February 1, 2023

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
Via email: comments@pcaob.org

Re: PCAOB Release No. 2022-006

Quality Control Standard

Dear Officers

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comment in response to the Public Company Accounting Oversight Board's (PCAOB, Board) proposal regarding a firm's system of Quality Controls.[1]

The PCAOB proposes a new standard for public auditing firms, which are a key watchdog over the world's most important companies. The purpose of good quality control, the Board explains, is to support "the consistent performance of high-quality audits."[2] Major accounting firms have failed to perform their duties as watchdogs because of inferior audits, as in the notorious cases of Enron,[3] other accounting scandals at the turn of the millennium, and more recently with PriceWaterhouseCoopers,[4] among others.

According to the Board, the new system would: "(1) supersede current PCAOB quality control standards with an integrated, risk-based standard; . . . . (2) create reporting requirements on quality control matters and a new, non-public reporting form; . . . (3) expand the auditor's

[1] Public Company Accounting Oversight Board, *A Firm's System of Quality Control,* PCAOB (Nov. 18, 2022) https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/2022-006-qc.pdf?sfvrsn=b89546e2_4

[2] Public Company Accounting Oversight Board, *A Firm's System of Quality Control,* PCAOB (Nov. 18, 2022) https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/2022-006-qc.pdf?sfvrsn=b89546e2_4

[3] Richard Oppel, *Enron's Collapse*, New York Times (Jan. 16, 2002) https://www.nytimes.com/2002/01/16/business/enron-s-collapse-overview-arthur-andersen-fires-executive-for-enron-orders.html

[4] Alison Frankel, *At Heart of FDIC's Win V. PwC, an Unsettled Theory,* Reuters, (Jan. 2, 2018) https://www.reuters.com/article/us-otc-fdic-idUSKBN1ER1U1

responsibility to respond to deficiencies on completed engagements; . . . [and] (4) better align our ethics requirements."[5]

The Board intends that the auditing firm maintains sufficient controls, procedures and resources necessary to complete fair audits of public companies and broker-dealers. This updates legacy standards essentially written by the profession during the era of self-regulation when investors had limited opportunity for input. These legacy standards, arguably, were designed to do little more than insulate the audit firm from legal liability where its audits failed to detect significant problems, as opposed to establishing rigorous investor-minded standards.

The PCAOB's proposal certainly improves on the status quo. It adds obligations on firms based upon the number of audit clients, meaning larger firms must adhere to stricter requirements.

Still, this proposal falls short of truly advancing the interests of investors. The Board describes the importance of meeting standards, but it should focus on the auditor's role in ensuring the quality of financial disclosure. This should specifically be included as part of the objective of any system of quality control.

This proposal provides little public accountability. There are no mandated material disclosures about the new system for investors. Investors will not be made aware of the deficiencies identified by the system, the personnel assigned to quality control, or the firm's assessment of the system. Nor will investors be made aware of any new the resources, such as additional senior partners joining junior, overworked and undertrained staff devoted to an audit.[6]

In effect, audit firms are allowed to conduct their own risk assessment and design their own controls to manage risks without any public awareness. This proved fatal in the case of PriceWaterhouseCoopers (PwC). According to the judge in the case, the auditor relied on the chief architect of the fraud to verify key information about for his company. The judge wrote that basing results on such an insider was "quintessentially the same as asking the fox to report on the condition of the hen house." PwC also signed off on Colonial's audit without ever understanding the most complex iteration of the fraud. After an auditor who was supposed to make sense of the transactions gave up, saying they were "above his pay grade," PwC assigned a college-aged intern to evaluate the nearly $600 million asset.[7]

There remains little reform of conflicts, such as when an audit firm provides other services to the audited company. As learned in the Enron and other accounting scandals of 20

[5]Public Company Accounting Oversight Board, *A Firm's System of Quality Control,* PCAOB (Nov. 18, 2022) https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/2022-006-qc.pdf?sfvrsn=b89546e2_4
[6] Robert Conway, Public Comment, PCAOB (Jan. 4, 2023) https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket046/3_conway.pdf?sfvrsn=cec2a71e_6
[7] Alison Frankel, *At Heart of FDIC's Win V. PwC, an Unsettled Theory,* REUTERS, (Jan. 2, 2018) https://www.reuters.com/article/us-otc-fdic-idUSKBN1ER1U1

years ago, audit firms placed their interest in winning consulting contracts ahead of the integrity of their audits.[8]

Promoting audit quality can be expensive—cutting into profits of the firm. It can involve controversial decisions and cause conflict with the management of the audited firm. This can challenge the ability of the audit firm to win and retain consulting (non-audit) consulting contracts with the audited firm. Without clear separation between those responsible for quality control and those responsible for maintaining client relationships and winning consulting contracts, investors can have less than full confidence the system of quality control will ensure the necessary level of audit quality.

The failures of the proposed standard can be seen from the results. The standard does not create incentives to use technology to improve audit quality, fails to adequately address the role of quality control in fraud detection, says nothing about a number of high-risk areas including crypto assets and climate change, and provides no explicit role for quality control in connection with the disclosure of areas particularly important to investors, such as critical audit matters, despite findings by the PCAOB and academics that raise substantial concern over the quality of the disclosure.

The PCAOB should revisit a number of key areas in the proposal. For example, the PCAOB should provide the public with additional disclosure about a firm's quality control system. This should include a function that updates how the audit firm is improving its surveillance.

Regarding conflicts, there should be a substantial role for an advisory council or a committee of the board to oversee audit quality. The council or committee should include a majority of independent non-employee members. Any advisory body should have the authority to call meetings with management, including the board, and the authority to request and obtain information from management relating to audit quality. The system should provide adequate transparency on the role of the non-employee members.

In conclusion, we ask the PCAOB to revisit its quality control proposal and devise a reform truly focused on investor interest.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org,

Sincerely

Public Citizen

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[8] Richard Oppel, *Enron's Collapse*, NEW YORK TIMES (Jan. 16, 2002) https://www.nytimes.com/2002/01/16/business/enron-s-collapse-overview-arthur-andersen-fires-executive-for-enron-orders.html