



## Consumer Federation of America

February 1, 2023

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Re: PCAOB Release No. 2022-006, PCAOB Rulemaking Docket Matter No. 046,  
A FIRM'S SYSTEM OF QUALITY CONTROL AND OTHER PROPOSED  
AMENDMENTS TO PCAOB STANDARDS, RULES, AND FORMS

To the Secretary:

We are writing on behalf of the Consumer Federation of America (CFA)<sup>1</sup> in response to the above captioned proposal regarding potential revisions to audit quality control standards. CFA previously wrote in response to the PCAOB's Concept Release on the same subject, in which we raised concerns that the approach being contemplating was not sufficiently rigorous to achieve its intended goal of ensuring a consistently high quality of audits and other engagements under PCAOB standards.<sup>2</sup> We are disappointed that the proposal largely mirrors, or as the proposal acknowledges, "substantially reflects," the Concept Release and does not adequately address the concerns that we raised in our previous letter. We urge the PCAOB to revisit its approach and to reexamine how its Quality Control Standard operates with regard to the objective, oversight, and transparency of firms' quality control systems, so that the new framework would enhance the quality of audits substantially and meaningfully, thereby ensuring that investors can place their trust and confidence in the accuracy and reliability of public company financial disclosures.

As we documented in our previous comment, evidence, including from PCAOB Inspection Briefs, suggests that existing quality control systems at many firms are not achieving an even minimally acceptable level of quality control, let alone the high level of audit quality that investors have a right to expect and on which the reliability of our financial reporting system depends. Perhaps most disturbing is the regularity with which the inspection staff finds deficiencies related to auditor independence and professional skepticism, the fundamental foundations on which audit quality depends. It is also disturbing how frequently weaknesses in quality control exist at the highest leadership levels of the firm.

The solution to this problem is not to retain a quality control system that is aimed largely at firms meeting minimum standards (i.e., a very low bar). Rather, the solution is to fundamentally

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<sup>1</sup> CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was established in 1968 to advance the consumer interest through research, advocacy, and education.

<sup>2</sup> CFA, *Comment Letter Re: PCAOB Release No. 2019-003, Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standards* (March 16, 2020), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/014\\_cfa.pdf?sfvrsn=30080d45\\_0](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/014_cfa.pdf?sfvrsn=30080d45_0)

rethink how firms can enhance their audit quality to ensure that investors' reasonable expectations are met. Yet the proposed QC 1000 closely tracks ISQM1, which is largely a process-driven and compliance-oriented framework, not one that encourages firms to meaningfully enhance their quality control standards for the benefit of investors. Specifically, under proposed QC 1000, the objective of the QC system would be to provide reasonable assurance as to compliance with the professional and legal requirements that apply to the firm's engagements. In other words, the objective of the system of quality management is to provide the firm with reasonable assurance that the firm and its personnel meet their basic legal obligations. To be clear, our concern is not that the "reasonable assurance" standard is not a sufficiently robust confidence level; rather, it's that that confidence level applies to meeting the bare minimum quality controls, not raising the level of quality controls to ensure that audit firms engage in "high financial reporting quality."<sup>3</sup> The Board's approach should create incentives not just to comply with the minimum but to require firms to maintain quality control frameworks that work best for high quality financial disclosure.

In our previous letter, we also highlighted the importance of having strong accountability mechanisms that ensure audits and other engagements are undertaken with meaningful independence from a firm's financial interests. As we stated, audit firms have strong economic incentives that too often work against high quality audits, including the conflicts of interest inherent in the issuer-pays business model. It can be too easy for a firm to compromise its independence, integrity, and rigor with regard to audit quality if doing so is in the firm's financial interest.

To address this concern, firms should be required to completely separate business interests from auditing functions, with the goal of ensuring that the firm's financial interests don't directly or indirectly influence audit quality. This approach has been implemented with some success with credit rating agency regulations. Unfortunately, the proposal's response to this concern was effectively meaningless. Specifically, proposed QC 1000 requires firms auditing more than 100 issuers to incorporate an oversight function for audit practice that includes at least one person who does not otherwise have a commercial, familiar, or other relationship with the firm or other relationship with the firm that would interfere with the exercise of independent judgment.

Requiring firms to have only one person in such an oversight function will not begin to overcome the predictably insurmountable financial incentives working against them. Having one person in such an important, but feckless, role would simply not be sufficient to affect the quality of a firm's decision-making process. It's all too likely that one person would be ignored or sidelined, and their influence would be minimized. Moreover, the proposal would allow firms to place the one person exercising an oversight function on an advisory council without any defined role over the firm's audit quality process. This person doesn't even need to be in the firm's "chain of command." As a result, these features of the proposal would likely render the one person with an oversight function toothless, thereby undermining the PCAOB's goal to "reduce negative impacts of commercial considerations on decision making by firms about their QC system." We continue to believe that firms and, in particular, firm leadership must be held accountable for the outcomes of their quality control efforts, and that accountability must be built into the standard. However, proposed QC 1000 does not come close to achieving these objectives.

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<sup>3</sup> See Mark DeFond & Jiyang Zhang, *A Review of Archival Auditing Research*, 58 *Journal of Accounting and Economics* 275, 279 (2014) ("we define higher audit quality as greater assurance of high financial reporting quality.").

In addition, the proposal does not provide investors and the public with any meaningful disclosure about the structure, operation, and effectiveness of the system of quality control. The proposal considered disclosure but decided that because of some limited restrictions in the statute, any disclosure would be “potentially misleading” to investors. This approach seeks to protect investors and the public by denying them information. This approach is fundamentally inconsistent with the federal securities laws, which favors disclosure (with appropriate explanations) and lets investors determine the relative value of the information. Put simply, without disclosure, there cannot be accountability, and unfortunately, the proposed approach would make accountability to investors and the public all but impossible.

In our previous comment, we mentioned the need for quality controls to have sufficient rigor, transparency, and measurability to ensure firms are engaging in high quality audits and other engagements. To do so, audits must be backed by concrete analysis of the results on audit quality and that analysis must be made publicly available, thereby enabling investors to assess the effectiveness of firms’ control systems system. Audit quality indicators (AQIs) can help to provide that data. If AQIs are developed and publicly disclosed, audit committees will have important information to factor into their selection of audit firms, shareholders will have data they can use to hold audit committees accountable for those selections, and firms will have an incentive to develop and maintain rigorous quality control systems in order to be able to compete more effectively on quality.

Yet proposed QC 1000 does little to advance disclosure of AQIs. The proposal largely relies on firms’ voluntarily disclosing AQI metrics and related information, something they have no incentive to do. As we said in our previous comment, it is frankly inconceivable to us that the Board would update its quality control standards without including a meaningful requirement on AQIs. But that is exactly what the PCAOB has proposed to do here. By failing to incorporate AQIs in the quality control standard, the proposal would seriously undermine its likely effectiveness, and quality control is likely to devolve into an empty exercise with little actual impact on the quality of audits.

The proposed approach in proposed QC 1000 is not sufficiently rigorous to achieve its intended goal of ensuring a consistently high quality of audits and other engagements under PCAOB standards that investors can place their trust and confidence in. We urge the PCAOB to revisit its approach regarding the objective, oversight, and transparency of firms’ quality control systems so that the new framework would enhance the quality of audits substantially and meaningfully, thereby ensuring that investors can place their trust and confidence in the accuracy and reliability of public company financial disclosures.

Respectfully submitted,



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