U.S. Chamber of Commerce

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December 20, 2024

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Securities and Exchange Commission Notice of Filing of PCAOB Proposed Rules on *Firm and Engagement Metrics and Related Amendments to PCAOB Standards* (Release No. 34-101724; File No. PCAOB-2024-06) (November 25, 2024)

Dear Ms. Countryman:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("Chamber") respectfully submits the following comments on the Notice of Filing of the Public Company Accounting Oversight Board ("PCAOB" or "Board") Proposed Rules on *Firm and Engagement Metrics and Related Amendments* ("Proposed Rules" or "adopting release"). The Securities and Exchange Commission's ("SEC") comment period for the Proposed Rules is insufficient to solicit a broad swath of comments, particularly because the comment period extends over several common year-end holidays.

The SEC should not approve the Proposed Rules for the following reasons:

- The adopting release inappropriately dismisses concerns that the Proposed Rules are not fit for purpose;

- The proposed disclosures fall woefully short of standard materiality application, which is the lodestar for regulatory disclosure requirements, and the adopting release fails to address concerns that the metrics are not material information;

- The adopting release fails to adequately address concerns that run counter to PCAOB beliefs on standardization and comparability that underpin the Proposed Rules;

- The PCAOB did not re-expose the Proposed Rules for public comment or at least re-expose portions, including the newly added training metrics, further contravening due process and the approach of prior Boards;

- The adopting release inappropriately dismisses concerns that the Proposed Rules allow no tolerance for unintentional errors – no matter how small or *de minimis*;

- The economic analysis fails to even-handedly assess comments, concerns, and evidence on need, benefits, costs, consequences, and alternatives and falls far short of demonstrating that the Proposed Rules are necessary or appropriate for the protection of investors and will promote efficiency, competition, and capital formation.

Discussion

The Proposed Rules do not update nor modernize the PCAOB's interim auditing standards or otherwise revise auditor performance standards with an objective of improving audit quality. Rather, the Proposed Rules would impose a sweeping new audit firm disclosure regime for firm and engagement metrics in a rushed rulemaking.

The SEC also rushed due process by submitting the Proposed Rules to the Federal Register within two business days of Board adoption and allowing only a few weeks for comments (i.e., twenty-one days from publication in the Federal Register). The SEC's approach ignores stakeholder requests that "the Commission consider the options it has to afford sufficient time for stakeholders to review the rules and participate in a robust comment process," including extension of the period to act on the Proposed Rules by another forty-five days.[1] The rushed approach to finalize rulemaking is also counter to views expressed by members of the U.S. Congress.[2]

Other factors reinforce the need for an extended comment period. The adopting release is complicated and lengthy (335 pages) and the PCAOB adopted the Proposed Rules just before the Thanksgiving holiday. A short SEC comment period during December also coincides with a time-constrained period for stakeholders, given other year-end financial reporting and audit-related demands and the Christmas and New Year holidays. Further, the PCAOB adopted the Proposed Rules together with others on *Firm Reporting* and the SEC submitted both rulemakings to the Federal

[1] See the letter to the SEC from the Center for Audit Quality ("CAQ") on *Firm and Engagement Metrics* and *Firm Reporting* dated November 22, 2024.
[2] See letters from Representative French Hill and Senator Tim Scott. Available at: Scott Letter on Rulemaking and Nominations; e559a2dd-e8c4-4f98-85e3-29ebfbe0ad06.pdf.

Register the same day,[3] which challenges stakeholders with overlapping comment periods on two significant PCAOB rulemakings.

Most commenters on the PCAOB's April proposal did not support the proposed metrics disclosure and over seventy percent expressed concerns.[4] In response, the Proposed Rules reflect revisions to the requirements proposed for comment. However, substantive issues remain. Further, the adopting release rejects offers to pilot test proposed metrics and preferable alternatives advanced by stakeholders in the spirit of cooperating on a path forward for a reasonable audit metric disclosure framework.

The adopting release inappropriately dismisses concerns that the Proposed Rules are not fit for purpose.

The PCAOB's investor protection mission under SOX is focused on "driving audit quality forward."[5] However, the Proposed Rules are not focused on improving audit quality.

The Proposed Rules require disclosure of 65 different metrics (numbers) – 45 (in eight categories) at the firm level and 20 (in six categories) at the engagement level.[6] The firm metrics are required to be disclosed by every firm that audits at least one accelerated or large accelerated filer and the engagement metrics for every audit of such filers.[7] The Proposed Rules also prescribe, in great detail, the inputs to and computation of each number, including rounding.

Comments on the file to the PCAOB explain that the prescribed metrics are flawed proxies for assessing audit quality. The metrics are not aligned with how audit firms manage and monitor their audit practices or relevant to how audit firms view audit quality in their systems of quality control.

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[3] See the SEC Notice of Filing of PCAOB Proposed Rules on *Firm Reporting* (Release No. 34-101723; File No. PCAOB-2024-07) (November 25, 2024).

[4] See the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024.

[5] For example, see the *Message from the Chair* in the PCAOB *2023 Annual Report* (page 4).

[6] Firm-level metrics are reported to the PCAOB as of September 30th of each year on a new Form FM, *Firm Metrics*. Engagement-level metrics for audits of accelerated and large accelerated filers are reported on a revised Form AP, *Audit Participants and Metrics*, within 35 days after the date the audit report is first included in a document filed with the SEC.

[7] The PCAOB estimates that about 210 audit firms will be subject to the firm-level disclosure requirements and approximately 3,400 accelerated and large accelerated filer audits will be subject to the engagement-level disclosure. Based on registration information on the PCAOB website (at November 26, 2024), 210 firms encompass almost half of the 438 audit firms that currently provide audit reports for at least one issuer.

Nonetheless, the adopting release attempts 'to have it both ways.' On one hand, it maintains the metrics are needed by investors and audit committees as "decision-useful" information to assess the quality of an audit firm's services overall and on each engagement. On the other hand, the adopting release acknowledges that the metrics are not audit quality indicators (either individually or collectively); that the specified metrics, inputs, and/or formulas are not consistent with those currently used by audit firms in their quality control processes; and that audit firms may not find the metrics useful in monitoring their quality controls and assessing audit quality. Given these considerations, the Proposed Rules (reasonably and appropriately) do not require audit firms to use the metrics internally or disclose them in audit firm audit quality and transparency reports.

However, the adopting release ignores the essential problem: A regulatory mandate for a one-size-fits-all set of granular metrics with detailed specifics on definitions, data inputs, and calculations for each metric (including rounding) - where the required metrics are not consistent with those used by firms for monitoring quality controls and assessing audit quality – cannot and does not result in "decision-useful" information for investors or audit committees. Further, mandated metrics are "cast in concrete" and cannot evolve over time with the evolution of audit practice, the use of technology by auditors and companies, and the regulatory and business environment.

The Proposed Rules create a metric disclosure regime grounded in a laborious compliance exercise and risk undermining audit quality by redirecting time and resources to such activities.

The adopting release ignores that the Proposed Rules are not fit for purpose.[8] In this regard, it is doubtful that the Proposed Rules can pass muster under the recent Fifth Circuit Appeals Court decision in *Alliance for Fair Board Recruitment et al. v. SEC*.[9]

The proposed disclosures fall woefully short of standard materiality application, which is the lodestar for regulatory disclosure requirements, and the adopting release fails to address concerns that the metrics are not material information

[8] In voting against adopting the Proposed Rules, Board Member Ho questioned whether the Proposed Rules are fit for purpose and emphasized that the rules and the rulemaking process fail to align with the principles of the Paperwork Reduction Act. See the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024.
[9] See *Alliance for Fair Board Recruitment; National Center for Public Policy Research v. Securities and Exchange Commission*, U.S. Court of Appeals Fifth Circuit (Case No. 21-60626), filed December 11, 2024.

Materiality is a bedrock of the U.S. capital markets.[10] The materiality standard ensures that investors have the information they need while protecting them from "information overload."[11] Importantly, the materiality standard prevents regulators and others from using disclosures to pursue objectives that may be at odds with investor interests.[12]

In the seminal case of *TSC Industries Inc. v. Northway Inc.*, the Supreme Court held that a fact is material if "there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote."[13] Further, the Court held that a fact is material if there is "a substantial likelihood that the ... fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[14]

Yet, the adopting release fails to address this foundational issue. The adopting release avoids using the term "material" information in regard to the Proposed Rules.[15] This obscures the failure to address comments that the mandated disclosures are not material information for investors or audit committees.[16] The adopting release also waves away numerous comments and concerns that the metrics are not "decision-useful" information (using the PCAOB's own terminology).

The adopting release ignores concerns that these granular metrics, particularly at the engagement level, do not represent information that meets the "substantial likelihood," "would consider," and "important" tests in voting or the "substantial likelihood," "would have been viewed" "as having significantly altered the total mix" of available information tests for any type of investor.[17]

The adopting release disregards comments that the Proposed Rules fail to meet the essential criteria for material information. By avoiding using the term "material," discussing the concept, or analyzing its application to the Proposed Rules,

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[10] For example, see U.S. Chamber of Commerce Center for Capital Markets Competitiveness, *Essential Information: Modernizing Our Corporate Disclosure System* (Winter 2017).
[11] In this regard, the economic analysis ignores comments that the Proposed Rules overload investors and audit committees with a large set of complex data not sought, not needed, not meaningful, and not obviously usable by them.
[12] See U.S. Chamber of Commerce Center for Capital Markets Competitiveness "Effective, Material Corporate Disclosure Is the Cornerstone of U.S. Capital Markets" by Evan Williams (October 13, 2022).
[13] See the letter to the SEC from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the SEC Concept Release on *Possible Revisions to Audit Committee Disclosures* dated September 8, 2015.
[14] See *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Also, see *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).
[15] The adopting release only uses the term "material" in the context of known errors in Forms FM and AP (that come to light after the Forms are filed), as subsequently discussed.
[16] The adopting release targets both investors and audit committees as beneficiaries of the Proposed Rules. However, audit committees are not included in the PCAOB's remit under SOX and the PCAOB has no authority over audit committees. Moreover, comments from audit committee member indicate that they do not want or need the metrics.
[17] The adopting release acknowledges that the metrics are unlikely to be "decision-useful" for retail investors.

the adopting release provides no indication that the PCAOB even considered concerns that the Proposed Rules fall woefully short of this lodestar for regulatory disclosure requirements affecting the U.S. capital markets.

The adopting release fails to adequately address concerns that run counter to PCAOB beliefs on standardization and comparability that underpin the Proposed Rules

The adopting release asserts a need by investors and audit committees for comparable audit metrics at both the firm and engagement levels. In response, the Proposed Rules mandate a uniform set of metrics, specify the data inputs, and prescribe the calculations. The adopting release maintains that standardization will generate comparable data with respect to all firms and engagements that are subject to the reporting requirements – both cross-sectionally and over time.

Commenters enumerate many reasons why this one-size-fits-all, granular approach will not yield comparable metrics – whether considered individually or collectively. As an overarching matter, the adopting release assumes *ceteris paribus* conditions. However, "all other things are not equal" with the underlying data inputs for the prescribed metrics. When the substance of a measure inherently differs among audit firms and engagements, the resulting metric is not comparable. Heterogeneity cannot be converted to homogeneity by regulatory fiat.

The adopting release goes on to dismiss comments on this issue and concerns about endless differences among firms and engagements that contribute to heterogeneity in the underlying data. For example, comments highlight differences in client portfolios at the firm level and elaborate on differences at both the firm and engagement levels in industries; the size, nature, and geographic reach of (client) company operations; financial reporting risks such as whether (client) companies have engaged in mergers, acquisitions, or divestitures during the period, their financial health, and their prospects; whether the engagement is new or continuing; and the list goes on.

The adopting release gives passing nod to the issue by allowing up to 1,000 characters per metric for qualitative information on context. Context matters, but 1,000 is a relatively small number of characters and allowing limited context does not solve the problem of information usefulness. Nonetheless, the adopting release clings to a belief that standardization will provide comparable metrics.

The adopting release also inappropriately dismisses other concerns with standardized metrics based on the specifics of the Proposed Rules. For example, the adopting release dismisses concerns that the standardized metrics will lack clarity, be challenging to understand and interpret, cause confusion, and add noise to the market for audit services. The adopting release does note – counterintuitively – that if the metrics are costly to understand, investors are free to ignore them.

The PCAOB did not re-expose the Proposed Rules for public comment or at least re-expose portions, including the newly added training metrics, further contravening due process and the approach of prior Boards

Past PCAOB Boards have used multiple exposure drafts, supplemental requests, and roundtables to obtain feedback before finalizing PCAOB rules and standards, particularly on complex issues. These tools are "good practices" that facilitate getting rulemaking and standard-setting right, rather than just getting it done.

Although the Proposed Rules impose a sweeping new audit firm disclosure regime, the Board rushed to adopt these transformative, complex, and controversial rules in record time without re-exposing them. Given the substantive changes between the proposed and adopted rules and the fatal flaws that remain, the Board should have re-exposed the rules before considering whether to adopt them. The failure to re-expose also undermines the economic analysis in the adopting release. It means the PCAOB did not receive relevant evidence to inform and update assessments of the costs and benefits of the Proposed Rules before adopting them.

The Board likewise rejected using a supplemental request for comment on portions of the Proposed Rules. While a much less desirable alternative for this rulemaking, it would have mitigated problems, for example, with the training metric. The April 2024 proposal included questions around training, but it did not mandate a training metric. The Board added training to the complex of required metrics in the Proposed Rules without notice and comment. The Proposed Rules require audit firms to disclose the average annual professional training hours for partners, managers, and staff (combined at the firm level) and on the core engagement team (combined at the engagement level). Professional training hours mean Continuing Professional Education ("CPE") hours under state licensure rules,[18] which makes the metric of questionable usefulness. As defined, the training metric captures neither the full

[18] The Proposed Rules define professional development training hours as the hours for credit in support of obtaining or maintaining a professional accounting license in a jurisdiction in which the auditor is licensed or pursuing a license.

array of auditing, accounting, independence, ethics, compliance, and non-technical training of firm professionals nor the importance firms place on the training of professionals. Board Member Ho questioned the inclusion of this metric in the Proposed Rules noting, for example, that the economic analysis in the adopting release admits that "[o]verall, the academic literature provides mixed evidence regarding how auditor training relates to audit quality."[19]

By not re-exposing and allowing public comment, the Board missed an opportunity to obtain feedback and correct flaws with the inclusion and measurement of the training metric, specifically, and the Proposed Rules, generally.

The adopting release inappropriately dismisses concerns that the Proposed Rules allow no tolerance for unintentional errors – no matter how small or de minimis

Currently, PCAOB Form AP has no tolerable error – zero. There is no *de minimis* threshold for determining whether to correct unintentional errors by filing an amended Form AP. The adopting release maintains this approach and requires that any error (even unintentional "foot faults") that subsequently comes to light, must be corrected by the firm in an amended Form AP or Form FM.

The adopting release is flawed in waving away concerns that Forms AP and FM have no *de minimis* error threshold. Concerns include that the granular prescriptiveness of the metrics; the short filing period (for Form AP); and an arbitrary filing date of September 30th (for Form FM) that does not coincide with each firm year-end – all increase the risk of minor, unintentional errors. In turn, this increases the costs and consequences of filing amended forms, along with increasing the risk of inspection deficiencies and PCAOB enforcement actions. The adopting release dismisses such concerns as speculative – claiming they can be handled down the road with guidance – and the economic analysis ignores the costs and consequences.

The economic analysis fails to even-handedly assess comments, concerns, and evidence on need, benefits, costs, consequences, and alternatives and falls far short of demonstrating that the Proposed Rules are necessary or appropriate for the protection of investors and will promote efficiency, competition, and capital formation.

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[19] See the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024.

The discussion above demonstrates that the economic analysis in the adopting release inadequately assesses the need for and benefits of the Proposed Rules, inadequately assesses costs and consequences, and inappropriately dismisses reasonable alternatives. The following summary reinforces and elaborates on some additional failures in the economic analysis, including failures to fairly and reasonably consider comments, concerns, (disconfirming) evidence, and alternatives.

- By inappropriately relying on conjectures, speculation, and the views of a few activist voices, the economic analysis maintains the belief that investors and audit committees need the Proposed Rules and supports the belief that the benefits of disclosure are substantial. The economic analysis waves away comments (which represent the majority) that express significant concerns about the need for and benefits of the Proposed Rules and provide credible disconfirming evidence supporting their concerns.

- Contrary to the available evidence, the economic analysis maintains the belief that the Proposed Rules will not be overly costly, time-consuming, or burdensome. This belief ignores comments from knowledgeable stakeholders and other evidence that changing systems, processes, and other actions to implement the Proposed Rules involve very significant one-time costs and complying with the rules over time involve meaningful on-going costs. The economic analysis also inappropriately walks back from (its own) quantitative evidence on the significant costs of implementing ERP systems and deems the evidence irrelevant.[20]

- The economic analysis maintains that the costs of the Proposed Rules cannot be estimated and/or quantified. Setting aside other issues, pilot testing (field testing) is one tool that regulators and standard-setters use to gather evidence on costs and burdens, along with other insights, before finalizing proposed rules and standards. Commenters recommend pilot testing the Proposed Rules before adopting them, with some commenters indicating a willingness to participate. However, the economic analysis rejects pilot testing as biased – claiming pilot testing could not be conducted in such a way that the evidence on costs and other matters would be representative.[21]

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[20] See the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024 and the portion of the archived webcast of the November 21st Board meeting with Board Member Ho questioning the PCAOB Chief Economist.
[21] In addition, see the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024.

- In a single paragraph, the economic analysis briefly and inappropriately dismisses significant concerns about reputational costs and other unintended consequences of the Proposed Rules. Commenters discuss costs and consequences that arise from market participants, media, academics, and others misunderstanding and or misusing the data; from increases in inspection deficiencies and enforcement costs; from unintentional errors in Forms AP and FM; and from increases in litigation related to the disclosed metrics, among other factors.

- The economic analysis inappropriately dismisses concerns that the Proposed Rules will reduce competition and increase the risk of audit firms (particularly smaller firms) withdrawing from the public company audit market.[22] The analysis even rejects comments made to help mitigate these unintended consequences. For example, comments recommend limiting any metric disclosures to the largest audit firms using a threshold of annually inspected firms or firms with more than 200 accelerated and large accelerated filer engagements.[23] The economic analysis also fails to consider the consequences of the Proposed Rules on the ability of non-issuers/non-broker-dealers to engage PCAOB registered and inspected firms to comply with the rules the SEC imposes on these entities.

- The economic analysis ignores concerns that the Proposed Rules create reputational risk for audit committees, audit firms, and the PCAOB. Investor advisory organizations (including proxy advisory firms), data aggregators, media sources, academics, and others engage in compiling and analyzing data, drawing conclusions from their analysis, developing benchmarks,[24] and marketing their efforts as part of their business models and activities. The economic analysis ignores comments that given the problematic nature of the metrics, these types of activities have a high risk for misunderstanding, misapplying, misinterpreting, and misusing the disclosures; second-guessing auditors, audit committees, and the PCAOB; and undermining confidence in corporate governance, public company auditing, and the PCAOB as an audit regulator.

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[22] In response to adoption of the Proposed Rules, the American Institute of Certified Public Accountants ("AICPA") issued a statement that emphasizes the rules place a significant burden on small and midsized audit firms. The statement also reports findings from a recent survey of large firms that more than half with audit practices plan to rethink engaging in public company audits if the metric rules are approved by the SEC. The AICPA statement urges the SEC to give these unintended consequences the weight they deserve. See the "PCAOB Will Require Firms to Share a New Set of Metrics" by Bryan Strickland in the *Journal of Accountancy* (November 22, 2024).

[23] In addition, see the Statement by Board Member Ho on the *Firm & Engagement Metrics Adopting Release – Will This Unusually Rushed Auditing Standard Suffer the Same Fate of the Auditing Standard 2?* dated November 21, 2024.

[24] The adopting release recognizes the disclosed metrics as unsuitable for developing benchmarks.

- The economic analysis inappropriately dismisses comments on preferable alternatives. Alternatives provided by commenters and dismissed include limiting required disclosures to firm-level metrics; limiting disclosures to firm-level metrics as a first-step before considering mandating engagement-level metrics; and limiting any disclosures to the largest audit firms. Another recommended alternative is for the PCAOB to work cooperatively with stakeholders to develop voluntary disclosures. Unfortunately, the economic analysis dismisses current voluntary disclosures of firm metrics in audit quality and transparency reports as "marketing materials."

Concluding Remarks

The Proposed Rules mandating disclosure of audit firm and engagement metrics represent rushed and problematic due process at the PCAOB. The Proposed Rules are not fit for purpose, are costly and burdensome, and will be detrimental to audit quality. The adopting release does not meet the threshold requirements for economic analysis, including appropriate consideration of need, benefits, costs, consequences, and alternatives.

The path forward for developing a reasonable disclosure framework for audit metrics necessitates the SEC disapproving the Proposed Rules and returning them to the PCAOB for reconsideration.

Thank you for your consideration and we stand ready to discuss these matters with you further.

Sincerely,

Tom Quaadman
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U.S. Chamber of Commerce