



July 1, 2024

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

**RE: File Number PCAOB 2024-02**

Dear Ms. Countryman:

We appreciate the opportunity to comment on 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* (the “PCAOB standard,” “PCAOB adopting release,” “PCAOB Release 2024-005,” or “QC 1000”).

We have provided feedback to the PCAOB (or the “Board”) in response to its initial concept release as well as on its proposed standard. As we have expressed to the PCAOB, we support its efforts to create a framework that (1) facilitates international alignment, (2) is integrated, risk-based, and scalable for application by firms of all sizes, and (3) promotes accountability. We also appreciate the significant effort the PCAOB and its staff has put in over the years, including the milestones of its initial concept release in 2019, its proposed standard in 2022, and its recent adoption. We support the ultimate goal of improving and modernizing its quality control standards. This has resulted in a QC standard based on an objective-driven and risk-based approach that will encourage a more proactive focus on quality management, while allowing a firm’s QC system to be tailored to the jurisdiction in which the firm operates.

While we support the quality objectives adopted in the standard that substantively set out such a framework, the PCAOB’s adopted standard includes a revised requirement for an External Quality Control Function (EQCF) that raises significant concerns including being inconsistent with the Sarbanes-Oxley Act of 2002 (SOX), and in one other respect, did not adequately address concerns that we and others raised on the ability for smaller firms to comply with the proposal for which we respectfully suggest further actions be considered by the PCAOB. On the basis of these concerns, notwithstanding our overall support for the project and the large majority of the provisions of the standard, we are unable to support SEC approval of the final standard in its current form.

**The EQCF requirement was not sufficiently vetted and is fundamentally flawed.**

The PCAOB adopting release contains a new — never exposed or publicly vetted — requirement in paragraph .28 of QC 1000 for firms with at least 100 issuer clients to implement an External Quality Control Function. It is novel, significant, unvetted, inconsistent with existing law and rules, and concerning. It did not benefit from sufficient public input, resulting in an approach to oversight that is fundamentally flawed. This very significant new EQCF requirement was described as a “key change” from the proposal and included for the first time in the adopting release. Notably, in the proposing release, the PCAOB expressly left discretion to firms regarding how to incorporate external oversight into their governance structures, 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.”<sup>1</sup> By contrast, the final rule leaves the firms little discretion, instead adopting a rigid and problematic requirement related to a firm’s overall QC conclusions that is poorly analogized to an engagement quality reviewer and poses legal and other challenges, as described below. Since the EQCF requirement was not included in the proposing release, we did not have an opportunity to properly consider it and provide important feedback on this requirement, which we believe would result in firms being required to take actions inconsistent with the PCAOB’s obligations pursuant to SOX.

### **The newly-introduced EQCF requirement conflicts with SOX and existing PCAOB rules.**

Had we been provided an opportunity to consider a Board proposal for an EQCF requirement, we would have observed that it introduces a new fundamental flaw to QC 1000, creating a conflict with SOX by requiring the firm to take certain actions the PCAOB is prevented from taking itself and therefore cannot require a firm to take.

Specifically, both SOX and existing PCAOB rules<sup>2</sup> provide that no portions of an inspection report that deal with criticisms of or potential defects in the QC system of the firm shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, no later than 12 months after the issuance of the inspection report. The PCAOB adopting release creates a conflict with SOX and the extant rules because it offers no appropriate way for one or more individuals to perform the newly required EQCF role without the firm disclosing to them non-public quality control (QC) criticism(s) in Part II of the PCAOB’s inspection reports and the firm’s related analysis of the nature and severity of such matters in reaching the firm’s conclusions about the effectiveness of its system of QC.<sup>3</sup> Because the EQCF review is required to be performed by persons otherwise external and independent to the firm, disclosure of QC criticisms (and other legally-privileged information that may be relevant) to the reviewer(s) could call into question whether these legal privileges were waived. That is inconsistent with the protections Congress intended under Section 105 of SOX. In fact, global network firms have robust year-round discussions with the PCAOB on such matters and provide extensive proprietary, sensitive, non-public information related to such matters that assist the PCAOB inspections staff in understanding a firm’s quality control evaluation, including significant judgments, and they have the ability to question those judgments if necessary. But these robust communications are facilitated and promoted by the protection of Section 105 of SOX. The inherent conflict of the EQCF requirement with both SOX and PCAOB’s own Rule 4009 does not appear to have been considered by the Board in developing the proposed requirement and the specific expectations for the role.

The proposal included a requirement for external oversight that did not pose the same conflict. It would have imposed a requirement for certain firms to have oversight from at least one independent individual as follows:

If the 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

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- <sup>1</sup> [PCAOB Release 2022-006](#), *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (the “proposed standard,” the “proposing release,” or “proposed QC 1000”), page 98.
  - <sup>2</sup> [PCAOB Rule 4009, Firm Response to Quality Control Defects](#), governs the process for addressing criticisms and potential defects as well as the process through which the Board could make nonpublic portions of the inspection report publicly available.
  - <sup>3</sup> [PCAOB Release 2024-005](#), page 122, states: “The responsibilities assigned to the EQCF will in turn drive decisions about the scope of the EQCF’s authority. At a minimum, that will entail sufficient access to information, documentation, and firm personnel to enable evaluation of the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system, but it could be broader depending on the scope of the EQCF’s responsibilities as assigned by the firm.”



the audit practice that includes 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.<sup>4</sup>

In our response to the PCAOB's 2019 Concept Release<sup>5</sup> where this proposed requirement was first explored, we explained our approach to obtaining perspectives from independent third parties, noting this can benefit audit quality by enhancing a firm's governance and decision-making processes. We have an external director on the US Board of Partners and Principals, and we maintain an independent Assurance Quality Advisory Committee (AQAC) consisting of three members who provide perspectives and advice to audit firm leadership on aspects of the business, operations, culture, governance, and risk management approach that are reasonably expected to impact audit and assurance quality. In our response to the 2019 concept release, we explained that we do not view these mechanisms as directly serving as oversight of our QC system or otherwise enabling us to obtain reasonable assurance that our QC system is operating effectively, and that we did not support adding a requirement in revised PCAOB QC standards that mandates independent oversight or that specifies the qualifications and duties of those providing independent oversight.

In the proposing release, the PCAOB acknowledged that we and other firms already had put in place a governance structure to obtain the benefits of independent perspectives. The release expressly noted: "[W]e believe firms with over 100 issuer clients typically have the resources to implement such structure, and based on our oversight activities, some firms already have non-employee governance structures." That was footnoted with: "In 2021, we observed the largest six firms had some form of governance structure that included a non-employee."<sup>6</sup> Given this stated acknowledgment in the proposing release related to firms' existing structures, we did not object to the proposed requirement. We reasonably understood that either our independent director or the AQAC structure would suffice. However, the description of the EQCF and its specific responsibilities in the final standard extend well beyond the responsibilities of either of those roles and represents a significant shift from what was included in the proposing release. As an example, the shift from an "oversight function of the audit practice" to an "oversight function for the QC system" represents a significant change, notwithstanding the reference to "independent judgment with respect to matters related to the QC system." Such significant change after the proposal effectively deprives us of an opportunity for public input into the revised requirement.

Despite the PCAOB's express statement in the proposal that it would not specify "how the firm would establish its governance structure or assign authority," the final standard ascribes minimum responsibilities for the EQCF to evaluate the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system, as well as requires the EQCF to have the experience, competence, authority, and time necessary to enable them to carry out the responsibilities the firm assigns to it. It even goes so far as to analogize this role to that of an Engagement Quality Reviewer (EQR),<sup>7</sup> a role that has very specific responsibilities and requirements that were not contemplated in any way by the proposal.

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<sup>4</sup> [PCAOB Release 2022-006](#), paragraph .28 of proposed QC 1000.

<sup>5</sup> See our [response](#) to PCAOB Release 2019-003, *Potential Approach to Revisions to PCAOB Quality Control Standards*.

<sup>6</sup> [PCAOB Release 2022-006](#), page 98 including footnote 163.

<sup>7</sup> [PCAOB Release 2024-005](#), page 121.



Further, the adopting release raises the possibility that individuals filling this role could be subject to liability under Section 105(c)(6) of SOX. That prospect would severely limit the pool of candidates who would be willing to accept this role.

The adopting release states “[a]n external oversight function should enhance the discipline with which the firm carries out its own QC system evaluation.”<sup>8</sup> We do not believe that firms should be viewed as incapable of performing their own evaluations and conclusions on their QC systems with full transparency to the PCAOB through its inspections process but without third-party involvement. In fact, firms are trusted to make similar conclusions on ICFR related to its issuer audit clients, even when the firm has previously opined that ICFR is effective but subsequently becomes aware of information that is contradictory to its prior conclusions. Regarding the Board’s statement that the EQCF’s evaluation is in some respects analogous to an Engagement Quality Reviewer,<sup>9</sup> an EQR is required to perform a review under very specific requirements that are the subject of an entire audit standard promulgated by the PCAOB. The EQR is not well analogized to the newly introduced EQCF, and the Board has not provided such specified requirements for the performance of the EQCF’s evaluation. If the PCAOB has doubts about a firm’s ability to reach its own reasonable assurance conclusion, it already has the authority to use these doubts to inform its inspections of a firm’s system of QC or require it to have an external monitor or consultant in the context of a settled enforcement action as per precedent.

It is unclear what benefits arise from an EQCF that justify the significant associated costs and burdens. In the Economic Impacts section of the adopting release, the Board acknowledges certain commenters’ cost concerns with implementing an oversight function as prescribed in the proposal, but states: “all of the U.S. GNFs indicate, as of the 2020 inspection cycle, that they already have a governance structure that includes a non-employee.”<sup>10</sup>

While the Board acknowledges these existing structures, it does not acknowledge that the novel requirements contained in the adopted rule would involve significant additional internal and external costs arising from (1) entering into a new arrangements with the same or other individuals who are determined to have sufficient competence for the specific role and who satisfy the rule as adopted, (2) sufficiently compensating individuals fulfilling the EQCF role for their time and potential liability, and (3) the additional resources needed for the firm to enable the EQCF to perform the required duties. These unnecessary costs would be passed on to issuers (and ultimately investors).

Unfortunately, given the lack of opportunity for comment on this far-reaching provision, our objections to this new requirement and concerns on due process are being raised for the first time in this comment letter. Based on the nature of these concerns and the questions that arise as to whether the Board has sufficiently followed due process in finalizing QC 1000, we do not believe there is a reasonable basis for approving the adopted standard under the statutory approval criteria, as at least this new aspect of it is not consistent with the requirements of SOX, nor is it necessary or appropriate in the public interest or for the protection of investors.<sup>11</sup> Instead, the SEC should either (1) disapprove the standard or (2) request that the PCAOB either (a) withdraw the final standard and repropose the standard including the EQCF requirement to give the public a meaningful opportunity to submit comments and questions that can fully inform the development of a more appropriate new requirement or (b) remove the EQCF requirement and resubmit an amended standard for approval. After that process, if the SEC and PCAOB determine that some form of a new requirement has merit, it could be addressed by separate rulemaking with appropriate consideration of the benefits and costs, as well as the conflict with SOX and existing PCAOB rules, before

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<sup>8</sup> [PCAOB Release 2024-005](#), page 124.

<sup>9</sup> [PCAOB Release 2024-005](#), page 121.

<sup>10</sup> [PCAOB Release 2024-005](#), page 347.

<sup>11</sup> [15 U.S. Code section 7217\(b\)\(3\)](#) (Commission oversight of the Board).



finalization. If the Board were to remove the newly adopted EQCF requirement we would strongly support the new standard as amended.

**The standard constrains smaller audit firms.**

In our [comment letter to the PCAOB](#), we recommended that the PCAOB allow registered firms that do not perform any engagements in accordance with PCAOB standards to design their systems of QC in line with ISQM 1<sup>12</sup> or SQMS 1<sup>13</sup> (which are substantially equivalent to each other) and perform an annual evaluation in accordance with these standards. We agreed with the PCAOB’s view in the proposing release that the costs of fully implementing proposed QC 1000 outweigh the benefits for those registered firms that do not perform any engagements in accordance with PCAOB standards but questioned whether it is necessary to require those firms to design a QC system in line with proposed QC 1000 (“design only”). Costs associated with the design and documentation of the QC system to address the incremental requirements in proposed QC 1000 could be significant. We observed that broadly applying the requirement to design a QC system aligned with QC 1000 could result in the following as well as other issues.

- Registered firms may decide it is no longer viable to remain as registered firms.
- A focus on “design only” may not result in a robust implementation whereas adoption of ISQM 1 or SQMS 1 promotes accountability for an effective QC system.

Despite a significant volume of comments on this element of the proposal, the Board retained the approach in proposed QC 1000. This remains a significant concern to several member firms in our network that are inactive, and the economic analysis continues to insufficiently consider the likely significant costs of designing a system of QC in accordance with QC 1000 on a hypothetical basis as the adopting release states that up to 60% of firms may not currently be required to comply with applicable professional and legal requirements with respect to any of their engagements.<sup>14</sup> These costs will either need to be absorbed by that firm or passed along to clients in a way that could price that firm out of the local market, thus reducing choice of potential auditors. In practice, even for firms that are performing a small number of engagements under PCAOB standards, the requirement to comply with two standards (i.e., either ISQM 1 or SQMS 1 and QC 1000) with two different sets of deficiency definitions and conclusion frameworks could present similar cost constraints.

Given the Board’s view that this approach is necessary in light of SOX’s stated directive to include requirements in QC standards related to numerous topics for “every” registered public accounting firm,<sup>15</sup> we acknowledge it is unlikely that the SEC will disapprove the standard on this basis even if it were in a position to otherwise approve it. However, a reasonable way to overcome the concerns expressed by commentators would be to defer the effective date of QC 1000 implementation for these firms until such time as they determine they intend to perform engagements in accordance with PCAOB standards and consider whether explicit guidance could be developed that would explain that a registered accounting firm is essentially prohibited from undertaking PCAOB engagements until a system of QC that complies with QC 1000 is in place. In the interim, those firms would continue to operate their systems of QC in accordance with existing PCAOB standards (QC 20, QC 30, and QC 40). However, these firms would likely

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<sup>12</sup> [International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements, which was effective December 15, 2022.](#)

<sup>13</sup> [AICPA Statement on Quality Management Standards No. 1, A Firm’s System of Quality Management, which is effective December 15, 2025.](#)

<sup>14</sup> [PCAOB Release 2024-005](#), page 345.

<sup>15</sup> [PCAOB Release 2024-005](#), page 59.



also have a system of QC in place that complies with either ISQM 1 or SQMS 1 that could serve as the basis for building a QC 1000-compliant system of QC if and when necessary.

**Ongoing monitoring of implementation of the final standard by the Board will be necessary.**

Given the significance of certain differences between QC 1000 and extant standards, PCAOB efforts to support the effective implementation of the new standard, if approved, will be necessary. Firms of all sizes would benefit from the ability to engage with the PCAOB and its staff, as it is likely that questions will arise from firms as they design a compliant system of QC, including as they evaluate the intent of the Board's statements made in the adopting release and consider the effects of incremental differences between QC 1000 and QC standards of the AICPA and IAASB.

We stand ready to engage with the PCAOB on the areas previously discussed in this letter, those shared by other respondents through the feedback process, as well as certain others including:

- The nature and extent of documentation required to comply with paragraph .83
- Quality responses that firms may design and implement relative to certain technological resource characteristics listed in paragraph .51<sup>16</sup>

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In summary, our objection raised with respect to the EQCF results in our inability to support SEC approval of the standard. We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions. Please contact Brian Croteau at [brian.t.croteau@pwc.com](mailto:brian.t.croteau@pwc.com) or Tim Carey at [d.timothy.carey@pwc.com](mailto:d.timothy.carey@pwc.com) regarding our submission.

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP

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<sup>16</sup> Attributes listed in paragraph .51, such as capacity, resiliency, and availability, may have been historically viewed as operationally important, but other standards have not previously specified these relative to the risk of failing to prevent or detect quality matters resulting from the use of technological resources.