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Office of the Secretary
Public Company Accounting Oversight Board
1666 K St. NW
Washington, D.C.

Re: PCAOB Rulemaking Docket Matter Numbers 41 and 55

I respond to the PCAOB's proposed adoption of two new rules requiring auditors registered with the Board to establish, file and publicly report on a multitude of statistical measurements of engagement conditions and firm operations. My comments will address these Proposals together since they share many of the same faults and mistaken objectives, both the specific features and the PCAOB's policy objectives. My comments are informed by my service as a member of the US Treasury Department Advisory Committee on the Audit Profession (ACAP) and Chair of its Subcommittee on Audit Firm Structure and Finance (2006-2008), as a member of the PCAOB Standing Advisory Group (SAG 2011-2017) and as the Founding Chair of the Center for Capital Market Competitiveness (CCMC, 2005-2010).

FEATURES OF THE PROPOSALS

The Proposals make no attempt to demonstrate a need for these high impact initiatives. Indeed, there is none.

+ Board members frequently extoll the virtues and competitive advantages of the US capital markets, which are clearly the world's fastest growing, most stable and most attractive.

+ Big Audit has survived the tumult of the past 50 years, growing ever more competent and technologically proficient as the key provider of assurance services.

+ Investors flock from everywhere, China included, to participate in the ownership of US listed stocks.

+ If there is a systemic deficiency needing attention it lies with the declining number of US publicly held investment vehicles. But this challenge has little, if anything, to do with audit performance. US public company formation languishes due in significant part to impediments created by securities regulation and other aspects of federal legislation.

In the absence of any demonstrable need for the Metrics Proposals, the PCAOB lists a series of new tools that it believes would be “nice-to-haves” for its regulatory use. Yet these supposed advantages are likely to have more adverse consequences for auditing, capital formation and the public interest than hypothetical regulatory benefits.

The Board bemoans that under current practice “INVESTORS AND AUDIT COMMITTEES CANNOT EASILY OBSERVE THE SERVICES PERFORMED BY AUDITORS” (Docket Matter 041, page 3 emphasis added) Of course not! Who would wish to have a spy cam mounted on the auditors shoulder 24/7? Certainly no one who believes in the value of auditor independence. Nor anyone who wishes to retain the legal structures of corporate governance in America. And it is likely that audit committee members would not welcome this opportunity to have as much liability exposure as their auditor.

The Board finds fault with current regulation because “THERE IS A LACK 0F INCENTIVE FOR FIRMS, ACTING ON THEIR OWN OR COLLECTIVELY, TO PROVIDE ACCURATE, STANDARDIZED AND DECISION RELEVANT INFORMATION ABOUT THEIR FIRM’S AND THE ENGAGEMENTS THEY PERFORM” (Ibid). Thank Heavens for that! It is fundamental to the public interest that auditors compete with one another as the primary source of practice enhancements and technological capabilities. Encouraging innovation through competition should be the Board’s objective. Instead, comments like this are sprinkled throughout the Proposals, demonstrating a desire to stifle self improvement and move toward one-size-fits-all regulatory control of the attest function.

PCAOB Release No. 2024-002 begins with a capstone statement that the Proposals should be adopted because “THIS WOULD ADVANCE INVESTOR PROTECTION AND PROMOTE THE PUBLIC INTEREST BY ENABLING STAKEHOLDERS TO MAKE BETTER INFORMED DECISIONS, PROMOTING AUDITOR ACCOUNTABILITY AND ULTIMATELY ENHANCING CAPITAL ALLOCATION AND CONFIDENCE IN OUR CAPITAL MARKETS.” (Ibid.) This statement explains more than the Board may have intended to disclose. It confirms this Board’s perspective that investor interests dominate its actions. It speaks of “investors” as if they were beneficial owners, rather than the 80% or more that are professional investment intermediaries. It assumes that investors have homogenized interests, when in fact there will always be a buyer and a seller with conflicting objectives. “Promoting auditor accountability” is a meme for the belief that securities liabilities for big audit are insufficient. None of these sweeping declarations is demonstrated in the Proposals, and all are beyond the authority of the PCAOB.

THE GENESIS OF AUDIT QUALITY INDICATORS

In the absence of any other demonstration of need for adopting the metric standard, the Proposals turn to the prior history of Audit Quality Indicators in audit regulation, the Board claims that validation is found in the prior attention to AQIs by ACAP and the SAG. But the history presented by the Board is not the history I witnessed as a participant through it all. Because the proposed uses of analytics are pervasive, untested and under-examined, it must be of concern that the concept could easily be harmful to audit quality and capable of other

adverse consequences. Consequently, it is worth a moment to reflect on how the ideas evolved.

- The AQI concept was initially aired in the ACAP discussions of 2007-2008. Opinions were sharply divided and strongly held regarding the feasibility and utility of using statistical data as indicators of audit quality. For example, proponents urged the value of staff-to-partner ratios, while opponents protested that too many and too few could both be of concern according to the context. One might as well ask how long a stick should be.

- The Committee found something like common ground with Recommendation 3 on Concentration and Competition: The PCAOB should…"in consultation with auditors, investors, public companies, audit committees, boards of directors, academics and others, DETERMINE THE FEASIBILITY OF DEVELOPING KEY INDICATORS OF AUDIT QUALITY AND EFFECTIVENESS and of requiring audit firms to publicly disclose these indicators." (ACAP p. VII:8 emphasis added.) The assessment of feasibility was central to that recommendation, as was the need for extensive consultation.

- The PCAOB did not respond to the ACAP Report until the PCAOB Staff produced a Briefing Paper on the ACAP Recommendations for a meeting of the SAG on April 7-8, 2010. The Briefing Paper described the favorable attention being given by the Board to many of the Recommendations, but as to AQIs it said only that "The Board has discussed this recommendation but has not taken any action." (Staff Briefing Paper, p. 8). The Recommendation was not discussed at that SAG meeting.

- The subject of AQIs did not reappear for 7 years. In April, 2017 a new version of the idea developed by the PCAOB staff became the central topic for a 2 day SAG discussion. There were diverse opinions expressed then as well, which is not surprising since many of us involved had been ACAP members.

- On this occasion,however, there was a clear majority opposed to the mandatory use of AQIs for audit Standard Setting, for audit performance assessment or for PCAOB Inspections and Enforcement. Despite this, the minutes of the meeting, prepared as always by the staff, declared that a consensus of SAG Members favored broad adoption and regulatory use of such metric standards. Tensions over Staff reporting were by then all too common, due in part to the Board's refusal to allow the SAG to take any form of vote. I do not express this view frivolously. I lodged a protest with the Board at the time, leading to extensive personal interaction with the Board and Staff over the succeeding months, and an hour long impolite debate at the SAG Meeting of November, 2017 which was videotaped in the meeting minutes for further attention However, the issue
- was not brought to a head due to the dismissal of the Board members at the end of that year.

- Another 7 years passed before the AQI concept appeared in the Proposals now before us. These proposals, however, depart materially from the ACAP recommendation. The PCAOB declares that the plan is feasible, but there is no public indication that the Board had made a "determination" in keeping with the ACAP position. Neither the costs nor the benefits of conversion to the metric system of regulation have been assessed. There have been no Roundtables or public dialogues. Nor has there been any attention or inquiry among any of the stakeholders deemed essential by ACAP. The interim 7 years appear to have considered the matter only by the staff and the IAG, if at all. Yet the Proposal is presented now with unexplained urgency and an unseemly short period for public comment.

THE RESHAPING OF PCAOB GOVERNANCE

The firm and engagement analytics cannot be justified, or even explained, on their individual or collective merit. Yet there must be a purpose that explains the rush to embrace the liability enhancing and market disturbing risks that would likely follow their adoption. I suggest that the purposes lie beyond the scope of these proposals, and that they are revealed by the PCAOB's current standard setting agenda and related initiatives.

For most of its 20 years, the PCAOB's standard setting has been highly deliberative, marked by extensive consultation with the Standing Advisory Group, which had been established as a SOX mandate. However, the Board's speed, structure, focus and outreach turned sharply with the Board's decision in February, 2022, to terminate the SAG and replace it with two advisory groups: the Investors Advisory Group (AIG) consisting principally of investor advocates, and the Strategic and Emerging Issues Advisory Group (SEIAG), consisting diverse capital market representatives directed to deal primarily with difficult policy issues. There had been an IAG functioning prior to this, but it was not created by SOX and it operated without a Charter It is noteworthy that several members of the new IAG were also appointed to the SEIAG, apparently to further assure the protection of investor interests. Not surprisingly, the Board has accelerated its pace of standards and rulemaking initiatives since 2022 and reduced its outreach efforts as well.

The Board's intentions were further revealed by its election to provide the new IAG with leadership of its own selection, powers of self initiative and freedoms of action that were withheld from the SEIAG, which is not permitted to call a meeting, set its own agenda, produce written materials or vote on matters before it. Clearly, the IAG had been promoted to the lead Advisory role, including authority to advise the Board on its own initiative and without scope limitations.

If there was any doubt about this being the Board's intention, it was removed on April 24 of this year when "members of the IAG" published a notice that they would be soliciting the public seeking nominations for the best public company Critical Audit Matters in SEC filed financial statements during 2023. Both actions are unheard of in PCAOB matters, and neither is

contemplated by SOX. Nor was there any public act of enablement issued by the Board. Yet the undertaking appears on the PCAOB website with all the hallmarks of an official and sanctioned act of the Board. The AIG Notice instructs that questions about this initiative should be directed to one of its members wi9th no required involvement of the Board, its staff or the public.

A similar event of undisclosed change in the PCAOB governance spectrum is the now regular practice of the investor advocates to submit Comment Letters as “Members of the IAG”. The names of those Members are not disclosed. How many Members claim responsibility for the content is not disclosed. The opinions of the unidentified dissenters are never revealed. Footnote disclosure does acknowledge that “several members dissent from the document” but without further explanation. Authorship and its significance have become dark matter.

It is fair comment to suggest (1) that the IAG has been given stature and influence contrary to statute and regulation, (2) that the unknown authors of IAG Comment Letters have nevertheless exceeded even the authority of its Charter and (3) those unacknowledged members have control of, or heavy influence over, the thinking and the actions of the Board.

A SEARCH FOR REASONS

In these curious circumstances, one must seek to understand the end game for audit regulation. It seems unlikely that making the world easier for investment advisors is sufficient reason for all this expensive, clandestine and poorly explained activity. My thoughts on the subject can only be circumstantial and speculative.

RESHAPING THE PCAOB MANDATE. Congress created the PCAOB with a mission to protect investors, maintain orderly capital markets and serve the public interest. While paying occasional lip service to this tripartite duty, public comments by the Chair of the PCAOB frequently focus exclusively on its mission to serve investor interests. Many such comments openly acknowledge that Board actions are intended to accommodate investor demands, without Board assessment of their merits, It is hardly surprising, then, that the Board’s statements of regulatory purpose are growing indistinguishable from those of the “Members of the IAG”.

Mandate reshaping is recognized in a perceptive commentary by Thomson Reuters explaining the Board’s adoption of AS 1000:

> “One of the key aspects of AS1000 is its emphasis on the AUDITOR’S FUNDAMENTAL OBLIGATION TO PROTECT INVESTORS…THE STANDARD (AS 1000) UNDERSCORES THAT THIS OBLIGATION TRANSCENDS THE AUDITOR’S RELATIONSHIP WITH THE MANAGEMENT AND THE AUDIT COMMITTEE OF THE COMPANY UNDER AUDIT.” Perhaps this ought to be the sole purpose of future audit regulation But it is not within the PCAOB’s authority today, nor does it comply with the established model of US corporate governance.

REPLACING THE “REASONABLE ASSURANCE” MODEL OF THE AUDITOR’S RESPONSIBILITY TO DETECT CORPORATE FRAUD. Auditor’s liability and the scope of the auditors duty to detect fraud were not an issue of concern before the 1970s, when a tidal wave of securities fraud created havoc in the capital markets and threatened the viability of the large audit firms. A few years of frontier warfare ensued between investors who pressed for fraud detection as an absolute obligation and auditors and public companies who sought a workable standard that accepted that there are limits on what is possible. Thus “the expectation gap” was born.

The dynamic tension of the expectation gap, and the parallel conflicts over the appropriate scope of the auditor’s responsibility to detect fraud precipitated the formation in 1975 of the predecessor of the FASB and its adoption of the reasonable assurance principles that have guided auditing standards and regulation for 50 years. The resolution was based on the belief that preservation of vital capital markets required both a reasonable level of risk for investors and the sustainability of assurance as objectives of similar importance to the reduction of investor risk.

That compromise has endured, but it did not end the controversy. Outbreaks of distress caused the convening of several lengthy study projects. Prominent among them were the Cohen Commission (1978), the Treadway Commission (1979), the O’Malley Study (1994) and ACAP (2006). Meanwhile, the Enron era crisis produced SOX in 2002 as a Congressional effort to solve the Gordian Knot of the expectation gap.

Despite the enormous attention given to the search, the reasonable assurance audit model has survived every effort to find a better audit mousetrap. The standard survived because the constituents - investors, regulators,directors, audit committees and policy makers - could not find an alternative that functioned better for the public interest.

The time and effort expended on the expectation gap nevertheless produced benefits. Confidence in the perceived legitimacy of the audit model has gained traction as the various market forces learned to work with it, and the US markets have flourished. It is unfortunate that the PCAOB appears determined to swim against the tides of success. This is a hazardous time for inviting disorder, with the Big Four audit firms in structural disarray triggered in part by regulatory policies, with investor groups looking to enlarge the liability risks of big audit and with a crisis of recruitment in the human resource component of auditing.

I urge withdrawal of these Proposals and deep reflection on the objectives of audit regulation.

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