



July 15, 2024

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

**Re: Securities and Exchange Commission Notice of Filing of PCAOB Proposed Rules on *A Firm's System of Quality Control and Related Amendments to PCAOB Standards* (Release No. 34-100277; File No. PCAOB-2024-02) (June 5, 2024)**

Dear Ms. Countryman:

The U.S. Chamber of Commerce (“Chamber”) Center for Capital Markets Competitiveness appreciates the opportunity to comment on the Securities and Exchange Commission (“SEC” or “Commission”) Notice of Filing of the Public Company Accounting Oversight Board (“PCAOB” or “Board”) Proposed Rules on *A Firm's System of Quality Control and Related Amendments to PCAOB Standards* (“QC 1000” or “adopting release”). The Chamber urges the SEC to reject the QC 1000 update from the PCAOB.

The QC 1000 standard directly conflicts with Section 104(g) (2) of the Sarbanes Oxley Act of 2002 (“SOX”) which prohibits public disclosure of items in an inspection report that have been corrected. The PCAOB cannot override the legal requirements as established by Congress. Accordingly, in its current form QC 1000 violates SOX and the Commission should reject it.

On its own, the SEC should reject the PCAOB’s final QC 1000 standard because it contains fundamental failures and flaws, as subsequently discussed. Alarming, the QC 1000 standard represents the first time since the inception of the PCAOB that a Board vote to adopt a final standard or rule has not been unanimous.<sup>1</sup>

The QC 1000 standard adopted by the PCAOB contains a new requirement for an External Quality Control Function (“EQCF”) that is not a logical outgrowth of what the Board proposed in November 2022 (“QC 1000 Proposal”) – denying the public an opportunity to comment – and that is fundamentally flawed. Further, QC 1000 fails to comport with the PCAOB’s authority under SOX and fails to comply with the standards the Board and SEC are required to satisfy when adopting new PCAOB standards, among other matters.

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<sup>1</sup> See the *Statement on QC 1000 Adoption – Demise to Audit Competition* by Board Member Christina Ho (May 13, 2024).

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As detailed further below, the Board's approval of QC 1000 rests on an economic analysis that falls far short of what is legally required and is not one on which the SEC may therefore rely. Instead, the SEC must conduct its cost-benefit analysis of the standard with due regard of the Commission's statutory mandate as interpreted by the courts, then publish that analysis for public comment. Failure to do so places any finally-adopted standard in legal peril.

In addition to the potential for increasing concentration and reducing competition in the smaller firm market for issuer and broker-dealer audit engagements, as discussed below, the QC 1000 has broader implications for the SEC. The SEC has both promulgated and proposed rules requiring the use of PCAOB registered and inspected audit firms by other than issuers and broker-dealers.<sup>2</sup> The SEC needs to consider the consequences of QC 1000 for these segments of the market and the ability of non-issuers/non-broker-dealers to engage the requisite audit firms and comply with the rules the SEC imposes on their organizations.

Under Section 103 of SOX, the Board may adopt professional practice standards "as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." After the Board adopts a standard, Section 107(b)(2) of SOX requires that it then must be approved by the SEC in order to take legal effect.<sup>3</sup> In evaluating a Board rule, Section 107(b)(4) of SOX in turn directs the SEC to follow the process under Section 19(b) of the Securities Exchange Act of 1934.

In the case of a PCAOB rulemaking, the SEC must consider the standard according to Section 107(b)(3) of SOX and may approve it "if it finds that the rule is consistent with the requirements of [the Sarbanes-Oxley] Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors."<sup>4</sup> In addition, Section 103(a)(3)(C) of SOX, added under the Jumpstart Our Business Startups Act of 2012 ("JOBS Act"), provides that in order for a new standard to apply to audits of emerging growth companies ("EGCs"), the Commission must determine "that the application of such additional requirements is necessary or appropriate in the

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<sup>2</sup> For example, see the SEC Final Rules on *Private Fund Advisers: Documentation of Registered Investment Advisers Compliance Reviews* (S7-03-22, IA-6282; August 23, 2023) and the SEC Proposed Rule on *Safeguarding Advisory Client Assets* (88 Fed. Reg. 14,672-14,792; March 9, 2023). Although, the former rule is subject to legal challenges (see "Fund Managers Win Case Against SEC's Fee Rules" in the *Wall Street Journal*, June 6, 2024).

<sup>3</sup> See also *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 486 (2010) ("The Act places the Board under the SEC's oversight, particularly with respect to the issuance of rules.")

<sup>4</sup> 15 U.S.C. § 7217(b)(3).

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public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.”

The use of the term “public interest” binds the Board’s process under SOX and the Commission’s process under Section 19(b). Section 3(f) of the Securities Exchange Act is clear that whenever the SEC “is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”<sup>5</sup> Therefore, because SOX includes the same “public interest” standard as the Securities Exchange Act, the SEC’s decision to approve a rule or standard proposed by the PCAOB is subject to statutory cost-benefit analysis.

The “public interest” standard tightly constrains the abilities of both the PCAOB to adopt audit standards and the SEC to approve them. Under the Administrative Procedure Act, a court must “set aside” agency actions found to be “in excess of statutory jurisdiction, authority, or limitations,” or that is “arbitrary, capricious, . . . or otherwise not in accordance with law.”<sup>6</sup> Once the SEC has approved a PCAOB rule, aggrieved parties may initiate a judicial challenge.<sup>7</sup>

Courts reviewing SEC action must be sure the agency has “examined the relevant data and articulated a satisfactory explanation for its action including a rational connection between the facts found and the choices made.”<sup>8</sup> The SEC also has a “statutory obligation to determine as best it can the economic implications of the rule.”<sup>9</sup> The SEC’s “failure to ‘apprise itself — and hence the public and the Congress — of the economic consequences of a proposed regulation’ ” renders the SEC action arbitrary and capricious.<sup>10</sup>

In light of the foregoing, the SEC has a “statutory obligation to determine as best it can the economic implications of the rule it has proposed.”<sup>11</sup> The SEC must “quantify the certain costs” or explain why those costs cannot be calculated.<sup>12</sup> As part of its cost-benefit analysis, the SEC “must identify benefits that ‘bear a rational

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<sup>5</sup> *Id.* § 78c(f).

<sup>6</sup> 5 U.S.C. § 706(2).

<sup>7</sup> *Free Enterprise Fund*, 561 U.S. at 489.

<sup>8</sup> *Business Roundtable and Chamber of Commerce v. SEC*, 647 F.3d 1144, 1148 (citing *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

<sup>9</sup> *Id.* at 1148 (citing *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005)).

<sup>10</sup> *Id.* (citing *Chamber of Commerce*, 412 F.3d at 144).

<sup>11</sup> *Chamber of Commerce*, 412 F.3d at 143.

<sup>12</sup> See *Business Roundtable*, 647 F.3d at 1149.

relationship to the . . . costs imposed.”<sup>13</sup> In doing so, the SEC may not ignore data it does not want to consider.<sup>14</sup> Courts will vacate an SEC rule that relies “upon insufficient empirical data.”<sup>15</sup>

Because the PCAOB fails to satisfy these requirements, among a host of other issues with QC 1000, the Chamber urges the SEC to reject the PCAOB’s QC 1000 standard.

The discussion below of the QC 1000 standard below also emphasizes the following points to which the SEC should give consideration:

1. **The QC 1000 standard directly conflicts with Section 104(g) (2) of SOX;**
2. **The new requirement for an EQCF was not appropriately exposed for public comment and is fundamentally flawed;**
  - a. The PCAOB has committed process violations in the completion of QC 1000.
  - b. The new EQCF requirement is fundamentally flawed and was not appropriately exposed for notice and comment.
3. **The requirement for registered but not inspected audit firms to implement the design-only requirement of QC 1000 is not fit for purpose;**
4. **The PCAOB’s economic analysis for QC 1000 is inadequate;**
5. **The PCAOB’s comment period for QC 1000 was inadequate;**
6. **The effective date for the new QC 1000 standard is inappropriate.**

*Discussion:*

1. **The QC 1000 standard directly conflicts with Section 104(g)(2) of SOX.**

The PCAOB’s new Exchange Quality Control Function (“EQCF”) conflicts with SOX. Section 104(g)(2) of SOX provides that no portion of the PCAOB audit firm inspection report that deals with criticisms of or potential defects in the Quality Control (“QC”) system 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 twelve months after the date of the inspection report. The PCAOB includes QC system criticisms and defects in Part II of audit firm inspection reports. In compliance with SOX, Part II findings are nonpublic unless the Board determines that any criticism or defect is not satisfactorily remediated by the firm in the allotted timeframe.

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<sup>13</sup> *Chamber of Commerce v. SEC*, 85 F.4th 760, 777 (5th Cir. 2023) (citing *Pub. Citizen v. EPA*, 343 F.3d 449, 455 (5th Cir. 2003)).

<sup>14</sup> *Id.* at 776.

<sup>15</sup> See *Business Roundtable*, 647 F.3d at 1150-51.

The EQCF cannot meet the required responsibilities without the firm disclosing to the EQCF the specifics of the nonpublic information in Part II of PCAOB audit firm inspection reports. The EQCF cannot evaluate the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system without having the details of the nonpublic Part II QC criticisms and defects and related information and analyses by the firm, including the firm's remediation activities to address the criticisms and defects.

Yet, disclosing Part II information to the EQCF – consisting of one or more independent third-parties<sup>16</sup> – would be considered a public disclosure, which negates the confidentiality provided by SOX for QC inspection findings and deficiencies (appropriately remediated). In contravention of SOX, the EQCF requirement forces audit firms to take actions that the PCAOB is prevented from taking itself. This represents a fundamental flaw with the EQCF requirement in QC 1000 on which the PCAOB did not provide an opportunity for notice and comment.

A PCAOB standard that conflicts with existing law is invalid on its face and must be rejected by the SEC.

## **2. The new requirement for an EQCF was not appropriately exposed for public comment and is fundamentally flawed.**

In addition to EQCF violating SOX, the new EQCF requirement in QC 1000 is fundamentally flawed. Stakeholders had no opportunity to raise issues or provide input to the PCAOB on the EQCF and the fundamental flaws discussed below.<sup>17</sup> The EQCF requirement was not included in the QC 1000 Proposal; it could not have been anticipated from the provisions of the QC 1000 Proposal; and, therefore, it has not been subject to notice and comment by the PCAOB. The constrained time-period for providing comments to the SEC limits our discussion of fundamental flaws to only selected matters.

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<sup>16</sup> To meet the requirement of QC 1000, independent third-party status would stand regardless of any EQCF responsibilities assigned by the firm that might result in the PCAOB considering the EQCF as associated persons, as subsequently discussed.

<sup>17</sup> This also means that subsequent PCAOB staff guidance is an insufficient alternative to or remedy for the lack of notice and comment.

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*2.a. The PCAOB has committed process violations in the completion of QC 1000.*

Importantly, the Board did not expose for public comment the substantial departures from the QC 1000 Proposal. Stakeholders had no opportunity to provide input on any aspect of the EQCF or illuminate the fundamental flaws with the new EQCF requirement prior to the Board adopting QC 1000.

According to the Administrative Procedure Act (“APA”), an agency “commits serious procedural error when it fails to reveal portions” of a rule’s basis “in time for meaningful commentary.”<sup>18</sup> Thus, in order to comport with the APA’s notice-and-comment requirements, “an agency’s final rule must be a logical outgrowth of the version set forth in its notice of proposed rulemaking.”<sup>19</sup> As the DC Circuit has explained, “if it were otherwise, agencies could evade their notice-and-comment obligations by adopting final rules unrelated to their published proposals.”<sup>20</sup> Accordingly, an “agency may not leave the public” to divine the agency’s unspoken thoughts” on a final rule that is “surprisingly distant from the proposed rule.”<sup>21</sup> While it is true that the APA does not “require that rules be subjected to multiple cycles of notice and comment until the version adopted as final is identical to the last notice of proposed rulemaking,” the parties nevertheless “should have anticipated” the final rule in light of the public notice.<sup>22</sup> Under this standard, “notice suffices when it has expressly asked for comments on a particular issue or otherwise made clear that the agency was contemplating a particular change.”<sup>23</sup>

The EQCF requirement could not have been anticipated from the QC 1000 Proposal and is therefore new to the QC 1000 standard adopted by the Board. The EQCF requirement is neither a clarifying response to nor a logical outgrowth of the QC 1000 Proposal.

*2.b. The new EQCF requirement is fundamentally flawed and was not appropriately exposed for notice and comment.*

The EQCF requirement in QC 1000 is neither realistic nor needed. The QC systems of annually inspected audit firms with a global reach are complex and involve a multitude of significant judgments and related conclusions by a firm when

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<sup>18</sup> *Solite Corp. v. EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991).

<sup>19</sup> *Brennan v. Dickson*, 45 F. 4th 48, 69 (D.C. Cir. 2022) (citing *Covad Comms. Co. v. FCC*, 450 F.3d 528, 548 (D.C. Cir. 2006).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* (internal quotations omitted).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* (internal quotations omitted).

evaluating and reporting on the effectiveness of its QC system. It is unrealistic to embed independent third-parties in the process with a recurring assignment to reassess audit firm QC system judgments and conclusions.<sup>24</sup> Moreover, the PCAOB annually inspects the QC systems of the larger firms. The PCAOB already evaluates the significant QC judgments and related conclusions of the firms. Requiring an EQCF to “step into the shoes” of the PCAOB is not needed and problematic.

Further, Section 105(b)(5)(A) on confidentiality provides that all documents and information (prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents), in connection with an inspection under Section 104, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process). However, information reported to the EQCF, along with information reported to the PCAOB in connection with fulfilling the role and responsibilities of the EQCF, does not appear to fall under Section 104. Thus, QC 1000 forces audit firms to impair privileges and protections provided by SOX.

Various other EQCF provisions involve essential matters that had no opportunity to be raised through the PCAOB’s notice and comment process – and represent additional flaws with the final standard. For example, given the definition for associated persons in PCAOB Rule 101(p)(i)<sup>25</sup> and considering the EQCF consists of one or more independent third-parties, members of the EQCF would not be associated persons. Nonetheless, discussions in the adopting release cloud this issue, although the distinction has significant implications, including for regulatory enforcement and litigation risks related to the EQCF.

For example, focusing on individuals (rather than audit firms), only associated persons are within the authority of the PCAOB for investigations and disciplinary proceedings under SOX Section 105, including Section 105(c)(6) for failure to supervise. The adopting release states that the EQCF would not be a supervisory person under Section 105(c)(6) “solely by virtue of having evaluated the significant judgments made and related conclusions reached by the firm when evaluating and reporting on the effectiveness of the firm’s QC system.”<sup>26</sup>

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<sup>24</sup> The assignment is more akin to that of an independent monitor used (rarely and selectively under certain facts and circumstances) by the SEC and PCAOB in enforcement matters.

<sup>25</sup> The PCAOB defines associated persons as any individual proprietor, partner, shareholder, principal, accountant, or professional employee of a public accounting firm, or any independent contractor or entity that, in connection with the preparation or issuance of any audit report (1) shares in the profits or, or receives compensation in any other form from, that firm; or (2) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

<sup>26</sup> See QC 1000 (PCAOB adopted version), page 123.

However, the adopting release also states that depending on the nature and degree of their responsibility, ability, or authority to affect the conduct of the firm's associated persons, as established by the firm, the EQCF could be subject to SOX Section 105(c)(6).<sup>27</sup> As a result, assigning the independent EQCF roles and responsibilities beyond the minimum requirement in QC 1000 (as the PCAOB seems to contemplate firms should do) could potentially cause the EQCF to be considered associated persons – resulting in a significant change in legal and regulatory risks for the EQCF, among other implications.

Relatedly, the PCAOB recently adopted an amendment to PCAOB Rule 3502 on *Responsibility Not to Knowingly or Recklessly Contribute to Violations* whereby the PCAOB can now hold associated persons accountable when they negligently, directly, and substantially contribute to a firm's violation. Does the PCAOB intend Rule 3502 to encompass the EQCF? If so, this application should have been subject to notice and comment in connection with both QC 1000 and Rule 3502, prior to their adoption by the Board.

The PCAOB also expects that either auditors or non-auditors would be appointed to the EQCF.<sup>28</sup> If PCAOB and SEC discipline and enforcement can extend to the EQCF, would it differ for individuals on the EQCF that are accountants versus those that are not?

The SEC should reject QC 1000 because of the PCAOB's failure to provide an opportunity for notice and comment on the issues raised above, which represent fatal flaws.

**3. The requirement for registered but not inspected audit firms to implement the design-only requirement of QC 1000 is not fit for purpose.**

QC 1000 requires that all audit firms must design a QC system that complies with the standard.<sup>29</sup> This means that PCAOB registered, but not inspected, audit firms must comply with the design portions of QC 1000 (the design-only requirement), although these firms do not render audit reports on issuer or broker-dealer engagements or play a substantial role in such engagements – i.e., these firms are inactive. Firms that are registered, but not inspected, are smaller audit firms that serve market segments for entities that become smaller issuers and broker-dealers, including emerging growth companies. It is neither fair nor reasonable for the PCAOB

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<sup>27</sup> *Id.*

<sup>28</sup> See QC 1000 (PCAOB adopted version), page 122.

<sup>29</sup> See QC 1000 (PCAOB adopted version), pages A1-3 and A1-4.



to unduly burden these smaller audit firms. The Chamber has previously expressed concerns that the PCAOB is focused on “culling-out” inactive audit firms by forcing and/or encouraging them to deregister.<sup>30</sup> The QC 1000 design-only requirements are consistent with this concern.

Moreover, PCAOB Board Member Christina Ho’s dissenting statement emphasizes that the design-only requirement is not fit for purpose. In her statement on QC 1000, Board Member Ho expressed concerns about the inconsistency of design-only with SOX.<sup>31</sup> The Chamber urges the Commission to heed the serious concerns raised by Board Member Ho’s statement.

The PCAOB could have adopted more reasonable alternatives rather than relying on a legal justification under SOX Section 103(a)(2)(B) for the design-only approach, as discussed by Board Member Ho. For example, many PCAOB registered, but not inspected, audit firms have implemented the International Auditing and Assurance Standards Board (“IAASB”) *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* (“ISQM 1”). U.S. registered, but not inspected, audit firms will be implementing (or have implemented) the American Institute of Certified Public Accountants (“AICPA”) Auditing Standards Board (“ASB”) related standards, including *Statement on Quality Management Standards No. 1, A Firm’s System of Quality Management* (“SQMS 1”).<sup>32</sup>

Considering that both ISQM 1 and SQMS 1 provide for the items listed in SOX Section 103(a)(2)(B), a more reasonable approach would be for the PCAOB to have inactive firms comply with other relevant professional standards (i.e., ISQM1 or SQMS 1) – until such time as they become subject to PCAOB standards and rules (i.e., become active). Then, they can implement QC 1000 based on the facts and circumstances of their issuer and/or broker-dealer audit engagements. As Board Member Ho stated: “... there is a big difference between designing a QC system under a hypothetical scenario and designing a QC system under an actual scenario.”<sup>33</sup> The

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<sup>30</sup> For example, see the letters to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on *Firm Reporting* dated June 7, 2024 and on *Proposals Regarding False or Misleading Statements Concerning PCAOB Registration and Oversight and Constructive Requests to Withdraw from Registration* dated April 15, 2024.

<sup>31</sup> *Supra* Fn. 1.

<sup>32</sup> IAASB ISQM 1 became effective on December 15, 2022 and the ASB SQMS 1 (which closely aligns with ISQM 1) will become effective on December 15, 2025.

<sup>33</sup> *Supra* Fn. 1.

statement also emphasizes that the economic analysis for QC 1000 erroneously dismisses the impact of the design-only requirement on competition.<sup>34</sup>

The undue impact to smaller firms of the design-only segment of QC 1000 suggest that the standard is not fit for purpose.

4. **The PCAOB's economic analysis for QC 1000 is inadequate.**

The Chamber is concerned that the Board's economic analysis of QC 1000 does not support its adoption. Likewise, Board Member Ho's statement provides clear and cogent support for her dissenting vote on QC 1000 in regard to the inadequacy of the PCAOB's economic analysis and the Chamber strongly urges the Commission to give it great weight. Board Member Ho emphasizes that the PCAOB's economic analysis "lacks the required rigor and neither justifies nor quantifies the benefits in relation to the costs to support the burdensome nature of this QC 1000." Moreover, Board Member Ho raises concerns that QC 1000 requirements are "unnecessarily complex" and that the "burdensome requirements" will be "harmful to audit quality and capital market resilience".<sup>35</sup>

The economic analysis for QC 1000 is deficient in not discussing any plans for post-implementation review or details on how the review will be conducted. The Board conducts post-implementation reviews to evaluate the efficacy of adopted standards and rules after they have been in effect for a reasonable timeframe. The purpose of a post-implementation review includes determining whether the standard accomplishes its intended objectives, assessing its costs and benefits, and identifying any unintended consequences. Including this discussion in the adopting release is particularly important given the PCAOB's analysis of the costs and benefits of QC 1000 is largely qualitative.

Further, clustering the effective dates for implementing multiple newly adopted standards and rules reinforces the importance of a post-implementation review discussion as part of the economic analysis. For example, the discussion needs to explain how the PCAOB will disentangle the effects of QC 1000 from those of other standards and rules with overlapping implementation periods.

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<sup>34</sup> *Id.* "The adopting release and its economic analysis lack evidence-based quantitative support for design-only, and blithely dismiss commenter concerns on its impact on competition and the harm it may cause smaller public companies, including emerging growth companies."

<sup>35</sup> See the *Statement on QC Adoption – Demise in Audit Competition* by Board Member Christina Ho (May 13, 2024).

**5. The PCAOB's comment period for QC 1000 was inadequate.**

The PCAOB is engaged in an aggressive standard-setting and rulemaking agenda that is overwhelming stakeholders with short comment periods.<sup>36</sup> Further, the PCAOB's standard-setting and rulemaking processes occur without holistic considerations such as appropriately sequencing these activities and avoiding clustering actions for comment and/or implementation.

These issues are particularly relevant in the context of QC 1000. For example, the PCAOB's *Firm Reporting* proposal introduced the concept of an EQCF and included requirements related to the EQCF. Neither the concept nor the requirements could be fully understood without considering QC 1000. However, QC 1000 was not publicly available until it was adopted by the PCAOB more than a month after the commencement of the sixty-day comment period for the proposal on *Firm Reporting*.

The PCAOB's unwillingness to reopen the comment period for QC 1000, prior to adopting a standard, is also consistent with the Board's aggressive approach to standard-setting and rulemaking that undermines due process. Further, the Chamber is concerned that this unwillingness may signal a lack of interest in feedback, which dissuades stakeholders with concerns from commenting – not just due to time limitations.

Nonetheless, reopening the comment period for QC 1000 would have allowed stakeholders to comment on the EQCF and other matters previously discussed. Reopening the comment period would have helped the PCAOB comply with due process and other requirements for standard-setting, mitigated the likelihood of the Board adopting a fatally flawed QC 1000 standard, and potentially avoided a dissenting Board vote.

An appendix summarizes the PCAOB's standard-setting and rulemaking activities since November 2022. The appendix illustrates the PCAOB's aggressive agenda and the implications for QC 1000. For example, the PCAOB adopted QC 1000 on May 13, 2024 (along with adopting AS 1000 on *General Responsibilities of the Auditor in Conducting an Audit*), which was during the open comment period for two PCAOB proposals on *Firm and Engagement Metrics* and *Firm Reporting* (which closed on June 7, 2024).

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<sup>36</sup> For example, see the letter to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on *Firm and Engagement Metrics* dated June 7, 2024.

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The appendix reveals that as stakeholders wrapped up comments on the *Firm and Engagement Metrics* and *Firm Reporting* proposals and considered QC 1000 and AS 1000 for SEC comment, they likewise faced considering the PCAOB's three Board actions on June 12.<sup>37</sup> Based on the texts of these seven PCAOB actions, stakeholders have considered or need to consider over 1,100 pages of materials during June and July 2024.<sup>38</sup> Moreover, each of the proposed or adopted standards and rules involve complex considerations not reflected in page-length alone.

Stakeholders do not have the bandwidth to respond to this deluge of activity and provide fulsome comments to the PCAOB and SEC on the proposed and adopted standards and rules. Although impacting all stakeholders, smaller audit firms are especially challenged in responding to the deluge of the PCAOB's new requirements.

In a letter to the PCAOB on May 22, 2024, the Center for Audit Quality ("CAQ") focused on this problem and requested an extension of the comment period for the PCAOB's *Firm and Engagement Metrics* and *Firm Reporting* proposals.<sup>39</sup> The CAQ also recommended that the PCAOB delay sending the Form 19b-4 filings to the SEC on QC 1000 and AS 1000. Two days later (on the Friday before the three-day Memorial holiday weekend), the PCAOB sent the Form 19b-4's to the SEC on QC 1000 and AS 1000. Comments on QC 1000 were due to the SEC on July 2, 2024 – the week of the July 4<sup>th</sup> holiday – but (on July 1<sup>st</sup>), the SEC extended the due date to July 16, 2024. The PCAOB did not extend the comment period for the *Firm and Engagement Metrics* and *Firm Reporting* proposals.

This discussion reinforces the need for the SEC to deny approval of QC 1000 and return it to the PCAOB for appropriate action, which should involve a reasonable period for public comment. The pace of PCAOB standard-setting and rulemaking, under short/condensed comment periods, compromises both due process and the quality of the resulting standards and rules. The PCAOB's investor protection mission focused on maintaining and improving audit quality is compromised by this overly aggressive approach to standard-setting and rulemaking.

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<sup>37</sup> On June 12, 2024, the PCAOB adopted amendments to auditing standards on audit procedures that involve technology-assisted analysis of information in electronic form; adopted an amended Rule 3502 on contributory liability; and proposed a new auditing standard on substantive analytical procedures.

<sup>38</sup> Instead of using PCAOB adopting releases, using PCAOB Form 19b-4's filed with the SEC (or SEC Notices of Filings) increase the counts to over 4,800 (or over 1,200) pages.

<sup>39</sup> See the letter to the PCAOB from the CAQ on *Proposing Release: Firm and Engagement Metrics* dated May 22, 2024.

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6. The effective date for the new QC 1000 standard is inappropriate.

If approved by the SEC, QC 1000 will take effect on December 15, 2025. Given the pace of the PCAOB's standard-setting and rulemaking activities since the close of the comment period for the QC 1000 Proposal (on February 1, 2023), the PCAOB should have reopened the comment period for QC 1000 to allow for additional comments on a reasonable effective date.

As of February 1, 2023, stakeholders could not have anticipated the volume of standards and rules that the PCAOB would require audit firms to implement in 2024 and 2025. To date, as shown in the appendix (subject to SEC approval for some), audit firms are implementing or will be required to implement six standards and rules, including on supervision of other auditors, confirmations, QC 1000, AS 1000, technology-assisted analysis in electronic form, and contributory liability.<sup>40, 41, 42</sup>

It is a non-trivial task to implement any new PCAOB standard or rule. Implementation requires changes in audit firm systems, processes, methodologies, training, and the list goes on. For many firms, these changes need to be made on a world-wide basis. Moreover, a complex and far-reaching standard on quality controls like QC 1000 involves its own unique challenges.

In pre-recorded video remarks at the recent University of Southern California ("USC")-Financial Executives Research Foundation SEC and Financial Reporting Conference, SEC Chief Accountant Paul Munter emphasized that auditing standards are only as good as their implementation. He reminded audit firms to do a good job of implementing new PCAOB standards and rules.<sup>43</sup>

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<sup>40</sup> The PCAOB's standard-setting agenda also includes adopting a standard on Non-Compliance with Laws and Regulations ("NOCLAR") in 2024. However, commenters and others have called for the PCAOB to re-open the comment period before adopting a NOCLAR standard. For example, see the transcript of the PCAOB NOCLAR Roundtable on March 6, 2024 and related comment letters.

<sup>41</sup> Further, on June 12, 2024, the Board proposed a new standard, AS 2505 on *Designing and Performing Substantive Analytical Procedures*. Proposed for comment is whether the PCAOB should require compliance of a new standard, if adopted and approved by the SEC, for audits of fiscal years beginning on or after December 15 of the year of approval by the SEC. For example, if SEC approval occurs in 2025, firms would need to be ready to implement the new standard by December 15, 2025. This would move the count for implementation to seven standards and rules in 2024 and 2025.

<sup>42</sup> These data belie the statement in the Rule 3502 adopting release that: "Many of the newly adopted standards, moreover, have staggered effective dates, and thus auditors would not be required to come into compliance with each at the same time" (page 21).

<sup>43</sup> See the Keynote Session with the SEC and the FASB at the USC Leventhal School of Accounting, SEC and Financial Reporting Institute, and Financial Executives Research Foundation 42<sup>nd</sup> Annual SEC and Financial Reporting Conference (June 6, 2023).

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The PCAOB and SEC should not only encourage – they should facilitate – a smooth implementation of new PCAOB standards and rules, including QC 1000. Instead, the regulators are creating unnecessary challenges and barriers by allowing for the clustering of implementation of multiple standards and rules during the same or overlapping periods, rather than appropriately sequencing the implementation of them, including QC 1000.<sup>44</sup>

The SEC should deny approval of QC 1000 and return it to the PCAOB for appropriate action. The action should include an opportunity for public comment to allow stakeholders to provide input on a reasonable effective date for QC 1000, given new information that reflects the PCAOB's aggressive standard-setting and rulemaking activities since February 2023.

### Conclusion

QC 1000 is in conflict with SOX Section 104 (g) (3) which prohibits disclosures of inspections issues that have been corrected. As such, the SEC must reject QC 1000. The PCAOB, and the SEC for that matter, cannot override the legal requirements as passed by Congress.

On its own, QC 1000 includes numerous flaws, including a new EQCF requirement that is fatally flawed and that was not made available for public notice and comment by the PCAOB. The EQCF requirement could not have been anticipated from the QC 1000 Proposal and it is not a logical outgrowth of what was proposed by the PCAOB. QC 1000 fails to comport with the PCAOB's authority under SOX and it fails to comply with the standards the Board and SEC are required to satisfy when adopting new PCAOB standards given its inadequate cost-benefit analysis fails to adhere to the public interest standard. These fundamental failures and flaws obligate the SEC to deny approval of QC 1000 and take the appropriate actions, as discussed, in accordance with that denial.

Thank you for your consideration and we stand ready to discuss these matters with you further.

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<sup>44</sup> As previously noted, clustering the implementation of PCAOB standards and rules also creates major challenges for the PCAOB in conducting post-implementation reviews.

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Sincerely,

A handwritten signature in black ink, appearing to read 'TKQ', with a long horizontal flourish extending to the left.

Tom Quadman  
Executive Vice President  
Center for Capital Markets Competitiveness  
U.S. Chamber of Commerce

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## Appendix

### Overview of PCAOB Standard-Setting and Rulemaking Proposals and Adopted Standards and Rules from June 2022 to May 2024

#### *Amendments Relating to the Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm (Docket 042)*

(June 21, 2022) Adopted by the Board (185 pages)

(July 1, 2022) Published for comment in the Federal Register

(July 22, 2022) SEC comment period ended

(August 12, 2022) SEC approved

Amendments effective for audits of financial statements for fiscal years ending on or after December 15, 2024 and include audits of EGC's and broker-dealers.

#### *Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards (Docket 028)*

(December 20, 2022) Proposed standard for public comment with comments due by February 20, 2023 (87 pages); the Proposal was preceded by a concept release in 2009 and a proposal in 2010

(September 28, 2023) Adopted by the Board (114 pages)

(October 17, 2023) Published for comment in the Federal Register

(November 7, 2023) SEC comment period ended

(December 1, 2023) SEC approved

Amendments effective for audits of financial statements for fiscal years ending on or after June 15, 2025 and include audits of EGC's.

#### *Quality Control ("QC 1000") (Docket 046)*

(November 18, 2022) Proposed standard for public comment with comments due by February 1, 2023 (394 pages); the Proposal was preceded by a concept release in 2019

(May 13, 2024) Adopted by PCAOB (465 pages)

(May 24, 2024) Form 19b-4 filed with the SEC by the PCAOB (2801 pages)

(June 5, 2024) SEC Notice of Filing of Proposed Rules (515 pages)



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(June 11, 2024) Published in the Federal Register

(July 2, 2024) SEC comment period ended

Subject to SEC approval, the new standard and related amendments will take effect on December 15, 2025, with the initial evaluation of the QC system to be performed as of September 30, 2026, and initial reporting to the PCAOB by November 30, 2026.

*General Responsibilities of the Auditor in Conducting an Audit* (Docket 049)

(March 28, 2023) Proposed standard for public comment with comments due by May 30, 2023 (112 pages)

(May 13, 2024) Adopted by PCAOB (138 pages)

(May 24, 2024) Form 19b-4 filed with the SEC by the PCAOB (869 pages)

(June 5, 2024) SEC Notice of Filing of Proposed Rules (153 pages)

(June 11, 2024) Published in the Federal Register

(July 2, 2024) SEC comment period ended

Subject to SEC approval, the new standard and related amendments will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2024. For smaller firms, the amendment relating to the documentation completion date will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025.

*Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations ("NOCLAR")* (Docket 051)

(June 6, 2023) Proposed standard for public comment with comments due by August 7, 2023 (146 pages)

(February 26, 2024) PCAOB announced it will host a virtual roundtable on NOCLAR on March 6, 2024 and reopened the comment period to March 18, 2024

*Proposed Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis in Electronic Form* (Docket 052)

(June 26, 2023) Proposed standard for public comment with comments due by August 28, 2023 (59 pages)

(June 12, 2024) Adopted by the Board (70 pages)

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(June 20, 2024) Form 19b-4 filed with the SEC by the PCAOB (361 pages)

Subject to SEC approval, the new standard and related amendments will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025.

*Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability* (Docket 053)

(September 19, 2023) Proposed rule for public comment with comments due by November 3, 2023 (35 pages)

(June 12, 2024) Adopted by the Board (71 pages)

(June 20, 2024) Form 19b-4 filed with the SEC by the PCAOB (361 pages)

Subject to SEC approval, the amended rule will become effective 60 days after such approval.

*Proposals Regarding False or Misleading Statements Concerning PCAOB Registration and Oversight and Constructive Requests to Withdraw from Registration* (Docket 054)

(February 27, 2024) Proposed rule for public comment with comments due by April 12, 2024 (67 pages)

*Firm and Engagement Metrics* (Docket 041)

(April 9, 2024) Proposed rule for public comment with comments due by June 7, 2024 (237 pages); the proposal was preceded by a concept release in 2015 on *Audit Quality Indicators*

*Firm Reporting* (Docket 055)

(April 9, 2024) Proposed rule for public comment with comments due by June 7, 2024 (107 pages)

*Proposed Auditing Standard – Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards* (Docket 056)

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(June 12, 2024) Proposed standard for public comment with comments due by  
August 12, 2024 (74 pages)