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PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Firm and Engagement Metrics

PCAOB Release No. 2024-002
April 9, 2024

PCAOB Rulemaking
Docket Matter No. 041

Summary: The Public Company Accounting Oversight Board (PCAOB or the "Board") is proposing amendments to its rules and reporting forms to require the reporting of specified firm-level metrics on new Form FM, *Firm Metrics*, and specified engagement-level metrics on an amended and renamed Form AP, *Audit Participants and Metrics*.

Public Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. Comments may also be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 041 in the subject or reference line and should be received by the Board by June 7, 2024.

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TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

We are proposing to require certain registered public accounting firms ("firms" or "audit firms") to publicly report specified metrics relating to their audits and their audit practices. We believe the proposed metrics would provide valuable additional information, context, and perspective on auditors and audit engagements, which could be used by investors, audit committees, and other stakeholders. 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.

Investors and audit committees cannot easily observe the services performed by auditors. This can limit investors' ability to make informed decisions about investing their capital, ratifying the selection of auditors, and voting for members of the board of directors, including directors who serve on the audit committee, and audit committees' ability to choose among and monitor the performance of auditors. At the same time, there is a lack of incentive for firms, acting on their own or collectively, to provide accurate, standardized, and decision-relevant information about their firms and the engagements they perform. In response to these challenges, the Board has studied ways to measure audit firm and audit engagement performance, primarily with a view to providing information useful to investors in their investment and proxy voting decisions, but also recognizing that metrics could potentially be informative to others. For example, audit committees could benefit from having additional context when deciding whether to select or retain a firm and overseeing the firm's work, and audit firms could use standardized information about themselves and their peers in designing, implementing, monitoring, and remediating their systems of quality control. The Board could also potentially benefit from having additional tools to use in its inspections program and standard-setting initiatives.

We have observed that some firms already publicly disclose certain firm-level metrics through audit quality reports, transparency reports, or similar documents. However, the disclosures are inconsistent across firms, and there are no common definitions or calculations allowing for consistent comparisons. Moreover, most of the disclosures are voluntary, so firms are free to revise or discontinue such reporting anytime. In our view, the current voluntary reporting regime does not provide consistent, comparable information that stakeholders can rely on to inform their decisions over time.

We propose to mandate public reporting of standardized firm- and engagement-level metrics that we believe would create a useful dataset available to investors and other stakeholders for analysis and comparison. The proposed amendments to our standards, rules, and forms (the "proposed amendments" or the "proposal") would include new Rule 2203C, *Firm Metrics*; new Form FM, *Firm Metrics*; and revisions and a new name, *Audit Participants and Metrics*, for Form AP, as well as a new name and amendment to Rule 3211, *Audit Participants and Metrics*.

The proposal would require reporting at both the firm and the engagement levels. Firm-level metrics would relate to aspects of the firm's audit practice (e.g., overall turnover of individuals across a firm's audit practice) and engagement-level metrics would relate to individual audit engagements (e.g., turnover of individuals working on a particular engagement). We are proposing to require firm-level metrics because information relevant to the firm could be beneficial in providing context for engagement-level metrics and in evaluating the firm's audit practice and its related system of quality control. We are proposing to require engagement-level metrics because information relevant to an audit engagement could be useful in gaining a richer understanding of a particular audit. Most metrics would be reported at both firm- and engagement-level, but for some, our proposal would require reporting at only one level (for example, restatements would be reported only at the firm level).

Proposed Metrics

We are proposing metrics in the following 11 areas:

- Partner and Manager Involvement. Hours worked by senior professionals relative to more junior staff across the firm's issuer engagements and on the engagement.

- Workload. Average weekly hours worked on a quarterly basis by engagement partners and by other partners, managers, and staff, including time attributable to engagements, administrative duties, and all other matters.

- Audit Resources – Use of Auditor's Specialists and Shared Service Centers. Percentage of issuer engagements that used specialists and shared service centers at the firm level, and hours provided by specialists and shared service centers at the engagement level.

- Experience of Audit Personnel. Average number of years worked at a public accounting firm (whether or not PCAOB-registered) by senior professionals across the firm and on the engagement.

- Industry Experience of Audit Personnel. Average years of experience of senior professionals in key industries audited by the firm at the firm level and the audited company's primary industry at the engagement level.

- Retention and Tenure. Continuity of senior professionals (through departures, reassignments, etc.) across the firm and on the engagement.

- Audit Hours and Risk Areas (engagement-level only). Hours spent by senior professionals on significant risks, critical accounting policies, and critical accounting estimates relative to total audit hours.

- Allocation of Audit Hours. Percentage of hours incurred prior to and following an issuer's year end across the firm's issuer engagements and on the engagement.

- Quality Performance Ratings and Compensation (firm-level only). Relative changes in partner compensation (as a percentage of adjustment for the highest rated group) between groups of partners based on internal quality performance ratings.

- Audit Firms' Internal Monitoring. Percentage of issuer engagements subject to internal monitoring and the percentage with engagement deficiencies at the firm level; whether the engagement was selected for monitoring and, if so, whether there were engagement deficiencies and the nature of such engagement deficiencies at the engagement level.

- Restatement History (firm-level only). Restatements of financial statements and management reports on internal control over financial reporting ("ICFR") that were audited by the firm over the past five years.

At this time, we are proposing to focus reporting requirements on situations where we believe additional perspective about the audit and the auditor would be most likely to inform the investment and proxy voting decisions that investors are called upon to make. Firm-level reporting would be required of every firm that audits at least one "accelerated filer" or "large accelerated filer" (as those terms are defined in the U.S. Securities and Exchange Commission ("SEC") rules) during the reporting period. Reporting of all the firm-level metrics would be required for each of the firms that met the reporting threshold, except that the quality performance ratings and compensation metric would not be required for firms that are exempt from partner rotation under Rule 2-01 of Regulation S-X. Engagement-level reporting would be required for every audit of an accelerated or large accelerated filer.

The proposed thresholds would apply to the audits, and auditors, of companies that account for the overwhelming majority of U.S. public company market capitalization, and we believe would capture the situations where investment and proxy voting decisions would be most likely to benefit from additional information about the audit and the auditor.

The proposal would:

- Require reporting of firm-level metrics annually on a new Form FM, *Firm Metrics,* pursuant to a new Rule 2203C, *Firm Metrics*, for firms that serve as lead auditor for at least one accelerated filer or large accelerated filer;

- Require reporting of engagement-level metrics for audits of accelerated filers and large accelerated filers on a revised Form AP, which would be renamed "Audit Participants and Metrics"; and

- Allow, but not require, limited narrative disclosures on both Form FM and Form AP to provide context and explanation for the required metrics.

This proposal builds on other actions we have taken to provide stakeholders with additional information about registered firms and the engagements they perform. From its inception, the Board's registration and reporting program has yielded important information about registered firms, including annual updates on Form 2 and current reporting of significant events on Form 3. In 2015, the Board adopted rules requiring firms to disclose the name of the engagement partner and information about other firms that participated in the audit. In 2017, the Board updated its standards to require communication of critical audit matters and auditor tenure. The Board currently has a rulemaking project to consider changes to firm reporting requirements. We believe the proposed metrics would complement these efforts by providing investors with additional information that would assist them in making decisions about audit-related matters, such as whether to ratify the company's selection of its auditor or to vote for reelection to the board of directors of members of the audit committee, as well as potentially assisting in audit committee oversight, supporting continuous improvement of firms' QC systems, and facilitating our own oversight and rulemaking efforts. We further believe that the value of these metrics would likely increase over time as firm reporting practices develop and trends become observable.

In our initial efforts to explore firm- and engagement-level metrics, we referred to "audit quality indicators" ("AQIs"). In this release, we use the term "firm and engagement metrics" instead. We believe the latter term avoids the potential misimpression that any set of metrics can comprehensively measure audit quality and emphasizes our goal of promoting informed decision making through robust disclosure requirements. Some of the most important elements of a high-quality audit, such as application of due care and professional skepticism, cannot be measured and quantified directly. The proposed metrics employ proxies, such as years of experience, auditor workloads, and percentage of audit hours attributable to more senior members of the audit team, which can only partially capture these concepts. Moreover, for some of our proposed metrics, numerical values may provide different signals in different contexts; for example, a relatively frequent use of auditor's specialists could indicate a particularly thorough audit effort but may also point to a lack of relevant expertise on the engagement team. We believe that consideration of the metrics in combination, together with any additional context a firm may choose to provide, would help users interpret potentially ambiguous data, and that the metrics, analyzed across firms and over time, would yield important, currently unavailable information that would assist investors, audit committees, and other stakeholders.

We developed the proposal after considering input from numerous sources, including the recommendations of the U.S. Department of Treasury's Advisory Committee on the Auditing Profession ("ACAP"), including ACAP's October 6, 2008 *Final Report to the Department of the Treasury* ("ACAP Final Report"); our *Concept Release on Audit Quality Indicators*, PCAOB Release No. 2015-005 (July 1, 2015) ("Concept Release"), and the comments received; the voluntary practices of firms; recommendations from the PCAOB's Investor Advisory Group ("IAG"); and the initiatives of international regulators. We have carefully considered this input and believe that our proposal strikes an appropriate balance between the expected benefits of the new reporting requirements and the associated costs of implementation and compliance.

Both firm-level and engagement-level reporting are proposed to be required for periods beginning October 1 of the year after the year in which SEC approval is obtained. We are also considering a phased implementation period for both firm- and engagement-level reporting, with firms that issue audit reports for more than 100 issuers beginning reporting in the first year that reporting is required and other firms beginning one year later.

This release provides background on the Board's rulemaking project; discusses the proposed rule, form, and other amendments; and includes an economic analysis addressing the need for rulemaking and the anticipated economic impacts of our proposal. The release also includes two appendices. Appendix 1 sets forth Rule 2203C and Form FM instructions and Appendix 2 sets forth amendments to Form AP.

Requesting Public Comment on Our Proposal

We seek comment on all aspects of the proposed rule, proposed form, and other amendments. Throughout the release, we have included detailed questions soliciting feedback on specific aspects of the proposal. You are encouraged to comment on any or all topics, respond to any or all questions, provide feedback in areas not covered by specific questions, and provide any evidence, including data or your practical experiences, that informs your views.

Instructions on how to comment, including by e-mail or postal mail, can be found on the cover sheet of this release. The release and comments can be found at the docket page of PCAOB Rulemaking Docket Matter No. 041.

II. BACKGROUND

A. Project History

1. Importance and Potential Benefits of Increased Information About Audit Firms and Engagements

With the passage of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the establishment of the PCAOB, Congress acknowledged and re-emphasized the auditor's important gatekeeping role.[1] Reflecting that importance, we believe requiring audit firms to provide additional information about the firm and the engagements it performs would advance investor protection and promote the public interest by enabling investors to make better-informed decisions. We have also heard from investors and other stakeholders that they believe such information would be beneficial. For example, some commenters on the Concept Release asserted that additional data and information would assist investors in making

[1] *See* Section 101(a) of Sarbanes-Oxley, 15 U.S.C. § 7211(a); Senate Report No. 107-205, at 5-6 (July 3, 2002).

informed decisions about whether to approve the ratification of the auditor or the election of audit committee members, and in otherwise exercising oversight of public companies.[2]

Sarbanes-Oxley also mandated new exchange requirements regarding the responsibilities of audit committees of listed companies, including requiring that audit committees be charged with responsibility for the appointment, compensation, and oversight of the auditor.[3] We believe that making information available to audit committees regarding both the specific audit and auditor they oversee and the audits and auditors of their peer companies would assist them in carrying out this statutory mandate.

Over the years, the Board has received significant input on the importance and potential benefits to stakeholders of additional information about audits and auditors. We summarize key elements of that input below.

i. ACAP recommendations

In 2007, the U.S. Treasury constituted the ACAP to consider and develop recommendations relating to the sustainability of the auditing profession.[4] On October 6, 2008, ACAP published a report detailing recommendations intended to enhance the sustainability of a strong and vibrant public company auditing profession.[5] One of the ACAP recommendations was that the PCAOB, 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 requiring auditing firms to publicly disclose those indicators"[6] and, assuming that development and disclosure of indicators of audit quality are feasible, that the PCAOB be required to monitor these indicators.

2 *See, e.g.,* comment letter from members of the IAG (Jan. 13, 2023), Rulemaking Docket 046: Quality Control, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/4_iag.pdf?sfvrsn=1941e7c0_4.

3 *See* Section 10A(m)(2) of the Exchange Act, 15 U.S.C. §78j-1(m)(2).

4 *See* ACAP Final Report, at IV:1.

5 *See* ACAP's *Fact Sheet: Final Report of the Advisory Committee on the Auditing Profession*, *available at* https://home.treasury.gov/news/press-releases/hp1158#:~:text=The%20U.S.%20Treasury%20Department%20%27s%20Advisory%20Committee%20on,into%20three%20sections%20by%20principal%20areas%20of%20focus.

6 *See* ACAP Final Report, at VIII:14.

ii. 2013 and 2017 PCAOB Investor Advisory Group Recommendations

At its October 2013 IAG Meeting,[7] the IAG working group on audit quality indicators made recommendations for the PCAOB to prescribe informative, forward-looking disclosures and indicators intended to measure the quality of audits and enhance auditor accountability. They argued that investors and audit committees generally care more about the quality and credibility of audit work on specific engagements—the companies in which they have invested or were considering investing, or the company on whose board of directors they served—rather than firms' more general efforts to improve quality. Accordingly, in addition to disclosures and metrics to be reported at the firm level, they also recommended disclosures and metrics to be reported at the engagement level.

At the October 2017 IAG meeting, an IAG working group discussed three topics: (i) why audit quality and AQIs matter to investors, (ii) the PCAOB's authority and efforts to date to enact AQIs, and (iii) audit quality initiatives in other jurisdictions.[8] The 2017 working group also endorsed the 2013 AQI working group's recommendations.

The recommendations provided by the 2013 and 2017 IAG working groups include many of the areas addressed by our proposed metrics.

2. PCAOB Initiatives

This section provides further background and expands on the history of PCAOB activities related to providing additional information about audit firms and audits, including firm and engagement metrics.

i. 2015 AQI Concept Release

In July 2015, the PCAOB issued the Concept Release and sought comment on 28 potential indicators. The indicators were organized into three groups:

- Audit professionals – Measures dealing with the availability, competence, and focus of those performing the audit.
- Audit process – Measures related to an audit firm's tone at the top and leadership, incentives, independence, attention to infrastructure, and record of monitoring and remediation.

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7 *See* Oct. 2013 IAG meeting and presentations, Report from the Working Group: Audit Quality Indicators, *available at* IAG Meeting Archive, https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting_758.

8 *See* Oct. 2017 meeting and presentation, *available at* IAG Meeting Archive, https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting_1085.

- Audit results – Financial statements, internal control, going concern, communications between auditors and audit committees, and enforcement and litigation.

The Concept Release discussed (i) the nature of the potential indicators and potential calculations, (ii) the usefulness of the indicators, (iii) suggestions for other indicators, (iv) potential users of the indicators, and (v) the approach to implementation. The PCAOB received 50 comment letters in response to the Concept Release.

Most commenters expressed support for the general idea that AQIs may be useful.[9] However, commenter views varied widely. Comments from firms and firm-related groups suggested that no standard group of indicators could advance a person's understanding of audit quality. These commenters suggested that AQIs should be voluntary, should be reported to audit committees through two-way discussions to provide context for the indicators, or should be required only at the firm level. Investors and investor-related groups argued that indicators should be made public and could be used to stimulate competition based on quality among audit firms, remedy the deficiency of information about audits, and give shareholders meaningful information to help them in voting on auditor selection. Some commenters suggested that engagement-level metrics are more useful than firm-level metrics. One commenter suggested that promoting competition around an implied variability in audit quality may not always be appropriate and in the public interest because audit quality should be nonnegotiable and a fundamental goal for all audits. Another commenter suggested that it was critical to define what AQIs do and do not represent so that they are used appropriately.

ii. PCAOB Rulemakings to Increase Audit Transparency: Identification of the Engagement Partner and Other Audit Participants on Form AP and Auditor Communication of Critical Audit Matters

In 2015, the PCAOB adopted rules requiring information on Form AP, *Auditor Reporting of Certain Audit Participants,* regarding the engagement partner and other accounting firms that participate in audits of issuers.[10] The rulemaking was initially in response to the ACAP recommendation that the engagement partner should be required to sign the audit report.[11] As the rulemaking evolved, it also took account of stakeholder input, including the IAG recommendations described above regarding identification of the engagement partner and of the firms, other than the firm signing the audit report, that participate in audits.

The Board's intention was to make available information about the engagement partner and other firms that participated in the audit, saying that such information, even if not useful in

[9] *See* Nov. 2015 Standing Advisory Group (SAG) Briefing Paper *available at* SAG Meeting Archive, https://pcaobus.org/news-events/events/event-details/standing-advisory-group-meeting_910.

[10] *See* PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants.*

[11] *See* ACAP Final Report, at VII:19.

every instance or meaningful to every investor, would make an overall contribution to the information available to investors in making voting and investment decisions. The Board also asserted that increased transparency should promote increased accountability in the audit process. The Form AP reporting requirements became effective in 2017.

In 2017, the PCAOB adopted AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which includes requirements regarding the disclosure of auditor tenure and auditor determination and communication of "critical audit matters."[12] This project was also initiated in response to ACAP's recommendation that the PCAOB undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model.[13] In the adopting release, the Board noted ACAP's statement that the complexity of financial reporting supports improving the content of the auditor's report beyond the then-current pass/fail model to include a more relevant discussion about the audit of the financial statements.

The auditor's report rulemaking explored potential ways to increase the transparency and relevance of the auditor's report, including by requiring expanded auditor reporting regarding the audit and the company's financial statements.[14] After multiple rounds of Board releases and stakeholder input, the requirements took effect between 2019 and 2020.

iii. Recent PCAOB activities

At the November 2022 Standing and Emerging Issues Advisory Group (SEIAG) and the October 2022 and 2023 IAG meetings, several members indicated that stakeholders continue to be interested in firm and engagement metrics. Some members of the IAG and SEIAG have requested increased information at the firm and engagement levels through easily accessible and quantified metrics, potentially with accompanying context provided by the auditors.[15]

In response to the Board's request for comment on the draft 2022-2026 Strategic Plan, some commenters encouraged the Board to continue to consider this topic.[16] Additionally, in a

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12 *See* AS 3101.11-.16.

13 *See* ACAP Final report, at VII:13.

14 *See Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards; Notice of Roundtable* (Jun. 21, 2011), *available at* *https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-issues-concept-release-on-auditor's-reporting-model_337*.

15 *See* Nov. 2022 SEIAG meeting, *available at* https://pcaobus.org/news-events/events/event-details/pcaob-standards-and-emerging-issues-advisory-group-meeting-2022. *See* Oct. 2022 IAG meeting, *available at* https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting and Oct. 2023 IAG meeting, *available at* https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting-october-2023.

16 *See* comments on 2022-2026 Strategic Plan Documents, *available at* *https://pcaobus.org/about/strategic-plan-budget/comments-on-pcaob-draft-strategic-plan-2022-2026*.

January 2023 comment letter on the PCAOB's proposed quality control project, members of the IAG advocated for "a minimum requirement of eight indicators."[17] These eight indicators were (i) staffing leverage; (ii) partner workload; (iii) manager and staff workload; (iv) audit hours and risk areas; (v) quality ratings and compensation; (vi) audit fees, effort, and client risk; (vii) audit firm's internal quality review results; and (viii) PCAOB inspection results.

a. Proposed QC 1000: Proposed Requirements and Commenter Feedback

The Board's proposal regarding a new quality control standard for firms, QC 1000, *A Firm's System of Quality Control* ("proposed QC 1000"),[18] contains provisions that, if adopted by the Board and approved by the SEC, would be relevant to firm reporting of firm- and engagement-level metrics. In addition, commenter feedback on proposed QC 1000 has informed the development of this proposal.

(1) Public communication of firm-level or engagement-level information

Under proposed QC 1000, if a firm publicly communicates firm-level or engagement-level information, such as firm or engagement performance metrics, (i) the firm's quality objectives should include that such information is accurate and not misleading and (ii) with respect to any performance metrics relating to the firm's audit practice, firm personnel, or engagements, the communication should explain in reasonable detail how the metrics were determined and, if applicable, how the metrics or the method of determining them changed since performance metrics were last communicated.[19] Several commenters, including firms and related groups, broadly supported this proposed objective or the importance of addressing communications to stakeholders about a firm's or engagement's performance, including that such communications should be accurate and not misleading. The proposed firm and engagement metrics include reporting elements that focus on the firm's responsibility to produce and report information that is accurate and not misleading, for example, an optional narrative to accompany the metrics. This element is discussed further below in Section III.

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17 *See* PCAOB Release No. 2022-006, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms* (Nov. 18, 2022). The comment letters received in response to the concept release are available on the Board's website in Docket 046. *See* comment letter from members of the IAG, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/4_iag.pdf?sfvrsn=1941e7c0_4.

18 *See* PCAOB Release No. 2022-006 (Nov. 18, 2022).

19 Proposed QC 1000.53e.

(2) Use of metrics in monitoring the firm's QC system

Under proposed QC 1000, in determining the nature, timing, and extent of QC system-level monitoring activities, the firm would be required to take into account any performance metrics that the firm may have developed for its QC system, among other things.[20] Several commenters to proposed QC 1000, including investor-related groups, suggested that the standard should require, either as part of the monitoring and remediation process or more generally, use of quantitative performance metrics. While we understand that some firms already use certain metrics to monitor their engagements and QC system, proposed QC 1000, if adopted, would not require the use of any specific metrics. Firms would have the ability to use any or all of our proposed metrics in their QC system, but that would not be required. We believe the metrics we are proposing would provide information about the firm's system of quality control, in particular through a proposed metric tracking firm-level and engagement-level information related to identified "engagement deficiencies," as that term is defined in proposed QC 1000.[21] However, not all firms may find all metrics useful in monitoring their QC system, so we are not proposing to mandate their use at this time.

(3) Commenter feedback on metrics

Some commenters on proposed QC 1000 expressed views related to the use of performance metrics in relation to components of the firm's QC systems (e.g., resources, information and communication, monitoring and remediation) and offered views about the usefulness of performance metrics generally. Some commenters, including firms and a related group, recommended that considerations related to performance metrics in proposed QC 1000 be taken up as part of the PCAOB's research project on firm and engagement performance metrics.

b. Proposed Firm Reporting

The Board's Firm Reporting proposal contains certain updates to its annual and special reporting requirements to facilitate the disclosure of more complete, standardized, and timely information regarding audit firms. Among other new requirements, the proposal would (1) require firms to disclose additional information on Form 2 about their fees and client base, leadership and governance structure, and network arrangements; (2) require an update to the firm's quality control policies and procedures on a new Form QCPP; and (3) shorten the deadline for filing Form 3 from 30 days to 14 days and expand the scope of special reporting to include events that pose a material risk, or represent a material change, to the firm's

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[20] Proposed QC 1000.65c.

[21] *See* Section III.B.2 for the discussion of the metric, Audit Firms' Internal Monitoring.

organization, operations, liquidity or financial resources, or provision of audit services , as well as new cybersecurity reporting requirements.[22]

3. Overview of Existing Requirements

This section discusses the key PCAOB standards and rules that require certain firm- and engagement-level information to be provided to various stakeholders.

i. Available information related to firms

PCAOB rules require firms to file Form 2 (Annual Report Form) to report basic information about the firm and its audit practice and Form 3 (Special Reporting Form) after the occurrence of certain events.[23] In addition, the PCAOB makes inspection reports publicly available for firms that are subject to annual or triennial PCAOB inspections.

a. Form 2 and Form 3

As required by Section 102(d) of Sarbanes-Oxley and Rule 2200, each year registered firms must file an annual report with the Board. Under PCAOB rules, firms must do so by filing Form 2. The annual reporting period runs from April 1 to March 31, and the due date for filing is June 30.[24] In addition to basic identifying information about the firm,[25] firms report on Form 2 general information about their audit practices and other business relationships. Information required to be provided on Form 2 includes:

- Whether the firm issues audit reports for issuers, brokers, or dealers or plays a substantial role in issuer or broker-dealer audits;[26]

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22 *See Firm Reporting*, PCAOB Release No. 2024-003 (April 9, 2024).

23 PCAOB Rules 2200, 2201, 2203; Instructions to Form 2, *available at* https://pcaobus.org/about/rules-rulemaking/rules/form_2; Instructions to Form 3, *available at* https://pcaobus.org/about/rules-rulemaking/rules/form_3. Information reported on Forms 2 and 3 is publicly available unless a firm requests confidential treatment.

24 PCAOB Rule 2201; General Instructions 3-4 to Form 2. A registered public accounting firm that has its application for registration approved by the Board in the period between and including April 1 and June 30 of any year is not required to file an annual report in that year. *Id.*

25 Instructions to Form 2, Item 1.1.

26 *Id.*, Item 3.1. This release uses the terms "issuer," "broker," and "dealer" as those term are defined under Sections 2(a)(7) and 110(3)-(4) of Sarbanes-Oxley. 15 U.S.C. § 7201(7), 7220(3)-(4). *See also* PCAOB Rule 1001(b)(iii), (d)(iii), (i)(iii). Entities that are brokers or dealers or both are sometimes referred to as "broker-dealers."

- Percentage of total fees billed to issuers for audit services, other accounting services, tax services, and non-audit services;[27]

- For each issuer or broker-dealer for which the firm issued an audit report, the issuer's or broker-dealer's name, its Central Index Key (CIK) number and Central Registration Depository (CRD) number (if any), and the date of the audit report, as well as the total number of firm personnel who exercised authority to sign the firm's name to an audit report for an issuer or broker-dealer during the reporting period;[28]

- Physical address (and, if different, mailing address) of each firm office;[29]

- Whether the firm has any memberships, affiliations, or similar arrangements involving certain activities related to audit or accounting services (including use of name in connection with audit services, marketing of audit services, and employment or lease of personnel to perform audit services), and the entities with which the firm has those relationships;[30]

- Total number of accountants, certified public accountants, and personnel;[31]

- Relationships with certain individuals and entities with disciplinary or other histories (if not previously identified);[32] and

- Acquisitions of another public accounting firm or a substantial portion of another firm's personnel.[33]

In addition to annual reporting on Form 2, firms are required to file Form 3 within 30 days after the occurrence of certain events, such as when the firm's legal name has changed while otherwise remaining the same legal entity, the firm has withdrawn an audit report on the financial statements of an issuer or has resigned, declined to stand for re-appointment, or been

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27 Instructions to Form 2, Item 3.2.

28 *Id.*, Item 4.1.

29 *Id.*, Item 5.1.

30 *Id.*, Item 5.2.

31 *Id.*, Item 6.1.

32 *Id.*, Items 7.1, 7.2.

33 *Id.*, Item 8.1.

dismissed from an audit engagement as principal auditor, and the issuer has failed to comply with applicable Form 8-K reporting requirements for such events.[34]

b. Firm inspection reports

Sarbanes-Oxley authorizes the PCAOB to inspect firms for the purpose of assessing compliance with certain laws, rules, and professional standards in connection with a firm's audit work for issuers, brokers, and dealers. Firms that issue audit reports for more than 100 issuers per year are inspected annually. Firms that issue 100 or fewer audit reports per year for issuers are generally inspected at least once every three years. The Board also inspects firms that play a substantial role in audits of issuers. Many firms registered with the Board perform no audit work for issuers or broker-dealers, or only participate in audits below the level of a substantial role, and the Board has not historically inspected those firms. The PCAOB provides each inspected firm with a report summarizing any deficiencies identified through the inspections process. Portions of these inspection reports are publicly available on the PCAOB's website.[35] Recently the PCAOB introduced enhanced search tools that enable investors and others to better access and understand data from PCAOB inspection reports.[36]

ii. Available information related to issuer engagements

a. Auditor's communications with audit committees

Investors and other financial statement users are the beneficiaries of the audit. Audit committees protect the interests of investors by assisting the board of directors in fulfilling its responsibility to oversee the integrity of the company's accounting and financial reporting processes, including the audit of the company's financial statements—and in carrying out that duty, they also benefit other financial statement users. To support the audit committee in this crucial role, PCAOB standards and rules and SEC rules require auditors to provide certain firm-

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[34] General Instruction 3 to Form 3; Instructions to Form 3, Items 2.17, 2.1, 2.1-C, 3.1, 3.2.

[35] *See* https://pcaobus.org/oversight/inspections for inspection reports, basics of inspections, and inspection procedures. Sarbanes-Oxley provides that no portions of an inspection report that deal with criticisms of or potential defects in the quality control systems of the firm shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, no later than 12 months after the issuance of the inspection report. *See* Sarbanes-Oxley Section 104(g)(2). Full (expanded) inspection reports are publicly available on the PCAOB's website when a firm fails to satisfactorily remediate within 12 months.

[36] *See* https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-launches-new-online-tools-to-help-users-find-and-compare-inspection-report-data for a summary of the enhancements, including six new search filters, including Part I.A deficiency rate, to help users analyze and compare more than 3,700 inspection reports.

and engagement-level information to audit committees.[37] AS 1301, *Communications with Audit Committees*, requires various communications to facilitate the audit committee's financial reporting oversight.[38] Among other things, AS 1301 requires the auditor to communicate: (i) significant risks;[39] (ii) critical accounting policies and practices, critical accounting estimates, and significant unusual transactions;[40] (iii) the auditor's evaluation of the quality of the company's financial reporting;[41] and (iv) other matters that are significant to the oversight of the company's financial reporting process.[42] In addition, other PCAOB standards and rules and SEC rules independently require certain audit committee communications.[43]

b. Auditor's public communications of certain information

AS 3101 and Rule 3211 require firms to publicly disclose certain engagement-specific information in the auditor's report and on Form AP. In addition to specifying the requirements for an unqualified opinion on the financial statements, AS 3101 requires the auditor's report to describe (i) critical audit matters, which inform investors and other financial statement users of matters arising from the audit that required especially challenging, subjective, or complex auditor judgment; and (ii) how the auditor addressed those matters. AS 3101 further requires the auditor's report to include a statement disclosing the year in which the auditor began serving consecutively as the company's auditor. Other standards require additional information to be included in the auditor's report, including AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, which requires an explanatory paragraph when the auditor concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.[44]

Rule 3211 requires auditors to file Form AP, which, among other things, provides information to investors and other financial statement users about the engagement partner

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[37] *See Auditing Standard on Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU Sec. 380*, PCAOB Release No. 2012-004 (Aug. 15, 2012), at 2, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket030/release_2012-004.pdf?sfvrsn=7872effb_0.

[38] *Id.* ("Communications with the audit committee provide auditors with a forum separate from management to discuss matters about the audit and the company's financial reporting process.").

[39] *See* AS 1301.09.

[40] *See* AS 1301.12.

[41] *See* AS 1301.13.

[42] *See* AS 1301.24.

[43] *See* Appendix B of AS 1301 (listing other PCAOB standards and rules requiring audit committee communications); *see also* Regulation S-X Rule 2-07, 17 C.F.R. § 210.2-07; PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*.

[44] *See* AS 2415.12.

and other accounting firms participating in the audit of issuers. Disclosures on Form AP provide increased transparency about key audit participants. The key provisions include annual disclosures of (a) the name of the engagement partner and (b) the name and extent of participation of other accounting firms in the audit.[45]

The PCAOB makes the Form AP dataset available on AuditorSearch, by which users can conduct live searches or download the entire dataset in a searchable, machine-readable format.[46] Using this data, a user can determine, for example, the changes in engagement partner for any given issuer or obtain a list of all issuers for which an engagement partner is responsible. After identifying an engagement partner, a user can then compile information from other sources, including information about whether the partner is associated with restatements of financial statements, has been subject to public disciplinary proceedings, or has experience as an engagement partner for issuers of a particular size or in a particular industry. Similarly, starting from the Form AP dataset, users may perform further research on the other accounting firms that participate in an audit, such as whether those firms are registered with the PCAOB, whether they have any publicly available disciplinary history, whether they have been inspected, and, if so, the results of those inspections.

4. Voluntary Firm Reporting

Since the Concept Release, some audit firms have been publicly disclosing certain firm-level information discussed in the Concept Release through their audit quality reports, transparency reports, or other published reports. Many firms may also be developing and monitoring certain firm and engagement metrics to be used internally by the firm. In 2023, a firm-related group published a summary analysis of the most recent audit quality reports issued by the eight firms represented on the group's governing board.[47] The report indicated that firms were reporting common quantitative metrics related to several areas, including audit firm inspections; training; use of auditor's specialists; audit report reissuances and financial

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[45] *See* Instructions to Form AP. Form AP requires different disclosures regarding other accounting firms that participate in an audit depending on their level of participation. For other accounting firms with individually 5% or greater participation in the audit, the Form AP filer must disclose the legal name of the other accounting firm, the city and state (or, if outside the United States, the city and country) of that firm's headquarters, and the percentage of total audit hours (either as a single number or within a range provided on the form) attributable to each other accounting firm. For other accounting firms with individually less than 5% participation, the filer must disclose the total number of such other accounting firms and the aggregate percentage (either as a single number or within a range provided on the form) of total audit hours for all such firms.

[46] *See* AuditorSearch, *available at* https://pcaobus.org/resources/auditorsearch.

[47] *See* the Center for Audit Quality's (CAQ) *Audit Quality Reports Analysis: A Year in Review* (Mar. 2023), *available at* https://www.thecaq.org/aqr-analysis-yir ("CAQ Report"). The eight firms on the CAQ's governing board are BDO USA, LLP, Crowe LLP, Deloitte & Touche LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP, PricewaterhouseCoopers LLP, and RSM US LLP.

statement restatements; measures of experience, such as tenure with the firm; and personnel turnover. The report further noted that some firms disclosed qualitative as well as quantitative information, including information relating to audit methodology and execution, people and firm culture, quality management and inspections, and technology and innovation.

We have observed that only a small number of firms report firm-level metrics and these firms rarely report engagement-level metrics.[48] Where firm-level metrics are reported, the firms report the information inconsistently and do not use common definitions, thereby preventing users from making comparisons across firms. One commenter on the Concept Release stated that many firms are using the 28 AQIs identified in the Concept Release at some level to (i) manage the firm and (ii) manage the quality of audits at the office level and at the engagement level. Another commenter specifically indicated that its audit committee reviewed the engagement-level AQIs identified in the Concept Release that were provided by their auditor.

B. Actions in Other Jurisdictions

Some jurisdictions outside the United States have moved forward with mandatory or voluntary initiatives related to the monitoring and disclosure of metrics. In May 2022, Accountancy Europe published a factsheet about recent related initiatives in Europe and elsewhere.[49] The factsheet described initiatives conducted in 10 countries (including the United Kingdom (UK), South Africa and Canada) by various organizations, including audit oversight bodies (including the UK's Financial Reporting Council (FRC), Portugal's Securities Market Commission (CMVM), South Africa's Independent Regulatory Board for Auditors (IRBA), and the Canadian Public Accountability Board (CPAB)),[50] professional organizations,[51] a group of independent experts,[52] and the CAQ. The primary users of the metrics from these initiatives

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[48] In connection with the November 2022 SEIAG meeting, the Board staff researched various reports issued during the prior three years by the top 20 accounting firms (by 2022 revenue) and identified nine firms that disclosed firm-level metrics. *See* Firm and Engagement Performance Metrics Briefing Paper and Related Attachments from Nov. 2022 SEIAG meeting, *available at* https://pcaobus.org/news-events/events/event-details/pcaob-standards-and-emerging-issues-advisory-group-meeting-2022. For each firm-level metric reported by those nine firms, the staff included examples of how firms calculated the metric as well as the number of firms reporting that metric.

[49] *See* Accountancy Europe, *Factsheet, Audit Quality Indicators – A Global Overview of Initiatives* (May 2022), *available at* https://www.accountancyeurope.eu/wp-content/uploads/220401-Factsheet-Audit-Quality-Indicators.pdf ("Accountancy Europe Report").

[50] *Id.* Other oversight bodies in the factsheet include the Federal Audit Oversight Authority (FAOA) in Switzerland and the Accounting and Corporate Regulatory Authority (ACRA) in Singapore.

[51] *Id.* Professional organizations in the factsheet include the Institute of Public Auditors (IDW), Germany and The Institute of Chartered Accountants (ICAI), India.

[52] *Id.* Quartermasters, Netherlands.

were audit committees, oversight bodies, and professional organizations. Although many of the metrics in these initiatives were nonpublic, public reporting was encouraged or anticipated in the future for half of the initiatives.[53] The factsheet suggested that several factors should be considered when selecting, evaluating, and reporting metrics and recommended that a combination of metrics would provide "profound insight into audit quality."

In January 2023, Accountancy Europe published a position paper.[54] The position paper defined key concepts related to audit quality, presented considerations for developing AQIs, and explained what can and cannot be achieved by reporting such indicators. The paper stated as part of its conclusion that "[AQIs] should not be considered as an end in themselves[,] but could be a useful tool to drive audit quality" and reiterated that a combination of metrics would provide insight into audit quality.

Additionally, the specific initiatives of some other regulators are:

- FRC, UK – The FRC issued a consultation document in June 2022 on publishing audit quality indicators for the largest UK audit firms.[55] The proposal included 11 indicators that covered a range of topics, including firm culture, audit quality inspection results, staff workload, and the level of partner involvement in individual audits. In December 2022, the FRC issued a consultation document for firm-level indicators.[56] Subsequently, in March 2023, the FRC issued a "definitions note" on firm-level AQIs, previously referred to as a methodological/guidance note in the consultation document.[57] Reporting of firm-level indicators will be required in

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53 *Id. See* ACRA, CAQ, FRC, IDW, and Quartermasters.

54 *See* Accountancy Europe, *Position Paper, Key Factors to Develop and Use Audit Quality Indicators* (Jan. 2023), *available at* https://accountancyeurope.eu/wp-content/uploads/221206-AQIs-Position-Paper_FINAL.pdf.

55 *See* FRC, *Consultation Document: Firm-level Audit Quality Indicators* (June 2022), *available at* https://media.frc.org.uk/documents/FRC_AQI_Consultation.pdf.

56 *See* FRC, *Feedback Statement: Firm-level Audit Quality Indicators Consultation* (Dec. 2022), *available at* https://www.frc.org.uk/getattachment/afbf3bc4-cf15-468a-85da-afb8e5af222a/Feedback-Statement_-2022.pdf ("FRC Feedback Statement"), at 16-18 for firm-level indicators and at 3 for the following information, "In addition to the written consultation, we have engaged with stakeholders, including Audit Committee Chairs (ACCs), in a number of different forums. The feedback from these discussions is not included in the quantitative information in this document but has been valuable in shaping our response." In addition, following the FRC's AQI thematic review in May 2020, it also conducted a pilot program on engagement-level AQIs with audit firm partners and audit committee chairs.

57 *See* FRC, *Firm-level Audit Quality Indicators (AQIs): Definitions Note* (Mar. 2023), *available at* https://www.frc.org.uk/getattachment/73ac018e-170a-4515-b39b-b82f0740ad90/Firm-level-AQIs-Definitions-Note_-March-2023.pdf ("FRC Report – Definitions Note").

2024[58] for UK statutory audits conducted by firms that audit 20 or more public interest entities (PIEs) or one or more FTSE 350 companies.[59]

- IRBA, South Africa – IRBA requested firms auditing listed companies to submit AQI-related information to the IRBA. The IRBA published survey reports in 2021 and 2022 that describe the results of the information submitted under five broad thematic categories: independence, tenure, internal firm quality review processes, workload of partners and audit managers, and other.[60] The report presents comparisons across audit firms on an anonymous basis. The comparisons illustrate some of the challenges associated with comparing certain metrics across firms without the benefit of qualitative context.

- CPAB, Canada – CPAB launched an exploratory pilot project to solicit feedback on AQIs' usefulness and support broader national and international discussions. In the pilot project, six audit committees, their management, and auditors agreed on certain metrics to monitor within the audit to gain feedback on their usefulness. The results of the initiative were summarized in the final report.[61] Benefits identified by the CPAB pilot project included more efficient and effective interactions between the audit committee and the auditor, as well as better information for the purposes of auditor evaluation by the audit committee. Challenges the pilot program identified included changes required in audit firm systems and processes to facilitate reporting. Following the completion of the pilot project, CPAB has not mandated the use of metrics but continues to support their use through information and tools available on the CPAB website.[62]

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58 *Id.*

59 The FTSE 350 is a stock market index that incorporates both the FTSE 100 and the FTSE 250. As such, it is made up of 350 stocks that are listed on the London Stock Exchange (LSE). The index is published by Financial Times Stock Exchange (FTSE), a British financial organization owned by The London Stock Exchange Group (LSEG).

60 *See* IRBA *2021 Survey Report Audit Quality Indicators, available at* https://www.irba.co.za/upload/IRBA%20AQI%20Report%202021.pdf and IRBA *2022 Survey Report Audit Quality Indicators, available at* https://www.irba.co.za/upload/2022%20AQI%20Report.pdf.

61 *See* CPAB *Audit Quality Indicators Final Report*, *available at* https://cpab-ccrc.ca/docs/default-source/thought-leadership-publications/2018-aqi-final-report-en.pdf?sfvrsn=5af68dba_12&sfvrsn=5af68dba_12 ("CPAB Final Report").

62 *See* CPAB *Audit Quality Indicators: How to put them to work, available at https://cpab-ccrc.ca/docs/default-source/thought-leadership-publications/2019-aqi-put-to-work-en.pdf?sfvrsn=246de787_10.*

III. DISCUSSION OF PROPOSAL

A. Overview of the Proposal

As noted above, we have considered ways to measure audit firm and audit performance, primarily with a view to providing information that investors could use in making investment decisions, such as ratifying the selection of the auditor and voting for members of the board of directors, including directors who serve on the audit committee. We also believe that such metrics could benefit other stakeholders, such as audit committees, who could benefit from having additional context when deciding whether to select or retain a firm and overseeing the audit, and audit firms, who could use standardized information about themselves and their peers in designing, implementing, monitoring, and remediating their systems of quality control. The Board could also potentially benefit from having additional tools to use in its inspections program and standard-setting initiatives.

This proposed rulemaking seeks to address this need for information by requiring consistent, comparable disclosures that we believe would provide insight into aspects of the firm and the engagement team conducting the audit, including information relating to workloads, retention, allocation of audit hours, experience, history of quality control deficiencies, and restatements.

1. Purpose of the Proposed Metrics

Investors and other stakeholders lack information that is available to company management. The federal securities laws seek to reduce this information asymmetry through various disclosure, internal control, and other requirements, including requirements for public companies to prepare and disclose financial statements accompanied by audit reports issued by an independent public accounting firm. Investors and other stakeholders also lack information available to the auditor and cannot observe the auditor's work or other aspects of a public company audit. Instead, they must rely on the audit committee, which is charged with overseeing the external auditor, and on other available public information, such as the reputation of the firm issuing the audit report or the name of the engagement partner. These difficulties in evaluating the audit and the auditor may lead to reduced accountability for auditors and an inefficient allocation of audit effort. Such allocations allow audit risk to remain insufficiently evaluated, ultimately risking suboptimal investment decisions, hampering the efficient functioning of the audit profession, and negatively affecting the capital markets.[63] Furthermore, while the audit committee has more information regarding the specific auditor it oversees, it lacks insight into other audit engagements and other firms; such comparable

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[63] There is a long stream of research regarding the effects that information asymmetry about product features, such as quality, and disclosure have on markets. *See, e.g.*, George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 The Quarterly Journal of Economics 488 passim (1970); and Robert E. Verrecchia, *Essays on Disclosure*, 32 Journal of Accounting and Economics 97 (2001).

information would assist the audit committee in more effectively selecting and monitoring the auditor.

Investors and other stakeholders may seek to reduce these information disparities by gathering additional information about the firm responsible for the audit and the relevant audit engagement. As discussed above, the PCAOB has previously sought to facilitate those efforts through rules and standards requiring the disclosure of such information. From its inception, the Board's registration and reporting program has yielded important information about registered firms. Annual updates on Form 2 include information such as the issuers audited by the firm, a breakdown of fees charged to issuers, and network affiliations. Current reporting on Form 3 discloses significant events such as the withdrawal of an audit report and certain legal actions involving the firm or its professionals. In 2015, the Board adopted rules requiring firms to disclose on Form AP the name of the engagement partner and certain audit participants.[64] Subsequently, in 2017, the Board adopted a new standard updating the auditor's report to make it more relevant and informative by, among other things, including communication of critical audit matters and the tenure of the auditor.[65] The Board intends the proposed firm and engagement metrics to complement these previous initiatives and to add to the mix of information available to investors and other stakeholders when evaluating the auditor and the audit.[66]

Our oversight activities have revealed that there are identifiable performance differences across firms and among engagement teams within the same firm, including variations among firms belonging to global networks. We consider such differences when performing regulatory functions. For example, the Division of Registration and Inspections uses, among other factors, information about the firm and the engagement to identify audit engagements for risk-based selections in our inspections program.

Mandating public disclosure of firm- and engagement-level metrics would provide investors, audit committees, and other stakeholders with information that would otherwise be difficult or impossible to obtain. These stakeholders could learn about both specific engagements and specific firms and have a basis to compare them to other engagements and other firms. The firms themselves would also benefit from access to information about their peers. Required disclosures would facilitate development of standardized data for consistent comparison and analysis over time, which we believe would be more valuable than the ad hoc, individualized disclosures that some firms have made on a voluntary basis. Mandatory public

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64 *See* PCAOB Rule 3211.

65 *See The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, PCAOB Rel. No. 2017-001 (June 1, 2017).

66 In addition to disclosures on Form AP and in the audit report, the Board previously required information on periodic and special reports to be publicly available. *See Rules on Periodic Reporting by Registered Public Accounting Firms*, PCAOB Release No. 2008-004 (June 10, 2008), 28-32.

disclosure would also ensure that the information would be accessible to all stakeholders, so that any value-relevant information could be readily evaluated. This information may enable investors, audit committees, and other stakeholders to make better-informed decisions.[67]

The proposed metrics would help investors and other stakeholders better assess the characteristics not only of the firm, but also of the engagement team, on the audits of companies in which they invest. Collectively, the proposed firm and engagement metrics, when used in conjunction with other publicly available data, could facilitate stakeholders' ability to assess the audit and hence the credibility of financial reporting.[68]

Our experience suggests that the value of the proposed disclosures would likely increase over time as users are able to aggregate multiple data points, make comparisons, and observe trends. We believe the new data points, when analyzed together with the audited financial statements, critical audit matters, auditor tenure, and other information about the firm and the engagement on Form 2 and Form AP, could provide more information about the audit and, therefore, the reliability of the financial statements.

2. Summary of the Proposed Metrics

In considering which metrics to propose, we have taken into account (i) input from investors and other stakeholders, (ii) the 28 metrics included in the 2015 Concept Release, (iii) information gathered by inspections, (iv) other jurisdictions' initiatives, (v) voluntary efforts by firms, and (vi) academic literature. For example, we considered that one commenter on the Concept Release suggested that 28 metrics may be too many, while another commenter suggested that having too many metrics could lessen their impact.

We are proposing a set of firm-level and engagement-level metrics across 11 areas. Firm-level metrics would provide a basis for drawing comparisons between firms as well as a baseline for evaluating engagement-level metrics. Engagement-level metrics would elicit more granular information and would enable comparisons over time and across engagements both within the firm and across other firms. We are proposing that firm-level metrics be disclosed on a new Form FM, *Firm Metrics,* and that engagement-level metrics be disclosed on Form AP,

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[67] Under Section 102 of Sarbanes-Oxley, the Board may require registered public accounting firms to submit periodic and special reports containing financial or other information as is "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 7212(d). Section 103 of Sarbanes-Oxley tasks the Board with adopting quality control and other standards to be used by registered firms "in the preparation and issuance of audit reports . . . as may be necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 7213(a)(1). *See also* 15 U.S.C. §§ 7211(a), (c)(5), 7213(a)(2)(B). We believe the proposed metrics would further the public interest and would protect investors in accordance with these provisions.

[68] *See, e.g.*, Mark DeFond and Jieying Zhang, *A Review of Archival Auditing Research*, 58 Journal of Accounting and Economics 275, (2014).

together with other engagement-specific information like the name of the engagement partner and the other firms participating in the audit.

Most of the metrics we are proposing would be presented at both the firm and the engagement level. However, two metrics would be reported only at the firm level, because we believe aggregated data would be most meaningful or appropriate, and one would be reported only at the engagement level, because aggregate data would not be meaningful.

The proposed metrics are:

- Partner and Manager Involvement. Hours worked by senior professionals relative to more junior staff across the firm's issuer engagements and on the engagement.

- Workload. Average weekly hours worked on a quarterly basis by engagement partners and by other partners, managers, and staff, including time attributable to engagements, administrative duties, and all other matters.

- Audit Resources – Use of Auditor's Specialists and Shared Service Centers. Percentage of issuer engagements that used specialists and shared service centers at the firm level, and hours provided by specialists and shared service centers at the engagement level.

- Experience of Audit Personnel. Average number of years worked at a public accounting firm (whether or not PCAOB-registered) by senior professionals across the firm and on the engagement.

- Industry Experience of Audit Personnel. Average years of experience of senior professionals in key industries audited by the firm at the firm level and the audited company's primary industry at the engagement level.

- Retention and Tenure. Continuity of senior professionals (through departures, reassignments, etc.) across the firm and on the engagement.

- Audit Hours and Risk Areas (engagement-level only). Hours spent by senior professionals on significant risks, critical accounting policies, and critical accounting estimates relative to total audit hours.

- Allocation of Audit Hours. Percentage of hours incurred prior to and following an issuer's year end across the firm's issuer engagements and on the engagement.

- Quality Performance Ratings and Compensation (firm-level only). Relative changes in partner compensation (as a percentage of adjustment for the highest rated group) between groups of partners based on internal quality performance ratings.

- Audit Firms' Internal Monitoring. Percentage of issuer engagements subject to internal monitoring and the percentage with engagement deficiencies at the firm level; whether the engagement was selected for monitoring and, if so, whether there were engagement deficiencies and the nature of such engagement deficiencies at the engagement level.

- Restatement History (firm-level only). Restatements of financial statements and management reports on ICFR that were audited by the firm over the past five years.

In Section III.B below, we provide a detailed discussion of key terms and concepts used in the metrics, as well as a description of each metric with examples of calculations.

Questions

1. Would the proposed metrics, individually or collectively, provide useful information for investors, audit committees, or other stakeholders? Why or why not? How would stakeholders use the metrics?

2. Are any of the metrics we are proposing overly focused on the operations of larger firms? If so, which metrics and how could we make them more neutral?

3. Comparability

Comparability has been a common objective both for the PCAOB and for other regulators and standard-setters when considering the benefits and challenges of reporting firm- and engagement-level metrics. In its Feedback Statement, the FRC noted that information being provided in firm transparency reports is challenging because firms' definitions of metrics are not consistent and are therefore hard to compare.[69] Some commenters on the Concept Release suggested that comparability should be the objective, but that it may be difficult to achieve. As noted previously, the information currently provided in firm transparency reports is reported inconsistently and is not based on common definitions or methods of calculation, which prevents users from being able to make comparisons across firms or over time. We believe that an important benefit of mandatory reporting would be the ability of investors and other stakeholders to compare the metrics, within the same firm over time, among firms, and among engagements.

The basic approach of our proposal—a required set of metrics, derived from specified calculations incorporating consistently defined terms and concepts—is designed to generate comparable data with respect to all firms and all engagements that are subject to the reporting requirements. In some cases, we have also designed the proposed metrics as percentages (e.g.,

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[69] *See* FRC Feedback Statement, at 12.

relative to total audit hours) or averages where we believe that would provide more comparability across firms and engagements than methods based on absolute amounts.

We understand that firms differ from each other in the number and types of audits they perform and their resources, including the number of partners, managers, and staff and their experience and degree of specialization. We also understand that engagements differ based on the size of the engagement, the industry of the company, the risks related to the company and the audit, whether it is a new engagement for the firm, or there has been a change in the engagement partner. This lack of standardization across both firms and engagements makes the task of comparison difficult. However, we believe that the proposed metrics would still provide useful information, enabling users to make both broad comparisons across the full population of reporting firms and accelerated filer and large accelerated filer audits, and more targeted comparisons across smaller subgroups of similar firms and engagements.

Questions

3. Are there other considerations we should be aware of that would increase or decrease comparability at the firm level? For example, would it be helpful to have subsets of information available by size of the firm or by size of the issuers the firm audits?

4. Are there other considerations we should be aware of that would increase or decrease comparability of the engagement-level metrics? For example, would it be helpful to capture information at the engagement level by industry sector, region, whether it is a first-year audit, or other criteria?

4. Time Period Covered by the Metrics

For firm-level metrics, we propose that the metric generally would be as of September 30 and the time period covered would be October 1 through September 30. In some cases, the proposed metrics are based on engagements for which the auditor issued an audit report during the 12-month period ending September 30. As discussed below in Section III.C.2, we are proposing that firms would be required to file Form FM on or before November 30, 61 days after the end of the reporting period.

The following proposed firm-level metrics relate to activities for which firms may already have defined periods or cycles that may not align with our proposed reporting date. In these cases, we propose that the time period covered by the metrics may be tailored to a firm's existing processes and procedures, for example:

- Quality Performance Ratings and Compensation – This metric would be based on the firm's most recently completed performance evaluation and compensation process.

- Audit Firms' Internal Monitoring – This metric is based on the firm's most recently completed 12-month quality review monitoring cycle.

For these metrics, the firm would use its internally established monitoring cycle, provided that the cycle covers a 12-month period (which is expected to be consistently applied). We believe allowing firms flexibility to use their internally established dates for certain metrics would be appropriate and still provide the comparability discussed above since all firms would be measuring over a 12-month period.

For engagement-level metrics, which would be reported on Form AP, the time period is generally based on the most recent period's audit. Some proposed engagement-level metrics would relate to information about people on the engagement, such as Experience of Audit Personnel, or compared to people on previous engagements, such as Retention and Tenure. One proposed engagement-level metric, Audit Firms' Internal Monitoring, would provide information regarding previous engagements for the company under audit.

The proposed time period covered by each metric is discussed in more detail in Section III.B.2.

5. Rounding and Use of Estimates

Many of the proposed metrics involve the calculation of a percentage or a dollar value that may result in very small fractional parts. Under the proposal, the firm would report metrics that are rounded to the nearest whole number, except where additional decimal places (no more than two) are needed to properly interpret the result or to enable comparison to prior periods.

In calculating the firm- and engagement-level metrics, actual amounts would be required to be used, if available. However, if actual amounts are unavailable, firms would be permitted to use a reasonable method to estimate the components of a calculation. This approach is consistent with existing Form AP, which allows firms to use a reasonable method to estimate certain information required in the calculation of total audit hours.[70] Firms would also be required to document in their files the method used to estimate amounts when actual amounts are unavailable.

Questions

5. Is it appropriate for firms to report metrics by rounding to the nearest whole number except in cases where additional decimal places (no more than two) are needed to properly interpret the result or enable comparison to prior periods? If not, what would an appropriate level of precision be?

6. Is it appropriate to allow firms to use reasonable estimates when actual amounts are unavailable? Should there be any other restrictions on the use of estimates? If so, what are they?

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70 *See* Instructions to Part IV of Form AP. Under the amendments to Form AP proposed today, this would appear in General Instruction 8, as amended.

6. Optional Narrative Disclosure

Several commenters on the Concept Release suggested that the metrics would need context to be meaningful. One commenter stated that viewing any one metric, or even many of them, without consideration and discussion of other factors affecting audit quality could be misleading. Some commenters suggested that firms be allowed to provide context in a narrative along with the metrics, arguing that a metric is merely a statistic or data point and that due to their inherent complexities and limitations they would need to be accompanied by contextual narrative in order to understand and evaluate the metrics.

We are proposing that firms would be permitted, but not required, to provide a brief narrative disclosure together with any or all of the firm-level and engagement-level metrics they report. This would give firms the ability to provide any context they thought necessary for an appropriate understanding of the reported metrics. We are proposing that the optional narrative disclosure would be no more than 500 characters per metric.

Questions

7. Should firms be permitted to provide narrative disclosure to provide context to the reported metrics? If not, why not? If yes, should narrative disclosure be allowed for all metrics or only certain ones? If limited, which ones?

8. Should we place limits on the length or content of the narrative disclosure? If so, what should they be? Is a 500-character limit per metric appropriate? Should it be less or more? Should there be no limit?

B. Proposed Firm and Engagement Metrics

1. Key Terms and Concepts

Key terms and concepts that are used in many of our proposed metrics are described below. One commenter on the Concept Release encouraged the Board to consider including definitions to accompany the metrics in order for the metrics to be consistent and comparable across all firms. Where practical, the key terms and concepts align with existing definitions in PCAOB standards and rules. The concepts and terminology developed specifically for our proposed metric calculations are not intended to inform the interpretation of other rules, standards, or forms of the PCAOB.

i. Partners, Managers, and Staff

We are proposing to create a standard taxonomy for the functional roles played by individuals involved in an audit, which would be used in the calculations of the proposed metrics. Some of these terms are used throughout our standards, such as engagement partner[71] and engagement quality reviewer.[72] We are proposing additional terms that we believe would clarify how various metrics should be calculated and help ensure consistent reporting.

- *Partners* – Partners or persons in an equivalent position (e.g., shareholders, members, or other principals) who participate in audits;[73]

- *Managers* – Accountants or other professional staff commonly referred to as managers or senior managers (or persons in an equivalent position) who participate in audits; and

- *Staff* – Accountants or other professional staff who participate in audits and are not partners or managers.

Participation in the audit is a broad concept that would include all individuals at these levels that were involved in the firm's audits, including tax personnel, IT personnel, and employed specialists. The proposed terms do not provide a participation threshold, such as a minimum number of hours, because we believe the metrics should capture all individuals that are partners, managers, and staff. We believe the proposed terms for partners, managers, and staff participating in an audit will be widely understood among firms, including in situations where firms have different titles (e.g., directors) for the roles than the terms we are proposing.

Generally, the proposed metrics do not specify how to account for promotions within the period from one level to another (e.g., from manager to partner).[74] Depending on a firm's reporting system it may be feasible to prorate such information between the periods prior to and after a promotion or to use the individual's level as of the beginning or end of the reporting period. The proposed metrics do not specify how this information is captured, although we do expect firms to be consistent in their approach across the proposed metrics. We do not believe that allowing flexibility with respect to the treatment of promotions would significantly affect comparability.

Some firm-level and engagement-level metrics differentiate between engagement partners and other partners who participate in the audit. We believe the differences between

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[71] *See* paragraph .A2 of AS 1201, *Supervision of the Audit Engagement* ("the member of the engagement team with primary responsibility for the audit").

[72] *See* AS 1220, *Engagement Quality Review*, for a description of the engagement quality reviewer's role.

[73] We believe this is consistent with the use of the term "partner" in our auditing standards. Although we do not usually state expressly that partners are limited to those who participate in audits, as a practical matter our auditing standards apply only in those circumstances.

[74] Note, however, that the proposed retention rate metric treats promotions as if they had occurred at the beginning of the year. *See* note in Section III.B.2.vi.

responsibilities borne by engagement partners and other participating partners would justify presenting data for both categories separately. Engagement partners as used in the firm-level metrics mean engagement partners for all of the firm's engagements, not just for issuer engagements. For a specific metric, if a partner is included in the engagement partner metric, they would not also be included in the other partner metric. In other words, partners would only be counted once within any metric.

a. Partners, managers, and staff of the firm

Some proposed firm-level metrics use the concept of "partners, managers, and staff of the firm," which refers to individuals participating in audits who work for the firm or work under the firm's direction and control and function as the firm's employees, such as secondees and contractors. For firm-level metrics, partners, managers, and staff of the firm would include all such individuals who participate in audits, whether the audits are performed under PCAOB standards or other auditing standards. We believe including individuals in the firm-level metrics who participate on any firm audit is appropriate because these metrics would provide information about the firm and not about specific engagements (for example, in the area of firm-level industry experience, which would be relevant across a firm's entire audit practice). Participation in audits means any involvement (including, for example, consultation on specific matters), and thus may include individuals outside the engagement team, such as national office personnel.

b. Engagement team

Certain proposed firm- and engagement-level metrics provide information about partners and managers on the engagement team, a term defined in AS 2101, *Audit Planning*.[75]

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[75] The "engagement team" is defined in AS 2101.A3 [as adopted by the Board and approved by the SEC in PCAOB Release No. 2022-002, to take effect with respect to audits of fiscal years ending on or after December 15, 2024] as follows (footnotes omitted):

.A3 Engagement team –

a. Engagement team includes:

   1. Partners, principals, and shareholders of, and accountants and other professional staff employed or engaged by, the lead auditor or other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to this standard or AS 1201, *Supervision of the Audit Engagement*; and

   2. Specialists who, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

b. Engagement team does not include:

We believe it is appropriate to provide metrics related specifically to the engagement team because this would provide investors and other stakeholders with relevant information related to the audit as a whole. For the proposed metrics, partners and managers on the engagement team would include:

- The engagement partner;

- Partners and managers from the firm issuing the audit report who perform audit procedures on the audit. This would also include partners and managers in the national office or centralized group in the firm (including within the firm's network) who perform audit procedures on the audit or assist in planning or supervising the audit;[76]

- Partners and managers of other accounting firms who perform audit procedures on the audit (supervised under AS 1201);[77] and

- Individuals in managerial roles at shared service centers if those individuals both work under the firm's direction and control and assist the engagement partner in fulfilling planning or supervisory responsibilities on the audit.

As proposed, members of the engagement team would include every partner and manager who worked on any aspect of the audit, even if their involvement was extremely limited. We are soliciting comment on whether the engagement team for purposes of the metrics should include a minimum hours threshold or otherwise exclude persons with minimal involvement in the audit. Because the engagement quality reviewer is not a member of the engagement team, engagement quality reviewers are excluded from most of the metrics we propose. We are soliciting comment on whether that exclusion is appropriate.

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1. The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);
2. Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; or
3. Engaged specialists.

[76] *See Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm,* PCAOB Rel. No. 2022-002 (June 21, 2022), at A4-4-A4-5, for examples of engagement team members.

[77] *Id.*

c. Core engagement team

Some proposed engagement-level metrics provide information about members of the "core engagement team." The core engagement team would include the engagement partner and members of the engagement team who are:

a. Partners or employees of the registered public accounting firm issuing the audit report (or individuals who work under that firm's direction and control and function as the firm's employees); and

b. Either of the following:

    (1) A partner (excluding the engagement partner) who worked ten or more hours on the engagement; or
    (2) Manager or staff who worked on the engagement for 40 or more hours or, if less, 2% or more of the total audit hours.[78]

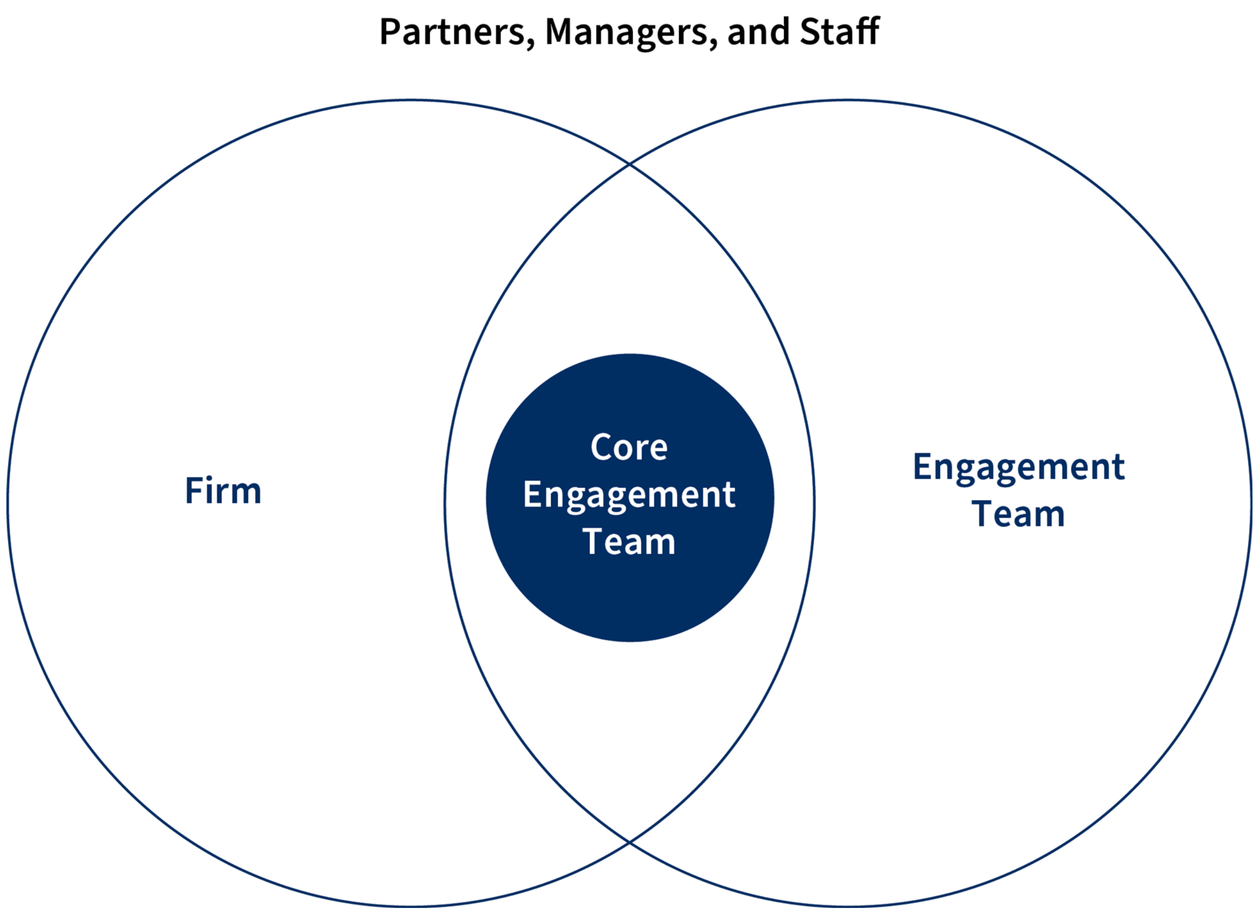
For some engagement-level metrics, such as workload, we believe that providing information for only the core engagement team, rather than the entire engagement team, may be more useful to investors and other stakeholders. This is because we believe that the core engagement team are the individuals who make the primary decisions regarding planning and performance of the audit and determine the final conclusions supporting the auditor's opinion. In many instances, they also incur the majority of the total audit hours, although that is not necessarily the case.

We propose to limit the concept of core engagement team to the engagement partner and personnel of the firm issuing the audit report who meet a minimum hours threshold. Under the proposed definition, the core engagement team would not include engagement team members whose participation was more limited and did not meet the hours threshold (for example, who only performed an inventory observation, helped on certain transactions, or consulted on specific matters). We are proposing to use a threshold of ten hours for partners and the lesser of 40 hours or 2% of total audit hours for managers and staff, because we believe that would filter out individuals whose participation in the engagement was limited or marginal.

Figure 1 illustrates how partners, managers, and staff used in the calculation of the metrics, relate to the firm, engagement team, and the core engagement team.

78 *See* Section III.B.1.ii.b below for the discussion of "total audit hours."

Figure 1. Relationship Between the Groups of Individuals Included in Metric Calculations



Questions

9. Are the definitions for partners, managers, and staff clear and appropriate? If not, how should they be changed?

10. If the firm assigns partners, managers, and staff to specific business lines (e.g., audit, tax), should the firm-level metrics only include partners, managers, and staff of the firm's audit practice? Why or why not?

11. Should we consider adding a threshold to the definition of partners or managers who participated on the engagement team, such as a minimum percentage of hours worked on an audit? If so, what should that percentage be for partners and managers?

12. Should other individuals involved in the audit (e.g., individuals in the firm's national office, engagement quality reviewers, employees of shared service centers, or individuals involved in loaned staff arrangements and alternative practice structures) be treated differently in the metrics? If so, how should they be considered in the definition of core engagement team?

13. Should engagement quality reviewers be added to any of the proposed metrics? If so, which metrics and should they be added as a separate category or together with a group, such as the engagement team?

14. Is the proposed definition of core engagement team appropriate? Are the proposed thresholds for core engagement team members appropriate?

a. The proposed threshold for partners (excluding engagement partners) is ten or more hours on the engagement. Should the hour threshold be higher or lower or based on a certain percentage of the total audit hours? If so, what is a more appropriate threshold to determine whether partners are part of the core engagement team?

b. The proposed threshold for managers and staff is 40 or more hours or, if less, 2% or more of the total audit hours. Should the hour or percentage thresholds be different? If so, what should the hours and/or percentage be to determine whether managers and staff are part of the core engagement team?

c. Alternatively, should partners, managers, and staff who reported a certain percentage of the hours on the engagement, whether they are from the firm issuing the auditor's report (lead auditor) or other firms performing audit work (other auditors), be considered as part of the core engagement team? If so, why, and what should the threshold be for inclusion of individuals or other firms?

ii. Hours

We are also proposing to use various terms in the calculations of the proposed metrics for "hours" incurred by partners, managers, and staff. Depending on the nature and intended use of the metric, "hours" included in the calculations may vary. We explain below "hours worked" and "total audit hours," which would be used by several metrics, and how hours would be counted for firm-level and engagement-level reporting.

a. Hours worked

In the calculations for proposed workload metrics, we are proposing to include "hours worked": i.e., the sum of hours that are incurred on engagements and hours spent on training, practice development, staff development, or other firm activities. We include all hours incurred because we believe that workload metrics should capture the full picture of the individual's (or group of individuals') workload, regardless of the type of activities the individual(s) spends time on. For both firm- and engagement-level reporting, we are proposing to include hours worked on both issuer and non-issuer engagements, because some individuals may work only on issuer engagements while others work on both issuer and non-issuer engagements. We believe both would be necessary to provide the full picture of the responsibilities and work demands on the engagement team.

b. Total audit hours

Several proposed metrics include the term "total audit hours." Total audit hours would be the same as the hours currently used to compute the extent of participation in an audit of other accounting firms in Form AP.

The current instructions to Form AP provide as follows: total audit hours in the most recent period's audit should be comprised of hours attributable to: (1) the financial statement audit; (2) reviews pursuant to AS 4105, *Reviews of Interim Financial Information*; and (3) the audit of ICFR pursuant to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Total audit hours exclude the hours incurred by: (1) the engagement quality reviewer; (2) the person who performed the review pursuant to SEC Practice Section 1000.45 Appendix K;[79] (3) specialists engaged, not employed, by the firm; (4) an accounting firm performing the audit of entities in which the issuer has an investment that is accounted for using the equity method; (5) internal auditors, other company personnel, or third parties working under the direction of management or the audit committee who provided direct assistance in the audit of internal control over financial reporting; and (6) internal auditors who provided direct assistance in the audit of the financial statements.[80] We believe that using total audit hours, as already defined by Form AP and collected by firms, would provide an appropriate and cost-effective basis for calculating metrics.

Firm-level metrics include both total hours across all issuer engagements and specific subsets. For example, if a firm has 15 issuer engagements (e.g., two large accelerated filers, four accelerated filers, four non-accelerated filers, and five Form 11-K filers), the total audit hours from the 15 issuer engagements would be used for some firm-level calculations. Relevant subsets would include (i) total audit hours for all issuer engagements for partners and managers

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79 We proposed to rescind Appendix K and eliminate this clause from the Form AP instructions in connection with the proposal of QC 1000.

80 *See* Instructions to Part IV of Form AP. Under the amendments to Form AP proposed today, this would appear in General Instruction 8, as amended.

and (ii) total audit hours for all issuer engagements incurred before or after the issuer's year end. We believe it would be appropriate to include all the firm's issuer engagements when reporting firm-level metrics because these metrics would provide information about the firm's entire issuer practice.

Some engagement-level metrics use a subset of total audit hours, such as those incurred by partners and managers, on certain areas of the audit, or within stated time periods before or after the issuer's year end.

Questions

15. Is the proposed term hours worked clear and appropriate? If not, how should it be changed?

16. Is it appropriate to use the Form AP hours for the total audit hours in the metrics? If not, how should the hours be accumulated for the metric calculations?

17. Is it appropriate to include total audit hours for all issuer engagements in the firm-level metrics, as proposed? Or should the metric be limited to total audit hours for large accelerated filer and accelerated filer engagements? Why or why not?

iii. Terms Used in Metrics

In addition to the terms discussed above, many of the terms used in the metrics are defined elsewhere in our standards and rules. Other terms would be defined specifically for use in the metric calculations and may differ from the way such terms are used elsewhere in PCAOB rules and standards.[81] Terms that are used in only one metric are discussed at greater length in Section III.B.2, in the context of discussing the relevant metric. We have italicized the terminology in the proposed calculations.

2. Metric Descriptions and Calculations

This section describes the firm-level and engagement-level performance metrics we are proposing. Each metric is provided in a text box that provides a description of the metric and the calculation of the metric. We also provide examples of how to calculate each metric.

i. Partner and Manager Involvement

Partners and managers are responsible for oversight of the engagement team, which includes less experienced staff. Spending time to oversee the work of the audit staff is critical to the engagement. Included in this oversight is the engagement partner's responsibility to

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81 For example, we propose to define "partner" to include only persons who participate in audits. While we believe that is consistent with the use of that term in our auditing standards (*see* note 73 above), it is narrower than the use of the term in connection with registration and reporting requirements.

exercise due professional care related to supervision and review of the audit, including evaluating whether significant findings or issues are appropriately addressed and determining that the significant judgments and conclusions on which the auditor's report is based are appropriate.[82] Less extensive supervision raises the risk of less effective audit procedures. With a lower ratio of senior engagement team time to staff time, the risk may be greater that partners and managers may not have sufficient time to supervise and review staff work and evaluate audit judgments. Some academic research, using mainly data obtained from foreign jurisdictions, suggests that greater partner or manager involvement in the audit is positively associated with proxies for the quality of the audit.[83]

Considering the important role played by partners and managers on engagements, we believe the following firm- and engagement-level metrics would provide useful information to assist in understanding hours worked by senior professionals relative to more junior staff and gauging the associated risks.

The proposed firm-level and engagement-level metrics would require firms to calculate the percentage of total audit hours incurred by partners and managers. We believe this metric could provide users with information regarding each firm's oversight of their engagements and the supervision of less experienced engagement team members.

In the Concept Release, this metric was described as measuring the time of experienced senior personnel relative to the volume of audit work overseen. Many commenters on this metric in the Concept Release agreed on including a metric for staffing leverage. Two commenters agreed that a calculation for staffing leverage that measures the ratio of partner and manager hours to total audit hours would be helpful. One of those commenters supported including all partner and manager hours in the calculation rather than excluding certain hours (e.g., tax or relationship partners). Another commenter suggested that audits with greater partner involvement tend to have more thorough planning and more effective execution.

One commenter noted the importance of the experience, expertise, and professional skepticism of the audit partner, manager, and senior personnel assigned to the audit, and the extent of their involvement in performing the audit. In light of the comments received, we are

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82 *See Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001 (Mar. 28, 2023), at 8-11, 23 (describing responsibilities of engagement partners under existing PCAOB standards); *see also*, e.g.*, In the Matter of Melissa K. Koeppel*, PCAOB File No. 105-2011-007, at 78 (Dec. 29, 2017) (concluding that, as the individual with final responsibility for the audit, the engagement partner must act with due professional care to ensure that the audit team performs all required audit procedures).

83 *See*, *e.g.*, a study using Korean data, Suyon Kim, *Does Engagement Partners' Effort Affect Audit Quality? With a Focus on the Effects of Internal Control System*, 9 Risks 225, (2021); a study using Japanese data, Sarowar Hossain, Kenichi Yazawa, and Gary S. Monroe, *The Relationship Between Audit Team Composition, Audit Fees, and Quality*, 36 AUDITING: A Journal of Practice and Theory 115, (2017); and Agnes WY Lo, Kenny Z. Lin, and Raymond MK Wong, *Does Availability of Audit Partners Affect Audit Quality? Evidence from China*, 37 Journal of Accounting, Auditing & Finance 407, (2022).

proposing metrics that would provide the ratio of audit partner and audit manager hours to total audit hours.

In its report, Accountancy Europe identified involvement of the senior personnel in the metrics related to four jurisdictions.[84] In its analysis of firm transparency reporting, a firm-related group found seven firms disclosing this metric at the firm level related to personnel oversight, although they calculate it in different ways, such as the leverage ratio of partners and managing directors to audit personnel or the leverage ratio of managers and senior managers to seniors and staff.[85]

Partner and Manager Involvement

Firm-level description: Total audit hours for partners and managers on the engagement team as a percentage of total audit hours for all issuer engagements for which the firm issued an audit report during the 12-month period ended September 30.

Engagement-level description: Total audit hours for partners and managers on the engagement team as a percentage of total audit hours.

Firm-level calculation:

$$\frac{\textit{Total audit hours} \text{ incurred by } \textit{partners} \text{ and } \textit{managers} \text{ on the } \textit{engagement team} \text{ for all issuer engagements}}{\textit{Total audit hours} \text{ for all issuer engagements}}$$

Engagement-level calculation:

$$\frac{\textit{Total audit hours} \text{ incurred by } \textit{partners} \text{ and } \textit{managers} \text{ on the } \textit{engagement team}}{\textit{Total audit hours} \text{ for the engagement}}$$

Example firm-level calculation:

<u>Details for total audit hours</u>

84 *See* Accountancy Europe Report, at 6, 7, and 11 for IDW (Germany), Quartermasters (Netherlands), and CPAB (Canada). *See also* FRC Report – Definitions Note, at 9.

85 *See* CAQ Report, at 10, 13.

- U.S. firm issues audit reports for Company X, Company Y, and Company Z (issuers).

Issuers	Total Audit Hours	Total Audit Hours incurred by partners and managers on the engagement team
Company X	3,900	1,400
Company Y	2,500	625
Company Z	1,500	300
Total	**7,900**	**2,325**

$$\frac{\textit{Total audit hours}\text{ incurred by } \textit{partners}\text{ and }\textit{managers}\text{ on the }\textit{engagement team}\text{ for all issuer engagements}}{\textit{Total audit hours}\text{ for all issuer engagements}}$$

Calculation: 2,325/7,900 = **29%**

Example firm-level reporting for Form FM:

Partner and Manager Involvement	Percentage of total audit hours for partners and managers for all issuer engagements	**29%**

Example engagement-level calculation:

Details for total audit hours

- U.S. firm issues the audit report for Company X (issuer).
- Total audit hours for the engagement: **3,900**

Details for partners and managers

Company X (issuer)	Audit hours incurred by partners and managers on the engagement team
Engagement Partner	300
U.S. (partners and managers)	700
France (partners and managers)	150
Germany (managers)	125
Italy (managers)	60
China (managers)	15

India shared service center (managers)	50
Total	**1,400**

$$\frac{\textit{Total audit hours} \text{ incurred by } \textit{partners} \text{ and } \textit{managers} \text{ on the } \textit{engagement team}}{\textit{Total audit hours} \text{ for the engagement}}$$

Calculation: 1,400/3,900 = **36%**

Example engagement-level reporting for Form AP:

Partner and Manager Involvement	Percentage of total audit hours for partners and managers	**36%**

Questions

18. Are the proposed descriptions and calculations of the firm-level and engagement-level metrics for partner and manager involvement clear and appropriate? If not, why not?

19. Would it be helpful to separate the calculations for partner involvement and manager involvement? Why or why not?

20. Because of the importance of the engagement partner's role, would it be helpful to separate the calculation for engagement partner involvement from the calculation of the other partners and managers on the audit? Why or why not? Is there another way in which a metric could focus on the role of the engagement partner and, if so, what is the metric and how should it be calculated?

21. Instead of partner and manager involvement, should firms disclose partner and manager hours compared to staff hours on the audit (i.e., a staffing leverage ratio)? If so, why?

ii. Workload

We believe that in general, the greater the workload, the greater the likelihood that members of the engagement team may have insufficient time to appropriately perform the necessary audit procedures and make the appropriate judgments that an audit requires.

Professionals may become less effective when working long hours,[86] and such an environment may affect the level of due professional care they exercise. For example, a heavy workload may create pressure on the audit staff to focus too much on efficiency in executing auditing procedures rather than on ensuring the effectiveness of those procedures or on supervising less experienced engagement team members.

The proposed firm-level and engagement-level metrics would require firms to calculate workload for (i) engagement partners and (ii) other partners, managers, and staff. The proposed calculations for workload include all working hours incurred during the relevant periods. These hours could be incurred on issuer and non-issuer engagements as well as on training, practice development, staff development, or other firm activities.[87] The proposed calculations would provide the firm-level metrics on a quarterly basis and would provide a comparative basis for the engagement-level metrics. At the engagement level, we believe that only information for members of the core engagement team would be useful to investors and other stakeholders.

The engagement-level metric would include the workload for the core engagement team calculated for each quarter of the preceding three quarters up to the issuer's year end and the portion of the final quarter of the engagement through the issuance of the audit report. The average weekly workload for the core engagement team would be calculated through the issuance of the audit report, rather than at the end of the quarter, to align more closely with the Form AP filing deadline. For example, in the case of a calendar year-end company with the audit report issued on February 29, 2024, the firm would report the average weekly hours worked for (i) the quarter ended June 30, 2023, (ii) the quarter ended September 30, 2023, (iii) the quarter ended December 31, 2023, and (iv) the two months ended February 29, 2024.

We are proposing separate firm- and engagement-level workload metrics for the engagement partner, as he or she has primary responsibility for the audit. We believe heavy workloads could prevent an engagement partner from providing adequate and focused attention to an audit engagement. Studies find that excessive audit partner workloads can have

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86 *See*, *e.g.*, Julie S. Persellin, Jaime J. Schmidt, Scott D. Vandervelde, and Michael S. Wilkins, *Auditor Perceptions of Audit Workloads, Audit Quality, and Job Satisfaction*, 33 Accounting Horizons 95, 101 (2019) and Brant E. Christensen, Nathan J. Newton, and Michael S. Wilkins, *How Do Team Workloads and Team Staffing Affect the Audit? Archival Evidence from U.S. Audits*, 92 Accounting, Organizations and Society 101225, (2021).

87 Hours worked for purposes of these proposed metrics exclude hours that are not considered working hours (e.g., paid time off and holiday time).

negative impacts on audit effectiveness; however, the literature also suggests that partners may be less affected than more junior staff.[88]

The information provided by these metrics may help audit committee members and other stakeholders understand the various activities competing for an engagement partner's time. The engagement-level information could be compared to the average quarterly workload for engagement partners within the firm or across firms.

A similar metric was included in the Concept Release as partner, manager, and staff workload with various illustrative annual calculations. Many commenters on those metrics agreed on including a metric for partner, manager, and staff workload. One commenter emphasized the importance of obtaining information on partner and manager workload on the basis that high leverage and heavy workloads at the partner and manager levels threaten the quality of the partners' and managers' supervision and review. The commenter further stated that a potential implication of a heavy workload includes less attention paid to critical audit items such as contract reviews and complex accounting matters. Another commenter suggested that a partner workload metric could be a starting point of discussion with the audit committee when measured at the engagement level and accompanied by appropriate context. In light of the comments received, we believe the proposed metrics for workload at all staff levels would provide appropriate information to users.

In its report, Accountancy Europe identified three jurisdictions with metrics in the area of partner utilization or workload and two jurisdictions with a metric in the area of manager utilization or workload.[89]

In its analysis of firm transparency reporting, a firm-related group identified two firms reporting similar metrics at the firm level on an annual basis, for example, average annual hours worked more than 40 hours per week by level or annual utilization rate.[90] We believe that providing these metrics on a quarterly basis rather than annually could provide users with more relevant information about the workload of the audit team members during different phases of the audit.

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88 *See*, *e.g.*, Seokyoun Hwang and Philip Keejae Hong, *Auditors' Workload and Audit Quality under Audit Hour Budget Pressure: Evidence from the Korean Audit Market*, 26 International Journal of Auditing 371, (2022); John Goodwin and Donghui Wu, *What is the Relationship Between Audit Partner Busyness and Audit Quality?*, 33 Contemporary Accounting Research 341, (2016); Persellin, et al., *Auditor Perceptions*.

89 *See* Accountancy Europe Report, at 11 and 14 for CPAB (Canada) and IBRA (South Africa) indicators, respectively. *See also* FRC Report – Definitions Note, at 12-13.

90 *See* CAQ Report, at 12 for a summary analysis on firm-level metric examples in the area of partner, manager, and staff workload.

Workload

Firm-level description: Average weekly hours worked by the firm's (i) engagement partners and (ii) partners (excluding engagement partners), managers, and staff, calculated for each calendar quarter of the preceding 12-month period ended September 30 (e.g., September 30, 20X3, June 30, 20X3, March 31, 20X3, and December 31, 20X2).

Engagement-level description: Average weekly hours worked by (i) the engagement partner and (ii) partners (excluding the engagement partner), managers, and staff, on the core engagement team, calculated for each of the preceding three fiscal quarters up to the issuer's fiscal year end and the portion of the final fiscal quarter of the engagement through the issuance of the audit report.

Firm-level calculations*:*

(i) Average weekly hours worked by the firm's engagement partners:

$$\frac{\text{Average number of hours worked by } \textit{engagement partners} \text{ in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

(ii) Average weekly hours worked by the firm's partners (excluding engagement partners), managers, and staff:

$$\frac{\text{Average number of hours worked by } \textit{partners} \text{ (excluding } \textit{engagement partners), managers,} \text{ and } \textit{staff} \text{ of the firm in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

Engagement-level calculations*:*

(i) Average weekly hours worked by the engagement partner:

$$\frac{\text{Number of hours worked by the } \textit{engagement partner} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

(ii) Average weekly hours worked by partners (excluding the engagement partner), managers, and staff, on the core engagement team:

$$\frac{\text{Average number of hours worked by } \textit{partners} \text{ (excluding the } \textit{engagement partner}\text{), } \textit{managers} \text{ and } \textit{staff} \text{ who are on the } \textit{core engagement team} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

Example firm-level calculation:

Details for hours worked by engagement partners at the firm

Quarter	Total hours worked for the quarter	Number of engagement partners	Average number of hours worked in the quarter	Weeks in the quarter	Average weekly workload
Sep 30, 20X3	1,875	3	625	13	48
Jun 30, 20X3	1,800	3	600	13	46
Mar 31, 20X3	2,400	3	800	13	61
Dec 31, 20X2	1,950	3	650	13	50

$$\frac{\text{Average number of hours worked by } \textit{engagement partners} \text{ in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

September 30, 20X3 Calculation: 625/13 = 48

Details for hours worked by partners (excluding engagement partners), managers, and staff at the firm

Quarter	Total hours worked for the quarter	Number of partners, managers, and staff	Average number of hours worked in the quarter	Weeks in the quarter	Average weekly workload
Sep 30, 20X3	18,625	30	620	13	48
Jun 30, 20X3	19,025	30	634	13	49
Mar 31, 20X3	25,000	30	833	13	64

Dec 31, 20X2	21,450	30	715	13	55

$$\frac{\text{Average number of hours worked by } \textit{partners} \text{ (excluding } \textit{engagement partners), managers,} \text{ and } \textit{staff} \text{ of the firm in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

Example firm-level reporting for Form FM:

		Average weekly hours worked	
	Quarter ended	Engagement Partners	Partners (excluding engagement partners), Managers, and Staff
Workload	Sep 30, 20X3	48	48
	Jun 30, 20X3	46	49
	Mar 31, 20X3	61	64
	Dec 31, 20X2	50	55

Example engagement-level calculation:

Company A has a December 31, 20X2 year end. The audit report was issued on March 1, 20X3 and the firm filed Form AP on March 15, 2023.

Details for hours worked by the engagement partner

Quarter	Number of hours worked in the quarter	Number of weeks in the quarter	Average weekly workload
Jun 30, 20X2	700	13	54
Sep 30, 20X2	600	13	46
Dec 31, 20X2	575	13	44
Mar 1, 20X3	536	8.5[91]	63

$$\frac{\text{Number of hours worked by the } \textit{engagement partner} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

91 As noted above, less than 13 weeks in the quarter would be used for the quarter in which the audit report is issued because Form AP is required to be filed shortly after issuing the audit report. The number of weeks for the quarter ended March 1, 20X3, represents the number of weeks through the issuance of the audit report.

September 30, 20X3 Calculation: 600/13 = 46

Details for hours worked by partners (excluding engagement partner), managers, and staff on the core engagement team

Quarter	Total hours for the quarter	Number of partners, managers, and staff	Average number of hours worked in the quarter	Weeks in the quarter	Average weekly workload
Jun 30, 20X2	4,280	7	611	13	47
Sep 30, 20X2	4,095	7	585	13	45
Dec 31, 20X2	5,005	7	715	13	55
Mar 1, 20X3	3,633	7	519	8.5	61

$$\frac{\text{Average number of hours worked by } \textit{partners} \text{ (excluding the } \textit{engagement partner}\text{), } \textit{managers} \text{ and } \textit{staff} \text{ who are on the } \textit{core engagement team} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

Example engagement-level reporting for Form AP:

Workload		Average weekly hours worked during the engagement	
	Period ended	Engagement Partner	Partners (excluding the engagement partner), Managers, and Staff
	Jun 30, 20X2	54	47
	Sep 30, 20X2	46	45
	Dec 31, 20X2	44	55
	Audit report date	63	61

Questions

22. Are the proposed descriptions and calculations of the firm-level metrics and engagement-level metrics for the engagement partner workload and partner (excluding the engagement partner), manager, and staff workload clear and appropriate? If not, why not?

23. Should we require separate metrics for partner (excluding the engagement partner), manager, and staff workload? If so, why? Should the metric be limited to workload information for partners (other than the engagement partner) and managers? Why or why not?

iii. Audit Resources – Use of Auditor's Specialists and Shared Service Centers

Auditors frequently use the work of auditor's specialists[92] and shared service centers[93] (SSCs) to assist on audits. The work of auditor's specialists is commonly used in the evaluation of significant accounts and disclosures, including accounting estimates, and the work of SSCs is commonly used in non-complex or routine audit areas.

As financial reporting frameworks continue to evolve and require greater use of estimates, including those based on fair value measurements, accounting estimates have become both more prevalent and more significant. As a result, the use of auditor's specialists also continues to increase in both frequency and significance. These specialists may include actuaries, appraisers, other valuation specialists, legal specialists, environmental engineers, and petroleum engineers.

Similar to the trend toward using auditor's specialists, auditors have increasingly sought to reduce less complex and routine tasks performed by the core engagement team by increasing their reliance on SSCs to perform such tasks as data input, data validation and data formatting, checking schedules for mathematical accuracy, updating standard forms and documents (such as engagement letters and representation letters), rolling forward standard work papers (such as lead sheets), and performing reconciliations, among others.

Given the prevalence of the use of both specialists on the evaluation of significant accounts and disclosures, the use of SSCs to reduce tasks performed by the core engagement team, and as further discussed below, the variety of methods firms use to involve specialists, we believe the proposed metrics would provide useful information. For example, at the firm level these metrics would provide an understanding of the frequency with which firms use

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92 A specialist, as used in this context, includes both auditor-employed specialists, as defined in AS 1201.C1, and auditor-engaged specialists, as described in paragraph .01 of AS 1210, *Using the Work of an Auditor-Engaged Specialist*. Under those definitions, a specialist is a person possessing special skill or knowledge in a particular field other than accounting or auditing. Specialists would generally not include members of the engagement team whose specialization is in the fields of either information technology (IT) or income taxes (tax) because IT and tax are specialized areas of auditing and accounting. However, if IT or tax specialists are employed or engaged in a capacity other than specialized auditing and accounting as part of the issuer engagement, it may be appropriate to include them as specialists.

93 A shared service center is described as an associated entity of a firm, set up by a network of accounting firms, that, among other things, supplies those firms with personnel to assist in the performance of audits, and that is not itself an other accounting firm. *See Staff Guidance – Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Nov. 21, 2023) ("Staff Guidance on Form AP"), at footnote 24, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/standards/documents/2023-11-21_form_ap_staff_guidance.pdf?sfvrsn=21640c72_3.

specialists and SSCs on their engagements generally and, at the engagement level, would provide the context required to understand the extent of the use of auditor's specialists and SSCs on a particular issuer engagement.

These are highly contextual measurements because the use of the work of specialists is generally performed to satisfy needs specific to an industry (e.g., financial institutions) or issuer (e.g., fair value measurements of specific types of assets) and the use of the work of SSCs is dependent on the structure and resources of each firm and the specific needs of individual engagement teams.

Some academic literature suggests that access to non-CPAs within an audit firm, including specialists, could be associated with improved audit effectiveness; however, the use of specialists could also be challenging and costly for the auditor.[94] With respect to SSCs, one recent survey of auditors based in seven European countries reports that reduced costs are a key driver of the use of SSCs. The survey paper further reports that this frees up other engagement team members to focus on other aspects of the audit which may increase audit quality. However, respondents also report that SSC work is subject to greater quality control focus due to concerns about audit quality arising from, for example, the lack of direct oversight and coordination challenges.[95]

At the firm level, these metrics are intended to provide audit committees and investors with some visibility into a firm's use of other resources on its issuer engagements. At the engagement level, these metrics may provide (1) audit committees with a basis for discussion with their auditors and (2) investors with a basis for discussion with management on the use of auditor's specialists or SSCs and the areas in which they were involved given the specific facts and circumstances of the engagement. This additional information may facilitate their ability to probe more deeply into the specific circumstances of the audit, the issues specific to the industry of the issuer, and the potential complexity of the audit.

Specialists may be either auditor-employed or auditor-engaged. A specialist, either employed or engaged by the auditor's firm ("auditor-employed specialist" or "auditor-engaged specialist") assists the auditor in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure. It is important for the metric to capture

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[94] Matthew G. Sherwood, Albert L. Nagy, and Aleksandra B. Zimmerman, *Non-CPAs and Office Audit Quality*, 34 Accounting Horizons 169, (2020). *But see*, *e.g.*, Emily E Griffith*, Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values*, 37 Contemporary Accounting Research 245, (2020); and Aleksandra Zimmerman, Dereck D. Barr-Pulliam, Joon-Suk Lee, and Miguel Minutti-Meza, *Auditors' Use of in-House Specialists*, Journal of Accounting Research, (2023), for a study that implies (1) auditors may find the use of specialists to be challenging or costly and (2) though specialist usage increases with audit complexity, it may not fully mitigate the positive relationship between audit complexity and audit process deficiencies.

[95] *See* Ewald Aschauer and Reiner Quick, *Implementing shared service centres in Big 4 audit firms: an exploratory study guided by institutional theory*, 37 Accounting, Auditing & Accountability Journal 1 (2024).

both auditor-employed and auditor-engaged specialist hours in order for the metric to provide the overall level of participation by specialists in the engagement. We expect that firms may have to aggregate data from multiple systems to ensure all specialist hours are included.

Generally, larger firms are more likely to use the work of auditor-employed specialists than auditor-engaged specialists. Due to the greater number of audit engagements requiring specialist assistance, larger firms have specialist practices with full-time personnel. In contrast, smaller firms may have relatively few engagements requiring the use of a specialist, so engaging an auditor's specialist only as needed may be economically more advantageous.[96]

Our view is that the use of auditor's specialist metrics should capture both auditor-employed and auditor-engaged specialist hours in order to provide the overall level of participation by specialists in the engagement. When actual hours are available, they should be used. We note however, that firms' timekeeping systems would not generally capture the hours of engaged specialists. Additionally, firms' arrangements with engaged specialists may be on a fixed-fee or other basis not dependent on recorded hours. As a result, in calculating the proposed engagement-level metrics, a firm would capture auditor-employed specialist hours through its timekeeping system but may not capture auditor-engaged specialist hours. We are proposing to address this difference by providing an estimated hour equivalent for auditor-engaged specialists when recorded hours are not available. The number of auditor-engaged specialist hours would be calculated by dividing the contracted amount by an estimated hourly rate. As illustrated in the example below, if a firm enters into a $20,000 contract and estimates an hourly rate of $250 for a specialist, the firm would include 80 hours of auditor-engaged specialist time in both the numerator and the denominator of its calculation of the engagement-level metric.

Commenters provided feedback on the Concept Release related to use of other resources, including both auditor's specialists and SSCs.

One commenter on the use of auditor's specialists suggested that a metric for persons with specialized skill or knowledge would provide more information to investors and therefore increase their confidence in the audit. Three commenters listed technical or specialized skills as among the metrics they consider most important. Another commenter stated that professionals with specialized skill or knowledge are necessary for an effective audit engagement team. Some commenters expressed concern that the metric would not be meaningful without context. Additionally, some commenters observed that such a metric could inadvertently disadvantage smaller firms that may not have engagements for which they need specialized skill or knowledge. While we understand that not every engagement will require the use of auditor's specialists, the metric can provide useful insight into those engagements that involve specialists.

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96 *See* PCAOB Release No. 2018-006, *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, at 35, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket044/2018-006-specialists-final-rule.pdf?sfvrsn=322a6948_0.

One commenter on SSCs indicated that disclosing the percentage of audit work outsourced to others would be useful. Another commenter suggested that a metric for the amount of audit work centralized at SSCs should be disclosed because it may indicate that a firm has succumbed to cost pressure if it has diverted increasingly higher percentages of audit work to low cost off-shore SSCs. However, other commenters suggested that the practice was not widespread, or stated that the metric was unlikely to be useful.

As a part of our review of activities in other jurisdictions and of firms' audit quality or transparency reporting, we identified the use of other resources, including both auditor's specialists and SSCs, was included in some of those initiatives.

In its report, Accountancy Europe identified that five jurisdictions have specified metrics for the use of auditor specialists.[97] Two jurisdictions include metrics at the firm level,[98] while three other jurisdictions include a metric at the engagement level.[99] The types of information requested by these jurisdictions about specialists includes the percentage of specialists' engagement hours compared to engagement team hours, the qualifications of specialists, and the specific audit areas where specialists were used. In its analysis of firm transparency reporting, a firm-related group provides information about the use of auditor's specialists such as the percentage of overall engagement hours worked by specialists.[100]

With respect to SSCs, we identified at least two jurisdictions that included relevant metrics. One of these jurisdictions include metrics at the firm level,[101] while the other includes a metric at the engagement level.[102] The information jurisdictions requested about audit work performed at SSCs was the percentage of engagement hours compared to engagement team hours.

Many firms that publish audit quality or transparency reports currently disclose information related to the use of internal and external resources, as noted above. This includes auditor-engaged and auditor-employed specialists, SSCs and technical resources of the firm, such as the national office or a similar entity.[103] The information disclosed by these firms includes, for example, headcount ratios, usage as a percentage of audit hours, or usage as a percentage of total firm engagements.

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[97] *See* Accountancy Europe Report, at 6, 7, 10, 11, and 12 for IDW (Germany), Quartermasters (Netherlands), UK (FRC), CPAB (Canada), and ICAI (India), respectively.

[98] *Id.* (Germany, India)

[99] *Id.* (Netherlands, UK, Canada)

[100] *See* CAQ Report, at 8 for a firm-level metric example related to the use of specialists.

[101] *See* Accountancy Europe Report, at 9 for FAOA (Switzerland).

[102] *Id.,* at 11 (Canada).

[103] *See* CAQ Report, at 8.

Audit Resources – Use of Auditor's Specialists and Shared Service Centers

Firm-level description: Percentage of issuer engagements that used (i) auditor's specialists and (ii) shared service centers, calculating the metric for the 12-month period ended September 30 for all issuer engagements for which the firm issued an audit report.

Engagement-level description: Percentage of total audit hours provided by (i) auditor's specialists and (ii) shared service centers.

Note: In the engagement level calculation for use of auditor's specialists below, when actual hours are unavailable, the auditor-engaged specialist hour equivalent is estimated by dividing the contracted amount by an estimated hourly rate.

Firm-level calculations:

(i) Use of auditor's specialists

$$\frac{\text{Total firm issuer engagements on which } \textit{specialists} \text{ were used}}{\text{Total number of issuer engagements}}$$

(ii) Use of shared service centers

$$\frac{\text{Total firm issuer engagements on which } \textit{shared service centers} \text{ were used}}{\text{Total number of issuer engagements}}$$

Engagement-level calculations:

(i) Use of auditor's specialists

$$\frac{\text{Total } \textit{specialists} \text{ hours (auditor-employed specialist hours + auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}{\textit{Total audit hours} \text{ + (auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}$$

(ii) Use of shared service centers

$$\frac{\text{Total } \textit{shared service center} \text{ hours}}{\textit{Total audit hours}}$$

Use of Auditor's Specialists and Shared Service Centers

Example firm-level calculation:

- The firm has **500** issuer engagements.
- The firm has certain sectors and industries that rely heavily on the use of auditor's specialists.
  - In the financial services sector, the firm has sufficient need and capacity to employ specialists it needs for issuer engagements.
  - In the energy sector, the firm needs specialists based on each issuer's specific type of energy and there is not sufficient need for these specialists to be available as permanent staff, therefore the firm engages them as needed.
  - The firm has a large number of issuer engagements that use specialists that are not industry specific, such as actuaries. These specialists are generally auditor-employed.
- The firm has a shared service center that it uses for certain audit support activities that are typically consistently performed across several of its issuer engagements.

As a result of the above, the firm used specialists and shared service centers on its engagements as follows:

- Engagements that use both auditor-employed and auditor-engaged specialists: 65
- Engagements that use only auditor-employed specialists: 225
- Engagements that use only auditor-engaged specialists: 30
- Engagements that use shared service centers: 400

Total engagements that use specialists = **320**

$$\frac{\text{Total firm issuer engagements on which } \textit{specialists} \text{ were used}}{\text{Total number of issuer engagements}}$$

Calculation: 320/500 = **64%**

Total engagements that use shared service centers = **400**

$$\frac{\text{Total issuer engagements on which } \textit{shared service centers} \text{ were used}}{\text{Total number of issuer engagements}}$$

Use of service centers calculation: 400/500 = **80%**

Example firm-level reporting for Form FM:

Use of Auditor's Specialists	Percentage of issuer engagements that used specialists	**64%**
Use of Shared Service Centers	Percentage of issuer engagements that used shared service centers	**80%**

Example of engagement-level calculation:

An engagement uses three specialists, one is an auditor-employed specialist (Specialist 1) and two are auditor-engaged specialists (Specialist 2 and Specialist 3).

- Specialist 1, a firm employee, worked on the engagement throughout the year and charged a total of **200** hours to the engagement.
- Specialist 2, who was not employed by the firm, provided the firm with **10** hours of work on estimates.
- Specialist 3, who was not employed by the firm, was hired under a contract to perform independent appraisals. The firm paid $5,000 to Specialist 2 (the firm assumed that the appraisal work would be approximately $250 per hour, therefore the *auditor-engaged specialist hour equivalent* would be **20** hours).
- Total audit hours: **12,000** hours.

$$\frac{\text{Total } \textit{specialists} \text{ hours (auditor-employed hours + auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}{\textit{Total audit hours} \text{ + (auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}$$

Calculation: (200+10+20) / (12,000+10+20) = 1.9% rounded to **2%**

On the same engagement, shared service centers charged a total of **1,800** hours to the engagement, primarily assisting with the importation of the issuer's financial statements to the firm's audit tool, providing reconciliation support, performing data input for certain schedules, checking schedules for mathematical accuracy, and updating standard forms and schedules.

Total *shared service center* hours

Total audit hours

Use of shared service centers calculation: (1,800) / (12,000) = **15%**

Example engagement-level reporting for Form AP:

Use of Auditor's Specialists	Percentage of total audit hours provided by specialists	**2%**
Use of Shared Service Centers	Percentage of total audit hours provided by shared service centers	**15%**

Questions

24. Are the proposed descriptions of the firm-level and engagement-level metrics for use of (i) auditor's specialists and (ii) shared service centers clear and appropriate? If not, why not?

25. In situations in which the hours are unavailable, we are proposing that firms estimate an hourly equivalent for auditor-engaged specialists. Is there another way this information could be captured? If so, what is it? Are there other practical challenges with respect to auditor-engaged specialists that we should consider?

26. With respect to the firm-level metrics for the use of (i) auditor's specialists and (ii) shared service centers:

a. The metrics calculate the percentage of issuer engagements on which (i) auditor's specialists and (ii) shared service centers were used. Alternatively, should these metrics calculate the average percentage of usage of (i) auditor's specialists and (ii) shared service centers across all of the firm's engagements?

b. The metrics for use of auditor's specialists and shared service centers at the firm-level calculate the percentage of issuer engagements in which specialists or shared services centers, respectively, were used, no matter how minor their involvement may have been. Should the metric capture only engagements in which an auditor's specialist or shared services center was used for a minimum number of engagement hours, such as 2% or 5%? If yes, what should the threshold be?

c. We have proposed that the firm-level use of (i) auditor's specialists and (ii) shared service centers metrics be provided in aggregate across all of the firm's issuer engagements. Alternatively, would it be beneficial to provide either of these metrics by industry for those industries included in a firm's industry experience metrics? Why or why not?

27. With respect to the proposed metrics related to shared service centers:

a. The description of what is a shared services center is consistent with the description in the Form AP guidance. Should the description be more broad to include other arrangements such as (1) those that are captive to an individual firm, where the staff are employees of the firm, (2) service centers that have a separate legal entity but dedicated solely to the support of an individual firm, (3) service centers that are external to a firm but provide similar services to several affiliated or non-affiliated firms, (4) service centers that are located in the same jurisdiction as a firm, or (5) solely those that are located in another jurisdiction? Why or why not?

b. At the engagement-level should the firm report the types of work performed by the service center (e.g., non-complex tasks such as data input, data validation and data formatting, checking schedules for mathematical accuracy, updating standard forms and documents (such as engagement letters and representation letters), rolling forward standard work papers (such as lead sheets), performing reconciliations, and similar activities) or indicate the specific areas of the audit in which work of shared service centers was used (e.g., revenue, cash)? If so, what should be reported?

iv. Experience of Audit Personnel

The auditor's years of experience at a public accounting firm may provide useful information about how the auditor approaches the audit. At the firm level, this metric may provide information regarding the "bench depth" of firm personnel and the ability of the firm to staff its engagements. At the engagement level, the engagement team's years of experience may provide useful information about the depth of experience of the engagement team for the particular issuer engagement. This experience metric would capture all experience at a public accounting firm, whether or not the firm was registered with the PCAOB, and include audits of issuers and non-issuers and non-audit work.

Academic studies show that auditor experience is related to improved audit effort and skill, through both pre-client and client-specific experience,[104] and through behavioral adaptations associated with managing their clients.[105]

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[104] *See*, *e.g.*, Wuchun Chi, Linda A. Myers, Thomas C. Omer, and Hong Xie, *The Effects of Audit Partner Pre-Client and Client-Specific Experience on Audit Quality and on Perceptions of Audit Quality*, 22 Review of Accounting Studies 361, 363 (2016).

[105] *See, e.g.*, G. Bradley Bennett and Richard C. Hatfield, *The Effect of the Social Mismatch Between Staff Auditors and Client Management on the Collection of Audit Evidence*, 88 The Accounting Review 31, (2012).

The proposed firm-level metric would require firms to identify the average years of experience at a public accounting firm of engagement partners and other partners and managers. While we understand that many partners serve both in the capacity of an engagement partner on some engagements and as a partner supporting the engagement partner on other engagements, we are proposing that each be separately disclosed. For the firm-level metric, if a partner served as engagement partner on any of the firm's engagements completed during the reporting period, whether on issuer audits or non-issuer audits, their experience would be included in the engagement partner metric, not the other partner metric. Our rationale is that having one metric for both the partners who serve as engagement partner and all other partners may dilute the value of the metric, given that the average experience of the more seasoned partners who serve as engagement partners may be greater than the average experience of other partners.

The proposed engagement-level metric would require firms to provide the years of experience at a public accounting firm of the engagement partner and the engagement quality reviewer (EQR) and calculate the average level of experience of other partners and managers who are part of the core engagement team. For engagements that involve other auditors, we believe that the most relevant information is likely to relate to the core engagement team. For that reason, we are proposing to limit the metric to the engagement partner, the EQR, and partners and managers who are part of the core engagement team.

A similar metric was included in the Concept Release. Several commenters suggested that experience of audit personnel is a key driver of audit quality and an important element in the execution of the audit. Another commenter suggested that a useful metric could be the percentage of engagement hours performed by team members with less than two years of experience. Some commenters indicated that this metric should not be viewed in isolation and that smaller firms could be unintentionally penalized depending on the definition of the metric and individual firm structures. The proposed metric may mitigate that concern by focusing on the experience of (1) the engagement partner, and (2) all other managers and partners on engagements. Particularly at the engagement level, we believe the proposed metric would be comparable across firms because, by definition, each engagement has a single engagement partner.

Some commenters suggested that audit committees already have access to auditor experience information and that there may be little to no benefit derived from providing the firm-level metric. We believe that requiring a metric on years of experience at a public accounting firm may provide incremental information by providing for a uniform method of calculation and enabling comparisons across firms and engagements. Metrics on experience are included in the metrics of six jurisdictions.[106] One jurisdiction supported reporting experience,

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[106] *See* Accountancy Europe Report, at 6, 8, and 11-14 for IDW (Germany), CMVM (Portugal), CPAB (Canada), ICIA (India), ACRA (Singapore), and IRBA (South Africa).

skills, qualifications, and specialized knowledge of the partners and staff at the engagement level.[107]

For this firm-level metric, we noted that while many firms that publish audit quality or transparency reports discuss the experience of their professionals, only a few provide specific metrics such as years of experience of a firm's audit partners.[108]

Experience of Audit Personnel

Firm-level description: Average experience at a public accounting firm for the firm's (i) engagement partners and (ii) partners (excluding engagement partners) and managers, as of September 30.

Engagement-level description: (i) Total experience at a public accounting firm of the engagement partner, (ii) Total experience at a public accounting firm of the engagement quality reviewer, and (iii) Average experience at a public accounting firm of the core engagement team who are partners (excluding the engagement partner) and managers.

Note: Experience at a public accounting firm is the total number of years worked as an accountant for a public accounting firm (whether or not PCAOB-registered).

Firm-level calculations:

(i) Average experience at a public accounting firm for the firm's engagement partners:

$$\frac{\text{Total experience at a public accounting firm of all } \textit{engagement partners}}{\text{Total number of } \textit{engagement partners}}$$

(ii) Average experience at a public accounting firm for the firm's partners (excluding engagement partners) and managers:

$$\frac{\text{Total experience at a public accounting firm of } \textit{partners} \text{ (excluding } \textit{engagement partners}\text{) and } \textit{managers}}{\text{Total number of } \textit{partners} \text{ (excluding } \textit{engagement partners}\text{) and } \textit{managers}}$$

Engagement-level calculations:

(i) Total experience at a public accounting firm of the engagement partner:

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107 *See* CPAB Final Report, at 4.

108 *See* CAQ Report, at 9.

$$\text{Total experience at a public accounting firm of the } \textit{engagement partner}$$

(ii) Total experience at a public accounting firm of the engagement quality reviewer:

$$\text{Total experience at a public accounting firm of the } \textit{engagement quality reviewer}$$

(iii) Average experience at a public accounting firm of the core engagement team who are partners (excluding the engagement partner) and managers:

$$\frac{\text{Total experience at a public accounting firm of the } \textit{core engagement team} \text{ who are } \textit{partners} \text{ (excluding the } \textit{engagement partner}\text{) and } \textit{managers}}{\text{Total number of people on the } \textit{core engagement team} \text{ who are } \textit{partners} \text{ (excluding the } \textit{engagement partner}\text{) and } \textit{managers}}$$

Example firm-level calculation:

- The Firm has 100 partners and 300 managers. Of the 100 partners 75 serve as engagement partners.

	Number	Years of experience
Engagement Partners	75	1,500
Partners (excluding engagement partners)	25	375
Managers	300	2,250

(i) Average experience at a public accounting firm for the firm's engagement partners:

$$\frac{\text{Total experience at a public accounting firm of all } \textit{engagement partners}}{\text{Total number of } \textit{engagement partners}}$$

Calculation: 1,500/75 = **20**

(ii) Average experience at a public accounting firm for the firm's partners (excluding engagement partners) and managers:

$$\frac{\text{Total experience at a public accounting firm of } \textit{partners} \text{ (excluding } \textit{engagement partners}\text{) and } \textit{managers}}{\text{Total number of } \textit{partners} \text{ (excluding } \textit{engagement partners}\text{) and } \textit{managers}}$$

Calculation: (375+2,250)/(25+300) = **8**

Example firm-level reporting for Form FM:

		Engagement Partners	Partners (excluding engagement partners) and Managers
Experience of Audit Personnel	Average years of experience at a public accounting firm	**20**	**8**

Example engagement-level calculation:

Core engagement team	Number	Total experience at a public accounting firm
Engagement Partner	1	23
Engagement Quality Reviewer*	1	19
Partners (excluding the engagement partner)	3	45
Managers	8	79

* Note that the Engagement Quality Reviewer is not part of the core engagement team

(i) Total experience at a public accounting firm of the engagement partner:

Total experience at a public accounting firm of the *engagement partner*

Calculation: **23**

(ii) Total experience at a public accounting firm of the engagement quality reviewer:

Total experience at a public accounting firm of the *engagement quality reviewer*

Calculation: **19**

(iii) Average experience at a public accounting firm of the core engagement team member who are partners (excluding the engagement partner) and managers on the core engagement team:

$$\frac{\text{Total experience at a public accounting firm of the \textit{core engagement team} who are \textit{partners} (excluding the \textit{engagement partner}) and \textit{managers}}}{\text{Total number of people on the \textit{core engagement team} who are \textit{partners} (excluding the \textit{engagement partner}) and \textit{managers}}}$$

Calculation: (45+79)/(3+8) = 11.27 round to **11**

Example engagement-level reporting for Form AP:

	Years of experience at a public accounting firm for the Engagement Partner	Years of experience at a public accounting firm for the Engagement Quality Reviewer	Average years of experience for Partners (excluding the engagement partner), and Managers on the Core Engagement Team
Experience of Audit Personnel	**23**	**19**	**11**

Questions

28. Are the firm-level and the engagement-level metrics we are proposing for experience of audit personnel clear and appropriate? Should relevant experience be limited to auditing experience rather than including all experience at a public accounting firm? Conversely, is there other relevant experience that would be valuable to include when determining years of experience (e.g., experience at a relevant regulator or standard setter)? If so, how should that experience be measured?

v. Industry Experience of Audit Personnel

As part of the planning activities of an audit, auditors have a responsibility to gain an understanding of the company's business. These activities include gaining an understanding of matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes.[109] Experience in a particular industry helps an auditor understand the industry's operating practices, the critical accounting issues confronting companies in that industry, the risks of material

109 *See* AS 2101.07.

misstatement of the financial statements specific to industry factors, and any industry-specific audit procedures.

Understanding the experience of firms' audit personnel across industries is an important factor in determining whether the firm has the capacity and resources to perform audits of issuer engagements that benefit from specific industry knowledge. We believe the following metric would assist in gaining that understanding.

The academic literature has long identified auditor industry specialization as related to the effectiveness of audits.[110] One study examines the impact of auditor industry specialization on the assessment of audit risk and in audit planning found that auditors with industry specific knowledge improved the auditor's assessment of differential audit risk and the quality of their audit planning decisions.[111]

The firm-level metrics could provide information related to the firm's industry specialization and the engagement-level metrics could provide information related to the assignment of partners, managers, and the engagement quality reviewer to issuer engagements based on that experience.

At the firm level, having industry experience may provide a group of professionals who can both work on engagements and advise members of engagement teams when additional technical, industry-specific knowledge is needed. Firm-level industry experience may indicate that the firm has specific industry-based audit knowledge, tools related to risk assessment, and industry specialized methodologies for accounting and auditing. We are proposing that firms provide information on firm-level industry experience for any industry that represents at least 10% of the firm's revenue from audit services. We also propose to allow firms to provide the information for additional industries voluntarily.

At the engagement level, industry experience may provide issuer engagements with engagement team members that have an understanding of risks unique to the industry and industry-specific auditing and accounting considerations. Given the roles that partners and managers typically play on audits, we are proposing that the engagement-level metric would be required for all partners and managers on the engagement team, not just core engagement team members. In audits of companies that operate regionally or globally, there may be

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[110] *See, e.g.*, W. Robert Knechel, Vic Naiker, and Gail Pacheco, *Does Auditor Industry Specialization Matter? Evidence from Market Reaction to Auditor Switches*, 26 Auditing: A Journal of Practice and Theory 19, (2007); Steven Balsam, Jagan Krishnan, and Joon S. Yang, Auditor Industry Specialization and Earnings Quality, 22 Auditing: A Journal of Practice and Theory 71, (2003); and Allen T. Craswell, Jere R. Francis, and Stephen L. Taylor, *Auditor Brand Name Reputations and Industry Specializations*, 20 Journal of Accounting and Economics 297, (1995).

[111] *See*, Kin-Yew Low, *The Effects of Industry Specialization on Audit Risk Assessments and Audit-Planning Decisions*, 79 The Accounting Review 201, 202 and 214 (2004).

partners or managers from firms in multiple jurisdictions whose experience in the issuer's industry is important in fulfilling their responsibilities.

Partners, who typically have at least 10-12 years of experience, may have developed specific knowledge in a particular industry. Having a greater number of years of experience in an issuer's industry may result in enhanced knowledge, skill, and ability. For partners, we are proposing disclosure of those who have at least five years of experience in a particular industry. We believe that most managers have at least five to 10 years of experience; we are proposing disclosure of managers who have at least three years of industry experience. A minimum of 250 hours, or 25% of hours worked, must be focused on an industry in a given year for it to qualify as a year of industry experience for the metric. We recognize that there may be other relevant considerations in determining what constitutes industry experience and are requesting comment on our proposed minimums.

When determining whether an individual has experience in a specific industry the following may be taken into account: (i) industry experience may be, but is not required to be, exclusive to experience on audit engagements, or exclusive to experience gained at a public accounting firm, but must be relevant, and[112] (ii) industry experience may be acquired in non-consecutive years. Also, individual auditors may have industry experience in more than one unrelated industry. For example, an auditor may have experience in both health care and insurance. Because experience may be obtained in different ways at different points throughout a professional's career, there are many ways in which information could be accumulated, including personnel self-reporting or a firm's own time-keeping system.

The proposed firm-level and engagement-level metrics would provide information regarding partner and manager experience in particular industries. In order for firms to use a consistent approach to industry identification, we have proposed the Industry Classification Benchmark (ICB), operated and managed by FTSE Russell. The ICB is used by global stock exchanges, including the London Stock Exchange, Euronext, and NASDAQ OMX, to categorize listed companies. Based on the ICB classification system, firms would select from among a total of 31 possible industry classifications.[113]

Our proposed list of industries is as follows:

Code(s)	**Supersector**	**Sector**
10101xxx	Technology	Software and computer service
10102xxx	Technology	Technology hardware and equipment
15101xxx	Telecommunication	Telecommunication
20101xxx	Health Care	Health care providers
20102xxx	Health Care	Medical equipment and services

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112 Relevant experience includes experience in accounting or auditing roles and other specializations, such as experience that is related to fair value estimates in the industry.

113 *See FTSE Russell Industry Classification Benchmark (ICB), available at* https://classification.codes/classifications/industry/icb.

20103xxx	Health Care	Pharmaceuticals and Biotechnology
30101010	Banks	Banks
30201xxx	Financial Services	Finance and Credit Services
30202xxx	Financial Services	Investment Banking and Brokerage Services
30203 - 30205	Financial Services	Other Financial Services
3030xxxx	Insurance	Including all subsectors
35101xxx	Real Estate	Real estate investment services
35102xxx	Real Estate	Real estate investment trusts (REITs)
40101xxx	Automobiles and Parts	Automobiles and parts
4020xxxx	Consumer Products and Services	Including all subsectors
40301xxx	Media	Media
40401xxx	Retail	Retailers
40501xxx	Travel and Leisure	Travel and leisure
4510xxxx	Food, Beverage, and Tobacco	Including all subsectors
45201xxx	Personal Care, Drug and Grocery Stores	Personal care, drug, and grocery stores
50101xxx	Construction and Materials	Construction and materials
50201 – 50202xxx	Industrial Goods and Services	Aerospace and Defense and Electronic and Electrical Equipment
50203 – 50206xxx	Industrial Goods and Services	Including all subsectors
55101xxx	Basic Resources	Industrial materials
55102xxx	Basic Resources	Industrial metals and mining
55103xxx	Basic Resources	Chemicals
60101xxx	Energy	Oil gas and coal
60102xxx	Energy	Alternative Energy
65101xxx	Utilities	Electricity
65102xxx	Utilities	Gas, water, and multi-utilities
65103xxx	Utilities	Waste and disposal services

In addition to ICB, we considered the Standard Industrial Classification system (SIC) and North American Industrial Classification System (NAICS), among others. We noted that the SIC system was originally developed in the 1930s to classify companies by the type of activity in which they were primarily engaged and reflected the industries in existence at that time. While the SIC system was updated through the 1980s, it does not reflect more recent changes to how businesses are structured for certain industries, such as alternative energy. The NAICS was established in 1997 in response to concerns about the comprehensiveness of the SIC system.[114] This system uses a production-oriented structure. While the NAICS was developed with

114 *See* U.S. Bureau of Labor Statistics, *What Is NAICS?* (Sept. 2002), *available at* https://www.bls.gov/sae/additional-resources/what-is-naics.htm.

collaboration among the United States, Canada, and Mexico, it may be interpreted as being U.S.-focused rather than more broadly accepted.

An experience metric was discussed in the Concept Release. The Concept Release sought comment on whether the metric should measure overall experience or experience in a particular industry. Several commenters suggested that industry information would be useful in conjunction with other metrics, such as experience of audit staff. Two commenters pointed out that using SIC codes as the basis for industry classifications would result in too many industry classifications. We believe that using the ICB industry classifications would address relevant industry sectors and provide a manageable number of industries, while providing useful information to investors and other stakeholders. We are soliciting comment on whether the ICB is an appropriate approach to industry classification, or whether we should use the SIC system, the NAICS, or another approach.

Some commenters on the Concept Release suggested that audit committees already have access to this information from their auditors. In addition, those commenters also thought that there would be too many challenges for the information to be useful on a comparative basis. Concerns as to the lack of comparability included challenges in comparing firms and issuers of different sizes and different level of complexity for an issuer's operations within an industry.

Our research indicates that six jurisdictions include metrics based on the experience of engagement teams,[115] including one[116] with metrics related specifically to industry experience. Some audit firms publicly report the industries in which they specialize by listing the industries they serve on their websites. For example, the largest six global network firms disclose from six to 23 industries on their websites. Transparency reports for several firms also include references to industry expertise or industry experience of their staff. However, the reports generally do not include detailed metrics that can be analyzed or used to perform comparative analyses and do not provide engagement-level industry experience.

Industry Experience of Audit Personnel

Firm-level description: For each industry sector that represents at least 10% of the firm's audit practice based on revenue from audit services,[117] the number of the firm's (i) partners with more than five years of industry experience and (ii) managers with more than three years of industry experience, as of September 30.

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115 *See* Accountancy Europe Report, at 6, 8, and 11-14 for IDW (Germany, CMVM (Portugal), CPAB (Canada), ICAI (India), ACRA (Singapore), and IRBA (South Africa).

116 *Id.*, at 6 for IDW (Germany).

117 Additional industries may be provided.

Engagement-level description: Experience in the issuer's primary industry: (i) years of industry experience of the engagement partner, (ii) years of industry experience of the engagement quality reviewer, and (iii) for the engagement team, the sum of (a) the number of partners (excluding the engagement partner) with more than five years of industry experience and (b) managers with more than three years of industry experience.

Note: At least 250 hours or 25% of hours worked focused on companies in a particular industry in a year qualifies as having a year of industry experience.

Firm-level calculations:

(i) The number of the firm's partners with greater than five years of industry experience:

Number of *partners* of the firm with greater than five years of industry experience in each industry that accounts for at least 10% of the firm's revenue from audit services.

(ii) The number of the firm's managers with greater than three years of industry experience:

Number of *managers* of the firm with greater than three years of industry experience in each industry that accounts for at least 10% of the firm's revenue from audit services.

Engagement-level calculations:

(i) Years of experience in the issuer's primary industry of the engagement partner:

Years of industry experience of the *engagement partner*

(ii) Years of experience in the issuer's primary industry of the engagement quality reviewer:

Years of industry experience of the *engagement quality reviewer*

(iii) The number of *partners* (excluding the *engagement partner*) with greater than five years of industry experience who are on the *engagement team* and the number of *managers* with greater than three years of industry experience who are on the *engagement team*, combined.

Number of *partners* (excluding the *engagement partner*) and *managers* on the *engagement team* with industry experience, combined.

Example firm-level calculation:

The firm audits several industries, including financial services, finance and credit services, investment banking and brokerage services, consumer services, retail, infrastructure, utilities (electricity, and gas, water and multi-utilities), energy (oil and gas; alternative energy) and natural resources & chemicals.

Using the ICB classification system and the listing provided for in the proposed rule, the firm determines that it meets the 10% threshold for banks, electricity, retail, consumer services, and oil and gas. Collectively, these industries make up approximately 70% of the firm's revenue from audit services.

Industry	% of firm revenue from audit services	Number of partners with > 5 years of industry experience	Number of managers with > 3 years of industry experience
Banks (see note 1)	18%	15	45
Finance and credit services	9%*	15	15
Investment banking and brokerage services	4%*	5	10
Electricity (see note 2)	11%	10	30
Gas, water and multi-utilities	8%*	4	10
Retail (see note 3)	12%	12	63
Consumer services	14%	5	13
Oil and gas	15%	4	6
Alternative energy	9%*	2	6

* While not required, a firm may choose to report on industries such as those marked "*" even though the industries represent less than 10% of firm revenue from audit services.

Note 1: In this example, partners and managers in the banking and finance related industries may specialize in one or more of these industries. For purposes of this example:

Partners

- Fifteen partners specialize in both Banks and Finance and credit services
    - Of those fifteen, three also specialize in Investment banking and brokerage services, and
- Two partners specialize only in Investment banking and brokerage services.

Managers

- Twenty-five managers specialize in Banking only,
- Thirteen managers specialize in both Banking and Finance and credit services,
- Two managers specialize in Banking, Finance and credit services and Investment banking and brokerage services,
- Five managers specialize in both Banking and Investment banking and brokerage services, and
- Five managers specialize only in Investment banking and brokerage services.

Note 2: The Utilities scenario is similar to the financial services scenario where the majority of the partners and managers with industry experience in gas, water, and multi-utilities are a subset of electricity with some also exclusive to gas, water and multi-utilities only.

Example firm-level reporting for Form FM:

	Industry that accounts for at least 10% of the firm's revenue from audit services	Number of Partners with > 5 years of industry experience	Number of Managers with > 3 years of industry experience
Industry Experience of Audit Personnel	Banks	15	45
	Utilities	10	30
	Retail	12	63
	Consumer services	5	13
	Oil and gas	4	6

Example engagement-level calculation:

The company's primary industry is retail

	Retail experience
Engagement partner	16 years
Engagement quality reviewer	24 years
UK Partner	12 years
Canada Partner	14 years
IT Partner	No specific retail experience

Tax Partner	No specific retail experience
Tax senior manager	1 year
US senior manager	6 years
US manager	4 years
UK manager	3 years
Canada manager	No specific retail experience
IT manager	No specific retail experience

Example engagement-level reporting for Form AP:

Industry Experience of Audit Personnel in the Issuer's Primary Industry	Select the issuer's primary industry from the list provided		Retail
	Engagement Partner years of experience in the issuer's primary industry	Engagement Quality Reviewer years of experience in the issuer's primary industry	Combined number of engagement team Partners (excluding the engagement partner) AND Managers who have industry experience[118]
	16	**24**	**5**

Questions

29. Is three years of experience for managers and five years of experience for partners an appropriate threshold for industry experience? If not, what number of years should we use? Should the same number of years be used to determine industry experience for all levels of seniority (e.g., audit partner and audit manager)?

30. We have proposed the following considerations to be taken into account when determining an individual's industry experience: (1) industry experience may be, but is not required to be, exclusive to experience on audit engagements but must be relevant, (2) industry experience is not required to be in consecutive years, and (3) auditors may have industry experience in more than one unrelated industry. Are these the right considerations? Should industry experience be determined by a minimum number (or percentage) of hours on engagements within a particular industry? Does it matter whether the years of experience have been recent or if the experience was not obtained as an auditor? If so, please provide an explanation.

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118 Partner industry experience is described as greater than five years in the issuer's primary industry and manager industry experience is described as greater than three years in the issuer's primary industry.

31. If an auditor does not work exclusively in one industry, what are the considerations to determine whether the auditor has qualifying experience in multiple industries? Should it be based on hours (time) worked in a specific industry with a minimum percentage, for example 250 hours or 25% of the auditor's time focused on a particular industry as we have proposed?

32. We have proposed the FTSE Russell Index as a reference for industry classification based on supersector and certain disaggregation to the sector or subsector level. Is this index and disaggregation appropriate? Is there a more suitable reference index? If so, what is it and what are the comparative benefits of other indices?

33. At the firm level we have proposed that firms disclose industry experience for those industries that represent at least 10% of the firm's revenue from audit services, with the option to include additional industries. Is 10% an appropriate percentage to use? If not, should the percentage be higher or lower?

34. Are there thresholds for disclosure that may be meaningful in addition to or instead of a percentage of the firm's revenue? For example, should we require firms to disclose industry experience for their top five or top ten industries by revenue from audit services? Are there other thresholds we should consider and, if so, what are they?

35. As proposed, firms would provide industry experience information at the engagement level based on only the issuer's primary industry. Would it be beneficial for this metric to be disclosed for additional industries in which the issuer operates? If so, are there practical considerations in determining the level of industry specialization disaggregation that should be requested or allowed? What threshold should be used to determine which other of an issuer's industries should be reported?

vi. Retention and Tenure

At the firm and engagement levels, the retention rate and the headcount change are intended to reflect the overall readiness, availability, and ability of the firm or the engagement team to conduct an effective and efficient audit. Some turnover is expected within audit firms and in the engagement[119] due to various reasons, such as voluntary or involuntary departures of auditors, reallocation of resources to other service lines or engagements, mandatory partner rotation,[120] or retirement. However, a comparatively high rate of turnover or higher-than-expected turnover could adversely affect the audit.[121] At the firm level, a comparatively high

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119 *See, e.g.*, Kris Hardies, *A Survival Analysis of Organizational Turnover in the Auditing Profession*, 97 MAB 5, (2023).

120 *See* Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01(c)(6)(i).

121 *See* Christophe Van Linden, Marie-Laure Vandenhaute, and Aleksandra Zimmerman, *Audit Firm Employee Turnover and Audit Quality*, Working Paper, Vrije Universiteit Brussel, SSRN (2023).

rate of turnover or higher-than-expected turnover could diminish the available pool of talent who have the appropriate competency gained over time through training programs and relevant experience with proper supervision. Therefore, it may take time and resources for the firm to replace the competency lost, likely through effective recruiting and further training.

Similarly, higher turnover at the engagement level could affect the audit because valuable knowledge about the company and its operations might be lost and the audit could be disrupted. While additional firm resources may be available to the engagement team, the engagement team would need to train the new members, modify the planned assignments or timing of work (including the review of the work), and transfer knowledge to newly assigned personnel. Furthermore, the impact of the retention rate at the engagement level could also be dependent on other factors such as the composition of the remaining team members, the experience of engagement team members, or the timing of the turnover. For example, an engagement team with a high retention rate of core engagement team members and longer tenures by the core engagement team members may experience less disruption from turnover compared to an engagement with no returning core engagement team members.[122] Academic literature consistently finds the same conclusion: turnover negatively affects audit quality, more so at longer-tenured engagements than newer engagements.[123]

The adopting release for the SEC's rule on auditor independence indicates that there is a need to strike a balance between achieving a fresh look, having an engagement team composed of competent accountants, and maintaining continuity of engagement team members with specific knowledge.[124] The disclosure of engagement team members' tenure is intended to add to the mix of information (i.e., information provided in conjunction with all the metrics proposed in this release), and not to suggest a specific correlation between tenure and audit quality or between tenure and auditor independence.

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122 *See* Wuchun Chi, et al., *The Effects of Audit Partner Pre-Client and Client-Specific Experience on Audit Quality and on Perceptions of Audit Quality*.

123 *See*, *e.g.*, Joshua Khavis and Brandon Szerwo, *Audit-Employee Turnover, Audit Quality, and the Auditor-Client Relationship*, SSRN Electronic Journal, (2023); Linden, et al., *Audit Firm Employee Turnover and Audit Quality*; W. Robert Knechel, Juan Mao, Baolei Qi, and Zili Zhuang, *Is There a Brain Drain in Auditing? the Determinants and Consequences of Auditors Leaving Public Accounting*, 38 Contemporary Accounting Research 2461 (2021); and Brant E. Christensen, et al., *How Do Team Workloads and Team Staffing Affect the Audit? Archival Evidence from U.S. Audits*.

124 *See Strengthening the Commission's Requirements Regarding Auditor Independence*, SEC Release No. 33-8183 (Mar. 26, 2003). "We believe that the partner rotation requirements must strike a balance between the need to achieve a fresh look on the engagement and a need for the audit engagement team to be composed of competent accountants. We believe that a proper balance is one that weighs the responsibility for decisions on accounting and financial reporting issues impacting the financial statements with the level of the relationship with senior management of the client. Such a balancing clearly would include the lead (high on both dimensions) and concurring partners (high on responsibility for final decisions, somewhat lower on level of relationship with management)."

The proposed firm-level and engagement-level metrics would require firms to calculate the annual retention rate and the annual headcount change of partners and managers. We considered establishing a category, in addition to managers and partners, for staff-level professionals with three to five years of experience (often called seniors). Some academic literature finds evidence that turnover of engagement team members negatively affects audit quality primarily when the turnover occurs at the staff level.[125] We are seeking comment on whether it would be beneficial to disclose the annual retention rate and the annual headcount change of seniors.

The annual retention rate measures the percentage of firm personnel continuously employed for the reporting period (for firm-level) or the percentage of core engagement team members remaining on the engagement (for engagement-level) to demonstrate the continuity of firm personnel. The average annual headcount change measures changes in the firm's overall headcount of managers or partners, giving an indication of the firm's effort to replace professionals who left roles in the audit practice and the overall availability of firm personnel. The annual retention rate and the annual headcount change are closely related; however, the annual retention rate would measure the "same people" within the firm or the engagement, while the annual headcount change would measure the "same number of people." Changes in annual headcount change could result from a variety of reasons, for example, changes in a firm's human resource strategy (e.g., greater use of technological resources, shifting more work to shared service centers), or a downturn in the economy.

We are proposing to require a firm-level metric for the average number of partners and managers. We believe this information provides context for the retention calculations because a 67% retention rate at a larger firm (e.g., 200 departures out of 600 professionals) would involve a different level of employee continuity than at a smaller firm (e.g., one departure out of three professionals) and would imply a different magnitude of possible impact on the firm's human resource management.

At the engagement level, a specific metric related to tenure would also be required—the average tenure on the engagement for partners and managers. We are proposing average tenure on the engagement by seniority level, to quantify the overall continuity of the engagement team members. Average annual retention rate is a year-over-year metric, but tenure would provide overall engagement-level experience as an important component to understand the experience of the engagement team on the specific audit.

A "turnover of audit personnel" metric with various illustrative calculations was included in the Concept Release.[126] Several commenters on the Concept Release generally supported a

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[125] *See*, *e.g.*, Khavis and Szerwo, *Audit-Employee Turnover, Audit Quality, and the Auditor-Client Relationship*; Linden, et al., *Audit Firm Employee Turnover and Audit Quality*.

[126] *See* Concept Release, at A-8. Turnover is described as "transfers to other engagements or movement outside the firm or firm's audit practice, at the engagement and, more generally, at the firm, level."

metric on turnover of audit personnel. Two of these commenters indicated that the percentage of staff turnover or the turnover rate of audit personnel could be a helpful indicator of audit quality. Other commenters asserted that the turnover metric was not useful in assessing audit quality primarily because turnover could result from a variety of circumstances and a turnover percentage using historical data would not reflect audit quality in the current year.

The Concept Release asked whether a distinction should be made between partner retirements and other types of turnover in applying the turnover metric. A few commenters responded and supported the future inclusion of this distinction; one commenter specifically supported including three categories: (i) mandatory retirement due to age limitations, (ii) early partner separations at the firm's direction, and (iii) early partner separations at the partner's direction. This commenter also questioned which types of partners to include (e.g., equity partners, only CPAs, only audit partners). We are not proposing to include a distinction between partner retirements and other changes in the number or types of partners because we believe users are primarily concerned with overall turnover at the partner level, rather than the reasons underlying such turnover.[127]

We are proposing to use the retention rate rather than the turnover rate as we believe the retention rate may better capture stability within the audit practice and focuses on the number of professionals who have been continuously employed. The turnover rate, on the other hand, captures the percentage of, and has a focus on the number of, professionals leaving the workplace. The two are generally inverses of each other, but in some circumstances may diverge. For example, if professional A left the firm and professional B was hired but subsequently left the firm during the same reporting period, the turnover rate would be calculated using two departures, while the retention rate would be calculated using one departure. In the instances where they differ, we believe the retention rate would be a more meaningful metric for reporting. We are also proposing headcount change and tenure as complementary metrics that provide information regarding the ability of the firm to replace personnel and the experience of the engagement team on the engagement.

Our research indicates that nine jurisdictions have identified this metric as a firm- and/or engagement-level metric, either as "turnover" or "attrition."[128]

In its analysis of firm transparency reports, a firm-related group found that seven U.S. firms publicly reporting this metric or similar metrics as firm-level metrics,[129] but the firms

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127 *See also* Van Linden, et al., *Audit Firm Employee Turnover and Audit Quality*.

128 *See* Accountancy Europe Report, at 6-14 for IDW (Germany), Quartermasters (Netherlands), CMVM (Portuguese), FAOA (Switzerland), FRC (UK), CPAB (Canada), ICAI (India), ACRA (Singapore), IRBA (South Africa) indicators, respectively.

129 *See* CAQ Report, at 10.

calculate the metrics in different ways, which limits comparability.[130] For example, most firms report the "retention rate" as opposed to the "turnover rate." Some firms report on retention by level, but do not include audit partners. Some firms report on "voluntary turnover" only.

Our proposed metrics in this area would eliminate the subjectivity inherent in distinguishing between voluntary and involuntary turnover. The proposed retention metric would also include "transfers out" from the audit practice to other service lines within the firm. In addition, we are proposing the "retention rate," which would be measured consistently using the average number of partners and managers as the denominator.

Retention and Tenure

Firm-level description: Retention and headcount change of (a) the firm's partners and (b) the firm's managers for the 12-month period ended September 30:

(i) Average number of the firm's partners and managers

(ii) Average annual retention rate (percentage of the firm's partners and managers who remained employed with the firm for the entire 12-month period)

(iii) Average annual headcount change (change in number of the firm's partners and managers from the previous reporting period to the current reporting period, as a percentage of the number at the beginning of the period)

Engagement-level description: Retention, headcount change, and tenure of (a) the partners and (b) the managers of the core engagement team during the engagement:

(i) Average annual retention rate (percentage of core engagement team partners and managers from the most recent previous audit period who remained on the engagement during the current year audit period)

(ii) Average annual headcount change (changes in number of core engagement team partners and managers from the most recent previous audit period to the current audit period)

(iii) Average tenure on the engagement (average number of years on the engagement) for partners and managers of the core engagement team

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130 *See* various public reports issued by BDO USA, LLP, CohnReznick LLP, Crowe LLP, Deloitte & Touche LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP, PricewaterhouseCoopers LLP, and RSM US LLP, identifying firm-level metrics.

Firm-level calculations:

(i) Average number

$$\frac{\text{The number of [}\textit{partners/managers}\text{] as of October 1 (20X0) + the number of [}\textit{partners/managers}\text{] as of September 30 (20X1)}}{2}$$

(ii) Average annual retention rate[131]

$$\frac{\text{The number of [}\textit{partners/managers}\text{] continuously holding the same position from October 1 (20X0) to September 30 (20X1)}}{\text{Number of [}\textit{partners/managers}\text{] as of October 1 (20X0)}}$$

(iii) Average annual headcount change

$$\frac{\text{Number of [}\textit{partners/managers}\text{] as of September 30 (20X1)}}{\text{Number of [}\textit{partners/managers}\text{] as of September 30 (20X0)}}$$

Engagement-level calculations:

(i) Average annual retention rate

$$\frac{\text{Number of the same [}\textit{partners/managers}\text{] on the }\textit{core engagement team}\text{ in both the current year (20X1) and prior year (20X0)}}{\text{Number of [}\textit{partners/managers}\text{] on the }\textit{core engagement team}\text{ in the prior year (20X0)}}$$

(ii) Average annual headcount change

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131 The partners and managers of the firm included in the numerator of this calculation are those with one or more years of service and who were employed continuously during of the 12-month period. Any partners and managers of the firm hired or positions added during the 12-month period would not be counted in either the numerator or denominator of this formula. The retention rate would not include departures of partners and managers of the firm who joined and subsequently left during the 12-month period. The retention rate treats promotions to another level of seniority as if they occurred at the beginning of the year; therefore, the number of promoted employees would be included in both the numerator and the denominator of the level at which they ended the year and excluded from both the numerator and the denominator of the level at which they began the year.

$$\frac{\text{Number of [}\textit{partners/managers}\text{] on the }\textit{core engagement team}\text{ in the current year (20X1)}}{\text{Number of [}\textit{partners/managers}\text{] on the }\textit{core engagement team}\text{ in the prior year (20X0)}}$$

(iii) Average tenure on the issuer engagement

$$\frac{\text{Total number of years on the engagement for [}\textit{partners/managers}\text{] on the }\textit{core engagement team}}{\text{Total number of [}\textit{partners/managers}\text{] on the }\textit{core engagement team}}$$

Example firm-level calculation (only manager calculation provided):

Firm A had 204 managers and 200 managers as of October 1, 20X0 and September 30, 20X1, respectively. During the 12-month period, 38 managers left the firm, 2 managers transferred out of the audit practice to accounting advisory services, 5 managers were promoted to partners, 37 staff were promoted to managers, and 4 managers were newly hired or transferred into the audit practice.

- *Average number of managers* ---- The total number of managers as of October 1, 20X0 was 204 and the total number of managers as of September 30, 20X1 was 200; therefore, the average number of managers would be 202 ($\frac{(204+200)}{2}$ = 202).

- *Average annual retention rate*
  Step 1 – Calculate the total number of managers who were continuously employed and held the same position from October 1, 20X0 to September 30, 20X1 (the numerator)

  Start with the number of employees as of October 1, 20X0 (204 managers) and adjust for employees who did not continuously hold the same position: deduct the 38 who left the firm, the 2 who left the audit practice, and the 5 who were promoted to partner; and add the 37 staff who were promoted to manager (because the promotion is treated as if it had occurred at the beginning of the period for the calculation (*see* footnote 131)). Because the 4 managers who were newly hired or transferred into the audit practice were not included in the beginning number of 204, no specific adjustment to the numerator relating to these 4 is necessary.

Step 2 – Adjust the number of managers as of October 1, 20X0 (204 managers) for the promotions as if they had occurred at the beginning of the period (the denominator).

Start with the number of managers as of October 1, 20X0 (204 managers), deduct the 5 manager promotions and add the 37 staff promotions.

The annual retention rate for Firm A would be 83% ($(\frac{(204\text{-}38\text{-}2\text{-}5+37)}{(204\text{-}5+37)}$ = 83).

- *Average annual headcount change* --- The total number of current year-end managers was 200 and the total number of prior year managers was 204; therefore, the average annual headcount change would be 98% ($\frac{200}{204}$ = 98.%).

***Example firm-level reporting for Form FM*:**

		Partners	Managers
Retention and Tenure	Average number	**85**	**202**
	Average Annual retention rate	**91%**	**83%**
	Average Annual headcount change	**125%**	**98%**

Example engagement-level calculation (only manager calculation provided):

The issuer engagement XYZ has engagement team members A, B, C, and others on the team as follows:

- Engagement team member A was hired in 20X0 and became a core engagement team member for 20X0 and 20X1.
- Engagement team member B was also hired in 20X0 and became a core engagement team member for 20X0 and 20X1.
- Engagement team member C was hired in 20X1 and became a core engagement team member for 20X1.

	Engagement team member A (20X0 Hire)		***Engagement team member B (20X0 Hire)***		***Engagement team member C (20X1 Hire)***	
	Job title/ Employment Status	**Total Hours Reported**	**Job title/ Employment Status**	**Total Hours Reported**	**Job title/ Employment Status**	**Total Hours Reported**
20X2	Sr. Manager	550	Manager/ Left the engagement	130	Manager	550

20X3	Sr. Manager	1100	N/A	N/A	Manager/ Left the firm	20

Based on the information above, the total number of the core engagement team are as follows:
<u>20X2:</u> Three (engagement team member A, B, and C as managers)
<u>20X3:</u> One (engagement team member A only as a manager)

- *Average annual retention rate*

  <u>20X3:</u> Because all three managers are in the denominator while only engagement team member A in the numerator, it is calculated to be 33% ($\frac{1}{3}$ = 33%).

- *Average annual headcount change*

  <u>20X3</u>: Because only one manager was a core engagement team member in 20X3 while all three managers were core team members in 20X2, it is calculated to be 33% ($\frac{1}{3}$ = 33%).

- *Average tenure on the engagement*

  <u>20X3:</u> Only engagement team member A's tenure would be used and it would be 4 years.

Example engagement-level reporting for Form AP:

		20X3 Audit – as of the date of the audit report		
Retention and Tenure		Average annual retention rate	Average annual headcount change	Average tenure on the engagement (years)
	Partners	**0%**	**100%**	**1**
	Managers	**33%**	**33%**	**4**

Questions

36. Are the descriptions and the calculations of the proposed (i) retention rate and (ii) headcount change at the firm level and engagement level clear and appropriate? If not, why not?

37. Are the description and the calculation of the proposed average number of the firm's partners and managers at the firm level clear and appropriate? If not, why not?

38. Are the description and the calculation of the proposed tenure on the engagement at the engagement level clear and appropriate? If not, why not?

39. Would it be beneficial to disclose the annual retention rate and the annual headcount change of staff with three to five years of experience (often called seniors)? Should disclosure be provided for all staff levels?

40. Are there alternative metrics that may be more useful than the proposed retention rate or headcount change? If so, what are they?

vii. Audit Hours and Risk Areas

The proposed engagement-level metric would require firms to calculate the time incurred by all partners and managers on the engagement team in auditing the areas of significant risks,[132] critical accounting policies and practices,[133] and critical accounting estimates,[134] in aggregate, as a percentage of total audit hours incurred by partners and managers on the engagement team. We are proposing to include all partner and manager hours on the engagement team, rather than only including those on the core engagement team, in order for this metric to fully capture the focus on these areas by all senior members of the engagement team. These are the areas that generally involve greater risk of material misstatement and are critical to the company's financial statements. We acknowledge that there likely may be overlap among the three categories, which is why we are proposing that the sum of hours spent in all three areas be reported as one percentage, not separately. Firms should not double count hours related to the same area of risk even when the recorded time relates to more than one category of risk. In addition, we are proposing to include all three categories in this metric because the hours spent auditing accounts or disclosures that are not considered to be critical accounting estimates or critical accounting policies and practices, but that represent a significant risk in the audit, would be informative to investors and other stakeholders.

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[132] As defined in paragraph .A5 of AS 2110, *Identifying and Assessing Risks of Material Misstatement* ("risk of material misstatement that requires special audit consideration").

[133] As defined in AS 1301.A4 ("A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.")

[134] As defined in AS 1301.A3 ("An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.")

We believe this metric would provide information regarding the extent to which partners and managers focused on areas that present a higher overall risk of material misstatement to the financial statements.

The time devoted by partners and managers to areas that represent particular risks in the audit could indicate whether partners and managers focused their time sufficiently on those areas. We expect, however, that time spent on significant risks and critical accounting policies, practices, and estimates could vary substantially across engagements based on the specific facts and circumstances of each engagement. Because a firm-level metric would accordingly be heavily influenced by the mix of companies that a firm audits, we are not proposing to require firms to report this metric at the firm level.

A similar metric was included in the Concept Release with various illustrative calculations (e.g., number of hours and percentage of hours) at both the firm and the engagement level. Approximately half of the commenters that provided comments on this metric supported this metric at the engagement level. The remaining commenters did not support this metric, arguing that the time spent on auditing areas of risk is best evaluated by individual audit committees on individual engagements and that, as this metric would vary considerably from firm to firm and engagement to engagement, it would not be an area that could be properly evaluated. As mentioned above, we believe this metric may provide important information to users regarding how the senior members of the engagement team allocated their time to the riskier areas of the engagement.

While the staff has not identified any firms that are currently reporting this information publicly, under AS 1301 the auditor is required to communicate significant risks, critical accounting policies and practices, and critical accounting estimates to the audit committee.[135] The staff identified one jurisdiction that launched an exploratory AQI pilot project involving audit committees, management, and their auditors where a similar metric was selected by more than 75% of the pilot participants.[136]

Audit Hours and Risk Areas (Engagement-level only)

Engagement-level description: The sum of total audit hours incurred in areas of significant risk, critical accounting policies and practices, and critical accounting estimates, by all partners and managers on the engagement team as a percentage of total audit hours incurred by partners and managers on the engagement team.

Note: Firms should not double-count hours that relate to more than one category of risk.

Engagement-level calculation:

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135 *See* AS 1301.09, .11, 12b., .12c, .13b, and .13c.

136 *See* Accountancy Europe Report, at 11 for CPAB (Canada). The objective of the pilot project was to receive feedback about the usefulness of certain metrics to support broader national and international discussions.

$$\frac{\textit{Total audit hours incurred by partners and managers on the engagement team in the areas of significant risks, critical accounting policies and practices, and critical accounting estimates}}{\textit{Total audit hours incurred by partners and managers on the engagement team}}$$

Example engagement-level calculation:

- The firm identified the following areas of risk in the 20X3 audit of Company X:
  - Critical accounting estimates – Intangible assets
  - Critical accounting policies and practices – Revenue
  - Significant risks – Business combinations, Revenue, Intangible assets, Warrants
- Total audit hours incurred by partners and managers on the engagement team was **900** hours

Audit areas	Total audit hours incurred by partners and managers on the engagement team
Intangible assets	60
Revenue	120
Business combinations	95
Warrants	45
Total	**320**

$$\frac{\textit{Total audit hours incurred by partners and managers on the engagement team in the areas of significant risks, critical accounting policies and practices, and critical accounting estimates}}{\textit{Total audit hours incurred by partners and managers on the engagement team}}$$

Calculation: 320 / 900 = **36%**

*Note: Firms should not double-count hours that relate to more than one category of risk.

Example engagement-level reporting for Form AP:

Audit Hours and Risk Areas	Percentage of total audit hours incurred by Partners and Managers on the engagement team on significant risks, critical accounting policies and practices, and critical accounting estimates	**36%**

Questions

41. Is the calculation of the audit hours and risk areas metric clear and appropriate, including the components of the calculation? Why, or why not?

42. Are firms currently tracking the time incurred by partners and managers on significant risks, critical accounting policies and practices, and critical accounting estimates? If not, what should the Board be aware of related to potential costs or challenges related to obtaining this information?

43. Should this metric only report the percentage of hours for the partners and managers on the core engagement team instead of all partners and managers on the engagement team? Why or why not?

44. Under the proposal, the definition of engagement team includes employed specialists, but not engaged specialists. Should this metric be revised to also include engaged specialist hours? Why or why not?

viii. Allocation of Audit Hours

The proposed firm-level and engagement-level metrics would require firms to report the percentage of total audit hours incurred both prior to the issuer's year end and following the issuer's year end, separately.

At the engagement level, performing audit work prior to the issuer's year end may allow the audit team to identify significant issues in a timely manner and provide the audit team with the opportunity to address those issues earlier. It may also enable engagement teams to have the resources available to appropriately respond to significant issues identified after year end. Discussing this metric with the audit committee could provide the audit committee with information regarding aspects of the engagement performance. Academic literature suggests that allocation of a greater proportion of total hours to earlier audit phases, prior to a company's year end, is associated with a lower likelihood of restatements[137] and late Form 10-K filings and also decreased total audit hours.[138]

We considered proposing that firms report total audit hours related to the different phases of the audit—planning, quarterly reviews, interim field work, final field work, and post-report release date—but instead opted to propose a more simplified metric so that auditors would not have to try to segregate hours into discrete phases of the audit.

A similar metric was introduced in the Concept Release that sought to measure the effort and staffing the audit devotes to audit planning, interim field work, and audit completion. Of the commenters who addressed this metric in the Concept Release, approximately half did not support requiring firms to report this information, the other half of commenters supported reporting this metric at either the firm level or the engagement level. One commenter suggested this metric may be most meaningful when presented in ranges. Another commenter suggested that this information may be more meaningful for a mid-market entity and significantly more challenging to collect and potentially less meaningful for a large multinational, multi-location group audit with standalone statutory filings in foreign jurisdictions. A commenter stated that additional considerations that should be factored into the analysis were the number of years the audit client has been with the audit firm, the industry classification, the experience of the engagement team, the complexity of the engagement, the engagement's risk profile, and account-specific risks. Another commenter noted that while this metric would provide audit committees with assurance that risk areas have been properly addressed and could be used as an indicator of higher audit quality, the overall quality and effectiveness of the audit strategies are better indicators of audit quality than the sole focus on the percentage of hours an audit firm devotes to different phases of an audit engagement.

Some commenters cited concerns such as the potential for comparability issues among firms, as well as the view that this metric would not be valuable without the full context of information about the auditor's work and would be better communicated as a two-way discussion between the auditor and the audit committee.

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137 Daniel Aobdia, Preeti Choudhary, and Noah Newberger, *The Economics of Audit Production: What Matters for Audit Quality? An Empirical Analysis of the Role of Midlevel Managers within the Audit Firm,* The Accounting Review, (2024).

138 Brant E. Christensen, Nathan J. Newton, Michael S. Wilkins, *Archival Evidence on the Audit Process: Determinants and Consequences of Interim Effort,* 38 Contemporary Accounting Research 2, (2021).

At least two jurisdictions identify metrics in the area of hours per audit phase for disclosure.[139] Further, we noted that two firms disclose the percentage of audit work completed prior to the company's year end.[140]

Allocation of Audit Hours

Firm-level description: Percentage of total audit hours incurred (i) prior to issuers' year ends and (ii) following issuers' year ends, for the 12-month period ended September 30 for all issuer engagements for which the firm issued an audit report.

Engagement-level description: Percentage of total audit hours incurred (i) prior to the issuer's year end and (ii) following the issuer's year end.

Firm-level calculations:

(i) Percentage of total audit hours incurred prior to issuers' year ends:

$$\frac{\textit{Total audit hours}\text{ incurred prior to issuers' year ends for all issuer engagements}}{\textit{Total audit hours}\text{ for all issuer engagements}}$$

(ii) Percentage of total audit hours incurred following issuers' year ends:

$$\frac{\textit{Total audit hours}\text{ incurred following issuers' year ends for all issuer engagements}}{\textit{Total audit hours}\text{ for all issuer engagements}}$$

Engagement-level calculations:

(i) Percentage of total audit hours incurred prior to the issuer's year end:

$$\frac{\textit{Total audit hours}\text{ incurred prior to the issuer's year end}}{\textit{Total audit hours}}$$

(ii) Percentage of total audit hours incurred following the issuer's year end:

139 *See* Accountancy Europe Report, at 8 and 13 for CMVM (Portugal) and ACRA (Singapore).

140 *See* CAQ Report, at 12 for a summary analysis on firm-level metric examples in the area of audit milestone completion.

$$\frac{\textit{Total audit hours}\text{ incurred following the issuer's year end}}{\textit{Total audit hours}}$$

Example firm-level calculation:

The firm audits seven issuers with various year ends. The hours incurred by the engagement teams during the audits were:

	Issuer's year end	Hours incurred prior to each issuer's year end	Hours incurred following each issuer's year end
Issuer A	December 31	20,415	12,056
Issuer B	December 31	7,856	3,020
Issuer C	March 31	10,583	8,023
Issuer D	June 30	5,570	3,502
Issuer E	March 31	4,508	3,752
Issuer F	December 31	1,575	1,208
Issuer G	December 31	3,301	1,833
Total		**53,808**	**33,394**

$$\frac{\textit{Total audit hours}\text{ incurred prior to issuers' year ends for all issuer engagements}}{\textit{Total audit hours}\text{ for all issuer engagements}}$$

Calculation: 53,808 / (53,808+33,394) = **62%**

$$\frac{\textit{Total audit hours}\text{ incurred following issuers' year ends for all issuer engagements}}{\textit{Total audit hours}\text{ for all issuer engagements}}$$

Calculation: 33,394 / (53,808+33,394) = **38%**

Example firm-level reporting for Form FM:

Allocation of Audit Hours	Percentage of audit hours incurred prior to issuers' year ends for all issuer engagements	**62%**

	Percentage of audit hours incurred following issuers' year ends for all issuer engagements	**38%**

Example engagement-level calculation:

The firm audits Issuer G with a December 31 year end. The hours incurred by the engagement team during the audit were:

	Hours incurred prior to December 31	Hours incurred following December 31
U.S. (lead auditor)	2,015	1,350
Germany	682	265
China	452	163
South Africa	152	55
Total	**3,301**	**1,833**

$$\frac{\textit{Total audit hours} \text{ incurred prior to the issuer's year end}}{\textit{Total audit hours}}$$

Calculation: 3,301 / (3,301+1,833) = **64%**

$$\frac{\textit{Total audit hours} \text{ incurred following the issuer's year end}}{\textit{Total audit hours}}$$

Calculation: 1,833 / (3,301+1,833) = **36%**

Example engagement-level reporting for Form AP:

Allocation of Audit Hours	Percentage of total audit hours incurred prior to the issuer's year end	**64%**
	Percentage of total audit hours incurred following the issuer's year end	**36%**

Questions

45. Is the calculation of the allocation of audit hours to prior to and following the issuer's year end clear and appropriate? Why, or why not?

46. Would a different, more granular, metric be more appropriate, for example allocation of audit hours devoted to each phase of the audit—planning, quarterly reviews, interim field

work, final field work up until report release date, and post-report release date until audit documentation completion date? Why, or why not?

47. Are there other considerations related to the reporting of this metric that would increase its usefulness and comparability (e.g., including a subset of the firm-level metric by industry, by client year end, etc.)?

ix. Quality Performance Ratings and Compensation

Some firms publicly state that their partner compensation policies generally include a connection between indications of the quality of a partner's audit work (e.g., internal or external inspection results and behaviors indicating a commitment to perform high-quality audits) and annual partner compensation adjustments. A commenter on the proposed quality control standard suggested that, because compensation incentivizes behavior, a firm's compensation structure should be aligned with promoting audit quality. Linking compensation to indications of the quality of a partner's audit work may provide strong evidence of the firm's commitment to that goal and may create equally strong incentives for partners.

We believe comparing the relationship between internal firm quality performance ratings and changes in compensation levels could provide evidence of the extent of any correlation between quality performance ratings and compensation, and thereby provide an important signal of the value of a quality commitment for the firm. This metric would capture the extent to which a firm's audit partners' evaluation process distinguishes partners by quality performance rating category by showing the distribution of quality performance ratings across partners. It would also give an indication of the extent to which different quality performance ratings translate into different compensation adjustments.

Furthermore, as suggested by academic literature, disclosing either firm-level compensation policies, or a calculation indicating the realized incentive alignment, would be beneficial in allowing markets to select auditors whose compensation provides better incentives to conduct a high-quality audit.[141]

The metric we are proposing would be based on the quality performance ratings assigned by the firm. If the firm assigns ratings that specifically measure the quality of

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[141] Some academic studies suggest that auditor compensation schemes that are tied to audit quality can incentivize auditors to conduct high-quality engagements. *See*, *e.g.*, Jurgen Ernstberger, Christopher Koch, Eva Maria Schreiber, and Greg Trompeter, *Are Audit Firms' Compensation Policies Associated with Audit Quality?*, 37 Contemporary Accounting Research 218, (2020); Limei Che, John Christian Langli, and Tobias Svanström, *Are Audit Partners' Compensation and Audit Quality Related to their Consulting Revenues?,* 40 Journal of Accounting and Public Policy 106896, (2021); and W. Robert Knechel, Lasse Niemi, and Mikko Zerni, *Empirical Evidence on the Implicit Determinants of Compensation in Big 4 Audit Partnerships*, 51 J. Acc. Res. 349, 351 (2013); Joseph V. Carcello, Dana R. Hermanson, and H. Fenwick Huss, *Going-Concern Opinions: The Effects of Partner Compensation Plans and Client Size*, 19 AUDITING: A Journal of Practice and Theory 67, (2000).

performance on audits, those would be used; otherwise, an overall performance rating would be used.[142] The proposed metric does not specify an annual period (e.g., October - September) that firms would be required to use as the performance evaluation and compensation cycle. Instead, firms would be allowed to calculate this metric based on their own annual performance evaluation and compensation cycle. We recognize that some firms have different categories of partners, for example, equity partners who hold an ownership stake in the firm and non-equity partners who do not. In this proposal, we do not differentiate between equity and non-equity partners and the metric is calculated and reported as one category of partners.

The proposed firm-level metrics would require firms to calculate (i) the distribution of quality performance ratings across partners and (ii) a comparison of average annual compensation adjustments (as a percentage of the average adjustment received by the highest rated group) for partners in each quality performance rating category over a one-year period.

The Concept Release provided various illustrative calculations such as "[p]ercentage of partners and managers, respectively, with exceptional performance ratings on audit quality."[143] To facilitate the calculation for the top or the bottom range of the quality performance rating assigned to partners and managers, it used terms such as "low quality rating" and "exceptional performance ratings on audit quality."

Commenters on the Concept Release, including audit firms and professional associations, generally did not support this metric. One commenter suggested that the metric should be better defined and there could be liability issues if personnel ratings, even on an aggregated basis, were publicly disclosed. Another commenter argued that audit firm disclosure of any issues identified by the PCAOB in this area should be sufficient because this element receives attention as part of the PCAOB's quality control examination, the results of which are described in Part II of the PCAOB's inspection report. Another commenter suggested that the PCAOB gather and analyze privately-held information while maintaining the confidentiality of the sensitive partner performance and compensation information in the future refinement of this metric.

To respond to the concern regarding individual partner information, we are proposing to base the metric on averages, and to require disclosure of relative differences in compensation adjustments (i.e., showing changes as a percentage of the adjustment received by the highest rated group) between groups with different quality performance ratings, rather than requiring disclosure of changes in the amount of compensation received by any group or individual. We are also proposing that the metric would not be required for firms that are

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142 We understand that firms use a variety of different scales for quality performance ratings, such as "Pass/Fail," "High, Medium, or Low," or "1 to 5." For example, a "1 to 5" system has five possible ratings (1, 2, 3, 4, and 5); firms using such a scale would calculate and report required metrics for each of the possible ratings, reporting zero or N/A if a possible rating was not assigned to any partners.

143 *See* Concept Release at A-14.

exempt from the SEC's partner rotation rule,[144] because averaging may not anonymize data for such a small population. Since the metric includes certain information regarding partner evaluations and compensation, we believe it is appropriate to exempt certain smaller firms from this metric to provide a level of anonymity. Those firms would not be required to report this metric but could report it on a voluntary basis. We believe that, together, those provisions would be sufficient to provide adequate anonymity in the reported metrics.

The Concept Release sought comment on whether this metric could be applied to produce comparability among firms, e.g., in terms of definitions of "exceptional performance ratings" and "low quality ratings." The same group of commenters, audit firms and professional associations, responded that definitions could not be applied to produce comparability among firms because the compensation of audit professionals is complex and is dependent upon a variety of factors and work is needed in terms of better defining how to measure "exceptional" and "low" quality ratings across firms. Another commenter stated that the measurement was too subjective and could be gamed for appearance of high quality.

We believe that the metrics we have proposed for quality performance ratings and compensation, which are modified in some respects from the metrics discussed in the Concept Release, would address some of the concerns raised by commenters on the Concept Release. We would not describe how to measure a "low quality rating" or "exceptional performance ratings on audit quality." Instead, we are proposing the firm would use its own quality performance ratings and report (i) the distribution of partners for each category of the quality performance rating and (ii) a comparison of average annual compensation adjustments as a percentage of the adjustment received by the highest rated group. For example, a firm with "1 to 4" rating scale ("1" being the best) would disclose (i) the percentage of partners who received each rating (e.g., 20% were 1-rated, 50% were 2-rated, 20% were 3-rated, and 10% were 4-rated), and (ii) a comparison of average annual compensation adjustments, using the highest rating as a base (e.g., 2% less increase for 3-rated partners, 6% less increase for 2-rated partners, and 10% less increase for 4-rated partners). The metric would give an indication of the extent (if any) to which differences in quality performance ratings translate into differences in compensation.

We are not proposing to require that firms report this metric at the engagement level due to a lack of anonymity. We are not aware of any U.S. registered firms that are publicly reporting this or similar metrics. Other jurisdictions are considering or using similar metrics.[145] The IDW issued a position paper that explains what constitutes audit quality from the

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[144] *See* Regulation S-X Rule 2-01(c)(6)(ii), 17 C.F.R. § 210.2-01(c)(6)(ii). Any accounting firm with less than five audit clients that are issuers (as defined in section 10A(f) of the Exchange Act) and less than ten partners is exempt from the partner rotation requirement.

[145] *See* Accountancy Europe Report, at 6 and 12 for IDW (Germany) and ICAI (India) indicators, respectively.

profession's point of view and how it can be measured and evaluated.[146] The position paper shows which criteria can be relevant when selecting metrics to assess audit quality, including "governance culture - leadership"[147] In addition, the Institute of Chartered Accountants of India requires certain firms to undertake a self-evaluation of audit quality maturity using the *Audit Quality Maturity Model*."[148]

Quality Performance Ratings and Compensation (Firm-level only)

Firm-level description: Provides the potential correlation between the firm's partner quality performance ratings and annual compensation adjustments based on the firm's most recent annual performance evaluation and compensation adjustment process completed during the reporting period. Calculate (i) the distribution of quality performance ratings across the firm's partners and (ii) a comparison of average annual compensation adjustments for the firm's partners in each quality performance rating group.

Note: Firms that are exempt from the SEC's partner rotation rule (i.e., accounting firms that have less than five audit clients that are issuers (as defined in section 10A(f) of the Securities Exchange Act of 1934) and less than ten partners) would be exempt from reporting this metric. *See* Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01(c)(6).

Firm-level calculations:

(i) The distribution of quality performance ratings (for each quality performance rating):[149]

$$\frac{\text{Total number of } \textit{partners} \text{ of the firm who received a specific quality performance rating}}{\text{Total number of } \textit{partners} \text{ of the firm evaluated in the firm's performance cycle}}$$

146 *Id.* at 6.

147 *See* https://www.idw.de/idw/idw-aktuell/idw-veroeffentlicht-positionspapier-zur-kommunikation-ueber-pruefungsqualitaet.html. One of the measurements could be translated as "incentives in the renumeration system to comply with quality of service."

148 *See* *https://resource.cdn.icai.org/71488caq57512.pdf* at 12. "This model lists prescribed competencies, including evaluation of the firm's culture that rewards high performance, "(w)hether the firm has a performance management culture that rewards high performing employees and those who demonstrate high levels of quality and ethics?"

149 Some totals may not add up to 100% due to rounding. Firms would present this metric with the highest quality performance rating at the top and the lowest quality performance rating at the bottom in its reporting. This formula would be used to calculate the distribution of each quality performance rating of the firm.

(ii) A comparison of average annual compensation adjustments (for each quality performance rating):[150]

Step 1 – Calculate the average annual compensation adjustment:[151]

$$\frac{\text{(Total current year compensation of all } \textit{partners} \text{ of the firm who received the specific quality performance rating)} - \text{(Total prior year compensation for the same } \textit{partners}\text{)}}{\text{Total number of } \textit{partners} \text{ of the firm who received the specific quality performance rating in the current year}}$$

Step 2 – Calculate the ratio of the average annual compensation adjustments between the highest quality performance-rated partners of the firm and other partners of the firm who received each performance rating:

$$\frac{\text{Average annual compensation adjustments for all } \textit{partners} \text{ of the firm who received the specific quality performance rating (as calculated in Step 1)}}{\text{Average annual compensation adjustments for all } \textit{partners} \text{ of the firm who received the highest rating}}$$

Example of firm-level calculation:

Firm ABC has 15 partners, and a "1 to 4" quality performance rating system is used (1 being the best). In year 20X3, one partner received a quality performance rating of 1 with a compensation increase of $100K, three partners received a quality performance rating of 2 with an average compensation increase of $80K, and the rest of the partners (11 partners) received a quality performance rating of 3 with an average compensation increase of $49K. No partners received a quality performance rating of 4 in the year 20X3.

- *The distribution of quality performance ratings*

150 Only partners who received compensation and a performance rating in the capacity as a partner during both the current year and the prior year would be included in the calculation.

151 The amounts should be calculated in the firm's functional currency.

In this example, the firm would report 7% ($\frac{1}{15}$ = 6.7%) for quality performance rating of 1, 20% ($\frac{3}{15}$ = 20%) for quality performance rating of 2, 73% ($\frac{11}{15}$ = 73.3%), for quality performance rating of 3, and 0% for quality performance rating of 4. As shown in the table below, the distribution of 7%, 20%, 73%, and 0% (in bold) would be reported in Form FM.

- *A comparison of average annual compensation adjustments*

<u>Step 1</u> - Average annual compensation adjustments

Firm ABC calculates the percentage of average annual compensation adjustments by comparing from prior year (20X2) to current year (20X3). In this example, the average annual compensation for a 1-rated partner was $1,000K in 20X3 and $900K in 20X2; therefore, the average change in compensation for a 1-rated partner was an increase of $100K. Similarly, partners with 2-rated quality performance ratings received an average compensation increase of $80K and partners with 3-rated quality performances rating received an average compensation increase of $49K.

<u>Step 2</u> - The ratio of the average annual compensation adjustments between the highest quality performance-rated partners of the firm and other partners of the firm who received each performance rating.

Firm ABC would calculate the differences in annual compensation adjustments as the partner with the highest quality performance rating being used as a base. The partner with a quality performance rating of 1 represents 100%. The partners with a quality performance rating of 2 would be calculated as $80K divided by $100K to report as 80%. The partners with a quality performance rating of 3 would be calculated as $49K divided by $100K to report as 49%. Since there were no partners with a quality performance rating of 4, it would be reported as N/A. The 100%, 80%, 49%, and N/A would be reported as firm-level metrics.

As shown in the table below, only the comparisons of compensation changes in percentage, 100%, 80%, 49%, and N/A (in bold) would be reported in the Form FM.

Quality perfor-mance rating assigned in 20X3	Number of partners assigned	**Distribution of quality performance ratings**	Average Annual Compen-sation in 20X3	Average Annual Compen-sation in 20X2	Average changes in dollars	**Average annual compensation adjustments (as a % of adjustment for the highest rated group)**

1	1	**7%**	$1,000K	$900K	$100K increase	**100/100 =100%**
2	3	**20%**	$880K	$800K	$80K increase	**80/100 =80%**
3	11	**73%**	$749K	$700K	$49K increase	**49/100 =49%**
4	0	**0%**	N/A	N/A	N/A	**N/A**

Example firm-level reporting for Form FM:

Quality Performance Ratings and Compensation	**Quality performance rating assigned in 20X3**	**Distribution of quality performance ratings**	**Average annual compensation adjustments (as a % of adjustment for the highest rated group)**
	1	7%	100%
	2	20%	80%
	3	73%	49%
	4	0%	N/A

Questions

48. Are the proposed metrics and calculations for quality performance ratings and compensation clear and appropriate? If not, why not? Are there other metrics that would be appropriate? If so, what are they? Is there another way to calculate the correlation between partner performance and compensation? If so, please provide an example.

49. Is the proposal to exempt firms that are exempt from the SEC's partner rotation rule clear and appropriate? If not, why not? Is there a more suitable threshold to exempt smaller firms from reporting this metric? If so, what would be an alternative threshold and why should those firms be exempt?

50. If firms do not have a specific quality performance rating for partners and use an overall performance rating instead, should they be required to indicate the use of an overall performance rating? Is there another way for these firms to report the correlation between partner performance and compensation? If so, what is it?

51. We do not propose to define partner compensation in Section III.B.1. Should the nature (e.g., cash vs. non-cash) or the types (e.g., distributions, bonus, partner draws, etc.) of compensation that should be included or excluded in the calculation be described? Are there any types of compensation that should be excluded? If so, what are they? And why?

52. The proposed metric does not differentiate between equity partners and non-equity partners in calculating and reporting this metric. Should equity partners and non-equity partners be differentiated and reported separately? Alternatively, should the metric only include equity partners? Why or why not?

53. Would it be more appropriate to disclose firm policies relating to partner compensation and how quality performance is measured and incorporated into the firm's policy, rather than reporting the proposed compensation and quality performance rating related metrics? Why or why not?

x. Audit Firms' Internal Monitoring

Information about and results of a firm's internal engagement monitoring activities could provide insight into the performance of a firm's engagements. Understanding this information could be important to audit committees and investors when evaluating the auditor's performance. At the firm level, these users may find it helpful to compare internal issuer engagement monitoring activities over time and across firms, for example, by comparing the percentage of issuer engagements that each firm selected for monitoring.

Information regarding the internal monitoring results of specific engagements may provide audit committees and others with more insight into the auditor's performance. Such information may provide areas for the audit committee and others to ask more detailed questions regarding the audit and the engagement team.

We believe this metric would provide useful information to assist in understanding firms' monitoring processes and results and would also allow for comparisons regarding the volume and nature of engagement deficiencies identified.

A firm's internal monitoring program is designed to improve the quality of firm engagements by identifying engagement deficiencies and remediating such deficiencies so that engagements are performed in accordance with applicable professional and legal requirements. Academic literature supports that a firm's internal monitoring procedures are likely to improve audit quality, similar to the monitoring and deterrence effects identified for PCAOB inspections.

Academic literature also supports that internal engagement monitoring is viewed by audit partners to be worthwhile in improving audit effectiveness.[152]

In calculating these metrics, the firm would use its internally established monitoring cycle, provided that the cycle covers a 12-month period (which is expected to be consistently applied). We believe allowing firms flexibility to use their internally established dates would be appropriate and still provide comparability since all firms would be measuring over a 12-month period.

The proposed firm-level metrics would require firms to calculate the percentage of issuer engagements that were selected for internal monitoring in the cycle (i.e., the number of completed issuer engagements internally monitored, divided by the number of total issuer engagements) and the percentage of those issuer engagements with engagement deficiencies.[153] We understand that there is a wide range of activities that could be described as monitoring of in-process engagements. For that reason, we are proposing to limit these firm-level metrics to monitoring of completed engagements to improve comparability. We believe the information will be useful and comparable over time as long as it is consistently measured.

At the engagement level, the proposed metric would require firms to disclose whether a previous engagement was selected for internal monitoring in the most recently completed monitoring cycle, the year-end date of the engagement subject to review, whether any engagement deficiencies were identified, and the nature of those deficiencies. The nature of the engagement deficiencies would be one of the following: (i) financial statement line item, (ii) disclosure, or (iii) other noncompliance with applicable professional or legal requirements.[154] We are also proposing that certain details be provided about the engagement deficiency, including the area of noncompliance (e.g., specific financial statement line item, disclosure, or area of audit testing deficiency or noncompliance), and the type of deficiency (e.g., controls design or operating effectiveness or deficiency in tests of details or the standard or rule with which noncompliance was identified).

A similar metric was included in monitoring and remediation in the Concept Release. Some commenters supported the inclusion of a metric for Audit Firms' Internal Quality Review Results, but suggested the disclosure would be better included in a firm's transparency report.

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[152] Richard W. Houston and Chad M. Stefaniak, *Audit Partner Perceptions of Post-Audit Review Mechanisms: An Examination of Internal Quality Reviews and PCAOB Inspections*, 27 Accounting Horizons 23, 25 (2013).

[153] The term "engagement deficiency" is used in this proposal as defined in proposed QC 1000, paragraph .A4 ("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").

[154] The term "applicable professional and legal requirements," as used in this rulemaking, has the same meaning as defined in Appendix A of proposed QC 1000.

A commenter referenced support for the metric from academic literature, emphasizing the importance of PCAOB inspection results, enforcement actions and internal quality reviews.

Many of the commenters who commented on a similar metric in the Concept Release did not support a metric for Audit Firms' Internal Quality Review Results, citing concerns that the information may not be comparable or meaningful, may lead to disclosure of confidential information,[155] and may be misleading because internal quality inspections have different purposes and objectives than PCAOB inspections. The Concept Release sought comment on how to compare firms' quality results with PCAOB inspection findings. Two commenters pointed out that the number of deficiencies may not be useful without understanding the substance of those deficiencies. We believe providing the information regarding the firm's engagement monitoring procedures would provide users with an understanding of the extent to which firms monitor their engagements and the nature of the deficiencies they identify.

At least eight jurisdictions identified metrics in the area of firm-level results of audit firms' internal quality reviews.[156] Several jurisdictions also identified a metric related to audit firms' internal quality results at the engagement level,[157] including the FRC which provided a metric for the percentage of internal quality reviews performed for completed audits and the results of those inspections.[158]

Many firms report publicly on information in the area of internal monitoring. These firm-level metrics may include internal inspections, external inspections, peer reviews, or other types of inspection programs disclosed based on quantities of engagements inspected, percentages of compliance, among other metrics, for singular or comparative periods.[159] One firm example provided in a firm-related group's report revealed the number of engagements

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[155] We do not consider the proposed metric to require disclosure of nonpublic or confidential information under Sections 104(g)(2) or 105(b)(5)(A) of Sarbanes-Oxley. First, firms would be required to report information about the nature of an engagement deficiency only at the engagement level; therefore, the proposed disclosure would not include PCAOB-identified "criticisms of or potential defects in" the firm's QC system that are nonpublic under Section 104(g)(2) if addressed to the Board's satisfaction within 12 months of an inspection report. Furthermore, the proposed metric concerns solely internal quality reviews and does not require disclosure of investigation or inspection information subject to Section 105(b)(5)(A). For these reasons, as well as the additional reason that firm-level reporting would consist only of summary data, Sections 104(g)(2) and 105(b)(5)(A) would not apply to the proposed firm-level metrics.

[156] *See* Accountancy Europe Report, at 6, 7, 8, 11, 12, 13, and 14 for IDW (Germany), Quartermasters (Netherlands), CMVM (Portugal), CPAB (Canada), ICAI (India), ACRA (Singapore), and IRBA (South Africa) indicators, respectively. *See also* FRC Report – Definitions Note, at 6.

[157] *See* Accountancy Europe Report at 6, 13, and 14 for IDW (Germany), ACRA (Singapore), and IRBA (South Africa), respectively, for audit firm quality results at the engagement-level.

[158] *See* FRC Report – Definitions Note, at 6.

[159] *See* CAQ Report, at 7.

internally inspected in the previous fiscal year and the percentage of inspections that did not find any deficiencies.[160]

Audit Firms' Internal Monitoring

Firm-level description: Provide, for the firm's most recent internal monitoring cycle completed during the reporting period, (i) the period covered by such internal monitoring cycle, (ii) the percentage of issuer engagements that were selected for internal monitoring in the cycle, and (iii) the percentage of internally inspected issuer engagements where the firm identified an engagement deficiency.

Note: Monitoring, for purposes of both firm-level and engagement-level calculations, is monitoring of completed engagements, not in-process engagements. The firm's internal monitoring cycle used in calculating this metric must cover a 12-month period and is generally expected to cover the same 12-month period every year.

Engagement-level description: Identify whether a previous audit engagement for this issuer was selected for internal monitoring in the firm's most recently completed internal monitoring cycle and, if so, provide (i) the year end of the engagement monitored and (ii) whether the firm identified any engagement deficiencies. If any engagement deficiencies were identified, identify (iii) the nature of the deficiencies (i.e., (a) whether the engagement deficiency relates to a financial statement line item, a disclosure, or other noncompliance with applicable professional and legal requirements,[161] (b) the area of noncompliance, and (c) the type of deficiency (e.g., control design or effectiveness testing, test of details, or the applicable professional or legal requirement with which noncompliance was identified)).

Firm-level calculations:

(i) The period covered by the firm's most recently completed internal monitoring cycle:

Period covered by the firm's most recently completed internal monitoring cycle

(ii) Percentage of issuer engagements selected for internal monitoring:

$$\frac{\text{Total number of issuer engagements internally monitored}}{\text{Total number of issuer engagements}}$$

160 *Id.*

161 The term "applicable professional and legal requirements," as used in this proposal, has the same meaning as defined in Appendix A of proposed QC 1000.

(iii) Percentage of internally monitored issuer engagements where the firm identified an engagement deficiency:

$$\frac{\text{Total number of issuer engagements that had an } \textit{engagement deficiency}}{\text{Total number of issuer engagements internally monitored}}$$

Engagement-level calculation:

Identify whether a previous audit engagement for this issuer was selected for internal monitoring during the firm's most recently completed internal monitoring cycle and, if so, (i) the year end of the engagement monitored, (ii) whether deficiency(ies) was(were) identified, (iii) description of the deficiencies, including (a) the nature of any identified *engagement deficiencies*, (b) the area of noncompliance, and (c) the type of deficiency (e.g., control design or effectiveness testing, test of details, or the applicable professional or legal requirement with which noncompliance was identified).

Example firm-level calculations:

The firm performed internal monitoring of issuer engagements consistent with its quality control monitoring period of September 1, 20X2 to August 31, 20X3, for 20X3 which incorporated some financial statement audits with year ends in 20X2, but the majority, including calendar year ends, were for 20X3.

The firm performs audits of **350** issuer engagements and has 100 partners who serve as engagement partners on those engagements and endeavors to monitor at least one issuer engagement for each partner in a three-year cycle. It also performs monitoring of an engagement for all new partners and issuer engagements and partners where quality concerns have been identified. As a result, the firm performed monitoring activities on **44** issuer engagements during its most recent monitoring cycle.

The results included 35 engagements with no engagement deficiencies and **9** engagements for which an engagement deficiency was identified.

<u>Example calculations</u>

(i) The period covered by the firm's most recently completed internal monitoring cycle:

QC 1000 monitoring period ended 20X3

(ii) Percentage of issuer engagements selected for internal monitoring:

$$\frac{\text{Total number of completed issuer engagements internally monitored}}{\text{Total number of issuer engagements}}$$

Calculation: 44/350 = 12.5% round to **13%**

(i) Percentage of internally monitored issuer engagements where the firm identified an engagement deficiency:

$$\frac{\text{Total number of issuer engagements that had an } \textit{engagement deficiency}}{\text{Total number of issuer engagements internally monitored}}$$

Calculation: 9/44 = 20.5% round to **21%**

Example firm-level reporting for Form FM:

Internal Engagement Monitoring	Period covered by the firm's most recently completed internal monitoring cycle	**September 1, 20X2 to August 31, 20X3**
	Percentage of issuer engagements selected for internal monitoring	**13%**
	Percentage of internally monitored issuer engagements where an engagement deficiency was identified	**21%**

Example engagement-level calculation:

The firm is reporting on Form AP information related to the most recent engagement for Company Y for the year ended December 31, 20X3. The audit of Company Y for the year ended December 31, 20X2 financial statements was selected for internal monitoring in the firm's 20X3 internal monitoring cycle.

The internal monitoring team identified the following when performing its review:

- The engagement team selected for testing a control over PP&E that relied on the use of system-generated reports. The engagement team did not identify and test any controls over the completeness of the system-generated reports used in the operation of these controls. (AS 2201.39)

- In its testing of the fair value leveling of investments, the engagement team failed to perform sufficient procedures to test the presentation and disclosure of those investments in the financial statements. (AS 2810.30)
- The engagement team did not establish an understanding of the terms of the audit engagement with the audit committee, record such understanding in an engagement letter, and provide the engagement letter to the audit committee. In this instance, the engagement team was noncompliant with AS 1301, *Communications with Audit Committees*.

Example engagement-level reporting for Form AP:

<table>
<tr><td rowspan="10">Internal Engagement Monitoring</td><td colspan="2">Previous engagement monitored</td><td colspan="2">Yes</td></tr>
<tr><td colspan="2">(i) Financial statement year end monitored</td><td colspan="2">December 31, 20X2</td></tr>
<tr><td colspan="2">(ii) Deficiency(ies) identified?</td><td colspan="2">Yes</td></tr>
<tr><td colspan="4">(iii) Deficiency description:</td></tr>
<tr><td colspan="2">a. Deficiency related to:

[Select from drop-down]
• Financial statement line item,
• Disclosure, or
• Other noncompliance with applicable professional and legal requirements</td><td>b. Area of noncompliance</td><td>c. Identify type of testing deficiency or area of noncompliance with other applicable professional or legal requirements</td></tr>
<tr><td>1</td><td>Financial statement line item</td><td>PP&E</td><td>Testing of control design or effectiveness</td></tr>
<tr><td>2</td><td>Disclosure</td><td>Fair value</td><td>Test of Details</td></tr>
<tr><td>3</td><td>Other noncompliance with applicable professional and legal requirements</td><td>Communications</td><td>AS 1301, Communications with Audit Committees</td></tr>
</table>

Questions

54. At the firm level, we are proposing to require firms to provide disclosure of (i) the period covered by the firm's most recently completed internal monitoring cycle, (ii) the percentage of issuer engagements selected for internal monitoring, and (iii) the percentage of internally monitored engagements that had an engagement deficiency. Should we also consider providing the actual numbers of engagement deficiencies identified in the firm's most recent monitoring calendar? Why or why not?

55. At the engagement level, firms would be required to disclose whether a previous engagement for the issuer was selected for internal monitoring in the most recently completed internal monitoring cycle and, if so, whether the firm identified any engagement deficiencies related to (1) financial statement line items, (2) disclosures, or (3) other noncompliance with applicable professional and legal requirements. Are these categories appropriate? If not, why not? Should there be additional categories? If so, what should they be and what types of deficiencies should they cover? Provide an explanation of your answer.

56. For each engagement deficiency identified, we are proposing that the areas of noncompliance and the type of testing deficiency or the standard or rule with which the noncompliance was identified also be disclosed. Is this an appropriate level of detail to understand identified deficiencies? Why or why not?

57. For each engagement deficiency identified that relates to (1) financial statement line items or (2) disclosures, we are proposing that the type of testing deficiency be identified (e.g., testing of design or testing of control effectiveness), whereas for deficiencies related to (3) other noncompliance with applicable professional and legal requirements we are proposing that the standard or rule with which the noncompliance was identified also be disclosed. Should we require that the standard or rule with which noncompliance was identified be disclosed in all cases? Why or why not?

xi. Restatement History

Restatements for errors (e.g., not for changes in accounting principles) are generally considered a signal of potential difficulties in at least parts of a firm's audit practice. Academic literature suggests that restatements provide the cleanest empirical measure of audit failure.[162] Overall, we believe the academic literature supports a measure that accumulates the pattern of restatements for firms, as this would provide a strong measure against which other metrics may be identified in the future.

The proposed firm-level metric would require firms to report information related to both revision restatements (sometimes referred to as "little r" restatements) and reissuance restatements (sometimes referred to as "Big R" restatements) of audited financial

[162] *See, e.g.*, DeFond and Zhang, *A Review of Archival Auditing Research*.

statements[163] for all issuer engagements of the firm as well as reissuance restatements of management's report on ICFR. A revision restatement occurs when an immaterial error in previously-issued audited financial statements, that is material to the current period financial statements, is corrected by an issuer in the current period comparative financial statements by restating the prior period information and disclosing the revision.[164] A reissuance restatement of the financial statements occurs when a material error in previously-issued audited financial statements, report on management's assessment of the effectiveness of ICFR, or both, is identified and disclosed by an issuer in a filing with the SEC (e.g., on Form 8-K Item 4.02, Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review).[165] Similarly, a reissuance restatement of management's report on ICFR occurs when a material error in a previously-issued report on management's assessment of the effectiveness of ICFR is identified and disclosed by an issuer in a filing with the SEC.

This metric would be reported for the current reporting period and each of the preceding four years, for a total of five years.[166] This metric only includes those restatements that related to corrections of errors and excludes restatements resulting from changes in accounting principle.

We considered requiring firms to simply report the percentage of restatements for each of the previous five years, but we do not believe this information would be meaningful for all firms. For example, in some cases, depending on how many issuer engagements the firm performs, the individual percentages could be very small. Instead, we are proposing that firms provide the number of issuer engagements for which the firm initially issued audit reports for each 12-month period ended September 30 so that restatement percentages could be calculated.

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[163] The term "restatements" has the same meaning as defined in the FASB Accounting Standards Codification ("FASB ASC") Topic 250, *Accounting Changes and Error Corrections; see also,* "retrospective restatement" as defined in IFRS Accounting Standard (IAS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The phrase "error in previously issued financial statements" has the same meaning as defined in the FASB ASC 250; *see also* "prior period errors" as defined in IAS 8.

[164] The correction in the current period financial statements of errors that were not material to the previously-issued financial statements and are not material to the current period financial statements (e.g., a voluntary restatement or an out-of-period adjustment) would not be considered a "revision restatement" for the purposes of this metric.

[165] *See Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors* (Mar. 9, 2022), *available at* https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922.

[166] Based on an internal evaluation of restatement patterns covering the period from Q1 2008 to Q2 2018 by the PCAOB's Office of Economic Risk and Analysis, 98% of restatements during this period were announced with a delay of approximately five years or less and about 80% of the restatements were announced with a delay of three years or less.

In addition, related to the proposed metric (i)(c) below, reissuances of management's report on ICFR that disclose an additional material weakness or additional elements to a previously disclosed material weakness, would only include those issuer engagements for which the firm issued a report expressing an ICFR opinion, not all issuer engagements of the firm. This is because under Sarbanes-Oxley, the auditor is only required to attest to management's assessment of the effectiveness of the company's internal control for companies that qualify as "large accelerated filers" or "accelerated filers," other than "emerging growth companies."[167] As discussed below in Section III.C.1., we are proposing that firms include all issuer engagements of the firm in the population when calculating firm-level metrics. Since a firm's issuer engagement population would include non-accelerated filers, to which this particular aspect of this metric would not apply, we therefore propose to require firms to include only those issuer engagements for which the firm issued an ICFR opinion. Since restatements are disclosed in the financial statements, we are not proposing to require that firms report this metric at the engagement level.

Restatements may be identified by the auditor related to a previously issued audit report by the firm or by subsequent auditors related to a predecessor's audit report. In these situations, the restatement would be included in the metric of the firm that issued the original audit report on the financial statements or on the audit of ICFR. Firms, in particular those that resign from the engagement or are otherwise replaced, would need to monitor whether previously-issued audited financial statements, reports on management's assessment of the effectiveness of ICFR, or both, are subsequently restated for at least for five years.

In the case of multi-year audits, where one auditor's report covers the audits of multiple years of financial statements, firms should consider each year that is restated as a separate restatement when calculating this metric. In the case of an audit engagement related to an initial public offering, the audit report included in the registration statement filed with the SEC generally includes two years of audited annual financial statements for a smaller reporting company or three years of audited annual financial statements for other reporting companies. For example, an IPO registration statement filed with the SEC in 2023 would need to include 2022, 2021, and (unless the issuer is a smaller reporting company) 2020 audited financial statements. If it is later determined that there were material errors in the financial statements for all three fiscal years, the firm would be required to report all three restatements in the year in which the initial audit report was issued when reporting this metric (2023, in this example).

This metric was included in the Concept Release as the frequency and impact of financial statement restatements for errors. Several commenters on this metric in the Concept Release supported a requirement that firms report this information. Of these commenters, one commenter in particular specifically supported the proposed reporting of ICFR restatements. Other commenters stated that this metric would not provide meaningful information to the public. One commenter stated that this metric could be more useful if it included additional information such as the number of adjustments, average absolute percentage of revenue of

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167 *See* Section 404 of Sarbanes-Oxley, 15 U.S.C. § 7262.

restated amounts, and the number of passed adjustments and the percentage of revenue. One commenter stated that metrics based on the financial statements appeared more within the control of management or others involved in financial reporting than with auditors.

Some firms publicly report information about restatements, such as the number of restatements of the financial statements or reissuances of the report on ICFR, or the percentage of audits that did not involve restatements.[168] We did not identify other jurisdictions that require similar reporting.

Restatement History (Firm-level only)

Firm-level description: For each of the last five 12-month periods ended September 30, provide the following:

(i) The number of audit reports initially issued by the firm during that 12-month period, in connection with which any of the following subsequently occurred:

(a) revision restatement of the financial statements for errors
(b) reissuance restatement of the financial statements for errors
(c) reissuance of management's report on ICFR disclosing an additional material weakness or additional elements to a previously disclosed material weakness.

(ii) Total issuer engagements for which the firm initially issued audit reports during that 12-month period.

(iii) Total issuer engagements for which the firm initially issued audit reports expressing an opinion on internal control over financial reporting during that 12-month period.

Firm-level calculations:

(i) The number of audit reports initially issued by the firm during that 12-month period, in connection with which any of the following subsequently occurred:

(a) *revision restatement* of the financial statements for errors
(b) *reissuance restatement of the financial statements* for errors
(c) *reissuance restatement of management's report on ICFR* disclosing an additional material weakness or additional elements to a previously disclosed material weakness.

[168] *See* CAQ Report, at 8.

(ii) Total issuer engagements for which the firm initially issued audit reports during that 12-month period.

(iii) Total issuer engagements for which the firm initially issued audit reports expressing an opinion on ICFR during that 12-month period.

Example firm-level calculation:

The following is true for Firm X's audit practice for the 12-month periods ended September 30 for the last five years:

- For 09/30/2019, Firm X issued 100 audit reports for its issuer engagements, 30 of which were integrated audits.
- For 09/30/2020, Firm X issued 105 audit reports for its issuer engagements, 35 of which were integrated audits.
- For 09/30/2021, Firm X issued 110 audit reports for its issuer engagements, 40 of which were integrated audits.
- For 09/30/2022, Firm X issued 105 audit reports for its issuer engagements, 35 of which were integrated audits.
- For 09/30/2023, Firm X issued 100 audit reports for its issuer engagements, 30 of which were integrated audits.

During the 12-month period ended September 30, 2023, Firm X had the following restatements for its issuer engagements*:

- 20 revision restatements. These restatements relate to audit reports initially issued during the following reporting periods:
    - 2019 – 8
    - 2020 – 3
    - 2021 – 6
    - 2022 – 3
- 7 reissuance restatements relate to the financial statements. These restatements relate to audit reports initially issued during the following reporting periods:
    - 2019 – 3
    - 2020 – 1
    - 2021 – 2
    - 2022 – 1
- 2 reissuance restatements of management's report on ICFR. These restatements relate to audit reports on ICFR initially issued during the following reporting periods:
    - 2019 – 0
    - 2020 – 0

- 2021 – 1
- 2022 – 1

* Note that for the 12-month period ended September 30, 2023, there were no restatements of audit reports issued during that 12-month period.

Example firm-level reporting for Form FM:

		Audit Report Initially Issued				
		2023	**2022**	**2021**	**2020**	**2019**
Restatement History	Revision restatements of the financial statements for errors	0	3	6	3	8
	Reissuance restatements of the financial statements for errors	0	1	2	1	3
	Reissuance restatements of management's report on ICFR	0	1	1	0	0
	Total issuer engagements	100	105	110	105	100
	Total issuer engagements with audits of ICFR	30	35	40	35	30

Questions

58. Are the proposed descriptions of revision restatement and reissuance restatement clear and appropriate? If not, what descriptions should we use?

59. Is five years an appropriate number of years to require firms to report? If not, what would be the appropriate number of years?

60. Should we require reporting of revision restatements? Why or why not?

61. Are firms currently tracking revision restatements, reissuance restatements, or both for issuer engagements for which the firm issued an audit report? If so, which category of restatements does the firm currently track and for how long does the firm track this information?

62. Do you agree with the proposal to count multi-year audit restatements based on each year impacted by the restatement? Why or why not?

63. Should we also require restatements to be reported at the engagement level on Form AP? Why or why not?

C. Reporting

1. Thresholds for Required Reporting

The Concept Release asked whether smaller audit firms should be treated differently than larger ones in designing a metrics project. Several commenters suggested that metrics could apply to all firms, regardless of firm size. Other commenters suggested that the requirement to report be based on the size of the firm or the size of the companies the firm audits. Certain commenters suggested that investment company audits should be excluded from the project based on the differences between the financial statements and audits of investment companies versus operating companies and because the metrics would not assist shareholders in evaluating investment company audits.

Regarding reporting at the engagement level, several commenters on the Concept Release suggested that any engagement-level metrics should apply to all issuers regardless of size or industry. A commenter suggested that metrics (e.g., training, competence, hours, experience, leverage) are similar for investment companies and employee stock plans as any other public company audit. Another commenter suggested that metrics should not be required to be reported for issuer engagements in certain industries, such as investment companies.

We propose to apply the same threshold for both firm-level and engagement-level reporting. Firm-level reporting would be required of every firm that audits at least one company that has self-identified as an "accelerated filer" or "large accelerated filer" by checking the box on an SEC filing (or, because Form 40-F does not contain such a check box, at least one Form 40-F filer that meets the criteria to be an "accelerated filer" or "large accelerated filer" under SEC rules)[169] during the reporting period. Engagement-level reporting

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[169] *See* Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2. Generally, under Rule 12b-2, a large accelerated filer is an issuer that meets certain reporting conditions and has a public float (aggregate worldwide market value of voting and non-voting common equity held by nonaffiliates) of $700 million or more. An accelerated filer is generally an issuer that meets the same reporting conditions; has a public float of $75 million or more, but less than $700 million; and had revenue of $100 million or more in the most recent fiscal year for which audited financial statements are available.

would be required for every audit of such an accelerated or large accelerated filer. We estimate that the proposed firm-level reporting requirements would apply to approximately 210 firms,[170] including 22 of the top 25 US firms by total firm revenue,[171] and 93% of the 2022 PCAOB annually inspected firms,[172] and that the proposed engagement-level reporting requirements would apply to approximately 3,400 issuer audits, representing 99% of the total market capitalization of issuers reporting on Form 10-K, Form 20-F, and Form 40-F.[173]

As noted above, investors have long expressed interest in additional information about audits and audit firms for use in making investment decisions and exercising oversight over issuers and audit committees. Investors have asserted that the additional information, including firm-level information, would assist them in making decisions such as ratifying the appointment of company auditors, as well as voting in board of directors' elections for members of the audit committee, who have oversight responsibility for the auditor. We believe this rationale primarily applies to accelerated filers and large accelerated filers, the largest reporting companies in the U.S. public markets, where the overwhelming majority of investor capital is at stake. Our preliminary view is that it would be appropriate to focus reporting requirements on the firms and engagements in which investors and other stakeholders have the greatest interest in additional information.

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[170] The data was obtained from Audit Analytics, Standard & Poor's, and publicly available data from the PCAOB's Registration, Annual and Special Reporting (RASR) *available at* https://rasr.pcaobus.org. Firms that filed audit opinions for issuers that met the large accelerated or accelerated filer definition in the 12 months ended September 30, 2023, were included in this number. Large accelerated filer or accelerated filer status was based on the most recently filed quarterly or annual report as of February 10, 2024. Form 40-F issuers that had revenue of $100 million or more in the most recent fiscal year were also included.

[171] *See* Accounting Today, *2024 Top 100 Firms + Accounting's Regional Leaders* (March 2024), for a listing of the top 25 Firms. Based on staff analysis, the three firms in the top 25 firms that would be excluded from the reporting requirements are Aprio, LLP; Carr, Riggs & Ingram LLC; and Citrin Cooperman & Company, LLP.

[172] *See* the 14 firms listed as 2022 Annually Inspected Firms, *available at* https://pcaobus.org/oversight/inspections/basics-of-inspections.

[173] The data was obtained from Audit Analytics, Standard & Poor's, and publicly available data from the PCAOB's Registration, Annual and Special Reporting (RASR) *available at* https://rasr.pcaobus.org. Large accelerated filers, accelerated filers, and Form 40-F filers that had revenue of $100 million or more with an audit opinion issued by firms in the 12 months ended September 30, 2023, were included in this number. Large accelerated filer or accelerated filer status was based on the most recent quarterly or annual filing as of February 10, 2024. Market capitalization was calculated as of December 31, 2023. Because in some instances multiple audit reports are issued in the same year, the total number of audit reports issued during the same time period using the same data source would be approximately 3,500.

We also believe it would be advantageous to apply the same threshold for firm-level and engagement-level reporting, so that all firms that meet the proposed threshold would provide both firm-level reporting and engagement-level reporting on the relevant engagements.[174] This should foster comparability across both issuers and firms and provide richer context for the evaluation of engagement-level information, and would avoid the potential inefficiency associated with reporting only firm-level or only engagement-level information.

Our proposed approach would not provide engagement-level information about audits of issuers that are not accelerated filers or large accelerated filers under SEC rules, such as smaller reporting companies,[175] investment companies,[176] and employee stock purchase, savings, and similar plans that are required to file reports with the SEC on Form 11-K;[177] or about audits of non-issuers, including broker-dealers; and would not provide firm-level information about firms whose PCAOB practice was limited to such audits.[178] We do not believe that the arguments underpinning requests for additional information about audits and auditors would apply, or apply with the same force, in these situations, where shareholder ratification of the appointment of the auditor may not be typical and the proposed metrics would be less likely to assist in investment and voting decisions.

174 It should be noted, however, that data reported at the firm level would not be limited to the engagements for which engagement-level reporting was required. Once a firm met the threshold for reporting firm-level metrics, the firm would have to include all the information called for by each specific metric, which may include information regarding all issuer audits in a firm's practice (including accelerated, large accelerated, and non-accelerated filers; employee stock plans; and some investment companies) and, with respect to some metrics, such as workload, non-issuer audits.

175 *See* Regulation S-K, Item 10(f)(1), 17 CFR §229.10(f)(1).

176 Section 3(a)(1) of the Investment Company Act, 15 U.S.C. § 80a-3(a)(1), defines an "investment company" as an issuer which (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. Audits of business development companies (BDCs) that met the criteria to be an accelerated filer or large accelerated filer would be included.

177 *See* Exchange Act Rule 15d-21, 17 CFR §240.15d-21.

178 Firms that do themselves not serve as lead auditor for an accelerated filer or large accelerated filer but play a substantial role in audits led by other firms would also not be subject to the proposed reporting requirements. *See* PCAOB Rule 1001(p)(ii) for the definition of "play a substantial role in the preparation or furnishing of an audit report."

Firms that did not meet the threshold for required firm-level or engagement-level reporting would not be required to report metrics but could choose to report voluntarily. Firms whose client portfolio changes from year to year may be required to report in some years and not others.

Questions

64. For firm-level metrics, is the threshold for reporting appropriate? If not, what would be an appropriate threshold? For example, should we require a threshold for firms that audit companies of a certain size, market capitalization, or another method?

65. Should smaller firms have different reporting requirements than larger firms? Why or why not? If so, how should the reporting of metrics differ?

66. For engagement-level metrics, is the threshold for reporting appropriate? If not, what would be an appropriate threshold? For example, should we require engagement-level metrics for audits of investment companies (other than BDCs that are accelerated filers or large accelerated filers) or non-accelerated filers? And if so, why?

2. Reporting of Firm-Level Metrics (Form FM)

We are proposing that firms report their firm-level metrics annually on a new Form FM, *Firm Metrics*. We are proposing a new reporting rule, Rule 2203C, *Firm Metrics*, together with new Form FM. The proposed text of Rule 2203C and Form FM, together with the proposed form instructions, is included in Appendix 1.

We are proposing that the information provided by firms on Form FM would be publicly available. As noted previously, some firms produce publicly available audit quality and transparency reports, either voluntarily or in response to the requirements of other jurisdictions, which provide some of the same or similar metrics as we are proposing. Several commenters on the Concept Release suggested that all metrics should be public, while other commenters suggested that metrics should be public only at the firm level. We believe that reporting firm-level metrics publicly on Form FM would provide investors and other stakeholders with useful information about auditors, and will provide a basis of comparison for the engagement-level metrics.

The information disclosed on Form FM would be available in a searchable database on the Board's website, similar to Form AP data. As noted above, in addition to the required firm-level metrics, we are proposing that the firm would be able to provide an optional narrative description to accompany each metric.

As is required for other PCAOB forms, we are proposing to require firms to amend Form FM to correct inaccurate information in a filed Form FM or provide omitted information that should have been included.[179]

We are soliciting comment on whether, in addition to Form FM reporting, some or all of the metrics disclosed on Form FM should also be included in the audit report the firm issues under PCAOB standards. See Section III.C.4 below for a further discussion.

The proposed reporting period for Form FM would generally be the 12-month period ended September 30 in each year. We are proposing September 30 as the end of the reporting period because we believe there may be fewer time pressures at that time, given that most issuers have December, March, or June year ends. As noted above, some of the metrics may provide the firm with flexibility regarding the reporting period covered.

We are proposing that firms would be required to file Form FM on or before November 30, 61 days after the end of the reporting period. We believe this would provide sufficient time for firms to accumulate and calculate the metrics and report to the PCAOB. In addition, November 30 is prior to the calendar year end and the traditional busy period for many firms, which we believe would alleviate any potential resource or time constraints and further benefit firms.

Questions

67. Is September 30 an appropriate reporting date for firm-level metrics with a filing date of November 30? Is there an alternative reporting date that would be more appropriate and if so, what date? Is there an alternative filing date that would be more appropriate and if so, what date?

68. Rather than reporting on Form FM, should firms report firm-level metrics, as of March 31 on Form 2, which is due on June 30? If so, why?

69. Are proposed Rule 2203C, *Firm Metrics*, and proposed Form FM instructions included in Appendix 1, clear and appropriate? If not, why not?

70. Are there certain firm organizational or legal structures that might make reporting certain metrics challenging (e.g., alternative practice structures)? If so, please describe the structure and which metrics would pose a challenge and why.

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[179] The proposed requirements for amendment of Form FM are similar to those that apply to Form 2. *See* https://pcaobus.org/about/rules-rulemaking/rules/form_2; *see also, e.g.,* Staff Questions and Answers Annual Reporting on Form 2, at Q34, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/registration/rasr/documents/staff_qa-annual_reporting.pdf?sfvrsn=5e7259ff_0.

3. Reporting of Engagement-Level Metrics (Form AP)

We propose to require firms to report engagement-level metrics on Form AP, along with the already required disclosure of the name of the engagement partner and information about other firms involved in the audit.[180] We believe that Form AP provides an established mechanism for conveying engagement-level information that is familiar to investors and other stakeholders. Reporting on Form AP would allow access to the engagement-level metrics in a centralized location and would allow for the dissemination of the metrics through already established data channels. Form AP is also downloadable, which would provide users of the information the ability to perform comparisons across engagements, including analyses of the entire Form AP dataset.

Similar to the other information provided on Form AP, we believe that engagement-level metrics should be made available so that they are useful to investors and other stakeholders, while also affording firms sufficient time to compile the necessary data and calculate the metrics. A key consideration in determining the date of Form AP was making the information publicly available before the shareholder vote to ratify the appointment of the auditor. We believe this rationale would also apply to the engagement-level metrics.

We are proposing to add a new section to Form AP for firms to report the required metrics. As noted above, in addition to the specific engagement-level metrics, we are proposing that the firm would be able to provide an optional narrative description to accompany each metric. As proposed, the firm would be able to provide up to 500 characters as part of their narrative description to provide context to facilitate the reader's understanding of the metric. To reflect Form AP's broader content, we also propose to rename it "Audit Participants and Metrics." The proposed text of the Form AP amendments and the form instructions is included in Appendix 2.

Questions

71. Are proposed amendments to Form AP instructions, included in Appendix 2, clear and appropriate? If not, why not?

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[180] *See* PCAOB Rule 3211. Rule 3211 requires the filing of a report on Form AP regarding an audit report the first time the audit report is included in a document filed with the SEC. In the event of any change to the audit report, including any change in the dating of the report, Rule 3211 requires the filing of a new Form AP the first time the revised audit report is included in a document filed with the SEC. If the auditor's report is reissued and dual-dated, the firm is required to file a new Form AP that would reflect the most updated information of the proposed engagement-level metrics (*e.g.*, total audit hours as of the latest audit report date based on the cumulative total audit hours). For most audits, Form AP is due within 35 days after an audit report is first included in an issuer SEC filing. The entire Form AP dataset (updated daily) and data dictionary are available to download in CSV format under the section, "Download the entire data set," at https://pcaobus.org/resources/auditorsearch.

72. Should we require communication of firm-level and/or engagement-level metrics to the audit committee? If so, which ones and why?

4. Inclusion of Metrics in the Audit Report

In addition to the proposed reporting on Form FM and Form AP, we are considering whether some or all of the firm-level and engagement-level metrics, together with any additional narrative that the firm may choose to provide, should also be included in the audit reports the firm issues for audits of large accelerated filers and accelerated filers. For example, this information could be provided at the bottom of the audit report, below the firm's signature, or as an attachment that immediately follows the audit report and precedes the financial statements.

Because the metrics would have to be calculated and reported anyway, we do not believe a requirement to include them in the audit report would impose significant additional costs, and it may provide incremental benefits. The additional disclosure would be directly responsive to our statutory mandate to "further the public interest in the preparation of informative . . . audit reports."[181] It could make the metrics more accessible to investors and other stakeholders who are not aware of the information available on the PCAOB's website or lack the time or resources required to search it, and may also serve to remind auditors that the addressees of the audit report—the shareholders of the company—are one of the key audiences for firm- and engagement-level metric disclosures.

We appreciate that inclusion of metrics in the audit report may raise concerns about the time necessary to gather information and make the required calculations, particularly with regard to engagement-level metrics, and are soliciting specific comment on that issue.

Questions

73. Would it be appropriate for us to require inclusion of some or all firm- and engagement-level metrics in the audit report in addition to PCAOB forms? On what basis should particular metrics be included or excluded?

74. Are there engagement-level metrics for which inclusion in the audit report would not be practicable, given the time needed to gather the data and make the required calculations? If so, which?

75. If we were to require inclusion of metrics in the audit report, is there a specific placement or format that we should require? If so, what should that be (for example, at the bottom of the audit report, below the firm signature, or as an attachment to the report)?

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181 Sarbanes-Oxley Section 101(a).

76. Are there costs associated with inclusion of metrics in the audit report that we have not considered? If so, what are they?

5. Confidential Treatment and Conflicts with non-U.S. Law

i. Requests for confidential treatment not permitted

We are proposing not to allow firms to request confidential treatment for the proposed metrics. Permitting confidential treatment requests would not advance a fundamental purpose of this rulemaking—public disclosure of new information about audits and auditors. Moreover, we believe public disclosure is consistent with Sarbanes-Oxley.[182]

Several commenters on the Concept Release urged that all metrics should be public. One of these commenters suggested that metrics would facilitate the ability of investors to assess the risk of a financial reporting failure and allow investors to compare public companies and the quality of their audits, and would also benefit investors when voting to ratify the appointment of the auditor at shareholder meetings.

Other commenters expressed a variety of concerns about making metrics public. Some commenters suggested that engagement-level metrics should not be public. Several of those, and other commenters, suggested that metrics should be provided to the audit committee instead. A group of audit committee members suggested that investors don't have the context of the full auditor relationship, including qualitative factors, such that metrics alone could actually be misleading to investors or could cause them to draw inappropriate conclusions based on their lack of access to certain qualitative information. One commenter on the Concept Release cautioned that, related to internal quality reviews ("Audit Firms' Internal Monitoring" in the current proposal), careful consideration must be given in providing firm-level information, particularly as it relates to smaller and medium-sized firms, as providing such information may inadvertently result in providing information that is client-specific and possibly confidential. Another commenter stated that while summarizing engagement-specific details into totals by firm or industry groups would help shield confidential company information,

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182 Section 102(e) of Sarbanes-Oxley provides that reports required under that section "shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information." Additionally, it requires the Board to "protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information." Consistent with the approach we have taken in our consideration of confidential treatment requests for information required by our existing forms, we understand "proprietary" to mean a formula, practice, process, or design owned by a particular firm that the firm keeps private for competitive advantage. *See Black's Law Dictionary* (11th ed. 2019) (cross referencing "proprietary information" and "trade secret"). We do not believe any of our proposed metrics would require disclosure of such proprietary information or, based on our experience in this area, that any other law shields the proposed metrics from disclosure.

based on the current definition of client confidentiality, client permission would need to be obtained to use any client-specific engagement data in these measurements.

We thoroughly evaluated the concerns raised by these commenters and believe that our proposal appropriately responds to them. In general, we have designed the metrics with a view to avoiding personally identifiable or client-specific information of the sort that could be protected by law. We would provide firms with the option to provide a narrative description to accompany each metric, which they could use to supply any missing context. And we propose to exempt small firms from reporting that we believe could inadvertently result in the disclosure of personally identifiable information.

Just as we concluded with respect to the information currently required to be disclosed on Form AP, we believe that prohibiting firms from asserting confidentiality with respect to the reporting of the proposed metrics on Form FM and Form AP would further the public interest and would serve to inform investors and other stakeholders. We welcome commenters to bring to the Board's attention anything that would indicate a realistic possibility that any law would prohibit a firm from providing the information.

ii. Assertions of conflicts with non-U.S. law

We acknowledge that there may be certain limitations with respect to the data or information about a firm, its personnel, or the performance of the firm's engagements that a firm may communicate publicly because it may conflict with a non-U.S. law. One commenter in response to proposed QC 1000 stated that certain disclosures related to firm-level or engagement-level metrics may conflict with requirements that may apply to firms outside of the U.S.

In considering whether to allow the opportunity to assert conflicts, the Board has considered both whether it is realistically foreseeable that any law would prohibit providing the required information and, even if it were realistically foreseeable, whether allowing a firm preliminarily to withhold the information is consistent with the Board's broader responsibilities and the particular regulatory objective.[183] In addition, even where the Board has allowed registered firms to assert legal conflicts in connection with other forms, that accommodation does not entail a right for a firm to continue to withhold the information if it is sufficiently important.[184]

Currently, we are not aware of any realistically foreseeable possibility that disclosure of metrics, either at the firm or engagement level, would conflict with applicable law outside the U.S. As a threshold matter, we do not believe that any of the proposed metrics would call for disclosure of personally identifiable information. The proposed firm-level metrics would be based entirely on aggregate and average data. The proposed engagement-level metrics would entail reporting additional information about the engagement partners of audits subject to

[183] *See* PCAOB Release No. 2015-008 at 37; PCAOB Release No. 2008-004 at 36.

[184] *See* PCAOB Release No. 2015-008 at 37; PCAOB Release No. 2008-004 at 37-38 n.38.

engagement-level reporting, but the name of the engagement partner is already publicly available and the additional information is not of the sort typically protected by law. And we have tailored what we believe may be the most sensitive metric—addressing quality performance ratings and compensation—specifically to avoid disclosure of individual data: the metric is required only at the firm level; is based on averages and intra-firm comparisons rather than absolute amounts; and, to assure anonymity, is not required to be reported by firms with fewer than five issuer audits and fewer than ten audit partners.

Accordingly, neither proposed Form FM nor Form AP, as proposed to be amended, provides for firms to assert such a conflict. However, we are soliciting comment regarding whether such provisions would be necessary or appropriate.

Questions

77. Would it be appropriate to allow confidential treatment of any of the metrics required on Form FM or Form AP? If so, which metrics and on what basis?

78. Are there any U.S. or non-U.S. laws that would prohibit reporting the proposed firm-level or engagement-level metrics to the PCAOB or publicly? If so, please describe such laws and the proposed metrics to which it is realistically foreseeable that they would apply. In particular, please identify any metrics that may call for disclosure of personally identifiable information and the type of personally identifiable information that could be required to be disclosed.

D. Documentation

For firm- and engagement-level metrics, the firm would be required to retain documentation in sufficient detail to enable an experienced auditor, having no previous connection with the determination of the metrics, to understand the calculations, the data on which they are based, and the method used to estimate data when actual amounts were unavailable. This is similar to the "experienced auditor" threshold specified in AS 1215, *Audit Documentation*.

Questions

79. Is the proposed documentation requirement clear and appropriate? If not, why not?

E. Potential Additional Firm and Engagement Metrics

In the process of developing this proposal, we considered a number of potential firm- and engagement-level metrics that we are not proposing to require. All of these are discussed in Section IV.D.3.iv below. In three particular areas—training, access to technical resources, and investment in audit infrastructure—we are not proposing metrics at this time but, in light of their potential significance, we are soliciting more specific commenter input.

All of these potential metrics relate to aspects of a firm's ongoing investment in audit quality, which we believe is critically important. However, as discussed in more detail below, in working to develop metrics in these areas we have encountered challenges in defining what to measure and how to measure it, questions about whether metrics would be informative and appropriately free from bias, and concerns about potential unintended consequences.

1. Training

The professional development training auditors receive should enhance their competence and therefore their ability to perform effective audits. Competence encompasses having the knowledge, skill, and ability to perform assigned activities in accordance with applicable professional and legal requirements and the firm's policies and procedures.[185] The competence of an auditor is developed through both practical experience and adequate training.

Licensing requirements for continuing education for public accountants to obtain and retain certification speak to the relationship between quality and appropriate training and education.[186] Additionally, proposed QC 1000, *A Firm's System of Quality Control*,[187] mandates certain training requirements, including with respect to ethics and independence.

The Concept Release included a metric for training hours per audit professional. Professional development training hours are typically those training hours for credit in support of a professional accounting license in the jurisdiction in which the auditor is licensed. (For example, in the U.S., professional development training hours would be synonymous with continuing professional education (CPE) as defined by the *National Association of State Boards of Accountancy* (NASBA).[188]) Several commenters on the Concept Release supported including a metric for training, citing benefits such as improving technical excellence and enabling auditors to provide high-quality services.[189] Some commenters indicated that training hours were an important indicator, particularly if correlated to CPEs, while others focused on the firm's investment in training as an important indicator of a firm's commitment to the growth of its staff. Other commenters mentioned that the amount of training is meaningless without understanding the quality, relevance, or effectiveness of the training provided. One commenter expressed concern about the impact on smaller firms of reporting this metric without

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185 *See* Proposed AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, at 20.

186 *See, e.g.*, https://us.aicpa.org/becomeacpa/licensure.

187 *See* Proposed QC 1000, at 117, 315.

188 *See* https://www.nasbaregistry.org/cpe-requirements.

189 The comment letters received on the Concept Release are available at https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-041-concept-release-on-audit-quality-indicators/comment-letters.

incorporating the differing levels of resources and types of training used by smaller versus larger firms.

Academic literature shows that training in general knowledge areas may not be specifically related to improved audit outcomes,[190] but also provides some evidence that auditors may benefit from specialized training that helps to provide specific skills used to identify risks of material misstatement.[191] However, a large portion of specialized training, including industry-specific training, is documented in the more general field of accounting and auditing by groups such as NASBA.[192] Moreover, quantitative measures such as the number of training hours cannot capture qualitative factors, such as the skill of trainers, the quality and relevance of training content, whether the training is in a specialized area specific to the trainee, and the degree of trainee engagement, that contribute to the effectiveness of training. Therefore, it is challenging to identify a framework for measuring professional development training that aligns to the potential benefits of training.

Metrics we have considered in this area, both at the firm level and the engagement level, include (1) the average total number of CPE hours per professional; (2) average number of CPE hours received by audit professionals in specified fields of study, such as (i) accounting and auditing and (ii) ethics and independence; and (3) CPE compliance rates at the firm or specific to engagement teams. We believe there may be potential benefits to having firms report this information. However, we are concerned that a training metric may be simply uninformative if it shows only that professionals obtain enough hours of training to maintain their licenses. We are also concerned that disclosing such a metric could have unintended consequences, such as encouraging a purely quantitative, "check the box" approach to training, or potentially disadvantaging smaller firms that may support professional development more through hands-on experience than formal training.

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[190] *See, e.g.*, Sarah E. Bonner and Barry L. Lewis, *Determinants of Auditor Expertise*, 28 Journal of Accounting Research 1, 16 (1990); and Josep García-Blandon, María Argilés-Bosch, and Diego Ravenda, *Learning by Doing? Partners Audit Experience and the Quality of Audit Services*, 23 Revista de Contabilidad (Spanish Accounting Review) 197 (2020).

[191] The academic literature provides mixed evidence that auditor training (i.e., as measured by hours of training), relates to overall audit quality. One study found that only specialized, or non-generic audit-knowledge, obtained by training could be beneficial to audit quality. *See* Josep García-Blandon, María Argilés-Bosch, and Diego Ravenda, *Learning by Doing? Partners Audit Experience and the Quality of Audit Services*, 23 Revista de Contabilidad (Spanish Accounting Review) 197 (2020). An older experiment found that specialized indirect experience (i.e., training), resulted in a stronger understanding for the auditor, but had a greater impact of knowledge unrelated to financial statement errors. *See* Ira Solomon, Michael D. Shields, and O. Ray Whittington, *What Do Industry-Specialist Auditors Know?,* 37 Journal of Accounting Research 191 (1999).

[192] *See* https://nasba.org/licensure/maintainingalicense/.

Because of these concerns, we are not proposing to require disclosure of a training metric at this time. However, in light of the critical importance of auditor competence and the importance of training to building and maintaining competence, we continue to consider whether such a metric should be included and are soliciting specific commenter input about how such a metric could be constructed and what the effects of including it would be.

Questions

80. Are there benefits to requiring a training metric at either the firm level or the engagement level that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

a. Would it be useful and appropriate to disaggregate by level for all audit professionals (e.g., partner, manager, and staff), or limit to only certain positions, (e.g., partners)? If so, what levels should be disclosed?

b. Would it be useful and appropriate to include a requirement for training to be disclosed for specific fields of study (e.g., accounting and auditing or independence and ethics, or fraud)? If so, what are they? Is it challenging to accumulate that information? Why or why not?

c. Would it be useful and appropriate to require disclosure of training hours? Or should we measure continuing professional education completion compliance rates instead of or in addition to training hours?

81. Are there other metrics related to training that we have not considered that would provide more useful information than those that we have considered? If so, what are they? Are there ways to capture the qualitative aspects of training in a metric? If so, how?

82. How could the information provided by a training metric be used by investors, audit committees, and other stakeholders? Would reporting a training metric have unintended consequences and, if so, what are they?

2. Access to Technical Resources

A firm's accounting and auditing resources (e.g., national office or equivalent) can enable it to deal with complex questions during an audit. For example, in larger firms, individuals in the national office may provide consultation on complex, unusual, or unfamiliar issues. Smaller firms may consult with others within the firm or engage individuals with such expertise from outside the firm.

Metrics related to audit teams' access to such technical resources and staff could indicate how accessible individuals are to audit teams and the extent to which they are, in fact, used.[193] These measurements could provide a sense of a firm's capacity to resolve complex accounting and auditing issues in an effective way. They could also provide a sense of whether and how a firm promotes consultation and collaboration with others.

Although several firms publicly report on certain aspects of "technical resources," measurability within audit firms and comparability among audit firms present challenges in developing a metric.[194] In particular, we believe there are significant differences between larger firms, which typically have a designated "national office," and smaller firms, which may access technical resources in a variety of other ways.

Moreover, quantitative differences in access to and use of technical resources may not correlate with differences in quality. For example, larger firms may tend to have relatively larger amounts of centralized resources than smaller firms in part because they benefit from economies of scale. Consultations outside the engagement team may be affected by firm-specific factors (such as policies on mandatory consultation on new accounting or auditing matters or concentration of a firm's practice in particular industries) that may not directly relate to quality.

The Concept Release included a metric on the size of a firm's technical audit resources, such as a national office, as a percentage of total audit personnel. Several commenters stated that while access to national office resources was important for engagement teams, it would be challenging to provide meaningful information by presenting a quantitative metric because the number of hours of participation by national office personnel does not provide insight into the specific facts and circumstances that led to that consultation and could have unintended consequences of inappropriately adversely impacting the ability of smaller firms to compete.[195] Another respondent believed that a metric related to national office resources would not be comparable amongst firms given the variety of firm structures.

Metrics we considered in this area at the firm level measured the relative size of a firm's central personnel (or other resources engaged by the firm) available to provide engagement teams with advice on complex, unusual, or unfamiliar issues and the extent to which such

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193 *See* Matthew Sherwood, Miguel Minutti-Meza, and Aleksandra B. Zimmerman, *Auditor's National Office Consultations*, Working Paper (Jan. 5, 2024) (accessed at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4777012).

194 *See, e.g.,* transparency and other quality reports from all GNFs, CohnReznick, Crowe, and RSM. For example, some firms reported total number of national office resources at partner and managing director level while others report total number of consultation with technical resources, total hours contributed by national office resources, and/or ratio of number (or FTE equivalent) of partner and managing directors to client-facing audit partner and managing directors.

195 The comment letters received on the Concept Release are available at https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-041-concept-release-on-audit-quality-indicators/comment-letters.

resources were used in the firms' engagements. Metrics that were considered at the engagement level focused on consultations that were performed with professionals outside of the engagement team on difficult or contentious matters.

However, after consideration and due to the variety of ways firms provide technical resources, we believe that metrics related to this area would likely not be informative or comparable for all firms. We also have a concern that some possible metrics could have unintended consequences; for example, requiring reporting on consultations outside the engagement team may disincentivize such consultations as it could be interpreted to imply that the team lacks the necessary competence to perform the audit, potentially impairing audit quality. Therefore, we are not proposing to require disclosure of these metrics, but we are soliciting additional commenter input.

Questions

83. Are there benefits to requiring a metric at the firm level specific to technical resources that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

84. Would it be useful and appropriate to require disclosure of firm- and engagement-level metrics specific to use of the firm's national office resources? If so, how would such information be used?

a. "National office" is not a defined term and may have different meanings at different firms. How should "national office" be defined?

b. Would it be useful and appropriate for a metric regarding national office involvement include every consultation (e.g., required or voluntary) or should a distinction be made between types of consultations? If so, how should that distinction be made?

c. Would a firm-level metric indicating the percentage of audit engagements that have consulted with the national office be appropriate and useful? Why or why not? Would an engagement-level metric indicating the number of consultations performed by the engagement team be appropriate and useful? Why or why not?

d. How would such a metric work at firms that do not have a national office or equivalent? Should such firms provide information regarding consultations with others inside or outside the firm?

3. Investment in Audit Infrastructure

Metrics related to investment in audit infrastructure (that is, a firm's processes, and technology) could provide information on the resources that audit teams have available to them. A firm's investment in audit infrastructure can demonstrate its commitment to audit quality. Defining the expenditures that represent such investment, however, is difficult. Investment in audit technology can produce better audits, but it is sometimes designed to streamline procedures to improve efficiency in a way that does not improve audit effectiveness. And not all investments succeed; firms can expend considerable amounts of time and resources on processes or technologies that do not yield significant improvements.

A metric on investment in audit infrastructure was included in the Concept Release. Commenters generally suggested that such a metric should only be applicable at the firm level. Although one commenter stated that information about investments in infrastructure could be useful,[196] other commenters said that concerns over comparability outweighed benefits of quantitative disclosure. Some were also concerned that large investments in infrastructure could reflect a lack of a sustained, continuous commitment to investment.

Metrics we considered in this area were primarily at the firm level and were focused on the expenditures that firms self-identified as being in support of audit quality either in total or on a per headcount basis.

We are concerned that a metric related to investment in audit infrastructure would face a number of challenges. There would be challenges in measurability because it would be difficult to define what costs are meaningful for firms to report. The amount of spending on technology alone is likely not helpful without context, so it is not clear that reporting would generate comparable or usable information. It is not clear that spending on technology always translates into significant improvements in the audit. Finally, smaller firms may be disadvantaged compared to larger firms.

Therefore, we are not proposing to require disclosure of a metric on investment in audit infrastructure. However, we are soliciting additional comment to assist our continued consideration.

Questions

85. Are there benefits to requiring a metric at the firm-level specific to investment in infrastructure that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

86. Are there other metrics related to investment in infrastructure that we have not considered that would provide more useful information than those that we have considered?

87. How would investment in infrastructure be defined?

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[196] The comment letters received on the Concept Release are available at https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-041-concept-release-on-audit-quality-indicators/comment-letters.

88. Are there specific considerations or other unintended consequences that we should take into account regarding the potential disadvantages of requiring such a metric for smaller firms?

IV. ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its standard setting. This economic analysis describes the economic baseline, need, and expected economic impacts of the proposal, as well as alternative approaches considered. Because there are limited data to quantitatively estimate the economic impacts of the proposal, much of the Board's economic analysis is qualitative. However, where feasible, the economic analysis incorporates quantitative information, including analysis of internal PCAOB data, publicly available data, and academic literature.

A. Baseline

This section establishes the economic baseline against which the impact of the proposal can be considered. Section II describes important components of the baseline, specifically a discussion of current firm-level disclosure requirements, engagement-level requirements, voluntary reporting practices, and actions in other jurisdictions relevant to this proposal. Below, we highlight information presented in Section II most relevant to the economic baseline and provide additional academic references and statistics.

Current PCAOB rules and standards do not require registered firms to publicly disclose firm or engagement-level metrics, as considered in the proposal. As discussed in Section II.A.3, firms are currently required to publicly disclose some information related to the firm and its engagements in a variety of PCAOB forms (e.g., Form AP, Form 2). Usage statistics suggest that the public actively seeks out the information contained in these forms. For example, PCAOB usage statistics show that during calendar year 2023, there were close to 7.4 million page views, and just over 23,000 unique visitors, for PCAOB's registration, annual and special reporting (RASR) Web service that provides public access to firm filings, including Forms 1, 2, 3, 4, and AP.[197] Additionally, in 2023 there were over 333,000 unique searches performed on PCAOB's AuditorSearch Web service and the Form AP dataset was downloaded over 2,000 times.[198]

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[197] The RASR database can be found on the PCAOB's website (https://rasr.pcaobus.org/Search/Search.aspx). The usage statistics may underestimate actual public interest because investors, researchers, auditors, audit committees, and issuer management may source PCAOB information through external third-party data service providers—such as Ideagen's Audit Analytics. However, they may also overestimate actual public interest to some extent because the usage statistics include internal PCAOB users.

[198] Information related to usage statistics can be found on the PCAOB's website (https://pcaobus.org/resources/auditorsearch).

In addition to the information that the firm makes public through required form filings, the PCAOB provides firm-level public disclosure through firm inspection reports.[199] For the 2023 calendar year, firm inspection reports were downloaded approximately 113,000 times. Academic research suggests that audit committees use the information contained in PCAOB inspection reports.[200] Additionally, some academic research suggests that PCAOB inspection reports provide useful information to investors.[201] However, some research suggests that institutional investors may not be aware of or find value in PCAOB inspection reports.[202]

Information related to auditor legal proceedings—e.g., pursuant to SEC enforcement actions—is also publicly available.[203] However, due to the investigation and litigation process, engagement-specific information may be publicly available only after a substantial lag. Academic researchers have also used a variety of publicly available firm and engagement-level proxies for audit quality including audit firm size, issuer restatements, and industry specialization.[204]

As discussed in Section II.A.4, some large U.S. audit firms voluntarily publicly disclose certain firm-level information through their firm transparency reports—e.g., general discussions of turnover rates, independence policies and practices, or aggregated staff headcounts. However, staff found that the metrics are not uniform or comparable across firms. Furthermore, staff found that firms rarely voluntarily publicly report engagement-level metrics.

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199 Firm inspection reports can be found on the PCAOB's website (https://pcaobus.org/oversight/inspections/firm-inspection-reports).

200 *See*, *e.g.*, Daniel Aobdia, *The Impact of the PCAOB Individual Engagement Inspection Process—Preliminary Evidence*, 93 The Accounting Review 53, 53 (2018) (finding that "the client is more likely to switch auditor" when offices or partners receive a Part I auditing deficiency).

201 *See*, *e.g.*, Nemit Shroff, *Real Effects of PCAOB International Inspections*, 95 The Accounting Review 399 (2020) (finding, using a sample of foreign companies, that companies enjoy greater access to capital when their auditor's PCAOB inspection report does not include Part I deficiencies).

202 *See*, *e.g.*, Center for Audit Quality, *Perspectives on Corporate Reporting, the Audit, and Regulatory Environment* (Nov. 2023) (finding that most institutional investors interviewed were unaware of PCAOB inspections reports, and to the extent investors were aware, found the report results to be expected) and Clive Lennox and Jeffrey Pittman, *Auditing the Auditors: Evidence on the Recent Reforms to the External Monitoring of Audit Firms*, 49 Journal of Accounting and Economics 84 (2010) (finding that companies do not perceive that the PCAOB's disclosed inspection reports are valuable for signaling audit quality).

203 *See, e.g.*, the SEC's *Accounting and Auditing Enforcement Releases available at* https://www.sec.gov/divisions/enforce/friactions.

204 *See*, *e.g.*, Daniel Aobdia, *Do Practitioner Assessments Agree with Academic Proxies for Audit Quality? Evidence from PCAOB and Internal Inspections*, 67 Journal of Accounting and Economics 144 (2019); Jere R. Francis, *A Framework for Understanding and Researching Audit Quality*, 30 AUDITING: A Journal of Practice & Theory 125 (2011); and DeFond and Zhang, *A Review of Archival Auditing Research*.

Audit committees can receive other information through sources not available to the public. Auditing standards and PCAOB and SEC rules require specific communications from auditors to audit committees regarding a variety of matters related to the audit engagement. For example, under AS 1301, the auditor is required to communicate to the audit committee *inter alia* (1) all critical accounting policies and practices to be used; (2) a description of the process management used to develop critical accounting estimates; and (3) significant risks identified during the auditor's risk assessment process.[205] Moreover, audit committees may obtain information under other disclosure requirements—e.g., Section 10A reports, where the auditor must report to the issuer's board of directors, in certain situations, related to illegal acts at an issuer.[206] In exercising their oversight responsibilities, audit committees may also request more firm- or engagement-specific information from their auditor. For example, audit committees may seek information from the auditor about PCAOB inspections, including information not contained in the PCAOB's public inspection reports.[207]

Audit firms, partners, and engagement teams have developed reputations based on the public and non-public information discussed above, as well as audit committees' direct experience with them. Through surveys and interviews with audit committee members, one study concluded that the firm's reputation for industry experience and the audit partner's accessibility, ability to address accounting issues on a timely basis, and ability to liaise with the firm's national office are the key characteristics that audit committees consider when selecting an auditor.[208] This finding suggests that audit committees currently use information like some of the proposed metrics (e.g., industry experience and workload).

We believe many firms internally track some information related to the proposed metrics. One commenter on the Concept Release stated that they believe that many firms are using the 28 AQIs identified in the Concept Release at some level to (1) manage the firm and (2) manage the quality of audits at the office level and at the engagement level. Three U.S. global network firms (GNFs) stated in their comments on the Concept Release that they track some of the proposed metrics discussed in the Concept Release for monitoring purposes.[209] Information

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205 *See* Section II.A.3.ii for additional discussion related to audit communications with audit committees. *See also* Section 10A(k) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j-1k and Rule 2–07 of Regulation S-X, 17 CFR § 210.2–07.

206 *See*, *e.g.*, Section 10A of the Exchange Act, 15 U.S.C. § 78j-1.

207 *See Information for Audit Committees About The PCAOB Inspection Process,* PCAOB Rel. No. 2012–003 (Aug. 1, 2012).

208 *See, e.g.*, Elizabeth D. Almer, Donna R. Philbrick, and Kathleen H. Rupley, *What Drives Auditor Selection?*, 8 Current Issues in Auditing A26, A27 (2014).

209 The six global networks that contain the largest number of registered, non-U.S. firms as reported on Form 2 filed in 2023 are: BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative,

gathered by staff in 2018 and 2019 pursuant to PCAOB oversight activities indicate that U.S. GNFs generally had identified and were tracking performance metrics at both the firm and engagement level. At the firm level, U.S. GNFs generally tracked PCAOB inspection history, restatements, voluntary turnover rates / retention rates, partner to staff ratios / professionals by level, average partner workload, and investment in audit quality. At the engagement level, U.S. GNFs generally tracked distribution of engagement hours during the year, partner workload and utilization, partner years of experience (by industry, level, or issuer), engagement leverage, engagement milestone compliance, involvement in pre-issuance review programs, and use of IT and other specialists. One firm tracked audit hours performed at SSCs. Though this information suggests that a significant amount of information is collected by the U.S. GNFs at both the firm and engagement levels, one academic study suggests that partners seldomly use metrics related to audit quality when evaluating the quality of their work or the work of their colleagues.[210]

Lastly, as discussed in Section III.C.1, staff estimates that approximately 210 firms would be subject to the proposed firm-level disclosure requirements, including 22 of the top 25 U.S. firms by 2023 total firm revenue and 93% of the 2022 annually inspected firms. Approximately 3,500 issuer audits would be subject to the proposed engagement-level disclosures, covering approximately 99% of the total market capitalization of issuers reporting on Form 10-K, Form 20-F, and Form 40-F.

Questions

89. Have we appropriately described the baseline? If not, how can we improve the analysis?

90. Is the literature cited for the baseline fairly represented? If not, please explain.

91. Are there additional studies or data that would inform our analysis of the baseline? If so, please direct us to them and explain how they would inform the analysis.

B. Need

This section discusses the economic problem to be addressed and explains how the proposal would address it. In general, two observations suggest that there is an economic need for the proposal:

- Investors and audit committees cannot easily observe the services performed by auditors. This restricts (1) audit committees' ability to more efficiently and

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and PricewaterhouseCoopers International Limited (the member firms of these networks are collectively referred to herein as "GNFs").

210 *See*, *e.g.*, Marion Brivot, Mélanie Roussy, and Maryse Mayer, *Conventions of Audit Quality: The Perspective of Public and Private Company Audit Partners*, 37 Auditing: A Journal of Practice & Theory 51, 68 (2018).

effectively monitor and select auditors as well as (2) investors' ability to more efficiently and effectively ratify the appointment of the auditor and allocate capital. As a result, there is a risk that auditors will not supply an efficient level of assurance to the market.[211]

- Furthermore, there is a lack of incentive for firms to meet the market demand for accurate, standardized, and decision-relevant information.[212] As a result, auditors are not supplying the market with an efficient level of information. Indeed, information about audit engagements and firms that would allow (1) audit committees to more efficiently and effectively monitor and select auditors and (2) investors to more efficiently and effectively ratify the appointment of the auditor and allocate capital, as sought by the market, is often limited or difficult to obtain.

The proposal would help address these problems in two primary ways:

- First, the proposal would require certain firms to publicly report specified metrics relating to certain audits and their audit practices. The proposed metrics would aid investor and audit committee decision making.

- Second, the proposal would impose standardized calculations and require regular public reporting of those metrics. The resulting comparability would further aid investor and audit committee decision making.

Importantly, we note that the proposed metrics are not intended to be used in isolation to ascertain audit quality at an audit firm or for an audit engagement because audit quality is driven by a complex array of factors beyond those that can be addressed by metrics.

1. Problem to be Addressed

i. Allocative Inefficiency in the Market for Audit Services

Auditors have a responsibility to provide reasonable assurance about whether issuers' financial statements are free of material misstatement. Reliable financial statements help investors evaluate issuers' performance and monitor management's stewardship of investor capital. However, because audits possess many of the attributes of a credence good, investors may find it challenging to evaluate the quality of the services provided by auditors. As a result,

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211 An efficient allocation of resources occurs when total surplus is maximized. Total surplus is maximized when the good or service in question is supplied until the marginal benefit is equal to the marginal cost. *See* N. Gregory Mankiw, *Principles of Economics* 146-148 (6th edition 2008).

212 Given the considerations in Sections IV.C.1 and IV.C.2, it appears reasonable to assume that this lack of incentive for firms to provide such information is likely to cause the apparent undersupply of information, rather than the cost of providing the information being greater than the social benefit.

the lack of transparency into the audit process could enable auditors to act on their private incentives and under-audit or deploy auditor resources insufficiently.[213] Similarly, investors may have limited visibility as to whether auditors are efficiently allocating their time and resources. As a result, auditors may engage in the practice of over-auditing (i.e., in which the engagement team undertakes more procedures than they otherwise might have performed and that do not efficiently contribute to forming an opinion on the financial statements).[214] In effect, there is a risk that auditors will not supply an efficient level of service to the market. While we acknowledge that audit quality is difficult to observe, the Board's oversight activities indicate that room for improvement exists.[215]

The issuer's board of directors is generally required to establish an audit committee that is statutorily entrusted to appoint, compensate, and oversee the work of the auditor.[216] However, audit committees may focus on the interests of current shareholders rather than the broader public interest (e.g., market confidence, potential future shareholders, or investors in other issuers). Furthermore, there are risks that the audit committee may not monitor the auditor effectively. For example, the auditor may seek to satisfy the interests of management rather than investors if management is able to exercise influence over the audit committee's supervision of the auditor.[217] Such circumstances can lead to a *de facto* principal-agent relationship between company management and the auditor.

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[213] *See*, *e.g.*, Monika Causholli and W. Robert Knechel, *An Examination of the Credence Attributes of an Audit*, 26 Accounting Horizons 631, 633 (2012) (discussing how audits have attributes of a credence good, namely the outcome of an audit is unobservable and the auditor is best informed regarding how much effort is necessary to perform the audit).

[214] *See id,* at 632.

[215] *See, e.g.*, *Spotlight Staff Update and Preview of 2022 Inspection Observations* (July 2023), *available at* https://pcaobus.org/resources/staff-publications (discussing the "concerning trend" in "the percentage of audit engagements reviewed that are expected to be included in Part I.A of an inspection report").

[216] Companies whose securities are listed on national securities exchanges are generally required to constitute an audit committee. *See* Section 301 of Sarbanes-Oxley; Section 10A(m)(2) of the Exchange Act. As an additional safeguard, the auditor is also required to be independent of the audit client. *See* Regulation S-X Rule 2-01, 17 C.F.R. § 210.2–01; *see also* PCAOB Rule 3520.

[217] *See, e.g.*, Joshua Ronen, *Corporate Audits and How to Fix Them*, 24 Journal of Economic Perspectives 189 (2010) (explaining that audit committee members are paid by the company and can be dependent on top company management for a variety of benefits, including referrals as a possible member on the board of directors and audit committees of other companies); Liesbeth Bruynseels and Eddy Cardinaels, *The Audit Committee: Management Watchdog or Personal Friend of the CEO?*, 89 The Accounting Review 113 (2014) (finding that companies whose audit committees have "friendship" ties to the CEO purchase fewer audit services and engage more in earnings management); Cory A. Cassell, Linda A. Myers, Roy Schmardebeck, and Jian Zhou, *The Monitoring Effectiveness of Co-Opted Audit*

As a result, investors have an important, albeit indirect, role overseeing the work of both the auditor and the audit committee. Indeed, while the audit committee more directly oversees the auditor, most publicly traded companies allow investors to vote to ratify the appointment of the auditor. This mechanism allows investors to voice their preferences on auditor selection.[218] However, a lack of transparency into the audit process may leave investors unable to make well-informed decisions when voting on selections made by the audit committee or on re-election of audit committee members to the board of directors.[219] Figure 2 illustrates oversight relationships pertinent to this proposal. The dotted line indicates that investors' oversight relationship with the auditor is less direct than the audit committee's.

Committees, 35 Contemporary Accounting Research 1732 (2018) (finding that the likelihood of a financial statement misstatement is higher and that absolute discretionary accruals are larger when audit committee co-option, as measured by the proportion of audit committees who joined the board of directors after the current CEO's appointment, is higher); and Nathan Berglund, Michelle Draeger, and Mikhail Sterin, *Management's Undue Influence over Audit Committee Members: Evidence from Auditor Reporting and Opinion Shopping,* 41 AUDITING: A Journal of Practice & Theory 49 (2022) (finding that greater management influence over audit committee members is associated with a lower propensity of the auditor to issue a modified going concern opinion to a distressed company under audit and with increased opinion shopping behavior).

[218] Shareholder ratification of the appointment of the auditor is not statutorily required in the U.S. and in many cases the ratification vote is non-binding. However, according to Audit Analytics, accessed on Mar. 1, 2024, in 2023, ratification votes were held by 2,802 distinct companies included in the Russell 3000 index, which comports with other estimates that indicate between 80 and 95 percent of companies hold votes on ratification proposals as part of their proxy process. *See also* ACAP Final Report, at VIII.20 (finding that 95 percent of S&P 500 companies and 70-80 percent of smaller companies put ratification proposals to an annual shareholder vote) and Lauren M. Cunningham, *Auditor Ratification: Can't Get No (Dis)Satisfaction*, 31 Accounting Horizons 159, 161 (2017) (finding that more than 90 percent of a sample of Russell 3000 companies voluntarily include a ratification vote on the ballot). We note that broker discretionary voting is permitted on ratification proposals and ratification proposals may be used as a mechanism by some companies to achieve a quorum to conduct an annual meeting as a result of brokers exercising discretionary votes.

[219] The IAG indicated in their comment letter regarding proposed QC 1000 that investors need information to make better decisions when voting to ratify the appointment of the auditor and the election to the board of directors of the Chair or members of the audit committee.

Figure 2. Oversight relationships pertinent to the proposal

ii. The Market for Information Related to Auditors and their Engagements is Inefficient

Supply-Side Problems

Some basic economic theories suggests that high-quality companies have an incentive to voluntarily disclose information to the extent it allows them to differentiate themselves from low-quality competitors.[220] However, such theories do not account for several countervailing incentives that likely limit voluntary disclosure among audit firms in practice. For example, firms may be deterred by the costs they would incur privately, such as how their competitors could leverage the disclosures to capture market share.[221] There may also be no mechanism for firms to credibly disclose certain non-verifiable or difficult to verify information, which can lead to the failure of such information markets to exist entirely.[222] There could also be a status-quo bias

220 *See*, *e.g.*, Kip W. Viscusi, *A Note on "Lemons" Markets with Quality Certification*, 9 The Bell Journal of Economics 277 (1978).

221 *See*, *e.g.*, *id.*; Oliver Board, *Competition and Disclosure*, 57 The Journal of Industrial Economics 197 (2009) (finding that companies may be reluctant to voluntarily disclose in competitive markets); and Daniel A. Bens, Philip G. Berger, and Steven J. Monahan, *Discretionary Disclosure in Financial Reporting: An Examination Comparing Internal Firm Data to Externally Reported Segment Data*, 86 The Accounting Review 417 (2011) (finding that companies provide fewer segment disclosures due to proprietary costs or competitive concerns).

222 *See* Akerlof, *The Market for "Lemons."*

whereby a firm prefers to continue a non-disclosure policy despite investors' calls for additional information.[223] Limited competition for the largest issuers could also reduce the largest firms' incentives to voluntarily disclose information. Finally, firms may tend to underprovide information due to the positive externalities[224] conferred by comparable and uniform public disclosures.[225]

Auditors could in principle supply information to investors and audit committees individually depending on their unique preferences. However, the costs to the firm to do so would grow with the number of interested investors and audit committees and the extent of information they would request.

Demand-Side Problems

While investors may seek to acquire information from the issuer, they could incur significant private costs in doing so.[226] Further, the company may need to publicly disclose any information provided on a selective basis. [227] Hence the potential benefits of the information to an individual investor would be dissipated because all other investors would have the same information and any informational advantage would be lost. This would further reduce individual investors' incentives to obtain the information. A free-rider problem thus exists among investors in which the costs incurred by one or more investors to convince firms to disclose information would not be shared by all investors who benefit from the disclosure.[228] As a result, there will be an under-provision of such information relevant to investors.

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[223] There are a variety of reasons why individuals may choose the *status quo* outcome in lieu of an unknown outcome, including aversion to the uncertainty inherent in moving from the *status quo* to another option. For additional discussion on status quo bias, *see* William Samuelson and Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 Journal of Risk and Uncertainty 7 (1988).

[224] *See* Mankiw, *Principles of Economics* 196 ("An externality arises when a person engages in an activity that influences the well-being of a bystander but neither pays nor receives any compensation for that effect… If it is beneficial, it is called a positive externality.").

[225] *See, e.g.*, Anat R. Admati and Paul Pfleiderer, *Forcing Firms to Talk: Financial Disclosure Regulation and Externalities*, 13 The Review of Financial Studies 479 (2000) (discussing how individual firms "internalize less than fully the social value of the information they release") and George Loewenstein, Cass R. Sunstein, and Russell Golman*, Disclosure: Psychology Changes Everything*, 6 Annual Review of Economics 391, 397 (2014).

[226] *See, e.g.*, Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 Journal of Financial Economics 610 (2013).

[227] *See* Regulation Fair Disclosure, 17 C.F.R. § 243.100(b)(1)(iv).

[228] *See* Mankiw, *Principles of Economics* 220 and 222 ("A free rider is a person who receives the benefit of a good but avoids paying for it... A free-rider problem arises when the number of beneficiaries is large and exclusion of any one of them is impossible.").

As discussed in Section IV.A, audit committees are already privy to certain information about their auditors beyond what is publicly available. In particular, audit committees could request the proposed metrics from their auditors or other tendering auditors. However, that information would not necessarily be comparable with other engagements. Requesting comparable information from multiple auditors could be burdensome or even impracticable. As a result, while the audit committee can use information from their auditor to better understand their current engagements, the audit committee likely has a limited view as to how other engagements—such as those of their peers—might be conducted. Furthermore, less effective audit committees may not be aware of the information and therefore would not request it in the first instance. If audit committees were aware of the information and made such a request, some audit firms may resist providing it to avoid the costs of gathering the information and potential negative reputational effects.

Evidence

Due in part to the problems discussed above, there is currently limited information available to investors specifically related to audit engagements. Indeed, investors know the least about the audit engagement, as they are less involved in the issuer's operations compared to management, the board of directors, and the audit committee—and are even further removed from the audit process. Over the last decade and a half, there have been sustained requests from investors for increased transparency into the audit process. As discussed in Section II, investor-related groups have requested increased disclosures at the firm and engagement levels—notably in the form of easily accessible and quantifiable metrics, potentially with accompanying context provided by the auditor. Furthermore, the ACAP Final Report recommended that the PCAOB, 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 requiring auditing firms to publicly disclose those indicators."[229]

There would likely be a significant cost to investors to conduct an exhaustive search of all existing publicly available information related to audit performance. For example, gathering the information could require an investor to process various types of data from various sources. Only the largest institutional investors likely have the economies of scale to profitably gather this information.[230] Further still, the presence of significant block holdings by diversified, passive investment-style funds, which often do not hold board seats, means that such information may not be provided by audit firms to a significant control group in cases where

[229] *See* ACAP Final Report, at VIII:14.

[230] Some research suggests that institutional investors are better-informed than retail investors. *See*, *e.g.*, Cory A. Cassell, Tyler J. Kleppe, and Jonathan E. Shipman, *Retail Shareholders and the Efficacy of Proxy Voting: Evidence from Auditor Ratification*, Review of Accounting Studies 75 (2022) and cites therein.

the fund managers do not hold a board seat.[231] Even proxy advisors rely upon relatively limited publicly available information in making voting recommendations, which investors may then rely upon in their own decision making.[232] Due to the lack of information currently available, audit committees and investors may need to wait several years before they have sufficient information to evaluate their auditor.

As described in the baseline, a small group of auditors voluntarily disclose some firm-level information through firm transparency reports.[233] However, many smaller firms do not voluntarily release transparency reports and for those that do provide such information, the metrics are not uniform or comparable across firms. Furthermore, staff found that firms rarely voluntarily report engagement-level metrics publicly. Some research on audit firm transparency reporting in foreign jurisdictions suggests that the information is not useful while other research finds that disclosure requirements improve audit quality for impacted firms.[234] Some academic studies find that, because the information contained in transparency reports is relatively unregulated, the disclosures and contextual discussion lack uniformity and comparability across or within audit firms.[235] Pointedly, audit firms could alter the methodology and construction of any metric they voluntarily choose to disclose. A lack of uniformity means

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231 *See, e.g.*, Amir Amel-Zadeh, Finoa Kasperk, and Martin C. Schmalz, *Mavericks, Universal, and Common Owners – The Largest Shareholders of U.S. Public Firms*, SSRN Electronic Journal, (2022).

232 *See, e.g.*, Cunningham, *Auditor Ratification* 163.

233 Audit firm transparency reports are voluntary and unregulated disclosures, as they are not required by PCAOB standards or applicable U.S. law. Consequently, audit firms can disclose metrics of their own choosing and construction. In practice, as discussed in Section II, audit firms that do publish transparency reports disclose metrics that are required in reports pursuant to disclosure rules in other jurisdictions, such as in the European Union (i.e., EU — No 537/2014 Article 13), or similarly adopted domestic requirements in the UK under the FRC's authority (i.e., the Companies Act of 2006, and Statutory Auditors and Third Country Auditors Regulations of 2016).

234 *See, e.g.*, Financial Reporting Council (FRC), *Transparency Reporting: AQR Thematic Review*, (Sept. 2019) (finding that surveyed investors and audit committee chairs are either unaware of or perceive limited use in audit firm transparency reporting in the U.K.) Rogier Deumes, Caren Schelleman, Heidi V. Bauwhede, and Ann Vanstraelen, *Audit Firm Governance: Do Transparency Reports Reveal Audit Quality?*, 31 AUDITING: A Journal of Practice & Theory 193, 194 (2012) (finding that EU audit firm transparency reporting is not associated with proxies for audit quality); and Shireenjit K. Johl, Mohammad Badrul Muttakin, Dessalegn Getie Mihret, Samuel Chung, and Nathan Gioffre, *Audit Firm Transparency Disclosures and Audit Quality*, 25 International Journal of Auditing 508 (2021) (finding that a requirement for audit firm transparency reporting in Australia led to an improvement in audit quality for the impacted entities).

235 *See, e.g.*, Sakshi Girdhar and Kim Klarskov Jeppesen, *Practice Variation in Big-4 Transparency Reports*, 31 Accounting, Auditing & Accountability Journal 261 (2018) (finding that "the content of transparency reports is inconsistent and the transparency reporting practice is not uniform within the Big-4 networks").

that the voluntary disclosures have limited comparative value, inhibiting their usefulness in allowing investors to evaluate the efficacy of their auditors.

2. How the Proposal Would Address the Need

i. Mandatory Disclosure of Metrics

The proposal would address the need by requiring mandatory public disclosure of metrics relating to auditors and audit engagements. Under the proposal, auditors would have the opportunity to discuss the context of their metrics. The proposal would thus reduce opacity in the audit market and reduce frictions in the information market, thereby enhancing (1) audit committees' ability to efficiently and effectively monitor and select auditors as well as (2) investors' ability to efficiently and effectively make decisions about ratifying the appointment of their auditors and allocating capital. The proposed metrics would quantify various aspects of firms' audit practice as a whole and engagements performed. As proposed in Section III.C, the collective history of these proposed metrics would be publicly available. Moreover, as noted in Section II.A.2.iii.a.(2), the proposed metrics would be subject to requirements designed to ensure their accuracy, including certification by the firm and, if proposed QC 1000 is adopted and approved, specific quality control requirements.

Investors and audit committees could use the proposed metrics to better understand how their auditor has conducted their engagement and how that compares to how other engagements were conducted.[236] Pointedly, the proposal would provide audit committees with additional information that would be useful to them in engaging in active discussions with their current auditors regarding the audit process and in interviewing candidate auditors when or if a replacement auditor is desired.[237] Audit committee disclosures indicate that some audit committees consider a variety of public and nonpublic information when engaging their auditor.[238] The information would also inform investors' auditor appointment ratification decisions. Research finds that investors are more likely to challenge auditor appointments when they have access to certain information about the firm, which suggests that, in some cases, investors would use standardized information across firms and over time to make better

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[236] *See*, *e.g.*, Brant E. Christensen, Steven M. Glover, Thomas C. Omer, and Marjorie K. Shelley, *Understanding Audit Quality: Insights from Audit Professionals and Investors*, 33 Contemporary Accounting Research 1648 (2016) (finding that surveyed investors believe many of the metrics discussed in the 2015 Concept Release are perceived by the majority of respondents as being associated with audit quality).

[237] *See, e.g.*, AICPA, *Hiring a Quality Auditor* 9, (2018) (discussing how audit committees should obtain all necessary information from the auditor).

[238] *See*, *e.g.*, CAQ, *2023 Audit Committee Transparency Barometer*, 15-18 (2023) (presenting examples of audit committee disclosures that summarize the information the audit committee considered when appointing the auditor).

decisions.[239] Furthermore, investor-related groups have indicated that they use the information contained in Form AP. This suggests that the proposed engagement-level metrics on Form AP would also be useful to investors.

By mandating public disclosure, the proposal would ameliorate the positive externality problem associated with public disclosure. Moreover, because these proposed metrics would be public, the increased reputational risk they bring for auditors may, in turn, create incremental incentives for auditors that would be subject to the proposed requirements to maintain their reputation, or face a loss of business, thereby increasing accountability. Public disclosure would also solve investors' free-rider problem by eliminating the need for a private actor to force firms to disclose.[240]

While we believe the proposed metrics would help reduce opacity in the audit market and reduce frictions in the information market, we note that the proposed metrics would not be direct measures of audit quality. Audit quality is an abstract concept, and there is no single comprehensive measure of audit quality. Audit quality is a conceptual framework designed to describe the characteristics of, and participants in, audit engagements in which the auditors are more likely to identify and report material misstatements. Or, more broadly, audit quality reflects all of the components of the audit that align with desirable outcomes.[241] The desired

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239 *See*, *e.g.*, Paul Tanyi, Dasaratha Rama, and Kannan Raghunandan, *Shareholder Ratification of Auditors after PCAOB Censures*, SSRN Electronic Journal (2021) (finding that first-time PCAOB censures of the largest accounting firms are associated with a higher percentage of shareholders not voting to ratify the appointment of the firm after the censure); Suchismita Mishra, K. Raghunandan, and Dasaratha V. Rama, *Do Investors' Perceptions Vary with Types of Nonaudit Fees? Evidence from Auditor Ratification Voting*, 24 Auditing: A Journal of Practice and Theory 9 (2005) (finding that the SEC's requirement for companies to disclose partitioned information about tax and other non-audit fees paid to a company's independent audit firm had a positive association with the proportion of votes against ratifying the appointment of the firm in 2003); Paul N. Tanyi, Dasaratha V. Rama, and K. Raghunandan, *Auditor Tenure Disclosure and Shareholder Ratification Voting*, 35 Accounting Horizons 167 (2021) (finding that in the case of companies with long (short) auditor tenure, the proportion of shareholder votes against ratifying the appointment of the auditor increased (decreased) after PCAOB mandated public disclosure of auditor tenure). We note that research also indicates that retail investors may not necessarily use information regarding an audit firm in their decisions to vote on a proposal to ratify the appointment of the firm. *See, e.g.,* Cassell, et al., *Retail Shareholders* (finding that, on average, shareholder votes against ratifying the appointment of the firm are not associated with audit failures but are associated with investment performance). However, the same study also suggests that non-retail investors are relatively better informed.

240 For additional discussion of the role of mandatory disclosure as a regulatory tool, *see, e.g.*, Admati and Pfleiderer, *Forcing Firms to Talk*; and John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 Virginia Law Review 717 (1984).

241 For a review of various definitions and discussions of the latent attributes of audit quality, *see*, Robert W. Knechel, Gopal V. Krishnan, Mikhail Pevzner, Lori B. Shefchik, and Uma K. Velury, *Audit*

outcomes of the framework depend (to some extent) upon the stakeholders involved, even if there are certain consistent areas of focus. As a result, the proposed metrics cannot directly *measure* audit quality. And they are not intended to do so, as—without additional context—it is unlikely they can be interpreted directly as measurements of audit quality. The proposed metrics are not intended to imply that an increase (decrease) in a particular metric, or a group of metrics, necessarily relates to an increase (decrease) in audit quality. Lastly, we do not believe that the proposed metrics, individually or taken together, could be appropriately used in isolation to ascertain audit quality at an audit firm or for an audit engagement. For example, some of the most important elements of a high-quality audit, such as application of due care and professional skepticism, are not capable of being measured and quantified directly.

ii. Uniform and Comparable Metrics

In addition to mandating disclosure, the proposal would also specify the data sources and calculations for each proposed metric and require their disclosure in PCAOB forms in an electronic, structured data format. Collecting and reporting information in this manner would enhance the usefulness of the information to investors and audit committees by allowing them to more easily access the information and compare firms and engagements.

Questions

92. Have we appropriately described a problem and how the proposal would address the problem? If not, how can we improve the analysis?

93. Is the literature cited for the need fairly represented? If not, please explain.

94. Are there additional studies or data that would inform our analysis of the need? If so, please direct us to them and explain how they would inform the analysis.

C. Economic Impacts

This section discusses the expected benefits, costs, and potential unintended consequences of the proposal. The magnitudes of the benefits and costs are likely to be affected by the degree to which firms have already voluntarily adopted disclosure practices that are similar to those required under the proposal or produce similar metrics for non-public purposes. As discussed in Section IV.A, as of the 2018 and 2019 inspection years, the U.S. GNFs already track some metrics like those being proposed. Though their practices may have evolved since then, we believe they would need to gather additional information (e.g., SSC hours) or adjust their calculations. We believe the proposal would have a greater impact on smaller firms which likely have less developed practices in this area.

Quality: Insights From the Academic Literature, 32 Auditing: A Journal of Practice & Theory 385, 387-388 (2013).

1. Benefits

The proposed metrics would enhance (1) audit committees' ability to efficiently and effectively monitor and select auditors as well as (2) investors' ability to efficiently and effectively make decisions about ratifying the appointment of their auditors and allocating capital. Moreover, there would likely be improvements to the PCAOB's oversight programs (i.e., selection of firms, engagements, and focus areas for review), as well as to policy research. As an important indirect benefit, the proposal could further spur competition to the benefit of investors. These impacts could improve audit quality.

Since auditors have a responsibility to provide reasonable assurance about whether the financial statements are free of material misstatement, higher audit quality could increase the likelihood that the auditor would discover a material misstatement or would qualify its audit opinion when a material misstatement exists and is not corrected by management. The SEC may not accept the financial statements when the auditor's report is qualified. Furthermore, a qualified audit opinion may evoke negative market reactions. For these reasons, higher audit quality could incentivize issuers to take steps to ensure their financial statements are free of material misstatement. Issuers could take these steps proactively, prior to the audit, or in response to adjustments requested by the auditor. Financial statements that are free of material misstatement are of higher quality and more useful to investors.[242]

In the following discussion, we discuss the direct benefits related to enhancing the information available to investors, audit committees, and the PCAOB and follow up with a discussion of the potential indirect benefits. We then review the extant literature related to the proposed metrics and examine how each proposed metric would contribute to achieving the proposal's intended benefits.

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[242] We note three caveats. First, some theoretical research finds that changes to auditing standards can have counterintuitive effects on audit quality. For example, some research finds that increased precision in auditing standards can reduce audit quality. *See* Marleen Willekens and Dan A. Simunic, *Precision in Auditing Standards: Effects on Auditor and Director Liability and the Supply and Demand for Audit Services*, 37 Accounting and Business Research 217 (2007). Other research finds that setting a higher minimum bar can reduce audit quality. *See* Pingyang Gao and Gaoqing Zhang, *Auditing Standards, Professional Judgment, and Audit Quality*, 94 The Accounting Review 201 (2019). We acknowledge that these studies examine the impacts of audit performance standards. By contrast, we are proposing a disclosure standard. This may limit the relevance of these studies to the proposal. We are also unaware of empirical evidence that directly tests these theories. Second, the conclusion that financial statements that are free of material misstatement are more useful to investors hinges on the assumption that investors value compliance with the applicable financial reporting framework (e.g., U.S. GAAP). The various market reactions to restatements that have been documented in academic literature suggests that this is the case. Third, the conclusion that improved audit quality would improve financial reporting quality assumes that issuers would not switch to sufficiently lower quality auditors in sufficient number as a result of the proposal.

i. Direct Benefits to Investors, Audit Committees, and the PCAOB

The direct benefits of the proposal relate to (1) improved investor and audit committee monitoring, (2) improved auditor selection, and (3) improved PCAOB oversight and scholarly auditing research.

We note that the benefits of mandatory disclosure are well-studied and have been measured in other markets such as credit ratings, health care, and financial reporting.[243] Likewise, the benefits of comparable information have been observed in financial reporting.[244] There are important similarities between the markets for credit ratings, health care, and financial reporting and the audit market. For example, credit ratings services, like audit services, are opaque and operate under an "issuer-pays" business model. Therefore, the impacts of disclosure observed in those markets provide some indication of the potential impacts the proposal would have on the audit market. However, there are also significant differences. For example, the quality of health care services may, in some cases, be more visible than the quality of audit services. These differences limit the relevance of these studies.

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[243] For example, in the context of credit ratings, research has found that the introduction of additional credit ratings information into the market leads relatively higher quality borrowers to obtain lower borrowing costs by 20 basis points. *See* Tony Tang, *Information Asymmetry and Firms' Credit Market Access: Evidence from Moody's Credit Rating Format Refinement*, 92 Journal of Financial Economics 325 (2009). In the context of nursing home care, one study finds that mandatory disclosure of quality indices leads to improvement in two of the five indices. *See* Dana B. Mukamel, David L. Weimer, William D. Spector, Heather Ladd, and Jacqueline S. Zinn, *Publication of Quality Report Cards and Trends in Reported Quality Measures in Nursing Homes*, 43 Health Services Research 1244 (2008). For a discussion of potential benefits of mandatory financial reporting quality as well as potential unintended consequences, *see* Christian Leuz and Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research,* 54 Journal of Accounting Research 525 (2016) and cites therein. However, some research also finds that mandatory disclosure can have little effect. For example, in the context of HMOs, one study finds that, following the introduction of public disclosure of six quality scores, only one—customer satisfaction—subsequently drove HMO market share and the effect was most pronounced in markets where true quality varied the most. *See* Leemore Dafny and David Dranove, *Do Report Cards Tell Consumers Anything They Don't Already Know? The Case of Medicare HMOs*, 39 The Rand Journal of Economics 790 (2008).

[244] *See, e.g.*, Mark L. DeFond, Xuesong Hu, Mingyu Hung, and Siqi Li, *The Impact of Mandatory IFRS Adoption on Foreign Mutual Fund Ownership: The Role of Comparability*, 51 Journal of Accounting and Economics 240, 241 (2011) (finding that greater financial reporting comparability leads to greater investment); Luigi Zingales, *The Future of Securities Regulation*, 47 Journal of Accounting Research 395 (2009) (concluding that a more subtle benefit of disclosure regulation is the standardization it entails); and Bingyi Chen, Ahmet C. Kurt, and Irene Gunnan Wang, *Accounting Comparability and the Value Relevance of Earnings and Book Value,* 31 Journal of Corporate Accounting & Finance 82 (2020) (finding that "accounting comparability increases the value relevance of earnings, but not book value").

We also note that the benefits of prior PCAOB disclosure rules vary by rule and analysis.[245] There are important similarities between these disclosure rules and the proposal. For example, CAM reporting and Form AP reporting requirements were significant changes in auditor reporting and the proposed engagement-level disclosures would be reported on Form AP. Therefore, the results of these studies provide some indication of how the proposed metrics would impact the audit market. However, there are also significant differences between prior PCAOB disclosure rules and the proposal. For example, the proposal would likely require firms to gather more engagement-level information than CAM and Form AP reporting requirements do. These differences limit the relevance of these studies.

a. Improved Monitoring

The proposal would increase the set of information available to audit committees and investors regarding their auditor. This would improve both investors' and audit committees' ability to monitor their auditors.[246] For example, an audit committee could engage in more meaningful discussions with their auditor regarding the auditor's performance and potential future work.[247] In response to improved monitoring, auditors may improve audit efficiency as well as audit outcomes as they become more responsive to investors' and audit committees' audit service needs. This could in turn lead to lower audit fees, improved audit quality, and

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245 *See*, *e.g.*, Michael J. Gurbutt and Wei-Kang Shih, *Staff White Paper: Econometric Analysis on the Initial Implementation of CAM Requirements*, Public Company Accounting Oversight Board 4 (2020) (discussing how PCAOB staff did not find "systematic evidence that investors respond to the information contents in CAMs" but nevertheless did find that "some investors are reading CAMs and find the information beneficial."); Kose John and Min Liu, *Does the Disclosure of an Audit Engagement Partner's Name Improve the Audit Quality? A Difference-in-difference Analysis*, 14 Journal of Risk and Financial Management 1 (2021) (suggesting that there was an increase in audit quality and audits costs as a result of Rule 3211); and Lauren M. Cunningham, Chan Li, Sarah E. Stein, and Nicole S. Wright, *What's in a Name? Initial Evidence of US Audit Partner Identification Using Difference-in-Differences Analyses*, 94 The Accounting Review 139 (2019) (finding evidence that any immediate impact of PCAOB Rule 3211 on audit quality or audit fees is limited to specific dimensions of audit quality, specific control groups, and/or specific company characteristics).

246 For a discussion of the same principle, but in the context of issuer financial reporting, *see*, *e.g.*, Leuz and Wysocki, *The Economics of Disclosure and Financial Reporting Regulation* (explaining that the disclosure of operating performance and governance arrangements by public companies can lower the cost of monitoring by providing investors with useful benchmarks that help investors evaluate other companies' managerial efficiency or potential agency conflicts).

247 One study reviewed the comment letters to the 2015 Concept Release and found that audit firms agreed with the notion that audit committees may benefit from enhanced dialog between the auditor and the audit committee. *See* Kathleen M. Harris, and L. Tyler Williams, *Audit Quality Indicators: Perspectives from Non-Big Four Audit Firms and Small Company Audit Committees*, 50 Advances in Accounting 1 (2020).

improved financial reporting quality.[248] The proposal could also reduce costs related to information gathering that would be incurred by investors and audit committees when monitoring their auditor. Some of the cost reductions could reflect reductions in duplicative work to the extent that various investors or audit committees collect the same information.

Two caveats could limit the potential benefit of improved audit performance through improved investor and audit committee monitoring and reduced monitoring costs. First, we note that this impact would be limited by the fact that audit committees are able to request information like the proposed metrics from their auditor. Indeed, one survey of audit committee members from smaller public companies reports that most of the survey participants believed there were no "gaps" in the information they were receiving from their audit firms.[249] However, we believe that, by making these disclosures mandatory and standardized across firms and engagements, the proposal would increase the accessibility and comparability of information about auditors and their engagements. For example, audit committees would be better able to compare their auditors to potential new auditors. Second, the benefit of improved monitoring of auditors could also vary depending on the abilities of the audit committee. For example, more proactive audit committees with greater financial or audit expertise may be able to make better use of the proposed metrics than other audit committees. However, under the proposal, investors may vote for re-election to the board of audit committee members who have the appropriate skillset to be able to effectively use the proposed metrics when executing their oversight responsibilities.

In addition to monitoring the auditor's performance, the proposed metrics would assist investors in monitoring and evaluating the choices of the audit committee. For example, investors could observe audit committee performance and express any potential concerns

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[248] *See, e.g.*, Bengt Holmström, *Moral Hazard and Observability*, The Bell Journal of Economics 74 (1979) (finding that efficiency improves when contractable information about an agent's performance is available to the agent's principal) and Mai Dao, K. Raghunandan, and Dasaratha V. Rama, *Shareholder Voting on Auditor Selection, Audit Fees, and Audit Quality*, 87 The Accounting Review 168 (2012) (finding evidence that shareholder involvement in firm selection is associated with higher audit fees and improved audit quality). Some research suggests that audit committees with financial expertise are more effective monitors (i.e., financial reporting quality improves). To the extent that providing additional information to audit committees is analogous to increasing their expertise, this suggests that the proposal could lead to more effective audit committee monitoring. *See* Dina El Mahdy, Jia Hao, and Yu Cong, *Audit Committee Financial Expertise and Information Asymmetry*, Journal of Financial Reporting and Accounting (2022). In principle, improved monitoring could lead to a reduction in the overall quality of audit services. For example, some issuers may seek lower audit fees at the expense of audit quality. Due to the fact that the proposed disclosures would be public, we believe, in most cases, this would be less likely. *See* Section IV.C.1.ii for additional discussion. Some issuers may have very strong financial reporting quality independent of their auditor (e.g., they have a lender with strong oversight). In these cases, the most suitable auditor may not necessarily be the "highest quality" auditor and overauditing may be more of a concern than underauditing.

[249] *See* Harris and Williams, *Audit Quality Indicators* Table 6.

through open dialogues with the board of directors or election of board and audit committee members. The audit committee is responsible for overseeing the auditor and the proposed metrics may assist investors in determining whether the audit committee was effective in this capacity (e.g., whether the audit committee continues to delay replacing the auditor despite the presence of metrics that indicate potentially poor audit performance). This improved monitoring could improve audit committee effectiveness (e.g., more effective monitoring of the auditors, better selection of auditors, etc.).[250]

Mandatory disclosure of the proposed metrics could also improve audit firms' internal monitoring of its (1) audit practices and related system of quality control, and (2) individual engagements. This could improve governance, accountability, and overall quality control within the audit firm. The proposed metrics may also help auditors identify efficiencies or room for improvement in their audit approach by comparing their proposed metrics to their competitors'.

b. Improved Auditor Selection

The proposal would also enhance auditor selection by improving the ability of investors and audit committees to compare their current auditor to an alternative auditor to determine which one could be a better fit. When considering an alternative auditor, audit committees may find the auditor's engagement-level metrics for similar engagements (e.g., an issuer of similar size to the audit committee's issuer) most useful. As discussed in Section III.C, investors

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[250] Some academic research suggests that audit committee effectiveness is associated with audit committee incentives. *See*, *e.g.*, Jeffrey Cohen, Ganesh Krishnamoorthy, and Arnold M. Wright, *The Corporate Governance Mosaic and Financial Reporting Quality*, 23 Journal of Accounting Literature 87 (2004) and cites therein. Some research suggests that investors are willing to pay for audit committee effectiveness and hold audit committees accountable for negative audit quality. *See, e.g.*, Ellen Engel, Rachel M. Hayes, and Xue Wang, *Audit Committee Compensation and the Demand for Monitoring of the Financial Reporting Process*, 49 Journal of Accounting and Economics 136, 138 (2010) (suggesting a willingness by companies to deviate from the historically prevalent one-size-fits-all approach to director pay in response to increased demands on audit committees and differential director expertise) and Suraj Srinivasan, *Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements and Audit Committee Members*, 43 Journal of Accounting Research 291 (2005) (concluding that audit committee members bear reputational costs for financial reporting failure). Some research suggests that audit committee members without Big 4 audit experience are more likely to favor auditors that are rated as "attractive." *See*, *e.g.*, Baugh, Matthew, Nicholas J. Hallman, and Steven J. Kachelmeier, *A Matter of Appearances: How Does Auditing Expertise Benefit Audit Committees When Selecting Auditors?*, 39 Contemporary Accounting Research 234 (2022). Together, this research suggests that audit committee effectiveness could respond to improved investor monitoring. Other research suggests that audit committee effectiveness is positively associated with proxies for audit quality. *See*, *e.g.*, Brian Bratten, Monika Causholli, and Valbona Sulcaj, *Overseeing the External Audit Function: Evidence from Audit Committees' Reported Activities*, 41 Auditing: A Journal of Practice & Theory 1 (2022) (finding that the strength of audit committee oversight, as implied by audit committee disclosures, is positively associated with proxies for audit quality).

and audit committees could electronically search for firm-level metrics and download engagement-level metrics when constructing rosters of candidate auditors. Moreover, audit committees would benefit by being able to engage in more meaningful discussions and interviews with candidate auditors during the selection process—improving the efficiency of auditor-issuer matching.[251] For example, the proposed metrics could help audit committees select an auditor that has the capacity to perform the audit.[252] Requiring mandatory, comparable, and uniform disclosure of the proposed metrics—across engagement teams and audit firms, and over time—would further enhance this benefit as it would allow audit committees to compare auditors on a common basis.[253] The proposal would also improve investors' decision-making regarding auditor ratification.[254] For instance, investors may decide that a particular proposed metric is especially important to their views on the auditor's efficacy and the quality of the financial statements.[255] Investors that rely on proxy advisors would also likely benefit from the proposed disclosures as proxy advisors could use the information in their recommendations.

Improved auditor selection could improve audit efficiency as well as audit outcomes as incoming auditors may be better equipped to meet investors' and audit committees' audit service needs. This could in turn lead to lower audit fees, improved audit quality, and improved financial reporting quality. As investors and audit committees use the proposed metrics to monitor and select their auditor, they would, over time, reveal their preference for certain aspects of the audit process that are described by the proposed metrics. Eventually, as auditors react to these preferences and adapt the audit services they provide, there could be additional

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[251] *See, e.g.*, Gene M. Grossman and Carl Shapiro, *Informative Advertising with Differentiated Products*, 51 The Review of Economic Studies 63 (1984) (finding that reduced information frictions (i.e., decreased informational advertising costs) could result in improved matching between sellers and buyers).

[252] Some academic research finds that audit committees do select auditors based on observable aspects of the quality of their services. *See, e.g.*, Vivek Mande and Myungsoo Son, *Do Financial Restatements Lead to Auditor Changes?*, 32 Auditing: A Journal of Practice & Theory 119 (2013).

[253] *See* preamble to Section IV.C.1.i for discussion of academic literature related to the benefits of comparability in financial reporting.

[254] Some research suggests that more informed shareholders make better audit ratification decisions (e.g., auditor ratification decisions are more closely associated with public signals of audit failure). *See*, *e.g.*, Cassell, et al., *Retail Shareholders* and cites therein.

[255] Some experimental research suggests that investors are less likely to support auditor ratification if metrics like those discussed in the 2015 Concept Release are trending downward. *See, e.g.*, J. Owen Brown and Velina K. Popova, *How Do Investors Respond to Disclosure of Audit Quality Indicators?*, 38 AUDITING: A Journal of Practice & Theory 31, 47 (2019).

improvements in audit quality and financial reporting quality. [256] The proposal could also reduce costs related to information gathering that would be incurred by audit committees when selecting their auditor and by investors when voting to ratify the appointment of the auditor. Some of the cost reductions could reflect reductions in duplicative work to the extent that various investors or audit committees collect the same information.

Two caveats could limit the potential benefit of improved auditor selection and the reduction in the associated information gathering costs. First, we note that the impact would be limited by the fact that audit committees could in principle request information like the proposed metrics from alternative auditors. However, we believe that, by making these disclosures mandatory and standardized, the proposal would increase the accessibility and comparability of information available and therefore help audit committees. Second, we note that, to the extent that benefits are derived from the ability to readily switch between auditors with less-advantageous metrics to auditors with more-advantageous metrics, those benefits could be limited due to stickiness in existing auditor-audited company relationships which creates switching costs. Furthermore, large multinational issuers may, as a practical matter, need a GNF auditor, which limits the pool of available alternatives—which may be in turn further limited by auditor geographic/industry specialization (e.g., a need for financial services expertise in a particular office/city), or by auditor independence rules (e.g., the existence of an independence-impairing financial or consulting relationship between the issuer and a potential alternative auditor).[257] Therefore, the benefit of improved auditor selection could be more limited for the largest issuers. However, we believe that the proposed metrics could also help the audit committees of the largest issuers select specific partners within the larger audit firms.

c. Benefits to the PCAOB's Inspection and Enforcement Programs and Scholarly Auditing Research

The proposed metrics are expected to provide direct benefits to the PCAOB's internal operating effectiveness. In the PCAOB's oversight capacity, it engages in inspection and enforcement activities for audits of issuers and, in the course of doing so, it uses data from issuers and audit firms. The proposed metrics would expand the basis on which selections are made. For example, the proposed metrics could improve the selection models used to aid in predicting negative audit outcomes, such as restatements or the potential for audit deficiencies. The enforceable validity that would be afforded by proposed QC 1000, if adopted

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[256] In principle, improved auditor selection could lead to a reduction in the overall quality of audit services. For example, some issuers may seek lower audit fees at the expense of audit quality. Due to the fact that the proposed disclosures would be public, we believe, in most cases, this would be less likely. *See* Section IV.C.1.ii for additional discussion. Some issuers may have very strong financial reporting quality independent of their auditor (e.g., they have a lender with strong oversight). In these cases, the most suitable auditor may not necessarily be the "highest quality."

[257] *See* United States Government Accountability Office, *Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action* 21 (Jan. 8, 2008).

and approved, as discussed in Section II.A.2.iii.a, would help to ensure that the proposed metrics would be reliable. Greater insight into audit risks could improve the PCAOB's ability to select potential enforcement matters. Overall, improved PCAOB oversight may give auditors additional incentive to comply with PCAOB professional standards and rules.[258]

Moreover, the PCAOB actively engages in policy research related to the market for assurance services to further the PCAOB's mission by informing the standard-setting and rulemaking agendas among other purposes. The additional data provided by this proposal would enhance the PCAOB's ability to produce impactful research and recirculate that gained knowledge into improved standards and rules. Relatedly, the additional data would also provide valuable information sources for the public, including academic research. Improved research quality is an important element of the PCAOB's standard setting and rulemaking projects.

Overall, this benefit is difficult to quantify, as the social and economic benefits of enhanced regulatory oversight that is more efficient in its allocation of resources are difficult to monetize. The benefits of additional scholarly research are also difficult to quantify because there are a broad set of beneficiaries.

ii. Indirect Benefits Linked to Competition

Capital Market Preferences for Metrics

As the additional information, context, and perspective on auditors and audit engagements would help investors assess audit performance, it would, by extension, help investors assess financial reporting quality.[259] For example, investors may infer that companies audited by auditors that align partner compensation to quality performance ratings tend to have higher financial reporting quality. Moreover, some of the proposed metrics could also enable investors to assess underlying financial reporting risk independent of audit quality. For example, more time spent on high-risk areas than expected (e.g., by comparison to similar

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[258] Some academic research suggests that PCAOB oversight is beneficial. For example, one study of audit firms in foreign jurisdictions finds that PCAOB inspections access is positively associated with proxies for audit quality. *See* Phillip T. Lamoreaux, *Does PCAOB inspection Access Improve Audit Quality? An Examination of Foreign Firms Listed in the United States*, 61 Journal of Accounting and Economics 313 (2016).

[259] The IAG indicated in their comment letter regarding proposed QC 1000 that information related to audit quality would provide investors with "a level of confidence in the financial statements of companies in which they invest. Their level of confidence in the financial statements has a bearing on the prices they will be willing to pay or demand for investments." The comment letters received in response to proposed QC 1000 are available on the Board's website in Docket 046. *See* comment No. 4 on the proposed rule from the IAG, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/4_iag.pdf?sfvrsn=1941e7c0_4. *See* the preamble to Section IV.C.1 for a discussion on the association between audit quality and financial reporting quality.

issuers or to the prior year's audit) could indicate that the issuer's financial statements are especially complex or required significant judgments to prepare. Investors would thus be able to incorporate the proposed metrics into their portfolio selection decisions.[260]

Issuers audited by auditors whose metrics capital markets associate with greater financial reporting quality may experience reduced cost of capital or other capital market benefits and investors may reallocate their capital accordingly. Taken in isolation, this would tend to result in a reallocation of capital from issuers with less reliable financial reporting quality to issuers with higher financial reporting quality. These capital market reactions could provide audit committees with a stronger incentive to appoint an auditor whose proposed metrics capital markets associate with greater financial reporting quality. These effects could lead to changes in audit fees as auditors respond to changing demand for their services. Facing capacity constraints, some audit firms may turn down engagements or recruit additional staff to expand capacity.

Auditor Competition

Against the backdrop of capital market reactions to the proposed metrics and as auditors become better able to monetize their reputations, auditors would have an incentive to compete on the proposed metrics.[261] For example, to win engagements, auditors may seek to manage their proposed metrics by redeploying staff resources, increasing focus on critical issues, or compensating their staff based on quality performance ratings. This competitive dynamic would improve audit quality and, by extension, financial reporting quality.[262] Reduced

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[260] There is an extensive body of academic literature suggesting that financial markets incorporate information into securities prices. *See, e.g.,* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work,* 25 The Journal of Finance 383 (1970).

[261] Improved competition following mandatory disclosure regimes has been observed in other markets. *See* preamble to Section IV.C.1.i for additional discussion.

[262] *See* the preamble to Section IV.C.1 for a discussion on the relationship between audit quality and financial reporting quality.

search costs could increase auditor competition.[263] In addition to allowing issuers to select a more suitable auditor, the increase in competition could potentially reduce audit fees.[264]

We note that the benefits linked to competition between audit firms could be reduced for the larger issuer segment of the market because larger issuers have fewer audit firms available to choose from that are able to perform large, complex audits, without violating independence rules and other constraints. However, the proposed metrics could help promote competition between partners within the larger firms.

iii. Indirect Benefits of Improved Financial Reporting Quality

As described above, we expect the proposal would improve financial reporting quality. More reliable financial information allows investors to improve the efficiency of their capital allocation decisions (e.g., investors may more accurately identify companies with the strongest prospects for generating future risk-adjusted returns and reallocate their capital accordingly). Investors may also perceive less risk in capital markets generally, leading to an increase in the supply of capital.[265] An increase in the supply of capital could increase capital formation while

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[263] Economic theory suggests that a reduction in search costs helps to make markets more competitive. *See, e.g.*, Helmut Bester, *Bargaining, Search Costs and Equilibrium Price Distributions,* 55 The Review of Economic Studies 201 (1988). There is an extensive literature in industrial organization economics studying the impact of search and advertising costs on competition. For example, Jean Tirole, *The Theory of Industrial Organization*, MIT Press 294 (1988) studies informative advertising (i.e., costs borne by sellers to inform buyers of the seller's existence, product quality, and pricing) in a model involving differentiated sellers, and finds that prices fall as information costs fall. *See also* Grossman and Shapiro, *Informative Advertising*; and Glenn Ellison and Alexander Wolitzky, *A Search Cost Model of Obfuscation*, 43 The RAND Journal of Economics 417 (2012). Glenn Ellison and Sarah F. Ellison, *Search, Obfuscation, and Price Elasticities on the Internet*, 77 Econometrica 427 (2009) also show that reductions in search costs increase the price-sensitivity of demand, resulting in decreased prices for near-substitute goods, and that sellers may attempt to engage in obfuscation strategies to reduce competitive pressure.

[264] The positive relationship between increased competition and lower audit fees is well-established, *see*, e.g., Wieteke Numan and Marleen Willekens, *An Empirical Test of Spatial Competition in the Audit Market,* 53 Journal of Accounting and Economics 450 (2012); and Andrew R. Kitto, *The Effects of Non-Big 4 Mergers on Audit Efficiency and Audit Market Competition*, 77 Journal of Accounting and Economics 101618 (2024).

[265] *See*, *e.g.*, Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of Audit Quality on Earnings Management and Cost of Equity Capital: Evidence from China*, 28 Contemporary Accounting Research 892 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 Journal of Accounting Research 385 (2007) (concluding that improving the quality of accounting disclosures can influence the cost of capital and under certain conditions can unambiguously lower the cost of capital).

also reducing the cost of capital to companies.[266] A reduction in the cost of capital reflects a welfare gain because it implies investors perceive less risk in the capital markets. Academic literature has attempted to quantify the impact of improved financial reporting quality on cost of capital by measuring the association between various quantitative proxies for financial reporting quality and cost of capital after controlling for other potential drivers of cost of capital. Subject to the caveats discussed below, this literature suggests, overall, that even small improvements in financial reporting quality can result in reductions in issuers' cost of capital of multiple basis points in magnitude. Due to the size of the U.S. capital markets, even a single basis point reduction in the cost of capital implies substantial welfare gains.

Some studies examine the relationship between improved financial reporting quality and companies' cost of equity capital. For example, one study quantified the relationship between earnings transparency and cost of equity capital.[267] The study found that, compared to a baseline of no transparency, companies with an average level of earnings transparency had between 1.7 and 3.4 percentage points lower cost of equity capital, depending on the estimation methodology. Using restatements as a proxy for financial reporting quality, another study found that a restatement increases the cost of equity capital by between 6 and 15 percent in the longer term.[268] Assuming a 10 percent cost of capital, this result corresponds to between a 60 and 150 basis point increase in the cost of equity capital. One study found that companies with the highest accruals quality had a 210 basis point lower cost of equity capital compared to companies with the lowest accruals quality.[269] Using disclosure quality ratings (determined by an index prepared by analysts) as a proxy for financial reporting quality,

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[266] Cost of capital is the rate of return investors require to compensate them for the lost opportunity to deploy their capital elsewhere. Equivalently, cost of capital is the discount rate investors apply to future cash flows. Cost of capital depends, among others, on the riskiness of the underlying investment. Accordingly, the rate of return required by equity holders—cost of equity capital—and the rate of return required by debt holders—cost of debt capital—may differ to the extent equity and debt securities expose investors to different levels of risks. In the context of a particular company or portfolio of companies, the weighted average cost of capital is the average of the cost of equity capital and the cost of debt capital, weighted by the market values of the underlying equity and debt securities, respectively. *See, e.g.,* R. A. Brealey, S. C. Myers, and F. Allen, *Principles of Corporate Finance*, 10th Edition McGraw-Hill 8, 90, and Chapter 7, (2011). For theoretical discussion on the link between financial reporting quality and cost of capital, *see*, *e.g.*, Richard A. Lambert, Christian Leuz, and Robert E. Verrecchia, *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 Review of Finance 1, 16–18 (2012); and David Easley and Maureen O'Hara, *Information and the Cost of Capital*, 59 Journal of Finance 1553, 1571 (2005).

[267] *See* Mary E. Barth, Yaniv Konchitchki, and Wayne R. Landsman, *Cost of Capital and Earnings Transparency*, 55 Journal of Accounting and Economics 206, 216–217 (2013).

[268] *See* Paul Hribar and Nicole Thorne Jenkins, *The Effect of Accounting Restatements on Earnings Revisions and the Estimated Cost of Capital*, 8 Review of Accounting Studies 337, 337 (2004).

[269] *See* Jennifer Francis, Ryan LaFond, Per Olsson, and Katherine Schipper, *The Market Pricing of Accruals Quality*, 39 Journal of Accounting and Economics 295, 297 (2005).

another study found that companies with the highest disclosure quality ratings had roughly a 0.7 percentage point lower cost of equity capital compared to companies with the lowest.[270] From an international perspective, one study found that companies in countries in the 75th percentile of strength of disclosure rules and associated enforcement had roughly a 200 basis point lower costs of equity capital than countries at the 25th percentile (i.e., countries with weaker disclosure rules and enforcement).[271] Another study found that, compared to companies in countries at the 75th percentile of earnings opacity, the cost of equity capital for companies in the 25th percentile (i.e., countries with less opaque earnings) had a 2.8 percentage point lower cost of equity capital.[272]

While the above studies examine the impact of improved financial reporting quality on companies' cost of equity capital, several studies examine instead the impact of improved financial reporting quality on companies' cost of debt capital. For example, one study found that companies with the highest disclosure quality ratings (determined by an index prepared by analysts) have roughly 1.1 percentage points lower cost of debt capital than companies with the lowest disclosure quality ratings.[273] Another study found that companies in the highest decile of accruals quality had a 126-basis point lower cost of debt capital than companies in the lowest decile of accruals quality.[274]

While we believe these studies are indicative of the potential impacts improved financial reporting quality may have on capital markets, we acknowledge that the studies are subject to certain caveats.[275] First, the studies do not indicate the degree to which the disclosure of firm and engagement metrics would impact financial reporting quality in the first instance. Therefore, the magnitudes must be treated as illustrative examples, rather than point estimates, of the potential benefits of the proposal.

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[270] *See* Christine A. Botosan and Marlene A. Plumlee, *A Re-examination of Disclosure Level and the Expected Cost of Equity Capital*, 40 Journal of Accounting Research 21, 22 (2002).

[271] *See* Luzi Hail and Christian Leuz, *International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?*, 44 Journal of Accounting Research 485, 488 (2006).

[272] *See* Utpal Bhattacharya, Hazem Daouk, and Michael Welker, *The World Price of Earnings Opacity*, 78 Journal of Accounting and Economics 641, 643 (2003).

[273] *See* Partha Sengupta, *Corporate Disclosure Quality and the Cost of Debt*, 73 The Accounting Review 459 (1998).

[274] *See* Francis, et al., *The Market Pricing* 297.

[275] For a more general discussion of challenges identifying causal relationships in financial reporting research, *see* Leuz and Wysocki, *The Economics of Disclosure and Financial Reporting Regulation*.

Second, some of the studies may be subject to some endogeneity bias.[276] For example, companies with high financial reporting quality may also be well-managed, a form of omitted variable bias. Similarly, companies that voluntarily provide higher quality information may do so because they are in a stronger financial position already, a form of self-selection bias. Due to these potential biases, some of the studies may overestimate the extent to which improved financial reporting quality reduces companies' cost of capital. Controlling for endogeneity bias is challenging and the results of any one methodology may be sensitive to the methodology's assumptions.[277] Indeed, after attempting to statistically control for endogeneity bias, one study found that the association between financial reporting quality and cost of equity capital remains while another found that it disappears.[278]

Third, while most research tends to find positive associations between financial reporting quality and the cost of capital, some studies have found counterintuitive or unexpected associations. For example, one study found that the timeliness of disclosures is negatively associated with the cost of equity capital.[279] The results of another study suggest that the association between improved financial reporting quality and reduced cost of capital may apply only to companies with low analyst following.[280]

Despite these caveats, we believe that the academic literature suggests overall that improved financial reporting quality results in lower costs of capital and, moreover, that even small improvements can reduce the cost of capital by one or more basis points. The studies discussed above found multiple percentage point reductions in cost of capital when companies (or countries) with the weakest financial reporting proxies are compared to the companies (or countries) with the strongest financial reporting proxies. As such, just one hundredth of the improvement in those measures could result in reductions in the cost of capital by multiple basis points. Due to the size of U.S. capital markets, even small reductions in the cost of capital, on the order of multiple basis points, can generate significant welfare gains. For example, using

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276 Endogeneity occurs when an explanatory variable in a multiple regression model is correlated with unobserved factors that affect the dependent variable. *See* Jeffrey M. Wooldridge, *Introductory Econometrics: A Modern Approach*, South-Western Cengage Learning, 4th edition 838 (2008).

277 *See* David F. Larcker and Tjomme O. Rusticus, *On the Use of Instrumental Variables in Accounting Research*, 49 Journal of Accounting and Economics 186, 203 (2010).

278 *See, e.g.,* Christian Leuz and Robert E. Verrecchia, *The Economic Consequences of Increased Disclosure*, 38 Journal of Accounting Research 91, 121 (2000) (using bid-ask spreads for German companies as a proxy for cost of capital) and David A. Cohen, *Does Information Risk Really Matter? An Analysis of the Determinants and Economic Consequences of Financial Reporting Quality*, 15 Asia-Pacific Journal of Accounting & Economics 69, 70 (2010).

279 The authors suggest that the result may be attributable to increased stock price volatility arising from excessive focus on short-term profits. *See* Botosan and Plumlee, *A Re-examination* 21 and 37.

280 *See* Christine A. Botosan, *Disclosure Level and the Cost of Equity Capital*, 72 The Accounting Review 323 (1997).

recent data on the size of the U.S. equity and debt capital markets, a single basis point reduction in the weighted average cost of capital would imply at least $91.6 billion in welfare gains.[281]

iv. Academic Literature Related to the Proposed Firm and Engagement Metrics

In the following discussion we review the extant literature related to the proposed metrics. In doing so, we separate the proposed metrics into three categories: (1) metrics related to audit personnel; (2) metrics related to the allocation of audit hours; and (3) metrics related to internal monitoring, incentives, and audit outcomes.

We note three important caveats. First, as most of the proposed metrics are not publicly available, the academic studies principally rely on information obtained from audit firms directly, surveys, or foreign jurisdictions. Their relevance is thus limited by the fact that the metrics they study are not equivalent to the proposed metrics and their results may not be directly applicable to the U.S. audit market more generally. Second, while the extant literature may draw conclusions regarding a particular metric's relationship to publicly available proxies for audit quality, this does not imply that a proposed metric would provide any new insights to investors and audit committees incremental to the insights already provided by the publicly available proxies for audit quality. Finally, those relationships may be non-linear or difficult to fully evaluate.

a. Metrics Related to Audit Personnel

The proposed metrics related to audit personnel cover audit team characteristics across multiple levels and predominantly focus on the audit team's involvement and workload (i.e., Partner and Manager Involvement, and Workload), turnover (i.e., Retention and Tenure),

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[281] (1 basis point / (8% average cost of capital – 1 basis point)) × ($62.6 trillion in equity market capitalization + $10.6 trillion in debt market capitalization) = $91.6 billion. Source: S&P Capital IQ and SIFMA. The debt market capitalization figure reflects U.S. corporate bonds outstanding as of 2023 Q3. It does not include private debt. We note several key assumptions and limitations of the calculation. The calculation assumes that debt and equity capital comprise all forms of capital (i.e., the calculation disregards other potential forms of capital) and that their total value is equal to the sum of all future cash flows discounted by the weighted average cost of capital. It assumes a weighted average cost of capital of 8% based on historic averages for the Russell 3000. *See* Michael J. Mauboussin and Dan Callahan, *Cost of Capital: A Practical Guide to Measuring Opportunity Cost*, Morgan Stanely Investment Management Counterpoint Global Insights, Exhibit 16 (2023). The calculation does not account for the potential beneficial impact of changes in the quantity of capital supplied nor does it account for potential general equilibrium effects in other markets. As discussed above, the calculation pertains to weighted average cost of capital reductions only. It does not capture potential increases in total market capitalization arising from improved management or improved capital allocation. We acknowledge that some issuers that contribute to our market capitalization figures are not audited by firms that would be subject to the proposed requirements and therefore would not be impacted by the proposed requirements. However, we believe they make up a small share of total market capitalization.

experience (i.e., Experience of Audit Personnel), and industry specialization (i.e., Industry Experience of Audit Personnel). These proposed metrics would provide investors and audit committees with insights into how their auditor is effectively staffing the engagement and may assist audit committees in selecting auditors that have sufficient involvement of the audit partner, sustainable workloads, sustainable audit team turnover, and appropriate levels of experience and industry-specific expertise.

The first metric related to audit personnel (i.e., Partner and Manager Involvement) would provide investors and audit committees with insights into how involved partners and managers are in engagements. Investors and audit committees could use this information to evaluate whether their engagement is being given appropriate attention or conversely whether the lead partner is delegating too much responsibility to auditors with less experience. Although the academic literature related to audit partner and manager involvement is limited, one study using Korean data suggests that audit partner involvement is positively associated with audit quality.[282] Another study finds that the offices of U.S. Big 4 audit firms with relatively more CPAs tend to provide higher audit quality.[283] This suggests that greater involvement of experienced staff is beneficial to audit quality.[284] Another study using Chinese data finds that a greater partner to staff ratio is positively associated with audit quality.[285] However, using U.S. data, another study finds partner time spent concurrently on other audits is not associated with audit quality.[286]

The next set of metrics relate to core engagement team workloads (i.e., Workload), including engagement partners and other partners, managers, and staff. These proposed metrics may provide insights into how busy partners and staff are and may also act as a proxy for auditor distraction. While there is no established optimal workload level for audit teams or their staffing components, academic literature suggests that auditors have high workloads, particularly during the busy season.[287] Furthermore, several academic studies, primarily using international data, find that high workload levels, particularly during the busy season,

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282 *See, e.g.*, Suyon Kim, *Engagement Partners' Effort*, 9 Risks 1 (2021).

283 *See*, *e.g.*, Albert L. Nagy, Matthew G. Sherwood, and Aleksandra B. Zimmerman, *CPAs and Big 4 Office Audit Quality*, 42 Journal of Accounting and Public Policy 107018 (2023).

284 Another study using Japanese data finds that the number of CPA holders staffed to an audit engagement is positively associated with audit quality while the number of non-CPA holders is not. *See* Hossain, et al., *The Relationship*.

285 *See, e.g.*, Lo, et al., *Does Availability of Audit Partners*.

286 *See*, *e.g.*, Christensen, et al., *Team Workloads*.

287 *See*, *e.g.*, Persellin, et al., *Auditor Perceptions* Table 2; Dana R. Hermanson, Richard W. Houston, Chad M. Stefaniak, and Anne M. Wilkins, *The Work Environment in Large Audit Firms: Current Perceptions*, 10 Current Issues in Auditing A38 (2016); and John T. Sweeney and Scott L. Summers, *The Effect of the Busy Season Workload on Public Accountants' Job Burnout*, 14 Behavioral Research in Accounting 223 (2002).

negatively impact audit quality.[288] Auditors that work on multiple engagements in different environments and scopes may also experience issues with memory-related errors.[289] However, the impacts of workload may depend on the auditor's ability to handle such normal workloads.[290] Furthermore, one study finds that audit partner busyness is not related to audit quality under equilibrium market conditions.[291]

The next set of metrics related to audit personnel (i.e., Retention and Tenure) examine, among other things, whether there were unexpectedly high levels of turnover between the start and the end of the engagement. Low engagement team retention could be a signal that there were problems on the engagement, or that the engagement was understaffed. Some research suggests that excessive levels of turnover, particularly at the staff level, could lead to a deterioration in audit quality.[292] Using Belgian data collected from private and public companies, one working paper found that abnormal turnover is more likely to affect audit quality than expected (i.e., normal or average) levels of turnover, and the negative consequences of turnover impact existing clients more than new clients.[293] Firms with larger internal labor pools may be better positioned to mitigate the negative consequences of turnover. For example, using data from Chinese audit firms on auditor departure from public accounting, one study finds that the negative effect of departure on audit quality is stronger for non-Big 4 firms.[294]

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288 *See*, *e.g.*, Christensen, et al., *Team Workloads*; Jun Chen, Wang Dong, Hongling Han, and Nan Zhou, *Does Audit Partner Workload Compression Affect Audit Quality?*, 29 European Accounting Review 1021 (2020); Jin Suk Heo, Soo Young Kwon, and Hun-Tong Tan, *Auditors' Responses to Workload Imbalance and the Impact on Audit Quality*, 38 Contemporary Accounting Research 338 (2021); Hwang and Hong, *Auditors' Workload*; Dennis M. Lopez and Gary F. Peters, *The Effect of Workload Compression on Audit Quality*, 31 Auditing: A Journal of Practice & Theory 139 (2012); Persellin, et al., *Auditor Perceptions*; and Ferdinand A. Gul, Shuai Mark Ma, and Karen Lai, *Busy Auditors, Partner-Client Tenure, and Audit Quality: Evidence from an Emerging Market*, 16 Journal of International Accounting Research 83 (2017).

289 *See, e.g.*, Sudip Bhattacharjee, Mario J. Maletta, and Kimberly K. Moreno, *The Cascading of Contrast Effects on Auditors' Judgments in Multiple Client Audit Environments*, 82 The Accounting Review 1097 (2007).

290 *See,* Persellin, et al., *Auditor Perceptions*.

291 *See* Goodwin and Wu, *What is the Relationship*.

292 *See, e.g.*, Khavis and Szerwo, *Audit-Employee Turnover, Audit Quality, and the Auditor-Client Relationship* 27; and Christensen, et al., *Team Workloads.*

293 *See, e.g.*, Linden, et al., *Audit Firm Employee Turnover and Audit Quality* 4.

294 *See, e.g.*, W. Robert Knechel, Juan Mao, Baolei Qi, and Zili Zhuang, *Is There a Brain Drain in Auditing? The Determinants and Consequences of Auditors Leaving Public Accounting*, 38 Contemporary Accounting Research 2461 (2021).

The next set of audit personnel metrics relates to the knowledge and expertise of the engagement team (i.e., Experience of Audit Personnel and Industry Experience of Audit Personnel). Engagement teams are comprised of auditors from various levels and varying degrees of experience in the auditing profession. The extant academic literature shows mixed results regarding the association between auditor experience and audit quality. One study found that less-experienced auditors may be less willing to request additional evidence from company controllers.[295] Using data from Taiwan, one study finds that an auditor's experience is positively associated with proxies for audit quality.[296] However, using data from Chinese audit firms, one study finds that the an auditor's birth year, a proxy for total experience, is not associated with several proxies for audit quality.[297] Another study finds that audit partner experience is not associated with audit quality.[298]

The academic literature provides a depth of evidence to support the relationship between auditor industry specialization and industry-specific experience and the quality and effectiveness of audit services.[299] Auditors that are industry specialists are more likely to understand the specific financial reporting requirements and risks that issuers in those industries face.[300] Moreover, these auditors may be more familiar with specific accounting treatments or industry norms which could enhance coordination with their issuers. However, some research suggests that the impact of industry specialization on audit quality may depend on other contextual factors (e.g., whether the auditor is local to the client or the difficulty of

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295 *See*, *e.g.*, Bennett and Hatfield, *The Effect of the Social Mismatch* 46–47.

296 *See*, *e.g.*, Chi, et al., *The Effects of Audit Partner* 363.

297 *See*, *e.g.*, Ferdinand A. Gul, Donghui Wu, and Zhifeng Yang, *Do Individual Auditors Affect Audit Quality? Evidence from Archival Data*, 88 The Accounting Review 1993, Table 6 (2013).

298 *See*, *e.g.*, Hye Seung Lee, Albert L. Nagy, and Aleksandra B. Zimmerman, *Audit Partner Assignments and Audit Quality in the United States*, 94 The Accounting Review 297 (2019).

299 The academic literature provides ample evidence that auditor industry expertise and specialized industry knowledge are important components of high-quality audit engagements. *See, e.g.*, Craswell, et al., *Auditor Brand Name* (finding, using a sample of Australian firms, that industry specialization is associated with greater audit fees, consistent with "demand for audit quality"); Mark L. DeFond, Jere R. Francis, and T. J. Wong, *Auditor Industry Specialization and Market Segmentation: Evidence from Hong Kong*, 19 AUDITING: A Journal of Practice & Theory 49 (2000) (finding, using a sample of publicly listed Hong Kong companies, that industry specialization is associated with greater audit fees among Big 6 auditors but lower audit fees among non-Big 6 auditors); Balsam, et al., 95 (finding audit quality proxies are positively associated with auditor industry specialization); Gopal V. Krishnan, *Does Big 6 Auditor Industry Expertise Constrain Earnings Management?*, 17 Accounting Horizons 1, 3 (2003); and Knechel, et al., *Does Auditor Industry Specialization Matter?*.

300 *See, e.g.*, Low, *The Effects of Industry Specialization* 202.

the audit).[301] We also note that some studies indicate that research on experience and industry specialization may be sensitive to design, proxy, and stratification level (i.e., office-level and national-level). However, they do not conclude that experience and industry specialization are unrelated to audit quality.[302]

By requiring auditors to disclose these personnel related metrics, investors and audit committees could, for example, select auditors with sustainable workloads, with the implicit outcome that sustainable workloads could improve auditor attentiveness, reduce error rates, and may—over time—improve the overall perception of the auditing profession as one that is characterized by high workloads and turnover. Additionally, investors and audit committees may find the proposed metrics to be useful in evaluating the risk that the auditor has overlooked errors or material misstatements due to overworked staff or that the engagement team was not sufficiently qualified or specialized. Moreover, investors may find the proposed metrics beneficial in understanding whether the engagement, and therefore the issuer, had significant risks or the issuer's operations were particularly complex compared to peer issuers. For example, if there was a significantly higher workload across partners, managers, and staff—or excessive turnover—compared to another investment opportunity of similar issuer size, the investor may then infer that the issuer had unique risks that necessitated increased audit effort. Such a signal may be particularly useful if the investor could ascertain whether peer issuers were more, or less, complex compared to the issuer under consideration. The investor may also be reasonably assured if there were positive audit outcomes as it may signal to the investor that the auditor exerted considerable or appropriate effort in obtaining a reasonable level of assurance on the issuer's financial statements in the context of their peers for that issuer's complexity and risk level.

Audit committees may also find these proposed metrics to be beneficial, as the audit committee may view them as confirming that the auditor is appropriately staffing the engagement. In addition, during the selection process for a new auditor, the audit committee may review the proposed metrics of potential candidate auditors in the context of peer-group engagements, thereby using the proposed metrics to make auditor selection decisions more effectively. By selecting an auditor based on their experience or industry-specific knowledge, investors and audit committees would be better able to choose the optimal candidate auditor

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301 *See*, *e.g.*, Jere R. Francis, Kenneth Reichelt, and Dechun Wang, *The Pricing of National and City-Specific Reputations for Industry Expertise in the U.S. Audit Market*, 80 The Accounting Review 113, 114 (2005) and Daniel Aobdia, Saad Siddiqui, and Andres Vinelli, *Heterogeneity in Expertise in a Credence Goods Setting: Evidence from Audit Partners*, 26 Review of Accounting Studies 693 (2021).

302 *See*, *e.g.*, Terry L. Neal and Richard R. Riley, *Auditor Industry Specialist Research Design*, 23 AUDITING: A Journal of Practice & Theory 169 (2004); Steven F. Cahan, Debra C. Jeter, and Vic Naiker, *Are All Industry Specialist Auditors the Same?*, 30 AUDITING: A Journal of Practice & Theory 191 (2011); and Miguel Minutti-Meza, *Does Auditor Industry Specialization Improve Audit Quality?*, 51 Journal of Accounting Research 779, 813 (2013) (finding that "auditor industry specialization, measured using the auditor's within-industry market share, is not a reliable indicator of audit quality").

for their engagement—thereby improving the matching efficiency of human capital within and across firms by helping to align the demand for resources with the supply.

Audit firms may find the proposed metrics beneficial as they may be better able to monitor whether they themselves are unintentionally over-auditing, as they would be able to view the personnel allocations on similar engagements for peer-group issuers. Audit firms may also benefit from identifying lead industry-specialist auditors and could improve their own audit services to compete with these industry specialists on the quality of those services. Importantly, incumbent auditors (i.e., current auditors of an issuer) know more about the issuer's operations than rival competitor auditors.[303] The disclosure of the proposed metrics could provide these competitor auditors with the ability to observe signals regarding the effort and complexity required on the engagement, and those auditors may be able to use that information to compete against the incumbent auditor for the issuer's prospective engagement more effectively.[304]

b. Metrics Related to the Allocation of Audit Hours

Metrics related to the allocation of audit hours (i.e., Audit Hours and Risk Areas, Allocation of Audit Hours, Audit Resources – Use of Auditor's Specialists and Shared Service Centers) predominantly focus on whether the audit team is being efficiently and effectively deployed. The proposed metrics may improve transparency into the audit process and help investors and audit committees to review: (1) whether the auditor is effectively allocating hours in response to areas of significant risk, (2) whether the auditor is appropriately allocating hours prior to the issuer's year end, (3) whether the auditor is efficiently and effectively deploying individuals with expertise to address areas that require their specialized knowledge; and (4) whether the auditor is efficiently and effectively using SSCs.

The first metric in this group, Audit Hours and Risk Areas, relates to the percentage of total audit hours incurred in areas of significant risk, critical accounting policies and practices, and critical accounting estimates (hereafter, collectively, "areas of significant risk"). Because areas of significant risk are typically confidential, there is limited academic research into the impacts of auditor effort on these areas; moreover, likely owing to such confidentiality, the available literature focuses only on overall audit risk. However, there is some evidence to suggest that auditors focus on risk areas by increasing audit effort on engagements with increased risk.[305] As a result, it could be important to audit committees and investors to know if

[303] *See, e.g.*, Monika Causholli, W. Robert Knechel, and Haijin Lin, and David E. M. Sappington, *Competitive Procurement of Auditing Services with Limited Information*, 22 European Accounting Review 573, 576–578 (2013).

[304] *Id.*

[305] *See*, *e.g.*, Karl Hackenbrack and W. Knechel Robert, *Resource Allocation Decisions in Audit Engagements*, 14 Contemporary Accounting Research 481 (2010) and Jean C. Bedard and Karla M. Johnstone, *Earnings Manipulation Risk, Corporate Governance Risk, and Auditors' Planning and Pricing Decisions*, 79 The Accounting Review 277 (2004).

auditors allocate relatively more hours to areas of significant risk. Moreover, as discussed in Section III.B.2.vii, this proposed metric would provide investors and audit committees with insights as to how the auditor is addressing these areas of significant risk. By definition, these areas have a higher risk of material misstatement, and thereby the proportion of hours spent addressing these concerns would serve as an important tool that investors and audit committees could use to evaluate whether the auditor is spending appropriate effort addressing these critical areas. Furthermore, the information provided to investors and audit committees as a result of this proposed metric could provide beneficial context to other proposed metrics. For example, the proposed metric could help audit committees understand how their auditor's industry expertise impacts their allocation of hours to areas of significant risk.[306]

Similarly, the second metric proposed in this group, Allocation of Audit Hours, relates to the allocation of audit hours to phases of the audit. Generally, the academic literature related to this proposed metric is limited, as information pertinent to studying this topic is non-public. However, one recent study used PCAOB inspections data and found that audit engagements in which relatively more audit effort was spent prior to the issuer's fiscal year end had overall improvements in audit effectiveness and a lower likelihood of negative audit outcomes.[307] As noted in that study, other researchers have identified that work conducted earlier in the audit process may lead to an earlier identification of issues that could improve the possibility those issues would then be corrected.[308] Another study, using data from one global accounting firm, also finds that a greater proportion of audit work performed earlier in the audit is associated with improved audit outcomes.[309] Investors and audit committees may benefit from understanding how audit firms allocate audit hours on their engagements.

Furthermore, investors could appreciate the ability to observe this proposed metric at the engagement level along with their auditor's experience and industry expertise. This proposed metric may allow investors to better understand how their auditor is addressing the issuer's particular audit needs and compare the allocation of audit hours on their issuer's engagement to the allocations of peer engagements. Moreover, this proposed metric could provide supplemental value to metrics associated with auditor workload and partner and manager involvement, such as when compared to how the auditor allocates hours on the engagement before and after the issuer's fiscal year end.

The third proposed metric in this group, Audit Resources – Use of Auditor's Specialists, relates to the use of individuals with specialized skills or knowledge. As discussed in Section III.B.2.iii, audit firms are increasing their use of specialists, and specialists are playing an ever-

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306 *See, e.g.*, Low, *The Effects of Industry Specialization* (finding, in an experiment, that "auditors' knowledge of the client's industry improves their audit risk assessments.").

307 *See, e.g.*, Aobdia, et al., *The Economics of Audit Production* 1, 6 and 11.

308 *See id*. at 12.

309 *See* Christensen, et al., *Archival Evidence*.

increasing role in audit engagements. As identified in our investor outreach efforts—and with reference to the above discussion in the prior proposed metric—auditors were found to be engaging auditor's specialists earlier in the year, and there was an increase in the use of auditor's specialists following the implementation of AS 1210.[310] Although the literature on the use of specialists is limited, one academic study finds that access to non-CPAs within an audit firm, including specialists, could be associated with improved audit effectiveness.[311] Investors and audit committees may benefit from knowing the proportion of the audit engagement that was handled by auditor's specialists. For example, an investor may notice within an issuer's financial statements that a substantial amount of fair-value accounting was used. That investor may then wish to confirm whether the auditor used a specialist on the engagement and to what degree. This information may provide investors with appropriate confidence that the financial statements truly reflect the fair value of the underlying assets, liabilities, and equities. By contrast, disclosure of the use of specialists may be less informative to audit committees because whether the engagement would require the use of specialized skill or knowledge is already a required communication for the auditor to provide to the audit committee.[312] Furthermore, a recent study using PCAOB inspections data found that the use of specialists is positively associated with audit process deficiencies, but that the use of specialists does not lead to a deterioration in financial reporting quality. Moreover, that study identified that engagements using specialists may be less profitable.[313]

The fourth proposed metric in this group, Audit Resources – Use of Shared Service Centers, relates to the portion of the audit that is performed in an SSC. Although the literature on the use of SSCs is limited and how they are used is evolving, the literature suggests that SSCs have allowed firms to perform routine tasks more efficiently and allow engagement teams to focus on more judgmental tasks. Greater focus on judgmental tasks by engagement teams could improve audit quality. However, the literature also points to potential risks to audit quality. For example, one survey of auditors based in seven European countries reports that reduced costs are a key driver of the use of SSCs. This frees up engagement teams to focus on other aspects of the audit which may increase audit quality. However, respondents also report that quality control is a focus due to, for example, the lack of direct oversight and coordination challenges.[314] The study also reports that firms are "highly secretive" about their use of SSCs

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310 *See, e.g.*, Michael J. Gurbutt, Wei-Kang Shih, Carrie von Bose, and Tasneem Raihan, *Staff White Paper: Stakeholder Outreach on the Initial Implementation of Estimates and Specialists Audit Requirements,* PCAOB 1, 17 (2022).

311 *See*, *e.g.*, Sherwood, et al., *Non-CPAs*.

312 *See* AS 1301.10.

313 *See* Ally Zimmerman, Dereck Barr-Pulliam, Joon-Suk Lee, and Miguel Minutti-Meza, *Auditor's Use of In-House Specialists*, Journal of Accounting Research, 3 and 22 (2023).

314 *See* Aschauer and Quick, *Implementing Shared Service Centres*.

and "avoid disclosing information about the SSC to their clients."[315] Other research suggests that IT centers allow firms to standardize their services. The authors argue that, while standardization may reduce costs, it may also threaten audit quality and inhibit professional judgment.[316] Finally, one unpublished study finds that the use of SSCs by U.S. Big 4 firms is not associated with proxies for audit quality but is positively associated with proxies for engagement profitability.[317]

Though SSCs are not necessarily offshored, research on the offshoring of audit work may also indicate the potential value of the proposed Audit Resources – Use of Shared Service Centers metric. For example, one survey of audit committees found that audit committees are largely indifferent as to whether offshored audit procedures impact audit quality. At the same time, the surveyed audit committees expressed a preference for audit procedures not to be offshored.[318] Another survey of six U.S.-based audit seniors and managers finds that, in addition to efficiency, offshoring allows firms to redeploy local resources. The same research also finds that offshored work is subject to greater quality control focus due to concerns about the quality of the work.[319] Some experimental research suggests that jurors expect offshored work to be lower quality.[320]

The above proposed metrics would provide investors and audit committees with insights as to how their auditor effectively staffs the audit engagement. The effective deployment of resources is of critical importance to a well-developed audit.[321] Moreover, audit firms must allocate resources effectively to meet the needs of human-capital expertise in certain areas of the engagement.[322] By requiring disclosure of the allocation of hours to risk areas, investors and audit committees would be given transparency into whether the auditor is

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315 *Id.* at 22.

316 *See, e.g.*, W. Robert Knechel, Edward Thomas, and Matthew Driskill, *Understanding Financial Auditing from a Service Perspective*, 81 Accounting, Organization and Society 1, 16 and n.54 (2020).

317 *See, e.g.*, Matthew G. Sherwood, *Offshore Shared Services Center Usage by U.S. Big 4 Audit Engagement Teams*, SSRN Electronic Journal (2024).

318 *See* Dickins and Daugherty, *Should Those Charged* Table 1.

319 *See* Denise Hanes Downey, *An Exploration of Offshoring in Audit Practice and the Potential Consequences of Associated Work "Redesign" on Auditor Performance*, 37 Auditing: A Journal of Practice & Theory 197 (2018).

320 *See*, *e.g.*, Alex Lyubimov, Vicky Arnold, and Steve G. Sutton, *An Examination of the Legal Liability Associated with Outsourcing and Offshoring Audit Procedures*, 32 Auditing: A Journal of Practice & Theory 97 (2013).

321 *See, e.g.*, Causholli, et al., *Competitive Procurement* (for an economic model describing the intersection of efficiency, quality, and competition in the market for audit services). *See also* Aobdia, et al., *The Economics of Audit Production*.

322 *See, e.g.*, Knechel, et al., *Understanding Financial Auditing*.

allocating resources to meet the particular needs of the issuer. The audit committee would already likely be aware of their corporate risk profile and would expect the auditor to have allocated sufficient resources to specific risk areas.[323] Disclosure of the allocation of auditor effort to these risk areas would be an important component in improving transparency in the audit process as it would provide the audit committee direct insights as to how the auditor is spending the engagement's budget. Investors may also benefit from the disclosure, as they would be better able to understand whether the audit committee is effectively overseeing the auditor and the degree to which areas of significant risk exist for the issuer.[324]

Disclosure of the overall allocation of hours in the audit would allow audit committees to understand how the audit team engages in a year-round audit process and avoids leaving substantial issues to the end of the engagement. These disclosures may have additional benefits in understanding risk areas and the auditor's perceived severity of those risks, as well as whether the audit team is effectively managing their engagement pipeline by planning out resource allocations throughout the year.

Disclosure of the use of auditor's specialists on the engagement would provide critical information to investors related to whether engagements require specialized knowledge or skill, and whether the auditor is deploying resources to meet those needs.[325] Disclosure of the use of shared service centers could help investors and audit committees understand their auditor's focus on efficiency as well as audit quality risks associated with shared service center use.

Auditors may find the disclosure of the above proposed metrics to be useful as they may benefit from comparing allocations on their own engagements to allocations of similar issuer engagements of their competitors. The ability of auditors to compare and evaluate planning and risk allocation could provide substantive benefits in that auditors may be over-allocating hours to risk areas (i.e., over-auditing) or improperly and inefficiently planning their audits. Auditors may also benefit from understanding which types of engagements required the use of specialists, which could enhance the effective deployment of specialists to where they are needed most, and less where they are least needed.

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323 *See, e.g.*, Matthew J. Beck and Elaine G. Mauldin, *Who's Really in Charge? Audit Committee versus CFO Power and Audit Fees*, 89 The Accounting Review 2057, 2078 (2014).

324 *See, e.g.*, Krishnagopal Menon and Joanne Deahl Williams, *The Use of Audit Committees for Monitoring*, 13 Journal of Accounting and Public Policy 121, (1994) and Cohen et al., *The Corporate Governance Mosaic* (discussing the monitoring role of audit committees).

325 By contrast, disclosure of the use of specialists would be less informative to audit committees because whether the engagement would require the use of specialized skill or knowledge is already a required communication for the auditor to provide to the audit committee. *See* AS 1301.10.

c. Metrics Related to Internal Monitoring, Incentives, and Audit Outcomes

Metrics related to internal audit quality review (i.e., Audit Firms' Internal Monitoring), incentive alignment (i.e., Quality Performance Ratings and Compensation), and audit outcomes (i.e., Restatement History) focus on the positive and negative incentives auditors face. Unlike the proposed metrics discussed above in Section IV.C.1.iv.a, which would provide additional transparency into the inner workings and characteristics of the audit team, the disclosure of these proposed metrics would provide information related to audit outcomes and the incentives that led to those results.

The first proposed metric in this group, Audit Firms' Internal Monitoring (IM), relates to firms' internal review of the quality of their auditors' work. The academic literature on IM and its relationship to audit quality is limited, as data related to these reviews is typically confidential. One study uses PCAOB data and finds that the existence of internal inspection findings is statistically correlated to several academic proxies for audit quality.[326] An academic survey of audit partners from large audit firms reports that the surveyed audit partners believe internal quality reviews are more focused on audit quality and may provide more useful feedback for improving audit quality than PCAOB inspections.[327] The same study also finds that audit partners even attempt to predict which engagements will be selected for review and allocate more hours to those engagements. Other academic literature suggests that IM causes audit partners to initiate behavioral responses to ensure their engagements are high quality.[328] This behavioral mechanism causes a "deterrence" effect for IM conducted by audit firms and, similarly, for PCAOB inspections.[329]

The second proposed metric in this group, Quality Performance Ratings and Compensation, relates to the alignment of auditor compensation with the outcomes of quality performance ratings. Overall, the academic literature examining the relationships among partner compensation, quality performance ratings, and audit quality is limited; however, economic theory,[330] and some evidence from academic studies, suggests that auditor compensation schemes—when tied to audit quality—can incentivize auditors to conduct high-

326 *See, e.g.*, Aobdia, *Practitioner Assessments*.

327 *See, e.g.*, Houston and Stefaniak, *Audit Partner Perceptions* 25.

328 *See, e.g.*, Chad M. Stefaniak, Richard W. Houston, and Duane M. Brandon, *Investigating Inspection Risk: An Analysis of PCAOB Inspections and Internal Quality Reviews*, 36 AUDITING: A Journal of Practice & Theory 151 (2017).

329 *See, e.g.*, *id.*

330 *See*, *e.g.*, Michael C. Jensen and Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 Journal of Political Economy 225, 226 (1990) (discussing how CEO compensation policies allow shareholders to align CEO's incentives with theirs).

quality engagements.[331] Auditors who face a pay reduction for failing to meet quality standards are likely to work towards receiving a high-pass rate on their reviews. Given that many partners have economic bonds to their partnership—due to partnership buy-in and equity-ownership based compensation agreements—auditors face combined incentives and constraints that could foster a paradigm of quality, provided the auditor legitimately faces a reduction in compensation (or wealth) for low-quality work. This proposed metric would allow audit committees to select and investors to ratify the appointment of auditors whose compensation policies provide incentives to conduct a high-quality engagement.

The last proposed metric in this group, Restatement History, would summarize historical trends in restatements. In the academic literature, restatements are widely regarded as the strongest indicator of poor audit quality.[332] Restatements have been shown to result in auditor dismissal or increased resources committed by the auditor to the issuer.[333] Using data from Japanese audit firms, one study finds that auditors devote additional resources to companies the year they restate their financial statements.[334] However, it is important to note that restatements are often observed after a significant lag following the restatement event—which causes a reduction in the informativeness of the restatement event, if such information is viewed as stale by investors and audit committees. Furthermore, the absence of a restatement does not imply audit quality was high and the occurrence of a restatement identified by a successor auditor may signal improved audit quality when the auditor increases audit effort to identify errors in the work of prior auditors.[335] We acknowledge that the value of the proposed metric would be limited by the fact that restatements are public information already (e.g., U.S.

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[331] *See, e.g.*, Knechel, et al., *Empirical Evidence*; Ernstberger, et al., *Are Audit Firms' Compensation Policies Associated with Audit Quality?*; Che, et al., *Are Audit Partners' Compensation and Audit Quality Related to Their Consulting Revenues?*; Carcello and Neal, *Going-Concern Opinions*; Simon Dekeyser, Ann Gaeremynck, W. Robert Knechel, and Marleen Willekens, *The Impact of Partners' Economic Incentives on Audit Quality in Big 4 Partnerships*, 96 The Accounting Review 129, (2021); Greg Trompeter, *The Effect of Partner Compensation Schemes and Generally Accepted Accounting Principles on Audit Partner Judgment*, 13 AUDITING: A Journal of Practice & Theory 56, (1994).

[332] *See, e.g.*, DeFond and Zhang, *A Review of Archival Auditing Research* (specifically, the discussion marked *Section 2.3.1 Output-based audit quality measures*).

[333] *See, e.g.*, Karen M. Hennes, Andrew J. Leone, and Brian P. Miller, *Determinants and Market Consequences of Auditor Dismissals after Accounting Restatements*, 89 The Accounting Review 1051 (2014); and Li-Lin Liu, K. Raghunandan, and Dasaratha Rama, *Financial Restatements and Shareholder Ratifications of the Auditor*, 28 Auditing: A Journal of Practice & Theory 225 (2009).

[334] *See*, *e.g.*, Chi, Wuchun and Chien-min Kevin Pan, *How Do Auditors Respond to Accounting Restatements? Evidence on Audit Staff Allocation*, 58 Review of Quantitative Finance and Accounting 1 (2022).

[335] *See, e.g.,* Stephen P. Rowe and Padmakumar Sivadasan, *Higher Audit Quality and Higher Restatement Rates: An Examination of Big Four Auditee Restatements*, SSRN Electronic Journal, (2021).

issuers must file Form 8-K when they materially restate their financial statements and the public financial statements themselves indicate when a restatement has occurred).

Questions

95. Have we appropriately described the benefits, including benefits to smaller firms or issuers? If not, how can we improve the analysis?

96. Are there additional academic studies or data that would inform our analysis of the benefits? If so, please direct us to them and explain how they would inform the analysis.

97. Are we fairly representing the academic literature related to the benefits? If not, please explain how.

98. Are there any quantifiable benefits? If so, please: (1) identify them; (2) describe a methodology to quantify them; (3) explain why the methodology is appropriate and relevant to the proposal; and (4) direct us to any studies or data that the methodology relies on.

2. Costs

In the following discussion, we consider direct and indirect costs related to the proposal. We have attempted to quantify certain costs where possible. However, most of the costs are intractable to quantify, particularly the indirect costs.

- First, auditors may incur direct costs building an appropriate reporting infrastructure or updating existing infrastructure.
- Second, auditors may incur direct costs producing the firm and engagement metrics.
- Third, auditors, investors, and audit committees may incur indirect costs understanding and integrating the proposed metrics into their current decision-making frameworks.
- Fourth, auditors may incur indirect costs revising their audit approaches.
- Fifth, investors, audit committees, and auditors may incur indirect costs when issuers switch auditors.

Larger firms would be able to take advantage of economies of scale by distributing any fixed costs over a higher number of audit engagements. Smaller firms would distribute any fixed costs over a lower number of audit engagements, which, taking fixed costs as given, would make implementation relatively more costly for smaller firms.[336] However, the fixed costs may also be less for smaller firms (e.g., they may not require significant IT systems).

i. Direct Costs to Comply with the Proposal

a. Building a System to Produce the Proposed Metrics

Auditors may incur certain initial fixed costs (i.e., costs that are generally independent of the number of audits performed) related to building a system that could collect the relevant data that is needed to generate the proposed metrics and produce compliant filings. Building such a system would also entail acquiring necessary IT infrastructure, establishing an appropriate system of controls, creating system documentation, and conducting system testing (e.g., with historical data or by conducting dry runs before the effective date of the proposed requirements). There could also be costs related to training personnel in how to use the system. This includes training: (1) engagement-level personnel on how to collect and document information relevant to the proposed metrics in compliance with proposed QC 1000 if adopted and approved; (2) centralized personnel on how to aggregate and produce the proposed metrics; and (3) administrative personnel on how to create filings and ensure proper control over the system.[337]

The effort needed to build such a system would likely depend on the extent to which firms already have such systems in place and would be able to modify them to comply with the proposal. As discussed in Section IV.A, we believe many firms track information related to the proposed metrics. In particular, information gathered by staff in 2018 and 2019 pursuant to PCAOB oversight activities indicate that U.S. GNFs generally track some metrics similar to the proposed metrics.[338] We believe firms that are already tracking information related to the proposed metrics likely have systems in place to help them do so. As a result, these firms may be able to leverage their existing internal systems to comply with the proposal. Similarly, firms may be able to leverage existing systems related to their compliance with other PCAOB reporting requirements (e.g., CAMs and Form AP).

However, we have also considered that existing systems may not be functionally joined together, and that systems designed and operated for internal monitoring or informal reporting

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[336] *See, e.g.,* Michael Minnis and Nemit Shroff, *Why Regulate Private Firm Disclosure and Auditing?*, 47 Accounting and Business Research 473, 498-499 (2017) (explaining that increased financial reporting regulation is disproportionately costly for smaller companies because complying with regulation has large fixed costs, and unlike larger companies, smaller companies do not benefit from economies of scale).

[337] *See* Michael J. Gurbutt, Wei-Kang Shih, Carrie von Bose, and Tasneem Raihan, *Staff White Paper: Second Stakeholder Outreach on the Initial Implementation of CAM Requirements*, Public Company Accounting Oversight Board 11 (2022).

[338] Moreover, one GNF commenter, in response to the 2015 Concept Release, noted that some of the metrics discussed therein and included in this proposal, would be "easy to compute."

purposes may need to be enhanced to meet the needs of public reporting. There are, therefore, likely to be costs associated with integrating the various reporting systems and enhancing or updating those systems to comply with the proposed requirements. One GNF commenter on the 2015 Concept Release suggested that this would likely be especially true for NAFs. The required changes would depend on a firm's size and the nature of their engagements. For example, through a review of inspections and oversight activity, we believe that the majority of firms, and particularly smaller firms, are unlikely to record hours related to significant risk areas or to have such information already available in their internal systems.

The costs associated with building a system may depend on the choice to build automated versus manual systems. Larger firms are more likely to build automated systems, or increase automation in existing systems, given the scale of their operations and the scope of data that would need to be collected to calculate the proposed metrics (i.e., they have a larger number of employees and engagements). Smaller firms may choose to build or expand upon existing manual systems (e.g., collecting information in spreadsheets or simple databases) because, for these firms, the scope of information to be collected and processed may be effectively collated in a spreadsheet-based tool. Firms may also opt for automated systems to the extent that the proposed metrics would require a larger number of individual components, a broader pool of individuals, or more complicated calculations (e.g., the proposed metrics related to audit-team retention, auditor experience, or industry expertise). The fixed costs to build, or expand upon existing, automated systems are likely to be greater than manual systems. However, automated systems would reduce variable costs in the long run.

The costs to implement an automated system from the ground up could be comparable to the costs to implement an enterprise resources planning (ERP) system. Using surveys of companies that have implemented ERP systems, some studies find that ERP system implementation costs scale with the company's revenues and staff count. Using audit fees as a proxy for revenue and number of accountants as a proxy for staff count, staff find that the total costs across all impacted firms to implement an automated system from the ground up could range from approximately $363 million to $506 million.[339]

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339 We identified two publicly available reports related to the costs of implementing ERP systems. Referring to the experiences of companies that had implemented a digital transformation effort in the past twenty years, one consulting firm estimated that implementation costs for companies with revenues under $1 billion were approximately 3–5% of annual revenue, and implementation costs for companies with revenues over $1 billion were approximately 2–3% of annual revenue (*The 2020 ERP Report*, Third-Stage Consulting Group, (2020)). Each of the U.S. Big 4 firms had over $1 billion of revenue for the 2022 issuer fiscal year, while all other firms that would be impacted had less than $1 billion. Using the midpoint of the ranges, 2.5% for Big 4 firms and 4% for all other firms, implementation costs related to building a system to produce the proposed metrics would be approximately $11.9 billion × 2.5% + $5.2 billion × 4% = $506 million. Using information on client implementation projects active between January 2021 and December 2021, another consulting firm reported that companies having over 500, between 50 and 499, or less than 50 employees project spent $11,000, $9,000, or $8,571 per

We note several important caveats to this quantitative analysis. First, we believe most larger firms have automated systems in place that could be leveraged to comply with the proposal. Second, smaller firms could opt for a manual approach. Indeed, firms are only expected to invest in an automated system if it would be efficient to do so. Third, ERP systems possess many features that would not be necessary in a compliant automated system. Fourth, audit firms are likely to need to make similar investments in their internal systems in the near term, owing to the rapid pace of technological advancement and other rules and standards currently being proposed, thus reducing the costs attributable to this proposal.

Finally, we also note the implementation costs could be offset in part by benefits to auditors. For example, technological enhancements to auditors' systems may, in the long run, increase operational efficiency and profitability.

b. Producing the Proposed Metrics

Auditors may incur engagement-level and firm-level variable costs related to producing the proposed metrics. For example, the proposal may lead auditors to spend additional time recording, collating, and reporting information for relevant engagement-level, and then aggregated firm-level, metrics. As discussed in Section III.A, the proposal does not impose new performance requirements other than the calculation and disclosure of metrics. In addition, reviews by others, such as the engagement quality reviewer or the national office, may result in additional recurring costs. Audit firms are also likely to experience costs, or administrative time, related to legal review and quality control for the proposed metrics.

Specifically, variable costs may arise from the following activities related to producing the proposed metrics:

Recording & collecting information

Audit firms may incur variable costs recording the necessary information and collecting it in a centralized location. The magnitude of the costs would likely depend on the extent to which existing practice differs from the proposed requirements. As discussed in Section IV.A, we believe many firms already internally track information related to the proposed metrics. This would reduce the variable costs attributable to the proposal.

ERP system user over a 5-year ERP implementation period and that 7.27%, 20.13%, and 34.8% of employees used the ERP system, respectively (*2022 ERP Software Report*, Software Path, (2022)). Information provided by registered firms that would be impacted by the proposed requirements on Form 2 indicates that, for the 2022 reporting year, 138, 51, and 21 firms employed over 500, between 50 and 499, or less than 50 accountants, employing a total of 425,204, 11,874, and 495 accountants, respectively. Using the number of accountants employed by a registered firm as a proxy for the number of employees at the surveyed companies, implementation costs related to building a system to produce the proposed metrics would be approximately 425,204 × 7.27% × \$11,000 + 11,874 × 20.13% × \$9,000 + 495 × 34.8% × \$8,571 = \$363 million. Source: Audit Analytics and RASR.

The magnitude of the variable costs may also depend on the size of the firm. As discussed, based on information obtained through inspections and oversight activities, we believe that the proposal would likely affect engagements performed by all firms but may have a greater impact on engagements performed by NAFs. However, NAFs that choose to use a manual recording system may face recurring costs associated with the continued collection of data and reporting of the proposed metrics. These costs likely would vary with the size of the audit team.

Finally, the magnitude of the variable costs to record and collect information may depend on the proposed metric. For example, collecting the information needed to calculate the proposed Workload metrics would likely be relatively straightforward as such information is likely already stored in firms' extant timekeeping systems. On the other hand, collecting the information needed to calculate the proposed Audit Hours and Risk Areas metrics may require additional functionality in firms' extant timekeeping systems.

Aggregating & calculating firm and engagement metrics

Once the information is collected, it would need to be aggregated and the proposed metrics would need to be derived following the calculation requirements discussed above in Section III.B. Costs would likely be incurred to make those calculations and to make and validate the filing. Moreover, these costs would be greater for firms that would use manual systems than firms that would use automated systems.

Making the filing

Once collected, aggregated, and calculated, the proposed metrics would then need to be filed with the PCAOB. There would be costs associated with developing the filing, validating the information, and drafting the voluntary textual disclosures. This could entail administrative costs such as legal review of the textual disclosures. Firms may also need to extend their existing quality control processes around PCAOB filings to cover these new filings.

Overall, it is difficult to estimate the potential costs that audit firms would incur to produce the proposed metrics owing in part to the variability in firms' current systems (e.g., automated versus manual) and the extent to which firms already produce similar metrics for internal reporting to national offices or external reporting in firm transparency reports. However, we may extrapolate from the economic impacts of prior PCAOB disclosure rules. For example, as a result of the implementation of AS 3101 in 2019, the largest four audit firms surveyed through the PCAOB's outreach activities indicated they incurred, on average, 23,000 hours to develop the processes and procedures to support the implementation of CAMs. The PCAOB staff monetized the economic impact to those largest four audit firms to be approximately $4.4 million dollars each.[340] Those audit firms also each reported 14,600 hours of

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340 *See, e.g.*, Michael J. Gurbutt, Wei-Kang Shih, Carrie von Bose, *Staff White Paper: Stakeholder Outreach on the Initial Implementation of CAM Requirements,* PCAOB 1, 8 (2020).

training, estimated at $2.1 million dollars. The next four largest audit firms reportedly incurred 3,700 hours, on average, to develop processes and procedures, and 3,100 hours in training their personnel to support the implementation of CAMs—estimated at $610,000 and $435,000, respectively, on average for each firm.[341] As estimated through April 2021, the smallest of audit firms, after excluding outliers, reported only 400 hours implementing the CAM requirements, with 600 hours associated with CAM related training. The average implementation costs for these smallest of firms was estimated to be approximately $185,000 per firm.[342] Extrapolating these data points to the population of firms expected to be impacted by the proposed requirements would imply a total cost of approximately $68 million.[343]

Following the implementation of processes, procedures, and training, surveyed audit partners report that 1% of total audit engagement hours were spent identifying, developing, and communicating CAMs.[344] Staff research found no systematic evidence of increased engagement hours for audits of large accelerated filers (LAFs)[345] and a statistically significant 6.6% increase in engagement hours for audits of non-LAFs. The findings suggest that there could potentially be variable costs associated with the proposed requirements that would persist after the implementation phase.

Auditors of large accelerated filers realized efficiencies in developing and communicating critical audit matters in the second year of implementation, reporting that they generally spent the same or less time on critical audit matters compared to the initial year of implementation.[346] Accordingly, we expect that the costs to produce the proposed metrics would be most significant for the initial filings under the proposal because firm personnel

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341 *Id.* The "next four largest firms" refers to BDO USA LLP, Crowe LLP, Grant Thornton LLP, and RSM US LLP. *See* Gurbutt et al., *Stakeholder Outreach* at footnote 4.

342 *See* Gurbutt, et al., *Staff White Paper: Second Stakeholder Outreach on the Initial Implementation of CAM Requirements* 1, 13. "Smaller audit firms" refers to Marcum LLP; Moss Adams LLP, Baker Tilly US LLP; BKD LLP; CohnReznick LLP; Dixon Hughes Goodman LLP (DHG); EisnerAmper LLP; Mayer Hoffman McCann P.C. (MHM); Plante & Moran, PLLC; and WithumSmith + Brown, PC.

343 As an example, aggregating these costs across active firms in the market implies roughly $6.5 million in procedures and training for the largest four audit firms ($4.4 million for processes and procedures and $2.1 million for training), $1.045 million for the next four largest firms, and $185,000 for 202 smaller impacted firms, would amount to a combined $67.6 million in costs to produce the proposed metrics outside of implementation costs associated with the systems ($6.5 million × 4 larger firms + $1.045 million × 4 next-largest firms + $0.185 × 202 smaller firms = $67.6 million).

344 *See* Gurbutt and Shih, *Econometric Analysis on the Initial Implementation of CAM Requirements* 4.

345 *See* Gurbutt and Shih, *Econometric Analysis on the Initial Implementation of CAM Requirements* 4.

346 *See, e.g.*, *Interim Analysis Report: Further Evidence on the Initial Impact of Critical Audit Matter Requirements*, PCAOB Rel. No. 2022-007 (Dec. 7, 2022).

would need to familiarize themselves with new reporting requirements and forms. In subsequent reporting periods, we anticipate that firms would incur lower costs as personnel become more familiar with the reporting requirements.

As noted above, AS 3101 and the proposal are different in ways that may limit the relevance of the costs of AS 3101 to the potential costs of the proposal. For example, as discussed in Section IV.C.1.i, the proposed metrics would require the collection of a broader array of engagement-level information whereas CAM requirements focus more on narrative description. However, the processes, procedures and training aspects are likely more comparable.

ii. Indirect Costs Arising from Market Reactions to the Proposed Metrics

We also reviewed and considered costs that would arise from how investors, audit committees, and auditors may react to the proposed metrics. For example, improved decision-making on the part of audit committees could lead to costs from switching auditors. Most of these costs are intractable to quantify and are only likely to be incurred in so much as they are deemed reasonable from a business perspective.

a. Understanding the Proposed Metrics

Investors would incur costs to understand the proposed metrics to the extent they would find the proposed metrics useful to their decision-making. Due to economies of scale, we believe institutional investors would be more likely to incur these costs than retail investors. Audit committees may incur costs to understand the proposed metrics because their fiduciary duties may prompt them to do so. Moreover, audit committees may spend additional time discussing the proposed metrics with their auditor, which would require both audit committees' and auditors' time. Auditors may spend time and resources developing materials to explain or contextualize their metrics for the audit committee (e.g., presentations and decision aids).

Furthermore, investors and audit committees may incur costs in monitoring the proposed metrics and learning to extract decision-making information from them. Investors may incur costs incorporating the proposed metrics into their investment decisions or exercising oversight over issuers and audit committees. Audit committees may incur costs to review the proposed metrics in support of their auditor oversight responsibilities.

There may also be costs associated with interpreting certain proposed metrics in relation to proposed metrics across other firms and engagements. For example, the proposed metric regarding the alignment of compensation with audit quality may be compared to other peer audit firms. Similarly, audit team retention (tenure) may be more informative when considered in the context of overall firm retention (tenure) from other engagements or firms.

Moreover, investors and audit committees may spend time researching the state of the market for assurance services to provide more context to the proposed metrics.[347]

Auditors may also incur costs to monitor how their proposed metrics compare to those of their competitors. GNFs, in particular, could deploy significant resources in this way. NAFsmay have less ability to fully evaluate the information contained in the proposed metrics and choose instead to retain outside experts to provide such research. Firms may also use the proposed engagement-level metrics to inform their acceptance and continuance policies (e.g., audit hours).

b. Revising Audit Approaches

Armed with the new information discussed above, audit committees may question their auditor's audit approach. This may prompt auditors to make changes to their audit approaches. For example, an audit committee may come to the belief that the audit partners have too many other duties and may express this concern to the auditor. This may prompt auditors to adjust how they are staffing the audit. Similarly, audit firms could incur costs making those changes. Some of these costs may be greater than others. For example, reducing excessive turnover and workloads, to the extent they exist, could require a significant investment in resources.

As discussed in Section IV.C.1.ii, the proposal may lead audit firms to compete on the proposed metrics. This could lead some firms to update their audit approaches, provide additional training, or increase their specialization. For example, auditors may increase training in industry-specific areas or hire additional individuals with specialized knowledge. As another example, to the extent issuer preferences show an increased demand for auditors with lower workloads, firms may increase staffing. Such an increase in human-capital investment would likely increase labor and overhead costs for audit firms. Auditors may also increase the quality review of their work to reduce the likelihood of restatements or enhance their audit procedures to compete on the basis of higher-quality audit services.

c. Switching Auditors

As discussed above in Section IV.C.1.i.b, the proposal could result in increased auditor switching as investors and audit committees compare and evaluate current and alternative auditors. Should audit committees ultimately choose to change auditors, there may be switching costs, both to the issuer and the auditor. For example, it can take several years for a new auditor to fully understand a new issuer's business and financial reporting risks. There would likely be a transitory period of increased auditor switching, after which auditor switching would stabilize as the audit market reaches a new equilibrium.

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[347] For example, some literature suggests that the implications of staff turnover are better understood in the context of accounting labor supply. *See* Khavis and Szerwo, *Audit-Employee Turnover, Audit Quality, and the Auditor-Client Relationship* 2.

iii. Indirect Costs to Issuers

Economic theory suggests that auditors may pass on to issuers costs incurred as a result of the proposal in the form of higher audit fees.[348] In addition, the degree to which increases in variable costs, such as certain firm compliance costs, are expected to be passed on would vary based on how widespread the costs are across competitors. Increases in variable costs that impact all sellers in an imperfectly competitive market are more likely to be passed on than cost increases that impact only a subset of sellers.[349] If compliance costs have a greater impact on a subset of firms, such as smaller firms, those firms may be less inclined to pass on the incremental costs in order to stay competitive with larger firms.

Evidence from the PCAOB's post-implementation review of AS 3101 suggests that there was no statistically significant increase in audit fees for the audits of LAFs but a statistically significant 3.0% increase for the audits of non-LAFs.[350] Financial statement preparers and audit committees interviewed during the PCAOB's investor outreach efforts indicated that there were minimal or immaterial costs.[351] One academic study found a small, statistically insignificant audit fee increases as a result of PCAOB Rule 3211.[352] Another study found that audit fees increased by a statistically significant 7.9 percentage points.[353]

Questions

99. Have we appropriately described the costs, including costs to smaller firms or issuers? If not, how can we improve the analysis?

100. Is the literature cited for the analysis of costs fairly represented? If not, please explain.

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[348] Economic theory suggests that fixed costs are less likely to be passed on. Only changes to variable costs are generally expected to impact sellers' pricing decisions. *See, e.g.*, Mankiw, *Principles of Economics* 284 and 307 (showing that the profit-maximizing price is a function of marginal cost rather than fixed costs).

[349] *See, e.g.*, Erich Muehlegger and Richard L. Sweeney, *Pass-Through of Own and Rival Cost Shocks: Evidence from the U.S. Fracking Boom*, 104 Review of Economics & Statistics 1361 (2022).

[350] *See* Gurbutt and Shih, *Econometric Analysis on the Initial Implementation of CAM Requirements*; and Jonathan T. Fluharty-Jaidee, Michael J. Gurbutt, and Wei-Kang Shih, *Staff White Paper: Second Econometric Analysis on the Initial Implementation of CAM Requirements*, Public Company Accounting Oversight Board, (2022).

[351] *See* Gurbutt, et al., *Staff White Paper: Second Stakeholder Outreach on the Initial Implementation of CAM Requirements* 21.

[352] *See* Cunningham, et al., *What's in a Name?* 141 and 156 (finding no statistically significant increase in fees following the implementation of AS 3211, Form AP, in 2017).

[353] *See, e.g.*, John and Liu, *Disclosure of an Audit Engagement Partner's Name*.

101. Are there additional studies or data that would inform our analysis of the costs? If so, please direct us to them and explain how they would inform the analysis.

102. Are there any quantifiable costs? If so, please: (1) identify them; (2) describe a methodology to quantify them; (3) explain why the methodology is appropriate and relevant to the proposal; and (4) direct us to any studies or data that the methodology relies on.

3. Unintended Consequences

In addition to the benefits and costs discussed above, the proposal could have unintended consequences. The following discussion describes potential unintended consequences we have considered and, where applicable, any mitigating or countervailing factors.

i. Auditors May Exit the Market for AF and LAF Due to Increased Competition and Costs

The proposal may lead auditors to compete on the proposed metrics. We believe this new competitive dynamic would be beneficial.[354] However, firms that are less able to compete on the proposed metrics could lose market share or be forced to lower their audit fees, resulting in strains on their profitability. Profitability could also be negatively impacted by the costs of the proposal. In some cases, these auditors may exit the public audit market for accelerated filer (AF) and LAF audits. This could reduce the number of potential auditors some AFs or LAFs may consider as well as the overall capacity of the audit market, thereby reducing competition.

This potential unintended consequence would be mitigated by several factors. First, exit may be limited primarily to smaller firms, which could be disproportionately impacted by the costs of the proposal. Reduced competition would thus tend to impact smaller AFs rather than larger LAFs, which typically require larger auditors. Second, competition may increase in the non-AF issuer audit market to the extent firms exiting the AF and LAF issuer markets redeploy capacity to the non-AF issuer audit market. Finally, more competitive firms in the AF and LAF issuer audit markets could expand their market share, perhaps by acquiring additional capacity from exiting firms.

ii. Some Auditors May Strategically Manage their Issuer Portfolios

As discussed in Section III.C.1, auditors that do not audit AFs or LAFs would be exempt from the proposed reporting requirements. Low-quality auditors may strategically seek to audit only non-AFs to avoid disclosure of the proposed metrics that could potentially damage their

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354 *See* Section IV.C.1.ii for a discussion on the benefits linked to competition.

reputation.[355] As a result, there could be a separating equilibrium in the audit market.[356] This would increase the supply of low-quality auditors to non-AFs and decrease the supply of low-quality auditors to AFs. For non-AFs, this supply shock could increase competition among audit firms for non-AFs and therefore reduce audit fees. However, because the supply shock would consist primarily of low-quality auditors, it could also lower audit quality for non-AFs. For AFs, the opposite would occur. Reduced availability of auditors would tend to reduce competition and therefore increase audit fees. However, because higher-quality auditors would remain, audit quality could increase. As a result of these complex and countervailing influences, it is unclear whether this unintended consequence would have a net positive or negative impact.

Auditors may also attempt to manage their metrics via their acceptance and continuance policies. Reputation risks to the auditor associated with individual engagements may start to play a greater role in firms' acceptance and continuance decisions as well as their audit fee decisions because new engagements could impact firms' metrics and hence their ability to charge audit fees on existing engagements. For example, a prospective issuer engagement may present a higher risk of restatement. Since restatements would be reported on Form FM in a uniform and comparable way, auditors may require a fee premium for this issuer to offset any negative effect the issuer may have on the auditor's metrics. In extreme cases, risky issuers may not be able to find an auditor, may be forced to hire a low-quality auditor, or may be forced to delist.

To avoid such adverse outcomes, issuers may take steps to reduce their contribution to audit risk.[357] For example, issuers may become more forthcoming with information or opt for less aggressive financial reporting. This potential unintended consequence would also be mitigated to the extent capital markets recognize that an auditor's metrics are driven in part by the riskiness of the auditor's client portfolio rather than the quality of the auditor.[358] Indeed, auditors would have the opportunity to explain important context like this in the qualitative portion of the proposed disclosures.

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355 Commenters on proposed QC 1000 said that mid-sized firms would deliberately manage their portfolios to avoid the proposed scalability requirements that apply only to annually inspected firms. Therefore, we believe that such portfolio management is possible in relation to this proposal.

356 Contextually, a separating equilibrium occurs when incentives cause a division in the market in which one type of auditor gravitates towards a particular market segment. *See*, *e.g.*, Michael Rothschild and Joseph E. Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information,* 90 The Quarterly Journal of Economics 629, 634 (1976) (specifically, the discussion marked *I.6 Imperfect Information: Equilibrium with Two Classes of Customers*).

357 Economic theory suggests that private negotiations yield efficient allocations of decision rights. *See* Ronald Coase, *The Problem of Social Cost*, 3 The Journal of Law and Economics 1 (1960).

358 Some research finds that poor financial reporting outcomes are attributable to client risk rather than poor audit quality. *See* Minutti-Meza, *Does Auditor Industry Specialization Improve Audit Quality?*.

iii. Investors, Audit Committees, and Auditors May Misinterpret or Misuse the Proposed Metrics

As discussed in Section IV.B, it is possible that the proposed metrics may not relate to audit quality in a well-defined way. As a result, there is a risk that investors, audit committees, and auditors could misinterpret, or misuse, the proposed metrics (e.g., by assuming they are strongly related to audit quality). The outcomes of misinterpretation or misuse are difficult to predict because they would be rooted in complex aspects of human psychology.[359] As one example, investors and audit committees could rely too heavily on a proposed metric (e.g., when making capital allocation or auditor selection decisions). In response to market forces or requests from audit committees, some auditors could make changes to their audit approach that could negatively impact audit quality. As another example, auditors could mistakenly attribute other firms' competitiveness to one proposed metric and adjust their audit approach in a way that compromises the quality of their services.

iv. Auditors May Attempt to Manipulate the Proposed Metrics

As discussed above, the proposal could lead firms to compete on the proposed metrics. As a result, we believe some firms would take steps to provide higher service quality. However, it is possible that some firms could instead manipulate the proposed metrics in ways that create an impression of providing higher service quality when in fact this is not the case. This unintended consequence would be analogous, in some regards, to earnings management by financial statement preparers.[360]

Some proposed metrics would be more difficult to manage than others. To the extent firms are able to manage a proposed metric, management of the proposed metric would tend to reduce the overall informativeness of the corresponding disclosures and could lead investors and audit committees to doubt the quality of other firms' disclosures as well. This could degrade existing empirical relationships between the proposed metrics and audit quality.[361]

Should it be adopted and approved, proposed QC 1000 would help mitigate this potential unintended consequence by explicitly subjecting the proposed metrics to firms' QC systems. Furthermore, firms' disclosure practices would be subject to PCAOB oversight.

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359 *See, e.g.*, Loewenstein et al., *Disclosure* (discussing how "[p]sychological factors severely complicate the standard arguments for the efficacy of disclosure requirements.").

360 *See*, *e.g.*, Graham, John R., Campbell R. Harvey, and Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 Journal of Accounting and Economics 3, 4 (discussing how "[a] surprising 78% of our sample admits to sacrificing long-term value to smooth earnings").

361 Such behavior can be ascribed to Goodhart's law in that, once the proposed metrics are disclosed and market participants act upon them, previously defined relationships change, and the proposed metrics may become unrelated to the alignments previously discussed.

v. Audit Labor Market Impacts

The proposed metrics could lead to increased public scrutiny of firms and their engagements. This could negatively impact the issuer audit labor market if individual auditors believe the increased public scrutiny negatively impacts their personal reputations or otherwise increases their work pressures. However, individual auditors could also use the proposed metrics to gain insights into workplace conditions and find firms more suitable to their skillsets and workplace preferences. This may lead firms to compete for labor by improving their workplace conditions.

Questions

103. Have we appropriately described the potential unintended consequences? If not, how can we improve the analysis?

104. Is the literature cited for the alternatives fairly represented? If not, please explain.

105. Are there additional studies or data that would inform our analysis of alternatives? If so, please direct us to them and explain how they would inform the analysis.

D. Alternatives Considered

The development of the proposal involved considering alternative approaches to address the problems described above. This section explains: (1) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts, (2) other standard-setting approaches that were considered, and (3) key policy choices made in determining the details of the proposed standard-setting approach.

1. Why Standard Setting is Preferable to Another Approach

As potential alternatives to standard setting, we considered whether interpretive guidance or greater focus on inspections or enforcement could better address the need described in Section IV.B above. We determined that, despite long-term requests by investors to disclose additional metrics, similar initiatives by other standard setters, and the apparent ability of firms to voluntarily disclose metrics, the fact that most auditors have not voluntarily acted to disclose effective metrics on a uniform basis at the firm and engagement level points to the need for regulatory intervention through standard setting.

Increased focus on inspections or enforcement is unlikely to incentivize audit firms to voluntarily disclose the proposed metrics. Likewise, interpretive guidance is unlikely to address audit firms' lack of incentives to voluntarily disclose the proposed metrics. As discussed in Section IV.B.2, required mandatory and uniform reporting would help audit committees make more informed decisions in hiring and monitoring auditors, and investors make more informed decisions when ratifying auditor appointments, electing board members (including those who serve on the audit committee), and allocating capital. The Board believes that standard setting would address the problem in the most beneficial way.

2. Other Standard-Setting Alternatives Considered

During the development of the proposal, we considered two alternatives to the current disclosure rules: (1) publishing benchmarks on the proposed firm and engagement metrics, and (2) requiring additional audit committee communications.

First, we considered collecting the proposed metrics from the firms privately and then publishing benchmarks publicly. This approach would benefit the Board in the ways described in Section IV.C.1.i.c. However, we believe investors and audit committees would be able to effectively interpret the proposed metrics in their proposed, disaggregated form and hence public transparency would be important. Moreover, as discussed in Section IV.C.3, benchmarking could even have potentially harmful unintended consequences.

Second, we considered requiring auditors to communicate the proposed metrics just to their audit committees. However, such a policy choice would not directly benefit investors' decision making. Moreover, it would limit audit committees' ability to compare the proposed metrics across firms and engagements and thus impair their decision making (e.g., auditor selection).

3. Key Policy Choices

During the development of the proposal, we considered different approaches to addressing key policy issues.

i. Definitions and Calculations of the Proposed Metrics

We considered a variety of alternative definitions and calculations of the proposed metrics. See Section III.B for a discussion of these considerations.

ii. Applicability

Section III.C describes the conditions under which firms would be required to comply with the proposed engagement and firm-level reporting requirements. During the development of the proposal, we considered limiting applicability to firms that met a certain aggregate issuer market capitalization threshold. We also considered broadening the set of applicable filer statuses.

Compared to the proposed approach, an aggregate issuer market capitalization threshold could help focus the proposal on auditors and engagements that investors are most interested in.

Commenters during the development of proposed QC 1000 indicated that a threshold based on market capitalization was perhaps preferable to a threshold based on issuer-count because many auditors audit numerous small engagements with limited operations (e.g., SPACs). However, such an approach could present challenges. As one commenter noted, thresholds based on market capitalization may be subject to the volatility of the market. During a review of the potential methodologies, we found that such a threshold would also be sensitive to auditor switches, particularly if the switching issuer had a large market capitalization. Some auditors near the threshold could move back and forth between applicability and non-applicability. We also considered alternative transition thresholds for market capitalizations, or a phase-out period in attempting to mitigate the negative aspects of these options. Ultimately, we have initially determined that there was limited benefit to using these alternative applicability thresholds.[362]

We also considered broadening the applicability of the proposed firm-level metrics to include all firms that audited at least one operating company. This would increase the number of firms impacted by the proposed firm-level metrics by approximately 160 and increase the number of engagements and market capitalization covered by the proposed firm-level metrics by approximately 16% and less than 0.1%, respectively.[363] Expanding the scope to cover all firms that audit at least one operating company could reduce any potential negative stigma associated with smaller firms for not being required to disclose the proposed metrics. However, these firms tend to be smaller and hence may lack the infrastructure and economies of scale to efficiently implement the proposal. Furthermore, the gain of information to audit committees and investors would be limited by the fact that these firms tend to have smaller or fewer issuers on average. It also could create confusion to have different thresholds for the proposed firm-level reporting requirements and the proposed engagement-level reporting requirements. Finally, firms that would not be subject to the proposed firm-level disclosure requirements could voluntarily disclose the proposed metrics.

We also considered broadening applicability of the proposed engagement-level metrics to include non-AF issuers. While the importance of audit quality may be more significant for smaller issuers,[364] staff analysis finds that non-AFs are proportionately smaller—at the median—than AF and LAFs in terms of audit fees and total assets.[365] One survey of audit

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[362] *See* a discussion on the proposed phased implementation in Section VI.

[363] *See* Section III.C.1 for discussion on data sourcing. We exclude firms that filed an audit opinion during the sample period but whose registration has since been withdrawn, revoked, or is pending withdrawal.

[364] *See* Section V for additional discussion.

[365] Based on data sourced through Audit Analytics' Web service for audit opinions, non-AFs paid median audit fees of roughly $258,884 and $240,000 for fiscal years 2020 and 2021, respectively. Non-AFs also had median total assets of $80.5 million and $109 million over the same respective period. Comparatively, AF issuers had median fees of $940,000 and $852,004, over those periods; and median total assets of $872 million and $707 million. LAFs had median fees of $2,645,000 and $2,447,000, over those periods, respectively; and median total assets of $5,289 million and $4,727 million. Only issuers filing pursuant to the Securities and Exchange Act of 1934 (a.k.a. Act-34 filers) were retained in the

committees of smaller public companies found that five of the 28 metrics discussed in the Concept Release were evaluated by more than half of the audit committees surveyed.[366] Staff also reviewed the relative trading volume associated with these filer status groups and found that non-AF issuers have higher average daily (unit) volume than AF issuers but lower average daily (unit) volume than LAFs.[367] Neither issuer group, in general, was "thinly traded," as measured by average daily volume.[368] Given these differences, the costs of the proposal associated with non-AF issuer engagements could be proportionally higher than the costs

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sample. Our results remain quantitatively and qualitatively similar if the data is sourced through Audit Analytics' API-Feeds. While on average (i.e., at the mean), non-AFs may appear to be as large, or larger, than their AF counterparts, this seems to be driven by a few larger non-AF issuers, especially within the banking sector. The SEC's filer status rules allow for a non-AF issuer to have a public float of up to $700 million measured six months prior to the issuer's fiscal year end, before that issuer would transition to the LAF status. AF issuers also have a public float cap of $700 million before they too transition to become LAFs. The predominant difference between the two filer status groups is the amount of total revenue, which is greater than (or equal to) $100 million for AFs, and less than $100 million for non-AFs. As a result, it is possible that some non-AFs have assets, book equities, or market capitalizations that are significantly larger than some AFs. These large-issuer non-AFs skew the observed distribution, and therefore we believe using the median is a more relevant benchmark.

[366] *See, e.g.*, Harris and Williams, *Audit Quality Indicators*.

[367] Sourcing data across the University of Chicago's Center for Research and Security Prices (CRSP) Annual flat-file to collect annual volume, along with Compustat, and Audit Analytics, we identified, using filer statuses reported by Audit Analytics, that the median average daily volume (ADV, the quantity of share units traded per year divided by 252 trading days) for LAFs in 2020 and 2021 was roughly 867,000 units per day and 762,000 units per day, respectively. For AF, the ADV was 183,000 and 168,000 respectively. For non-AFs, the ADV was 528,000 and 756,000, units per day, for 2020 and 2021. One reason for this is possibly the relatively lower share price non-AF issuers have, resulting in a higher unit-volume (per trade lot) compared to AF issuers. We maintain share codes 10, 11 (i.e., US issuers), and 12 (foreign issuers trading on US exchanges) in our analysis, and remove ADRs, SBIs, REITs, and closed-end funds. Additionally, we retain only Securities and Exchange Act 1934 filers (aka Act-34 filers) and volumes related to the first audit opinion filed with the SEC for a given fiscal year. Filer status, as sourced through Audit Analytics, may be an imperfect proxy of the true filer status of the entity-issuer due to errors in reporting and or collection. Furthermore, we retain only observations in which there is recorded to be complete volume (CV) for the entire annual period. There were 1,350 LAF issuers in our sample in 2020, and 1,358 in 2021. For AFs there are 337 and 329 issuers in each 2020 and 2021 that remain in our sample, and for non-AFs there are 121 and 134 issuers, respectively. We attempt to remove issuers additionally classified as Small Reporting Companies (SRCs) from the reported statistics. Lastly, not all issuers, particularly smaller issuers, trade on exchanges observed in the CRSP dataset—as a result our sample may be biased towards larger issuers, or issuers that trade on exchanges observed by CRSP.

[368] For a discussion of "thinly traded" markets, *see Division of Trading and Markets: Background Paper on the Market Structure for Thinly Traded Securities*, Roundtable on Market Structure for Thinly Traded Securities (April 23, 2018), *available at* https://www.sec.gov/rules/policy/2019/thinly-traded-securities-tm-background-paper.pdf.

associated with AF or LAF issuers engagements. As a result, we have proposed to restrict the applicability of the proposed engagement-level metrics to AF and LAF engagements. Firms that would not be subject to the proposed engagement-level disclosure requirements could voluntarily disclose the proposed metrics.

Finally, we considered whether the scope for engagement-level reporting should be extended to non-operating company issuers whose financial statements are required under SEC rules to be audited under PCAOB standards (i.e., investment companies, employee stock plans) and-or broker dealers. While these additional disclosures could be informative, we are considering whether there are other opportunities for more customized disclosures better suited to these issuers and welcomes the public's comment on such scoping considerations.

iii. Reporting of the Proposed Firm and Engagement Metrics on PCAOB Form AP, Proposed Form FM, and the Audit Report

As discussed in Section III.C.3, firms subject to the proposed engagement-level reporting requirements would be required to disclose the proposed engagement-level metrics in Form AP, to be filed by the 35th day (for most audits) after the date the audit report is first included in a document filed with the SEC. Firms subject to the proposed firm-level reporting requirements would also be required to disclose the proposed firm-level metrics in the newly created Form FM.

As contemplated above in Section III.C.4, we are considering including the proposed metrics in the audit report in addition to Form AP and Form FM. Under this alternative, costs incurred by investors and audit committees when gathering information to inform their decision-making could be further reduced. Investors would be able to look down from the auditor's opinion and immediately review the proposed metrics. Moreover, this would serve as a prime opportunity for the firm to communicate critical context through narratives that might be beneficial for investors in reviewing the proposed metrics.

The disclosure of the proposed metrics in the audit report would not impair the usefulness of their disclosure through Form AP and Form FM. Indeed, such additional reporting may enhance their usefulness by setting the proposed metrics within the full context of the issuer's financial reporting. However, some investors and audit committees may prefer to obtain the information from Form AP and Form FM, or from other sources (e.g., a subscription-based data provider), and hence may find little use for metrics in the audit report. There likely would not be appreciable costs associated with this additional reporting, outside of costs to include the report in the filing of the audit opinion. Firms would already be required to collate information and compute the proposed metrics for reporting to the PCAOB in their relevant forms. We are soliciting feedback on this policy alternative.

We also considered proposing to require firms subject to the proposed firm-level reporting requirements to disclose the firm-level metrics on Form 2 rather than Form FM. This approach could benefit some investors or audit committees because the firm-level metrics would appear in the context of other firm-level information. It could also reduce compliance costs for firms because firms are already familiar with Form 2. However, Form 2 is currently not downloadable as a structure dataset. This could reduce the accessibility of the proposed firm-level metrics to investors and audit committees. Furthermore, the proposed firm-level metrics use terms that have different meanings in the context of Form 2 (e.g., "Partners"). This could lead some investors or audit committees to misunderstand the proposed firm-level metrics or lead some firms to mistakenly provide incorrect information in Form 2.

iv. Alternative Firm and Engagement Metrics Considered

We considered but are not proposing metrics related to: (1) auditor proficiency testing; surveys of firms and audit committees; and auditor absenteeism; (2) legal proceedings against audit firms and firm ownership structures; (3) engagement-level PCAOB deficiencies; (4) training, access to national office or other technical resources and staff, and investments in infrastructure to support audit quality; (5) auditor independence and financial reporting quality; (6) timely issuance of internal controls weaknesses and going concern opinions and fraud or other financial reporting misconduct; and (7) audit fees, effort, and client risk. In the following discussion we briefly describe and evaluate the literature on these metrics and provide our rationale for not proposing them.

a. Metrics Related to Proficiency Testing, Surveys of Firms and Audit Committees, and Auditor Absenteeism

Metrics related to proficiency testing, surveys of firms and audit committees, and auditor absenteeism would generally speak to the "Tone at the Top" or workplace culture of the audit firm. There is a lack of literature covering the economic impacts that disclosure of these metrics might engender. While some academic literature suggests strong work culture and a "Tone at the Top" is associated with audit quality,[369] it is unclear how an informative metric could be constructed. Similarly, while some academic literature suggests competence is associated with audit quality, there is limited research related to proficiency testing per se and it is unclear how an informative metric on proficiency testing could be constructed.[370] Finally, we are unaware of any literature related to auditor absenteeism. Therefore, we are not proposing to require disclosure of these metrics under this proposal at this time.

b. Metrics Related to Legal Proceedings Against Audit Firms and Firm Ownership Structure

Some academic literature suggests there may be no relationship between the quality of audit services or the auditor's provision of reasonable assurance and the likelihood that an

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369 *See, e.g.,* Stephen Perreault, James Wainberg, and Benjamin L. Luippold, *The Impact of Client Error-Management Climate and the Nature of the Auditor-Client Relationship on External Auditor Reporting Decisions*, 29 Behavioral Research in Accounting 37, 38 (2017) and Donna D. Bobek, Derek W. Dalton, Brian E. Daugherty, Amy M. Hageman, Robin R. Radtke, *An Investigation of Ethical Environments of CPAs: Public Accounting versus Industry*, 29 Behavioral Research in Accounting 43 (2017).

370 *See*, *e.g.*, Christensen et al., *Understanding Audit Quality*.

auditor could be sued, a case settled, or taken through court.[371] Many cases brought against auditors fail to meet the threshold of fault required to show the auditor is liable for the damages incurred by investors. Information related to legal proceedings may also be confidential or otherwise sensitive. Furthermore, the incidence of lawsuits against auditors has declined in recent years.[372] One investor survey finds that investors perceive private litigation as being unrelated to audit quality.[373] Metrics related to firm ownership structure are being considered by the PCAOB's Firm Reporting rulemaking project. Therefore, we are not proposing to require disclosure of these metrics under this proposal at this time.

c. Metrics Related to Engagement-Level PCAOB Deficiencies

While academic literature suggests that engagement-level PCAOB auditing deficiencies are indicative of low audit quality, Sarbanes-Oxley already provides a robust framework for making PCAOB inspection findings and sanctions public.[374] Therefore, we are not proposing to require the disclosure of engagement-level PCAOB auditing deficiencies under the proposal at this time.

d. Metrics Related to Training, Access to the National Office or Other Technical Resources and Staff, and Investments in Infrastructure to Support Audit Quality

Section III.E.1 discusses our considerations regarding potential metrics related to training. Overall, academic literature provides some evidence that auditors may benefit from *specialized* training which helps to provide specific skills used to identify risks of material misstatement.[375] Moreover, the ubiquitous state licensing requirements for continuing education for public accountants to obtain and retain certification speaks to the relationship between quality and appropriate training and education.[376] However, the academic literature shows that training in general knowledge areas may not be specifically related to improved

371 *See, e.g.*, Colleen Honigsberg, Shivaram Rajgopal, and Suraj Srinivasan, *The Changing Landscape of Auditors' Liability,* 63 The Journal of Law and Economics 367, 389 (2020).

372 *See* Honigsberg et al., *The Changing Landscape*.

373 *See* Christensen et al., *Understanding Audit Quality*.

374 *See*, *e.g.,* Aobdia et al., *Practitioner Assessments*.

375 The academic literature provides mixed evidence that auditor training (i.e., as measured by hours of training), relates to overall audit quality. One study found that only specialized, or non-generic audit-knowledge, obtained by training could be beneficial to audit quality. *See* García-Blandon, et al., *Learning by Doing?*. An older experiment found that specialized indirect experience (i.e., training), resulted in a stronger understanding for the auditor, but had a greater impact of knowledge unrelated to financial statement errors. *See* Solomon, et al., *What Do Industry-Specialist Auditors Know?*.

376 *See, e.g.*, https://us.aicpa.org/becomeacpa/licensure.

audit outcomes.[377] We believe we believe it would be difficult to devise a meaningful and comparable training metric. Therefore, we are not proposing to require disclosure of metrics related to training under this proposal at this time.

Section III.E.2 discusses our considerations regarding potential metrics related to access to technical resources. Overall, metrics related to audit teams' access to such technical resources and staff could indicate how accessible individuals, decision aids, or technical audit-process manuals are to audit teams. For example, in larger firms, individuals in the national office may provide consultation on complex, unusual, or unfamiliar issues. One study using PCAOB data found that national office consultations are common among PCAOB-inspected engagements and that national office consultation use is associated with engagement characteristics and proxies for audit quality.[378] Smaller firms may retain individuals with such expertise from outside the firm. Metrics related to infrastructure that supports audit quality could provide information on resources audit teams have available to them that could support audit quality. However, due to the variety of ways firms provide technical resources and infrastructure to support audit quality, we believe that metrics related to these areas would likely not be informative or comparable for all firms. Furthermore, disclosures related to network relationships currently being considered as part of the PCAOB's Firm Reporting rulemaking project would provide some information to investors and audit committees regarding firms' access to technical resources. Therefore, we are not proposing to require disclosure of metrics related to access to technical resources under the proposal at this time.

Section III.E.3 discusses our considerations regarding potential metrics related to investment in audit infrastructure. Overall, we do not believe a metric would be informative and comparable. Therefore, we are not proposing to require disclosure of metrics related to access to investment in audit infrastructure under this proposal at this time.

e. Metrics Related to Auditor Independence and Financial Reporting Quality

Disclosures related to audit fees and non-audit fees are currently being considered as part of the PCAOB's Firm Reporting rulemaking project. Furthermore, the proposal already includes a metric for restatements, a well-accepted proxy for financial reporting quality. Therefore, we do not think there is a need to expand disclosures related to this information under this proposal at this time.

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[377] *See, e.g.*, Bonner and Lewis, *Determinants of Auditor Expertise* 16 and García-Blandon, et al., *Learning by Doing?*.

[378] *See*, *e.g.*, Matthew G. Sherwood, Miguel Minutti-Meza, and Aleksandra B. Zimmerman, *Auditors' National Office Consultations*, SSRN Electronic Journal (2024).

f. Metrics Related to the Timely Issuance of Internal Controls Weaknesses and Going Concern Opinions, and Fraud or Other Financial Reporting Misconduct

Academic research suggests that (1) markets react to going concern reporting and (2) timely reporting of a going concern opinion is an indicator of audit quality.[379] However, there is a lack of academic research related to timely reporting of internal control weaknesses. The proposal includes metrics related to restatements and the results of internal monitoring, which we believe would provide clearer signals of audit quality. Firms' reporting of internal control weaknesses and their inclusion of going concern explanatory paragraphs in the audit report are also publicly available already, as are indicators of auditors' timeliness (e.g., subsequent restatements or bankruptcies). Additionally, we are considering other standard-setting opportunities related to the reporting of fraud or other financial reporting misconduct as well as the auditor's going concern evaluation. Therefore, we do not think there is a need to require disclosure of these metrics under this proposal at this time.

g. Metrics Related to Audit Fees, Effort, and Client Risk

The proposal includes several metrics related to workload and time incurred on risk areas. We believe these proposed metrics would provide insights into auditor effort and client risk. Additionally, engagement-level audit hours are highly correlated with engagement-level audit fees which are publicly available.[380] Firm-level audit fees may be calculated based on the engagement-level audit fee data that is publicly available. Academic research provides mixed evidence on the contribution of overall audit hours to audit quality.[381] Regarding client risk, we have observed through our oversight activities that firms classify clients as high risk in various ways. For these reasons, we are not proposing to require disclosure of these metrics under this proposal at this time.

Questions

106. Have we appropriately described alternatives? If not, how can we improve the analysis?

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379 *See* DeFond and Zhang, *A Review of Archival Auditing Research*.

380 *See*, *e.g.*, Aobdia, *Practitioner Assessments* Table 4.

381 See, *e.g.*, Aobdia et al., *The Economics of Audit Production* Table 3 and Table 4 (finding that audit effort is not related to various proxies for audit quality after holding other factors constant); Constantinos Caramanis and Clive Lennox, *Audit Effort and Earnings Management*, 45 Journal of Accounting and Economics 116 (2008) (studying Greek audit firms, finding that lower audit hours are associated with decreases in various proxies for audit quality) and Dafydd Mali and Hyoung-Joo Lim, *Can Audit Effort (Hours) Reduce a Firm's Cost of Capital? Evidence from South Korea,* 45 Accounting Forum 171 (2020) (finding, using data on Korean audit firms, that audit effort is negatively associated with weighted average cost of capital).

107. Are any alternative approaches preferable to the proposed approach? If so, please describe them and explain why they are preferable.

108. Is the literature cited for the alternatives fairly represented? If not, please explain.

109. Are there additional studies or data that would inform our analysis of alternatives? If so, please direct us to them and explain how they would inform the analysis.

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

The proposed mandatory disclosure rules would apply to audits of Emerging Growth Companies ("EGCs"), as defined in Section 3(a)(80) of the Exchange Act. Section 104 of the Jumpstart Our Business Startups ("JOBS") Act imposes certain limitations to the application of the Board's standards to audits of EGCs. Under Section 104, the JOBS Act further provides that any additional rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of EGCs unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action would promote efficiency, competition, and capital formation."[382] As a result, the final amendments are subject to a separate determination by the SEC regarding their applicability to audits of EGCs.[383]

To inform consideration of the application of auditing standards to audits of EGCs, the staff publishes a white paper annually that provides general information about characteristics of EGCs. The data on EGCs outlined in the most recent white paper, released in February 2024, remains generally consistent with the data outlined in prior EGC white papers.[384] As of the November 15, 2022 measurement date, PCAOB staff identified 3,031 companies that self-

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[382] *See* Pub. L. No. 112–106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act. Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The proposed mandatory disclosure rules do not fall within either of these two categories.

[383] We are providing this analysis of the impact on EGCs to assist the SEC in making the determination required under Section 104 to the extent that the requirements apply to "the audit of any emerging growth company" within the meaning of Section 104 of the JOBS Act.

[384] *See* PCAOB, *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2022* (Feb. 20, 2024), *available at* https://pcaobus.org/resources/other-research-projects ("EGC White Paper").

identified with the SEC as EGCs and filed with the SEC audited financial statements in the 18 months preceding the measurement date.[385]

The discussion of benefits, costs, and unintended consequences of the proposal in Section IV is generally applicable to all audits performed pursuant to PCAOB standards, including audits of EGCs. The economic impacts of the proposal on an individual EGC audit would depend on factors such as the auditor's ability to distribute implementation costs across its audit engagements and whether the auditor has already incorporated the proposed metrics into its audit approach. One survey of audit committees of smaller public companies found that five of the 28 metrics discussed in the Concept Release were evaluated by more than half of the audit committees surveyed.[386] EGCs are more likely to be newer companies, which are typically smaller in size and receive lower analyst coverage.[387] For example, smaller companies have very little, if any, analyst coverage, which reduces the amount of information made available to financial statement users and therefore makes markets less efficient.[388] These factors may increase the importance to investors of the higher audit quality resulting from the proposal, as high-quality audits generally enhance the credibility of management disclosures.[389] The costs of

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385 The EGC White Paper uses a lagging 18-month window to identify companies as EGCs. Please refer to the "Current Methodology" section in the EGC White Paper for details. Using an 18-month window enables staff to analyze the characteristics of a fuller population in the EGC White Paper, but may tend to result in a larger number of EGCs being included for purposes of the present EGC analysis than would alternative methodologies. For example, an estimate using a lagging 12-month window would exclude some EGCs that are delinquent in making periodic filings. An estimate as of the measurement date would exclude EGCs that have terminated their registration, or that have exceeded the eligibility or time limits. *See id*.

386 *See, e.g.*, Harris and Williams, *Audit Quality Indicators*.

387 *See* EGC White Paper at Figure 9 and Figure 12 (indicating that exchange-listed EGCs have less market capitalization and revenue than exchange-listed non-EGCs).

388 *See* SEC, *Final Report of the Advisory Committee on Smaller Public Companies to the U.S. Securities and Exchange Commission* (Apr. 23, 2006) at 73.

389 Researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs. To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance the credibility of management disclosures. *See*, *e.g.*, Steven A. Dennis and Ian G. Sharpe, *Firm Size Dependence in the Determinants of Bank Term Loan Maturity,* 32 Journal of Business Finance and Accounting 31 (2005); Michael J. Brennan and Avanidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 Journal of Financial Economics 361 (1995); David Aboody and Baruch Lev, *Information Asymmetry, R&D, and Insider Gains*, 55 Journal of Finance 2747 (2000); Raymond Chiang and P. C. Venkatesh, *Insider Holdings and Perceptions of Information Asymmetry: A Note*, 43 Journal of Finance 1041 (1988); and Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 Accounting Horizons 185 (2004).

the proposal may disproportionately impact smaller audit firms, and in so much as smaller audit firms tend to audit smaller issuers, pass through of these costs may disproportionately impact EGCs.[390]

However, two important caveats would limit the impact of the proposal on EGCs. First, the vast majority of EGC engagements would be conditionally exempt from the proposed engagement-level reporting requirements because an EGC cannot be an LAF and few AFs maintain the EGC status.[391] We believe these EGCs would therefore not be impacted by the proposed engagement-level reporting requirements. Second, approximately 23% of EGC engagements (712 out of 3,031) would not be included in any proposed firm-level reporting because they are not audited by a firm that would subject to the proposed firm-level reporting requirements. We believe these EGCs would therefore not be impacted by the proposed firm-level reporting requirements.

Overall, among the impacted EGCs, the proposal is expected to enhance the quality of EGC audits and financial reporting quality.[392] To the extent the proposal would improve EGCs' financial reporting quality, it may also improve the efficiency of capital allocation, lower the cost of capital, and enhance capital formation. For example, investors may improve their capital allocation by more accurately identifying EGCs with the strongest prospects for generating future risk-adjusted returns and reallocating their capital accordingly. Investors may also perceive less risk in the impacted EGC capital markets generally, leading to an increase in the supply of capital to the impacted EGCs. This may increase capital formation and reduce the cost of capital to impacted EGCs. The proposal could reduce competition in an EGC's product market if the indirect costs to audited companies disproportionately impact EGCs relative to their competitors.

As discussed in Section IV.D.3.ii, we considered broadening the applicability of the proposal to include information from audits of EGCs generally. However, for the reasons described there, we are not proposing to do so at this time. In particular, non-AF EGCs may be disproportionately impacted by cost passthrough and tend to be smaller than in-scope issuers.

Accordingly, and for the reasons explained above, the Board believes that, if it adopts the proposed amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the proposed amendments to audits of EGCs (that are also accelerated filers).

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390 Staff analysis indicates that, compared to exchange-listed non-EGCs, exchange-listed EGCs are approximately 2.6 times as likely to be audited by an NAF and approximately 1.3 times as likely to be audited by a triennially inspected firm. Source: EGC White Paper and S&P.

391 As of November 15, 2022, among the 2,562 EGCs for which "accelerated filer" status information is available, just 163 identified as accelerated filers. *See* EGC White Paper at 26.

392 *See* the preamble to Section IV.C.1 for a discussion on the link between audit quality and financial reporting quality.

Questions

110. Have we appropriately considered the impacts of the proposal on EGCs (including impacts on efficiency, competition, and capital formation)?

VI. EFFECTIVE DATE

For firm-level metrics, we are considering an effective date beginning October 1 of the year after the year in which SEC approval is obtained, with the first reporting period ending the following September 30. We are also considering a phased implementation period:

- Firms that issued audit reports with respect to more than 100 issuers in the calendar year preceding the effective date would begin reporting firm-level metrics in the first year; and

- All other firms would begin reporting firm-level metrics one year later.

For example, if adopted and approved by the SEC in 2024, the effective date of the firm-level metrics would be October 1, 2025. For firms that issued audit reports with respect to more than 100 issuers in 2024, the first reporting period would end on September 30, 2026, with the first reporting date of November 30, 2026. For all other firms, the first reporting period would end on September 30, 2027, with the first reporting date of November 30, 2027.

For engagement-level metrics, we are also considering a phased implementation period:

- Firms that issued audit reports with respect to more than 100 issuers in the calendar year preceding the effective date– for audits of companies with fiscal years beginning on or after October 1 of the year after the year in which SEC approval is obtained; and

- All other firms – for audits of companies with fiscal years beginning on or after October 1 two years after the year in which SEC approval is obtained.

For example, if adopted and approved by the SEC in 2024, reporting of engagement-level metrics would start for firms that issued audit reports with respect to more than 100 issuers in 2024 with audits of companies with fiscal years beginning on or after October 1, 2025. For other firms, it would start with audits of companies with fiscal years beginning on or after October 1, 2026.

Questions

111. Would the effective dates described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

112. Is a phased effective date appropriate for firm-level and engagement-level reporting? Should we phase in requirements based on the number of issuer audit reports issued, as proposed, or on some other basis (and if so, what)?

VII. LIST OF QUESTIONS

Summary of the Proposed Metrics

1. Would the proposed metrics, individually or collectively, provide useful information for investors, audit committees, or other stakeholders? Why or why not? How would stakeholders use the metrics?

2. Are any of the metrics we are proposing overly focused on the operations of larger firms? If so, which metrics and how could we make them more neutral?

Comparability

3. Are there other considerations we should be aware of that would increase or decrease comparability at the firm level? For example, would it be helpful to have subsets of information available by size of the firm or by size of the issuers the firm audits?

4. Are there other considerations we should be aware of that would increase or decrease comparability of the engagement-level metrics? For example, would it be helpful to capture information at the engagement level by industry sector, region, whether it is a first-year audit, or other criteria?

Rounding and Use of Estimates

5. Is it appropriate for firms to report metrics by rounding to the nearest whole number except in cases where additional decimal places (no more than two) are needed to properly interpret the result or enable comparison to prior periods? If not, what would an appropriate level of precision be?

6. Is it appropriate to allow firms to use reasonable estimates when actual amounts are unavailable? Should there be any other restrictions on the use of estimates? If so, what are they?

Optional Narrative Disclosure

7. Should firms be permitted to provide narrative disclosure to provide context to the reported metrics? If not, why not? If yes, should narrative disclosure be allowed for all metrics or only certain ones? If limited, which ones?

8. Should we place limits on the length or content of the narrative disclosure? If so, what should they be? Is a 500-character limit per metric appropriate? Should it be less or more? Should there be no limit?

Key Terms and Concepts

9. Are the definitions for partners, managers, and staff clear and appropriate? If not, how should they be changed?

10. If the firm assigns partners, managers, and staff to specific business lines (e.g., audit, tax), should the firm-level metrics only include partners, managers, and staff of the firm's audit practice? Why or why not?

11. Should we consider adding a threshold to the definition of partners or managers who participated on the engagement team, such as a minimum percentage of hours worked on an audit? If so, what should that percentage be for partners and managers?

12. Should other individuals involved in the audit (e.g., individuals in the firm's national office, engagement quality reviewers, employees of shared service centers, or individuals involved in loaned staff arrangements and alternative practice structures) be treated differently in the metrics? If so, how should they be considered in the definition of core engagement team?

13. Should engagement quality reviewers be added to any of the proposed metrics? If so, which metrics and should they be added as a separate category or together with a group, such as the engagement team?

14. Is the proposed definition of core engagement team appropriate? Are the proposed thresholds for core engagement team members appropriate?

a. The proposed threshold for partners (excluding engagement partners) is ten or more hours on the engagement. Should the hour threshold be higher or lower or based on a certain percentage of the total audit hours? If so, what is a more appropriate threshold to determine whether partners are part of the core engagement team?

b. The proposed threshold for managers and staff is 40 or more hours or, if less, 2% or more of the total audit hours. Should the hour or percentage thresholds be different? If so, what should the hours and/or percentage be to determine whether managers and staff are part of the core engagement team?

c. Alternatively, should partners, managers, and staff who reported a certain percentage of the hours on the engagement, whether they are from the firm issuing the auditor's report (lead auditor) or other firms performing audit work (other auditors), be considered as part of the core engagement team? If so, why, and what should the threshold be for inclusion of individuals or other firms?

15. Is the proposed term hours worked clear and appropriate? If not, how should it be changed?

16. Is it appropriate to use the Form AP hours for the total audit hours in the metrics? If not, how should the hours be accumulated for the metric calculations?

17. Is it appropriate to include total audit hours for all issuer engagements in the firm-level metrics, as proposed? Or should the metric be limited to total audit hours for large accelerated filer and accelerated filer engagements? Why or why not?

Partner and Manager Involvement

18. Are the proposed descriptions and calculations of the firm-level and engagement-level metrics for partner and manager involvement clear and appropriate? If not, why not?

19. Would it be helpful to separate the calculations for partner involvement and manager involvement? Why or why not?

20. Because of the importance of the engagement partner's role, would it be helpful to separate the calculation for engagement partner involvement from the calculation of the other partners and managers on the audit? Why or why not? Is there another way in which a metric could focus on the role of the engagement partner and, if so, what is the metric and how should it be calculated?

21. Instead of partner and manager involvement, should firms disclose partner and manager hours compared to staff hours on the audit (i.e., a staffing leverage ratio)? If so, why?

Workload

22. Are the proposed descriptions and calculations of the firm-level metrics and engagement-level metrics for the engagement partner workload and partner (excluding the engagement partner), manager, and staff workload clear and appropriate? If not, why not?

23. Should we require separate metrics for partner (excluding the engagement partner), manager, and staff workload? If so, why? Should the metric be limited to workload information for partners (other than the engagement partner) and managers? Why or why not?

Audit Resources – Use of Auditor's Specialists and Shared Service Centers

24. Are the proposed descriptions of the firm-level and engagement-level metrics for use of (i) auditor's specialists and (ii) shared service centers clear and appropriate? If not, why not?

25. In situations in which the hours are unavailable, we are proposing that firms estimate an hourly equivalent for auditor-engaged specialists. Is there another way this information could be captured? If so, what is it? Are there other practical challenges with respect to auditor-engaged specialists that we should consider?

26. With respect to the firm-level metrics for the use of (i) auditor's specialists and (ii) shared service centers:

a. The metrics calculate the percentage of issuer engagements on which (i) auditor's specialists and (ii) shared service centers were used. Alternatively, should these metrics calculate the average percentage of usage of (i) auditor's specialists and (ii) shared service centers across all of the firm's engagements?

b. The metrics for use of auditor's specialists and shared service centers at the firm-level calculate the percentage of issuer engagements in which specialists or shared services centers, respectively, were used, no matter how minor their involvement may have been. Should the metric capture only engagements in which an auditor's specialist or shared services center was used for a minimum number of engagement hours, such as 2% or 5%? If yes, what should the threshold be?

c. We have proposed that the firm-level use of (i) auditor's specialists and (ii) shared service centers metrics be provided in aggregate across all of the firm's issuer engagements. Alternatively, would it be beneficial to provide either of these metrics by industry for those industries included in a firm's industry experience metrics? Why or why not?

27. With respect to the proposed metrics related to shared service centers:

a. The description of what is a shared services center is consistent with the description in the Form AP guidance. Should the description be more broad to include other arrangements such as (1) those that are captive to an individual firm, where the staff are employees of the firm, (2) service centers that have a separate legal entity but dedicated solely to the support of an individual firm, (3) service centers that are external to a firm but provide similar services to several affiliated or non-affiliated firms, (4) service centers that are located in the same jurisdiction as a firm, or (5) solely those that are located in another jurisdiction? Why or why not?

b. At the engagement-level should the firm report the types of work performed by the service center (e.g., non-complex tasks such as data input, data validation and data formatting, checking schedules for mathematical accuracy, updating standard forms and documents (such as engagement letters and representation letters), rolling forward standard work papers (such as lead sheets), performing reconciliations, and similar activities) or indicate the specific areas of the audit in which work of shared service centers was used (e.g., revenue, cash)? If so, what should be reported?

Experience of Audit Personnel

28. Are the firm-level and the engagement-level metrics we are proposing for experience of audit personnel clear and appropriate? Should relevant experience be limited to auditing experience rather than including all experience at a public accounting firm? Conversely, is there other relevant experience that would be valuable to include when determining years of experience (e.g., experience at a relevant regulator or standard setter)? If so, how should that experience be measured?

Industry Experience of Audit Personnel

29. Is three years of experience for managers and five years of experience for partners an appropriate threshold for industry experience? If not, what number of years should we use? Should the same number of years be used to determine industry experience for all levels of seniority (e.g., audit partner and audit manager)?

30. We have proposed the following considerations to be taken into account when determining an individual's industry experience: (1) industry experience may be, but is not required to be, exclusive to experience on audit engagements but must be relevant, (2) industry experience is not required to be in consecutive years, and (3) auditors may have industry experience in more than one unrelated industry. Are these the right considerations? Should industry experience be determined by a minimum number (or percentage) of hours on engagements within a particular industry? Does it matter whether the years of experience have been recent or if the experience was not obtained as an auditor? If so, please provide an explanation.

31. If an auditor does not work exclusively in one industry, what are the considerations to determine whether the auditor has qualifying experience in multiple industries? Should it be based on hours (time) worked in a specific industry with a minimum percentage, for example 250 hours or 25% of the auditor's time focused on a particular industry as we have proposed?

32. We have proposed the FTSE Russell Index as a reference for industry classification based on supersector and certain disaggregation to the sector or subsector level. Is this index and disaggregation appropriate? Is there a more suitable reference index? If so, what is it and what are the comparative benefits of other indices?

33. At the firm level we have proposed that firms disclose industry experience for those industries that represent at least 10% of the firm's revenue from audit services, with the option to include additional industries. Is 10% an appropriate percentage to use? If not, should the percentage be higher or lower?

34. Are there thresholds for disclosure that may be meaningful in addition to or instead of a percentage of the firm's revenue? For example, should we require firms to disclose industry

experience for their top five or top ten industries by revenue from audit services? Are there other thresholds we should consider and, if so, what are they?

35. As proposed, firms would provide industry experience information at the engagement level based on only the issuer's primary industry. Would it be beneficial for this metric to be disclosed for additional industries in which the issuer operates? If so, are there practical considerations in determining the level of industry specialization disaggregation that should be requested or allowed? What threshold should be used to determine which other of an issuer's industries should be reported?

Retention and Tenure

36. Are the descriptions and the calculations of the proposed (i) retention rate and (ii) headcount change at the firm level and engagement level clear and appropriate? If not, why not?

37. Are the description and the calculation of the proposed average number of the firm's partners and managers at the firm level clear and appropriate? If not, why not?

38. Are the description and the calculation of the proposed tenure on the engagement at the engagement level clear and appropriate? If not, why not?

39. Would it be beneficial to disclose the annual retention rate and the annual headcount change of staff with three to five years of experience (often called seniors)? Should disclosure be provided for all staff levels?

40. Are there alternative metrics that may be more useful than the proposed retention rate or headcount change? If so, what are they?

Audit Hours and Risk Areas

41. Is the calculation of the audit hours and risk areas metric clear and appropriate, including the components of the calculation? Why, or why not?

42. Are firms currently tracking the time incurred by partners and managers on significant risks, critical accounting policies and practices, and critical accounting estimates? If not, what should the Board be aware of related to potential costs or challenges related to obtaining this information?

43. Should this metric only report the percentage of hours for the partners and managers on the core engagement team instead of all partners and managers on the engagement team? Why or why not?

44. Under the proposal, the definition of engagement team includes employed specialists, but not engaged specialists. Should this metric be revised to also include engaged specialist hours? Why or why not?

Allocation of Audit Hours

45. Is the calculation of the allocation of audit hours to prior to and following the issuer's year end clear and appropriate? Why, or why not?

46. Would a different, more granular, metric be more appropriate, for example allocation of audit hours devoted to each phase of the audit—planning, quarterly reviews, interim field work, final field work up until report release date, and post-report release date until audit documentation completion date? Why, or why not?

47. Are there other considerations related to the reporting of this metric that would increase its usefulness and comparability (e.g., including a subset of the firm-level metric by industry, by client year end, etc.)?

Quality Performance Ratings and Compensation

48. Are the proposed metrics and calculations for quality performance ratings and compensation clear and appropriate? If not, why not? Are there other metrics that would be appropriate? If so, what are they? Is there another way to calculate the correlation between partner performance and compensation? If so, please provide an example.

49. Is the proposal to exempt firms that are exempt from the SEC's partner rotation rule clear and appropriate? If not, why not? Is there a more suitable threshold to exempt smaller firms from reporting this metric? If so, what would be an alternative threshold and why should those firms be exempt?

50. If firms do not have a specific quality performance rating for partners and use an overall performance rating instead, should they be required to indicate the use of an overall performance rating? Is there another way for these firms to report the correlation between partner performance and compensation? If so, what is it?

51. We do not propose to define partner compensation in Section III.B.1. Should the nature (e.g., cash vs. non-cash) or the types (e.g., distributions, bonus, partner draws, etc.) of compensation that should be included or excluded in the calculation be described? Are there any types of compensation that should be excluded? If so, what are they? And why?

52. The proposed metric does not differentiate between equity partners and non-equity partners in calculating and reporting this metric. Should equity partners and non-equity partners be differentiated and reported separately? Alternatively, should the metric only include equity partners? Why or why not?

53. Would it be more appropriate to disclose firm policies relating to partner compensation and how quality performance is measured and incorporated into the firm's policy, rather than reporting the proposed compensation and quality performance rating related metrics? Why or why not?

Audit Firm's Internal Monitoring

54. At the firm level, we are proposing to require firms to provide disclosure of (i) the period covered by the firm's most recently completed internal monitoring cycle, (ii) the percentage of issuer engagements selected for internal monitoring, and (iii) the percentage of internally monitored engagements that had an engagement deficiency. Should we also consider providing the actual numbers of engagement deficiencies identified in the firm's most recent monitoring calendar? Why or why not?

55. At the engagement level, firms would be required to disclose whether a previous engagement for the issuer was selected for internal monitoring in the most recently completed internal monitoring cycle and, if so, whether the firm identified any engagement deficiencies related to (1) financial statement line items, (2) disclosures, or (3) other noncompliance with applicable professional and legal requirements. Are these categories appropriate? If not, why not? Should there be additional categories? If so, what should they be and what types of deficiencies should they cover? Provide an explanation of your answer.

56. For each engagement deficiency identified, we are proposing that the areas of noncompliance and the type of testing deficiency or the standard or rule with which the noncompliance was identified also be disclosed. Is this an appropriate level of detail to understand identified deficiencies? Why or why not?

57. For each engagement deficiency identified that relates to (1) financial statement line items or (2) disclosures, we are proposing that the type of testing deficiency be identified (e.g., testing of design or testing of control effectiveness), whereas for deficiencies related to (3) other noncompliance with applicable professional and legal requirements we are proposing that the standard or rule with which the noncompliance was identified also be disclosed. Should we require that the standard or rule with which noncompliance was identified be disclosed in all cases? Why or why not?

Restatement History

58. Are the proposed descriptions of revision restatement and reissuance restatement clear and appropriate? If not, what descriptions should we use?

59. Is five years an appropriate number of years to require firms to report? If not, what would be the appropriate number of years?

60. Should we require reporting of revision restatements? Why or why not?

61. Are firms currently tracking revision restatements, reissuance restatements, or both for issuer engagements for which the firm issued an audit report? If so, which category of restatements does the firm currently track and for how long does the firm track this information?

62. Do you agree with the proposal to count multi-year audit restatements based on each year impacted by the restatement? Why or why not?

63. Should we also require restatements to be reported at the engagement level on Form AP? Why or why not?

Thresholds for Required Reporting

64. For firm-level metrics, is the threshold for reporting appropriate? If not, what would be an appropriate threshold? For example, should we require a threshold for firms that audit companies of a certain size, market capitalization, or another method?

65. Should smaller firms have different reporting requirements than larger firms? Why or why not? If so, how should the reporting of metrics differ?

66. For engagement-level metrics, is the threshold for reporting appropriate? If not, what would be an appropriate threshold? For example, should we require engagement-level metrics for audits of investment companies (other than BDCs that are accelerated filers or large accelerated filers) or non-accelerated filers? And if so, why?

Reporting of Firm-Level Metrics

67. Is September 30 an appropriate reporting date for firm-level metrics with a filing date of November 30? Is there an alternative reporting date that would be more appropriate and if so, what date? Is there an alternative filing date that would be more appropriate and if so, what date?

68. Rather than reporting on Form FM, should firms report firm-level metrics, as of March 31 on Form 2, which is due on June 30? If so, why?

69. Are proposed Rule 2203C, *Firm Metrics*, and proposed Form FM instructions included in Appendix 1, clear and appropriate? If not, why not?

70. Are there certain firm organizational or legal structures that might make reporting certain metrics challenging (e.g., alternative practice structures)? If so, please describe the structure and which metrics would pose a challenge and why.

Reporting of Engagement-Level Metrics

71. Are proposed amendments to Form AP instructions included in Appendix 2, clear and appropriate? If not, why not?

72. Should we require communication of firm-level and/or engagement-level metrics to the audit committee? If so, which ones and why?

Inclusion of Metrics in the Audit Report

73. Would it be appropriate for us to require inclusion of some or all firm- and engagement-level metrics in the audit report in addition to PCAOB forms? On what basis should particular metrics be included or excluded?

74. Are there engagement-level metrics for which inclusion in the audit report would not be practicable, given the time needed to gather the data and make the required calculations? If so, which?

75. If we were to require inclusion of metrics in the audit report, is there a specific placement or format that we should require? If so, what should that be (for example, at the bottom of the audit report, below the firm signature, or as an attachment to the report)?

76. Are there costs associated with inclusion of metrics in the audit report that we have not considered? If so, what are they?

Confidential Treatment and Conflicts with non-U.S. Law

77. Would it be appropriate to allow confidential treatment of any of the metrics required on Form FM or Form AP? If so, which metrics and on what basis?

78. Are there any U.S. or non-U.S. laws that would prohibit reporting the proposed firm-level or engagement-level metrics to the PCAOB or publicly? If so, please describe such laws and the proposed metrics to which it is realistically foreseeable that they would apply. In particular, please identify any metrics that may call for disclosure of personally identifiable information and the type of personally identifiable information that could be required to be disclosed.

Documentation

79. Is the proposed documentation requirement clear and appropriate? If not, why not?

Potential Additional Firm and Engagement Metrics

80. Are there benefits to requiring a training metric at either the firm level or the engagement level that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

a. Would it be useful and appropriate to disaggregate by level for all audit professionals (e.g., partner, manager, and staff), or limit to only certain positions, (e.g., partners)? If so, what levels should be disclosed?

b. Would it be useful and appropriate to include a requirement for training to be disclosed for specific fields of study (e.g., accounting and auditing or independence and ethics, or fraud)? If so, what are they? Is it challenging to accumulate that information? Why or why not?

c. Would it be useful and appropriate to require disclosure of training hours? Or should we measure continuing professional education completion compliance rates instead of or in addition to training hours?

81. Are there other metrics related to training that we have not considered that would provide more useful information than those that we have considered? If so, what are they? Are there ways to capture the qualitative aspects of training in a metric? If so, how?

82. How could the information provided by a training metric be used by investors, audit committees, and other stakeholders? Would reporting a training metric have unintended consequences and, if so, what are they?

83. Are there benefits to requiring a metric at the firm level specific to technical resources that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

84. Would it be useful and appropriate to require disclosure of firm- and engagement-level metrics specific to use of the firm's national office resources? If so, how would such information be used?

a. "National office" is not a defined term and may have different meanings at different firms. How should "national office" be defined?

b. Would it be useful and appropriate for a metric regarding national office involvement include every consultation (e.g., required or voluntary) or should a distinction be made between types of consultations? If so, how should that distinction be made?

c. Would a firm-level metric indicating the percentage of audit engagements that have consulted with the national office be appropriate and useful? Why or why not?

Would an engagement-level metric indicating the number of consultations performed by the engagement team be appropriate and useful? Why or why not?

d. How would such a metric work at firms that do not have a national office or equivalent? Should such firms provide information regarding consultations with others inside or outside the firm?

85. Are there benefits to requiring a metric at the firm-level specific to investment in infrastructure that we have not considered? If so, what metric would provide useful information and how would the challenges that we have considered be overcome?

86. Are there other metrics related to investment in infrastructure that we have not considered that would provide more useful information than those that we have considered?

87. How would investment in infrastructure be defined?

88. Are there specific considerations or other unintended consequences that we should take into account regarding the potential disadvantages of requiring such a metric for smaller firms?

Baseline

89. Have we appropriately described the baseline? If not, how can we improve the analysis?

90. Is the literature cited for the baseline fairly represented? If not, please explain.

91. Are there additional studies or data that would inform our analysis of the baseline? If so, please direct us to them and explain how they would inform the analysis.

Need

92. Have we appropriately described a problem and how the proposal would address the problem? If not, how can we improve the analysis?

93. Is the literature cited for the need fairly represented? If not, please explain.

94. Are there additional studies or data that would inform our analysis of the need? If so, please direct us to them and explain how they would inform the analysis.

Benefits

95. Have we appropriately described the benefits, including benefits to smaller firms or issuers? If not, how can we improve the analysis?

96. Are there additional academic studies or data that would inform our analysis of the benefits? If so, please direct us to them and explain how they would inform the analysis.

97. Are we fairly representing the academic literature related to the benefits? If not, please explain how.

98. Are there any quantifiable benefits? If so, please: (1) identify them; (2) describe a methodology to quantify them; (3) explain why the methodology is appropriate and relevant to the proposal; and (4) direct us to any studies or data that the methodology relies on.

Costs

99. Have we appropriately described the costs, including costs to smaller firms or issuers? If not, how can we improve the analysis?

100. Is the literature cited for the analysis of costs fairly represented? If not, please explain.

101. Are there additional studies or data that would inform our analysis of the costs? If so, please direct us to them and explain how they would inform the analysis.

102. Are there any quantifiable costs? If so, please: (1) identify them; (2) describe a methodology to quantify them; (3) explain why the methodology is appropriate and relevant to the proposal; and (4) direct us to any studies or data that the methodology relies on.

Unintended Consequences

103. Have we appropriately described the potential unintended consequences? If not, how can we improve the analysis?

104. Is the literature cited for the alternatives fairly represented? If not, please explain.

105. Are there additional studies or data that would inform our analysis of alternatives? If so, please direct us to them and explain how they would inform the analysis.

Alternatives Considered

106. Have we appropriately described alternatives? If not, how can we improve the analysis?

107. Are any alternative approaches preferable to the proposed approach? If so, please describe them and explain why they are preferable.

108. Is the literature cited for the alternatives fairly represented? If not, please explain.

109. Are there additional studies or data that would inform our analysis of alternatives? If so, please direct us to them and explain how they would inform the analysis.

Special Considerations for Audits of Emerging Growth Companies

110. Have we appropriately considered the impacts of the proposal on EGCs (including impacts on efficiency, competition, and capital formation)?

Effective Date

111. Would the effective dates described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

112. Is a phased effective date appropriate for firm-level and engagement-level reporting? Should we phase in requirements based on the number of issuer audit reports issued, as proposed, or on some other basis (and if so, what)?

VIII. OPPORTUNITY FOR PUBLIC COMMENT

The Board is seeking comments on all aspects of its proposal, as well as specific comments on the proposed rule and new Form FM and the proposed rule amendments and amendments to Form AP. Among other things, the Board is seeking comment on the economic analysis relating to its proposal, including potential costs. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the proposed rule and new Form FM and the proposed rule amendments and amendments to Form AP.

Comments should be sent by email to comments@pcaobus.org or through the Board's website at www.pcaobus.org. Comments may also be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 041 in the subject or reference line and should be received by the Board by June 7, 2024.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt a final rule and new Form FM and final rule amendments and amendments to Form AP, with or without changes from the proposal. Any such final rule, rule amendments, and form amendments adopted will be submitted to the Commission for approval. Pursuant to Section 107 of the Act, proposed rules of the Board do not take effect unless approved by the Commission.

* * *

On the 9th day of April, in the year 2024, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

April 9, 2024

* * *

APPENDIX 1 – PROPOSED REPORTING RULE AND FORM FM

Rule 2203C. Firm Metrics

(a) Each registered public accounting firm that issued an audit report with respect to at least one issuer that identified itself as an "accelerated filer" or "large accelerated filer" by checking the box on its most recent annual report filed with the Commission (or, for issuers that report on Form 40-F, at least one issuer that met the criteria to be an "accelerated filer" or "large accelerated filer," as defined in Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2, as of the date of its most recent annual report) during the reporting period of October 1 to September 30, must file with the Board a report on Form FM with respect to such reporting period by following the instructions to that form. Other registered firms may elect to voluntarily file a report on Form FM with the Board.

(b) Form FM is deemed to be timely filed if the form is filed no later than November 30, provided, however, that a registered public accounting firm that has its application for registration approved by the Board in the period between and including October 1 and November 30 of any year shall not be required to file a Form FM in that year.

> Note: Pursuant to Rule 1002, in any year in which the filing deadline falls on a Saturday, Sunday, or federal legal holiday, the deadline for filing Form FM shall be the next day that is not a Saturday, Sunday, or federal legal holiday.

(c) Unless directed otherwise by the Board, the registered public accounting firm must file Form FM electronically with the Board through the Board's Web-based system.

Form FM - Firm Metrics

GENERAL INSTRUCTIONS

1. Submission of this Report. Effective XX/XX/XXXX, a *registered public accounting firm* that issued an audit report with respect to at least one *issuer* that identified itself as an "accelerated filer" or "large accelerated filer" by checking the box on its most recent annual report filed with the Commission (or, for *issuers* that report on Form 40-F, at least one *issuer* that met the criteria to be an "accelerated filer" or "large accelerated filer," as defined in Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2, as of the date of its most recent annual report) during the reporting period October 1 to September 30 must use this Form to file with the Board the report required by Rule 2203C and to file any amendments to such report. Unless otherwise directed by the *Board*, the Firm must file this Form electronically with the *Board* through the *Board*'s Web-based system.

2. Defined Terms. The definitions in the *Board's rules* apply to this Form. Italicized terms in the instructions to this Form are defined in the *Board's rules*. In addition, as used in the instructions to this Form, the term "the Firm" means the *registered public accounting firm* that is filing this Form with the *Board*.

3. When this Report is Considered Filed. A report on Form FM is required to be filed on or before November 30. A Form FM is considered filed when the Firm has submitted to the *Board* a Form FM in accordance with Rule 2203C that includes the signed certification required in Part V of Form FM.

4. Period Covered by this Report. Reports on this Form shall cover a 12-month period from October 1 to September 30 (the "reporting period"), except as expressly provided in Items 4.8 and 4.9 below.

5. Amendments to this Report. Amendments shall not be filed to update information in a filed Form FM that was correct at the time the Form was filed, but only to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required or permitted to be provided at the time the Form was filed. When filing a Form FM to amend an earlier filed Form FM, the Firm must supply not only the corrected or supplemental information, but must include in the amended Form FM all information, affirmations, and certifications that were required to be included in the original Form FM. The Firm may access the originally filed Form FM through the Board's Web-based system and make the appropriate amendments without needing to re-enter all other information.

    Note: The *Board* will designate an amendment to a Form FM as a report on "Form FM/A."

6. *Rules* Governing this Report. In addition to these instructions, the rules in Part 2 of Section 2 of the *Board rules* govern this Form. Read these *rules* and the instructions carefully before completing this Form.

7. Language. Information submitted as part of this Form, including any exhibit to this Form, must be in the English language.

PART I – IDENTITY OF THE FIRM

Item 1.1 Name of the Firm

State the legal name of the Firm.

PART II – GENERAL INFORMATION CONCERNING THIS REPORT

Item 2.1 Reporting Period

State the reporting period covered by this report.

Note: The reporting period, which the Firm should enter in Item 2.1, is the period beginning on October 1 of the year before the year in which Form FM is required to be filed and ending September 30 of the year in which Form FM is required to be filed. That is the period referred to where this Form refers to the "reporting period."

Item 2.2 Voluntary Reporting

Indicate, by checking the box corresponding to this item, that the firm is not required to file this Form FM pursuant to Rule 2203C.

PART III – TERMINOLOGY

Item 3.1 Terminology used in this report that applies to Part IV

a. Engagement partner (as defined in paragraph .A2 of AS 1201, *Supervision of the Audit Engagement*): The member of the engagement team with primary responsibility for the audit.

b. Engagement team (as defined in paragraph .A3 of AS 2101, *Audit Planning* [as adopted by the Board and approved by the SEC in PCAOB Release No. 2022-002, to take effect with respect to audits of fiscal years ending on or after December 15, 2024]):

   a. Engagement team includes:

      (i) Partners, principals, and shareholders of, and accountants[1] and other professional staff employed or engaged by, the lead auditor or other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to this standard or AS 1201, *Supervision of the Audit Engagemen*t; and

      (ii) Specialists who, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

   b. Engagement team does not include:

(i) The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);

(ii) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; or

(iii) Engaged specialists.[2]

[1] *See* paragraph (a)(ii) of PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "accountant."

[2] AS 1210, *Using the Work of an Auditor-Engaged Specialist*, establishes requirements that apply to the use of specialists engaged by the auditor's firm. Appendix A of AS 1105, *Audit Evidence*, sets forth the auditor's responsibilities for using the work of a specialist employed or engaged by the company. *See also* paragraphs .16-.17 of AS 2101, *Audit Planning*.

c. Managers: Accountants or other professional staff commonly referred to as managers or senior managers (or persons in an equivalent position) who participate in audits.

d. Partners: Partners or persons in an equivalent position (e.g., shareholders, members, or other principals) who participate in audits.

e. Staff: Accountants or other professional staff who participate in audits and are not partners or managers.

f. Total Audit Hours (as described in General Instruction 8 of Form AP [as proposed to be amended under this proposal]): Comprised of hours attributable to: (1) the financial statement *audit*; (2) reviews pursuant to AS 4105, *Reviews of Interim Financial Information*; and (3) the *audit* of internal control over financial reporting pursuant to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*; and excluding hours incurred by: (1) the engagement quality reviewer; (2) the person who performed the review pursuant to SEC Practice Section 1000.45; (3) specialists engaged, not employed, by the Firm; (4) an accounting firm performing the audit of entities in which the *issuer* has an investment that is accounted for using the equity method; (5) internal auditors, other company personnel, or third parties working under the direction of management or the audit committee who provided direct assistance in the *audit* of internal control over financial reporting; and (6) internal auditors who provided direct assistance in the *audit* of the financial statements. Hours incurred in the *audit* by entities other than *other accounting firms* are included in the calculation of total *audit* hours and should be allocated among the Firm and the *other accounting firms* participating in the *audit* on the basis of which accounting firm commissioned and directed the applicable work.

PART IV – METRIC CALCULATIONS, REPORTING AND DISCUSSION

Actual amounts (e.g., audit hours) should be used if available. If actual amounts are unavailable, the Firm may use a reasonable method to estimate the components of a calculation. The Firm should retain documentation in sufficient detail to enable an experienced auditor, having no previous connection with the determination of the metrics, to understand the computations of amounts, the amounts on which they are based, and the method used to estimate the amounts when actual amounts were unavailable. Metrics should be rounded to the nearest whole number, except where additional decimal places (no more than two) are needed to properly interpret the result or to enable comparison to prior periods.

Boldfaced terms in Part IV of this Form are described in Part III.

Item 4.1 Partner and Manager Involvement

Total audit hours for partners and managers on the engagement team as a percentage of total audit hours for all *issuer* engagements for which the Firm issued an audit report during the 12-month period ended September 30.

a. Provide the calculated metric for this item.

Total audit hours incurred by
partners and **managers** on the **engagement team** for all *issuer* engagements
———————————————————————————
Total audit hours for all *issuer* engagements

Partner and Manager Involvement	Percentage of total audit hours for partners and managers for all *issuer* engagements	XX%

b. Optional narrative.

Item 4.2 Workload

Average weekly hours worked by the Firm's (i) engagement partners and (ii) partners (excluding engagement partners), managers, and staff, calculated for each calendar quarter of the preceding 12-month period ended September 30 (e.g., September 30, 20XX, June 30, 20XX, March 31, 20XX, and December 31, 20YY).

Note: Hours worked are the sum of hours that are incurred on issuer and non-issuer engagements and include hours spent on training, practice development, staff development, or other firm activities. Hours worked exclude hours that are not considered working hours (e.g., paid time off and holiday time).

a. Provide the calculated metric for these items.

(i) Average weekly hours worked by the Firm's engagement partners:

$$\frac{\text{Average number of hours worked by } \textbf{engagement partners} \text{ in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

(ii) Average weekly hours worked by the Firm's partners (excluding engagement partners), managers, and staff:

$$\frac{\text{Average number of hours worked by } \textbf{partners} \text{ (excluding } \textbf{engagement partners}\text{), } \textbf{managers}\text{, and } \textbf{staff} \text{ of the Firm in the calendar quarter}}{\text{Number of weeks in the calendar quarter}}$$

		Average Weekly Hours Worked	
	Quarter ended	(i) Engagement Partners	(ii) Partners (excluding engagement partners), Managers, and Staff
Workload	Sep 30, 20XX	XX	XX
	Jun 30, 20XX	XX	XX
	Mar 31, 20XX	XX	XX
	Dec 31, 20YY	XX	XX

b. Optional narrative.

Item 4.3 Audit Resources – Use of Auditor's Specialists and Shared Service Centers

Percentage of *issuer* engagements that used (i) auditor's specialists and (ii) shared service centers, calculating the metrics for the 12-month period ended September 30 for all *issuer* engagements for which the Firm issued an audit report.

<u>Specialist</u>: A person possessing special skill or knowledge in a particular field other than auditing or accounting. Specialists would generally not include members of the engagement team whose specialization is in the fields of either information technology (IT) or income taxes (tax) because IT and tax are specialized areas of auditing and accounting. However, if IT or tax specialists are employed or engaged in a capacity other than specialized auditing and accounting as part of the *issuer* engagement, it may be appropriate to include them as specialists.[1]

<u>Shared Service Center</u>: An associated entity of a firm, set up by a network of accounting firms, that, among other things, supplies those firms with personnel to assist in the performance of audits, and that is not itself an other accounting firm.[2]

a. Provide the calculated metric for these items.

$$\frac{\text{Total Firm } \textit{issuer} \text{ engagements on which [specialists/shared service centers] were used}}{\text{Total number of } \textit{issuer} \text{ engagements}}$$

Use of Auditor's Specialists	Percentage of *issuer* engagements that used specialists	XX%
Use of Shared Service Centers	Percentage of *issuer* engagements that used shared service centers	XX%

b. Optional narrative.

Item 4.4 Experience of Audit Personnel

Average experience at a public accounting firm for the Firm's (i) engagement partners and (ii) partners (excluding engagement partners) and managers, as of September 30.

[1] A specialist includes both those who are auditor-employed specialists as defined in AS 1201.C1 and auditor-engaged specialists as described in paragraph .01 of AS 1210, *Using the Work of an Auditor-Engaged Specialist*.

[2] An other accounting firm is (i) a *registered public accounting firm* other than the Firm; or (ii) any other *person* or entity that opines on the compliance of any entity's financial statements with an applicable financial reporting framework. (*See* Form AP instructions (as proposed to be amended)).

Experience at a public accounting firm: The total number of years worked as an accountant for a public accounting firm (whether or not PCAOB-registered).

a. Provide the calculated metric for these items.

(i) Average experience at a public accounting firm for the Firm's engagement partners:

$$\frac{\text{Total experience at a public accounting firm of all } \textbf{engagement partners}}{\text{Total number of } \textbf{engagement partners}}$$

(ii) Average experience at a public accounting firm for the Firm's partners (excluding engagement partners) and managers:

$$\frac{\text{Total experience at a public accounting firm of } \textbf{partners} \text{ (excluding } \textbf{engagement partners}\text{) and } \textbf{managers}}{\text{Total number of } \textbf{partners} \text{ (excluding } \textbf{engagement partners}\text{) and } \textbf{managers}}$$

Experience of Audit Personnel		(i) Engagement Partners	(ii) Partners (excluding engagement partners) and Managers
	Average years of experience at a public accounting firm	XX	XX

b. Optional narrative.

Item 4.5 Industry Experience of Audit Personnel

For each industry sector that represents at least 10% of the Firm's audit practice based on revenue from audit services, the number of the Firm's (i) partners with more than five years of industry experience and (ii) managers with more than three years of industry experience, as of September 30. Firms may, but are not required to, provide the same metric for one or more industry sectors that represent less than 10% of the Firm's audit practice based on revenue.

Note 1: Industry experience is accumulated throughout an individual's career (i.e., aggregates experience obtained at all career levels). When determining whether an individual has experience in a specific industry the following may be taken into account: (i) industry experience may be, but is not required to be, exclusive to experience on audit engagements, or exclusive to experience gained at an accounting firm, but must be relevant, and (ii) industry experience can be acquired in non-consecutive years. Relevant experience includes experience in accounting or auditing roles and other specializations, such as experience that is related to fair value estimates in the industry.

Note 2: In determining industry experience, at least 250 hours or 25% of hours worked focused on companies in a particular industry in a year qualifies as having a year of industry experience.

Note 3: A complete list of industries available to be used to report this metric can be found at Appendix A to these instructions.

a. Provide the calculated metric for these items.

(i) The number of the Firm's partners with greater than five years of industry experience:

Number of **partners** of the Firm with greater than five years of industry experience in each industry that accounts for at least 10% of the Firm's revenue from audit services.

(ii) The number of the Firm's managers with greater than three years of industry experience:

Number of **managers** of the Firm with greater than three years of industry experience in each industry that accounts for at least 10% of the Firm's revenue from audit services.

Industry Experience of Audit Personnel	Industry that accounts for at least 10% of the Firm's revenue from audit services	(i) Number of partners with > 5 years of industry experience	(ii) Number of managers with > 3 years of industry experience
	[Industry]	XX	XX
	[Industry]	XX	XX
	[Industry]	XX	XX
	[Industry]	XX	XX
	[Industry]	XX	XX

b. Optional narrative.

Item 4.6 Retention

Retention and headcount change of (a) the Firm's partners and (b) the Firm's managers for the 12-month period ended September 30:

(i) Average number of the Firm's partners and managers.

(ii) Average annual retention rate (percentage of the Firm's partners and managers who remained employed with the Firm for the entire 12-month period).

> Note: The partners and managers of the firm included in the numerator of paragraph (ii) of this Item are those with one or more years of service and who were employed continuously during of the 12-month period. Any partners and managers of the firm hired or added during the 12-month period would not be counted in either the numerator or denominator of this formula. The retention rate would not include departures of partners and managers of the firm who joined and subsequently left during the 12-month period. The retention rate treats promotions to another level of seniority as if they occurred at the beginning of the year; therefore, the number of promoted employees would be included in both the numerator and the denominator of the level at which they ended the year and excluded from both the numerator and the denominator of the level at which they began the year.

(iii) Average annual headcount change (change in number of the Firm's partners and managers from the previous reporting period to the current reporting period, as a percentage of the number at the beginning of the period).

a. Provide the calculated metrics for (a) the Firm's partners and (b) the Firm's managers

(i) Average number:

$$\frac{\text{The number of [}\textbf{partners/managers}\text{] as of October 1 (20X0) + the number of [}\textbf{partners/managers}\text{] as of September 30 (20X1)}}{2}$$

(ii) Average annual retention rate:

$$\frac{\text{The number of [}\textbf{partners/managers}\text{] continuously holding the same position from October 1 (20X0) to September 30 (20X1)}}{\text{Number of [}\textbf{partners/managers}\text{] as of October 1 (20X0)}}$$

(iii) Average annual headcount change:

$$\frac{\text{Number of [}\textbf{partners/managers}\text{] as of September 30 (20X1)}}{}$$

Number of [**partners/managers**] as of September 30 (20X0)

		Partners	Managers
Retention and Tenure	(i) Average number	XX	XX
	(ii) Average annual retention rate	XX%	XX%
	(iii) Average annual headcount change	XX%	XX%

b. Optional narrative.

Item 4.7 Allocation of Audit Hours

Percentage of total audit hours incurred (i) prior to *issuers*' year ends and (ii) following *issuers*' year ends, for the 12-month period ended September 30 for all *issuer* engagements for which the Firm issued an audit report.

a. Provide the calculated metric for these items.

(i) Percentage of total audit hours incurred prior to *issuer*s' year ends:

$$\frac{\textbf{Total audit hours} \text{ incurred prior to } \textit{issuer}\text{s' year ends for all } \textit{issuer} \text{ engagements}}{\textbf{Total audit hours} \text{ for all } \textit{issuer} \text{ engagements}}$$

(ii) Percentage of total audit hours incurred following *issuer*s' year ends:

$$\frac{\textbf{Total audit hours} \text{ incurred following } \textit{issuer}\text{s' year ends for all } \textit{issuer} \text{ engagements}}{\textbf{Total audit hours} \text{ for all } \textit{issuer} \text{ engagements}}$$

Allocation of Audit Hours	Percentage of audit hours incurred prior to *issuer*s' year ends for all *issuer* engagements	XX%
	Percentage of audit hours incurred following *issuers*' year ends for all *issuer* engagements	XX%

b. Optional narrative.

Item 4.8 Quality Performance Ratings and Compensation

Provides the potential correlation between the Firm's partner quality performance ratings and annual compensation adjustments based on the Firm's most recent annual performance evaluation and compensation adjustment process completed during the reporting period.

Calculate:

(i) the distribution of quality performance ratings across the Firm's partners and

(ii) a comparison of average annual compensation adjustments for the Firm's partners in each quality performance rating group.

Quality performance rating: Performance evaluation given to audit partners that specifically measures the person's quality of performance on audits. If the Firm does not assign specific quality performance ratings, an overall rating should be used instead.

Note 1: In reporting the distribution of the Firm's quality performance ratings, the Firm should report a metric for each possible rating in the Firm's performance rating scale, even if there was no partner assigned that rating.

Note 2: Only partners who received compensation and a performance rating in the capacity as a partner during both the current year and the prior year would be included in the calculation.

Note 3: Firms that are exempt from the SEC's partner rotation rule (i.e., accounting firms that have less than five audit clients that are issuers (as defined in section 10A(f) of the Securities Exchange Act of 1934) and less than ten partners) would be exempt from reporting this metric. *See* Regulation S-X Rule 2-01, 17 C.F.R. § 210.2-01(c)(6).

a. Provide the calculated metric for these items.

(i) The distribution of quality performance ratings (for each quality performance rating):

$$\frac{\text{Total number of } \textbf{partners} \text{ of the Firm who received a specific quality performance rating}}{\text{Total number of } \textbf{partners} \text{ of the Firm evaluated in the Firm's performance cycle}}$$

(ii) A comparison of average annual compensation adjustments (for each quality performance rating):

Step 1 – Calculate the average annual compensation adjustment:

$$\frac{\text{(Total current year compensation of all } \textbf{partners} \text{ of the Firm who received the specific quality performance rating) − (Total prior year compensation for the same } \textbf{partners}\text{)}}{\text{Total number of } \textbf{partners} \text{ of the Firm who received the specific quality performance rating in the current year}}$$

Step 2 – Calculate the ratio of the average annual compensation adjustments between the highest quality performance-rated partners of the Firm and other partners of the Firm who received each performance rating:

$$\frac{\text{Average annual compensation adjustments for all } \textbf{partners} \text{ of the Firm who received the specific quality performance rating (as calculated in Step 1)}}{\text{Average annual compensation adjustments for all } \textbf{partners} \text{ of the Firm who received the highest rating}}$$

Quality Performance Ratings and Compensation	Quality performance rating assigned in 20XX	(i) Distribution of quality performance ratings	(ii) Average annual compensation adjustments (as a % of adjustment for the highest rated group)
	X – Highest rating	XX%	100%
	X	XX%	XX%
	X	XX%	XX%
	X – Lowest Rating	XX%	XX%

b. Optional narrative.

Item 4.9 Audit Firms' Internal Monitoring

Provide, for the Firm's most recent internal monitoring cycle completed during the reporting period, (i) the period covered by such internal monitoring cycle, (ii) the percentage of *issuer* engagements that were selected for internal monitoring in the cycle, and (iii) the percentage of internally inspected *issuer* engagements where the Firm identified an engagement deficiency.

Engagement deficiency: 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.[3]

Note: Monitoring, as used in this metric, is monitoring of completed engagements, not in-process engagements. The firm's internal monitoring cycle used in calculating this metric must cover a 12-month period and is generally expected to cover the same 12-month period every year.

a. Provide the calculated metric for these items.

  (i) The period covered by the Firm's most recently completed internal monitoring cycle

  (ii) Percentage of *issuer* engagements selected for internal monitoring:

$$\frac{\text{Total number of } \textit{issuer} \text{ engagements internally monitored}}{\text{Total number of } \textit{issuer} \text{ engagements}}$$

  (iii) Percentage of internally monitored *issuer* engagements where the Firm identified an engagement deficiency:

$$\frac{\text{Total number of } \textit{issuer} \text{ engagements that had an engagement deficiency}}{\text{Total number of } \textit{issuer} \text{ engagements internally monitored}}$$

Internal Engagement Monitoring	(i) Period covered by the Firm's most recently completed internal monitoring cycle	[Date range]
	(ii) Percentage of *issuer* engagements selected for internal monitoring	XX%
	(iii) Percentage of internally monitored *issuer* engagements where an engagement deficiency was identified	XX%

b. Optional narrative.

[3] As defined in paragraph .A4 of proposed QC 1000, *A Firm's System of Quality Control.*

Item 4.10 Restatement History

For each of the last five 12-month periods ended September 30, provide the following:

(i) The number of audit reports initially issued by the Firm during that 12-month period, in connection with which any of the following subsequently occurred:

(a) revision restatement of the financial statements for errors

(b) reissuance restatement of the financial statements for errors

(c) reissuance of management's report on ICFR disclosing an additional material weakness or additional elements to a previously disclosed material weakness.

(ii) Total *issuer* engagements for which the Firm initially issued audit reports during that 12-month period.

(iii) Total *issuer* engagements for which the Firm initially issued audit reports expressing an opinion on internal control over financial reporting during that 12-month period.

Reissuance restatement:[4] When a material error in previously-issued financial statements[5] is identified and disclosed by an *issuer* in a filing with the SEC (e.g., on Form 8-K Item 4.02, Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review).

Reissuance restatement of management's report on ICFR: When a material error in a previously-issued report on management's assessment of the effectiveness of internal control over financial reporting is identified and disclosed by an *issuer* in a filing with the SEC.

Revision restatement: When an immaterial error in previously-issued financial statements is corrected in the current period comparative financial statements by restating the prior period information and disclosing the revision.

a. Provide the calculated metric for these items.

---

[4] The term "restatements" has the same meaning as defined in the FASB Accounting Standards Codification ("FASB ASC") Topic 250, *Accounting Changes and Error Corrections; see also,* "retrospective restatement" as defined in IFRS Accounting Standard (IAS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

[5] The phrase "error in previously issued financial statements" has the same meaning as defined in the FASB ASC 250; *see also* "prior period errors" as defined in IAS 8.

		Audit Report Initially Issued				
		Year	*Year*	*Year*	*Year*	*Year*
Restatement History	Revision restatements of the financial statements for errors	X	X	X	X	X
	Reissuance restatements of the financial statements for errors	X	X	X	X	X
	Reissuance restatements of management's report on ICFR	X	X	X	X	X
	Total *issuer* engagements	X	X	X	X	X
	Total *issuer* engagements with audits of ICFR	X	X	X	X	X

b. Optional narrative.

PART V – CERTIFICATION OF THE FIRM

Item 5.1 Signature of Partner or Authorized Officer

This Form must be signed on behalf of the Firm by an authorized partner or officer of the Firm including, in accordance with Rule 2204, both a signature that appears in typed form within the electronic submission and a corresponding manual signature retained by the Firm. The signer must certify that –

a. the signer is authorized to sign this Form on behalf of the Firm*;*

b. the signer has reviewed this Form;

c. based on the signer's knowledge, this Form does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading; and

d. based on the signer's knowledge, the Firm has not failed to include in this Form any information or affirmation that is required by the instructions to this Form.

The signature must be accompanied by the signer's title, the capacity in which the signer signed the Form, the date of signature, and the signer's business mailing address, business telephone number, and business email address.

PART VI – AMENDMENTS

Item 6.1 Amendments

If this is an amendment to a report previously filed with the Board –

a. Indicate, by checking the box corresponding to this item, that this is an amendment.

b. Identify the specific Item numbers of this Form (other than this Item 6.1) as to which the Firm's response has changed from that provided in the most recent Form FM or amended Form FM filed by the Firm with respect to the reporting period.

Appendix A

The following list provides the categories that are available with respect particular industries, which is derived from the Industry Classification Benchmark (ICB), operated and managed by FTSE Russell and consists of 31 possible industry classifications.[1]

Code(s)	**Supersector**	**Sector**
10101xxx	Technology	Software and computer service
10102xxx	Technology	Technology hardware and equipment
15101xxx	Telecommunication	Telecommunication
20101xxx	Health Care	Health care providers
20102xxx	Health Care	Medical equipment and services
20103xxx	Health Care	Pharmaceuticals and Biotechnology
30101010	Banks	Banks
30201xxx	Financial Services	Finance and Credit Services
30202xxx	Financial Services	Investment Banking and Brokerage Services
30203 - 30205	Financial Services	Other Financial Services
3030xxxx	Insurance	Including all subsectors
35101xxx	Real Estate	Real estate investment services
35102xxx	Real Estate	Real estate investment trusts (REITs)
40101xxx	Automobiles and Parts	Automobiles and parts
4020xxxx	Consumer Products and Services	Including all subsectors
40301xxx	Media	Media

[1] See FTSE Russell Industry Classification Benchmark (ICB), available at *https://classification.codes/classifications/industry/icb*.

Code(s)	**Supersector**	**Sector**
40401xxx	Retail	Retailers
40501xxx	Travel and Leisure	Travel and leisure
4510xxxx	Food, Beverage, and Tobacco	Including all subsectors
45201xxx	Personal Care, Drug and Grocery Stores	Personal care, drug, and grocery stores
50101xxx	Construction and Materials	Construction and materials
50201 – 50202xxx	Industrial Goods and Services	Aerospace and Defense and Electronic and Electrical Equipment
50203 – 50206xxx	Industrial Goods and Services	Including all subsectors
55101xxx	Basic Resources	Industrial materials
55102xxx	Basic Resources	Industrial metals and mining
55103xxx	Basic Resources	Chemicals
60101xxx	Energy	Oil gas and coal
60102xxx	Energy	Alternative Energy
65101xxx	Utilities	Electricity
65102xxx	Utilities	Gas, water, and multi-utilities
65103xxx	Utilities	Waste and disposal services

APPENDIX 2 – PROPOSED AMENDMENTS TO REPORTING RULE AND FORM AP

Language that would be deleted by the proposed amendments is ~~struck though~~. Language that would be added by the proposed amendments is underlined.

Rule 3211. ~~Auditor Reporting of Certain~~ Audit Participants and Metrics

* * *

(d) Form AP shall be deemed to be filed on the date that the registered public accounting firm submits a Form AP in accordance with this rule that includes the certification in Part VII of Form AP.

* * *

Form AP - ~~Auditor Reporting of Certain~~ Audit Participants and Metrics

GENERAL INSTRUCTIONS

1. Submission of this Report. ~~Effective January 31, 2017, a~~A *registered public accounting firm* must use this Form to file with the *Board* reports required by Rule 3211 and to file any amendments to such reports. Unless otherwise directed by the *Board*, the *registered public accounting firm* must file this Form electronically with the *Board* through the *Board's* Web-based system.

2. Defined Terms*.* The definitions in the *Board's rules* apply to this Form. Italicized terms in the instructions to this Form are defined in the *Board's rules*. In addition, as used in the instructions to this Form, the term "the Firm" means the *registered public accounting firm* that is filing this Form with the *Board*. Additional defined terms used in parts III, IV, V, and VI of this form are included below at General Instruction 8. ~~and the term, "other accounting firm" means (i) a *registered public accounting firm* other than the Firm; or (ii) any other *person* or entity that opines on the compliance of any entity's financial statements with an applicable financial reporting framework~~.

3. When this Report is Considered Filed*.* A report on Form AP is considered filed on the date the Firm submits to the *Board* a Form AP in accordance with Rule 3211 that includes the certification required by Part VII of Form AP.

* * *

4. Amendments to this Report. Amendments to Form AP are required to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required or permitted to be provided at the

time the Form was filed. When filing a Form AP to amend an earlier filed Form AP, the Firm must supply not only the corrected or supplemental information, but it must include in the amended Form AP all information and certifications that were required to be included in the original Form AP. The Firm may access the originally filed Form AP through the Board's Web-based system and make the appropriate amendments without needing to re-enter all other information.

* * *

8. Terminology used in parts III, IV, V, and VI

   a. Core engagement team: The engagement partner and members of the engagement team who are:

      1. Partners or employees of the registered public accounting firm issuing the audit report (or individuals who work under that firm's direction and control and function as the firm's employees); and

      2. Either of the following:

         i. A partner (excluding the engagement partner) who worked ten or more hours on the engagement; or

         ii. Managers and staff who worked on the audit for 40 or more hours or, if less, 2% or more of the *total audit hours.*

   b. Engagement partner: (as defined in paragraph .A2 of AS 1201, *Supervision of the Audit Engagement*): The member of the engagement team with primary responsibility for the audit.

   c. Engagement quality reviewer: (as described in AS 1220, *Engagement Quality Review*) An associated person of a registered public accounting firm who performs an engagement quality review and provides concurring approval of issuance.

   d. Engagement team: (as defined in paragraph .A3 of AS 2101, *Audit Planning* [as adopted by the Board and approved by the SEC in PCAOB Release No. 2022-002, to take effect with respect to audits of fiscal years ending on or after December 15, 2024]):

      a. Engagement team includes:

         (i) Partners, principals, and shareholders of, and accountants[1] and other professional staff employed or engaged by, the lead auditor or other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to this standard or AS 1201, *Supervision of the Audit Engagement*; and

(ii) Specialists who, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

b. Engagement team does not include:

(i) The engagement quality reviewer and those assisting the reviewer (to which AS 1220, *Engagement Quality Review*, applies);

(ii) Partners, principals, and shareholders of, and other individuals employed or engaged by, another accounting firm in situations in which the lead auditor divides responsibility for the audit with the other firm under AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; or

(iii) Engaged specialists.[2]

[1] *See* paragraph (a)(ii) of PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "accountant."

[2] AS 1210, *Using the Work of an Auditor-Engaged Specialist*, establishes requirements that apply to the use of specialists engaged by the auditor's firm. Appendix A of AS 1105, *Audit Evidence*, sets forth the auditor's responsibilities for using the work of a specialist employed or engaged by the company. *See also* paragraphs .16-.17 of AS 2101, *Audit Planning*.

e. Managers: Accountants or other professional staff commonly referred to as managers or senior managers (or persons in an equivalent position) who participate in audits.

f. Other accounting firm: (i) a *registered public accounting firm* other than the Firm; or (ii) any other *person* or entity that opines on the compliance of any entity's financial statements with an applicable financial reporting framework.

g. Partners: Partners or persons in an equivalent position (e.g., shareholders, members, or other principals) who participate in audits.

h. Staff: Accountants or other professional staff who participate in audits and are not partners or managers.

i. Total audit hours: Comprised of hours attributable to: (1) the financial statement *audit*; (2) reviews pursuant to AS 4105, *Reviews of Interim Financial Information*; and (3) the *audit* of internal control over financial reporting pursuant to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*; and excluding hours incurred by: (1) the engagement quality reviewer; (2) the person who performed the review pursuant to SEC Practice Section 1000.45; (3) specialists engaged, not employed, by the Firm; (4) an accounting firm performing the audit of entities in which the *issuer* has an investment that is accounted for using the equity method; (5) internal auditors, other company personnel, or third parties working under the direction of management or the audit committee who provided direct assistance in the *audit* of internal control over financial reporting; and (6) internal auditors who provided direct assistance in the *audit* of the financial statements. Hours incurred in the *audit* by entities other than *other accounting firms* are included in the calculation of total *audit* hours and should be allocated among the Firm and the *other accounting firms* participating in the *audit* on the basis of which accounting firm commissioned and directed the applicable work.

Boldfaced terms in Parts IV and VI of this Form are described in this General Instruction 8.

9. Actual amounts (e.g., audit hours) should be used if available. If actual amounts are unavailable, the Firm may use a reasonable method to estimate the components of a calculation. The Firm should document in its files the method used to estimate amounts when actual amounts are unavailable and the computation of amounts on a basis consistent with AS 1215, *Audit Documentation*. Under AS 1215, the documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the computations of amounts and the method used to estimate amounts when actual amounts were unavailable. Amounts should be rounded to the nearest whole number, except where additional decimal places (no more than two) are needed to properly interpret the result or to enable comparison to prior periods.

* * *

PART I – IDENTITY OF THE FIRM

In Part I, the Firm should provide information that is current as of the date of the certification in Part VII.

* * *

PART III – *AUDIT* CLIENT AND *AUDIT REPORT*

Item 3.1 *Audit Report*

a. Provide the following information concerning the *issuer* for which the Firm issued the *audit report* –

1. Indicate, by checking the box corresponding to this item, whether the *audit* client is an *issuer* other than an employee benefit plan or investment company; an employee benefit plan; or an investment company;

    i. Indicate by checking the box corresponding to this item, if the audit client identified itself as an "accelerated filer" or "large accelerated filer" by checking the box on its most recent annual report filed with the Commission.

* * *

PART IV – RESPONSIBILITY FOR THE *AUDIT* IS NOT DIVIDED

~~In responding to Part IV, total *audit* hours in the most recent period's *audit* should be comprised of hours attributable to: (1) the financial statement *audit*; (2) reviews pursuant to AS 4105, *Reviews of Interim Financial Information*; and (3) the *audit* of internal control over financial reporting pursuant to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Excluded from disclosure and from total *audit* hours in the most recent period's *audit* are, respectively, the identity and hours incurred by: (1) the engagement quality reviewer; (2) the person who performed the review pursuant to SEC Practice Section 1000.45 Appendix K; (3) specialists engaged, not employed, by the Firm; (4) an accounting firm performing the audit of entities in which the issuer has an investment that is accounted for using the equity method; (5) internal auditors, other company personnel, or third parties working under the direction of management or the audit committee who provided direct assistance in the *audit* of internal control over financial reporting; and (6) internal auditors who provided direct assistance in the *audit* of the financial statements. Hours incurred in the *audit* by entities other than *other accounting firms* are included in the calculation of total *audit* hours and should be allocated among the Firm and the *other accounting firms* participating in the *audit* on the basis of which accounting firm commissioned and directed the applicable work.~~

~~Actual audit hours should be used if available. If actual audit hours are unavailable, the Firm may use a reasonable method to estimate the components of this calculation. The Firm should document in its files the method used to estimate hours when actual audit hours are unavailable and the computation of total audit hours on a basis consistent with AS 1215, *Audit Documentation*. Under AS 1215, the documentation should be in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the~~

~~computation of total audit hours and the method used to estimate hours when actual hours were unavailable.~~

* * *

PART VI – REPORTING OF ENGAGEMENT METRICS

Part VI must be completed for each audit in which the audit client identified itself as an "accelerated filer" or "large accelerated filer" by checking the box on its most recent annual report (or, for *issuers* that report on Form 40-F, at least one *issuer* that met the criteria to be an "accelerated filer" or "large accelerated filer," as defined in Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2, as of the date of its most recent annual report) filed with the Commission. This section may, but is not required to be completed, for other audits.

Item 6.1 Partner and Manager Involvement

Total audit hours for partners and managers on the engagement team as a percentage of total audit hours.

a. Provide the calculated metric for this item.

$$\frac{\textbf{Total audit hours}\text{ incurred by }\textbf{partners}\text{ and }\textbf{managers}\text{ on the }\textbf{engagement team}}{\textbf{Total audit hours}\text{ for the engagement}}$$

Partner and Manager Involvement	Percentage of total audit hours for partners and managers	XX%

b. Optional narrative.

Item 6.2 Workload

Average weekly hours worked by (i) the engagement partner and (ii) partners (excluding the engagement partner), managers, and staff, on the core engagement team, calculated for each of the preceding three fiscal quarters up to the *issuer's* fiscal year end and the portion of the final fiscal quarter of the engagement through the issuance of the audit report.

Note: Hours worked are the sum of hours that are incurred on issuer and non-issuer engagements and include hours spent on training, practice development, staff development, or other firm activities. Hours worked exclude hours that are not considered working hours (e.g., paid time off and holiday time).

a. Provide the calculated metric for these items.

(i) Average weekly hours worked by the engagement partner:

$$\frac{\text{Number of hours worked by the } \textbf{engagement partner} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

(ii) Average weekly hours worked by partners (excluding the engagement partner), managers, and staff, on the core engagement team:

$$\frac{\text{Average number of hours worked by } \textbf{partners} \text{ (excluding the } \textbf{engagement partner}\text{), } \textbf{managers,} \text{ and } \textbf{staff} \text{ who are on the } \textbf{core engagement team} \text{ in the fiscal quarter}}{\text{Number of weeks in the fiscal quarter}}$$

	Average Weekly Hours Worked During the Engagement		
	Period ended	(i) Engagement Partner	(ii) Partners (excluding the engagement partner), Managers, and Staff
Workload	Quarter end, YYYY	XX	XX
	Quarter end, YYYY	XX	XX
	Quarter end, YYYY	XX	XX
	Audit Report date YYYY	XX	XX

b. Optional narrative.

Item 6.3 Audit Resources - Use of Auditor’s Specialists and Shared Service Centers

Percentage of total audit hours provided by (i) auditor’s specialists and (ii) shared service centers.

Specialist: A person possessing special skill or knowledge in a particular field other than auditing or accounting. Specialists would generally not include members of the engagement team whose specialization is in the fields of either information technology (IT) or income taxes (tax) because IT and tax are specialized areas of auditing and accounting. However, if IT or tax specialists are employed or engaged in a capacity other than specialized auditing and accounting as part of the *issuer* engagement, it may be appropriate to include them as specialists.[1]

Shared Service Center: An associated entity of a firm, set up by a network of accounting firms, that, among other things, supplies those firms with personnel to assist in the performance of audits, and that is not itself an other accounting firm.

Note: When actual hours are unavailable, the auditor-engaged specialist hour equivalent is estimated by dividing the contracted amount by an estimated hourly rate.

a. Provide the calculated metric for these items.

Percentage of total audit hours provided by:

(i) Auditor's specialists

$$\frac{\text{Total specialists hours (auditor-employed specialist hours + auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}{\textbf{Total audit hours} \text{ + (auditor-engaged specialist hours + auditor-engaged specialist hour equivalent)}}$$

(ii) Shared service centers

$$\frac{\text{Total shared service center hours}}{\textbf{Total audit hours}}$$

(i) Use of Auditor's Specialists	Percentage of total audit hours provided by specialists	XX%
(ii) Use of Shared Service Centers	Percentage of total audit hours provided by shared service centers	XX%

[1] A specialist includes both those who are auditor employed specialists as defined in AS 1201.C1 and auditor engaged specialists as described in paragraph .01 of AS 1210, *Using the Work of an Auditor-Engaged Specialist*.

b. Optional narrative.

Item 6.4 Experience of Audit Personnel

Experience of Audit Personnel for the following individuals and groups:

(i) Total experience at a public accounting firm of the engagement partner,

(ii) Total experience at a public accounting firm of the engagement quality reviewer, and

(iii) Average experience at a public accounting firm of the core engagement team who are partners (excluding the engagement partner) and managers.

Experience at a public accounting firm: The total number of years worked as an accountant for a public accounting firm (whether or not PCAOB-registered).

a. Provide the number for items (i) and (ii) and the calculated metric for item (iii)

Calculation for (iii):

(i) Total experience at a public accounting firm of the engagement partner

(ii) Total experience at a public accounting firm of the engagement quality reviewer

(iii) Average experience at a public accounting firm of the core engagement team who are partners (excluding the engagement partner) and managers:

$$\frac{\text{Total experience at a public accounting firm of the } \textbf{core engagement team} \text{ who are } \textbf{partners} \text{ (excluding the } \textbf{engagement partner}\text{) and } \textbf{managers}}{\text{Total number of people on the } \textbf{core engagement team} \text{ who are } \textbf{partners} \text{ (excluding the } \textbf{engagement partner}\text{) and } \textbf{managers}}$$

Experience of Audit Personnel	(i) Years of experience at a public accounting firm for the Engagement Partner	(ii) Years of experience at a public accounting firm for the Engagement Quality Reviewer	(iii) Average years of experience for Partners (excluding the engagement partner), and Managers on the Core Engagement Team
	XX	XX	XX

b. Optional narrative.

Item 6.5 Industry Experience of Audit Personnel

Experience in the *issuer's* primary industry:

(i) Years of industry experience of the engagement partner,

(ii) Years of industry experience of the engagement quality reviewer, and

(iii) Number of partners (excluding the engagement partner) and managers on the engagement team with industry experience, combined.

Note 1: Industry experience is accumulated throughout an individual's career (i.e., aggregates experience obtained at all career levels). When determining whether an individual has experience in a specific industry the following may be taken into account: (i) industry experience may be, but is not required to be, exclusive to experience on audit engagements, or exclusive to experience gained at an accounting firm, but must be relevant, and (ii) industry experience can be acquired in non-consecutive years. Relevant experience includes experience in accounting or auditing roles and other specializations, such as experience that is related to fair value estimates in the industry.

Note 2: In determining industry experience, at least 250 hours or 25% of hours worked focused on companies in a particular industry in a year qualifies as having a year of industry experience.

Note 3: A complete list of industries available to be used to report this metric can be found at Appendix A to these instructions.

a. Provide the number for items (i) and (ii) and the calculated metric for item (iii)

(i) Years of experience in the *issuer's* primary industry of the **engagement partner,**

(ii) Years of experience in the *issuer's* primary industry of the **engagement quality reviewer**, and

(iii) **Partners** on the engagement team (excluding the **engagement partner**) with at least five years of experience in the *issuer's* primary industry

\+

Managers on the engagement team with at least three years of experience in the *issuer's* primary industry

<table>
<tr><td colspan="3">Select the issuer's primary industry from the list provided</td><td>[Industry]</td></tr>
<tr><td rowspan="2">Industry Experience of Audit Personnel in the Issuer's Primary Industry</td><td>(i) Engagement Partner years of experience in the issuer's primary industry</td><td>(ii) Engagement Quality Reviewer years of experience in the issuer's primary industry</td><td>(iii) Combined number of engagement team Partners (excluding the engagement partner) AND Managers who have industry experience</td></tr>
<tr><td>XX</td><td>XX</td><td>XX</td></tr>
</table>

b. Optional narrative.

Item 6.6 Retention and Tenure

Retention, headcount change, and tenure of (a) the partners and (b) the managers of the core engagement team during the engagement:

(i) Average annual retention rate (percentage of core engagement team partners and managers from the most recent previous audit period who remained on the engagement during the current year audit period)

(ii) Average annual headcount change (changes in number of core engagement team partners and managers from the most recent previous audit period to the current audit period)

(iii) Average tenure on the engagement (average number of years on the engagement) for partners and managers of the core engagement team.

a. Provide the calculated metric for items (i), (ii), and (iii)

(i) Average annual retention rate

$$\frac{\text{Number of the same [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}\text{ in both the current year (20X1) and prior year (20X0)}}{\text{Number of [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}\text{ in prior year (20X0)}}$$

$$\text{Average annual headcount change} = \frac{\text{Number of [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}\text{ in the current year (20X1)}}{\text{Number of [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}\text{ in prior year (20X0)}}$$

(ii) Average tenure on the *issuer* engagement

$$\frac{\text{Total number of years on the engagement for [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}}{\text{Total number of [}\textbf{partners/managers}\text{] on the }\textbf{core engagement team}}$$

<table>
<tr><td rowspan="4">Retention and Tenure</td><td rowspan="2"></td><td colspan="3">20X3 Audit – as of the date of the audit report</td></tr>
<tr><td>(i) Average annual retention rate</td><td>(ii) Average annual headcount change</td><td>(iii) Average tenure on the engagement (years)</td></tr>
<tr><td>Partners</td><td>XX%</td><td>XX%</td><td>XX</td></tr>
<tr><td>Managers</td><td>XX%</td><td>XX%</td><td>XX</td></tr>
</table>

b. Optional narrative.

Item 6.7 Audit Hours and Risk Areas

The sum of total audit hours incurred in areas of significant risk, critical accounting policies and practices, and critical accounting estimates, by all partners and managers on the engagement team as a percentage of total audit hours incurred by partners and managers on the engagement team.

Critical accounting estimate: (as defined in paragraph .A3 of AS 1301, *Communications with Audit Committees*): An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material.

Critical accounting policies and practices: (as defined in AS 1301.A4): A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

Significant risk: (as defined in paragraph .A5 of AS 2110, *Identifying and Assessing Risks of Material Misstatement):* A risk of material misstatement that requires special audit consideration.

Note: Firms should not double-count hours that relate to more than one category of risk.

a. Provide the calculated metric for this item.

$$\frac{\textbf{Total audit hours}\text{ incurred by }\textbf{partners}\text{ and }\textbf{managers}\text{ on the }\textbf{engagement team}\text{ in the areas of significant risks, critical accounting policies and practices, and critical accounting estimates}}{\textbf{Total audit hours}\text{ incurred by }\textbf{partners}\text{ and }\textbf{managers}\text{ on the }\textbf{engagement team}}$$

Audit Hours and Risk Areas	Percentage of total audit hours incurred by partners and managers on the engagement team on significant risks, critical accounting policies and practices, and critical accounting estimates	XX%

b. Optional narrative.

Item 6.8 Allocation of Audit Hours

Percentage of total audit hours incurred (i) prior to the *issuer's* year end and (ii) following the *issuer's* year end.

a. Provide the calculated metric for these items.

(i) Percentage of total audit hours incurred prior to the *issuer's* year end:

$$\frac{\textbf{Total audit hours}\text{ incurred prior to the }\textit{issuer's}\text{ year end}}{\textbf{Total audit hours}}$$

(ii) Percentage of total audit hours incurred following the *issuer's* year end:

$$\frac{\textbf{Total audit hours}\text{ incurred following the }\textit{issuer's}\text{ year end}}{\textbf{Total audit hours}}$$

Allocation of Audit Hours	Percentage of total audit hours incurred prior to the *issuer's* year end	XX%
	Percentage of total audit hours incurred following the *issuer's* year end	XX%

b. Optional narrative.

Item 6.9 Audit Firm's Internal Monitoring

Identify whether a previous engagement for this *issuer* was selected for internal monitoring in the firm's most recently completed internal monitoring cycle and, if so, provide (i) the year end of the engagement monitored and (ii) whether the firm identified any engagement deficiencies. If any engagement deficiencies were identified, identify (iii) the nature of the deficiencies (i.e., (a) whether the engagement deficiency relates to a financial statement line item, a disclosure, or other noncompliance with applicable professional and legal requirements,[2] (b) the area of noncompliance, and (c) the type of deficiency (e.g., control design or effectiveness testing, test of details, or the applicable professional or legal requirement with which noncompliance was identified).

Engagement deficiency: 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.[3]

Note: Monitoring, as used in this metric, is monitoring of completed engagements, not in-process engagements. The firm's internal monitoring cycle used in calculating this metric must

[2] The term "applicable professional and legal requirements," as used in this rulemaking, has the same meaning as defined in Appendix A of proposed QC 1000, *A Firm's System of Quality Control*.

[3] As defined in paragraph .A4 of proposed QC 1000.

cover a 12-month period and is generally expected to cover the same 12-month period every year.

a. Provide the requested information for these items.

<table>
<tr><td rowspan="7">Firm's Internal Engagement Monitoring</td><td colspan="2">Previous engagement monitored?</td><td>Yes/No</td></tr>
<tr><td colspan="2">(i) Financial statement year end monitored</td><td>MM/DD/YYYY</td></tr>
<tr><td colspan="2">(ii) Deficiency(ies) identified?</td><td>Yes/No</td></tr>
<tr><td colspan="3">(iii) Deficiency description:</td></tr>
<tr><td>a. Deficiency related to:
[Select from drop-down]
• Financial statement line item,
• Disclosure, or
• Other non-compliance with applicable professional and legal requirements</td><td>b. Area of non-compliance</td><td>c. Identify type of testing deficiency or area of non-compliance with other applicable professional or legal requirements</td></tr>
<tr><td>1. [select from drop down]</td><td></td><td></td></tr>
<tr><td>2. [Add rows as necessary]</td><td></td><td></td></tr>
</table>

b. Optional narrative.

PART VII – CERTIFICATION OF THE FIRM

Item ~~6~~7.1 Signature of Partner or Authorized Officer

* * *

Appendix A

The following list provides the categories that are available with respect particular industries, which is derived from the Industry Classification Benchmark (ICB), operated and managed by FTSE Russell and consists of 31 possible industry classifications.[1]

Code(s)	Supersector	Sector
10101xxx	Technology	Software and computer service
10102xxx	Technology	Technology hardware and equipment
15101xxx	Telecommunication	Telecommunication
20101xxx	Health Care	Health care providers
20102xxx	Health Care	Medical equipment and services
20103xxx	Health Care	Pharmaceuticals and Biotechnology
30101010	Banks	Banks
30201xxx	Financial Services	Finance and Credit Services
30202xxx	Financial Services	Investment Banking and Brokerage Services
30203 - 30205	Financial Services	Other Financial Services
3030xxxx	Insurance	Including all subsectors
35101xxx	Real Estate	Real estate investment services
35102xxx	Real Estate	Real estate investment trusts (REITs)
40101xxx	Automobiles and Parts	Automobiles and parts
4020xxxx	Consumer Products and Services	Including all subsectors
40301xxx	Media	Media

1 See FTSE Russell Industry Classification Benchmark (ICB), available at https://classification.codes/classifications/industry/icb.

Code(s)	Supersector	Sector
40401xxx	Retail	Retailers
40501xxx	Travel and Leisure	Travel and leisure
4510xxxx	Food, Beverage, and Tobacco	Including all subsectors
45201xxx	Personal Care, Drug and Grocery Stores	Personal care, drug, and grocery stores
50101xxx	Construction and Materials	Construction and materials
50201 – 50202xxx	Industrial Goods and Services	Aerospace and Defense and Electronic and Electrical Equipment
50203 – 50206xxx	Industrial Goods and Services	Including all subsectors
55101xxx	Basic Resources	Industrial materials
55102xxx	Basic Resources	Industrial metals and mining
55103xxx	Basic Resources	Chemicals
60101xxx	Energy	Oil gas and coal
60102xxx	Energy	Alternative Energy
65101xxx	Utilities	Electricity
65102xxx	Utilities	Gas, water, and multi-utilities
65103xxx	Utilities	Waste and disposal services