

# Inspection Modernization Council

## Updates

These materials reflect amendments to QC 1000 that have been adopted by the Board and are subject to approval by the SEC.

Discussion draft | October 2026

For Discussion Purposes Only

# DISCLAIMER

*The following materials were prepared by PCAOB staff for discussion purposes. Except for the Board's authorization to share the materials with the IMC for discussion purposes, the materials have not otherwise been approved, adopted, requested, directed, selected, or authorized by the Board. The materials should not be construed as an indication that the Board has considered, discussed, endorsed, or is considering any of the matters, analyses, options, or actions described herein. The Board was not involved in identifying, selecting, or compiling materials.*

*The materials also have not been subjected to comprehensive internal review and remain subject to further development, revision, or withdrawal based on legal, regulatory, policy, or other considerations.*

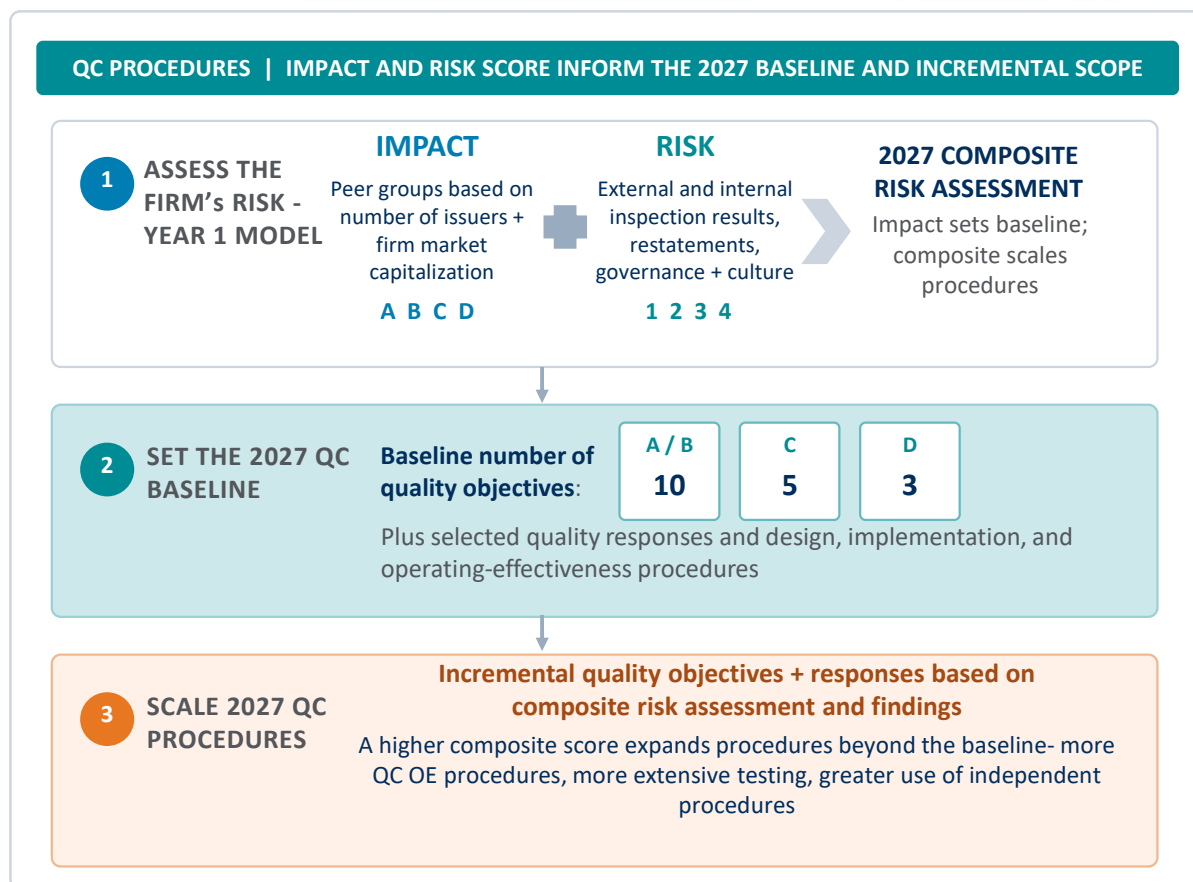
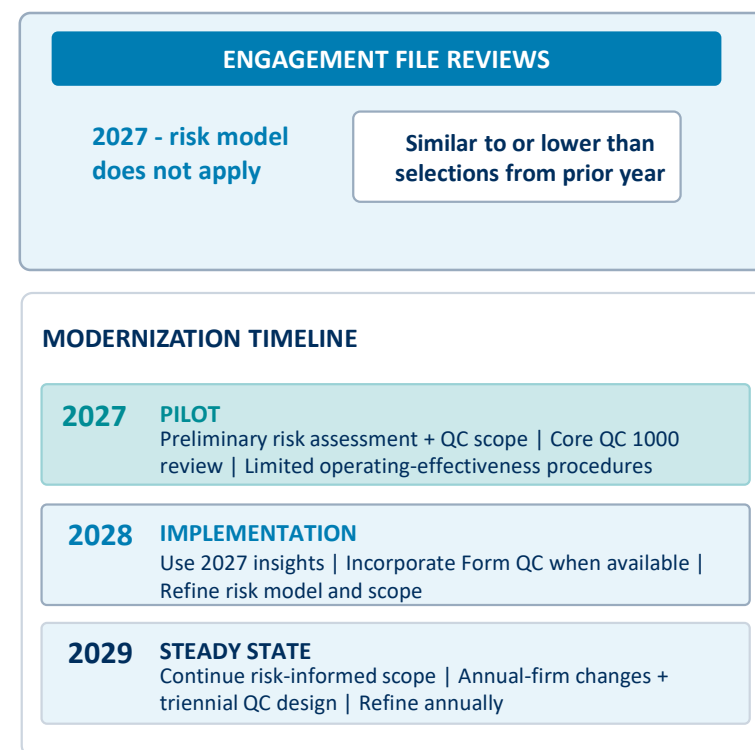


# 2027 QC-Informed Approach



# 2027 APPROACH: RISK-DRIVEN MODEL ON QC PROCEDURES IN YEAR 1

Steps 1–3 establish and scale the 2027 QC scope using a preliminary risk assessment model. Engagement file reviews to maintain established methodology.



# Severity Scales

A decision framework for inspection findings and reporting



# ENGAGEMENT SEVERITY SCALE

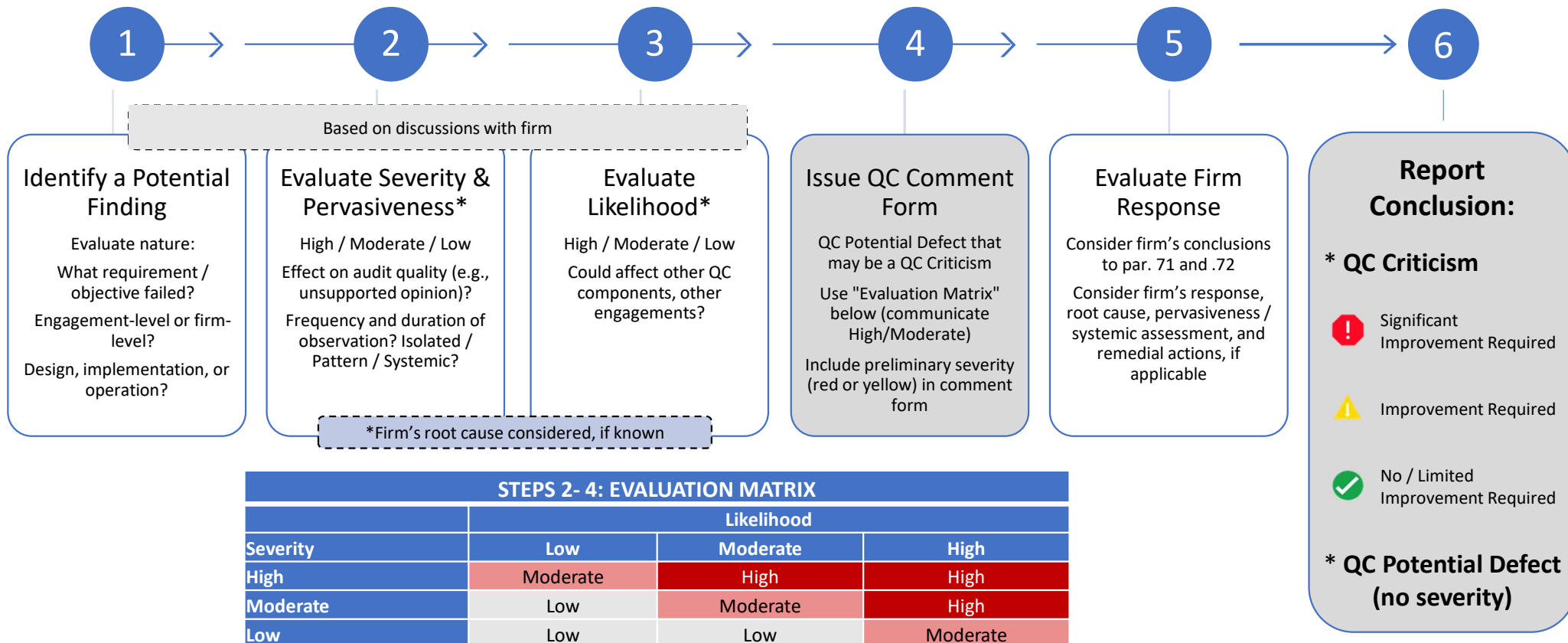
| Symbol                                                                              | Scale                                    | Inspection Severity Definition                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Related QC 1000 Concept                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|-------------------------------------------------------------------------------------|------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|    | <b>Significant Improvement Required</b>  | <p>An <i>engagement deficiency</i>, as defined in QC 1000, of such significance that, individually or in combination:</p> <ul style="list-style-type: none"> <li>the auditor did not identify a material misstatement or material weakness;</li> <li>there is a <i>reasonable possibility</i> that the auditor would not have identified a material misstatement or material weakness, <i>if it existed</i>; or</li> <li>the auditor is not capable of exercising objective and impartial judgment as a result of not being independent.</li> </ul> | <b>Significant Engagement Deficiency</b> | A significant engagement deficiency exists when (1) the engagement team failed to obtain sufficient appropriate evidence or failed to perform interim review or attestation procedures necessary in the circumstances in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the <i>engagement</i> , (3) the <i>engagement</i> report is not appropriate in the circumstances, or (4) the firm is not independent of its client. This concept aligns with “significant engagement deficiency” in AS 1220, <i>Engagement Quality Review</i> (see Notes to AS 1220.12, .17, .18B), and applies to all engagements as defined in QC 1000. |
|  | <b>Improvement Required</b>              | An <i>engagement deficiency</i> that does not rise, individually or in combination, to the level of significant improvement required.                                                                                                                                                                                                                                                                                                                                                                                                               |                                          |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|  | <b>No / Limited Improvement Required</b> | No <i>engagement deficiency</i> , or an <i>engagement deficiency</i> for which only limited improvements are necessary to fully respond.                                                                                                                                                                                                                                                                                                                                                                                                            | <b>Engagement Deficiency</b>             | An instance of noncompliance with applicable professional and legal requirements by the firm, firm personnel, or other participants with respect to an engagement of the firm, or by the firm or firm personnel with respect to an engagement of another firm.                                                                                                                                                                                                                                                                                                                                                                                                                                                              |

# QC SEVERITY SCALE

| Symbol                                                                              | Scale                                    | Inspection Severity Definition                                                                                                                                                                                                                       | Related QC 1000 Concept                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|-------------------------------------------------------------------------------------|------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|    | <b>Significant Improvement Required</b>  | A QC criticism, identified by the PCAOB, that, individually or in combination, is of such severity that it requires significant improvement and the likelihood of not achieving a quality objective has not been reduced to an acceptably low level. | <p>QC deficiency – A <i>QC observation</i> that, based on the evaluation under par. 72, individually, or in combination with one or more other <i>QC observations</i>, evidences:</p> <ol style="list-style-type: none"> <li>1. That the likelihood of the firm not achieving the reasonable assurance objective or one or more <i>quality objectives</i> has not been reduced to an acceptably low level;</li> </ol> <p>Note: The likelihood of not achieving the reasonable assurance objective or one or more <i>quality objectives</i> would be above an acceptably low level if, for example, a <i>quality objective</i> is not established, a <i>quality risk</i> is not properly identified or assessed, or a <i>quality response</i> is not properly designed or implemented or is not operating effectively and other <i>quality responses</i> do not achieve the relevant objective(s).</p> <ol style="list-style-type: none"> <li>2. Noncompliance with requirements of QC 1000, other than those under “Documentation”; or</li> <li>3. Noncompliance with requirements of QC 1000 under “Documentation” that adversely affects the firm's ability to comply with any of the other requirements of QC 1000.</li> </ol> |
|    | <b>Improvement Required</b>              | A QC criticism, identified by the PCAOB, that requires improvement, but does not rise, individually or in combination, to the level of significant improvement required.                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|  | <b>No / Limited Improvement Required</b> | No QC criticism or no finding; or a finding that does not rise to the level of a QC criticism.                                                                                                                                                       | No QC Deficiency.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |

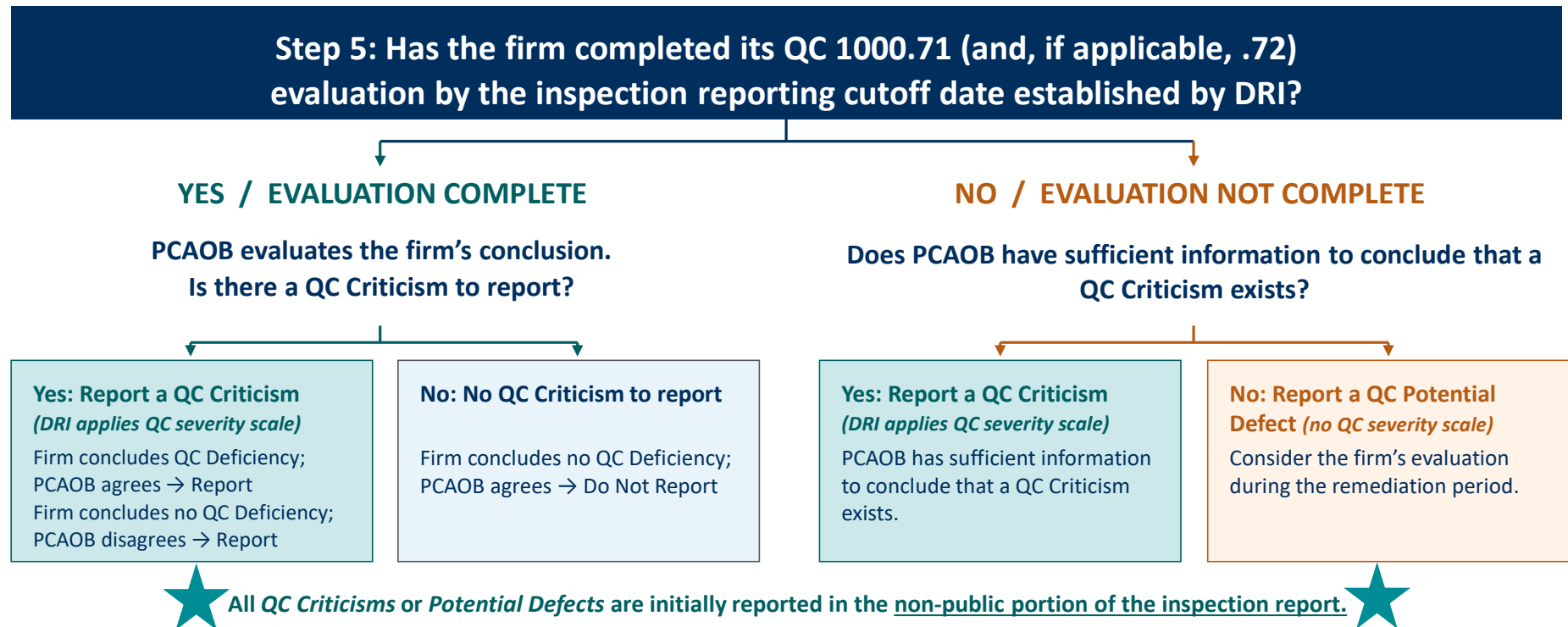
**Non-public reporting and remediation:** QC Criticisms (i.e., matters requiring improvement or significant improvement) and QC Potential Defects that could be QC Criticisms (reported outside of the severity scale) are reported in the non-public portion of the inspection report. If they are not remediated to the Board’s satisfaction within the one-year remediation period, they will be made public.

# PCAOB QC EVALUATION PROCESS



# QC POTENTIAL DEFECTS: INSPECTION REPORTING PATHS

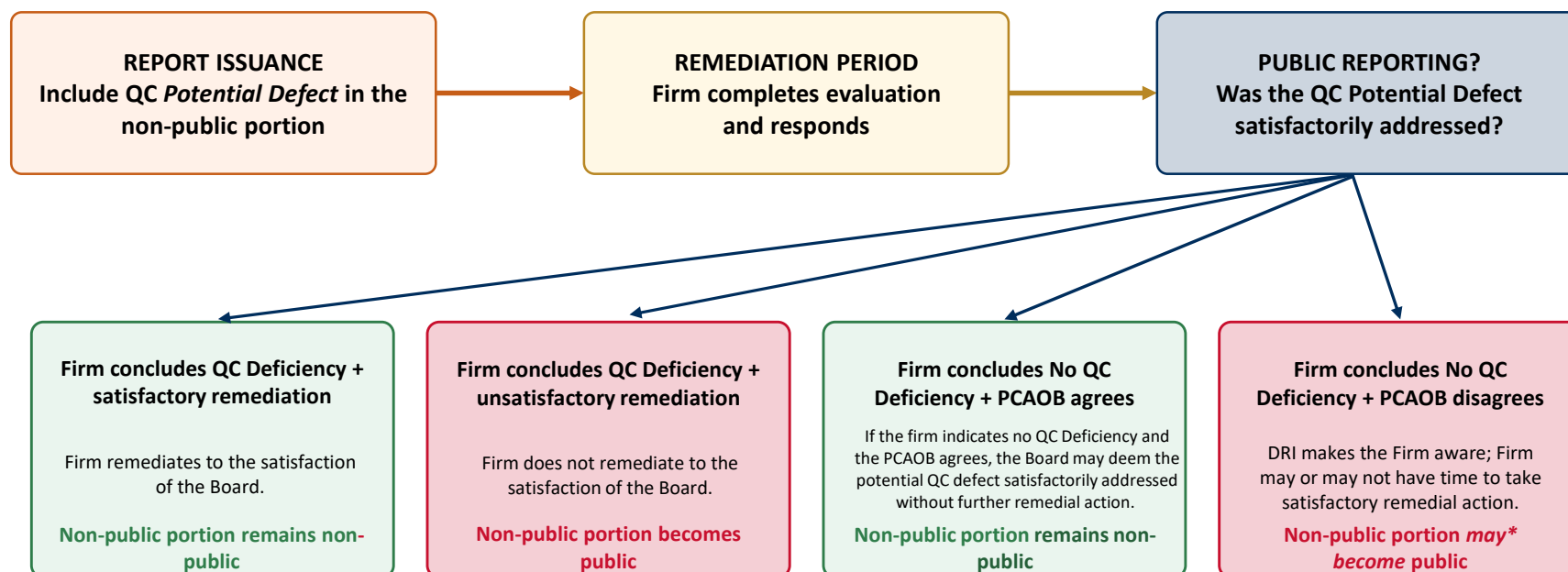
PCAOB identifies a QC Potential Defect through inspection and communicates it to the firm.



Statutory basis: Sarbanes-Oxley Act Section 104(g)(2): "no portions of the 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."

# COULD POTENTIAL DEFECTS BECOME PUBLIC?

The QC *Potential Defect* is included in the non-public portion of the inspection report when the QC criticism question is not resolved (reasonably so) by the inspection reporting cutoff date. There is no severity assigned.



\* PCAOB's disagreement with a firm's conclusion that no QC deficiency exists does not necessarily mean that the related non-public QC Potential Defect will be made public. Rather, such disagreement should feed the formal remediation determination (i.e., firms may design and implement remedial actions despite their conclusion, and such efforts would then be evaluated consistent with the process for QC criticisms).

# FACTORS FOR EVALUATING THE SEVERITY OF QC & ENGAGEMENT DEFICIENCIES



**Concept:** Evaluative factors are applied to the QC and engagement deficiencies to determine the severity category. While inherently judgmental, standardized factors promote consistency in the evaluation of severity.

| Factors for Evaluating Severity                                                                                                                                                                                                                                                                                                                                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| QC                                                                                                                                                                                                                                                                                                                                                                         | Engagement                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| <ul style="list-style-type: none"><li>• Extent and pervasiveness</li><li>• Evidence of actual or potential quality impact</li><li>• Relative importance of the affected quality objective or control</li><li>• Nature of the deficiency</li><li>• Root cause(s)</li><li>• Compensating controls</li><li>• Remediation status</li><li>• Reoccurrence and duration</li></ul> | <ul style="list-style-type: none"><li>• Totality of procedures performed and evidence obtained (on an account assertion level basis)</li><li>• Magnitude (quantitative)</li><li>• Qualitative effect on users of financial statements/other reporting/covenants</li><li>• Volume and pervasiveness</li><li>• Relative importance of related rule or standard</li><li>• Relationship to associated risk, including significant risks, CAMs and/or CAEs, as well as the sufficiency or appropriateness of the firm's risk assessment</li><li>• Review of AS 2901 actions (e.g., results, extent of additional procedures required, need for additional information from issuer)</li></ul> |

# Report Options

Alternative Reporting



# OPTIONS FOR LONG-FORM AND SHORT-FORM REPORTING

The options differ in how much narrative accompanies the descriptive statistics and findings tables.

## Option # 1: Long-form report

- Descriptive Statistics of Firm
- Tables Detailing Engagement-Level with brief narrative and QC (non-public) Findings
- Expanded Narrative Discussion of Engagement-Level and QC (non-public) Findings
- Charts and Graphs
- Narrative of Inspection Approach (in body of report and website more fully)

## Option # 2: Short-form report

- Abbreviated Descriptive Statistics of Firm
- Tables Detailing Engagement-Level with no brief narrative and QC (non-public) Findings
- Narrative Discussion of Engagement-Level and QC (non-public) Findings
- Charts and Graphs (on website)
- Narrative of Inspection Approach (in body of report and website more fully)

## Option # 3: Short-form report abbreviated

- Abbreviated Descriptive Statistics of Firm
- Tables Detailing Engagement-Level with brief narrative and QC (non-public) Findings
- Narrative of Inspection Approach (on the website only)

# APPENDICES TO BE INCLUDED/EXCLUDED WITH DIFFERENT REPORT OPTIONS

|                                                    | Option 1 -Long Form | Option 2 – Short Form | Option 3 – Short Form (Abbreviated) |
|----------------------------------------------------|---------------------|-----------------------|-------------------------------------|
| <b>Appendix A – Engagement Findings</b>            | √ (in report)       | √ (in report)         | N/A*                                |
| <b>Appendix B – Charts and Graphs (on website)</b> | √ (in report)       | √ (website)           | N/A*                                |
| <b>Appendix C – QC Findings</b>                    | √ (in report)       | √ (in report)         | N/A*                                |
| <b>Website – Inspection Approach</b>               | √ (website)         | √ (website)           | √ (website)                         |

\* Reported in aggregate for peer group firms in 4010 Reports when on the PCAOB website