and their QC systems reflect and reinforce their role in protecting investors through the preparation of informative, accurate, and independent audit reports. In connection with the PCAOB’s oversight, certain firms have acknowledged the limitations of internal QC functions led by non-independent employees and have touted the benefits of independent review, which can help a firm identify areas of improvement in its QC system. Some firms already have embraced that approach by creating leadership or advisory roles for independent third parties.⁶ QC 1000 thus incorporates an independent oversight requirement, which would apply only to firms with 100+ issuer clients (14 firms as of 2023).⁷

QC 1000’s EQCF provision—and its core requirement of independent external oversight—is informed by, and has evolved from, extensive stakeholder input over many years. In 2008, the Department of the Treasury’s Advisory Committee on the Auditing Profession recommended that the PCAOB consider “firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms.”⁸ Thereafter, the

⁵ See *id.* at 81 (describing the general due professional care requirement set forth in QC 1000.10). QC 1000.10 adapts to the QC context familiar concepts of due professional care from the PCAOB’s auditing standards (acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with applicable professional and legal requirements) that currently apply to all persons involved in the planning and performance of an audit, whether or not they are accountants. See generally AS 1015, *Due Professional Care in the Performance of Work*, and proposed AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

⁶ See, e.g., *infra* footnotes 29-31 and accompanying text.

⁷ The conduct of one of those fourteen firms underscores the potential risks to investors and the public. In May 2024, the Commission concluded that BF Borgers CPA PC engaged in “a deliberate and systematic failure” to audit and review issuer and broker-dealer clients’ financial statements in accordance with PCAOB standards in connection with hundreds of audits and quarterly reviews. *In re Matter of BF Borgers CPA PC, and Benjamin F. Borgers, CPA*, SEC Release No. 34-100053 (May 3, 2024), at 2.

⁸ U.S. Treasury Department, *Advisory Committee on the Auditing Profession Final Report* (Oct. 6, 2008), at VII.8.

PCAOB’s Standing Advisory Group repeatedly expressed interest in exploring an independent governance requirement.⁹

Against this backdrop, the PCAOB issued its December 2019 QC Concept Release.¹⁰ In that release, the PCAOB observed that some firms had appointed independent directors or established equivalent or alternative means of “external oversight,” that such roles varied and “may or may not be within the firm’s QC system,” and that some non-U.S. jurisdictions required certain firms to have “independent directors.”¹¹ With that landscape in mind, the PCAOB sought feedback from its stakeholders on several related questions:

Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms’ QC systems (e.g., boards with independent directors or equivalent)? If so, what criteria should be used to determine whether and which firms should have such independent oversight (e.g., firm size or structure)? What requirements should we consider regarding the qualifications and duties of those providing independent oversight?¹²

Twenty-seven commenters on the Concept Release weighed in on these questions, highlighting, among other things, the importance of independent oversight of a QC system,¹³ the potential

⁹ See, e.g., Transcript of PCAOB Standing Advisory Group’s October 13, 2010 Meeting at 62-63; Transcript of PCAOB Standing Advisory Group’s November 29, 2018 Meeting at 16.

¹⁰ See *Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standards*, PCAOB Release No. 2019-003 (Dec. 17, 2019) (“Concept Release”).

¹¹ *Id.* at 17. For example, Section D of the U.K. Financial Reporting Council’s Audit Firm Governance Code contemplates that firms that audit “public interest entities” will generally include “independent non-executives” in their governance structure. In a similar vein, Principle 3 and accompanying guidance of the Audit Firm Governance Code of the Japan Financial Services Agency call for firms that audit listed companies to “establish a structure responsible for supervision and evaluation and effectively utilize the knowledge and experience of independent third persons.”

¹² Concept Release at 16.

¹³ See, e.g., Letter from Consumer Federation of America (Mar. 16, 2020) at 7 (“With an appropriately high standard for board member independence, such an approach could help to bring appropriate focus to key issues that are priorities for investors, such as independence and professional skepticism. Independent oversight also has the potential to help counteract economic incentives to under-invest in audit quality or to view retaining customers, rather than protecting investors, as the firm’s top focus. For that reason, we believe more can and should be done to implement this policy change, at least at the larger firms. A review of quality control

duties of those providing such oversight,¹⁴ and the question of which firms should be subject to such a requirement.¹⁵

The comments received on the Concept Release laid the groundwork for the PCAOB's November 2022 QC Proposing Release. As proposed, and in response to comments received, QC 1000 provided that firms that issued audit reports with respect to more than 100 issuers during the prior calendar year must incorporate into their governance structure "an oversight function for the audit practice" that included "at least one person" whose relationship with the firm would not "interfere with the exercise of independent judgment with regard to matters related to the QC system."¹⁶ The PCAOB sought feedback from stakeholders on this idea yet again, including by posing specific questions about the 100-issuer threshold¹⁷ and the appropriateness of the independent-oversight requirement.¹⁸

Twenty-two commenters weighed in on this topic, and the revised independent-oversight requirement adopted by the PCAOB in May 2024 reflected the comments received on

systems offers a perfect opportunity to do so."). The comments received by the PCAOB relating to QC 1000 are available at <https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-046-quality-control/comment-letters>.

¹⁴ See, e.g., Letter from Council of Institutional Investors (Mar. 19, 2020) at 4 ("In addition, we believe the duties of those providing independent oversight should include, among other responsibilities, 'resource allocation decisions . . . the annual review of the QC system, the effectiveness of remediation of QC concerns, and the integration of audit quality into the system of incentives and rewards for firm personnel.'") (ellipses in original; footnote omitted).

¹⁵ See, e.g., Letter from Center for Audit Quality (Mar. 16, 2020) at 11 ("Independent oversight may be an appropriate response for some firms based on their risk assessment; however, such a requirement may not be necessary or effective for all firms. Further, independent oversight may take various forms including independent advisors who are not board members.").

¹⁶ *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Release No. 2022-006 (Nov. 18, 2022) ("Proposing Release"), at 97. The initial proposal required that the oversight function include at least one person who "is not a partner, shareholder, member, other principal, or employee of the firm and does not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system." These criteria are analogous to those applied to independent directors in the corporate context (*cf.* Nasdaq Rule 5605(a)), and they remained substantively the same in the standard adopted by the PCAOB.

¹⁷ *Id.* at 101 (Question 22).

¹⁸ *Id.* at 101 (Question 23: "Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?").

the Proposing Release. Many commenters called for more clarity and specificity about the role of the oversight function.¹⁹ In response, the PCAOB changed “oversight function” to “external oversight function”—consistent with the Concept Release’s and Proposing Release’s references to “external oversight” and with the provision’s independence requirement—to underscore that the function is to be carried out by one or more persons who are independent and, necessarily, external to the firm.²⁰ Additionally, the PCAOB revised the provision to specify a single baseline requirement of that function: evaluating the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of the firm’s QC system.²¹ The PCAOB also clarified certain other aspects of the function.²²

The Role of the EQCF

The PCAOB believes that requiring the EQCF to evaluate the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of the firm’s QC system will improve audit quality. By enhancing the discipline with which a firm carries out its own QC system evaluation, the PCAOB believes that the EQCF would drive improvements in a firm’s QC system, which ultimately would benefit investors, audit committees, and other stakeholders.

¹⁹ See, e.g., Letter from Grant Thornton LLP (Feb. 1, 2023) at 13 and Letter from U.S. Chamber of Commerce (Feb. 1, 2023) at 10 (clarification of key terms, including “governance structure,” “oversight function” and “independent judgment”); Letter from RSM US LLP (Feb. 1, 2023) at 8 and Letter from Ceres Accelerator for Sustainable Capital Markets (Feb. 1, 2023) at 6 (clarification regarding role); Letter from Institute of Management Accountants (Jan. 3, 2023) at 3 and Letter from Forvis, LLP (Feb. 1, 2023) at 6 (clarification regarding qualifications of persons serving in the role).

²⁰ See Final Release at 120. Satisfying the independence requirement set forth in the Proposing Release and Adopting Release would result in retaining an external person or persons.

²¹ See *id.* at 120-21.

²² The reference to oversight of “the audit practice” was changed to oversight of “the QC system” to clarify that the function is focused on the firm’s QC system. See *id.* at 120. The PCAOB also established a name for the role (“External Quality Control Function”) and, consistent with QC 1000’s treatment of other specified QC roles, provided that individuals who fill the EQCF role should have the experience, competence, authority, and time necessary to carry out their assigned responsibilities. See *id.* Lastly, the revised provision frames the EQCF as consisting of “one or more persons” rather than “at least one person.” See *id.* at 118, 121-22.

In response to the Commission’s solicitation of public comments on the Proposal, many commenters expressed their support for the Proposal.²³

Other commenters expressed their opposition to or concerns about the EQCF requirement.²⁴ One commenter suggested that the EQCF requirement is not realistic because an annually inspected firm’s QC system is complex and involves a multitude of significant judgments and related conclusions.²⁵ Elaborating, that commenter stated that it is unrealistic to “embed” independent third parties in the process with a recurring assignment to “reassess” audit firm “QC judgments and conclusions.”²⁶ But these concerns do not reflect what the EQCF provision actually requires. QC 1000 affords substantial flexibility to firms to design their EQCF, without specifying how the EQCF should fulfill its role.²⁷ Specifically, within the EQCF requirements of QC 1000, firms may designate different responsibilities depending on their circumstances and needs—as is the case with respect to many aspects of QC 1000. Nor must the EQCF “reassess” the firm’s judgments and conclusions; as the PCAOB made clear, the EQCF would evaluate the work performed by others but it would not redo that work, and there is no requirement for the EQCF to provide concurring approval with respect to the firm’s conclusions.²⁸ Moreover, the EQCF’s responsibility does not extend to all of the firm’s QC-related judgments and conclusions, but only to significant ones made in connection with the firm’s annual QC-system evaluation and reporting. With all this in mind, and drawing on the two decades of organizational experience inspecting the sufficiency of QC systems that

²³ See, e.g., Letter from Consumer Federation of America (July 1, 2024) at 2 (explicitly supporting proposed EQCF requirement); Letter from CFA Institute (July 1, 2024) at 1; Letter from AFL-CIO (July 1, 2024) at 1; Letter from Robert A. Conway (June 26, 2024) at 1; Letter from the Members of the Investor Advisory Group (June 28, 2024) (“Members of the Investor Advisory Group Letter”) at 1; Letter from the Council of Institutional Investors (June 27, 2024) (“Council of Institutional Investors Letter”) at 2-3; Letter from Jack T. Ciesielski (July 2, 2024) at 1.

²⁴ See, e.g., Letter from Pennsylvania Institute of Certified Public Accountants (June 24, 2024) (“PICPA Letter”) at 3-4; Letter from PricewaterhouseCoopers LLP (July 1, 2024) (“PwC Letter”) at 1-5; Letter from BDO USA, P.C. (July 2, 2024) (“BDO Letter”) at 2-3; Letter from the Center for Audit Quality (July 2, 2024) (“CAQ Letter”) at 1-4; Letter from Forvis Mazars (July 2, 2024) (“Forvis Mazars Letter”) at 2; Letter from Moss Adams LLP (July 2, 2024) (“Moss Adams Letter”) at 1-2; U.S. Chamber of Commerce Letter (July 15, 2024) (“Chamber Letter”) at 1, 4-8; Letter from Grant Thornton LLP (July 16, 2024) (“GT Letter”) at 1-3; Letter from RSM US LLP (July 16, 2024) (“RSM Letter”) at 2.

²⁵ See Chamber Letter at 6-7.

²⁶ *Id.* at 7.

²⁷ See Final Release at 121.

²⁸ See *id.*

informed the development of QC 1000 as a whole, the PCAOB believes that the baseline responsibility assigned to the EQCF—which, to be sure, would entail substantially less than a PCAOB QC inspection—is a realistic one.

Indeed, some firms already choose to incorporate elements of independent oversight into their corporate governance structures, and the existence and variety of those roles demonstrate that implementing the EQCF requirement is feasible rather than unrealistic. For example, one firm has publicly disclosed that it had “robust discussions” regarding its initial QC system evaluation under International Standard on Quality Management 1 with its external quality advisors.²⁹ Another has indicated that its audit advisory council addresses matters related to the QC system, including inspection results and remediation efforts.³⁰ Another firm discloses that it grants its audit quality advisory council “full access to firm information to help them fully understand [the] system of quality control” with a view to enabling the council “to advise . . . regarding ways to maintain and improve the firm’s system of quality control in accordance with applicable professional standards, and to champion the public interest nature of the audit practice.”³¹

In sum, the PCAOB has scaled the EQCF requirement to apply to a limited number of firms, and has provided those firms flexibility to design the EQCF to suit their particular needs and circumstances. As long as the firm incorporates into its governance structure an EQCF that can appropriately discharge its single prescribed responsibility (and any additional responsibilities the firm might voluntarily assign to it) in accordance with the QC 1000 standard, the firm would have wide latitude to decide—in its discretion and based on its particular circumstances—how best to design its EQCF. That includes how many people should comprise the EQCF, what qualifications or skillsets they should possess, whether they should include non-auditors, how they should be compensated, under what circumstances they can be removed, whether they are subject to limits on the length of their service, what lines of communication should be established from them to others, whether to require the EQCF to provide concurring approval, whether to assign additional responsibilities to the EQCF, what authority to afford to the EQCF in light of its assigned responsibilities, and whether to disclose publicly the EQCF’s

²⁹ See Ernst & Young LLP, *2023 Audit Quality Report*, at 10, available at <https://www.ey.com/content/dam/ey-unified-site/ey-com/en-us/campaigns/assurance/audit-quality-report/documents/ey-audit-quality-report-2023.pdf>.

³⁰ See BDO USA, P.C., *2023 Audit Quality Report*, at 15, available at <https://www.bdo.com/getmedia/a877d588-479f-467a-a4d0-6913ea2b549c/ASSR-BDO-2023-Audit-Quality-Report-web.pdf>.

³¹ See Grant Thornton LLP, *Audit Quality & Transparency Report 2022*, at 20, available at <https://www.grantthornton.com/content/dam/grantthornton/website/assets/content-page-files/audit/pdfs/2023/audit-quality-transparency-report-2022.pdf>.

practices, methods, or procedures or the manner or results of the EQCF's evaluation.³² Importantly, the firm's broad decision-making authority also encompasses the details regarding how the EQCF will conduct its evaluation, including the specific procedures the EQCF should follow.³³

Two commenters suggested that the EQCF is unnecessary because a firm's annual self-evaluation of its QC system, coupled with the PCAOB's annual inspections of that QC system, should suffice.³⁴ The PCAOB believes, however, that the EQCF would complement, and enhance the efficacy of, those self-evaluations and inspections. Although the PCAOB has been inspecting firms' QC systems for two decades and those inspections have undoubtedly improved audit quality, the PCAOB's oversight experience—including the audit deficiency rate observed in recent PCAOB inspections—indicates that firms' QC systems continue to fall short.³⁵ As part of QC 1000's comprehensive package of innovations intended to rectify those shortcomings, which includes self-evaluations by firms, the EQCF requirement would add an independent perspective to an annually inspected firm's QC system self-evaluation, thus promoting a more rigorous evaluation process by those firms. In this regard, the EQCF would not "step into the shoes" of the PCAOB, as one commenter put it,³⁶ but rather would assist the firm in carrying out its own responsibility under QC 1000 to evaluate and report on the effectiveness of its QC system with due professional care.³⁷

³² See Final Release at 121-23.

³³ See *id.* at 121.

³⁴ See Chamber Letter at 6-7; PwC Letter at 4.

³⁵ See Final Release at 5-6; see also *id.* at 310-18.

³⁶ See Chamber Letter at 7.

³⁷ One commenter pointed to the role firms play in evaluating the effectiveness of an issuer's internal control over financial reporting ("ICFR") as a basis for trusting firms to conduct self-evaluations without external involvement. See PwC Letter at 4. The commenter asserted that a firm can reach conclusions about the effectiveness of an issuer's ICFR even if the firm had previously opined that the issuer's ICFR was effective but thereafter learned of information contradicting its prior conclusion. See *id.* The PCAOB believes that the ICFR analogy cuts the other direction, however. In the ICFR context, management assesses the effectiveness of the issuer's ICFR and then the independent external auditor audits management's assessment. Under QC 1000, the firm would evaluate the effectiveness of its QC system, and then the EQCF would evaluate the significant judgments made and conclusions reached, similarly introducing an element of independent external oversight into QC-system evaluation and reporting. However, unlike the ICFR context, the EQCF would not be required to provide any sign off; rather, the EQCF's findings would be information for the firm to take into account in its ongoing efforts to enhance its QC system.

Nor would imposing an independent QC monitor or independent QC consultant as a sanction in a PCAOB enforcement action serve as a viable substitute for the EQCF requirement, as one commenter suggested.³⁸ Although such sanctions can be imposed in appropriate cases when a firm or its personnel have violated applicable professional or legal requirements,³⁹ the EQCF requirement is aimed at preventing such violations from occurring in the first place—that is, before investors are potentially placed at risk and without the need for enforcement action—by driving improvements in the firm’s QC system.

Some commenters expressed concern or doubt about the role of the EQCF, including whether individuals who serve in an EQCF role would be “associated persons” or “supervisory persons” under the Sarbanes-Oxley Act.⁴⁰ The PCAOB believes that an individual who serves in an EQCF role would meet the definition of an “associated person,” but whether such individual also would be a “supervisory person” would depend on the responsibilities assigned to the individual by the firm.

Pursuant to the Sarbanes-Oxley Act and PCAOB rules, an “associated person” of a firm includes an “independent contractor” who, in connection with the preparation or issuance of any audit report, receives compensation from the firm or participates as an agent or otherwise on behalf of the firm in any activity of that firm.⁴¹ Because individuals serving in an EQCF role cannot be partners, shareholders, members, other principals, or employees of the firm, the PCAOB expects that such individuals would be engaged as independent contractors. Those independent contractors presumably would be compensated for their work, and, in any event, they would participate on behalf of the firm in the firm’s activities (at a minimum, the firm’s evaluation and reporting process). Lastly, their compensation and activities would be in connection with the preparation or issuance of audit reports, because they would be evaluating the significant judgments made and conclusions reached regarding the effectiveness of the QC system of a firm that issued more than 100 audit reports in the prior calendar year.⁴²

³⁸ See PwC Letter at 4.

³⁹ See Section 105(c)(4)(G) of the Sarbanes-Oxley Act; PCAOB Rule 5300(a)(7), (8), (10), *Sanctions*.

⁴⁰ See Chamber Letter at 7; BDO Letter at 2-3; PwC Letter at 4.

⁴¹ Section 2(a)(9) of the Sarbanes-Oxley Act; PCAOB Rule 1001(p)(i), *Definitions of Terms Employed in Rules*.

⁴² The EQCF’s “associated person” status was no different under the EQCF requirement initially proposed. As independent contractors paid to exercise their independent judgment regarding matters related to the firm’s QC system in connection with the preparation or issuance of audit reports, those individuals also would have qualified as “associated persons.” Therefore, the suggestion that the revised EQCF provision altered the “associated person” status of individuals who fill the EQCF role is incorrect. See BDO Letter at 3-4.

It necessarily follows that, as “associated persons,” the individuals who serve in the EQCF role could be held accountable if they violate the laws, rules, or standards applicable to them that the PCAOB is responsible for enforcing. While their responsibilities would be limited to conducting the evaluation specified in QC 1000.28 and performing any other responsibilities assigned by the firm, such individuals would be required to exercise due professional care when discharging those responsibilities,⁴³ would be prohibited from contributing to any violations by the firm in contravention of the PCAOB’s contributory-liability rule,⁴⁴ would be required to cooperate and comply with requests for testimony or documents made by the Board in the furtherance of its authority and responsibilities under the Sarbanes-Oxley Act,⁴⁵ and would be required to adhere to any applicable PCAOB ethics standards.⁴⁶ In each of these respects, the PCAOB believes that being able to hold such individuals accountable for violations is not only appropriate given the importance of their role, but also potentially vital to the EQCF’s proper functioning.

Individuals who serve in the EQCF role, however, would not necessarily be “supervisory persons” for purposes of Section 105(c)(6) of the Sarbanes-Oxley Act, which authorizes the PCAOB in certain circumstances to impose sanctions upon supervisory persons who failed to reasonably supervise another associated person who violated a law, rule, or standard that the PCAOB is charged with enforcing. As the PCAOB explained, the individuals who comprise the EQCF would not be supervisory persons “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.”⁴⁷ Instead, they would qualify as “supervisory

⁴³ See Final Release at A1-5 (QC 1000.10) (imposing a due professional care obligation on all “other participants” involved in the design, implementation, or operation of a firm’s QC system); see also *id.* at 51 (illustrating that the individuals who comprise the EQCF function are “other participants” under QC 1000).

⁴⁴ See PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*. The PCAOB has adopted an amendment to Rule 3502 that, if approved by the Commission, would change the standard of conduct for contributory liability from recklessness to negligence but would retain the language that limits contributory liability to instances in which an associated person “directly and substantially” contributes to the firm’s violation. See *Amendment to PCAOB Rule 3502 Governing Contributory Liability*, PCAOB Release No. 2024-008 (June 12, 2024), at 22-25.

⁴⁵ See, e.g., Section 102(b)(3) of the Sarbanes-Oxley Act; see also PCAOB Rule 4006, *Duty to Cooperate With Inspectors*; PCAOB Rule 5110, *Noncooperation with an Investigation*.

⁴⁶ See, e.g., Final Release at A4-1 (adopting, subject to Commission approval, a new ethics standard, EI 1000, *Integrity and Objectivity*, applicable to “associated persons”).

⁴⁷ Final Release at 123.

persons” only if the firm afforded them the responsibility, ability, or authority to affect the conduct of other associated persons such that they serve in a supervisory capacity. But that decision rests entirely with the firm: QC 1000 empowers firms to decide whether to bestow upon those individuals additional responsibilities that make them “supervisory persons.”⁴⁸

The EQCF Requirement Does Not Conflict with the Sarbanes-Oxley Act

Some commenters asserted that the EQCF requirement is not consistent with Section 104(g)(2) or Section 105(b)(5)(A) of the Sarbanes-Oxley Act.⁴⁹ Section 104(g)(2) provides that “no portions of [a PCAOB] inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.” Section 105(b)(5)(A) provides that, with certain exceptions, “all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees or agents, in connection with an inspection . . . or with an investigation . . . shall be confidential and privileged as an evidentiary matter . . . in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure . . . under the Freedom of Information Act or otherwise.” These commenters stated that the EQCF would need access to information covered by Section 104(g)(2) and/or Section 105(b)(5)(A) to conduct the evaluation required by QC 1000.28, but that disclosing such information to the EQCF might be inconsistent with these statutory provisions or impair the privileges and protections provided by the Sarbanes-Oxley Act.

The PCAOB believes that such concerns are unfounded, because even if the EQCF needs such information, disclosure of it to the EQCF would not be tantamount to public disclosure under Section 104(g)(2), nor would it be inconsistent with the confidentiality provided by Section 105(b)(5)(A). Indeed, it appears that some firms currently share such information with external advisors.⁵⁰

As noted above, the Sarbanes-Oxley Act expressly contemplates that “independent contractors” could be compensated by a firm or participate in activities on behalf of a firm in

⁴⁸ *Id.* (“[D]epending 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).

⁴⁹ See Chamber Letter at 1, 4-5, 7; PwC Letter at 2; BDO Letter at 3; CAQ Letter at 3-4; Forvis Mazars Letter at 2; GT Letter at 2; RSM Letter at 2.

⁵⁰ See *supra* footnotes 30-31 and accompanying text (referring to inspection results and remediation efforts, and to full access to firm information, respectively).

connection with the preparation or issuance of audit reports.⁵¹ The statute treats those independent contractors as “associated persons,” and, like all other associated persons, they must cooperate in, and comply with PCAOB requests in connection with, inspections and investigations.⁵²

The commenters’ position cannot be squared with this treatment. As noted above, the PCAOB expects that the individuals who comprise the EQCF would be independent-contractor associated persons.⁵³ Not only must they cooperate in PCAOB inspections and investigations and comply with the PCAOB’s related requests, but they also may prepare inspection- or investigation-related documents or information for the PCAOB that is covered by Section 105(b)(5)(A) of the statute. The commenters, however, would read the statute in a way that treats these individuals as strangers to the inspection or investigation process, despite their status as associated persons. Such a reading ignores the overall statutory scheme and therefore would run afoul of canons of statutory interpretation.⁵⁴ It also would depart from the prevailing approach to independent contractors in other contexts.⁵⁵

The commenters’ position, if accepted, also could have consequences that stretch beyond the EQCF. For example, firms may enter into other types of independent-contractor arrangements that bestow “associated person” status upon an individual, including individuals at an affiliated firm within a global network, personnel at shared service centers outside of the firm, or engagement quality reviewers from other firms. It is unclear whether the commenters

⁵¹ See *supra* footnote 41 and accompanying text.

⁵² See *supra* footnote 45 and accompanying text.

⁵³ The commenters also overlook that the individuals who comprise the EQCF presumably will be bound to maintain the information they receive from the firm in confidence, either through contractual non-disclosure agreements or by other means.

⁵⁴ See, e.g., *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132-33 (2000) (“The meaning—or ambiguity—of certain words or phrases may only become evident when placed in context. It is a ‘fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.’ A court must therefore interpret the statute ‘as a symmetrical and coherent regulatory scheme,’ and ‘fit, if possible, all parts into an harmonious whole.’”) (citations omitted).

⁵⁵ See, e.g., *In re Bieter Co.*, 16 F.3d 929, 940 (8th Cir. 1994) (addressing the waiver of attorney-client privilege in the context of disclosure to an independent contractor); *In re Flonase Antitrust Litig.*, 879 F. Supp. 2d 454, 459 (E.D. Pa. 2012) (same); *In re Copper Mkt. Antitrust Litig.*, 200 F.R.D. 213, 219 (S.D.N.Y. 2001) (same); see also, e.g., *Am. S.S. Owners Mut. Protection & Indem. Ass’n v. Alcoa S.S. Co.*, 232 F.R.D. 191, 198 (S.D.N.Y. 2005) (addressing the waiver of attorney-client privilege in the context of disclosure to corporate directors); *Strougo v. BEA Assocs.*, 199 F.R.D. 515, 525 (S.D.N.Y. 2001) (same, with respect to outside directors).

intend to suggest that if such individuals' conduct were to become the focus of an inspection or investigation, Sections 104(g)(2) and 105(b)(5)(A) would limit the information that could be shared with those people or Section 105(b)(5)(A)'s confidentiality protection would not extend to documents or information they prepare for the PCAOB.⁵⁶ The commenters offer no basis upon which to treat EQCF independent contractors differently than these other independent contractors, and the Sarbanes-Oxley Act does not support such a distinction.

EQCF-Related Documentation

Two commenters suggested that there are unanswered questions about documentation requirements as they relate to the EQCF.⁵⁷

As an initial matter, there are no special or heightened documentation requirements related to the EQCF. Rather, as with other aspects of the QC system, the documentation requirements related to the design, implementation, and operation of the EQCF are addressed in QC 1000.81-.83. In particular, QC 1000.81 articulates the firm's overarching documentation obligation with respect to its QC system, and the scope of that obligation is then specified in QC 1000.82 and QC 1000.83.⁵⁸

The documentation requirements for the EQCF are keyed off the fact that the EQCF is a "specified quality response" under QC 1000.⁵⁹ As a "quality response," the EQCF consists of policies (which state what should or should not be done) and accompanying procedures (the actions taken to implement and comply with those policies).⁶⁰

It is the firm, rather than the individual or individuals who comprise the EQCF, that bears responsibility for designing the policies that govern the EQCF.⁶¹ As with all documentation under QC 1000, those policies must be documented by the firm in sufficient detail to enable an experienced auditor who understands QC systems but has no experience with the firm's QC

⁵⁶ PCAOB inspections assess the degree of compliance of "associated persons" (see Section 104(a)(1) of the Sarbanes-Oxley Act), and the PCAOB investigates potential violations by "associated person[s]" (see Section 105(b)(1) of the Sarbanes-Oxley Act).

⁵⁷ See CAQ Letter at 4; GT Letter at 2.

⁵⁸ See Final Release at 278.

⁵⁹ See QC 1000.26-.29 (establishing Governance and Leadership Specified Quality Responses, including the EQCF).

⁶⁰ See QC 1000.A11 (defining "quality response").

⁶¹ See, e.g., Note to QC 1000.21. Firms could, of course, consult with any individual serving in an EQCF role when designing, or amending the design of, the EQCF.

system to understand how the EQCF is designed.⁶² Although the PCAOB expects that a firm’s EQCF policies would thereafter be revised and updated as appropriate over time, the most significant documentation efforts associated with the design of the EQCF are likely to occur when it is first incorporated into the firm’s governance structure.

After the firm’s EQCF policies are designed, the firm must implement them (that is, establish an EQCF that is incorporated into the firm’s governance structure). The firm’s documentation likewise must be in sufficient detail to enable an experienced auditor who understands QC systems but is unfamiliar with the firm’s QC system to understand how the EQCF was implemented.⁶³ Again, these requirements reflect the documentation requirements under QC 1000 more broadly.

Following implementation, the EQCF must be placed into operation, meaning that, at a minimum, it must conduct the evaluation of significant judgments and related conclusions required by QC 1000.28. The firm’s documentation, in turn, must be in sufficient detail to enable that same experienced auditor to understand how the firm’s EQCF operates.⁶⁴ It bears reiterating that QC 1000 imposes a documentation requirement regarding the EQCF’s operation on the firm,⁶⁵ not on the individuals who comprise the EQCF—though the firm’s EQCF policies could provide guidance to those individuals about what they should or should not do to facilitate the firm’s retention of appropriate documentation about the EQCF’s operation. Furthermore, as the PCAOB discussed at length in its Final Release, QC 1000’s approach to documenting the operation of a quality response is principles-based, scalable, and should not require the preparation and retention of excessively voluminous documentation.⁶⁶

Economic Analysis of the EQCF Requirement

Some commenters on the Proposal expressed concerns that the benefits of the EQCF requirement did not justify the costs.⁶⁷ One commenter observes that, in response to the

⁶² See QC 1000.83b.

⁶³ See *id.*

⁶⁴ See *id.*

⁶⁵ See, e.g., QC 1000.81; QC 1000.86.

⁶⁶ See Final Release at 285-87. While the firm’s documentation must enable an experienced auditor to evaluate the operation of the EQCF (see Note to QC 1000.83b), the firm is able to consider, among other things, the nature and circumstances of the firm and the nature and complexity of its EQCF when determining the form, content, and extent of documentation that must be prepared and retained. See Final Release at 287.

⁶⁷ See PwC Letter at 4; BDO Letter at 2; Moss Adams Letter at 2.

Proposing Release, commenters had asked for more information on the initially proposed oversight function, but claims that the Final Release “concluded on a requirement that was vastly different than that proposed and that of current practice,” and that the economic analysis did not provide substantive analysis to justify the costs, benefits, and unintended consequences.⁶⁸ For several reasons, the PCAOB believes the economic analysis in the Proposal discusses these economic considerations.

First, as discussed above, the Proposal clarifies certain minimum requirements that the EQCF function must address. From an economic perspective, specifying these minimum requirements involves tradeoffs of benefits and costs. While more clearly defining this role may generate incremental costs for firms, such as recruiting one or more new individuals, entering into new arrangements for the EQCF, and making adjustments to existing oversight functions to bring them into compliance with the new requirement, it can also enhance governance and reduce compliance uncertainty. Academic research shows that regulatory uncertainty can have a dampening effect on investment activities.⁶⁹ By clarifying and specifying the responsibilities of the EQCF, the Proposal helps reduce uncertainty for firms on how to comply with QC 1000 and allows them to plan for investments in the EQCF needed to meet the new standard.⁷⁰

Second, in addition to clarifying the role of the EQCF, the economic analysis highlights that, to help address the incremental costs of the EQCF function, the Proposal offers flexibility, allowing firms to implement an oversight function into their QC system suitable for their circumstances. Firms can determine the appropriate scope, responsibilities, and qualifications for the EQCF based on their existing governance structures and the complexity of their QC systems. This flexibility allows firms to integrate the EQCF into their current practices without the need for significant restructuring or additional resources, thereby minimizing the financial and operational burden of compliance. The flexibility of the final standard allows firms to potentially allocate resources efficiently to oversight. Firms with well-established oversight mechanisms may only need to make incremental adjustments, rather than implementing

⁶⁸ See BDO Letter at 2.

⁶⁹ See, e.g., Wensheng Kang, Kiseok Lee, and Ronald A. Ratti, *Economic Policy Uncertainty and Firm-Level Investment*, 39 *Journal of Macroeconomics* (2014) (“When firms are in doubt about costs of doing business due to possible changes in regulation, cost of health care and taxes, they become more guarded with investment plans.”).

⁷⁰ While QC 1000 clarified these expectations, the PCAOB believes that firms would have considered many of the same factors for the role in the Proposing Release. For example, if the non-employee individual(s) lacked the necessary experience, competence, authority, or time, the PCAOB likely would have raised concerns during inspections. Clarifying these expectations upfront could expedite oversight benefits and reduce the need for costly adjustments to the oversight function later.

entirely new processes, which can lower costs. This approach reduces the potential for duplicative efforts or unnecessary expenditures, as firms can focus on addressing their unique risks and challenges.

Third, the economic analysis in the Proposal describes how the incremental costs and benefits associated with the EQCF requirement may vary depending on whether a suitable individual is already performing an external governance role for the firm. It notes that costs may be higher for firms incorporating a QC oversight function into their governance structure for the first time, while those with an existing oversight function may still incur expenses in finding individuals to fulfill the role. Additionally, the economic analysis discusses how firms with an existing oversight function may incur incremental costs to incorporate the baseline requirement to evaluate, at a minimum, significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system.

Another commenter on the Proposal reiterated concerns already raised by commenters on the Proposing Release that the EQCF requirement might prompt firms near the 100-issuer threshold to reduce their issuer count.⁷¹ The PCAOB acknowledged this possibility in the economic analysis in the Proposal and discussed it further, noting that very few firms are close to the 100-issuer threshold.⁷² The commenter did not raise any new questions or provide any new data that would alter the economic analysis in the Proposal.

Other commenters on the Proposal suggested that the potential for liability exposure under Section 105(c)(6) of the Sarbanes-Oxley Act would limit the pool of candidates who would be willing to accept this role.⁷³ One of these commenters also said that the PCAOB failed to acknowledge that the EQCF requirement introduced in QC 1000 would generate new costs associated with entering into new arrangements and compensating qualified individuals.⁷⁴ This

⁷¹ See Moss Adams Letter at 2.

⁷² Specifically, during the 2022 calendar year, the number of firms in the range of the 100-issuer threshold included two that audited between 80 and 100 issuers and two that audited between 100 and 120 issuers. See Final Release at 355.

⁷³ See PwC Letter at 4; BDO Letter at 3; CAQ Letter at 4.

⁷⁴ See PwC Letter at 4. This commenter also said that the PCAOB did not acknowledge that QC 1000 would introduce costs related to additional resources needed for the firm to enable the EQCF to perform the required duties. The economic analysis in the Proposal acknowledges that firms might need additional resources to broadly administer new or revised quality control responses. Thus, the PCAOB agrees that these additional resources would include the EQCF function. However, these additional costs should be limited by the fact that, under QC 1000,

claim is inaccurate. The economic analysis in the Proposal discussed both of these costs and concerns.⁷⁵ It notes that firms will likely incur costs when hiring external individuals for this governance role, including search costs.⁷⁶ For example, in response to one comment received on the Proposing Release, which expressed concern about the liability expenses beyond compensation related to hiring someone for the oversight function and questioned the type of directors and officers (“D&O”) insurance required for such a position, the economic analysis in the Proposal includes data on the average compensation for non-employee directors of public companies, which accounts for insurance premiums.⁷⁷

While the economic analysis in the Proposal discusses the cost to a public company of hiring an independent non-employee director as a comparison for engaging suitable external individuals for the EQCF role, the PCAOB recognizes that the relevance and implications of this comparison depend on factors such as: (1) the role’s complexity and potential exposure to liability; (2) the number of hours required to fulfill the EQCF’s responsibilities under QC 1000 and as otherwise determined by the firm; and (3) the availability of qualified candidates. To accompany the discussion in the economic analysis, the PCAOB expands on these comparisons below.

First, the EQCF is expected to consider significant and possibly dynamic judgments made and the related conclusions reached by the firm when evaluating and reporting on the

both as initially proposed and as adopted by the PCAOB, firms would be required to document the basis for the conclusions reached pursuant to the firm’s evaluation of the effectiveness of its QC system, and that documentation can be provided to the EQCF.

⁷⁵ See Final Release at 356.

⁷⁶ The PCAOB further notes that the economic analysis highlights the lack of sufficient data to accurately estimate the potential costs arising from QC 1000. In the context of EQCF, the PCAOB lacks specific information, for example, on factors such as the number of hours non-employees currently devote to governance roles, their hourly compensation, and the specific roles and responsibilities of existing quality committees. Additionally, the total hours required for the EQCF role will vary significantly based on firm-specific factors, including the scope of the firm’s practice; the number, nature, and extent of any QC deficiencies; whether the firm assigns additional responsibilities to the EQCF; and the availability of necessary information, including the accuracy and completeness of QC documentation. Commenters did not provide the PCAOB with information that would facilitate a more detailed analysis of these costs.

⁷⁷ See Letter from Forvis (Feb. 1, 2023) at 6 (“An additional concern we have is the cost associated with hiring this individual as well as what type of D&O insurance coverage might be needed for an individual acting in such a capacity for a firm. We believe firms may either be required to carry additional insurance coverage for this individual and/or compensate them accordingly for the risk they will be assuming in association with this role.”).

effectiveness of its QC system. Similarly, corporate directors face a complex and evolving business environment, requiring them to continually assess and enhance their oversight on emerging and critical issues. As a result, the PCAOB would expect the EQCF role to require experience and competence comparable to the corporate director role in order to carry out its oversight responsibilities.

Second, the cost of the EQCF role can be compared, in some respects, to that of an independent board director. One study indicates that corporate directors spend an average of 245 hours per year on their director duties.⁷⁸ According to the economic analysis in the Proposal, data from the Spencer Stuart study reports that the average compensation for a non-employee director was \$327,764 in 2023. This translates to an estimated hourly rate of \$1,338 per hour (\$327,764 divided by 245 hours). If the EQCF role demands fewer or more hours or has a different hourly rate, then the comparable cost could be lower or higher accordingly.

Third, the comparison between non-employee directors and the EQCF role also depends on the availability of qualified candidates. The final standard requires that the EQCF should have the necessary experience, competence, authority, and time to fulfill these responsibilities, along with meeting independence requirements. Similarly, the pool of non-employee directors may be limited by factors such as the need to meet independence requirements, which often exclude individuals with significant financial or personal ties to the company. Additionally, public company audit committees must disclose whether they have a financial expert as defined by the Commission, which can have the effect of further narrowing the pool to those with specific financial and accounting expertise. Therefore, both the EQCF and non-employee directors may face challenges related to a limited pool of qualified candidates.

Another data point that may help gauge the costs associated with the EQCF is the compensation for the independent non-executive (“INE”) role for audit firms in the U.K., which served as part of the conceptual basis for the independent external role explored in the Concept Release, now labeled EQCF. INEs likely share some similar roles and responsibilities with the EQCF.⁷⁹ According to the transparency reports from six large U.K. audit firms,

⁷⁸ See National Association of Corporate Directors (“NACD”), *Preparing for Board Compensation in Times of Distress* (Apr. 28, 2020) (“According to the 2018–2019 NACD Public Company Governance Survey, the average public company director’s time commitment is roughly 245 hours each year . . .”), available at <https://www.nacdonline.org/all-governance/governance-resources/directorship-magazine/online-exclusives/preparing-for-board-compensation-in-times-of-distress/>.

⁷⁹ Deloitte LLP describes the role of an INE as “[i]ndividuals who are independent of the management of the firm and who are responsible for providing independent advice and recommendations for management’s consideration regarding certain UK firmwide and non-

individual INEs received total remuneration ranging from approximately £60,000 to £300,000 (or \$77,000 to \$385,000) in 2023.⁸⁰ The average total remuneration for INEs was approximately £130,000 (or \$167,000). It is important to recognize that differences in remuneration norms and potential liability could limit the accuracy of this comparison, possibly resulting in higher costs in the EQCF context.

Some commenters on the Proposal asked for clarity in understanding the benefits of the EQCF.⁸¹ As discussed in the economic analysis in the Proposal, the EQCF could help mitigate the influence of commercial considerations on firms' decision-making regarding their QC systems. It could benefit investors by encouraging the implementation of QC systems that better align with the interests of investors and other financial statement users. The economic analysis points to academic research suggesting that greater independence on a board of directors is linked to

audit matters. INEs are members of the UK Oversight Board and one of them is its deputy chair." See Deloitte, *2023 Transparency Report*, at 159, available at <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/about-deloitte/deloitte-uk-annual-review-2023-audit-transparency-report.pdf> ("Deloitte Transparency Report").

⁸⁰ See Deloitte Transparency Report; PricewaterhouseCoopers LLP, *UK Transparency Report 2023* at 37, available at <https://www.pwc.co.uk/transparencyreport/assets/pdf/uk-transparency-report-2023.pdf>; KPMG, *Transparency Report 2023*, available at <https://kpmg.com/uk/en/home/about/our-impact/our-firm/transparency-report.html>; Ernst & Young LLP, *EY UK 2023 Transparency Report*, at 82, available at https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2023/ey-uk-2023-transparency-report.pdf; BDO LLP, *Transparency Report* (Oct. 2023), at 115, available at <https://www.bdo.co.uk/getmedia/2d2fedc5-468a-4b58-8e9e-b6880597dcd5/Transparency-Report-2022-23.pdf>; Grant Thornton UK LLP, *Transparency Report: Grant Thornton UK LLP year ended 31 December 2023* (Apr. 2024), at 83, available at <https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/annual-reports/transparency-report-2023.pdf>. Four of these reports provide total remuneration amounts for each INE, while two only provide the base salary. However, the average remuneration and range are similar if the data from these two firms is excluded. These reports do not include details on insurance costs, which the U.K.'s Financial Reporting Council ("FRC") specifies should be provided to each INE by audit firms in the form of indemnity insurance. See FRC, *Audit Firm and Governance Code* (Apr. 22, 2022) at 12, available at <https://www.frc.org.uk/library/standards-codes-policy/audit-assurance-and-ethics/audit-firm-governance-code/>. The estimate was converted to U.S. dollars using the 5-year average yearly exchange of 1.28344 pound sterling to 1 U.S. dollar over 2019 to 2023. See Board of Governors of the Federal Reserve System, U.S. Dollars to U.K. Pound Sterling Spot Exchange Rate [AEXUSUK], retrieved from FRED, Federal Reserve Bank of St. Louis, Aug. 13, 2024.

⁸¹ See BDO Letter at 3; PwC Letter at 4.

benefits such as improved operating performance and increased company value.⁸² This suggests that independent oversight within a firm’s governance structure could potentially enhance the quality of its audit services.

One commenter on the Proposal expressed concern that the supply of individuals qualified to serve on the EQCF could be strained due to the timing of firms’ judgments on the effectiveness of their QC systems, which would likely be concentrated around evaluation and reporting dates.⁸³ The commenter said that this strain could negatively impact the quality of the EQCF’s review. It is true that, under QC 1000, all firms subject to the EQCF will be making these judgments at similar times of the year and, by implication, EQCFs will be performing their evaluations of the significant judgments at similar times of the year. However, since only 14 of the approximately 1,600 PCAOB-registered firms issued audit reports to more than 100 issuers as of 2023 and would therefore be subject to the EQCF requirement, the PCAOB believes the incremental demand for qualified individuals would be relatively small compared to the available supply. Additionally, the PCAOB notes that the common evaluation and reporting dates are unlikely to substantively affect the supply of qualified individuals, as it is improbable that individuals will serve as multiple firms’ EQCF simultaneously. The economic analysis in the Proposal also discusses potential labor market demand shocks related to this issue.

II. Economic Analysis

Some commenters raised questions about aspects of the economic analysis in the Proposal other than the discussion of the EQCF requirement. Those comments are addressed in this section.

Quantification of Costs and Benefits

One commenter on the Proposal asserted that the economic analysis was insufficiently rigorous in that it did not quantify the benefits of the standard in relation to its costs.⁸⁴

The PCAOB considered available data and research relevant to the standard when developing the economic analysis, and specifically sought comment on data that could help quantify the effects of the standard. For example, staff analyzed PCAOB inspections data,

⁸² See *Final Release* at 347 n.483 (citing Anzhela Knyazeva, Diana Knyazeva, and Ronald W. Masulis, *The Supply of Corporate Directors and Board Independence*, 26 *The Review of Financial Studies* 1561 (2013)).

⁸³ See GT Letter at 2, 3.

⁸⁴ See Chamber Letter at 2-4, 10.

conducted a survey to collect quantitative and qualitative information about firms' QC systems that was incorporated into the baseline analysis, and published a staff white paper supporting the economic analysis.⁸⁵ The economic analysis was also informed by the significant academic literature on audit quality and threats to audit quality, including additional studies that were suggested by commenters.⁸⁶

These sources provide quantitative and qualitative information that helps understand the potential effects of the rule, but they do not provide the data necessary to quantify all benefits and costs of the Proposal. Commenters also did not provide studies or data that permitted complete quantification of the benefits or costs of QC 1000. When commenters did suggest relevant data or research, the PCAOB considered it and incorporated it into the economic analysis as appropriate. As stated in the economic analysis in the Proposal, the PCAOB provides quantitative estimates where reasonable and feasible but, given data limitations, generally relies on qualitative analysis.

To quantify the benefits of the rule in relation to the costs, the PCAOB would need to be able to estimate, in dollar terms, both the costs and the anticipated benefits of the standard, including benefits to investors arising from more reliable audits of public company financial statements. Although, as discussed, the PCAOB considered the available data relevant to quantifying the benefits and costs of the Proposal, available data and methods do not permit us to fully quantify all the benefits and costs of QC 1000. Commenters also did not provide data and methods that would permit full quantification in dollar terms. Absent a full quantification of benefits and costs, QC 1000 was appropriately informed by the discussion of qualitative and quantitative factors in the economic analysis.

⁸⁵ See PCAOB, *The Impact of Quality Control System Remediation on Audit Performance and Financial Reporting Quality* (Nov. 2022).

⁸⁶ For example, the economic analysis points to one academic study that finds the average total compliance cost for Section 404 of the Sarbanes-Oxley Act was \$2.2 million (\$3.7 million adjusted for inflation), with a median of \$1.2 million (\$2.0 million adjusted for inflation). See Jagan Krishnan, Dasaratha Rama, and Yinghong Zhang, *Costs to Comply with SOX Section 404*, 27 *Auditing: A Journal of Practice & Theory* 169 (2008). The economic analysis acknowledges several limitations of the analogy between Section 404 and QC 1000. It also highlights that the study relied on voluntary disclosures by issuers as its data source. The fact that these disclosures were voluntary means that these estimates may not be representative—that is, issuers that chose to disclose costs may be systematically different in some respects from issuers that chose not to disclose information about their costs. Nonetheless, the PCAOB believes this quantitative information is potentially informative of the potential costs of the Proposal. See Final Release at 351, 352.

Burden of the Standard and Effects on Small Firms and on Competition

Some commenters on the Proposal argued that the costs of the Proposal would be burdensome and would disproportionately impact smaller firms, potentially leading firms to exit the market and reduce competition.⁸⁷ The PCAOB acknowledges in the economic analysis that the Proposal will impose costs on firms, and the commenters did not provide new evidence or point to studies suggesting that the economic analysis understates these costs.

In particular, the economic analysis acknowledges that some provisions of the standard will impose burdens on firms and that these burdens may disproportionately affect smaller firms. As discussed in the economic analysis, most firms in the market for public company audits, including smaller registered firms, are subject to other QC standards, such as the AICPA's new quality control standard, SQMS 1, or the international quality control standard, ISQM 1. Such firms will be able to leverage the investments they make to comply with the requirements of these other standards when meeting the requirements of QC 1000. Costs faced by these firms will be incremental to comply with aspects of the QC 1000 standard that differ from or go beyond those in other standards. Those costs are identified and discussed in detail in the economic analysis.

The economic analysis also acknowledges that smaller firms may face disproportionate cost increases from the new standard, and it notes potential consequences of this as well as mitigating factors.⁸⁸ The principles-based features of QC 1000, as well as the 100-issuer threshold for some provisions, help to mitigate their costs by reducing the resources needed by smaller firms to design and, if applicable, implement and operate their QC systems. That said, the economic analysis in the Proposal acknowledges that increased costs for smaller firms could be passed on to their clients or could lead to exit or consolidation or could deter entry. Such effects could be especially likely for the minority of firms that are not subject to ISQM 1 or other QC standards. As discussed in the economic analysis, available research suggests that the market for smaller public company audits is relatively competitive, mitigating consequences if relatively small firms were to exit.⁸⁹ The economic analysis also notes that, to the extent there is increased concentration in some segments of the market, the effect on audit quality is ambiguous.⁹⁰ In light of these factors, the PCAOB does not expect the effects on smaller firms to be as significant as suggested by these commenters.

⁸⁷ See Chamber Letter at 9, 10; PwC Letter at 1, 5; BDO Letter at 1.

⁸⁸ See Final Release at 354.

⁸⁹ See *id.* at 362.

⁹⁰ See *id.* at 363.

Post-Implementation Review

Two commenters, both of which supported the Proposal and believed it will protect the interests of investors, encouraged the PCAOB to consider a post-implementation review (“PIR”) to evaluate whether the amendments have achieved their intended goals.⁹¹ Another commenter asserted that the economic analysis in the Proposal is deficient in not discussing any plans for PIR or providing details on how a PIR will be conducted.⁹² The commenter further pointed to clustered implementation dates for new standards as a challenge to designing a PIR.

The PCAOB has an established PIR program under which staff of the Office of Economic and Risk Analysis (“OERA”) conduct an analysis of the overall effect of certain new auditing requirements on key stakeholders in the audit process, including whether a standard is fulfilling its intended purpose and identifying any benefits, costs, and unintended consequences flowing from the standard. In making a recommendation to the PCAOB as to whether to conduct a PIR of a new or revised standard, staff will consider a range of factors including the nature of the new standard (including the magnitude of and degree of uncertainty around the key economic effects), the feasibility (including research design and data availability), and the potential utility to the PCAOB (including whether the PIR might identify a demand for additional guidance or amendments). The PCAOB expects that OERA staff will consider whether, based on these factors, a PIR is warranted for QC 1000 and that, if so, OERA staff will recommend that the PCAOB determine to conduct one.

The PCAOB does not see a reason to deviate from its normal practice and pre-commit to a particular approach to conducting a PIR in this case. Initial experience with the standard, from inspections and other monitoring of the market, will provide the PCAOB and its staff with valuable insights into how the standard is being implemented and allow stakeholders to offer feedback to the PCAOB on how QC 1000 is working in practice. Such early feedback is crucial in shaping the design of any PIR plan. Additionally, as pointed out by the commenter, any PIR design should consider the possibility of other new standards becoming effective around the same time, as well as other significant events that could influence the same outcomes affected by the standard. Developments specific to the market for audit services (e.g., changes to accounting rules or audit standards), as well as broader economic events (e.g., the COVID-19 pandemic or the 2008 financial crisis), could complicate the ability to make reliable inferences about the impact of a particular standard. Therefore, it would be inappropriate for the PCAOB to commit to a PIR plan without a clearer understanding of other potential influences on audit firms during the standard’s implementation period.

⁹¹ See Council of Institutional Investors Letter at 3; Members of the Investor Advisory Group Letter at 2.

⁹² See Chamber Letter at 10.

The PCAOB intends to monitor the implementation of QC 1000 through its inspections program and outreach activities and will remain vigilant for any information regarding the standard’s effectiveness or implementation challenges. The findings from this monitoring effort will inform the strategy and design of any PIR.

III. **Other Issues**

The Requirement to Design a QC 1000-Compliant System

Several commenters raised concerns about the proposed requirement that all registered firms must design a QC system that complies with QC 1000, even if they are not subject to applicable professional or legal requirements with respect to PCAOB engagements.⁹³ Commenters on the Proposal questioned whether that provision is consistent with the Sarbanes-Oxley Act⁹⁴ and whether it would be unduly costly and burdensome for smaller firms.⁹⁵ Some commenters on the Proposal suggested that, rather than designing a QC 1000-compliant system, such firms should be permitted to comply with the other quality control standards to which they are subject, such as the international standard, ISQM 1, and the AICPA standard, SQMS 1.⁹⁶ Others suggested that QC 1000 should not apply to such firms until such time as they intend to take on a PCAOB engagement.⁹⁷

As discussed in the Proposal,⁹⁸ the PCAOB believes that requiring all registered firms to design a QC system that complies with QC 1000, regardless of whether they presently have obligations with respect to PCAOB engagements, is consistent with the PCAOB’s statutory mandate. The Sarbanes-Oxley Act requires the PCAOB to include in its QC standards requirements related to numerous topics for “every” registered public accounting firm.⁹⁹ Importantly, those required topics include the acceptance of engagements,¹⁰⁰ which necessarily

⁹³ See QC 1000.06.

⁹⁴ See Chamber Letter at 9; BDO Letter at 4; RSM Letter at 1; PICPA Letter at 2.

⁹⁵ See Chamber Letter at 8-10; BDO Letter at 4; PICPA Letter at 1-2; Letter from Johnson Global Advisory (June 26, 2024) (“JGA Letter”) at 2-3; PwC Letter at 5-6.

⁹⁶ See Chamber Letter at 9; JGA Letter at 2-3; PwC Letter at 5-6.

⁹⁷ See PwC Letter at 5; RSM Letter at 1.

⁹⁸ See Final Release at 59.

⁹⁹ Section 103(a)(2)(B) of the Sarbanes-Oxley Act.

¹⁰⁰ See Section 103(a)(2)(B)(v) of the Sarbanes-Oxley Act (“the acceptance and continuation of engagements”).

implies that the PCAOB’s QC standards must address firms that have not yet accepted an engagement and therefore have no current obligations with respect to one.

The design requirement also comports with the PCAOB’s historical practice, pursuant to which all applicants for registration are required to provide a summary of the design of their QC system regardless of whether they have obligations with respect to engagements.¹⁰¹ Because registering with the PCAOB enables a firm to issue audit reports or play a substantial role on audits performed under PCAOB standards for issuers and broker-dealers, and because investors and companies considering engaging the firm could reasonably expect that any firm that could pursue such an engagement would already have a PCAOB-compliant QC system designed and ready for implementation and operation, the PCAOB believes that imposing a design requirement on all registered firms promotes its mission of protecting investors and promoting the public interest.

The PCAOB does not believe that any of the approaches suggested by commenters instead of the design requirement would be appropriate. QC 1000 includes requirements that do not appear in other QC standards or that are more prescriptive or more specifically tailored to the U.S. legal and regulatory environment than the provisions of ISQM 1 or SQMS 1. Because of these key differences, the PCAOB does not believe that a QC system design based on ISQM 1 or SQMS 1, as suggested by some commenters, would be an adequate substitute. The PCAOB also believes that, because of local variations of ISQM 1, audit firms in some jurisdictions already have to design and operate a QC system that goes beyond the requirements of ISQM 1, and it would not be appropriate for QC 1000 to permit compliance with less stringent quality control requirements than those that apply in the local regulatory environment. Conversely, the PCAOB does not believe that it would be appropriate for QC 1000 to permit firms to comply with their locally applicable variation of ISQM 1, as this would result in the PCAOB requiring and managing compliance with a multitude of different QC standards.

Nor does the PCAOB believe that it would serve its regulatory purposes to provide firms with an extended compliance period after they take on an engagement. As noted above, the Sarbanes-Oxley Act mandates that the PCAOB’s standards address acceptance of engagements.

QC 1000 shares a basic structure and approach with ISQM 1 and SQMS 1, so designing for the incremental features unique to QC 1000 should not be unduly burdensome for firms that are subject to either or both of those other QC standards (which the PCAOB believes will

¹⁰¹ See Frequently Asked Questions Regarding Registration with the Board, PCAOB Rel. No. 2003-011F (Dec. 4, 2017) (Question #32), available at https://pcaobus.org/Registration/Information/Documents/Registration_FAQ.pdf. As part of this rulemaking, the requirements for a registration application are also proposed to be amended.

be the case for a very substantial majority of firms that are in a position to perform PCAOB engagements). The PCAOB does not believe that QC 1000 conflicts with the requirements of other standard setters or that anything prevents firms from developing a single QC system for their entire practice that satisfies both PCAOB requirements and other professional standards to which the firm is subject. There are certain differences between QC 1000 and the quality management standards set by other standard setters, in particular areas where QC 1000 establishes additional or more stringent requirements. However, the PCAOB believes that quality responses developed by firms under QC 1000 can be considered by firms for the purposes of other quality management standards to which they are subject, reducing the need for two or more separate QC systems and simplifying compliance with the design requirement.

Effective Date

Under the Proposal, QC 1000 would take effect on December 15, 2025. By comparison, the analogous international standard, ISQM 1, became effective on December 15, 2022, and the analogous AICPA standard, SQMS 1, will take effect on the same day as the Proposal. Given the commonalities noted above between QC 1000 and these other standards, the PCAOB believes the December 15, 2025 effective date strikes a reasonable balance, providing firms sufficient time to design and implement QC 1000-compliant systems, while also delivering the benefits of the new standard to investors as promptly as practicable. Firms that are already operating their QC system under ISQM 1 will be able to leverage the investments already made¹⁰² and focus their efforts on the differences between ISQM 1 and QC 1000. Firms that are subject to SQMS 1 and not ISQM 1—generally, smaller U.S.-based firms—will have the opportunity, if they choose, to integrate their design and implementation efforts and develop a QC system that complies with both sets of requirements at the same time.

One commenter raised concerns that the clustering of multiple new or amended PCAOB standards and rules could create unnecessary challenges.¹⁰³ The commenter said that implementing changes in audit firm systems, processes, methodologies, and training is a complex task. The PCAOB recognizes that, subject to adoption by the PCAOB and approval by the Commission, several PCAOB standards and rules could come into effect over the next few years, requiring firms to make these adjustments. The PCAOB also acknowledges that the relevant audit labor market may be relatively inelastic in the short run, which could increase the costs associated with additional systems, processes, methodologies, and training. However, implementing multiple PCAOB standards and rules in relatively quick succession could

¹⁰² For example, one firm has noted that compliance with ISQM 1 has positioned it well to adapt to future regulatory developments, including the adoption of QC 1000. See PwC, *2023 Audit Quality Report*, at 49.

¹⁰³ See Chamber Letter at 13.

potentially reduce the incremental costs attributable to each change in requirements. For example, certain systems or training could be more efficiently implemented on an integrated basis, addressing multiple new requirements simultaneously.

Implementation Guidance and Identification of Good Practices

Several commenters indicated that they would benefit from implementation guidance regarding QC 1000.¹⁰⁴ The PCAOB anticipates that its staff will issue such guidance and will engage in other activities to support firms' implementation efforts. The PCAOB also anticipates that, following the implementation of QC 1000, the PCAOB or its staff will provide information regarding good practices observed in connection with QC 1000.

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The PCAOB believes that the foregoing responds to the material issues raised by the commenters regarding the Proposal. If you have any questions, please contact Barbara Vanich at (202) 207-9363.

By the Board.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

¹⁰⁴ See, e.g., CAQ Letter at 4; Forvis Mazars Letter at 2; GT Letter at 3.