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Vanessa A. Countryman, Secretary
Office of the Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

26 August 2024

Re: Securities and Exchange Commission Release No. 34-100277 (File No. PCAOB-2024-02), *Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on A Firm's System of Quality Control and Related Amendments to PCAOB Standard*

Dear Ms. Countryman:

Ernst & Young LLP appreciates the opportunity to share our views with the Securities and Exchange Commission (SEC or Commission) on the final standard (final standard, adopting release or QC 1000) that was adopted by the Public Company Accounting Oversight Board (PCAOB or Board) on 13 May 2024 (File No. PCAOB 2024-02) and filed with the SEC on 24 May 2024 in SEC Release No. 34-100277, *Notice of Filing of Proposed Rules on A Firm's System of Quality Control and Related Amendments to PCAOB Standards*.

We recognize and appreciate the PCAOB's significant efforts to consider the views of stakeholders on its December 2019 concept release and 2022 proposed standard, and to analyze and leverage the approaches other standard setters have taken to update their quality control standards. We have provided feedback to the PCAOB throughout this process, emphasizing our belief that a firm's system of quality control (QC) is foundational to audit quality. We agreed that revising the PCAOB's QC standards is necessary because the auditing environment has changed significantly since the PCAOB adopted the American Institute of Certified Public Accountants (AICPA) standards on quality control on an interim basis in 2003.

Clarity and consistency in standards are essential for fostering investor trust and understanding. The standard-setting process benefits greatly from stakeholder feedback. Integral to that process is a clear articulation of the standard setter's objectives, intent and underlying basis and rationale for its proposed action.

While we support the quality objectives adopted in the final standard, we unfortunately have concerns about the requirement for certain firms to have an external quality control function (EQCF) that was included in the adopting release. We believe this requirement is not a logical outgrowth of the Board's 2022 proposed standard and did not benefit from stakeholder input since it is a significant change from the proposal. Our concerns are consistent with those raised by the Center for Audit Quality¹ in its

¹ [Center for Audit Quality letter to the SEC](#), dated 2 July 2024.

letter to the Commission. Furthermore, we believe that the PCAOB's letter² to the Commission on this topic does not sufficiently address these concerns and raises additional questions that have not been subject to due process.

Specifically, when the PCAOB proposed the standard, it had put forth a flexible requirement under which the largest firms would incorporate some form of external oversight, and the Board stated that it "would not specify" how a firm would accomplish this, "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." Since the proposal did not specify how firms could comply with this proposed requirement, our comments on it were focused on seeking clarification on certain terms.

However, the Board took a very different approach when adopting the final standard, mandating a never-before-discussed "External Quality Control Function" and specifying types of involvement in a firm's QC evaluation. We have questions and concerns about this novel requirement that should be addressed through the PCAOB's standard-setting process, and not at this late stage of SEC consideration.

While we appreciate the additional arguments put forth in the Board's letter to the Commission, such arguments do not substitute the diligence of the standard-setting process, because fundamental concerns and questions regarding the EQCF role and its potential consequences remain. As a result, we are unable to support SEC approval of the final standard in its current form and believe the SEC should not approve the standard in its current form.

External quality control function

The PCAOB's proposed standard would have required that "if a firm issued audit reports with respect to more than 100 issuers during the prior calendar year, the firm's governance structure should incorporate an oversight function for the audit practice that includes at least one individual 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."

Notably, the proposed standard would have expressly provided firms with flexibility in how they would incorporate external oversight into their governance structure, stating: "The requirements 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."³

Furthermore, the PCAOB stated in the proposed standard: "In addition, we believe firms with over 100 issuer clients typically have the resources to implement such structures, and based on our oversight activities, some firms already have non-employee governance structures." The PCAOB acknowledged that the largest firms already had some form of governance structure that included a non-employee.⁴

² [PCAOB letter in response to the SEC's comments on the rule filing](#), dated 16 August 2024.

³ [PCAOB Release 2022-006](#), *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, page 9.

⁴ [PCAOB Release 2022-006](#), page 98, including footnote 163.

In contrast, the adopting release significantly reduces this flexibility by imposing specific requirements related to a firm's overall QC conclusion that were not vetted - notably that the EQCF must be conducted by individuals external to and independent from the firm, whose duties, at a minimum, include evaluating the significant judgments made in the assessment of the effectiveness of a firm's QC system.

Given the PCAOB's acknowledgment of existing firm structures in its proposal, we agreed in our comment letter to the PCAOB that the largest firms should adopt a formal structure that provides independent perspectives on assurance matters, including matters involving QC, to firm leadership. However, we noted the potential for confusion regarding the use of the terms "governance structure," "oversight function" and "independent judgment." Therefore, we recommended that the final standard expressly acknowledge that independent advisory boards are a permissible approach, given that they represent the prevalent structure in place today across the profession.

As a result, we do not believe stakeholders could have reasonably anticipated that the EQCF was an alternative being considered by the PCAOB. If the EQCF provision had been subject to public comment, we would have posed a number of questions and expressed our concerns, as more fully detailed below.

Analogy to an engagement quality reviewer

The Board stated in the adopting release that the EQCF's evaluation is, in some respects, analogous to the engagement quality reviewer's evaluation of significant judgments made during an audit. Similar to the engagement quality reviewer, the EQCF is expected to review and evaluate work performed by others while exercising due professional care.⁵ However, unlike the engagement quality reviewer, who is governed by the requirements in the PCAOB's engagement quality review standard (AS 1220 *Engagement Quality Review*), the final standard does not specify the procedures the EQCF should perform to evaluate the significant judgments made and related conclusions reached. This omission creates uncertainty regarding the application of the responsibilities specified in the final standard.

For example, QC 1000 does not address the nature, timing and extent of the EQCF's review. Furthermore, because QC 1000 does not require the EQCF to provide concurring approval of the firm's evaluation of or reporting on its QC system, it is unclear how firms will understand and document the EQCF's identification of and conclusion about the firm's significant judgments.

In addition, the final standard does not address how differing judgments made by the EQCF and the firm should be resolved or documented.⁶ These matters, combined with the expectation that the firm consider the EQCF's evaluation in its ongoing monitoring of its QC system and related evaluation process, raise questions about the potential for the EQCF to be viewed as a "supervisory person" for purposes of Section 105(c)(6) of the Sarbanes-Oxley Act and the PCAOB's rules, and the potential liability of the EQCF (including under the recently amended Rule 3502). This, in turn, presents significant uncertainty about the costs and benefits of the EQCF.

⁵ [PCAOB Release 2024-005](#), page 121.

⁶ AS 1220: Engagement Quality Review; .02 "The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team1A and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance." And .12 "In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by this standard, he or she is not aware of a significant engagement deficiency."

We believe these issues are particularly important in light of the Board's recent letter to the Commission, in which it expanded the expectation for the EQCF by stating: "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, would be prohibited from contributing to any violations by the firm in contravention of the PCAOB's contributory-liability rule, 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, and would be required to adhere to any applicable PCAOB ethics standards."

These statements highlight the importance of clarity regarding the intended role, responsibilities and practices of the EQCF, which we believe will also significantly impact firms' ability to attract and retain qualified individuals for such a role.

While we remain supportive of requirements to establish structures that provide independent perspectives to firm leadership, we believe that the PCAOB has neither sufficiently addressed the basis for the role of the EQCF nor engaged in adequate due process. The function as outlined in the final standard, as well as the related requirements as clarified in the PCAOB's letter to the Commission, raise additional questions related to the practical operation of the EQCF and its potential impact on audit firms and their quality control processes. We stand ready to actively engage with the PCAOB to provide additional input on the provision.

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We again thank the Commission for considering our comments on this important matter. We would be pleased to discuss our comments further with the Commission or its staff at your convenience.

Very truly yours,



Copy to:

SEC

Gary Gensler, Chair
Caroline A. Crenshaw, Commissioner
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Hester M. Peirce, Commissioner
Mark T. Uyeda, Commissioner
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