PICPA
Pennsylvania Institute of CPAs

June 7, 2024

Erica Y. Williams, Chair
Office of the Secretary
Public Company Accounting Oversight Board
1666 K St. NW
Washington, DC 20006-2803
comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 055

Dear Chair Williams:

The Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to provide input on the Public Company Accounting Oversight Board's (PCAOB) questions and topics included in the proposed release on Firm Reporting. The PICPA is a professional CPA association of about 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The PICPA's comments are included below.

General Comments

We are concerned with the PCAOB's aggressive standard-setting agenda, including the timing of proposals and the completion of recent projects. In addition, some proposals overlap in content with recently issued standards. For example, firms have not had an opportunity to evaluate the changes associated with AS 1000, yet additional changes to these new standards and incremental requirements are being proposed. That dynamic, combined with incredibly short response periods, does not support reasonable and effective due process or ensure sound public policy. To highlight our point, this proposal was issued in early April, which is the busiest time of the year for many practitioners. Smaller and medium-size firms do not have teams available to focus on and engage in the standard-setting process during their busiest weeks.

The PCAOB's regulatory agenda appears to be tone deaf to a profession that is already struggling with severe staffing challenges. The commentary on page 10 highlights the recommendations of the Advisory Committee on Accounting Profession. The first bullet point refers to "monitor potential sources of catastrophic risk which could threaten audit quality." We believe that the staffing pipeline issue is the most critical issue confronting the audit profession today, and we are concerned that many of the PCAOB's proposal and agenda items are contributing to talented CPAs leaving the profession. Added stressors on the profession are counterproductive when accounting and auditing are fundamental to the effective operations of the capital markets. In fact, audit quality has been improving, restatements are down, and inspection findings are increasingly more narrowly focused. But instead of building on these successes, we are learning from our members that the PCAOB appears to be trying to find deficiencies in immaterial areas.

The PCAOB should undertake a more rigorous economic evaluation of these proposals that would comply with the Paperwork Reduction Act of 1950 (PRA). We understand that the PCAOB as structured is not required to comply with the PRA. This appears to be a growing problem. All the recent changes, proposed changes, short comment periods, and current agenda items raise concerns regarding whether changes need to be made in how the PCAOB operates. Also, we believe that a comprehensive economic assessment should be undertaken. Many recent proposals will not only radically increase costs but will also drive auditors away from performing audits requiring PCAOB registration. The time has come for a rigorous and comprehensive economic assessment of the complete costs to investors of all of the PCAOB's regulatory requirements. The public has a right to know the full cost of compliance with PCAOB's regulatory regime. These regulatory costs are disproportionately borne by smaller firms that lack the ability to recruit additional talent and to increase fees to smaller publicly held entities and broker dealers. This anticompetitive trend is not good for the capital markets and will strain new capital formation, moving investors toward private equity investments that are not available to many investors. The section of the commentary related to emerging growth companies (EGCs) seems to imply that the benefits of additional disclosures could be beneficial; however, we disagree. It would likely adversely impact the ability of EGCs and other smaller companies to find auditors at a reasonable cost. We need a large range of firm sizes to audit companies of varying sizes. This is critical to the continued ability of EGCs, small companies, and broker dealers to continue to participate in capital markets.

We support rigorous audit quality and the modernization of audit standards that will have that effect but we also believe additional regulatory proposals should be weighed against the overall objective of improving audit quality. We are concerned that this particular proposal does not contribute to improving audit quality; it simply provides the PCAOB with expanded opportunities for regulatory enforcement actions. The arguments within the proposal document are contrived, and some observers may suppose they are evidence of a hostile agenda. This is unfortunate. There are opportunities to improve audit quality through meaningful changes to risk assessment standards and the enabling and encouragement of innovative approaches to technology adoption, but the PCAOB appears to want to flex its regulatory muscle in unproductive areas.

We believe that standard-setting must move away from largely meaningless and costly compliance requirements to focus on audit innovations that leverage advances in technology and substantively improve audit quality. Changes are needed to the standards to ensure that they are sufficiently robust to address the client's use of technology, including artificial intelligence applications. Proposals that add significant reporting requirements, including providing U.S. GAAP financial statements, consume a lot of time and divert focus away from meaningful audit quality enhancements.

Confidentiality – Despite the proposal's assurances of confidentiality, we are concerned about the validity of these assurances if the information is reported on Form 2 and/or Form 3. Instead, if the PCAOB finalizes the proposed reporting requirements, we support providing it through the inspection program, for which confidentiality is reasonably assured as evidenced by years of experience.

Information Beyond Issuers – We do not believe that the PCAOB has oversight authority over firm information and operations beyond the issuer ecosystem. Therefore, we disagree with requiring financial and operational information, and policies and procedures for engagements for private company audit clients and for nonaudit services. We believe that the proposed financial reporting metrics should be revised to ensure that there are appropriate boundaries around the information being requested.

Research Projects - Based on the discussion in the executive summary, some of the proposed metrics appear to be data-gathering for research projects. For example, on page 17 the discussion indicates that "the additional data provided by this proposal would enhance the PCAOB's ability to produce impactful research and translate that gained knowledge into improved standards and rules." We do not support this excessive cost-gathering exercise to inform a research project. Clear linkage to specific audit quality objectives should be provided; if there aren't any, the proposal should be abandoned.

Investor Auditor Evaluation and Ratification - In other sections of the executive summary, the language refers to transparency and disclosures that help the capital markets evaluate firms. For example, on page 5, "such disclosure would be informative and useful to investors, audit committees, and other stakeholders when evaluating audit firms and the audits of public companies." Firms are not publicly traded companies, and many of the firm's operational plans and challenges are proprietary. Using an investor's lens to evaluate a firm's financial success does not equate to evaluating a firm's audit quality. Additionally, there is significant discussion surrounding the need for investors to obtain the proposed information so they can more effectively vote to ratify the auditor. This effort to circumvent the important work done by audit committees is specious. The investors' vote to ratify the auditor is in many cases not binding. Furthermore, investors will not be privy to important discussions regarding the context of the reported information, nor would they necessarily have the requisite training on the PCAOB's standards to be in a position to understand the reported information and data. We believe that before adding costly reporting requirements, further outreach is needed to determine how investors would use the information and whether it would be meaningful given the lack of context. We are concerned that providing this information publicly would undermine the audit committee chair's role. As investors would not be privy to the audit firm's conversations with the company's audit committee, contextual information would be missing from any evaluation of the firm's disclosures. We believe that audit committee chairs are well positioned to understand the audit firm's approach to audit quality and can easily obtain additional information from the auditor without burdensome regulation.

Effective Date - The proposed effective date of March 31, 2026 (and March 31, 2028, for compliance with the appropriate financial reporting framework) is not workable in light of the recently finalized project on AS 1000.

Specific comments on aspects of the proposal are included in the attachment.

We appreciate your consideration of our comments and are available to discuss any of these comments with you at your convenience.

Sincerely,

Allison M. Henry, CPA
Vice President – Professional & Technical Standards
PICPA

Attachment

1. Financial Information

a. Fee Information

We do not support disclosure requirements for fee information for audits of privately held entities and services for nonaudit clients. Furthermore, we are concerned about the granularity of the reporting requirement that would require firms to implement a costly compilation aggregation and reporting process that would include a cumbersome allocation exercise between multiple reporting entities and network firms and affiliates. The proposed information could be incredibly cumbersome to compile, and the proposal seems to suggest a level of precision that is not realistic given the significant degree of estimation and allocation protocols needed to present this information. We question whether this level of detail is beneficial to investors and support further cost-benefit analysis be performed prior to proceeding with any requirement.

b. Statement Reporting Requirement

We do not agree with the proposed requirement that the largest firms share financial statements in accordance with the applicable financial reporting framework (FRF) in the firm's jurisdiction. We do not believe the PCAOB has provided adequate justification articulating exactly how this information will be used, how providing this information will improve audit quality, or how this information will safeguard investors. We believe greater transparency in how the PCAOB will evaluate a firm's level of financial distress and how the information will be used are critical to effectively evaluating the costs and benefits.

The language in the executive summary tries to make the argument that the evaluation of the quality of an audit firm is the same or similar to the evaluation of an investment. Specifically, the language at page 4 discussing the type of information that investors need regarding a company's audit firm relates more to evaluating companies for investment decisions rather than auditors for audit quality (e.g., "access to meaningful information about a public company allows investors to make informed judgments about the company's financial position and the stewardship exercised by the company's directors and management." This is completely incongruous.

Furthermore, firms generally do not use U.S. GAAP (or IFRS) financial statements to manage their businesses. Requiring firms to create new financial reporting systems to capture the data needed to produce additional U.S. GAAP (or IFRS) financial statements would be extremely costly. This costly exercise would, in fact, distract and hamper firms from their efforts to ensure high quality audits. The proposed reconciliation process is not a relief from the transition burden as the information would need to be gathered to comply with the transition requirements. Further, many of the larger firms have deficiency rates that are significantly lower than other firms; so, forcing these firms to take this draconian step would be unnecessarily punitive. At the same time, as firms are structured differently the information obtained would not necessarily be comparable. Separately, we are concerned that while the PCAOB states that firms would be providing this information confidentially, since it is not included within the inspection process there may be avenues where the information could become publicly available.

Finally, we question the PCAOB's regulatory authority to require this information. It is unclear how the PCAOB has the authority to oversee the "financial stability" of accounting firms and their resilience against financial challenges. This is the responsibility of the Financial Stability Oversight Council (FSOC), not the PCAOB.

2. Audit Firm Governance and Networks

Some of these proposals are duplicative of requirements included in QC 1000. We do not support this extra reporting requirement or making this information public. We agree with the comments of PCAOB Chair Christina Ho, in her statement on the release of this proposal:[1]

> "This proposal would duplicate the same reporting requirements in proposed Form 2, Item 1.4.a and 1.4.c which would require firms to annually identify the principal executive officer of the firm and the executive officer(s) that oversee the firm's audit practice. Unlike the proposed QC 1000, this proposal would make this same information public. To make matters worse, Form 2, Item 1.4.a and Item 1.4.e contain duplicative reporting requirements. Specifically, Item 1.4.a would require each firm to identify its principal executive officer. Item 1.4.e would require each firm to identify the

[1] Statement on the Firm Reporting Proposal - Are We Regulating the Audit Firms or Driving Out Competition? April, 9, 2024

individuals who have responsibilities under paragraphs .11 and .12 of proposed QC 1000. Paragraph .11 specifies that the firm's principal executive officer is ultimately responsible and accountable for the QC system as a whole. As a result, Item 1.4 would needlessly require each firm to identify the same information twice; and if proposed QC 1000 is adopted, this proposal and QC 1000 would require triplicate annual reporting of this same information – twice publicly and once confidentially."

We find the reporting of the process that would govern a change in the form of organization to be too detailed and, in some cases, these processes are fluid and could evolve quickly as the change is occurring. This could be operationally problematic.

Finally, we question the appropriateness of requiring firms to publicly report on their extensive proprietary network, as well as ownership, legal, and related information that could include parties not registered with the PCAOB. These reporting requirements seem to go beyond the PCAOB's area of oversight and could have significant legal or regulatory implications. We support a more principles-based approach to these requirements.

3. Other

Item 8.2 - With respect to Form 2, Item 1.4(f), if such a person as is described in Form 2, Item 1.4(f), is appointed, resigns, is dismissed, ceases to meet the criteria to be a person designated in Item 1.4(f), or changes roles, report the date of such event and whether the change was recommended or approved by any governing board or management committee.

The committee is concerned regarding the public reporting of confidential human resource information, which might violate other legal or contractual requirements (e.g., if a professional is dismissed and this is approved by a governing board). Putting firms in a position to violate laws so that they can comply with PCAOB requirements is not appropriate. We request additional analysis as to the extent to which these requirements could violate other legal requirements.

4. Cybersecurity

We support firms having rigorous cybersecurity policies and procedures and risk management systems, and believe that there are best practice materials that PCAOB staff could provide to the firms to assist with their practice management considerations. However, we have concerns about the proposed reporting requirements. Instead, we believe these considerations should be incorporated into the firm's quality control system and considered in connection with the firm's inspection.

The comment on page 76 that "a firm's cybersecurity disclosures may help investors more efficiently price an issuer's securities to the extent they are confident that a firm's policies and procedures provide sufficient protection against a potential cyberattack" is disconnected from reality. Firms are not in possession of a company's intellectual property or a company's personal identifying information. There is therefore little risk that a cybersecurity breach at a firm will impact a company's operations or financial reporting systems.

a. Item 1.5, Statement of Policies and Procedures to Identify and Manage Cybersecurity Risks

The requirement to communicate whether and how policies and procedures to manage cybersecurity risks have been integrated into the registrant's overall risk management system or processes is unclear. Further, disclosing proprietary risk management systems and processes could be contrary to sound risk management processes. How much documentation of the firm's risk management system or processes is required? Further guidance is needed regarding this requirement; especially to assist smaller firms in complying with this proposal.

The PICPA does not support the requirement to report "whether the firm engages assessors, consultants, auditors, or other third parties in relation to cybersecurity risks." This requirement is overly broad, its value is unknown, and it could provide a signal to hackers regarding the firm's cybersecurity defenses. The end result would be contrary to any sound purpose for this proposed requirement.

The requirement to report "whether the firm has policies and procedures to oversee and identify such risks from cybersecurity threats associated with its use of any third-party service provide" should be incorporated into the diligence considerations associated with the use of third-party service providers is in AS 1000. This does not warrant repeating in the proposed standard.

b. Part IX, Significant Cybersecurity Incident Reporting

The terms "disrupted," "degraded," "critical operations," "significant," and "substantial harm" need additional definition. The PICPA notes that there are numerous laws and regulations addressing cybersecurity breaches and the proposed reporting requirements may not be in alignment with these other requirements or may even conflict with these requirements and may put firms in a legal quandary of trying to figure out which regulatory entity takes precedence. An in-depth analysis of all of the regulatory requirements should be performed to ensure that the requirements do not conflict with other regulatory requirements.

The language includes the use of "reasonably likely to lead," which requires significant speculation and could be second guessed in hindsight. Further, the requirement to report incidents in which it is reasonably likely to lead to unauthorized access is challenging, as a firm may not be aware of the unauthorized access for a significant amount of time. The reporting requirement is stated as "five days from the day the firm determines that the cybersecurity event is significant" not "five days from becoming aware of a significant event."

Consistent with many of the other proposals, this proposal appears to extend to systems that go beyond the PCAOB's jurisdiction, even to third parties. This is beyond what is appropriate.

Further, it is unclear how a breach at an audit firm would be likely to substantially harm investors. Firms do not have access to personal identifying information, a company's operations or intellectual property, or a part of a company's financial reporting systems.

5. Form 3, Reporting of Events – Part VIII Material Event Reporting

The PCAOB has not clearly articulated the rationale for reporting to the PCAOB material financial and operating events that do not directly impact the firm's ability to provide the audit services the firm is engaged to perform. The examples listed are lacking in clarity with respect to the types of events that need to be reported and disconnected from any audit quality objective. Firms need flexibility in conducting operations, including planning and investing based on their overall operating objectives, without having to disclose these plans to the PCAOB. We also note that the proposal refers to material events of the firm and not simply the audit practice. We do not believe that financial or operational information related to the firm's nonaudit practice is relevant to the PCAOB's oversight. We further question how firms will comply with these requirements for the portion of their operations under the PCAOB's jurisdiction. Would firms be required to come up with allocation analyses? This is excessive and, given its confidential nature, the firm's operating activity should not be publicly disclosed.

<u>Below are specific comments to examples included in the proposal:</u>

- Any event or matter that has or is reasonably likely to materially impact the firm's total revenue as reported in its last Form 2 filing.

  The purpose of this requirement is not clear. Firms are already required to communicate when they resign from an engagement. If a firm decides to exit audits in a particular industry, appropriate communication will be provided through the existing requirement. The committee also notes that this requirement will disproportionately impact smaller firms because every decision could be material to the firm.

  Further, reporting based on speculation is unreasonable. We request the removal of the words "or is reasonably likely to".

- Planned or anticipated acquisition of the firm, change in control, or restructuring, including external investment and planned acquisition or disposition of assets or of an interest in an associated entity.

This requirement lacks clarity in that the terms "plan" and "anticipated" are not defined. Firms plan for years before entering into any agreements. What constitutes a plan and at what point is it considered "anticipated"? Further, the timing of the publication of these plans is typically only done once the deal has been completed, not beforehand because plans change. If this information is publicized prior to the completion of the agreement, it could be factually inaccurate or misleading. Further, what is the purpose of the requirement to communicate the acquisition or disposition of an asset? Why does the PCAOB need to know if a firm acquires or disposes of a training facility, a CPE business, a significant investment in real estate or blockchain, for example?

- Entering into or disposing of a material financial arrangement that would affect the firm's liquidity or financial resources (such as a line of credit, revolving credit facility, revolver, loan, or other financing), or group of related arrangements.

This requirement is particularly onerous and administratively burdensome. It would be a significant distraction from the operations of a firm. Would this include switching financial institutions or entering into lease arrangements? The purpose of requiring this information is not clear. Furthermore, much of this activity relates to aspects of the firm's business that is outside of the PCAOB related activity. Would this require an allocation methodology to only capture the portion of this requirement that relates to PCAOB's jurisdiction?

- Material changes in the insurance or loss reserves of the firm and material changes related to captive insurance or reinsurance policies including events that triggered material claims on such policies.

Would a switch in insurance companies require reporting? Much of this requirement is confidential and the purpose of public disclosure is not clear.

- Material changes in the amount of unfunded pension liabilities.

To the extent that these assets are invested in the stock market, would a firm have to provide notice in the event of a material change in the stock market? It is unclear how this information would help investors assess audit quality.

6. Summary Description of the Firm's Quality Control Policies

The requirement for inactive firms who are registered with the PCAOB as of Dec. 15, 2025, assuming QC 1000 is approved by the SEC, to provide this information is excessively burdensome. We understand that these firms can deregister, but some may be considering taking on an audit that would require PCAOB registration. Driving these firms to deregister will reduce the level of potential competition. We support revising the requirements for inactive firms so that they provide this information when they are engaged to perform an audit.