Maintaining Investor Trust:

Independent Oversight in the System of Quality Control

J. Robert Brown, Jr.[1]

"You can't really know where you are going until you know where you have been."[2]

Thank you, John [Parsons], for the kind introduction.

It is a pleasure to have an opportunity to speak to a group of professionals dedicated to protecting the well-being of our teachers, firefighters, policemen, and other local and state workers. It's also a pleasure to be in Massachusetts, albeit virtually. The Commonwealth of Massachusetts is one of significant achievement, including the first subway in the U.S., the first college in North America, and, perhaps most important for me, the fig newton cookie. I look forward to a time when I can be back in Massachusetts in person.

Before I go on, I want to note that the views I share today are my own and do not necessarily reflect the views of the Public Company Accounting Oversight Board ("PCAOB"), my fellow Board members, or the staff of the PCAOB.

I want to talk today about the vital importance of quality control.

We rely on quality control in all aspects of our daily lives. We get on a plane with little or no apprehension because of the quality control system operating behind the scenes that helps ensure safety. Dynamic and robust systems protect the quality of our cars, our food, our clothing. When the COVID-19 vaccine arrives, and I hope it's soon, quality control will hopefully make certain that each dose is safe and effective.

Properly done, quality control allows us to simply trust that the expected results will occur. Our markets, economy, and society rely on trust to function efficiently and effectively.

The same principles apply to financial reporting. Trust in the accuracy of financial statements is essential to investors of public companies. Some of that trust is due to the annual audit by independent accounting firms.[3]

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1 Board Member, Public Company Accounting Oversight Board, see PCAOB, J. Robert Brown, Jr. (*available at* https://pcaobus.org/About/Board/Pages/J-Robert-Brown.aspx). This statement is based upon remarks made at the Massachusetts Public Employee Retirement Administration Commission's Emerging Issues Webinar (Sept. 17, 2020). I want to thank Clara Fryer, an intern in my office during the fall of 2020, for her valuable work in this statement.

2 Maya Angelou, Academy of Achievement Interview, High Point, NC (Jan. 22, 1997).

3 James R. Doty, Chairman, PCAOB, The PCAOB's Initiatives to Bolster Investor Trust in the Audit, AICPA Conference on SEC and PCAOB Developments, Washington, DC (Dec. 4, 2017) (*available at* https://pcaobus.org/News/Speech/Pages/initiatives-bolster-investor-trust-in-audit-12-4-17.aspx) ("At the end of the day, the purpose of the audit and the audit report has always been to communicate a basis for trust to investors.").

Trust in audits, like medicine, food or transportation, depends upon a robust system of quality control. The requirements for the audit firms' system of quality control are set out in PCAOB's standards.[4] These standards, however, are out-of-date. They were written decades ago, with little, if any, input from investors. They do not reflect changes in the business and audit environment or the financial failures and crises that have occurred since the PCAOB opened its doors in 2003.

Our current standards were, in other words, written in, and for, another time.[5]

Efforts to revise these quality control ("QC") standards are underway. The International Auditing and Assurance Standards Board ("IAASB") is meeting this week to consider adopting changes to its QC standards;[6] while the PCAOB has sought comments in a Concept Release about possible revisions to its QC standards, including whether any future U.S. effort should be based on the IAASB's standards.[7]

We have learned from comments by investors and others that aspects of the QC approach proposed by the IAASB raise concerns. In particular, investors indicated that such an approach may not adequately address the importance of independent oversight for audit quality and I want to talk about this issue.

Independent oversight takes into account the possible conflict between the commercial interests of an audit firm and audit quality. This is only one aspect of any system of quality control, nonetheless an important one.

Investors through the comment process provided strong views on this issue and, as a result, they deserve careful consideration. The failure to do so would risk repeating history. During the period of self-regulation by the audit profession, investor input was largely absent

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4 In April 2003, the Board adopted certain preexisting standards as its "interim" standards. *See* PCAOB, Release No. 2003-006: Establishment of Interim Professional Auditing Standards (Apr. 18, 2003) (*available at* https://pcaobus.org/Rulemaking/Interim_Standards/Release2003-006.pdf). *See also* Order Regarding Section 103(a)(3)(B) of the Sarbanes-Oxley Act of 2002, Securities Exchange Act Release No. 47745 (Apr. 25, 2003) (*available at* https://pcaobus.org/Rulemaking/Pages/InterimStandards.aspx). The elements of quality control are identified in QC Section 20 - System of Quality Control for a CPA Firm's Accounting and Auditing Practice. *See* QC Section 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (*available at* https://pcaobus.org/Standards/QC/Pages/QC20.aspx).

5 *See* Megan Zietsman, Chief Auditor, PCAOB, Annual Auditing Conference at Baruch (Feb. 26, 2020) (*available at* https://www.cpajournal.com/2020/02/26/regulators-and-standards-setters-2/) ("Clearly, the PCAOB standards are old. They haven't been substantially overhauled since they were adopted as interim standards back when the PCAOB was established. For example, they don't even take into account how technology is transforming not only how audits are being done, but how firms are using technology as part of quality control and broadly as part of running their businesses.").

6 *See* IAASB Board Meeting, Virtual by Videoconference (Sept. 14-23, 2020) (*available at* https://www.iaasb.org/meetings/iaasb-board-meeting-virtual-videoconferencing-1).

7 PCAOB, Release No. 2019-003: Potential Approach to Revisions to PCAOB Quality Control Standards (Dec. 17, 2019) (*available at* https://pcaobus.org/Rulemaking/Pages/docket-046-quality-control.aspx).

from the standard-writing process. This failure resulted in a lack of investor trust, causing harm to the capital markets, to investors and to companies. Congress altered that dynamic with the creation of the PCAOB. The PCAOB was given an explicit mission of acting in the interests of investors and the public.[8]

As we consider what to do with respect to QC standards, we are in mid-flight in the process. The debate is ongoing. Whether we issue any proposal to revise our QC standards remains to be seen. To the extent that we do, the need for, and the role of, independent oversight over a firm's QC system is something that will be determined only after a fulsome debate that is only just beginning. As we continue to consider the matter, I am interested in hearing comments and views from all stakeholders on the issue and encourage everyone here to participate in the discussion.

So today, I'd like to talk about quality control and what we have learned so far from investors and others, particularly about their views on the importance of independent oversight in a QC standard.

First, I'd like to discuss the importance of revising the standards governing an audit firm's system of quality control.

Second, I'd like to discuss the comment letters we received on our Concept Release, particularly the views on independent oversight.

Finally, I'd like to talk about possible future steps by the PCAOB and the role everyone listening to this talk can play.

I. The Outdated Standards Governing Quality Control

The largest firms audit hundreds of public companies each year.[9] Investors, and the public, benefit from these audits.[10] To make sure that audits deliver the expected quality, firms

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8 *See* 15 U.S.C. § 7211(a) (mission of PCAOB "to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports"). *See also* Bill Gradison & Ron Boster, *The PCAOB's First Seven Years: A Retrospection*, 4 CURRENT ISSUES IN AUDITING A9, A12 (2010) (describing the mission as "precise and unambiguous" and noting that "the Board's statutory mandate is to protect investors, not issuers or their management, nor their external auditors.").

9 PCAOB, *PCAOB Issues Six Largest U.S. Firm Inspection Reports in New User-Friendly Format, Guide to Reading Reports*, (June 1, 2020) (*available at* https://pcaobus.org/News/Releases/Pages/PCAOB-issues-six-largest-US-firm-inspection-reports-new-user-friendly-format-guide-to-reading-reports.aspx).

10 PCAOB Release No. 2017-001: The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards (June 1, 2017) (*available at* https://pcaobus.org/Rulemaking/Docket034/2017-001-auditors-report-final-rule.pdf) ("Investors are the beneficiaries of the audit and the auditor's report is the primary means by which the auditor communicates with them.").

are required to have in place a system of controls that seek to ensure the engagements are properly conducted.[11]

The standards governing quality control are in serious need of revision. They were written in the era of self-regulation when the audit profession held the drafting pen[12] and investors and the public had little input into the process.[13] The PCAOB, when it opened its doors in 2003, adopted these same standards on an "interim" basis.[14] While some auditing standards have since been amended or updated, those governing the system of quality control largely have not.

The IAASB and the PCAOB are, fortunately, taking steps to consider whether and how to revise their respective quality control standards. The IAASB's approach includes as a goal the continuous improvement in audits through the implementation of a feedback loop.[15] Under this

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11 AS 1110: Relationship of Auditing Standards to Quality Control Standards (*available at* https://pcaobus.org/Standards/Auditing/Pages/AS1110.aspx) ("A firm of independent auditors has a responsibility to adopt a system of quality control in conducting an audit practice.").

12 As late as 2002, the Auditing Standards Board, which drafted the standards, consisted entirely of practicing auditors, excepting only an academic and state regulatory. *See* Public Oversight Board, Final Annual Report 2001, at 32 (*available at* http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/2000/2002_0501_POBAnnualReport.pdf) ("Members for the ASB's 2001-2002 year include one representative from each of the eight largest accounting firms, five from local or regional firms, one from academia, and one from government."). *See also* United States General Accounting Office, GAO/AIMD-96-98, The Accounting Profession, Major Issues: Progress and Concerns (September 1996) (*available at* https://www.govinfo.gov/content/pkg/GAOREPORTS-AIMD-96-98/pdf/GAOREPORTS-AIMD-96-98.pdf) ("In practice, audit standard setting has been primarily the domain of the accounting profession. In that respect, auditing standards have been influenced by auditors' liability concerns.").

13 *Accounting Reform and Investor Protection*, *Hearings Before the S. Comm. on Banking, Hous., and Urban Aff.*, 107th Cong. (Feb. 26, 2002) (Statement of Shaun F. O'Malley, Chairman, 2000 Public Oversight Board Panel on Audit Effectiveness, Former Chairman, Price Waterhouse, Past President, Financial Accounting Foundation, Accounting Reform and Investor Protection) ("The panel found that the current system of governance lacks sufficient public representation"). *See also Id.* (testimony of Lynn Turner, Chief Accountant, SEC) (during era of self-regulation, standards "written to protect the accounting firms in case they get in trouble on an audit;"), quoting Testimony of John C. (Sandy) Burton, Chief Accountant, SEC (1978) ("As long as you leave that standard setting process in the hands of the firms and the firm's legal counsel, you are going to get standards written to protect them in court, as opposed to standards written to ensure that they do audits that will protect the public.").

14 *See* PCAOB, Release No. 2003-006: Establishment of Interim Professional Auditing Standards (Apr. 18, 2003) (*available at* https://pcaobus.org/Rulemaking/Interim_Standards/Release2003-006.pdf). *See also* Order Regarding Section 103(a)(3)(B) of the Sarbanes-Oxley Act of 2002, Securities Exchange Act Release No. 47745 (Apr. 25, 2003) (*available at* https://pcaobus.org/Rulemaking/Pages/InterimStandards.aspx). This was of course a necessary expediency. The PCAOB adopted the standards only on an interim basis. The expectation was that they would eventually be replaced by provisions that better reflected the interests of investors and the public.

15 This is no accident. The Concept Release specifically quoted extensively from the IAASB proposal and referenced it as a possible "starting point" for revisions of PCAOB standard. *See* Concept Release, *supra* note 7 ("We are considering whether and how PCAOB QC standards should be revised to address developments in audit practices and provide more definitive direction regarding firms' QC systems. We are considering an approach based on Proposed ISQM 1 as the starting point for potential revisions to PCAOB QC standards.").

approach, firms would be required to put in place a system to identify risks that could compromise audit quality.

Once identified, the QC system would need to be adjusted to prevent the risk from recurring or, better still, from occurring in the first place. By repeating the process, a QC system would constantly evolve and the quality of audits would continually improve.[16] The PCAOB's Concept Release asks whether the PCAOB should use a similar approach with respect to any future PCAOB QC standard.

Whatever the promise of this approach, investors through the comment process raised a number of significant concerns.[17] Investors indicated that the approaches under consideration would be improved by greater accountability, including increased transparency[18] and metrics

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16 This is in fact an old idea. *See* The Commission on Auditors' Responsibilities: Report, Conclusions, and Recommendations, at 128 (1978) (*available at* http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1978_0101_CohenAuditors.pdf) ("This suggests the profession must continuously monitor performance, deal quickly with substandard performance, and attempt to anticipate future problems.").

17 PCAOB, *Comment Letters for Docket 046* (*available at* https://pcaobus.org/Rulemaking/Pages/Docket046Comments.aspx).

18 Letter from CFA Institute to PCAOB, PCAOB Rulemaking Docket No. 046: Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046)-- (May 11, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/036_CFA.pdf) ("The details of the quality control system of each audit firm should be fully communicated to the users of financial statements including investors – as the standard being proposed is meant to accommodate public company audits, companies that are public because of their listing, in the United States. Firms should be required to provide disclosures of audit quality and quality control, including audit quality indicators (AQIs) and how the firm responds to identified deficiencies. "); Letter from AFL-CIO to PCAOB, PCAOB Release No. 2019-003, Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/024_AFL-CIO.pdf) ("As we commented in our September 29, 2015 letter to the PCAOB, we also support the disclosure of quantitative data on audit quality indicators as a matter of transparency to investors."); Letter from Colorado Public Employees' Retirement Association to PCAOB, Rulemaking Docket No. 046 - Request for Comments on the Potential Approach to Revisions to PCAOB Quality Control Standards Concept Release (Mar. 18, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/033_CoPERA.pdf) ("Along with publication of AQIs, we also believe that auditors should provide a detailed account of their audit quality control systems. Updating and strengthening the quality control standards will help to improve audit quality, but the addition of AQIs and quality control transparency would be the critical driver of improved investor confidence."); Letter from CII to PCAOB, PCAOB Rulemaking Docket No. 046 Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 19, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/035_CII.pdf) ("We believe a future PCAOB QC standard should require public disclosure by firms about their QC systems.").

designed to measure quality,[19] an omission of which one commenter labeled "inconceivable."[20] Investors also asked for mandatory outreach by audit firms to investors as part of the feedback loop,[21] heightened accountability through a certification requirement,[22] and a broader objective against which to measure the success or failure of the system.[23]

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19 *See* Letter from CFA Institute, *supra* note 18 ("However, for a market to be perfectively competitive not only does an efficient market need numerous buyers and sellers but they also need them to be well informed. In the current audit market, buyers of audit services – ultimately investors – do not have the information necessary to judge audit quality."); *see also* Letter from AFL-CIO, *supra* note 18 ("we urge the PCAOB to require the use of audit quality indicators as part of audit firm quality control standards. Measuring audit quality indicators will promote enhanced audit quality."); Letter from Colorado PERA, *supra* note 18 ("The PCAOB can further the connection between these two critical groups through the adoption of Audit Quality Indicators (AQIs) as part of the quality control standards. The adoption of Audit Quality Indicators has been discussed at the PCAOB for years, and we believe the review of the quality control standards is an excellent opportunity to finalize the process of developing AQIs."); Letter from CII, *supra* note 18 ("We believe firms should be required to establish quantifiable performance measures for the achievement of quality objectives.").

20 Letter from Consumer Federation of America to PCAOB, PCAOB Release No. 2019-003, Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) ("Consumer Federation") (*available at* https://pcaobus.org/Rulemaking/Docket046/014_CFA.pdf) ("It is frankly inconceivable to us that the Board would update its quality control standards without including a requirement on AQIs.").

21 Letter from ICGN to PCAOB, ICGN Response to the PCAOB Concept Release for Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/016_ICGN.pdf) ("We note that there is an ongoing gap in consideration of the investor in these processes. We believe that QC standards should include express efforts to engage with investors and reflect those investor needs. This would be welcome at a firm level as well as at individual engagement levels, where investors offer a valuable sounding board for potential concerns around accounting quality that could help direct auditors' work."); Letter from Colorado PERA, *supra* note 18 ("We view the reassessment of quality control standards as another opportunity to further improve the connection and communication between investors and auditors.").

22 Letter from Colorado PERA, *supra* note 18 ("Based on our discussions with management teams during the implementation of Sarbanes-Oxley, having to sign off on their company's financial statements was an important driver in improving financial reporting quality. We believe having senior management at the audit firms sign off on their quality control systems will create the same level of personal accountability."). Certification or attestation can improve the quality of the decision making process. *See, e.g.,* Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 72936 (Aug. 27, 2014) ("the Commission believes that having an individual attest to the information disclosed in the form will promote analytical independence. In particular, the individual executing the attestation will want to ensure that it contains no untrue or inaccurate statements. Consequently, the individual will have an incentive to take steps to verify that the credit rating was not influenced by any other business activities, was based solely on the merits of the instruments being rated, and was an independent evaluation of the risks and merits of the instrument.").

23 Investors and academic commenters noted that the objective of an audit firm's system of quality control should explicitly refer to the protection of investors and customers of broker dealers. *See, e.g.,* Letter from Douglas R. Carmichael, Ph.D., CPA and Thomas J. Ray, CPA Eli and Claire Mason Professor Distinguished Lecturer Baruch College, CUNY Baruch College, CUNY, to PCAOB (Mar. 13, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/008_Carmichael-Ray.pdf) ("We recommend that the goals of a system of quality control include explicitly the goal of performing audits in a manner that protects the interests of investors, and customers of broker dealers, as applicable, and furthers the public interest in the preparation of audit reports that are informative, accurate, and independent.").

II. The PCAOB Concept Release

These are all issues that should be given serious consideration. In my remarks today, though, I want to focus on another concern raised by investors, the importance of independent oversight for any system of quality control. Investors expressed strong support for the inclusion of independent oversight in any potential revision of our QC standards.

The issue of independent oversight arises, as the letters indicated, from the potential conflict between the commercial nature of firms and audit quality.[24] Partners at firms are compensated based on the profits generated by the firms.[25] Audit quality, in turn, is a cost that can conflict with commercial interests, at least in the short term.[26] A potential risk exists, therefore, that commercial interests may sometimes improperly override audit quality.

How might this occur? Given the competing nature of these interests, investors identified some possibilities. Firms might under-invest in audit quality, leaving the area without adequate resources. Firms may be less willing to dismiss a lucrative client notwithstanding concerns over quality. Those responsible for audit quality may be less willing to make difficult or unpopular decisions out of concerns over the impact on their professional standing within the firm.

Independent oversight is used throughout the capital markets to address similar conflicts of interest. Listed companies address the potential conflict between the interests of management and shareholders through the use of independent directors.[27] The major stock exchanges in the

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[24] *See* The Dutch Authority for the Financial Market, Vulnerabilities in the Structure of the Audit Sector (Nov. 2018) ("Vulnerabilities in The Structure of The Audit Sector") (*available at* https://www.afm.nl/~/profmedia/files/doelgroepen/accountantsorganisaties/2018/engels-rapport-kwaliteit-structuur.pdf?la=en) ("Although both attitudes of course exist, this study revealed that the technical-commercial attitude had the upper hand among auditors at the organisations reviewed. One important reason for this is that people with this attitude are more likely to be promoted to partner status. The study concludes that this culture, in which employees with a commercial attitude to their work strive to progress to become partners, is contrary to the 'accounting profession's public interest mandate'.").

[25] Jan Bouwens, Olaf Bik, & Yuxia Zou, *Determinants of Audit Partner Compensation*, (Aug. 2019) (*available at* https://pcaobus.org/EconomicAndRiskAnalysis/Conference/Documents/Submission%2023%20-%20Determinants%20of%20Audit%20Partner%20Compensation%20v20190909.pdf) ("Partnerships use profit-sharing systems to incentivize individual partners as each time when firm profit increases, so will each partner's profit share).

[26] *See* Vulnerabilities in The Structure of The Audit Sector, *supra* note 24 ("Such investment will take a long time to be repaid, and the return is by no means certain in advance. In other words, it takes a relatively long time before investment in matters such as quality control and compliance systems, innovation and training in ethics, business conduct and professional behaviour will result in higher earnings. The propensity to make such investments on the basis of the principle of an economic return may thus be lower than desirable from the point of view of the public interest. This effect possibly intensifies as the partners approach retirement, since they will not see a return at all.").

[27] *See* NYSE: Corporate Governance Guide (Dec. 2014) (*available at* https://www.nyse.com/publicdocs/nyse/listing/NYSE_Corporate_Governance_Guide.pdf).

U.S. use independent oversight to safeguard regulatory responsibilities from undue influence from commercial interests.[28] Independent oversight, as part of the investment company regulatory framework, has been characterized as "fundamental."[29] Accordingly, mechanisms of independent oversight are well-known by investors.

We specifically asked about the issue in the Concept Release. We sought comments on whether any future PCAOB standard should "incorporate mechanisms of independent oversight over firms' QC system".[30] The question struck a nerve.

A. Comments We Received

Investors, investor associations, consumer groups, and the U.S. Government Accountability Office (GAO) all supported requirements of independent oversight as an element of a audit firm's system of quality control.[31] They agreed that such oversight should be

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[28] Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change Amending the Eighth Amended and Restated Operating Agreement of the Exchange to Establish a Regulatory Oversight Committee as a Committee of the Board of Directors of the Exchange and Amending Other Rules of the Exchange, Exchange Act Release No. 75991 (Sept. 28, 2015) (*available at* https://www.sec.gov/rules/sro/nyse/2015/34-75991.pdf) ("The Exchange believes that its proposal to establish a ROC to undertake the independent oversight of the Exchange's regulatory responsibilities would ensure independent oversight of the regulatory process and would have the additional benefit of aligning the Exchange's corporate governance practices with its industry peers."). *See also* Findings, Opinion, and Order of the Commission Exchange Act Release No. 53128 (Jan. 13, 2006) (*available at* https://www.sec.gov/litigation/opinions/34-53128.pdf) ("In addition, the Nasdaq Exchange has created an independent regulatory department, Nasdaq Regulation, for the purpose of functionally separating its regulatory functions from its business lines. Nasdaq Regulation will carry out many of the Nasdaq Exchange's regulatory functions, including administering its membership and disciplinary rules.").

[29] Treatment of Asset-Backed Issuers Under the Investment Company Act, Investment Company Act Release No. 29779 (Sept. 7, 2011) (*available at* https://www.sec.gov/rules/concept/2011/ic-29779.pdf) ("The concept of independent oversight or independent review is fundamental to the regulatory framework of the Investment Company Act. Registered investment companies typically rely for their structure and operations on third parties that have their own financial interests separate and distinct from those of the investment companies and their shareholders, presenting potential conflicts of interest that require independent oversight. The independent oversight in the case of registered management investment companies is provided by the company's board of directors, and in particular the independent board members, as required by the Act."). There are other examples that employ structural mechanisms to operationalize independent oversight. Investment banks have in place quality controls that separate their brokerage business from the analyst function to ensure the integrity and independence of the research function. Similarly, credit-rating agencies must separate the ratings function from sales and marketing activities as part of their system of quality control. The structural mechanisms, however, often accompany robust independent oversight.

[30] *See* Concept Release, *supra* note 7 ("We are considering whether a future PCAOB QC standard should address mechanisms for independent oversight over firms' QC systems (for example, boards with independent directors or equivalent).").

[31] Of the 25 or so commenters who expressed views on public disclosures as a component of a firm's system of quality control, 100% of investors supported public disclosures. No comment letter from a registered accounting firms supported the requirement. *But see* Letter from Institute of Management Accountants (IMA) to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB

required[32] and made part of the "structure" of such a system.[33] Independent oversight would "greatly enhance the quality of controls standards"[34] and improve accountability.[35] In particular, the Consumer Federation of America told us that independent oversight "has the potential to help counteract economic incentives to under-invest in audit quality or to view retaining customers, rather than protecting investors, as the firm's top focus."[36]

The letters included specific suggestions for the largest firms. Investor concerns about a firm being too commercially driven could be mitigated[37] through a system that incorporated

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Release No. 2019-003; Rulemaking Docket No. 046) (Feb. 26, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/005_IMA_FRC.pdf) ("The time probably has come for there to be a requirement for an annual quality control report to be issued by at least the largest accounting firms – perhaps, initially, for those firms that audit more than 100 registrants. However, this is an area where scalability should be considered; the public interest in such a report would be much less for smaller firms and need not be required at this time. We do continue to believe that firms should be given wide discretion in the form and content of such reports.").

[32] *See* Letter from CII, *supra* note 18 ("Given the importance of independent oversight to audit quality, we believe audit firms should be required to have independent oversight of their systems."); *see also* Letter from CFA Institute to PCAOB, *supra* note 18 ("[A]ll the largest audit firms should be required to have independent directors on their boards.").

[33] Letter from California Public Employees' Retirement System (CalPERS), Concept Release, Potential Approach to Revisions to PCAOB Quality Control Standard (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 18, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/034_CalPERS.pdf) ("Having high level independent oversight in a company's governance structure provides an objective point to mitigate concerns with conflicts of interest as well as assessing the effectiveness of the auditor. We support more independent governance structures and would like it to become a central part of audit firm governance.").

[34] *See* Letter from Colorado PERA, *supra* note 18 ("We believe independent oversight would greatly enhance the quality control standards.").

[35] *See* Letter from CFA Institute, *supra* note 18 ("We believe, however, that this goal is most likely to be achieved if firm leaders are held accountable for results achieved. And this in turn can only be achieved through independent oversight of the quality control system and where there is transparency of the details of the quality control system of each audit firm. . .").

[36] *See* Letter from Consumer Federation, *supra* note 20 ("Given the incentives firms have to under-invest in quality control, we believe that goal is most likely to be achieved where there is independent oversight of the quality control"). *See also id.* ("Independent oversight also has the potential to help counteract economic incentives to under-invest in audit quality or to view retaining customers, rather than protecting investors, as the firm's top focus.").

[37] *See* Letter from CalPERS, *supra* note 33 ("Independent directors can mitigate concerns over a firm being too commercially driven."). *See also* Letter from CFA Institute, *supra* note 18 ("Given the importance of independent oversight to audit quality, we believe audit firms should be required to have independent oversight of their systems of governance and quality control") and consequently that all of the largest audit firms should be required to have independent directors on their boards."); *see also* Letter from CII, *supra* note 18 ("We believe that all of the largest audit firms should be required to have independent directors on their boards. We believe the benefits of requiring independent directors on firm boards would exceed the costs of imposing such a change at the largest audit firms. In addition, we believe the duties of those providing independent oversight should include, among other responsibilities, "resource allocation decisions . . . the annual review of the QC system, the

independent oversight, such as a mechanism to report directly to independent directors on the firm's board.[38] A reporting line directly to these directors could result in a board better informed about audit quality issues.[39]

The Council of Institutional Investors ("CII") endorsed a U.S. Treasury Report recommendation that audit firms' boards should have "independent members with full voting power." CII further explained that the benefits of independent oversight exceed the "costs of imposing such a change at the largest audit firms." [40]

At the same time, commenters recognized that independent oversight could be made scalable. As the letter from the Consumer Federation of America stated:

> Much as an independent board committee is required to oversee the public company audit, an independent board committee of the audit firm should have responsibility for overseeing the firm's quality control system. For smaller firms that do not have independent boards or advisory committees, responsibility for maintaining a robust QC system should reside with top firm leadership.[41]

B. Possible Concerns

The views of audit firms and their associations were more mixed. Most commenters from audit firms or their associations recognized the value and importance of independence.[42] Indeed

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effectiveness of remediation of QC concerns, and the integration of audit quality into the system of incentives and rewards for firm personnel.").

38 S*ee* Letter from AFL-CIO, *supra* note 18 ("Accordingly, we support improving the oversight of quality control systems through the appointment of independent directors to audit firm boards for this purpose.").

39 John Armour, Jeffrey Gordon & Geeyoung Min, Taking Compliance Seriously, 37 YALE J. ON REG. 1 (Winter 2020) (**"**A direct channel of reporting from compliance personnel to the board is thought to be a means of fostering not only autonomy within the compliance program but also open upward transmission of information.").

40 *See* Letter from CII, *supra* note 18 ("We believe that all of the largest audit firms should be required to have independent directors on their boards. We believe the benefits of requiring independent directors on firm boards would exceed the costs of imposing such a change at the largest audit firms. In addition, we believe the duties of those providing independent oversight should include, among other responsibilities, "resource allocation decisions . . . the annual review of the QC system, the effectiveness of remediation of QC concerns, and the integration of audit quality into the system of incentives and rewards for firm personnel.")

41 Letter from Consumer Federation, *supra* note 20.

42 A number of letters, including many from audit firms, recognized the value of independence. *See* Letter from KPMG to PCAOB, PCAOB Rulemaking Docket No. 46: Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/020_KPMG.pdf) ("Independent oversight of the firm's QC system can provide benefits to the system of quality control. In our experience, independent directors provide valuable insight and support the achievement of the firm's quality objectives."); *See* Letter from PwC to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/030_PwC.pdf) ("Perspectives from independent third parties can add an

many firms have incorporated some form of independence and external participation into their governance structures through in a variety of ways. No firm commenter, with one possible exception,[43] however, supported making this a requirement for a firm's system of quality control in a future PCAOB standard.

important dimension of input to a firm's internal assessments and can benefit audit quality by enhancing a firm's governance and decision-making processes. This approach is consistent with widely-accepted governance best practices."); Letter from EY to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/021_EY.pdf) ("Independent perspective can enhance stakeholder confidence in audit firms by providing valuable insights about matters that can affect a firm's audit quality, such as its business, operations, culture, talent, strategy, governance and risk management."); Letter from Grant Thornton to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://www.grantthornton.com/-/media/content-page-files/audit/pdfs/comment-letters-2020/comment-PCAOB-quality-control-revisions-1.ashx) ("We are supportive of the notion that independent directors or advisory committees can provide helpful business insights to audit firms."); *see also* Letter from Committee on Corporate Reporting, Financial Executives International, to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/019_FEI_CCR.pdf) ("We acknowledge the role that audit firm governance plays in contributing to audit quality and that this is an area where the profession continues to evolve.). One firm did suggest that an independence requirement could harm audit quality. *See* Letter from MAZARS to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/029_MAZARS_US.pdf) ("No, we do not believe the revised PCAOB QC standard should include the incorporation of independent oversight over firms' QC systems. The prescribing of such mechanisms may not be adaptable to all firms of varying sizes; limiting scalability. In addition, mandating independent oversight may result in unintentional consequences that would compromise audit quality, as firms may be forced to expend financial resources that would be more effectively used on audit quality initiatives.").

[43] *See* Letter from Grant Thornton, *supra* note 42 ("Regardless of the path the Board chooses, we do not believe specific criteria should be used to determine which firms would be required to have independent oversight. If the Board believes that audit quality will be enhanced by such oversight, we do not believe certain firms should be exempt from such requirements. Rather, we encourage the Board to establish requirements that can be appropriately instituted by all registered firms, considering the operational challenges we noted above.").

Their hesitancy seemed to be mostly about application.[44] Firms expressed concern over scalability,[45] particularly the impact of any such requirement on smaller firms.[46] They also noted

44 Some objected to the requirement as inconsistent with a risk based approach to quality control. *See* Letter from CAQ to PCAOB, PCAOB Rulemaking Docket No. 46: Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/010_CAQ.pdf) ("We do not believe such a provision should be required, as we are concerned this would limit the scalability of a future PCAOB QC standard. Independent oversight may be an appropriate response for some firms based on their risk assessment; however, such a requirement may not be necessary or effective for all firms. Further, independent oversight may take various forms including independent advisors who are not board members."); Letter from Crowe LLP to PCAOB, PCAOB Rulemaking Docket No. 46: Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (*available at* https://pcaobus.org/Rulemaking/Docket046/025_Crowe.pdf) ("Independent oversight over a firm's QC systems is a relatively new concept for most firms, and while it is clearly an option a firm might take, firms do not have public investors who have the same level of need for independent oversight as that of a public company. We believe that with a risk-based approach, a firm may determine that independent oversight or independent advisors is an appropriate response to their risk assessment process, however, it should be part of a firm's overall response to its risk assessment not a prescriptive requirement. Requiring independent oversight may also limit the scalability of a future PCAOB QC standard."); Letter from Moss Adams to PCAOB, PCAOB Rulemaking Docket No. 46 (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/023_Moss_Adams.pdf) ("We do not believe such a provision should be required as we are concerned this would limit the scalability of a future PCAOB QC standard. Independent oversight may be an appropriate response for some firms based on their risk assessment; however, such a requirement may not be necessary or effective for all firms. Further, independent oversight may take various forms including independent advisors who are not board members.").

45 *See* Letter from PwC, *supra* note 42 ("Regarding scalability, we note that certain incremental requirements could disproportionately affect smaller firms. For example, requirements for firms to have mechanisms for independent oversight over their QC systems could prove challenging for smaller firms – whether due to an inability to remunerate suitable candidates competitively with other firms or finding individuals willing to be subject to a firm's independence requirements."); Letter from KPMG, *supra* note 42 ("While there is value to including an element of independent oversight to support the QC system, we also acknowledge that it is challenging to identify qualified, diverse and independent individuals that can fulfill this role. These challenges may impact the scalability of a future PCAOB QC standard to all firms; and, therefore, we do not recommend that a future Quality Control standard require a mechanism for independent oversight."); Letter from RSM US LLP to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 13, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/009_RSM-US-LLP.pdf) ("Also, a requirement to incorporate mechanisms for independent oversight would not make the standard easily scalable for smaller firms. We believe the discernment regarding whether to have independent directors or other advisory oversight bodies should take place in the board room of the individual firms."); *see also* Letter from NYSSCPA to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 17, 2020) *available at* https://pcaobus.org/Rulemaking/Docket046/032_NYSSCPA.pdf) ("Consistent with our view set forth under our General Comments above, we believe scalability should be a primary consideration in determining the nature and extent of any oversight to be applied to a firm's QC function . . . and that an "independent" QC oversight should not be mandated except perhaps for the largest of firms.").

46 Letter from Baker Tilly to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/011_Bakertilly.pdf) ("This approach should not be a requirement. Firms have developed different forms of governance that are suitable for them. To prescribe some sort of required structure would be contrary to a risk-based approach and probably unsuitable for the smaller firms.").

the need for flexibility.[47] A consistent theme was that a single model for independent oversight had not emerged and therefore should not be required.[48] Instead, there should be room to allow for evolution[49] and to consider alternative models.[50]

To the extent that the structure would include oversight by independent directors, a number of issues would need to be addressed.[51] Questions were raised about the ability of small firms to find qualified candidates,[52] with suggestions that any independent oversight "should not

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47 *See* Letter from PwC, *supra* note 42 ("It is important for firms to have flexibility to consider whether independent oversight is necessary and, if so, what is most appropriate based on the structure of their firm and where they operate."); Letter from EY, *supra* note 42 ("Today, there are a variety of ways that firms gather perspectives from an independent body as a means to strengthen audit quality. We believe firms should continue to have this flexibility.").

48 Letter from BDO to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/018_BDO.pdf) ("we do not believe that there is observable evidence that the use of independent directors is effective in improving audit quality with accounting firms, as we believe that firms that have voluntarily adopted the use of independent directors have not used them in an oversight capacity as proposed by the PCAOB."). *See also* Letter from RSM, *supra* note 45 ("Currently, professionals from outside a firm primarily are hired in an advisory (i.e., not an oversight) capacity. We do not believe it would be helpful or practicable to require firms to incorporate mechanisms for independent oversight as we believe that, even with a requirement to have such independent oversight, the roles of independent directors would vary as to levels of authority, responsibility and influence within each firm.").

49 *See* Letter from IMA, *supra* note 31 ("We acknowledge that various practices have emerged in recent years including independent directors on firms' boards of directors and separate audit advisory boards comprised of independent individuals. It is too early to know which form of oversight, if any, will be most effective in improving firm-wide audit quality. Likewise, it would be premature to specify duties for such oversight. We believe that best practices for such oversight will develop in the marketplace. This is like the evolution of audit committees within the corporate governance system. For decades, such committees were considered a good practice, but few companies established them, and the existing committees had widely varied practices. Only in relatively recent years has it become accepted that such committees are an essential element of corporate governance, should be required, and should follow at least a minimum list of required procedures.").

50 A variety of other options were also suggested. *See* Letter from Grant Thornton, *supra* note 42 ("We believe that a similar objective can be met by either designating an individual on a firm's board as an 'audit quality expert' (similar to audit committee requirements for a 'financial expert') or by having independent external advisors outside of the board construct, to focus on and advise firms regarding audit quality or their systems of quality control.").

51 Letter from NYSSCPA, *supra* note 45 ("Also, we believe that the size, composition and qualifications of members of a body designated with responsibility for overseeing a firm's internal QC function might best be similar to those of audit committees – with independent members and at least one representative who represents a wider scope of stakeholders, for example, someone who is not a CPA or an auditor.").

52 *See* Letter from PwC, *supra* note 42 ("Requirements for firms to have mechanisms for independent oversight over their QC system could make it challenging, especially for smaller firms, to attract suitable candidates – whether due to an inability to remunerate them competitively with other firms or difficulty finding individuals willing to be subject to relevant aspects of a firm's independence requirements."). *See also* Letter from KPMG, *supra* note 42 ("While there is value to including an element of independent oversight to support the QC system, we also acknowledge that it is challenging to identify qualified, diverse and independent individuals that can fulfill this role. These challenges may impact the scalability of a future PCAOB QC standard to all firms; and, therefore, we do not recommend that a future Quality Control standard require a mechanism for independent oversight.").

be mandated except perhaps for the largest firms."[53] Some commenters favored increased disclosure about "the composition and activities of the firm's governance structure… "[54] All of these concerns are important and deserve serious consideration.

In addition to concerns over scalability and flexibility, at least two other reasons have been suggested for omitting independent oversight from any future QC standard. Let me briefly discuss these reasons and what I understand so far.

First, the inclusion of an independent oversight requirement in a future PCAOB standard may result in differences in approach between the IAASB and the PCAOB, and therefore, should not be implemented.

The PCAOB's Concept Release described the IAASB's approach as a possible "starting point"[55] but indicated a goal of minimizing the differences between the two approaches.[56] The IAASB is considering adopting standards this week that may not include any requirements for independent oversight.

The goal of minimalizing differences as a justification for leaving out independent oversight has a number of flaws. The reasoning does not adequately take into account the differences between the PCAOB and the IAASB in connection with standard setting. While the IAASB's proposed standard does provide useful input for the Board's consideration, differences in the two organizations may make one universal standard on quality control difficult to achieve and not necessarily desirable.

For one thing, the IAASB's standards are intended to be implemented across the globe and, therefore they must, by their nature, be general enough to suit a wide array of stakeholders, including the varied legal and cultural needs in other countries. Many jurisdictions that implement IAASB standards can, and sometimes do, add additional requirements in order to reflect specific local needs.[57] The PCAOB, in contrast, is in a position to include those "local needs" suggested by investors in the comment process directly in any revised QC standard.

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[53] *See* Letter from NYSSCPA, *supra* note 45.

[54] *See* Letter from FEI, *supra* note 42 ("It is likely too soon, however, to know which type of independent oversight mechanism, if any, is most effective in promoting quality audits. Thus, at this time, we would not support either a required certain composition of a firm oversight body, or requirements for the duties of those providing oversight. On the other hand, we would support disclosure of the composition and activities of the firm's governance structure, such as in the audit quality reports the largest firms now issue annually, in order to allow the market to drive best practice in this area."). *See also* Letter from IMA, *supra* note 31 ("We would support disclosure of the composition and the general responsibilities of such independent audit oversight activities in the quality control reports mentioned in Question 39 below.").

[55] *See supra* note 15.

[56] *See* Concept Release, *supra* note 7 ("Due to the foundational nature of QC systems, we believe that it would not be practical to require firms to comply with fundamentally different QC standards.").

[57] Japan has adopted requirements designed to "clarify audit procedures to address the risks of material misstatements due to fraud. . . ." *See* Opinion on the Standard Setting to Address Risks of Fraud in an Audit,

Further, the mission of the PCAOB specifically emphasizes the interests of investors, something that reflects both the particular concerns present with respect to the U.S. capital markets and the deficiencies that arose during the period when the auditing profession engaged in self-regulation.[58] The PCAOB's standard-setting activities therefore must give significant weight to this mission in connection with its oversight of auditors for both issuers and broker-dealers, as well as any other current and emerging issues applicable to the U.S. capital markets.[59]

In fulfilling this mission, the PCAOB has, at least historically, considered the perspectives of an advisory group that consisted entirely of investors and their representatives.[60] One out of every five comment letters received on the PCAOB's Concept Release came from the investor community.

The views of these commenters on the relationship between the IAASB proposal and the PCAOB's approach to a future QC standard are instructive. They did not see the IAASB proposal as a limit. One letter characterized the use of the IAASB's approach as a "starting point" as premature.[61] Others supported coordination, but did not view it as restricting potential incremental additions, such as independent oversight. All of this suggests that the goal of international alignment should not be elevated above the specific concerns and interests of investors and the public.

Business Accounting Council (Mar. 26, 2013) (*available at* https://www.fsa.go.jp/en/news/2013/20130411-1/01.pdf).

[58] Our mission specifically references investors. *See* Section 101 of the Sarbanes-Oxley Act (15 USC § 7211) ("There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors."). The IAASB mission references the public which includes but does not specifically emphasize investors. *See* IAASB, *About IAASB* (*available at* https://www.iaasb.org/about-iaasb) ("The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards.").

[59] While this is good policy, it is also legally required. The PCAOB standards cannot take effect unless and until approved by the SEC pursuant to Rule 19b-4 under the Securities Exchange Act of 1934. 17 CFR § 240.19b-4. The failure to adequately consider a statutorily mandated requirement would be a basis for non-approval or a possible legal challenge to the final standard.

[60] *See* PCAOB, *Investor Advisory Group Members* (*available at* https://pcaobus.org/About/Advisory/Pages/Investor_Advisory_Group_Members.aspx). The IAG has not held a public meeting since November 2018. *See* PCAOB, *Investor Advisory Group Meeting* (*available at* https://pcaobus.org/News/Events/Pages/PCAOB-IAG-Meeting.aspx). Both organizations have advisory groups that include representatives of multiple stakeholders. The membership varies, significantly, particularly with respect to the number of investors and investor groups. *Compare* PCAOB, *Standing Advisory Group Members* (*available at* https://pcaobus.org/Standards/SAG/Pages/Current.aspx) with IAASB, Consultative Advisory Group, (*available at* https://www.iaasb.org/consultative-advisory-group).

[61] *See* Letter from Consumer Federation, *supra* note 20 (describing use of IAASB proposal as "starting point" as "premature at best").

And let's be clear. Not all "differences" in standards are the same. Given the global nature of the audit profession, inconsistencies may sometimes present unique challenges with respect to implementation. Adding additional, more detailed requirements, however, do not raise the same concerns. Independent oversight and other matters sought by investors commenting on our Concept Release do not appear to result in inconsistencies with, but for the most part are additions to, the QC approach of the IAASB.[62]

Second, some say that independent oversight as an element of the standard may be unnecessary because of the role of the PCAOB.[63] This is a complement when you think about it. Some may be suggesting that a regulatory body can effectively replace an internal system of independent oversight. Complement though it is, I am concerned that this view misconceives the function of the PCAOB.

PCAOB inspections of audit firms can include a review of the system of quality control for conformity with established standards.[64] Accordingly, these inspections do sometimes identify instances where the system does not meet these standards. The PCAOB cannot do this if a requirement is not in our standards, nor will we be able to enforce what that is not there.

Without a requirement for independent oversight in an audit firm's system of quality control, the PCAOB has limited ability to ensure that commercial interests are not unduly

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62 The IAASB approach also permits differences in approach. The IAASB QC proposed standard does not, for example, require all firms to issue transparency reports. In response to legal and regulatory requirements in certain jurisdictions, many audit firms are required to issue transparency reports generally containing information on audit firm's governance, including the firm's internal quality control system, independence practices, compensation and remuneration, among other things. Some firms have also chosen to issue transparency reports voluntarily, when not mandated by regulations. *See* European statutory audit regulations (Article 13 of Regulation (EU) 537/2014), Australian law (Sections 332 to 332G of the Corporations Act 2001 and Regulation 2M.4A and Part 3 of Schedule 7A in the Corporations Regulations 2001), Korean law (Regulation on External Audit and Accounting, Article 22(2)). The IAASB observed that there are still many jurisdictions where transparency reporting is not required or common practice, largely because there is a lack of demand from stakeholders in those regions for such information. While "certain respondents, mostly investors, did call for the IAASB to more specifically address transparency reports in the IAASB's standards…," the IAASB is considering adopting a standard that does not require a firm transparency report. *See supra* note 6.

63 *See* Letter from Deloitte & Touche LLP to PCAOB, PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046) (Mar. 16, 2020) (*available at* https://pcaobus.org/Rulemaking/Docket046/031_DT.pdf) ("Though not an aspect within a firm's system of quality control, mechanisms for independent oversight over firms' systems of quality control exist today via the PCAOB's inspection program (which includes a review of the firm's quality control system) as well as inspections or similar programs in other jurisdictions or by other regulators or standard setters (e.g., the AICPA's peer review program).").

64 PCAOB Inspection Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted? (*available at* https://pcaobus.org/Inspections/Pages/PCAOB-inspection-procedures-what-does-PCAOB-inspect-how-inspections-conducted.aspx) ("A PCAOB inspection is designed to assess the firm's compliance with PCAOB standards and rules, and other applicable regulatory and professional requirements in the firm's system of quality control and in the portions of audits selected for inspection. Inspections do not involve a review of all aspects of a firm's quality control system.").

influencing or negatively impacting audit quality.[65] Granted, the problem may become so severe that it can be identified through deficient engagements. But this will be rare. And the view fundamentally conflicts with the goal that the system of quality control should be designed to ensure that the problems or concerns do not occur in the first instance.

On the other hand, should a requirement of independent oversight be added to any resulting standard, the PCAOB can play an active role in ensuring adequate implementation and enforcement. PCAOB inspections can make sure the element is present and appropriately integrated into the firms' system of quality control. The PCAOB can also facilitate public accountability through disclosure. As I have said in the past, I believe that we have the authority to include in the public portion of the inspection report a description of a firm's QC system, something that would presumably include the implementation of independent oversight.[66]

These issues clearly need to be considered, debated and addressed in determining whether independent oversight should or should not be included in a future QC standard. Some of these concerns were at most touched upon lightly in the comment process and would benefit from additional insight. Moreover, there may be ways to address commercial influences. We would benefit from further insight on this topic. I look forward to hearing those views.

III. Conclusion

So where does this leave us?

Quality control is essential for trust.[67] Like consumers of food, medicine, and transportation, those relying on audits expect regulators to require, and audit firms to implement, a rigorous system of quality control. On that, there is, I think, agreement.

The importance of independent oversight is really one piece of that broader debate.

There may be multiple ways to construct a QC system that adequately promotes audit quality without independent oversight. Investors have, however, advanced the view that

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65 Of course, to the extent there are ways to protect audit quality from commercial interests other than independent oversight and they are included in any revised standard, they will be subject to inspection and enforcement.

66 J. Robert Brown, Jr., *Seeing Through the Regulatory Looking Glass: PCAOB Inspection Reports*, CFA Institute's Corporate Disclosure Policy Council and Capital Markets Policy Council, July 23, 2020 (*available at* https://pcaobus.org/News/Speech/Pages/Brown-Seeing-Through-Regulatory-Looking-Glass-PCAOB-Inspection-Reports.aspx).

67 Competition & Markets Authority, *Statutory audit and services market study* (Apr. 18, 2019) (*available at* https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit_final_report_02.pdf) ("Lack of trust in the provision of audits will undermine credibility and confidence in the quality of audits and the accuracy of financial statements published by large companies. These will prevent investors, customers and suppliers from being able to identify the companies that have more effective and those that have less effective audits (other than in the extreme case of corporate failure).").

independent oversight can improve quality,[68] result in greater accountability[69] and increase the confidence placed by investors and the public in the quality of audits.[70] These are important points that warrant serious consideration.

Nonetheless, the debate is far from resolved. I very much look forward to hearing and carefully considering any additional thoughts on this issue. I am particularly interested in views that either support or challenge the positions taken by parties submitting comments on the Concept Release. All of this will help develop a more fulsome record that will be useful in determining whether independent oversight should or should not be a requirement in any standard addressing QC systems.

I encourage everyone here to participate in the debate. Give us your thoughts on independent oversight and anything else you think may help improve our standards on quality control. Your participation is important. The letters we received on the Concept Release were extremely helpful. While sometimes the interests of investors and the public can be discerned, nothing is better than hearing from you directly.

Write to us, email us, or meet with us. I'm happy to arrange a conversation, whether with me, our staff or other Board members.[71]

Should the PCAOB issue a proposed standard in the area, be prepared to give us your feedback. I expect the issue will generate a spirited debate during any notice and comment period over whether an independent oversight requirement should be included in the standard and, if so, how it should be implemented.

If past history is any indication, the differences in commenter views will be significant. The auditing profession has traditionally favored a principles-based approach that uses general language applicable to all firms, irrespective of their differences in size, resources and number of clients. Investors tend to favor an approach that involves a mix of principles and specific requirements.[72]

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68 *See supra* note 34. *See also* Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest, GAO-12-209 (Jan. 2012) (*available at* thttps://www.gao.gov/assets/590/587613.pdf) ("Two studies found that the relationship between analyst recommendations and valuation estimates strengthened after the regulatory reforms, indicating that the reforms improved analyst independence.").

69 *See supra* note 35.

70 Letter from CalPERS, *supra* note 33 ("having independence within the governance structure strengthens investor trust in the system.")

71 My email address is brownj@pcaobus.org.

72 *See* Modernization of Regulation S-K, Items 101, 103, and 105, Exchange Act Release No. 86614 n. 17 (Aug. 8, 2019) (supporting disclosure standards that were "some combination of both principles-based and prescriptive rules."). Standards that are too general can raise accountability concerns. *See supra* note 13 (testimony of Lynn Turner, Chief Accountant, SEC) (stating that standards were "so general that, as a practical matter, it is difficult to hold anyone accountable for not following them.").

And remember, your views are essential to the PCAOB. Our mission is to act in the interests of investors and the public. To do this, we need you to tell us what those interests are.