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Proposing Release:

Firm Reporting

PCAOB Release No. 2024-003
April 9, 2024

PCAOB Rulemaking
Docket Matter No. 055

Summary: The Public Company Accounting Oversight Board (PCAOB or the “Board”) is proposing to amend reporting requirements for registered firms. The proposed changes are designed to improve and modernize reporting requirements; address potential gaps in the information available to the PCAOB, investors, audit committees, and other stakeholders; and facilitate more complete, standardized, and timely reporting of firm information.

Public

Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board’s website at www.pcaobus.org. Comments may also be submitted by mail to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 055 in the subject or reference line and should be received by the Board by June 7, 2024.

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I. EXECUTIVE SUMMARY

The Board is proposing to amend its annual and special reporting requirements to facilitate the disclosure of more complete, standardized, and timely information by registered public accounting firms. The proposed changes include enhanced reporting of firm financial, governance, and network information; more timely and expanded special reporting; and cybersecurity reporting, among other topics. In formulating these requirements, we have taken into account the staff's experience with the current reporting framework and developments since the Board's adoption of its current periodic and special reporting forms in 2008, including the activities of other regulators, increased threats from cybersecurity incidents, and relevant academic studies, among other considerations. After careful consideration, we believe that the proposed additional reporting requirements are necessary or appropriate in the public interest or for the protection of investors and, if adopted, would enhance firm transparency and improve the PCAOB's oversight of firms.

As the Board has previously observed, robust disclosure is the cornerstone of the U.S. federal securities regulatory regime and is essential to efficient capital formation and allocation.¹ Access to meaningful information about a public company allows investors to make informed judgments about the company's financial position and the stewardship exercised by the company's directors and management. With the passage of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), Congress acknowledged and re-emphasized the auditor's important gatekeeping role within the public company reporting framework and required PCAOB-registered firms to submit public annual reports to the Board.² Sarbanes-Oxley also provides that firms may be required to report more frequently and authorizes the Board to require "such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors."³

We have observed an increase in voluntary audit firm transparency reporting, potentially reflecting market demand for more information regarding firms to support informed decision-making by market participants. We have also observed other jurisdictions implementing audit firm reporting initiatives. Indeed, investors and investor-related groups have long sought more transparency about firms, asserting that additional data and information would assist investors in making informed decisions when exercising oversight of

¹ See *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit*, PCAOB Rel. No. 2013-009, at 2 (Dec. 4, 2013).

² See Section 101(a) of Sarbanes-Oxley, 15 U.S.C. § 7211(a); Senate Report No. 107-205, at 5-6 (July 3, 2002).

³ See Sections 102(b)-(e) of Sarbanes-Oxley.

public companies, including whether to approve the ratification of the auditor and the election of audit committee members.⁴

The basic framework for the PCAOB's annual and special reporting requirements, however, has not been substantively reevaluated since its adoption in 2008.⁵ The Board has considered the reporting requirements established in 2008, the staff's experience with those requirements, and concerns raised by investors regarding a lack of audit firm transparency. We believe that improvements to the reporting requirements should be made to facilitate more public disclosure about aspects of registered firms' operations that could impact firms' ability to conduct quality audits, and that such disclosure would be informative and useful to investors, audit committees, and other stakeholders when evaluating audit firms and the audits of public companies. We further believe that the reporting requirements we are proposing would enhance investor confidence in public company audits and, therefore, in financial reporting.

In addition to transparency benefits, enhanced reporting requirements would facilitate the PCAOB's regulatory functions, and thus, better inform our oversight activities to protect investors. Specifically, we believe that more disclosure about registered firms would (1) facilitate monitoring of firms for risks or issues that, individually or taken together with other factors, may affect the ability of firms to conduct quality audits and may potentially affect the broader market for audit services; (2) facilitate analysis and planning related to the PCAOB's inspection program; (3) identify circumstances or events that may warrant or inform enforcement investigations; and (4) inform the PCAOB's standard-setting process.

Although the PCAOB may request information from firms from time to time as part of its regulatory activities, requiring the regular periodic and special reporting of certain information would standardize the provision of the information and enhance its comparability and timeliness, supporting the PCAOB's regulatory functions and therefore supporting investor protection.

⁴ See, e.g., Comment No. 4 from Members of the Investor Advisory Group ("IAG") (Jan. 13, 2023), Rulemaking Docket 046: Quality Control, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/4_iag.pdf?sfvrsn=1941e7c0_4; Comment No. 5 from the Council of Institutional Investors (Jan. 19, 2023), Rulemaking Docket 046: Quality Control, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/5_cii.pdf?sfvrsn=69b3e6bd_4; Center for Audit Quality ("CAQ"), *Audit Quality Disclosure Framework* (Jan. 2019), available at [caq_audit_quality_disclosure_framework_2019-01.pdf \(thecaq.org\)](https://www.thecaq.org/wp-content/uploads/2019/01/audit-quality-disclosure-framework-2019-01.pdf); PCAOB Investor Advisory Group Meeting (October 27, 2016), available at https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting_1052.

⁵ The PCAOB amended its rules and form in 2013 to conform to the Dodd-Frank Wall Street Reform and Consumer Protection Act as it relates to the Board's oversight of audits of broker-dealers. See *Amendments to Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications*, PCAOB Rel. No. 2013-010 (Dec. 4, 2013).

Key aspects of the proposed changes would:

- Revise the annual reporting form (“Form 2” or the “Annual Report Form”) to require more information regarding a firm’s network arrangements; leadership and governance structure; and fees collected and client base, and implement a new requirement for the largest accounting firms to confidentially submit financial statements to the PCAOB on an annual basis;
- Revise the special reporting form (“Form 3” or the “Special Reporting Form”) to shorten the timeframe for reporting from 30 days to 14 days (or more promptly as warranted), and expand the scope of special reporting to include (on a confidential basis) events that pose a material risk, or represent a material change, to the firm’s organization, operations, liquidity or financial resources, or provision of audit services;
- Implement new cybersecurity reporting requirements, including reporting of significant cybersecurity incidents within five business days on a confidential basis and public reporting of a description of a firm’s policies and procedures, if any, to identify, assess, and manage cybersecurity risks; and
- Implement a new form (“Update to the Statement of Applicant’s Quality Control Policies and Procedures” or “Form QCPP”) to capture updates to a firm’s quality control policies currently provided in a firm’s application for registration (Form 1).

This release provides background on the Board’s rulemaking project, discusses the proposed amendments to the Board’s forms and rules, and includes an economic analysis that further considers the need for rulemaking and the anticipated economic impacts of our proposed approach. Appendix 1 sets forth the text of the proposed form modifications, a new form, and rule amendments.

Requesting Public Comment on Our Proposal

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

Instructions on how to comment, including by email or postal mail, can be found on the cover sheet of this release. The release and comments can be found at the docket page of PCAOB Rulemaking Docket Matter No. 055.

II. BACKGROUND AND KEY CONSIDERATIONS

A. Current Reporting Framework

Section 102(d) of Sarbanes-Oxley provides that each registered public accounting firm shall submit an annual report to the Board and may also be required to report more frequently “such additional information as the Board or the Commission may specify.”⁶ In 2008, the Board adopted rules and forms to govern and facilitate annual reporting of certain information and to require, govern, and facilitate special reporting of certain other information if specified events occur.⁷

The Board specified that the reporting requirements were intended to serve three fundamental purposes. First, firms were required to report information to keep the PCAOB’s records current about such basic matters as the firm’s name, location, contact information, and licenses. Second, firms were required to report information reflecting the extent and nature of the firm’s audit practice to facilitate analysis and planning related to the PCAOB’s inspection responsibilities, to inform other PCAOB functions, and to provide potentially valuable information to the public. Third, firms were required to report circumstances or events that could merit follow-up through the PCAOB’s inspection or enforcement processes, and that may otherwise warrant being brought to the public’s attention (such as a firm’s withdrawal of an audit report in circumstances where the information is not otherwise publicly available).⁸

The current reporting framework includes two types of reporting obligations. First, it requires each registered firm to provide basic information once a year about the firm and the firm’s audit practice over the most recent 12-month period. The firm must do so by filing an annual report on Form 2. Second, upon the occurrence of specified events, a firm must report certain information by filing a special report on Form 3. The Board has not substantively revisited the annual and periodic reporting framework set forth on Forms 2 and 3 since their adoption in 2008.

At the time, the Board noted that, by adopting these requirements, it did “not mean to suggest that the information encompassed by these rules is the only information that the Board will require firms to report under Section 102(d) of the [Sarbanes-Oxley] Act.” To the contrary,

⁶ Section 102(d) of Sarbanes-Oxley provides:

Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

⁷ *See Rules on Periodic Reporting by Registered Public Accounting Firms*, PCAOB Rel. No. 2008-004 (June 10, 2008).

⁸ *See id.* at 6.

the Board noted that it “may identify other useful requirements by, for example, monitoring public discussion of relevant issues or considering disclosure requirements in other auditor regulatory regimes,” specifically citing the work of the Department of the Treasury’s Advisory Committee on the Auditing Profession (ACAP) as a potential area of interest.⁹

In 2008, the Board adopted Form 4, *Succeeding to the Registration Status of a Predecessor Firm*, which permits a registered public accounting firm’s registration status to continue with an entity that survives a merger or other change in the firm’s legal form.¹⁰ Also, in 2015, the Board adopted rules to require registered firms to file Form AP to disclose the names of engagement partners and certain information about other accounting firms that participated in their audits of public companies.¹¹ Form AP requires information specific to particular audit engagements, rather than information that is firmwide and operational in nature.

In addition, in 2022, the Board proposed new requirements (QC 1000, *A Firm’s System of Quality Control*) for an audit firm’s system of quality control (QC) that included, among other things, the proposed requirement that a firm report to the Board annually the outcome of the evaluation of the firm’s QC system with respect to any period during which the firm was required to implement and operate the QC system. In the release and throughout the draft form text in the appendix, references to QC 1000 and the related other proposed amendments to PCAOB standards, rules, and forms refer to proposed requirements.¹² The Board may not necessarily adopt QC 1000 and the other related amendments in the precise form proposed (or at all). Any reference to proposed QC 1000 and the related other proposed amendments to PCAOB standards, rules, and forms are subject to adoption by the Board and approval by the SEC.

Finally, in *Firm and Engagement Metrics*, the Board is concurrently proposing to mandate public reporting of standardized firm- and engagement-level metrics regarding a firm’s audit work and audit practice.

B. Developments Since the Implementation of the Current Framework

The Board has considered various developments since the adoption of the current annual and special reporting framework, including the following:

⁹ See *id.* at 4-5.

¹⁰ See *Rules on Succeeding to the Registration Status of a Predecessor Firm*, PCAOB Release No. 2008-005 (July 29, 2008).

¹¹ See *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, PCAOB Release No. 2015-008 (Dec. 15, 2015).

¹² See *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

- The staff’s experience with the current reporting framework;
- The issuance, and the staff’s continued assessment, of the ACAP Final Report to the Department of the Treasury (“ACAP Final Report”), including (1) recommendations for the PCAOB to enhance firm reporting and monitoring and (2) its emphasis on the risk that the failure of a large audit firm could have disruptive effects on the ability of firms to conduct quality audits and on the audit market;
- Audit firm transparency initiatives in other jurisdictions, including certain mandatory reporting requirements, the development of voluntary transparency reporting in the United States,¹³ and studies of the effects of enhanced transparency on audit quality and investor confidence;
- PCAOB outreach and activities regarding audit firm transparency; and
- The growing risk to audit firms from cyberattacks and cyberbreaches and the increase of such incidents at audit firms.¹⁴

1. Staff Experience with the Current Framework

The staff has at times received important information from registered firms on a voluntary ad hoc basis rather than pursuant to required reporting or through any formal mechanism. Examples of such ad hoc reporting include changes in leadership, reductions in workforce, pending merger transactions, and cybersecurity incidents. In addition, the staff routinely requests certain information from firms, including business and financial metrics, to inform inspection planning and scoping that may be more efficiently collected in a standardized form via periodic or special reporting. Finally, the staff has at times found voluntarily and mandatorily reported information to be incomplete, inaccurate, or insufficiently detailed. For example, the staff has at times found fee information reported on the Annual Report Form insufficiently specific, inconsistently reported from year-to-year with respect to methodology,

¹³ See, e.g., CAQ, *Audit Quality Report Analysis: A Year in Review* (Mar. 2023), available at <https://www.thecaq.org/aqr-analysis-yir>. In 2023, the CAQ published a summary analysis of the most recent audit quality reports issued by the eight firms represented on the CAQ’s Governing Board. The CAQ report noted that some firms disclosed qualitative as well as quantitative information, including information relating to audit methodology and execution, people and firm culture, quality management and inspections, and technology and innovation.

¹⁴ See Gary Salman, *The rise of cybercrime in the accounting profession continues*, Accounting Today Online (August 24, 2020); see also Maggie Miller, *FBI sees spike in cyber crime reports during coronavirus pandemic*, The Hill (April 16, 2020); see also Karen Nakamura, *Cybersecurity risk: Constant vigilance required*, Journal of Accountancy (September 1, 2022). See also Department of Homeland Security, *Cyber Safety Review Board to Conduct Second Review on Lapsus\$* (Dec. 2, 2022), available at <https://www.dhs.gov/news/2022/12/02/cyber-safety-review-board-conduct-second-review-lapsus>; Tim Starks, *The Latest Mass Ransomware Attack Has Been Unfolding For Nearly Two Months*, Washington Post (Mar. 27, 2023).

or not reported in accordance with form instructions, which has inhibited the degree to which the information can effectively inform the PCAOB's statutory oversight function.

2. ACAP Final Report

In October 2008, after the Board's adoption of Forms 2 and 3, the ACAP—a committee of business leaders, investors, former SEC staff members, and accounting professionals that had studied the auditing profession for one year—issued the ACAP Final Report with recommendations for the SEC, PCAOB, and auditing profession. In presenting the ACAP Final Report, the ACAP co-chairs contended that “the major auditing firms are key actors in the public securities markets” and “must comply with the same principles of transparency that we ask of other major market actors, both for the sake of the credibility of the market system as a whole, and for the credibility and long-term health of the firms themselves.”¹⁵

The ACAP Final Report included the following recommendations, among others, for the PCAOB:

- Monitor potential sources of catastrophic risk which would threaten audit quality; and
- Create a requirement for larger auditing firms to produce a public annual report including, among other things, information required by the European Union's transparency report, and to file on a confidential basis with the PCAOB audited financial statements.¹⁶

In making these recommendations, the ACAP noted that the PCAOB was “uniquely qualified to monitor the firms” and that monitoring for disruptions to the market that could threaten audit quality was consistent with the PCAOB's mission and mandate.¹⁷ Within the report, Treasury Secretary Henry Paulson notes the importance of striking a balance between investor protection and market competitiveness, while the co-chairs of the advisory committee highlight a related goal of reducing the barriers for smaller firms to enter the public company audit market.¹⁸ This release and the pursuant economic analysis consider these overarching principles in connection with these requirements.

¹⁵ Advisory Committee on the Auditing Profession, *Final Report to the Department of the Treasury* (Oct. 6, 2008) (“ACAP Final Report”) at II:6.

¹⁶ *Id.* at VII:20, VIII:10. The ACAP Final Report included recommendations in three areas: (i) concentration and competition, (ii) firm structure and finance, and (iii) human capital. The two bulleted recommendations come from areas (i) and (ii). The Board has addressed other ACAP recommendations by, for example, adopting Form AP which is in part responsive to an ACAP recommendation that the PCAOB undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report.

¹⁷ *Id.* at VII:24, VIII:11.

¹⁸ *Id.* at D:3, II:5.

We agree that the Board’s mandate extends to monitoring firms and the audit market for disruptions, including those related to firm viability, staffing, or potential legal liabilities.¹⁹ For example, in the event of a solvency-threatening event at an audit firm, the Board would need adequate information to assess whether that failure may have a disproportionate impact on a particular sector and the extent to which other audit firms are positioned to absorb the threatened firm’s companies under audit.²⁰ The Board would also need adequate information to respond to inquiries from its oversight authorities, the SEC and Congress, and to share pertinent information with other regulators as appropriate.

3. Transparency Reporting Developments

Currently, in certain other jurisdictions, audit firms disclose governance and other information according to legal and regulatory frameworks, including those imposed by authorities in the European Union, the United Kingdom, Japan, and Canada. For example, the European Union’s transparency report requires a description of the legal structure and ownership of the audit firm, network-related information, a description of the governance structure of the audit firm, information concerning the basis for the partners’ remuneration, and information regarding revenue, including disaggregation of revenue from audit and non-audit services.²¹

In 2021, the International Forum of Independent Audit Regulators (IFIAR) published a report analyzing developments in the audit market, including developments in transparency reporting.²² Discussing a survey of IFIAR members, the report noted that, of 50 respondents, 36 had adopted transparency reporting by audit firms and, of those 36, 27 had done so on a mandatory basis.²³ The report further observed that, while transparency reporting may vary from jurisdiction to jurisdiction, transparency reports generally include “information related to governance and commitments of each firm including but not limited to legal/governance structure; relationships with an audit firm network; quality control system and outcomes; tone

¹⁹ See Section 101(c)(5) of Sarbanes-Oxley, which provides, in addition to performing core functions such as registrations and inspections, the Board’s duties extend to “perform[ing] such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest.”

²⁰ For the purposes of this standard, the phrase “issuer under audit” or “company under audit” has the same meaning as “audit client” under PCAOB Rule 3501(a)(iv).

²¹ See *Regulation (EU) No 537/14 of the European Parliament and of the Council of 16 April 2014 on Specific Requirements Regarding Statutory Audit of Public-Interest Entities and Repealing Commission Decision 2005/909/EC Text with EEA Relevance* at Article 13, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0537>.

²² See IFIAR, *Internationally Relevant Developments in Audit Markets* (July 20, 2021), available at <https://www.ifiar.org/?wpdmdl=13063>.

²³ See *id.* at 24.

at the top; development of qualified professionals; financials; and responses to relevant regulations.”²⁴

Recent academic studies support these initiatives, having found that audit firms subject to transparency regulations display improvement in audit quality, and transparency is associated with improved investor confidence,²⁵ as discussed more fully in Section C of this release’s economic analysis.²⁶

Many firms also voluntarily disclose governance and other information in transparency reports. For example, one audit quality disclosure framework published in 2023 seeks to support those firms’ efforts with a disclosure framework “to assist firms in their ongoing efforts to determine, assess, and communicate information that may be useful to stakeholders in understanding how audit quality is supported and monitored at the firm level.” Among other things, the model disclosure framework emphasizes governance disclosures, noting that “organizational structure and composition of a firm’s governing body, leadership team, internal committees, professional practice group (e.g., national office or similar body), audit quality networks, and partnerships/alliances (for example) give insight into who is responsible for oversight of audit quality initiatives.”²⁷

As another example, in 2015, after yearslong public engagement and study, the International Organization of Securities Commissions (IOSCO) published a report, *Transparency of Firms that Audit Public Companies*.²⁸ In connection with this consultation, IOSCO observed that “[m]ost investors, audit oversight bodies, and banking and securities regulators expressed views that increased transparency reporting should be an obligation of audit firms and that such reporting could have direct or indirect benefits, including a favorable impact on audit quality.”²⁹ IOSCO further noted that “user/investor groups and auditor oversight bodies and regulators expressed support for the full range of transparency reporting discussed in the

²⁴ See *id.* at 23-24.

²⁵ See e.g., Shireenjit K Johl, Mohammad Badrul Muttakin, Dessalegn Getie Mihret, Samuel Cheung, and Nathan Gioffre, *Audit Firm Transparency Disclosures and Audit Quality*, 25 *International Journal of Auditing* 508 (2021); Fabio La Rosa, Carlo Caserio, Francesca Bernini, *Corporate Governance of Audit Firms: Assessing the Usefulness of Transparency Reports in a Europe-wide Analysis*, 27 *Corporate Governance: An International Review* 14 (2018).

²⁶ See *infra* pp. 69-70 (discussing that increased transparency would increase investor confidence in financial reporting quality).

²⁷ See CAQ, *Audit Quality Disclosure Framework (Update)* (June 2023), available at https://thecagprod.wpenginepowered.com/wp-content/uploads/2023/06/caq_audit-quality-disclosure-framework-update_2023-06.pdf.

²⁸ See IOSCO, *Transparency of Firms that Audit Public Companies Final Report* (November 2015), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD511.pdf>.

²⁹ See IOSCO, *Comments Received in response to Consultation Reports on Issues Pertaining to the Audit of Publicly Listed Companies* (2010), at 12, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD337.pdf>.

Consultation Paper,” which included information related to audit firm governance, audit firm financial statements, and audit quality indicators.³⁰ Respondents from the audit profession, the report notes, “broadly supported transparency reporting related to audit firm organization and governance, to make the structure of the firm more transparent to stakeholders, but had mixed views on transparency reporting of audit firm operational metrics and performance statistics that might serve as audit quality indicators, especially with respect to public reporting of such information.”³¹

In issuing its report, IOSCO observed that “in comparing audit firms competing for an audit engagement, audit firm transparency reporting can aid those responsible for selecting a public company’s auditor in their decision making process by providing information on a firm’s audit quality,” and that “[t]ransparency reporting can foster internal introspection and discipline within audit firms and may encourage audit firms to sharpen their focus on audit quality, which would also be of benefit to investors and other stakeholders.”³² The report contended that an audit firm transparency report could be considered of high quality if the information in the report included, among other elements, information about the audit firm’s legal and governance structure.³³

In sum, there is substantial transparency reporting by audit firms, including but not limited to audit firm financial, governance, and network-related information, both in response to regulatory requirements and to market demands. Much of this reporting, moreover, provides information beyond what is currently required by the PCAOB’s periodic and special reporting requirements.

4. PCAOB Advisory Group Input

The PCAOB’s June 2022 Investor Advisory Group (IAG) meeting included discussion of audit firm transparency, including support for reporting measures of audit quality and other outstanding ACAP recommendations.³⁴ For example, during an IAG discussion that was focused on the relationship between a firm’s audit practice and the firm’s overall business, an IAG member urged the PCAOB to revisit ACAP’s recommendations and noted ACAP’s emphasis on governance, leadership, and structure and business model.³⁵ Moreover, the IAG previously discussed the status of ACAP recommendations, including the recommendation for large firms

³⁰ See *id.* at 12-14.

³¹ See *id.*

³² See IOSCO, *Transparency of Firms* (2015), at 1.

³³ See *id.*

³⁴ See PCAOB Investor Advisory Group Meeting (June 8, 2022), available at <https://pcaobus.org/news-events/events/event-details/pcaob-investor-advisory-group-meeting-2022>.

³⁵ See PCAOB Investor Advisory Group Meeting (June 8, 2022), Transcript, at 127:2; 152:18.

to submit financial statements, which generated support from IAG members.³⁶ For example, discussing the importance of audit firms, an IAG member stated that “the investor community strongly believes that . . . it is only reasonable to expect some level of disclosure about the manner in which the firms are governed and about their financial strength and sustainability that is much greater than the information that's provided today.”³⁷ Similarly, the PCAOB’s June 2022 Standards and Emerging Issues Advisory Group (SEIAG) meeting also touched on the importance of audit firm transparency and the continued education of audit committees in the context of the PCAOB’s agenda. For example, one SEIAG member stressed the usefulness of PCAOB inspection reports as a communication tool and that the PCAOB should seek to enhance them to provide even richer insights.³⁸

5. Cybersecurity Developments

Cybersecurity incidents have increased in recent years in size, frequency, and sophistication. Federal financial regulators have responded by imposing new cyber-specific reporting requirements. For example, the SEC has adopted new cybersecurity reporting requirements for public companies and proposed new cybersecurity reporting requirements for investment managers and other market entities.³⁹ In proposing certain of these requirements, the SEC noted that

³⁶ See PCAOB Investor Advisory Group Meeting (October 27, 2016); see also Steven B. Harris, Board Member, PCAOB, *Audit Industry Concentration and Potential Implications*, address at the 2017 International Institute on Audit Regulation (December 7, 2017), available at https://pcaobus.org/news-events/speeches/speech-detail/audit-industry-concentration-and-potential-implications_674 (“At this year’s IAG meeting, members recommended by unanimous consent that the Big Four provide annual audited financial statements.”).

³⁷ See PCAOB Investor Advisory Group Meeting (October 27, 2016) Meeting Transcript, at 179:16, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/news/events/documents/102716-iag-meeting/iag-meeting-transcript-10-27-16.pdf?sfvrsn=5cb1d454_0.

³⁸ See PCAOB Standards and Emerging Issues Advisory Group Meeting (June 15, 2022) at 47:30 of the afternoon session, available at <https://pcaobus.org/news-events/events/event-details/pcaob-standards-and-emerging-issues-advisory-group-meeting>.

³⁹ See *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*, SEC Rel. No. 33-11216 (July 26, 2023); *Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, SEC Rel. No. 33-11028 (February 9, 2022); *Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents*, SEC Rel. No. 34-97142 (March 15, 2023). For market entities, the SEC proposed to define “significant cybersecurity incident” as a cybersecurity incident, or a group of related cybersecurity incidents, that: (i) significantly disrupts or degrades the ability of the market entity to maintain critical operations; or (ii) leads to the unauthorized access or use of the information or information systems of

[t]he U.S. securities markets are part of the Financial Services Sector, one of the sixteen critical infrastructure sectors whose assets, systems, and networks, whether physical or virtual, are considered so vital to the United States that their incapacitation or destruction would have a debilitating effect on security, national economic security, national public health or safety, or any combination thereof.⁴⁰

The SEC has further noted that

[c]ybersecurity risks have increased for a variety of reasons, including the digitalization of registrants' operations; the prevalence of remote work, which has become even more widespread because of the COVID-19 pandemic; the ability of cyber-criminals to monetize cybersecurity incidents, such as through ransomware, black markets for stolen data, and the use of crypto-assets for such transactions; the growth of digital payments; and increasing company reliance on third party service providers for information technology services, including cloud computing technology.⁴¹

Bank regulators now require that certain banks and their service providers notify regulators within 36 hours of cybersecurity incidents that have "materially disrupted or degraded" the organization.⁴² In adopting these requirements, the banking regulators noted that "cyberattacks targeting the financial services industry have increased in frequency and severity in recent years."⁴³

PCAOB staff experience indicates that the cybersecurity landscape faced by audit firms continues to evolve and that cybersecurity incidents at audit firms are increasing in both volume and complexity. Accounting and financial data may be particularly attractive targets for

the market entity, where the unauthorized access or use of such information or information systems results in or is reasonably likely to result in: (A) substantial harm to the market entity; or (B) substantial harm to a customer, counterparty, member, registrant, or user of the market entity, or to any other person that interacts with the market entity.

⁴⁰ SEC Rel. No. 34-97142, at 8.

⁴¹ See *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*, SEC Rel. No. 33-11038 (March 9, 2022), at 6-7.

⁴² See *Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers*, 86 Fed. Reg. 66424 (Nov. 23, 2021).

⁴³ *Id.* at 66425.

such attacks.⁴⁴ Some reports suggest that cyberattacks on accounting firms increased by 300 percent in the several months after the onset of the COVID-19 pandemic.⁴⁵

The increased prevalence of cybersecurity incidents has implications for the operations of audit firms, the degradation of which could impact their provision of audit services, as well as for improper access to confidential data of issuers and individuals by bad actors and other third parties.

C. Improvements to Audit Firm Reporting Requirements

The Board believes that the proposed changes would improve audit firm reporting in several respects:

- Decision-useful information. The Board's oversight indicates that quantitative and qualitative aspects of firm structure, resources, and operations could impact the ability of firms to conduct quality audits, and therefore more public disclosure about registered firms would facilitate informed decision-making and risk assessment by investors, audit committees, and other stakeholders. As discussed further in the economic analysis, because standardized disclosures by audit firms support audit committees' and investors' abilities to identify a firm whose characteristics best meet investor needs regarding the audit, the proposal should ultimately enhance the quality of audits. In this regard, we note that the proposed information may be useful both on its own and in conjunction with other public information regarding audit firms, including, for example, the metrics proposed in Firm and Engagement Metrics, if adopted and approved. We further believe enhanced firm transparency would improve investor confidence in public company audits because it would increase the information available to efficiently and effectively evaluate a firm for ratification.
- Data and information to support the PCAOB's regulatory mission. We believe that more reporting by registered firms would (1) facilitate monitoring of firms for risks or issues that may affect the ability of firms to conduct quality audits and may potentially affect the broader market for audit services; (2) facilitate analysis and planning related to the PCAOB's inspection program; (3) identify circumstances or events that may warrant or inform enforcement investigations; and (4) inform the PCAOB's standard-setting and

⁴⁴ See Chris Gaetano, *More than a third of orgs had accounting-related cyber incidents*, Accounting Today Online (February 8, 2023). ("A recent poll of C-suite and other executives from Big Four firm Deloitte showed evidence of this. It found that 34.5% of organizations have experienced at least one 'cyber event' targeting accounting and financial data over the past year. Of these, 12.5% have experienced more than one. Executives don't expect this to ease up anytime soon either, as almost half — 48.8% — expect that the number of cyber incidents will increase over the next year.").

⁴⁵ See Gary Salman, *The rise of cybercrime in the accounting profession continues*, Accounting Today Online (August 24, 2020); see also Maggie Miller, *FBI sees spike in cyber crime reports during coronavirus pandemic*, The Hill (April 16, 2020).

rulemaking processes. We note the PCAOB actively engages in policy research related to the market for assurance services to further the PCAOB's mission, by informing the standard-setting agenda among other things. The additional data provided by this proposal would enhance the PCAOB's ability to produce impactful research and translate that gained knowledge into improved standards and rules. Relatedly, the additional data would also provide valuable information sources for the public, including academic research. Improved research quality is an important benefit, as it is an important element of the PCAOB's standard-setting projects.

- Improved standardization of information. In addition to making more information available, formalizing reporting requirements would make the information more useful by increasing standardization and comparability. This would serve both public transparency interests and the PCAOB's regulatory function.
- Improved timeliness of information. By increasing the scope of special reporting and requiring special reports on a shorter timeframe, enhanced special reporting requirements would get useful information to the PCAOB, investors, audit committees, and other stakeholders more quickly.

D. Key Provisions of the Proposed Changes

In light of the above, the Board is proposing to enhance the required reporting of certain information by registered firms:

- Financial Information: We are proposing to require all registered firms to report on the Annual Report Form additional fee information, and to require the largest registered firms to confidentially submit financial statements to the PCAOB. We believe such information would provide insight into a firm's practice, focus, and incentives and inform the PCAOB's oversight of registered firms. We also believe that public fee data would inform decision-making and risk assessment by investors, audit committees and others.
- Audit Firm Governance Information: We are proposing to require all registered firms to report on the Annual Report Form additional information regarding their leadership, legal structure, ownership, and other governance, including information that would govern a change in the form of the organization. We believe that such information would help investors, audit committees, and other stakeholders to better understand firm processes and priorities, and to differentiate among firms with respect to, for example, leadership, oversight, and independence practices. Such information would bolster the PCAOB's oversight of registered firms, enhancing the information already collected through the inspections process.
- Network Information: We are proposing to require a more detailed description of any network arrangement to which a registered firm is subject, including describing the legal

and ownership structure of the network, network-related financial obligations, information-sharing arrangements between the network and registered firm, and network governing boards or individuals to which the registered firm is accountable. We believe such information would give the PCAOB, investors, audit committees, and other stakeholders greater insight into how a network arrangement influences firm governance, including oversight and access to resources.

- **Special Reporting:** We are proposing to shorten the timeframe for special reporting on the Special Report Form from 30 days to 14 days (or more promptly as warranted) and implement a new special reporting requirement for events material to a firm's organization, operations, liquidity or financial resources, or provision of audit services. We believe that information sufficiently important to warrant special reporting should be available to the PCAOB, investors, audit committees, and other stakeholders in a more timely fashion and that more formalized reporting of events material to a firm's operations would inform the PCAOB's oversight of registered firms.
- **Cybersecurity:** We are proposing to require prompt confidential reporting of significant cybersecurity events on the Special Report Form and periodic reporting of a brief description of the firm's policies and procedures, if any, to identify and manage cybersecurity risks on the Annual Report Form. We believe that reporting of such information would inform the PCAOB, investors, audit committees, and other stakeholders of critical information regarding the potential for disruptions of audit firm operations that may impact the provision of audit services and indicate potential compromises of individual or issuer information, and information regarding the audit firm's management of cybersecurity risk that would inform decision-making and risk assessment.
- **Updated Description of QC Policies and Procedures:** We are proposing to create a new form that, if QC 1000 is adopted by the Board, approved by the SEC, and becomes effective, would require any firm that registered with the Board prior to the date that QC 1000 becomes effective to submit an updated statement of the firm's quality control policies and procedures pursuant to QC 1000. We believe it is important that firms update the statement regarding their quality control policies and procedures, originally made in connection with their registration application, to reflect the changes to their policies and procedures made in response to the new quality control standard.

Questions:

1. Will the proposed areas for enhanced reporting provide investors, audit committees, and other stakeholders with relevant information? Should the Board consider enhanced reporting in other areas?
2. Should the Board consider enhanced reporting in the area of auditor resignations, withdrawals, or dismissals? The Board's current rules require auditor reporting of

auditor changes only where the issuer has failed to comply with its Form 8-K requirements. Should we consider requiring audit firm reporting of resignations, withdrawals, or dismissals, irrespective of issuer compliance with its reporting obligations?

3. In its 2023 Annual Report, the Financial Stability Oversight Council discussed the heightened vulnerability of the financial system to certain factors.⁴⁶ Should any of these elements discussed in this report be considered in our new reporting rules? Why or why not?

1. Confidentiality

Information to be Reported Publicly:

Under the proposal, certain of the information provided in response to the new reporting items would be reported publicly, namely enhanced fee information, governance and network information, and information related to a firm's policies and procedures, if any, that are intended to manage cybersecurity risks.⁴⁷ We do not propose to permit confidential treatment requests for the publicly reported information. Permitting confidential treatment would be inconsistent with an important goal of these enhanced reporting requirements—informing investors, audit committees, and other stakeholders, and promoting investor confidence in public company audits and financial reporting. Moreover, we believe public disclosure is consistent with Sarbanes-Oxley.⁴⁸

We believe that much of the information to be publicly reported is of the type that is already made public in some form by audit firms, including in existing transparency reporting, or is otherwise publicly available (although not currently centralized or presented on a comparable basis). We have also designed the reporting requirements to avoid disclosure of

⁴⁶ Financial Stability Oversight Council, *Annual Report 2023* (December 14, 2023), available at <https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf>.

⁴⁷ The proposal also contemplates a public one-time update to the "Statement of Applicant's Quality Control Policies," as discussed below.

⁴⁸ Section 102(e) of Sarbanes-Oxley provides that reports required under that section "shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information." Additionally, it requires the Board to "protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information." Consistent with the approach we have taken in our consideration of confidential treatment requests for information required by our existing forms, we understand "proprietary" to mean a formula, practice, process, or design owned by a particular firm that the firm keeps private for competitive advantage. See *Black's Law Dictionary* (11th ed. 2019) (cross referencing "proprietary information" and "trade secret"). We do not believe the information we propose for public reporting would require disclosure of such proprietary information or, based on our experience in this area, that any other law shields the proposed information from disclosure.

personal-identifying or client-specific information that might be protected by law.⁴⁹ We welcome commenters to bring to the Board's attention anything that would indicate a realistic possibility that any law would prohibit a firm from publicly disclosing such information.

Information to be Reported Confidentially:

Under the proposal, certain other information would be provided to the PCAOB confidentially, namely financial statements from the largest firms, special reporting of material events, and cybersecurity incident reporting.⁵⁰ In proposing not to make this information publicly available, we have weighed the public interest in public reporting of this information, the potentially sensitive and developing nature of the information requested, and the Board's obligations under Sarbanes-Oxley.

With respect to financial information, we propose to require financial statements from the largest firms to give the PCAOB more complete information regarding the financial condition of these firms.⁵¹ In addition, the proposed requirement for special reporting of material events includes events that may bear on a firm's financial condition or solvency. We recognize there is a public interest in this information. For example, indications of financial distress may have implications for the firm's ability to allocate resources towards audits.

At present, however, we lack sufficient information to understand what specific financial metrics may be most useful to investors and others such that they merit public reporting. In addition, in certain limited circumstances, some of the financial information required may be subject to laws relating to the confidentiality of proprietary, personal, or other information, or might be identified by a firm as proprietary. In such a scenario, the Board, in accordance with Section 102(e) of Sarbanes-Oxley, would need to honor a firm's properly substantiated request for confidential treatment of such information. We do not believe the public interest would be served by incomplete, piecemeal reporting of a firm's financial information.

With respect to material event reporting, we note the potentially sensitive and developing nature of this information. For example, the material event reporting item contemplates advance reporting of events that are anticipated and may still be developing. Cybersecurity incident reports, similarly, may involve developing events. As detailed below, we

⁴⁹ We acknowledge certain requirements call for the names and titles of those in audit firm leadership positions. However, we believe the proposed reporting requirements call for information regarding individuals in sufficiently senior positions that such information should already be public.

⁵⁰ Such information described herein would be reported confidentially without a need for the firm to request confidential treatment.

⁵¹ Similar financial information submitted by other regulated entities like nationally recognized statistical rating organizations ("NRSRO") may be granted confidentiality. See Exchange Act Rule 17g-3 which explains that a nationally recognized statistical rating organization may file or furnish a Form NRSRO and request that it be kept confidential ("Information in a report filed or furnished, as applicable, on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law").

believe the PCAOB has a regulatory interest in timely notice of these types of events. However, we do not believe the public interest would be served by potentially incomplete reporting of such information. In addition, we believe firms may be in a better position to report fully and candidly to the PCAOB about developing or prospective events if they are confident that the information would be confidential and part of an ongoing dialogue between the firm and the PCAOB regarding such events.

Further, with respect to cybersecurity incident reporting, we considered the potential that public reporting of such information could create vulnerabilities for the audit firm (e.g., reporting would provide information that bad actors could leverage against audit firms) in addition to the potentially developing nature of such incidents at the time of reporting. While we believe that cybersecurity incident information could be reported in a summary fashion that both protects the audit firm and informs the public, we think it may better facilitate timely reporting of such information if firms are not required to expend the resources and time necessary to consider the implications of public reporting of cybersecurity incident information and carefully scope it in deference to public reporting. In addition, we note that there are state and consumer laws and regulations that require notification to individuals in cases of compromised data.

We think it strikes an appropriate balance to propose that the financial statement, material event, and cybersecurity incident reporting requirements be confidential.

If the proposed financial statement reporting requirements are adopted, however, the Board intends to analyze the information reported to better understand how such information may be useful to the public, and whether the reporting requirements should be further amended to make some or all of the reported financial information public. Moreover, the Board may make some of the financial information public in an anonymized, aggregated manner as appropriate.

2. Assertion of Conflicts of Laws

We acknowledge that there may be certain limitations with respect to the data or information about a firm and its personnel that a firm may communicate publicly because public dissemination of it may conflict with a non-U.S. law. In considering whether to allow the opportunity to assert conflicts, the Board has considered both whether it is realistically foreseeable that any law would prohibit providing the required information and, even if it were realistically foreseeable, whether allowing a firm preliminarily to withhold the information is consistent with the Board's broader responsibilities and the particular regulatory objective.⁵² In addition, even where the Board has allowed registered firms to assert legal conflicts in connection with other forms, that accommodation does not entail a right for a firm to continue to withhold the information if it is "sufficiently important."⁵³

⁵² See PCAOB Rel No. 2015-008, at 37.

⁵³ See, e.g., PCAOB Release No. 2008-004, at 37-38 n.37.

At the time it implemented Form 2, the Board extended an accommodation to registered non-U.S. firms by permitting them to request confidential treatment of information provided in response to Form 2, Item 3.2 (Fees Billed to Issuer Audit Clients).⁵⁴ The staff's experience of reporting in response to that item has suggested that such an accommodation is not necessary. Firms have not generally been afforded this accommodation and we are not aware of any law that prohibits providing the fee information that is currently required or the fee information that we propose to require. We note that audit firm fee information is routinely reported under various international transparency directives. Accordingly, we propose to revise the instructions to Form 2 to delete the language permitting foreign registered firms to seek confidential treatment of information provided in response to Form 2, Item 3.2.

With respect to the remaining information we propose to require (with the limited exceptions of certain Quality Control roles identified below), based on our experience in this area, we do not foresee a realistic possibility that any law would prohibit a firm from providing the information. As noted above, in general, we believe that the information to be publicly reported is of the type that is already made public in some form by audit firms, including in existing transparency reporting, or is otherwise publicly available. We have also designed the reporting requirements with a view to avoiding personal identifying or client-specific information of the sort that could be protected by law.⁵⁵ We welcome commenters to bring to the Board's attention anything that would indicate a realistic possibility that any law would prohibit a firm from providing the information publicly.

Questions:

4. Is our proposed approach to confidential treatment requests for publicly reported information appropriate? Should we permit confidential treatment requests for any of the information proposed to be public? If so, what information?
5. Is our proposal to provide for confidential reporting of certain information, namely financial statements from the largest firms, special reporting of material events, and cybersecurity incident reporting, appropriate? Why or why not? Should we require any

⁵⁴ For a firm to request confidential treatment, PCAOB Rule 2300, *Public Availability of Information Submitted to the Board; Confidential Treatment Requests*, at (c)(2) requires both a representation that the information has not otherwise been publicly disclosed and either (1) a detailed explanation of the grounds on which the information is considered proprietary, or (2) a detailed explanation of the basis for asserting that the information is protected by law from public disclosure and a copy of the specific provision of law.

⁵⁵ We acknowledge certain requirements call for the names and titles of those in audit firm leadership positions. However, we believe the reporting requirements call for information regarding individuals in sufficiently senior positions that such information should already be public, with the limited exceptions of certain Quality Control roles discussed below.

of the confidential information to be reported publicly? If so, what information? Is the proposed approach to conflict of laws appropriate?

6. Should smaller firms, like sole proprietors, be subject to a different confidential treatment regime as some of the information to be publicly reported per this release may not already be publicly available?
7. Should we consider other types of financial information, in addition to fee information, for public disclosure? If so, what types of financial metrics would be useful to investors and other stakeholders?

III. DISCUSSION OF THE REPORTING UPDATES

We are proposing to amend Forms 2 and 3 to impose new reporting requirements, and to implement a new form for firms to update their “Statement of Applicant’s Quality Control Policies” reported on Form 1⁵⁶ on a one-time basis. This section discusses the specific amendments.

A. Financial Information

1. Fee Information

The Annual Report Form currently requires firms to report the percentages of total fees that were billed to issuer clients for audit services, other accounting services, tax services, and non-audit services relative to the total fees billed for the period.⁵⁷ When the Board originally conceived this requirement, it intended for it to provide “a picture of how the firm’s services for issuer audit clients compare generally with the firm’s services for other clients, and [] also [to] provide a picture of the allocation of services the firm provided to issuer audit clients.”⁵⁸ We continue to believe that such information is useful to investors, audit committees, and other stakeholders in understanding a firm’s audit practice, individually and relative to other services provided. However, we believe that requiring reporting in actual dollar amounts, rather than percentages, and providing more complete and further disaggregated fee information, would

⁵⁶ The Statement of Applicant’s Quality Control Policies is currently reported on Form 1.

⁵⁷ See Form 2, Item 3.2

⁵⁸ See *Proposed Rules on Periodic Reporting by Registered Public Accounting Firms*, PCAOB Release No. 2006-004 (May 23, 2006), at 4. With respect to the PCAOB’s regulatory authority to impose requirements to disclose non-audit related fees, Sarbanes Oxley Section 102(d) gives the PCAOB authority to require “additional information as the Board or Commission may specify, in accordance with subsection (b)(2).” Section 102(b)(2)(H), in turn, specifies that such information can be necessary or appropriate in the public interest or for the protection of investors. Here, obtaining additional data on non-audit services allows Form 2 user to better assess how the firm’s audit practice compares to other parts of its business. This is consistent with the PCAOB’s original rationale for collecting information for fees from non-audit services.

decrease inconsistency due to varying methodologies and increase the benefit of this reporting requirement.

Accordingly, we are proposing to amend Form 2, Item 3.2 to require enhanced information regarding a firm's audit fees. Specifically, the proposal would require firms to report:

- Fees for audit services, in total and from
 - issuers;
 - broker-dealers;
 - and other companies under audit (delineating sources, e.g., fees from private company audits and custody rule audits);⁵⁹
- Fees from other accounting services;⁶⁰
- Fees from tax services;⁶¹ and
- Fees from non-audit services.⁶²

Overall, consistent with the original rationale for reporting fee information, we believe the proposed fee information reporting would help investors, audit committees, and other stakeholders better understand a registered firm's audit practice and the relationship of its audit practice to its overall business, including the incentives that may influence allocation of resources to the audit practice. Further disaggregation of fee data would facilitate differentiation among firms based on audit versus non-audit focus, client type, and expertise, which could help assess whether a firm has the technical and operating capacity to address the issuer's needs. Reporting in actual dollar amounts would allow stakeholders to better compare

⁵⁹ PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, at (a)(vii) defines "audit services" as follows: (1) With respect to issuers, the term "audit services" means professional services rendered for the audit of an issuer's annual financial statements, and (if applicable) for the reviews of an issuer's financial statements included in the issuer's quarterly reports or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years; (2) With respect to brokers and dealers, the term "audit services" means professional services rendered for the audit of a broker's or dealer's annual financial statements, supporting schedules, supplemental reports, and for the report on either a broker's or dealer's compliance report or exemption report, as described in Rule 17a-5(g) under the Exchange Act.

⁶⁰ PCAOB Rule 1001(o)(i) defines "other accounting services" as assurance and related services that are reasonably related to the performance of the audit or review of the client's financial statements, other than audit services.

⁶¹ PCAOB Rule 1001(t)(i) defines "tax services" as professional services rendered for tax compliance, tax advice, and tax planning.

⁶² PCAOB Rule 1001(n)(ii) defines "non-audit services" as all services other than audit services, other accounting services, and tax services.

audit practice size from firm to firm, which the current percentage figures do not facilitate. This may help investors, audit committees, and other stakeholders better compare the extent of firm resources. We also observe that financial information reported pursuant to transparency reporting requirements in other jurisdictions, such as the EU and UK, is reported in currency amounts.

Finally, some firms currently provide certain varying fee information in transparency reports pursuant to regulatory requirements in other jurisdictions and in voluntary transparency reports. Requiring this information on Form 2 would increase the standardization and comparability of the financial information available to the PCAOB, investors, audit committees, and other stakeholders across the audit market. In addition, we note that some audit fee information is available from other sources, such as SEC reporting by issuers, and may be analyzed to extrapolate some of the information we are proposing to require. By requiring the information on Form 2, however, we would level the playing field and make the data more accessible to smaller and/or less-resourced market participants, including retail investors, who may not have the resources to derive this information from other sources or to pay for data subscriptions.

2. Financial Statements

In addition to enhanced fee information, we are proposing to require that the largest firms provide annual financial statements to the PCAOB on a confidential basis. We are proposing to define such firms as those who had more than 200 reports issued for issuer audit clients and had more than 1,000 personnel during the relevant reporting period.⁶³ We are proposing that such financial statements be reported in accordance with the applicable financial reporting framework in the firm's jurisdiction (i.e., either U.S. GAAP or IFRS, exclusively).⁶⁴ These financial statements would not be required to be audited. We propose to provide for an extended transition period of three years in connection with this requirement. For years 1 and 2, firms would be permitted to provide financial statements that do not conform to the applicable financial reporting framework, provided that they (1) identify the information that is not readily available but is required to produce U.S. GAAP or IFRS statements, and (2) provide notes that would reconcile non-conforming financial statements to the applicable financial reporting framework. We propose to require that the largest firms

⁶³ The number of firm personnel is currently reported in Item 6.1 of Form 2 and information regarding audit reports for issuers is currently reported in Item 4.1 of Form 2. As of December 31, 2022, the registered firms that meet such criteria audit issuers that possess a combined market capitalization of \$50.62 trillion, which represents 99.03% of the total market capitalization of all issuers audited by registered firms.

⁶⁴ We believe that firms that would currently meet this threshold are U.S. firms; therefore, the applicable financial reporting framework would be U.S. GAAP.

submit financial statements for the most recent fiscal year ended during the Annual Report Form reporting period. We are not proposing to define a fiscal year for reporting firms.

For the reasons discussed above, we are not proposing public reporting of financial statements. We do propose, however, to modify the Annual Report Form to include a checkbox for the largest firms to indicate they have submitted financial statements confidentially to the PCAOB.

In limiting this requirement to this subset of firms, we have weighed their significance to the overall audit market, the potentially outsized consequences of such a firm exiting the market, and the costs to smaller firms of preparing full financial statements relative to the benefit of providing such information.

We believe requiring financial statements from the largest firms would enhance the PCAOB's oversight and monitoring of these firms and the audit market. This information would help the PCAOB better understand a registered firm's audit practice, the relationship of its audit practice to its overall business, and the overall financial stability of a firm. This financial information would provide a baseline from which the PCAOB can understand a firm's ability to invest in technology and personnel, and/or generate profit within a specific service line. This information would also be useful because a firm that is financially at risk may be lacking sufficient resources to deliver quality audits and/or may be viewed as having compromised incentives that could affect a firm's ability to conduct quality audits. It may also facilitate the Board's regulatory response in the event of, for example, special reporting of solvency-related events (see Section IV.D below) if the PCAOB has more complete current financial information already on hand, particularly for the largest firms. While financial distress does not always predict the collapse of a firm, we believe it can be helpful in indicating vulnerabilities and in understanding the significance of risks posed by certain solvency-related events.

An assessment of audit firm resources would enable the Board to understand a firm's capacity to withstand risks associated with events such as a firm's break-up, court judgments against the firm, or threats to global networks or other affiliates that may require the firm's support. In addition, if there is a threat to a global network affiliate, financial statements would enable the Board to evaluate whether the U.S. firm has the operating and financial capacity to provide support to the distressed affiliate in order to preserve the network's ability to perform a multinational audit. The availability of financial statements would also enable the Board to observe detectable unexplained changes in the firm's financial health and discuss those changes with firm leadership to better understand the circumstances that caused the changes.

The proposed financial information would inform the PCAOB's inspection function by providing a baseline understanding of a firm's operations, the resources devoted to its audit practice, and its focus and incentives. Further, financial information would inform overall economic and risk analysis, including as it relates to analysis performed to support standard-setting, inspections, and enforcement activities, and the Board's overall oversight.

Finally, requiring this information to be presented in accordance with an applicable financial reporting framework would increase the usefulness of this information to the PCAOB

by facilitating analysis and comparison across firms and ensuring the information is presented completely and in an accessible manner.

Questions:

8. Are the proposed fee reporting requirements clear and appropriate? Will they elicit useful information for investors, audit committees, and other stakeholders? Is there other revenue or expenditure information that should be reported?
9. Would it be beneficial to require further disaggregation of non-audit service fees, such as a classification of non-audit services broken down by issuer, broker-dealer, investment adviser, municipal, and private commercial clients?
10. What would be the anticipated effects if the financial statements were submitted without the confidentiality provisions? Should the PCAOB allow the confidentiality provisions to expire after the passage of a period of time? If so, what would be a reasonable period of time?
11. Should we require a larger subset of firms to submit financial statements confidentially? For example, should we require all firms subject to annual inspection, or all firms that conduct audits of issuers representing a certain market capitalization, to submit financial statements confidentially?
12. Should financial statements for any subset of firms be disclosed publicly?
13. Is the requirement that financial statements be presented in accordance with an applicable financial framework reasonable? Are the accommodations allowed during the interim transition period reasonable? Are there exceptions or modifications to the applicable financial reporting framework that we should accept?
14. Specifically regarding the requirement to provide notes that would reconcile non-conforming financial statements for years 1 and 2 if a firm does not conform to its applicable financial reporting framework, are there further accommodations we should permit such as requiring reconciliation notes only where “feasible” or “practicable”? Should we instead require a firm to provide reconciliation notes or explain why it is not able to do so?
15. Should we define the fiscal year for firms required to submit financial statements?
16. Should we consider other changes related to the submission of financial statements such as the requirement for a certification by an officer of the audit firm?
17. Should we consider any amendments to our rules (e.g., the definition of “audit services”) to clarify how to comply with the proposed reporting requirements?

18. Should we consider requiring more structured reporting such as XBRL of the financial statements or any other element of this proposal? Are there other ways to incorporate a data taxonomy into reporting? Are there other approaches we should consider to increase the utility of reported financial information both internally and for the public?
19. Should we include a de minimis threshold below which fee information need not be reported?
20. Should we consider changing the reporting period (April 1 through March 31) and reporting deadline (June 30) of Form 2 in light of the additional proposed financial reporting items, or any of the other additional proposed period reporting items? Should we consider revising the Form 2 reporting period and deadline to align with the reporting period and deadline for Form FM included in the Firm and Engagement Metrics proposal, for example?
21. Are there any other changes to this provision that the Board should consider?

B. Governance Information

The Annual Report Form currently requires firms to identify the legal name of the firm, contact information for the firm, and a primary contact person for the Board. In recent years, regulatory requirements, investor demands, and market practices have come to reflect a consensus around the importance of governance information to investors, audit committees, and other stakeholders. For example, IOSCO, after extensive study and outreach, published a guidance document for audit firm transparency reporting in which it specified including a description of the firm's legal, ownership, and governance structure.⁶⁵ One disclosure guide for transparency and audit quality reporting notes the direct relationship between firm leadership and governance on the one hand, and audit quality on the other, identifying governance and leadership as a component of audit quality.⁶⁶ Transparency regulations in other jurisdictions require firms to publish certain governance information⁶⁷ The prevalence of such information in mandatory and voluntary transparency frameworks reflects its fundamental importance to understanding and assessing an audit firm and its ability to deliver audit services. Importantly, however, voluntary transparency reports have not resolved the present opacity with respect to audit firm structure, governance, and operations. We believe we can mitigate the lack of

⁶⁵ IOSCO, *Transparency of Firms that Audit Public Companies* (November 2015).

⁶⁶ CAQ, *Audit Quality Disclosure Framework* (June 2023), at 8.

⁶⁷ See, e.g., *Regulation (EU) No 537/14* at Article 13.

transparency through enhanced governance reporting requirements, which would also increase standardization of the information available.

Accordingly, we are proposing to amend Form 2 to create new Item 1.4 to identify the following enhanced governance-related information:

- the principal executive officer and all direct reports to that officer, including names and titles;⁶⁸
- the individuals who are responsible for various components of the QC system (outlined in QC 1000, *A Firm's System of Quality Control*, if adopted), including the individual(s) with ultimate accountability for the QC system as a whole;⁶⁹
- whether the firm has a governing board or management committees to which the principal executive officer reports and, if so, the identity of the members of that board or committee;
- the executive officer(s) who oversee(s) the firm's audit practice;
- whether the firm has an external oversight function for the audit practice composed of one or more persons who are not a partner, shareholder, member, other principal, or employee of the firm and does not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system and, if so, the identity of the person or persons and an explanation for the basis of the firm's determination that each such person is independent (including the criteria used for such determination) and the nature and scope of each such person's responsibilities (within this release, such persons who meet the outlined criteria are referred to as the firm's "External QC Function (EQCF)");⁷⁰ and
- a description of the legal structure, ownership, and governance of the firm, including processes that would govern a change in the form of the organization (e.g., what are the relevant governing bodies, voting rights, and approval requirements relevant to such an organizational change). In addition, the proposal would revise the form to specify that a

⁶⁸ Direct reports to the principal executive officer should not be understood to include administrative staff.

⁶⁹ It is expected that such reporting would include those individuals with roles and responsibilities with respect to the Firm's QC system as described in paragraphs .11 and .12 of proposed QC 1000, *A Firm's System of Quality Control*. We propose that the names of these individuals be subject to assertions of a conflict of laws by foreign registered firms. We think the names of these individuals are distinguishable from other names called for by this section insofar as these names may not already be public in connection with these roles.

⁷⁰ See *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Release No. 2022-006 (November 18, 2022), at 97.

firm should identify any change in the applicant's form of organization reported on Form 1, Item 1.4.

With respect to the disclosure of the role of the EQCF within the audit oversight function, the firm would be obligated to report if such a role exists, and the name of any person occupying that role.⁷¹ In the event the firm reported one or more persons occupying the EQCF on Form 2, the firm would also be required to report on Form 3 when such a person is appointed, resigns, is dismissed, ceases to meet the criteria to serve in the EQCF, or changes roles, the date of such event, and whether the change was recommended or approved by any governing board or management committee.

We believe that enhanced governance information would allow investors, audit committees, and other stakeholders to better understand the practices of firms and differentiate among firms with respect to, for example, leadership, oversight of the audit practice, oversight of auditor independence practices, and board of directors composition, including independence of directors. Governance reporting would provide more information to allow stakeholders to understand internal firm processes and priorities that may influence a firm's provision of audit services. For example, independent governance of registered firms has long been suggested as a means of improving audit quality.⁷² In that context, disclosure of the EQCF within the firm's audit oversight function would therefore inform stakeholders of a governance mechanism that they may consider relevant to audit quality, which would align with our goal of improving the ability of stakeholders to understand an audit firm and assess its services. Governance information would also provide a more comprehensive lens through which to view and understand other, more granular firm and engagement-level metrics⁷³ including those being proposed in the PCAOB's Firm and Engagement Metrics project. In addition, requiring this information through a reporting requirement would increase the standardization, and therefore comparability, of information available to investors, audit committees, other stakeholders, and the PCAOB.

We also believe that governance reporting would inform the PCAOB's regulatory function. For example, governance information is used to inform the PCAOB's baseline understanding of the firm's structure and leadership, including the firm's oversight of its audit practice. The PCAOB has long considered firm governance and leadership to be an important

⁷¹ We propose that the name of the proposed EQCF be subject to assertions of a conflict of laws by foreign registered firms. We think the name of the EQCF is distinguishable from other names called for by this section insofar as this name or names may not already be public in connection with this role.

⁷² See ACAP Final Report at VII: 8-11.

⁷³ See Shireenjit K Johl, et al., *Audit firm transparency disclosures and audit quality* ("Governance disclosures could provide a more comprehensive basis to consider the inputs and processes that influence audit quality than individual audit quality proxies, such as audit partner rotation and auditor tenure.").

aspect of firms' QC systems.⁷⁴ For example, PCAOB inspections have historically covered the firm's "tone at the top," a foundational aspect of governance and leadership, during the process for reviewing firms' QC systems. PCAOB inspection procedures focus on how firm management is structured and whether actions and communications by the firm's leadership demonstrate a commitment to audit quality.⁷⁵ Along those lines, we believe that this governance information would be particularly useful for inspecting and investigating firm QC systems, particularly if the PCAOB's current QC proposal is adopted. As the Board has observed, "establishing and maintaining appropriate firm organizational structures provides an institutional framework supporting the firm's QC system and the performance of the firm's engagements."⁷⁶

Finally, we believe that enhanced governance reporting requirements could result in improved governance practices at some firms. In the public company context, it has long been observed that when companies have to formulate disclosures on processes, it may influence their approach to them.⁷⁷ The PCAOB has recognized that affecting registered firms' conduct is a potential benefit of its reporting requirements. For example, in adopting requirements for firms to report when a firm has taken on, or entered into arrangements with, persons or entities who are subject to certain sanctions, such as a bar or suspension on association with a registered public accounting firm, the Board noted that the "reporting requirement should drive firms to ascertain that disciplinary status in circumstances in which some firms might otherwise overlook it."⁷⁸ We similarly expect that the process of formulating disclosures on governance processes may have a salutary effect on those processes and, therefore, on the provision of audit services.⁷⁹ Moreover, public reporting on governance processes may lead to

⁷⁴ See, e.g., *Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms*, PCAOB Release No. 2008-008 (Dec. 5, 2008) at 6; and PCAOB, *Staff Inspection Brief, Vol. 2017/3: Information about 2017 Inspections* (Aug. 2017) at 8.

⁷⁵ See PCAOB, *PCAOB Inspection Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted?*, available at <https://pcaobus.org/oversight/inspections/inspection-procedures> for information related to the PCAOB's inspection procedures.

⁷⁶ See PCAOB Rel. No. 2022-006.

⁷⁷ See *Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally*, SEC Rel. No. 34-15384 (Dec. 6, 1978) (noting that "disclosure may, depending on determinations made by a company's management, directors and shareholders, influence corporate conduct" and that "[t]his sort of impact is clearly consistent with the basic philosophy of the disclosure provisions of the federal securities laws.").

⁷⁸ See PCAOB Rel. No. 2006-004 at 10.

⁷⁹ IOSCO, *Transparency of Firms that Audit Public Companies* (November 2015), at 1 ("Transparency reporting can foster internal introspection and discipline within audit firms and may encourage audit firms to sharpen their focus on audit quality, which would also be of benefit to investors and other stakeholders.").

increased engagement between audit firms and audit committees, investors, and other stakeholders, which may similarly influence a firm's approach to governance.

Questions:

22. Are the proposed requirements for audit firm governance information clear and appropriate? Will they elicit useful information for investors, audit committees, and other stakeholders? Should we consider additional requirements?
23. Will the proposed requirements elicit sufficient information regarding firm leadership and management bodies?
24. Will the proposed requirements meaningfully contribute to improving audit quality?
25. Is the proposed request to describe the legal structure, ownership, and governance of the firms sufficiently specific?
26. Should the proposed requirements ask for information regarding alternative practice structures, including the role of private equity investments in accounting firms?
27. Is the proposed approach to governance information appropriate? Are there governance-related metrics we should consider requiring?

C. Network Information

The Annual Report Form currently requires firms to identify whether they are a part of certain networks, arrangements, alliances, partnerships, or associations and, if so, to identify them and provide a description of those relationships.⁸⁰ In conceiving this reporting requirement, the Board noted that it intended to identify arrangements that “afford[] the firm access to resources for use in issuer audits, including procedures, manuals, or personnel.”⁸¹ We continue to believe that reporting regarding network arrangements that affect the resources, financial or otherwise, available to firms in the performance of audits is important to investors, audit committees, and others in their evaluations of audit firms and audit quality. However, the current network-related requirement asks only for “a brief description of such relationship” without specifying the content of such a description. We believe that the benefits of this

⁸⁰ See Form 2, Item 5.2.

⁸¹ See PCAOB Rel. No. 2008-004, at 10.

reporting requirement would be enhanced by requiring greater specificity in reporting on network arrangements.

Network arrangements have provided members with benefits that research has found have contributed to higher quality audits.⁸² As the largest four accounting firms still provide audits to the vast majority of publicly held companies, it also follows that most public company audits are conducted by firms with network affiliations. Currently, while the PCAOB receives information regarding member firms within a network, we do not require significant information about the networks themselves.

Accordingly, we propose to amend Form 2, Item 5.2 to require a more detailed description of the network arrangement, including describing the legal and ownership structure of the network, network-related financial arrangements of the registered firm (e.g., loans and funding arrangements to or from the network member firm), information-sharing arrangements between the registered firm and the network (including both sharing of such information as training materials, audit methodologies, etc. and sharing of audit client information), and network governing boards or individuals to which the registered firm may be accountable. We note we would expect firms to indicate specifically whether they have outstanding loan and/or funding arrangements with their networks, in addition to noting whether such arrangements are permissible under their network arrangements.

We believe it is important for investors, audit committees, and other stakeholders to have access to information regarding the resources a registered firm may devote to audit engagements and to other aspects of its audit practice, such as training resources. To the extent that network arrangements may affect access to such resources, including through financial arrangements between the registered firm and the network, enhanced reporting regarding these aspects of a network arrangement would inform stakeholders' evaluation of the registered firm and its audit practice. Further, we think it is important for investors, audit committees, and other stakeholders to understand network oversight and accountability of the audit firm and other network processes that may influence the provision of audit services, including as it relates to training resources, access to personnel, and network policies and procedures and/or systems applicable to, or used by, the registered firm's audit practice. To the extent that the network arrangement has implications for the governance and oversight of the registered firm and its audit practice, including through network governing boards that oversee the audit firm, reporting on such aspects of the member network would inform stakeholders' evaluation of the registered firm and its audit practice. In addition, reporting on information sharing between the registered firm and its network would allow stakeholders to better

⁸² See, e.g., Kenneth L. Bills, Lauren M. Cunningham, and Linda A. Myers, *Small Audit Firm Membership in Associations, Networks, and Alliances: Implications for Audit Quality and Audit Fees*, 91 *The Accounting Review* 767 (2016) (finding that specialized expertise, solutions to staffing and geographic limitations, and technical trainings are among the benefits that contribute to improved audits performed by smaller firms).

understand how information, including shareholder and issuer information, may be shared in the network.

Requiring this information through a reporting requirement would also increase the standardization, and therefore comparability, of information collected, which would benefit all users of this information.

In addition, we believe enhanced network reporting would inform the PCAOB's regulatory function. It would provide a baseline understanding of how the network arrangement influences the firm's governance and accountability, including oversight of its audit practice, and access to resources, including an understanding of the methodology, tools, and technology used in audits and network-related financial arrangements.

Questions:

28. Is the enhanced network information appropriate and will the network related requests elicit useful information for investors, audit committees, and others?
29. Should we consider further limiting the types of networks that are subject to the proposed enhanced requirements or, for example, consider tiered requirements under which smaller firms would be required to disclose a reduced set of items?
30. Should we consider requesting network membership agreements as part of the requirements for network information? If so, should they be confidentially or publicly reported to the PCAOB?

D. Special Reporting

The Special Reporting Form currently imposes a 30-day reporting requirement for certain specified events. When the Board originally conceived its special reporting requirements through Form 3, it provided that the specified special reporting events were "potentially of some immediate concern to the Board"⁸³ and that "the public interest, as well as the ability to consider whether prompt action is warranted by the Board's inspection staff or enforcement staff, would be served by contemporaneous reporting of the event."⁸⁴ We continue to believe that contemporaneous reporting of specified events serves both the Board's regulatory function and the public interest. However, we have considered changes in the information environment in the over 15 years since the Board adopted the 30-day reporting deadline and we believe more prompt special reporting is practicable and warranted. In addition, we have considered that certain significant events that have implications for the firm's operations, and therefore its audit practice, are not currently captured by the types of events required to be reported on Form 3, and thus we believe that certain additional special reporting triggers are warranted.

⁸³ PCAOB Rel. No. 2022-006, at 10.

⁸⁴ PCAOB Rel. No. 2008-004, at 17.

Accordingly, the proposed amendment would (1) revise Form 3's reporting deadline to 14 days after the triggering event occurs, or more promptly as warranted, and (2) impose a general special reporting obligation for any event or matter that poses a material risk, or represents a material change, to the firm's organization, operations, liquidity or financial resources, or provision of audit services. As proposed, such events or matters would include, but would not be limited to:

- Any event or matter that has or is reasonably likely to materially impact the firm's total revenue as reported in its last Form 2 filing;⁸⁵
- A determination that there is substantial doubt about the firm's ability to continue as a going concern;⁸⁶
- Planned or anticipated acquisition of the firm, change in control, or restructuring, including external investment and planned acquisition or disposition of assets or of an interest in an associated entity;
- Entering into or disposing of a material financial arrangement that would affect the firm's liquidity or financial resources (such as a line of credit, revolving credit facility, loan, or other financing), or group of related arrangements;
- Any actual or anticipated non-compliance with loan covenants;
- Material changes in the insurance or loss reserves of the firm and material changes related to captive insurance or reinsurance policies, including events that triggered material claims on such policies;
- Material changes in the amount of unfunded pension liabilities;
- That the firm has entered into, or plans to enter into, a definitive agreement or other arrangement that would cause a material change to the firm's operations or provision of services (e.g., spinning off a consulting business or severing a portion of the business for private equity involvement);
- That the firm has obtained a license or certification authorizing the firm to engage in the business of auditing or accounting and which has not been identified on any Form 1 or Form 3 previously filed by the firm, or there has been a change in a license or

⁸⁵ This may include, but is not intended to be limited to, a solvency-threatening change in revenue. We note an increase in revenue would also warrant reporting if it would necessitate significant audit staffing increases or other comparable organizational changes.

⁸⁶ Firms may refer to the applicable audit standard and/or applicable financial reporting framework requirements for guidance in connection with this item.

certification number identified on a Form 1 or Form 3 previously filed by the firm;

- A change in principal executive officer; or
- Any other planned or anticipated material amendments or changes to the firm's organization, legal structure, or governance.⁸⁷

As discussed above, we propose that material events be reported confidentially.

Timely reporting on events (including solvency-threatening events) that may materially impact the firm's operations, and therefore its provision of audit services, would provide the PCAOB with more complete information regarding the audit firm and its audit practice. The proposed material event reporting would enhance the Board's understanding of significant events at the registered firms it oversees, including events that may pose a risk not just to an individual firm, but to the broader market for audit services, such as a large firm exiting the market.

With respect to the proposed change in timeframe, we believe that increased automation and processing of information since the adoption of Form 3 warrants more accelerated special reporting. Inclusion of specified events on Form 3 reflected the Board's judgment in 2008 that such events may have "immediate bearing on how the Board carries out its regulatory responsibilities."⁸⁸ Because of changes in the information environment since the Board adopted Form 3, we believe 30 days represents too delayed a reporting timeframe for events with "immediate bearing" and 14 days represents a more appropriate reporting deadline.

We note that when the Board originally conceived the special reporting requirements, it stated that part of its intended purpose was to trigger reporting of "circumstances or events that could, depending upon the situation, merit follow-up through the Board's inspection process or its investigative process."⁸⁹ Indeed, in conjunction with adopting the reporting requirements, the Board adopted a rule amendment clarifying the Board's ability to require additional information from firms to allow the Board "to follow up with focused inquiries concerning a matter, without in the first instance launching a full inspection or investigation, in order to determine whether any more formal action or inquiry is immediately warranted."⁹⁰ In other words, the special reporting triggers, in and of themselves, do not need to provide a basis for formal action by the Board. Rather, they need only to be appropriate subjects for follow-up. Such follow-up may result in formal action by the PCAOB, such as an inspection or investigation. Alternatively, it may result in more informal action by the PCAOB, such as the sharing of

⁸⁷ For example, a plan to restructure to separate auditing and non-auditing functions would warrant reporting under the proposed requirement. Such reporting should capture transactions whereby a legal separation of entities would result in assurance business partners maintaining or receiving an ownership interest in a new or existing non-assurance entity.

⁸⁸ PCAOB Rel. No. 2008-004, at 6.

⁸⁹ *Id.*

⁹⁰ *Id.* at 26-27.

information with the Board’s oversight authorities, or other regulators. It may also result in a determination that no further action is necessary.

In formulating these requirements, we also considered that firms often report to the Board voluntarily the types of events the proposed requirements are designed to elicit. However, the reporting of such events is not consistent, which may reflect confusion on the part of registered firms regarding the Board’s expectations with respect to communicating such information. Therefore, we believe that the proposed requirements would provide clarity to firms regarding the Board’s expectations, in addition to ensuring more consistent and timely reporting of material events.

In certain instances, we have specified an event that should always trigger a special report (e.g., a change in principal executive officer). In other instances, and with respect to the general requirement, we use the term “material” to limit the requirement to events that warrant reporting. We recognize that materiality is traditionally defined in the securities laws from the perspective of an investor in a public company, or a private company offering securities, and that the audit firm does not have a perfectly analogous relationship to investors. However, we think materiality is an appropriate threshold for this special reporting requirement because firms are accustomed to applying it, not only in the performance of audits, but as it relates to the firm itself. For example, in making auditor independence determinations, auditors are required to identify whether the firm has a “material indirect” relationship with a company under audit.⁹¹ In this regard, we observe that some firm commenters on the QC proposal asked for materiality thresholds for the filing of amendments to Form QC.⁹²

For greater clarity, in assessing materiality in connection with this reporting requirement, we refer auditors to SEC guidance on materiality judgments.⁹³ SEC guidance provides that “qualitative” materiality refers to “the surrounding circumstances that inform an investor’s evaluation of financial statement entries.”⁹⁴ With respect to events that require qualitative judgments in connection with this proposed requirement (e.g., a material change to the firm’s operations), we do not intend to convey that the events at the audit firm would

⁹¹ 17 CFR § 210.2-01(c).

⁹² See, e.g., Letter from KPMG to PCAOB Office of the Secretary RE: PCAOB Rulemaking Docket No. 046, (February 1, 2023), available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/34_kpmg.pdf?sfvrsn=82a5e840_4.

⁹³ See SEC Staff Accounting Bulletin No. 99 – Materiality (Aug. 12, 1999) (“The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that – without considering all relevant circumstances – a deviation of less than the specified percentage with respect to a particular item on the registrant’s financial statements is unlikely to be material. The staff has no objection to such a “rule of thumb” as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations.”).

⁹⁴ See *id.*

directly inform an investor’s evaluation of individual financial statement entries. Rather, we intend “material” in this context to refer to surrounding circumstances that may affect the audit practice or companies under audit so as to influence the degree of trust or reliance that a reasonable investor would place in the audit report and therefore the financial statements. For example, organizational changes at an audit firm that require a vote of the partnership would likely be material.

In addition, we note that, for material events that are anticipated or forward looking in nature, the timeframe for reporting would begin to run after the firm determines that it is substantially likely that the event will occur. In some instances, it may not be possible to reach such a level of certainty regarding planned events until the firm has definitively entered into an agreement regarding the event. We note that, where, for example, the firm has begun to prepare public relations plans, such as a press release, that is suggestive that the firm has determined there is a substantial likelihood that the event will occur.

With respect to the requirement that events be reported “more promptly” than 14 days “as warranted,” this is intended to permit a facts and circumstances judgment by the firm of circumstances where 14 days would not constitute prompt reporting. For example, where a firm has determined that there is a substantial likelihood of an anticipated material event occurring and such an event would be publicly reported in the press on a shorter timeframe than 14 days, more prompt reporting on Form 3 would likely be warranted. Further, where information may become public through other sources, such SEC filings, before the 14-day period elapses, more prompt reporting would likely be warranted.

Reporting within 14 days is a practice that audit firms are familiar with as reporting by companies on Form 8-K is generally required by the SEC within four business days after a reportable event. Further, per Item 4.01 of Form 8-K, companies must request that auditors furnish the company with a letter addressed to the SEC stating their agreement or disagreement with a company’s characterization of its change in auditor and file that letter with the SEC within ten business days of the company’s initial filing.⁹⁵ Audit firms must also notify the SEC not later than one business day after they resign from an audit engagement under the conditions set forth in Section 10A(b)(4) of the Exchange Act.⁹⁶

Because firms already have such special reporting requirements, they should have systems in place to satisfy their reporting obligations. Thus, we think costs to accelerate reporting would be incremental and may be assisted by greater automation in the reporting function at some firms. In addition, as the Board previously stated, the Form 3 triggers “are not

⁹⁵ See Item 304 of Regulation S-K, 17 C.F.R. § 229.304.

⁹⁶ See Section 10A(b)(4) of the Exchange Act, 15 U.S.C. § 78j-1(b)(4).

events that routinely occur.”⁹⁷ This should likewise mitigate the costs of accelerated reporting requirements.

Questions:

31. Should we consider some other period for reporting? Is the “more promptly” component sufficiently clear and workable? Are there specific items or events that necessitate reporting more promptly than 14 days that we should clearly delineate? Should material events, for example, be reported more promptly (e.g., within five business days)? Should the PCAOB align its reporting deadlines and requirements with those of the SEC’s Form 8-K?
32. Is 14 days sufficient time for smaller firms or non-U.S. firms to comply with the proposed reporting requirement?
33. Currently, for special reporting, the firm is deemed to have become aware of the relevant facts on the date that any partner, shareholder, principal, owner, or member of the Firm first becomes aware of the facts, triggering the reporting obligation. Is this a reasonable trigger for the beginning of the special reporting timeframe? Should the trigger for material event reporting be different, i.e., the date on which the firm determines the event to be material?
34. Will the additional material event reporting requirement elicit useful information for stakeholders? Is the non-exhaustive list helpful in understanding potential subjects for material event reporting?
35. Is the use of the term “material” appropriate? Is the guidance on this topic clarifying? Should we limit the event reporting using a different threshold (e.g., significant)?
36. To the extent certain enumerated material event reporting items would be reported on Form 4 (e.g., acquisition or change in control), should we consider changes to Form 4 in addition to or in lieu of changes in special reporting requirements? Should we consider combining Form 4 with Form 3?

E. Cybersecurity

1. Cybersecurity Incident Reporting

We know that firms experience cybersecurity incidents. We further know that such incidents have the potential to cause substantial harm to audit firms, companies under audit, and investors through, for example, the disruption of the provision of audit services or the exposure of confidential information to the public. The PCAOB has no formal mechanism to receive prompt information about such incidents and any responses. Accordingly, we are

⁹⁷ PCAOB Rel. No. 2008-004, at 17.

proposing to implement special reporting requirements for prompt reporting of significant cybersecurity incidents. Specifically, we are proposing to revise Form 3 to require the reporting of significant cybersecurity incidents within five business days on a confidential basis. We propose to define “significant cybersecurity incidents” as those that have significantly disrupted or degraded the firm’s critical operations, or are reasonably likely to lead to such a disruption or degradation; or those that have led, or are reasonably likely to lead, to unauthorized access to the electronic information, communication, and computer systems (or similar systems) (“information systems”) and networks of interconnected information systems of the firm in a way that has resulted in, or is reasonably likely to result in, substantial harm to the audit firm or a third party, such as companies under audit or investors. The reporting period would be measured from the time the firm determined the event to be significant.

We would expect such confidential reports to include sufficient information for the PCAOB to understand the nature of the incident and whether regulatory follow-up is warranted, including a brief description of the nature and scope of the incident; when it was discovered and whether it is ongoing; whether any data was stolen, altered, accessed, or used for any unauthorized purpose; the effect of the incident on the firm’s operations; whether the firm has remediated or is currently remediating the incident; and whether the firm has reported the incident to other authorities.

Confidential reporting of significant cybersecurity incident information is important to the Board’s ability to understand significant events at the firms it oversees and to assess whether their operations and/or issuer and investor information has been compromised in a way that would affect the provision of audit services or that otherwise merits follow-up. Cybersecurity incident information, including a firm’s response to cybersecurity incidents, would also inform the PCAOB’s inspection function by, for example, informing the PCAOB’s review of a firm’s QC system (including subsequent improvements in response to a breach). Requiring this information through a confidential reporting requirement (as opposed to through, for example, the inspection process) would increase the standardization and timeliness of information collected.

2. Cybersecurity Policies and Procedures

In addition to cybersecurity incident reporting, we believe that investors, audit committees, other stakeholders, and the PCAOB would benefit from information regarding a firm’s policies and procedures related to cybersecurity risks. Such information would allow all parties to assess and understand a firm’s vulnerability to cybersecurity incidents that may ultimately: (1) expose issuer data to third parties and/or bad actors, and/or (2) impact audit firm operations or audit quality. Accordingly, we are proposing to revise the Annual Report Form to request a brief description of the audit firm’s policies and procedures, if any, to identify, assess, and manage material risks from cybersecurity threats. The proposed item would instruct the audit firm to include: (i) whether and how any such policies and procedures have been integrated into the registrant’s overall risk management system or processes; (ii) whether the firm engages assessors, consultants, auditors, or other third parties in relation to cybersecurity risks; and (iii) whether the firm has policies and procedures to oversee and

identify such risks from cybersecurity threats associated with its use of any third-party service provider. The proposed requirement is not intended to elicit detailed, sensitive information but rather to inform the PCAOB, investors, audit committees, and other stakeholders of the firm's general policies and procedures, if any, to identify and manage cybersecurity risks.

In addition to informing stakeholders and the PCAOB, we note that cybersecurity policies and procedures reporting may influence firms' attention to such governance issues in way that would improve their processes, consistent with our discussion of firm governance disclosures above.

Questions:

37. Is the proposed cybersecurity incident reporting requirement formulated clearly?
38. Should cybersecurity incident reporting be completely confidential or should there be some degree of public reporting?
39. Should the reporting be more prompt? Should we require, for example, that cybersecurity incidents be reported immediately, or with all practicable speed but no later than five business days?
40. Should we require reporting additional information regarding the incident such as whether the firm has hired security consultants to assist with its response?
41. Should we provide more guidance regarding how the significance of a related group of cybersecurity incidents should be determined or when the filing deadline should begin to run for a related group of cybersecurity incidents?
42. Would the proposed confidential reporting to the PCAOB create any conflicts with other obligations that audit firms may incur when they experience a cybersecurity incident?
43. Is the proposed cybersecurity policies and procedures reporting requirement formulated clearly?
44. Should we define any other terms (e.g., "information systems") in Form 3 similar to how we currently propose to define "significant cybersecurity incidents"?
45. Are there any unintended consequences of our proposed approach? If so, what are they?

F. Updated Description of QC Policies and Procedures

In addition to the above proposed changes to the periodic and special reporting framework, we are proposing a reporting-related requirement that has evolved out of the QC 1000 proposal.

Any public accounting firm applying to the Board for registration pursuant to Rule 2100, *Registration Requirements for Public Accounting Firms*, must file an application for registration on Form 1. Form 1 requires that an applicant furnish, as an exhibit, a narrative, summary description, in a clear, concise and understandable format, of the quality control policies of the applicant for its accounting and auditing practices (“Statement of Applicant’s Quality Control Policies and Procedures”).

In November 2022, the Board issued a proposal regarding a new PCAOB QC standard, QC 1000, *A Firm’s System of Quality Control*, and other proposed amendments to PCAOB standards, rules, and forms. It includes a proposed amendment to Form 1 that would require applications for registration after the effective date of QC 1000 to also indicate whether the firm has designed a QC system in accordance with QC 1000. However, the proposal did not include any mechanism for firms that registered with the Board prior to the effective date of QC 1000 to provide an updated statement on the firm’s quality control policies pursuant to QC 1000.

We are proposing to create a new form, Update to the Statement of Applicant’s Quality Control Policies and Procedures (Form QCPP), to require that, if QC 1000 is adopted by the Board, approved by the SEC and becomes effective, then any firm that registered with the Board prior to the date that QC 1000 becomes effective must submit an updated statement of the firm’s quality control policies and procedures pursuant to QC 1000. We believe it is important that firms update the statement regarding their quality control policies and procedures, originally made in connection with their registration application, to reflect the changes to their policies and procedures made in response to the new quality control standard. This is consistent with Sarbanes-Oxley Section 102(d), which permits the Board to require reporting “to update the information contained in [a firm’s] application for registration.” It would increase transparency to investors and audit committees, who could then evaluate whether and how firms are addressing QC 1000.

Questions:

46. Would this update be useful to investors, audit committees, and other stakeholders?
47. Should we require updated statements? For example, should we require an update for material changes to quality control policies and procedures?
48. Would any other procedural approach (e.g., in conjunction with any other PCAOB form) be more efficient for firms or more helpful for public access to information?

IV. ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its rulemakings. This economic analysis describes the economic baseline, need, and expected economic impacts of the proposal, as well as alternative approaches considered. Due to data limitations, much of the economic analysis is qualitative in nature; however, where reasonable and feasible, the economic analysis incorporates quantitative information, including on the number of PCAOB-registered public

accounting firms and the number of Form 2 and Form 3 filings. The analysis also incorporates information from academic literature.

A. Baseline

This section discusses the economic baseline against which the economic impacts of the proposal and related amendments can be considered. Section II describes important components of the baseline, including an overview of existing reporting requirements on PCAOB Form 2 and Form 3.

The current reporting requirements on Form 2 and Form 3, together with uses of the information collected, practices firms have developed to comply with the reporting requirements, and other sources of audit firm information, form the baseline from which we assess the economic impacts of the proposed public disclosures and confidential reporting. We discuss below: (i) PCAOB uses of Form 2 and Form 3, including firms' filing practices; (ii) investor and audit committee potential uses of Form 2 and Form 3; and (iii) other sources of audit firm information.

1. PCAOB Uses of Form 2 and Form 3

Pursuant to the Sarbanes-Oxley Act, Form 2 and Form 3 are used by the Board to exercise its statutory oversight function and provide decision-useful information to the public. Form 2 collects basic information once a year about the firm and the firm's audit practice over a 12-month reporting period. Form 2 is required to be filed by all PCAOB-registered firms. Form 3 collects information upon the occurrence of specified events, such as when a firm resigns or is dismissed from an audit engagement in certain circumstances or when a firm has become aware that it has become a defendant in a criminal proceeding. The contents of Form 2 and Form 3 for each firm are generally made publicly available on the PCAOB website, with some exceptions if the firm requests and is granted confidential treatment.

The Board uses information reported on Form 2 and Form 3 to: (i) keep firms' basic records current; (ii) plan and inform the Board's statutory oversight function; and (iii) monitor special events that could merit follow-up. The number of PCAOB-registered firms as of December 31, 2023 was 1,599, most of which were subject to Form 2 and Form 3 reporting requirements⁹⁸ in the 2023 filing year and would be subject to this proposal in the absence of any withdrawals. Figure 1 and Figure 2 below present the counts of registered firms and the counts of Form 2 and Form 3 filings the registered firms utilized to communicate annual information and specified events, respectively, to the Board based on current reporting requirements. The counts in Figure 1 and Figure 2 provide a reference point for the number of

⁹⁸ Form 2 and Form 3 filings are suspended while a registered firm has a Form 1-WD pending. See PCAOB Rule 2107(c)(2), *Withdrawal from Registration*. In addition, Form 2 is not required by a registered firm that has an application for registration approved by the Board in the period between and including April 1 and June 30 of the filing year. See PCAOB Rule 2201, *Time for Filing of Annual Report*.

firms that would be expected to comply with the additional reporting requirements of this proposal.

i. [Form 2](#)

Form 2 reporting provides a profile of a firm at a point in time, based on the firm's activity related to audits of issuers and broker-dealers over the most recent 12-month reporting period. For example, issuer and broker-dealer information reported on Form 2 Part V (Offices and Affiliations) is used by PCAOB staff as the starting point for making inspection selections. Information reported on Form 2 also keeps current the Board's records about basic matters, such as the firm's name, location, and contact information, which informs other Board oversight activities. For example, primary contact information reported on Form 2 Part I (Identity of the Firm and Contact Persons) is used by PCAOB staff to identify the firm-designated contact person to whom document requests for investigations should be sent.

PCAOB supports either extensible markup language ("XML") or an internet-based form for firms to file Form 2. For the XML option, PCAOB makes available a schema, and firms develop their own computer program consistent with the schema to then generate the filing. Some large firms share the same program within their network to manage the cost of developing a program. The XML filing option for Form 2 generally facilitates filing for firms with large numbers of audits due to the standardized nature of data collected for each audit on Form 2. Approximately twelve of the largest firms currently file Form 2 via XML, which covers the vast majority of issuer engagements based on market capitalization. All other firms file Form 2 via the PCAOB Web-based form.

Figure 1 provides for the 2023 filing year counts of PCAOB-registered firms that filed a Form 2 and counts of firms that signed an issuer or a broker-dealer audit opinion. For the 2023 filing year, the number of registered firms that filed Form 2 was 1,419 and the number of firms that did not file was 180. The number of registered firms that filed a Form 2 and signed an opinion in the 2023 filing year was 570. Firms are subject to Form 2 reporting requirements whether or not they sign an audit opinion.

Figure 1: Counts of PCAOB-Registered Firms for the 2023 Form 2 Filing Year⁹⁹

	As of 12/31/2023
Number of registered firms	1,599
Filed Form 2	1,419
Did not file Form 2	180
<i>Types of opinions for firms that filed Form 2</i>	
Signed issuer opinions only	321
Of which: Indicated substantial role	5
Signed broker-dealer opinions only	128
Of which: Indicated substantial role	3
Signed issuer and broker-dealer opinions	121
Of which: Indicated substantial role	2
Signed no opinions	849
Of which: Indicated substantial role	74

ii. **Form 3**

Form 3 reporting alerts the Board to the occurrence of specified events, such as disciplinary proceedings or withdrawal of an audit report in certain circumstances, that may have more immediate bearing on how the Board carries out its statutory oversight function. In addition, information reported on Form 3 is used by PCAOB staff to assess whether the information indicates a potential violation of applicable standards or rules. The ability to consider whether prompt action is warranted by the Board’s inspection process or enforcement process is served by special reporting of the event. Under the extant rules, firms currently have 30 days after a reportable event to file Form 3.¹⁰⁰ PCAOB staff analysis indicates that during the period 2018-2022, firms filed Form 3 in less than 15 days after a reportable event for 12.1 percent of specified events reported.¹⁰¹ PCAOB supports either XML or a Web-based form for

⁹⁹ Counts include: (i) registered firms with status “Currently Registered” (1,568), “Suspended” (1), “Suspended; Withdrawal Pending” (0), and “Withdrawal Pending” (30) and (ii) firms exempted from Form 2 filing under PCAOB Rule 2201 because they had an application for registration approved by the Board in the period between and including April 1 and June 30 of the 2023 filing year. Opinion categories are based on data from Audit Analytics (including Feed 6, Feed 34, and Feed 27) for firms that filed Form 2. Indicators of substantial role are based on data from Form 2. For more discussion of firms’ registration status and firms that do not file Form 2, see *Proposals Regarding False or Misleading Statements Concerning PCAOB Registration and Oversight and Constructive Requests to Withdraw from Registration*, PCAOB Rel. No. 2024-001 (Feb. 27, 2024).

¹⁰⁰ See PCAOB Rel. No. 2008-004.

¹⁰¹ The following reportable events were included in the staff analysis: Item 3.1 (Withdrawn Issuer Audit Reports and Consents); Item 3.2 (Issuer Auditor Changes); Item 4.1 (Criminal, Governmental, Administrative, or Disciplinary Proceedings); Item 4.2 (Concluded Criminal, Governmental,

firms to file Form 3. Based on the unique nature of each Form 3 filing, no firms have chosen to file Form 3 via XML.

Figure 2 provides counts of firms that filed at least one Form 3, counts of Form 3 filed, and counts of the reasons for which Form 3 was filed. For the 2023 filing year, the number of firms that filed Form 3 was 299 and the number of Form 3 filed was 563. The Board does not have information on the number of firms that failed to file Form 3 or the number of Form 3 that firms failed to file. The top three reasons firms filed Form 3 are: (i) the firm became aware of changes related to certain legal proceedings; (ii) there was a change in the firm’s legal name or in the business contact information of the firm’s primary contact with the Board; and (iii) the firm experienced a change in license or certification to engage in the business of auditing or accounting in a certain jurisdiction.

Figure 2: Counts of PCAOB-Registered Firms for the 2023 Form 3 Filing Year¹⁰²

	As of 12/31/2023
Number of registered firms	1,599
Number of firms that filed at least one Form 3	299
Number of Form 3 filed	563
Number of reasons for filing Form 3	739
Changes in certain legal proceedings	332
Changes in the firm’s name or contact person	191
Changes in licenses and certifications	127
Amendments	55
Withdrawal, resignation, or issuance of audit reports	30
Changes in certain relationships	4

2. Investor and Audit Committee Potential Uses of Form 2 and Form 3

The Board does not monitor specific uses of Form 2 or Form 3 by investors and audit committees. However, Form 2 and Form 3 information is generally publicly available for investors and audit committees to inform their views of firms and the audit market. For example, investors and audit committees can observe information reported on Form 2, such as a firm’s client base or number of CPA personnel, to inform their selection of a firm. Likewise, investors and audit committees can observe information reported on Form 3, such as a

Administrative, or Disciplinary Proceedings); Item 5.1 (New Relationship with Person Subject to Bar or Suspension).

¹⁰² Counts include registered firms with status “Currently Registered” (551), “Withdrawal Pending” (6), and “Registration Withdrawn” (6). Counts are determined based on the number of original Form 3 and amended Form 3 filed in a given calendar year. A firm may file more than one Form 3. A single Form 3 filing may include more than one reason, and each reason is included in the counts.

withdrawal of an audit report, to monitor and understand developments that may impact their confidence in financial reporting quality.

The Board does not track types of visitors to specific forms on the PCAOB website, reasons for those visits, or views of specific forms. However, the Board does track unique visits to all PCAOB forms filed—i.e., Forms 1, 2, 3, 4, and AP—that are publicly available on the PCAOB website. For calendar year 2023, there were just over 23,000 unique visitors, and close to 7.4 million page views, for PCAOB’s registration, annual and special reporting (RASR) Web service that provides public access to firm filings, including Forms 1, 2, 3, 4, and AP.¹⁰³ Additionally, in 2023 there were over 333,000 unique searches performed on PCAOB’s AuditorSearch Web service, and the Form AP dataset was downloaded over 2,000 times.¹⁰⁴ In addition to the information that the firm makes publicly available through required form filings, the PCAOB provides firm-level public disclosures through firm inspection reports.¹⁰⁵ For the 2023 calendar year, firm inspection reports were downloaded approximately 113,000 times. Academic research suggests that audit committees use the information contained in PCAOB inspection reports.¹⁰⁶ Additionally, some academic research suggests that PCAOB inspection reports provide useful information to investors.¹⁰⁷ However, some research suggests that institutional investors may not be aware of or find value in PCAOB inspection reports.¹⁰⁸

¹⁰³ The RASR database can be found on the PCAOB’s website, available at <https://rasr.pcaobus.org/Search/Search.aspx>. The usage statistics may underestimate actual public interest because investors, researchers, auditors, audit committees, and issuer management may source PCAOB information through external third-party data service providers—such as Ideagen’s Audit Analytics. The usage statistics may also overestimate actual public interest to some extent because they include internal PCAOB users.

¹⁰⁴ Information related to usage statistics can be found on the PCAOB’s website, available at <https://pcaobus.org/resources/auditorsearch>.

¹⁰⁵ Firm inspection reports can be found on the PCAOB’s website, available at <https://pcaobus.org/oversight/inspections/firm-inspection-reports>.

¹⁰⁶ See, e.g., Daniel Aobdia, *The Impact of the PCAOB Individual Engagement Inspection Process—Preliminary Evidence*, 93 *The Accounting Review* 53 (2018) (finding that companies are more likely to switch auditor when firm offices or partners receive a Part I audit deficiency).

¹⁰⁷ See, e.g., Nemit Shroff, *Real Effects of PCAOB International Inspections*, 95 *The Accounting Review* 399 (2020) (finding, using a sample of foreign companies, that companies enjoy greater access to capital when their auditor’s PCAOB inspection report does not include Part I deficiencies).

¹⁰⁸ See, e.g., CAQ, *Perspectives on Corporate Reporting, the Audit, and Regulatory Environment* (Nov. 2023) (finding that most institutional investors interviewed were unaware of PCAOB inspections reports, and to the extent investors were aware, found the report results to be expected); Clive Lennox and Jeffrey Pittman, *Auditing the Auditors: Evidence on the Recent Reforms to the External Monitoring of Audit Firms*, 49 *Journal of Accounting and Economics* 84 (2010) (finding that companies do not perceive that the PCAOB’s disclosed inspection reports are valuable for signaling audit quality).

3. Other Sources of Audit Firm Information

In addition to Form 2 and Form 3, investors, audit committees, and the Board have access to audit firm information through other public sources. As discussed in Section II.B.3, some firms disclose information—such as financial, governance, and network information—as part of voluntary or mandatory transparency reports.¹⁰⁹ These reports are generally published by firms annually for access by the public.¹¹⁰ In addition, the SEC requires issuers to disclose audit fees, audit-related fees, tax fees, and other fees paid to audit firms in the two preceding fiscal years. The disclosed amounts may include fees paid to multiple audit firms rather than a single audit firm. Information related to certain legal proceedings—e.g., pursuant to SEC enforcement actions—is also publicly available.¹¹¹ However, due to the investigation and litigation process, information may be publicly available only after a substantial lag.

Certain information regarding some individual audit firms—such as total revenue, breakdown of revenue by service line, and number of partners and professionals—is accessible through paid subscription services, but these sources do not include all firms.¹¹² In addition, certain aggregated information regarding groups of firms—such as revenue, profits, and compensation—is accessible through paid subscription services, but these sources do not provide information regarding individual firms.¹¹³

Audit committees can request and receive firm information through sources not available to the public, including directly from their incumbent auditors and tendering firms. In exercising their oversight responsibilities, for example, audit committees may seek information from the firm about PCAOB inspections, including information not contained in the PCAOB's

¹⁰⁹ Under PCAOB auditing standards and applicable U.S. law, audit firm transparency reports are voluntary and unregulated disclosures. Consequently, firms can disclose metrics of their own choosing and construction. In practice, firms that do publish transparency reports disclose metrics that are required in reports pursuant to disclosure rules in other jurisdictions, such as in the European Union (i.e., EU - No 537/2014 Article 13), or similarly adopted domestic requirements in the UK under the Financial Reporting Council's authority (i.e., the Companies Act of 2006, and Statutory Auditors and Third Country Auditors Regulations of 2016).

¹¹⁰ See, e.g., Deloitte, *2023 Transparency Report* (Sep. 2023); EY US, *2023 Transparency Report* (Oct. 26, 2023); KPMG International, *Transparency Report 2023* (Dec. 2023); PricewaterhouseCoopers LLP, *2023 Transparency Report* (Oct. 31, 2023).

¹¹¹ See the SEC's *Accounting and Auditing Enforcement Releases* site, available at <https://www.sec.gov/divisions/enforce/friactions>.

¹¹² See, e.g., Accounting Today, *Top 100 Firms* (2022).

¹¹³ See, e.g., AICPA, *National Management of an Accounting Practice Survey Results Report* (Oct. 2023); Audit Analytics, *20-Year Review of Audit Fee Trends* (July 2023).

public inspection reports.¹¹⁴ In addition, auditing standards and PCAOB and securities law provisions require specific communications from auditors to audit committees regarding a variety of matters related to the audit engagement. For example, audit committees receive information through communications from auditors to audit committees under PCAOB AS 1301, *Communications with Audit Committees*, and Exchange Act Section 10A reports regarding illegal acts at an issuer in certain situations, but this information pertains to the audit engagement or the issuer rather than the audit firm.

The Board routinely collects supplemental audit firm information through the inspection process. For example, PCAOB staff periodically requests and receives select financial information, such as revenue and net income, to understand a firm's business and thereby to inform inspection scoping and planning. In addition, PCAOB staff periodically requests and receives data on audit firm boards of directors, including their composition and governance committees, to understand firms' governance structures and inform inspection scoping and planning. The supplemental information is not available to investors or audit committees because information collected for inspections is privileged and confidential under the Sarbanes-Oxley Act,¹¹⁵ while information collected as part of the periodic reporting process is presumptively public.¹¹⁶

PCAOB staff has also requested and received through the inspection process, financial statements for the U.S. global network firms ("GNFs")¹¹⁷ to understand changes at these firms that may affect audit quality or the provision of audit services. All U.S. GNFs compile financial statements on a non-GAAP or modified GAAP basis of accounting. Some compile financial statements in accordance with partnership agreements or agreements with lenders. While the financial statements are not fully consistent with GAAP, the U.S. GNFs generally use an accrual basis of accounting. The U.S. GNFs do not compile any disaggregated information at the service line level (i.e., assurance, tax, consulting) for their full financial statements. Two U.S. GNFs compile disaggregated information at the service line level for revenue only. In addition, some firms compile consolidated financial statements for the entire professional service practice, and other firms compile financial statements only for the audit practice.

PCAOB staff observations indicate that U.S. GNFs have designed policies and procedures to identify, mitigate, and respond to cybersecurity threats. The current PCAOB reporting framework does not specify that firms should provide PCAOB with notification of cybersecurity

¹¹⁴ See *Information for Audit Committees About the PCAOB Inspection Process*, PCAOB Rel. No. 2012-003 (Aug. 1, 2012).

¹¹⁵ See Section 105(b)(5) of Sarbanes-Oxley.

¹¹⁶ See Section 102(e) of Sarbanes-Oxley. Although some information may nonetheless be determined to be confidential and, thus, would not be publicly reported.

¹¹⁷ GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.).

incidents or disclose information regarding cybersecurity policies and procedures. Cybersecurity is identified in recent surveys as a top risk by company executives, investors, and audit committees.¹¹⁸ In addition, PCAOB oversight indicates that the cybersecurity landscape faced by firms continues to evolve and that cybersecurity incidents at firms are increasing in both volume and complexity. Estimates of aggregate and per-incident annual costs associated with cybersecurity incidents vary widely.¹¹⁹ Accounting firms are targeted by cybercriminals because firms are stewards of confidential information.¹²⁰ In addition, small- and medium-size firms are targeted because they may lack sophisticated cybersecurity infrastructure and can act as gateways to other targets.¹²¹ While research finds that the statistical probability of a cybersecurity incident at smaller companies is lower than for larger companies,¹²² the costs of a cybersecurity incident are statistically disproportionately higher for smaller companies than for larger companies.¹²³

Questions:

49. Have we appropriately described the baseline? If not, how can we improve the analysis?
50. Is the literature cited for the baseline fairly represented? If not, please explain.

¹¹⁸ See, e.g., EY, *EY CEO Imperative Study 2019* (July 2019); PCAOB, *SPOTLIGHT: 2021 Conversations with Audit Committee Chairs* (Mar. 2022); CAQ, *Audit Committee Practices Report* (Mar. 2024).

¹¹⁹ See, e.g., Cybersecurity and Infrastructure Security Agency, *Cost of a Cyber Incident: Systematic Review and Cross-Validation* (Oct. 26, 2020) (explaining that aggregate annual estimates for U.S. economic impacts from cyber incidents range from under \$1 billion to over \$242 billion while median estimates per incident range from about \$56,000 to almost \$1.9 million); Sasha Romanosky, *Examining the Costs and Causes of Cyber Incidents*, 2 *Journal of Cybersecurity* 121 (2016) (finding the cost of a typical cyber incident is about 0.4 percent of a company's annual revenue); Cyentia Institute, *Information Risk Insights Study* (2020) ("Cyentia Report"), at 20 (finding that a data breach of 100,000 records has a 96 percent probability of costing at least \$10,000 and only a 2.7 percent probability of costing more than \$100 million).

¹²⁰ See, e.g., Malia Politzer, *Top Cyberthreats Targeting Accounting Firms*, *Journal of Accountancy* (Mar. 16, 2020); Olivia Powell, *PwC and EY Impacted by MOVEit Cyberattack*, *Cyber Security Hub* (June 21, 2023).

¹²¹ See, e.g., Politzer, *Top Cyberthreats*.

¹²² See, e.g., Cyentia Report, at 12 (finding that companies under \$1 billion in annual revenue have less than a 2 percent chance of experiencing a breach whereas companies with at least \$1 billion in annual revenue have at least a 9.6 percent chance).

¹²³ See, e.g., Cyentia Report, at 22 (finding that a \$100 billion company that experiences a typical cybersecurity incident should expect a cost of approximately \$292,000, whereas a \$100,000 company should expect a cost of approximately \$24,000).

51. Are there additional studies or data that would inform our analysis of the baseline? If yes, please direct us to them and explain how they would inform the analysis.

B. Need

This section discusses the problem that needs to be addressed and explains how the proposed changes are expected to address it. In general, three observations suggest that there is an economic need for the proposal:

- Investors and audit committees encounter persistent opacity regarding audit firm information that is consistent and comparable across firms and over time. As a result, there is a risk that audit committees and investors will not accurately assess a firm's capacity, incentives, and constraints that best meet investor needs regarding the audit.
- Information regarding audit firm characteristics that would help assess a firm's capacity, incentives, and constraints has been requested by investors. However, the market for information does not provide standardized information regarding certain firm characteristics because firms, investors, and audit committees lack sufficient incentives necessary to develop a system of voluntary disclosure. As a result, firms do not supply the market with sufficient decision-useful information.¹²⁴
- PCAOB staff experience with the extant PCAOB reporting framework has revealed incomplete or imperfect information regarding certain events at some audit firms. This impairs the Board's ability to perform its statutory oversight function.

The proposal would help address this problem in two primary ways:

- The proposal would require audit firms to publicly disclose firm information that is standardized across firms and over time and would aid investor and audit committee decision-making.
- The proposal would require audit firms to report additional information and specified events and, in some cases, financial statements, which would enhance the effectiveness of the Board's statutory oversight.

¹²⁴ Given the considerations in Section IV.C.1 and Section IV.C.2 below, it appears reasonable to assume that the frictions in the market for information are likely to cause an apparent undersupply of information, rather than the cost of providing the information being greater than the social benefit.

The following sections describe in more detail the problem to be addressed and how the proposal would address it.

1. Problem to be Addressed

i. Persistent Opacity Regarding Firm Information

a. Investors and Audit Committees

Reliable company financial statements help investors evaluate company performance and monitor managements' stewardship of investor capital. An audit committee is established by the company's board of directors and is statutorily entrusted to appoint, compensate, and oversee the work of the audit firm.¹²⁵ In its appointment decision, the audit committee evaluates firms to identify a firm with the capacity, incentives, and constraints that best meet investor needs regarding the audit. Once the audit committee appoints a firm, the audit committee then monitors the firm.¹²⁶ However, the audit committee may focus on the interests of investors who are current shareholders rather than the broader public interest (e.g., market confidence, potential future shareholders, or investors in other companies). Moreover, there is a risk that the audit committee may not monitor the firm effectively because the firm may seek to satisfy the interests of company management rather than investors if management is able to exercise influence over the audit committee's supervision of the firm.¹²⁷

¹²⁵ See Section 301 of Sarbanes-Oxley and Section 10A(m)(2) of the Securities Exchange Act.

¹²⁶ See, e.g., CAQ, *2023 Audit Committee Transparency Barometer* (Nov. 2023) ("CAQ Barometer Report") (noting that oversight of the external auditor continues to be at the core of the audit committee's responsibilities).

¹²⁷ See, e.g., Joshua Ronen, *Corporate Audits and How to Fix Them*, 24 *Journal of Economic Perspectives* 189 (2010) (explaining that audit committee members are paid by the company and can be dependent on top company management for a variety of benefits, including referrals as a possible member on the board of directors and audit committees of other companies); Liesbeth Bruynseels and Eddy Cardinaels, *The Audit Committee: Management Watchdog or Personal Friend of the CEO?*, 89 *The Accounting Review* 113 (2014) (finding that companies whose audit committees have "friendship" ties to the CEO purchase fewer audit services and engage more in earnings management); Cory A. Cassell, Linda A. Myers, Roy Schmardebeck, and Jian Zhou, *The Monitoring Effectiveness of Co-Opted Audit Committees*, 35 *Contemporary Accounting Research* 1732, 1733-1734 (2018) (finding that the likelihood of a financial statement misstatement is higher and that absolute discretionary accruals are larger when audit committee co-option, as measured by the proportion of audit committees who joined the board of directors after the current CEO's appointment, is higher); Nathan Berglund, Michelle Draeger, and Mikhail Sterin, *Management's Undue Influence over Audit Committee Members: Evidence from Auditor Reporting and Opinion Shopping*, 41 *Auditing: A Journal of Practice & Theory* 49 (2022) (finding that greater management influence over audit committee members is associated with a lower propensity of the auditor to issue a modified going concern opinion to a distressed company under audit and with increased opinion shopping behavior).

As a result of this risk, investors have an important, albeit indirect, role in overseeing the audit firm and the audit committee. Indeed, while the audit committee more directly oversees the firm, most publicly traded companies allow investors to vote on a proposal to ratify the audit committee's appointment of an audit firm. This ratification vote enables investors to demonstrate whether they support the audit committee's appointment of the firm.¹²⁸ To inform the appointment ratification vote, audit committee disclosures in annual company proxy statements indicate that some audit committees consider a variety of public and non-public information when appointing their auditor, including public data regarding the candidate firm and its peer firms.¹²⁹

Research suggests that investor decisions regarding the appointment ratification vote rely in part on the alignment of the firm's capacity, incentives, and constraints with investor needs regarding the audit.¹³⁰ Research also suggests that investors are more likely to challenge an audit committee's appointment of a firm when they have access to firm information that reflects a firm's capacity, incentives, and constraints, such as information regarding a breakdown of the firm's audit and non-audit fees that can be used to assess independence.¹³¹

¹²⁸ Voting on a proposal to ratify the appointment of the audit firm is not statutorily required and in many cases the ratification vote is non-binding. However, according to Audit Analytics accessed on Mar. 1, 2024, ratification votes had been held for the year ended in 2023 by 2,802 distinct companies included in the Russell 3000 index, which comports with other estimates that indicate between 80 and 95 percent of companies hold votes on ratification proposals as part of their proxy process. *See, e.g.*, ACAP Final Report, at VIII.20 (finding that 95 percent of S&P 500 companies and 70-80 percent of smaller companies put ratification proposals up for an annual shareholder vote); Lauren M. Cunningham, *Auditor Ratification: Can't Get No (Dis)Satisfaction*, 31 Accounting Horizons 159, 161 (2017) (finding that more than 90 percent of a sample of Russell 3000 companies voluntarily include an appointment ratification vote on the ballot). We note that broker discretionary voting is permitted on ratification proposals and ratification proposals may be used as a mechanism by some companies to achieve a quorum to conduct an annual meeting as a result of brokers exercising discretionary votes.

¹²⁹ *See, e.g.*, CAQ Barometer Report, at 15-18 (presenting examples of audit committee disclosures that summarize the information the audit committee considered when appointing the audit firm).

¹³⁰ *See, e.g.*, Mai Dao, K. Raghunandan, and Dasaratha V. Rama, *Shareholder Voting on Auditor Selection, Audit Fees, and Audit Quality*, 87 The Accounting Review 149, 168 (2012) (concluding that shareholder votes on proposals to ratify the appointment of an audit firm can be viewed as aligning the firm's incentives more with shareholders than in cases where the audit committee makes the hiring decision without a shareholder vote); Cunningham, *Auditor Ratification* 174 (noting that proxy advisor guidelines recommend against a proposal to ratify the appointment of a firm if there is information that suggests a conflict between the firm's interests and shareholder interests).

¹³¹ *See, e.g.*, Suchismita Mishra, K. Raghunandan, and Dasaratha V. Rama, *Do Investors' Perceptions Vary with Types of Nonaudit Fees? Evidence from Auditor Ratification Voting*, 24 Auditing: A Journal of Practice and Theory 9 (2005) (finding that the SEC's requirement for companies to disclose partitioned information about tax and other non-audit fees paid to a company's independent audit firm had a positive association with the proportion of investor votes against ratification proposals in 2003);

However, a lack of transparency regarding firm information leaves investors less equipped to assess a firm's capacity, incentives, and constraints when voting on a proposal to ratify the appointment made by the audit committee or in exercising their rights to oversee the audit committee through board of director elections. Even proxy advisors rely upon relatively limited publicly available information in making voting recommendations regarding ratification of the audit committee's appointment, which institutional and retail investors may then rely upon.¹³² Moreover, the presence of significant block holdings by diversified, passive investment funds, which often do not hold board of director seats, means that decision-useful information may not be provided by audit firms to a significant control group in cases where the fund managers do not hold a board seat.¹³³

b. Evidence of Persistent Opacity

As described in Section IV.A.3, the Board collects supplemental information through the PCAOB inspection process. Investors cannot use the information in their decision-making because the information cannot be publicly disclosed. However, some of the information could be useful to inform investors' views of firms.

Two sources suggest that some of the supplemental information collected through the inspection process, and proposed for disclosure, would be useful to investors. First, the ACAP

Cunningham, *Auditor Ratification* 174 (noting that proxy advisor guidelines recommend against a proposal to ratify the appointment a firm if non-audit fees exceed the sum of audit fees, audit-related fees, and tax preparation fees). Other research indicates that investors rely on publicly available PCAOB information to make informed appointment ratification decisions. See, e.g., Paul N. Tanyi, Dasaratha V. Rama, and K. Raghunandan, *Auditor Tenure Disclosure and Shareholder Ratification Voting*, 35 *Accounting Horizons* 167 (2021) (finding that in the case of companies with long (short) auditor tenure, the proportion of shareholder votes not ratifying the appointment of an auditor increased (decreased) after PCAOB mandated public disclosure of auditor tenure).

¹³² See, e.g., Cunningham, *Auditor Ratification*, 163 (explaining that proxy advisors are left to rely on publicly available cues about auditor independence and audit quality because SEC DEF 14-A proxy statement disclosures require relatively little information about the audit committee's process for appointing or retaining a specific firm subject to vote). We note that research also indicates that retail investors may not necessarily use information regarding an audit firm in their decisions to vote on a proposal to ratify the appointment of the firm. See, e.g., Cory A. Cassell, Tyler J. Kleppe, and Jonathan E. Shipman, *Retail Shareholders and the Efficacy of Proxy Voting: Evidence from Auditor Ratification*, 29 *Review of Accounting Studies* 75 (2024) (finding that appointment ratification votes become less informed—i.e., associated with factors that do not reflect auditor performance—as retail ownership increases).

¹³³ While diversified, passive investment funds hold large shares of U.S. companies, non-financial blockholders or insiders may also hold large shares. See, e.g., Amir Amel-Zadeh, Fiona Kasperk, and Martin Schmalz, *Mavericks, Universal, and Common Owners – The Largest Shareholders of U.S. Public Firms*, available on SSRN: <https://ssrn.com/abstract=4219430> (2022) (showing that between 2003-2020 up to one-fifth of the largest U.S. companies had a non-financial blockholder or insider as their largest shareholder).

Final Report¹³⁴ recommends, based in part on investor support, that the PCAOB require each large firm to produce an annual report that includes disclosure of firm operating characteristics such as legal and network structure, governance, partner remuneration policies, and financial information, including audit fees, tax advisory fees, and consulting fees.¹³⁵ Moreover, the report recommends that the PCAOB determine which of the characteristics should be required in annual reports of smaller firms, taking into account firm resources.¹³⁶ Second, as described in Section II.B.4, investor-related groups have more recently invoked the ACAP Final Report and suggested that certain firms be required to disclose information regarding firm operating characteristics, such as annual audited financial statements or information about firm governance, leadership, and structure.¹³⁷

ii. **Lack of Sufficient Incentives to Develop a System of Voluntary Disclosures Regarding Firm Information**

The market does not provide audit firms with sufficient incentives to develop an efficient and effective system of standardized voluntary disclosures regarding firm operating characteristics. If market forces do not provide sufficient incentives, then economic theory suggests regulation may be necessary to generate changes in behavior.¹³⁸ We consider supply-side and demand-side reasons that market forces do not provide sufficient incentives.

¹³⁴ The ACAP included investor leaders among other leaders and was focused on strengthening the audit profession for investor protection. The ACAP considered issues affecting the sustainability of the auditing profession, including human capital, firm structure and finances, and audit market concentration and competition. Most closely related to this proposal, the ACAP Final Report recognized on behalf of investors and the public that disclosure of certain firm operating characteristics, including financial and governance information, affect how the firm functions. See ACAP Final Report, at II.2, II.4.

¹³⁵ See ACAP Final Report, at VII.21.

¹³⁶ See ACAP Final Report, at VII.23.

¹³⁷ See, e.g., PCAOB Investor Advisory Group Meeting (June 8, 2022) (suggesting that unimplemented ACAP recommendations be implemented, including information regarding firm governance, leadership, and structure); PCAOB Investor Advisory Group Meeting (Oct. 27, 2016) (discussing the status of ACAP recommendations, including large firm provision of financial statements); Comment No. 35 from the Council of Institutional Investors (Mar. 19, 2020), Rulemaking Docket 046: Quality Control, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket046/035_cii.pdf?sfvrsn=5ade7257_0, at 7 (suggesting that certain firms be required to provide annual audited financial statements and information about firm governance).

¹³⁸ See, e.g., Anat R. Admati and Paul Pfleiderer, *Forcing Firms to Talk: Financial Disclosure Regulation and Externalities*, 13 *The Review of Financial Studies* 479 (2000); Ronald A. Dye, *Mandatory Versus Voluntary Disclosures: The Cases of Financial and Real Externalities*, 65 *The Accounting Review* 1 (1990); John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 *Virginia Law Review* 717 (1984).

a. Supply-Side Reasons

Economic theory suggests that high-quality companies have an incentive to voluntarily disclose information to the extent it allows them to differentiate themselves from low-quality competitors.¹³⁹ However, there are countervailing forces that limit firms' incentives to develop a system of standardized voluntary disclosures.

Firms would incur private coordination costs to collectively develop and comply with a system of standardized voluntary disclosures. If regulation makes the information available in a standardized manner, then the coordination costs would instead be covered by the regulator. Firms may also be deterred by private competitive costs they could incur, such as costs associated with competitors leveraging disclosed information to capture market share.¹⁴⁰ There could also be a status quo bias whereby firms prefer to continue a non-disclosure policy despite investors' calls for additional information.¹⁴¹

There is also a positive externality associated with the availability of firm information.¹⁴² Standardized disclosures across firms and over time would provide benefits to a variety of investors, including current shareholders, potential future shareholders, and investors in other companies. However, firms do not negotiate with all of these parties, and some beneficiaries of the disclosures may have no influence over the firm at all. Economic theory suggests that, in the presence of positive externalities, markets may undersupply goods or services absent any regulatory intervention.¹⁴³ As a result, the positive externality may create a risk that the firm would not provide complete information to the market because the firm would not consider the benefits that accrue to all investors.

¹³⁹ See, e.g., Kip W. Viscusi, *A Note on "Lemons" Markets with Quality Certification*, 9 *The Bell Journal of Economics* 277 (1978).

¹⁴⁰ See, e.g., Oliver Board, *Competition and Disclosure*, 57 *The Journal of Industrial Economics* 197 (2009) (finding that companies may be reluctant to voluntarily disclose in competitive markets); Daniel A. Bens, Philip G. Berger, and Steven J. Monahan, *Discretionary Disclosure in Financial Reporting: An Examination Comparing Internal Firm Data to Externally Reported Segment Data*, 86 *The Accounting Review* 417 (2011) (finding that companies provide fewer pseudo-segment disclosures due to proprietary costs or competitive concerns).

¹⁴¹ There are a variety of reasons why individuals may choose the *status quo* outcome in lieu of an unknown outcome, including aversion to the uncertainty inherent in moving from the *status quo* to another option. See, e.g., William Samuelson and Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 *Journal of Risk and Uncertainty* 7 (1988).

¹⁴² See, e.g., N. Gregory Mankiw, *Principles of Economics* 200, 201 (6th ed. 2008) ("In the presence of a positive externality, the social value of the good exceeds the private value. The optimal quantity is therefore larger than the equilibrium quantity...Positive externalities lead markets to produce a smaller quantity than is socially desirable.").

¹⁴³ See, e.g., Mankiw, *Principles of Economics* 200, 201.

In addition, investors lack a mechanism to independently validate the information. This information asymmetry creates a risk that the firm would provide inaccurate information.¹⁴⁴ Firms may further be inclined to offer voluntary disclosures for marketing purposes because the disclosures would not be subject to the regulatory review and enforcement that accompanies mandatory disclosures, which could have implications for the overall relevance and quality of the information. Likewise, firms may have incentives to withhold certain information, such as negative information, if the firms perceive that disclosure may damage their reputation or commercial prospects.¹⁴⁵ Thus, voluntary disclosure could result in an inefficient disclosure of information to the market and reduce the utility of the information to investors, so much so that a market could fail to exist.¹⁴⁶ Enforcement mechanisms that are available to regulators could be used to ensure the completeness and accuracy of firm information under a mandatory reporting framework.

b. Demand-Side Reasons

Investors do not directly contract with audit firms and, thus, generally lack bargaining power to request and receive information from the firm. Moreover, gathering standardized information regarding peer firms' operating characteristics would incur significant private costs because that information is also non-public. While investors could seek to acquire information regarding firm characteristics from the company under audit, a free-rider problem exists in which the costs incurred by one or more investors to convince the company to provide such information would not be shared by all other investors.¹⁴⁷ However, all other investors would benefit from the required public disclosure of that information because the information would likely need to be publicly disclosed.¹⁴⁸ Since the investors who incur the costs would not reap the exclusive benefit of their efforts, their incentive to make the effort is lower, and the likelihood of an under-provision of the information by firms is higher.

As discussed in Section IV.A, audit committees are already privy to certain information about their auditors beyond what is publicly available. However, even if the audit committee

¹⁴⁴ See, e.g., Mankiw, *Principles of Economics* 468 ("A difference in access to relevant knowledge is called an information asymmetry.").

¹⁴⁵ See, e.g., Eli Amir, Shai Levi, and Tsafrir Livne, *Do Firms Underreport Information on Cyberattacks? Evidence from Capital Markets*, 23 *Review of Accounting Studies* 1177 (2018) (concluding that managers voluntarily disclose less severe cyberattacks and withhold information from investors regarding cyberattacks that cause greater damage).

¹⁴⁶ See, e.g., George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 *The Quarterly Journal of Economics* 488 (1970) (discussing how low-quality cars may drive out high-quality cars from the used car market).

¹⁴⁷ See Mankiw, *Principles of Economics* 220, 222 ("A free rider is a person who receives the benefit of a good but avoids paying for it...A free-rider problem arises when the number of beneficiaries is large and exclusion of any one of them is impossible.").

¹⁴⁸ See Regulation Fair Disclosure, 17 C.F.R § 243.100(b)(1)(iv).

requests information and the information is provided by the firm, the information would be with respect to that firm alone and could lack consistency and comparability with peer firms. Audit committees could also conceivably request and receive information from all tendering firms but obtaining standardized information would be burdensome. Thus, without mandatory disclosure, audit committees also lack context to be able to efficiently and effectively evaluate the characteristics of a candidate firm against those of peer firms.

c. Evidence of Ineffective Voluntary Disclosures by Firms

As described in Section II.B.3 and Section IV.A.3, some audit firms disclose certain firm information through voluntary transparency reports; however, many smaller firms do not release such reports. Extant academic literature provides mixed evidence as to whether transparency reports are an effective tool for conveying informative disclosures regarding audit quality.¹⁴⁹ Some research also finds that, because the information contained in transparency reports is relatively unregulated, the disclosures and contextual discussion lack standardization across firms or even within firms.¹⁵⁰ A lack of standardization means that the disclosures have limited comparative value, inhibiting their usefulness to investors and audit committees.¹⁵¹ In addition, the UK Financial Reporting Council has concluded that transparency reports, as they currently exist, are not an effective means of disclosure.¹⁵²

iii. Statutory Oversight

As noted in Section II.B.1, PCAOB staff experience indicates instances of incomplete or imperfect information—i.e., information that is not requested, not reported, or reported inaccurately, inconsistently or without sufficient detail—regarding certain events at firms that

¹⁴⁹ See, e.g., Rogier Deumes, Caren Schelleman, Heidi Vander Bauwhede, and Ann Vanstraelen, *Audit Firm Governance: Do Transparency Reports Reveal Audit Quality?*, 31 *Auditing: A Journal of Practice & Theory* 193, 207-208 (2012) (concluding that current transparency report disclosures required in the European Union do not appear to reveal underlying audit firm quality); Johl, et al., *Audit Firm Transparency Disclosures* 508 (finding for Australian firms a positive association between governance disclosures and audit quality for large firms but no statistical association for medium and smaller firms).

¹⁵⁰ See, e.g., Sakshi Girdhar and Kim Klarskov Jeppesen, *Practice Variation in Big-4 Transparency Reports*, 31 *Accounting, Auditing & Accountability Journal* 261 (2018) (finding that the content of transparency reports is inconsistent and the transparency reporting practice is not uniform within large-firm networks).

¹⁵¹ Similar economic outcomes exist for comparability in financial disclosures, suggesting there may be inherent value and information efficiency benefits generated under uniform disclosure regimes. See, e.g., Bingyi Chen, Ahmet C. Kurt, and Irene Guannan Wang, *Accounting Comparability and the Value Relevance of Earnings and Book Value*, 31 *Journal of Corporate Accounting & Finance* 82 (2020).

¹⁵² See, e.g., Financial Reporting Council, *Transparency Reporting: AQR Thematic Review* (Sep. 2019) (finding that surveyed investors and audit committee chairs are either unaware of or perceive limited use in audit firm transparency reporting in the UK).

could impair the Board's ability to perform its statutory oversight function as it relates to emerging risks associated with the events. The following paragraphs discuss four instances of incomplete or imperfect information.

First, voluntary *ad hoc* reporting by firms to the PCAOB indicates that the current PCAOB reporting framework lacks specificity regarding certain events, such as financial constraints, mergers, or changes in governance. In some cases, such as insolvency or market consolidation, certain events could have implications for audit quality or the audit market.¹⁵³ In addition, certain events could affect a company's relationship with the audit firm, such as changes in the firm's ownership or arrangements with third parties that could impact the quality of the firm's provision of audit services. For example, private equity investment in a firm could have implications for the firm's independence, the approach the firm takes for making decisions, or the allocation of resources to the firm's provision of audit services.¹⁵⁴ As a result, the Board may not have a complete picture of the firm's incentives or constraints, which could potentially negatively affect audit quality or the audit market.

Second, without special reporting specified for cybersecurity incidents, the Board may not be timely notified of incidents that could impact audit quality or the audit market.¹⁵⁵ The consequences of a cybersecurity incident at an audit firm include inadvertent exposure of companies' confidential data that could lead to inappropriate use of the data by third parties or malicious actors.¹⁵⁶

Third, without confidential reporting of the largest firms' financial statements, the Board may not have financial statements readily available to assess a firm's wherewithal to withstand risks associated with events such as court judgments against the firm or threats to global

¹⁵³ See, e.g., Joseph Gerakos and Chad Syverson, *Competition in the Audit Market: Policy Implications*, 53 *Journal of Accounting Research* 725, 762 (2015) (finding evidence that the exit of any of the largest firms would result in a loss of welfare and an increase in audit fees for public companies).

¹⁵⁴ See, e.g., Andrew Kenney, *Private Equity Eyes Accounting Firms Large and Small*, *Journal of Accountancy* (Feb. 1, 2023) (explaining that private equity investment could have implications for firm independence, decision-making processes, and use of technology and other resources); Jonathan Levin and Steven Tadelis, *Profit Sharing and the Role of Professional Partnerships*, 120 *The Quarterly Journal of Economics* 131, 163 (2005) (providing a theoretical model that demonstrates that in markets where clients of professional service providers cannot observe quality, partnerships emerge as a desirable form of organization because hiring is more selective than in profit-maximizing corporations).

¹⁵⁵ While U.S. states generally have laws regarding companies' obligations to notify individuals of cybersecurity incidents related to personal data, we are not aware of similar requirements for business data. For a summary of states' notification laws, see, e.g., National Conference of State Legislatures, available at <https://www.ncsl.org/technology-and-communication/security-breach-notification-laws>.

¹⁵⁶ See, e.g., Vernon J. Richardson, Rodney E. Smith, and Marcia Weidenmier Watson, *Much Ado about Nothing: The (Lack of) Economic Impact of Data Privacy Breaches*, 33 *Journal of Information Systems* 227, 249 (2019) (finding that the costs of a data breach at a target company can spill over from the initial target to individuals and economically linked companies).

networks or other affiliates that may require the firm's support. Without financial statements, the Board also misses potential opportunities to observe detectable unexplained changes in the firm's financial health.

Fourth, the current 30-day reporting requirement for specified events is not consistent with the increased pace at which information is generated and consumed today, nor is it consistent with advances in automation and processing. For example, if a firm has withdrawn an audit report on an issuer's financial statements and is required to report that incident on Form 3, the 30-day time lag may not provide investors with timely notice or the Board with sufficient notice for appropriate timely follow-up.

2. How the Proposal would Address the Need

i. Investors and Audit Committees

The proposal would enhance transparency of audit firms by mandating public disclosure of firm information—including financial, governance, network, and cybersecurity characteristics—relating to the firm's capacity, incentives, and constraints to provide quality audit services. The proposal would thus reduce frictions in the information market discussed above and thereby enhance: (i) audit committees' abilities to efficiently and effectively compare firms in their appointment and monitoring efforts and (ii) investors' abilities to efficiently and effectively compare firms in their decisions to vote on ratifications proposals and allocate capital.¹⁵⁷ The proposal would require firms to report standardized information using PCAOB structured forms, further promoting consistency across firms and over time. Collecting standardized information would enhance the usefulness of the information to investors and audit committees by allowing them to more easily compare firms.

ii. Statutory Oversight

The proposal would enhance the effectiveness of the Board's statutory oversight related to audit firms and the audit market by reducing the extent of incomplete or imperfect information in the current PCAOB reporting framework. The proposed disclosures and confidential reporting would replace similar information currently collected on a supplemental basis or received on a voluntary *ad hoc* basis by the PCAOB. However, PCAOB supplemental data collection would still be necessary to the extent that any relevant information that supports statutory oversight is not added to the reporting requirements.

Questions:

52. Have we appropriately described the problem and how the proposal would address it, including investor and audit committee needs for consistent and comparable information across audit firms and over time? If not, how can we improve the analysis?

¹⁵⁷ See Section IV.C.1 below for further discussion.

53. Is the literature cited for the need fairly represented? If not, please explain.
54. Are there additional studies or data that would inform our analysis of the need? If yes, please direct us to them and explain how they would inform the analysis.

C. Economic Impacts

This section discusses the expected benefits and costs of the proposal and potential unintended consequences.

1. Benefits

The proposed disclosures would enhance: (i) audit committees' abilities to efficiently and effectively compare firms in their appointment decisions and monitoring efforts and (ii) investors' abilities to efficiently and effectively compare firms in their ratification and capital allocation decisions. The proposed disclosures could also provide indirect benefits linked to audit quality, financial reporting quality, capital market efficiency, and competition. In addition, the proposed disclosures and confidential reporting would enhance the effectiveness of the Board's statutory oversight function.

In the following discussion, we discuss the direct benefits associated with enhancing the information environment regarding firm characteristics. We then discuss indirect benefits of the proposed reporting changes. We then review academic literature related to the proposed disclosures. Throughout the discussion, we assume that investors and audit committees would use the proposed disclosures based on their roles described in Section IV.B.1. and that firms would report complete and accurate information based on the Form 2 and Form 3 certification requirements and the regulatory enforcement incentive.

i. Direct Benefits

The proposal would enhance transparency and comparability of audit firms to support audit committee and investor decision-making. In addition, the proposal would enhance the effectiveness of the Board's statutory oversight function. We note that the benefits of comparable information have been observed in research regarding financial reporting.¹⁵⁸ We also note that the benefits of prior PCAOB disclosure rules vary by rule and analysis.¹⁵⁹ Although

¹⁵⁸ See, e.g., Mark L. DeFond, Xuesong Hu, Mingyi Hung, and Siqi Li, *The Impact of Mandatory IFRS Adoption on Foreign Mutual Fund Ownership: The Role of Comparability*, 51 *Journal of Accounting and Economics* 240, 241 (2011) (finding that greater financial reporting comparability leads to greater investment).

¹⁵⁹ See, e.g., *Interim Analysis Report: Further Evidence on the Initial Impact of Critical Audit Matter Requirements*, PCAOB Rel. No. 2022-007 (Dec. 7, 2022), at 4 (suggesting that as of the analysis date investors may still be learning how to find value-relevance in the information content of disclosed

there are differences between financial reporting disclosures and the proposed disclosures and between prior PCAOB disclosure rules and this proposed disclosure rule, we expect these findings are informative of the potential benefits of this proposal because of the public availability of the disclosures.

a. **Investors and Audit Committees**

The proposed disclosures would facilitate better-informed appointment decisions and monitoring by audit committees and better-informed appointment ratification decisions and monitoring by investors because the disclosures would enhance audit firm transparency with a cost-effective source of standardized information across firms and over time. To the extent that firm operating characteristics provide investors and audit committees with information to assess a firm's capacity, incentives, and constraints, the proposed disclosures would serve as a potential resource for more reliable audit committee appointment of the firm and investor ratification of the appointment proposal.¹⁶⁰ To the extent that firm characteristics change following a selection decision, the proposed disclosures would serve as a potential resource for more reliable periodic monitoring of the firm.

Audit committees would benefit from the enhanced information by being enabled to more efficiently and effectively review and compare information from peer firms against information from incumbent and tendering firms. Investors would benefit by being enabled to more efficiently and effectively evaluate firms. Market participants that rely on proxy advisors would also likely benefit from the proposed disclosures as proxy advisors could use the information in their recommendations, which in turn could provide benefits to less-resourced investors.

critical audit matters); PCAOB, *Staff White Paper: Econometric Analysis on the Initial Implementation of CAM Requirements* (Oct. 2020), at 4, available at <https://pcaobus.org/EconomicAndRiskAnalysis/pir/Documents/Econometric-Analysis-Initial-Implementation-CAM-Requirements.pdf> (discussing how PCAOB staff did not find systematic evidence that investors respond to the information contents in critical audit matters but nevertheless did find that some investors are reading critical audit matters and find the information beneficial); John Kose and Min Liu, *Does the Disclosure of an Audit Engagement Partner's Name Improve the Audit Quality? A Difference-in-difference Analysis*, 14 *Journal of Risk and Financial Management* 1 (2021) (suggesting that there was an increase in audit quality and audits costs as a result of PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*); Lauren M. Cunningham, Chan Li, Sarah E. Stein, and Nicole S. Wright, *What's in a Name? Initial Evidence of US Audit Partner Identification Using Difference-in-Differences Analyses*, 94 *The Accounting Review* 139 (2019) (finding evidence that any immediate impact of PCAOB Rule 3211 on audit quality or audit fees is limited to specific dimensions of audit quality, specific control groups, and/or specific company characteristics).

¹⁶⁰ See, e.g., Gene M. Grossman and Carl Shapiro, *Informative Advertising with Differentiated Products*, 51 *The Review of Economic Studies* 63 (1984) (finding that reduced information frictions can result in improved matching between sellers and buyers).

Mandatory standardized disclosure would enhance the effectiveness and efficiency of comparing firm characteristics across firms and over time. Form 2 provides standardized information with well-defined fields and a structured format that can be made conveniently available for access and use.¹⁶¹ Standardization of the proposed disclosures would decrease investors' and audit committees' search costs and monitoring costs.¹⁶² The public availability of the proposed information via disclosure could also lead the firm to more proactively consider and take actions regarding a company's stake in matters such as the firm's use and protection of the company's data.¹⁶³

Three caveats could attenuate the potential benefits of better-informed selection decisions and monitoring. First, the incremental benefits of the proposed disclosures for audit committees would be reduced to the extent that audit committees request and receive firm information via *ad hoc* requests from incumbent or tendering firms. However, by making the disclosures mandatory and standardized, the proposal would increase the accessibility and comparability of publicly available information regarding PCAOB-registered firms. For example, audit committees would be better able to compare an incumbent firm to peer firms.¹⁶⁴ Second, the benefits of better-informed appointment decisions and monitoring could vary depending on the involvement and experience of audit committees. For example, more proactive audit committees with greater firm appointment and monitoring experience may be more likely to use the information than other audit committees. However, audit committees may come to appreciate the accessibility and comparability of the proposed disclosures through the iterative process of appointing and monitoring firms. Third, to the extent that benefits are derived from the ability to readily switch between firms, the benefits could be reduced by stickiness in existing firm-issuer relationships. In particular, large multinational issuers may, as a practical

¹⁶¹ See, e.g., Luigi Zingales, *The Future of Securities Regulation*, 47 *Journal of Accounting Research* 391, 395 (2009) (concluding that a more subtle benefit of disclosure regulation is the standardization it entails); Jeffrey R. Kling, Sendhil Mullainathan, Eldar Shafir, Lee C. Vermeulen, and Marian V. Wrobel, *Comparison Friction: Experimental Evidence from Medicare Drug Plans*, 127 *The Quarterly Journal of Economics* 199 (2012) (finding that standardized information better enables individuals to assess tradeoffs and make coherent, rational decisions).

¹⁶² See, e.g., Zingales, *The Future of Securities Regulation* 395 (concluding that a company chooses a presentation format that is most favorable to the company's data, which impairs investors' ability to make comparisons across companies); Christian Leuz and Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54 *Journal of Accounting Research* 525, 553 (2016) (explaining that the disclosure of operating performance and governance arrangements by public companies can lower the cost of monitoring by providing investors with useful benchmarks that help investors evaluate other companies' managerial efficiency or potential agency conflicts).

¹⁶³ See, e.g., George Loewenstein, Cass R. Sunstein, and Russell Golman, *Disclosure: Psychology Changes Everything*, 6 *Annual Review of Economics* 391 (2014) (suggesting that the disclosure of information can have indirect effects that lead to changes in behavior).

¹⁶⁴ See, e.g., CAQ Barometer Report, at 15.

matter need a GNF, which limits the pool of available alternatives.¹⁶⁵ Therefore, the benefits of better-informed selection decisions and monitoring could be reduced for the largest issuers.

In addition to assisting investors with their appointment ratification votes and monitoring an audit firm, the proposed disclosures would assist investors in monitoring and evaluating the audit committee. The audit committee is responsible for overseeing the firm and the proposed disclosures may assist investors in determining whether the audit committee is effective in this role (e.g., whether the audit committee continues to delay replacing a firm despite firm information that indicates insufficient capacity or poorly managed incentives and constraints). Enhanced investor monitoring of the audit committee could improve audit committee effectiveness.¹⁶⁶

Some of the proposed disclosures may not directly reflect a firm's capacity, incentives, and constraints. For example, stronger member networks may not directly translate to more technical resources for some firms or the composition of governing boards and management committees in some firms may not directly reflect accountability or its enforcement. However, we expect the proposed disclosures, either individually or taken together with other factors, to enhance the information environment for investors and audit committees. Moreover, the relevance of the proposed disclosures to decision-making is evident in academic research. For

¹⁶⁵ See United States Government Accountability Office, *Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action* (Jan. 8, 2008), at 21.

¹⁶⁶ Some academic research suggests that audit committee effectiveness is associated with audit committee incentives. See, e.g., Jeffrey Cohen, Ganesh Krishnamoorthy, and Arnold M. Wright, *The Corporate Governance Mosaic and Financial Reporting Quality*, 23 *Journal of Accounting Literature* 87 (2004) (concluding that personal ties and/or professional ties between the CEO and audit committee members can potentially impair members' objectivity). Some research suggests that investors are willing to pay for audit committee effectiveness and hold audit committees accountable for negative audit quality. See, e.g., Ellen Engel, Rachel M. Hayes, and Xue Wang, *Audit Committee Compensation and the Demand for Monitoring of the Financial Reporting Process*, 49 *Journal of Accounting and Economics* 136, 138 (2010) (suggesting a willingness by companies to deviate from the historically prevalent one-size-fits-all approach to director pay in response to increased demands on audit committees and differential director expertise); Suraj Srinivasan, *Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements and Audit Committee Members*, 43 *Journal of Accounting Research* 291 (2005) (concluding that audit committee members bear reputational costs for financial reporting failure). Some research suggests that audit committee members without Big 4 audit experience are more likely to favor auditors that are rated as attractive. See, e.g., Matthew Baugh, Nicholas J. Hallman, and Steven J. Kachelmeier, *A Matter of Appearances: How Does Auditing Expertise Benefit Audit Committees When Selecting Auditors?*, 39 *Contemporary Accounting Research* 234 (2022). Together, this research suggests that audit committee effectiveness could respond to improved investor monitoring. Other research suggests that audit committee effectiveness is positively associated with proxies for audit quality. See, e.g., Brian Bratten, Monika Causholli, and Valbona Sulcaj, *Overseeing the External Audit Function: Evidence from Audit Committees' Reported Activities*, 41 *Auditing: A Journal of Practice & Theory* 1 (2022) (finding that the strength of audit committee oversight, as implied by audit committee disclosures, is positively associated with proxies for audit quality).

example, academic research finds that certain audit firm characteristics—including firm size and financial situation, governance and network information, and insurance and litigation history—are used by insurance companies to assess the firm’s risk exposure and set premiums.¹⁶⁷

Firms may also benefit from the proposed reporting as the firms would be able to compare their own information against other firms and, thus, better manage their own audit practices. The extent of this benefit would depend on whether the firms already collect information for comparison or benchmarking purposes. Firms that do not currently collect any information would likely benefit more from the proposed reporting.

b. Statutory Oversight

The proposed disclosures and confidential reporting would enhance the PCAOB’s statutory oversight function and operating effectiveness. The proposed disclosures and confidential reporting would enable the Board to reduce supplemental information collection to the extent that the proposed reporting overlaps with supplemental information, but supplemental information collection would still be necessary for oversight purposes. Standardization of information would facilitate statutory oversight and would expedite Board efforts to identify regulatory tools and mechanisms in response to potential occasional disruptions in the timely issuance of audit opinions under certain circumstances.¹⁶⁸ Enhanced PCAOB oversight would benefit firms and investors through more effective allocation of inspection resources, more effective standard setting and rulemaking, and better-informed assessments of specified events.

Collecting the proposed disclosures on Form 2 annually, across firms, would support the PCAOB’s efforts to enhance audit quality and protect investors by more effectively planning and scoping inspection selections.¹⁶⁹ The proposed disclosures on Form 2 would also enhance the

¹⁶⁷ See, e.g., Mark Linville and John Thornton, *Litigation Risk Factors as Identified by Malpractice Insurance Carriers*, 17 *The Journal of Applied Business Research* 93, 95 (2001) (finding that insurance companies request information regarding audit firm revenue, predecessor firms, types of services provided, location, independence, organizational form, related-party involvement, fiduciary responsibilities, professional sanctions, and insurance and litigation history); Minjung Kang, Ho-Young Lee, Vivek Mande, and Yong-Sang Woo, *Audit Firm Attributes and Auditor Litigation Risk*, 55 *Abacus* 639, 641 (2019) (finding that audit firms with operating losses, rapid revenue growth, or no separation between audit and non-audit practices pay higher liability insurance premiums, while firms with a high proportion of partners and higher growth in the number of CPAs employed pay lower insurance premiums).

¹⁶⁸ See, e.g., *Temporary Final Rule and Final Rule: Requirements for Arthur Anderson LLP Auditing Clients*, SEC Rel. No. 33-8070 (Mar. 18, 2002).

¹⁶⁹ See, e.g., Phillip T. Lamoreaux, *Does PCAOB Inspection Access Improve Audit Quality? An Examination of Foreign Firms Listed in the United States*, 61 *Journal of Accounting and Economics* 313 (2016) (finding that auditors subject to PCAOB inspection access provide higher quality audits as

PCAOB's ability to perform cross-sectional analyses and policy research, which would inform future standard setting and rulemaking. These planning, analyses, and research impacts would be limited by the fact that some firms file Form 2 late or never and some do not sign an opinion or play a substantial role as demonstrated in Figure 1 for the 2023 filing year.

The proposed confidential reporting of specified material events on Form 3 and the accelerated filing deadline for the form would better position the Board to assess an event and share information in a timely manner with the Board's oversight authorities (i.e., SEC or Congress) to consider any response that may be warranted.¹⁷⁰ To the extent that firms are experiencing currently unspecified events that are relevant to effective statutory oversight but not reporting the events to PCAOB on a voluntary *ad hoc* basis, the firms may lack clarity about what is expected of them. By adding more specified events to Form 3, potential ambiguity would be mitigated, and the effectiveness of PCAOB oversight would be enhanced. Based on the additional coverage of specified events, we anticipate that the occurrence of firms filing Form 3 and the number of Forms 3 filed would likely increase relative to the counts reported in Figure 2 for the 2023 filing year.

In combination, the proposed information collection on Form 2 and Form 3 would inform PCAOB staff's understanding of a firm's operations and financial strength to help the Board assess and share information with the Board's oversight authorities regarding certain developments. For example, in the case of a material financial event that threatens a firm's ability to continue as a going concern or the quality of a firm's audits, reporting of the event on Form 3 would better position the Board to assess and share information with the Board's

measured by more going concern opinions, more reported material weaknesses, and less earnings management, relative to auditors not subject to PCAOB inspection access); Inder K. Khurana, Nathan G. Lundstrom, and K.K. Raman, *PCAOB Inspections and the Differential Audit Quality Effect for Big 4 Non-Big 4 US Auditors*, 38 *Contemporary Accounting Research* 376 (2021) (suggesting that initial PCAOB inspections improve audit quality more for the largest firms than for other annually inspected or triennially inspected firms); Albert L. Nagy, *PCAOB Quality Control Inspection Reports and Auditor Reputation*, 33 *Auditing: A Journal of Practice & Theory* 87 (2014) (concluding that public disclosure of PCAOB Part II inspection findings leads to a loss of the firm's market share and provides a credible signal of audit quality). We note that the results from these studies that suggest a positive association between PCAOB oversight and audit quality do not necessarily mean that PCAOB oversight causes higher audit quality. These studies merely find positive associations between PCAOB oversight and audit quality.

¹⁷⁰ For examples of events that the Board could potentially assess with more formalized and timely reporting, see, e.g., Mark Maurer, *BDO to Establish Employee Stock Ownership Plan as Part of U.S. Restructuring*, *Wall Street Journal* (Aug. 14, 2023); Kenney, *Private Equity Eyes Accounting Firms Large and Small*; Natalia M. Greene, *Private Equity and Auditor Independence*, *Accounting Today* (June 28, 2023).

oversight authorities regarding potential implications for the firm and its issuers.¹⁷¹ Information reported on the most recent Form 2, such as disaggregated fees, would be useful to determine if the firm's practice is concentrated on a particular client type and assess implications for issuers to find another firm. The information may also prompt the Board to request additional information to further its understanding or to take no action.

The proposed confidential reporting of the largest firms' financial statements would enable PCAOB staff to assess the operating and financial resources a firm has available in light of the large number of audits and complex audit engagements the firms perform. An assessment of resources could aid the Board's understanding of a firm's capacity to withstand risks associated with events such as court judgments against the firm or threats to global networks or other affiliates that may require the firm's support. For example, if there is a threat to a global network affiliate, financial statements could aid PCAOB staff's evaluation of whether the U.S. firm has the operating and financial capacity to provide support to the distressed affiliate in order to preserve the network's ability to perform a multinational audit. The availability of financial statements would also enable the Board to observe detectable unexplained changes in the firm's financial health and decide whether to discuss those changes with firm leadership to understand the circumstances that caused the changes. The benefits associated with comparability of firms' financial statements would be reduced to the extent that PCAOB-registered firms vary between consolidated financial statements compiled for an entire registered professional service practice and financial statements compiled only for a single registered audit practice.

The failure of a large firm could be broadly consequential if it leads to market disruptions that threaten audit quality. While the proposed information collection would be useful to enhance the effectiveness of PCAOB oversight for individual firms, some proposed disclosures or confidential reporting regarding large firms may indicate implications for the broader audit market. For example, research finds an association between increases in concentration and audit fees after Arthur Anderson's exit from the market.¹⁷² The failure of a large firm may pose challenges to issuers trying to engage a new firm and could lead to less reliable audits in the short run because remaining firms might be overworked or lack relevant knowledge and resources. While economic research presents evidence that the failure of any of the largest firms could reduce a public company's welfare and increase audit fees, the research also suggests that the effects of such failure could be mitigated to the extent that audit teams from the exiting firm move with companies to the remaining firms.¹⁷³ Economic theory is

¹⁷¹ See, e.g., ACAP Final Report, at VIII.9, which recommends that regulators monitor potential sources of catastrophic risk faced by firms and create a mechanism for the preservation and rehabilitation of troubled larger firms.

¹⁷² See, e.g., Emilie R. Feldman, *A Basic Quantification of the Competitive Implications of the Demise of Arthur Anderson*, 29 *Review of Industrial Organization* 193 (2006).

¹⁷³ See, e.g., Gerakos and Syverson, *Competition in the Audit Market* 729, 762.

inconclusive on the relationship between audit market competition and audit quality.¹⁷⁴ The proposed disclosures and confidential reporting are not intended to prevent potential failure of a large firm, but they would provide information for the Board to monitor transient market disruptions that could result until the market establishes a new equilibrium.

The PCAOB actively engages in policy research related to the market for assurance services to further the PCAOB's mission, by informing the standard-setting and rulemaking agenda among other uses. The additional data provided by this proposal would enhance the PCAOB's ability to produce impactful research and recirculate that gained knowledge into improved standards and rules. Relatedly, the additional data would also provide valuable information sources for the public, including academic research. Improved research quality is an important benefit because it contributes to PCAOB's standard setting and rulemaking projects.

Overall, estimates of the social and economic benefits of more effective regulatory oversight and additional academic research would be too imprecise to quantify.

ii. Indirect Benefits

Enhanced transparency of audit firms may prompt some firms to manage their operating characteristics in anticipation of investor and audit committee reactions to the proposed disclosures. For example, some firms may establish or strengthen governing boards, which would support leadership and promote accountability within the firm. Some firms may also seek network memberships or initiate more active participation in existing networks, which could strengthen the firms' own technical capacity and the networks' governance. In addition, some firms may establish or improve integration of cybersecurity policies and procedures into their risk management systems or engage more third-party specialists to address cybersecurity risks, which could reduce firms' vulnerabilities to cyberattacks and thereby reduce the impacts of future cyberattacks. These indirect benefits would enhance firms' capacities, incentives, and constraints to provide quality audit services. We next discuss indirect benefits linked to improved audit quality, financial reporting quality, capital market efficiency, and competition.

a. Improved Audit Quality, Financial Reporting Quality, and Capital Market Efficiency

While the proposed disclosures would not necessarily have a direct relationship to audit quality, they may enhance audit quality as investors and audit committees iteratively select and

¹⁷⁴ See, e.g., Yue Pan, Nemit Shroff, and Pengdong Zhang, *The Dark Side of Audit Market Competition*, 75 *Journal of Accounting and Economics* 1 (2023) (explaining that greater competition may foster audit process innovation, reduce firm complacency, or strengthen firm reputational incentives to supply high audit quality or that competition may lower audit quality if it leads firms to focus on appeasing clients by reducing professional skepticism and allowing clients excessive financial reporting discretion).

monitor firms and advance their understanding of the information content of the proposed disclosures through communication with firms and evaluation of firm characteristics.¹⁷⁵ Since auditors have a responsibility to provide reasonable assurance about whether financial statements are free of material misstatements, enhanced audit quality could increase the likelihood that the auditor would discover a material misstatement or would qualify its audit opinion when a material misstatement exists and is not corrected by management. If a registrant files with the SEC financial statements that are accompanied by a qualified auditor's report, the filing may be deemed deficient and considered not timely filed.¹⁷⁶ Furthermore, a qualified audit opinion may evoke negative market reactions. For these reasons, enhanced audit quality could incentivize issuers to take steps to ensure their financial statements are free of material misstatements. Issuers could take these steps proactively, prior to the audit, or in response to adjustments requested by the auditor. Financial statements that are free of material misstatements are of higher quality and more useful to investors.¹⁷⁷

¹⁷⁵ See, e.g., Dao, et al., *Shareholder Voting on Auditor Selection* 168 (finding evidence that shareholder involvement in firm selection is associated with higher audit fees and improved audit quality); Mert Erinc and Tzachi Zach, *Auditor-Client Compatibility and Audit Quality*, available on SSRN: <https://ssrn.com/abstract=4703916> (2024) (finding that auditor fit—as measured by a metric that links PCAOB inspection deficiencies to the most critical accounting areas disclosed in 10Ks—is negatively related to restatements, abnormal accruals, and Dechow-Dichev discretionary accruals). In principle, iterative selection and monitoring could lead to a reduction in the overall quality of audit services. For example, some issuers may seek lower audit fees at the expense of audit quality. Due to the fact that the proposed disclosures would be public, we believe, in most cases, this would be less likely.

¹⁷⁶ See, e.g., SEC, Division of Corporation Finance, *Financial Reporting Manual*, Section 4220 (last updated: 10/30/2020), available at <https://www.sec.gov/corpfin/cf-manual/topic-4>.

¹⁷⁷ We note three caveats. First, some theoretical research finds that changes to auditing standards can have counterintuitive effects on audit quality. See, e.g., Marleen Willekens and Dan A. Simunic, *Precision in Auditing Standards: Effects on Auditor and Director Liability and the Supply and Demand for Audit Services*, 37 *Accounting and Business Research* 217 (2007) (finding that increased precision in auditing standards can reduce audit quality); Pingyang Gao and Gaoqing Zhang, *Auditing Standards, Professional Judgment, and Audit Quality*, 94 *The Accounting Review* 201 (2019) (showing that setting a higher minimum bar can reduce quality). We acknowledge that these studies examine the impacts of audit performance standards. By contrast, we are proposing a disclosure rule. We are also unaware of empirical evidence that directly tests these theories. Second, the conclusion that financial statements that are free of material misstatements are more useful to investors hinges on the assumption that investors value compliance with the applicable financial reporting framework (e.g., U.S. GAAP). The various market reactions to restatements that have been documented in academic literature suggests that this is the case. See, e.g., Mark DeFond and Jieying Zhang, *A Review of Archival Auditing Research*, 58 *Journal of Accounting and Economics* 275, 284 (2014) (explaining that restatements are one of the most commonly used measures of misstatements in auditing research). Third, the conclusion that improved audit quality would improve financial reporting quality assumes that issuers would not switch to sufficiently lower quality auditors in sufficient numbers as a result of the proposal.

More reliable financial information allows investors to improve the efficiency of their capital allocation decisions (e.g., investors may more accurately identify companies with the strongest prospects for generating future risk-adjusted returns and reallocate their capital accordingly).¹⁷⁸ Investor confidence in financial reporting quality could also increase and lower investors' perceived risk in capital markets generally, which economic theory suggests can lead to an increase in the supply of capital.¹⁷⁹ An increase in the supply of capital could increase capital formation while also reducing the issuer's cost of capital.¹⁸⁰ A reduction in the cost of capital reflects a welfare gain because investors perceive less risk in capital markets.¹⁸¹

b. Competition

1) Capital Market Reactions to Firm Information

As the additional information, context, and perspective regarding audit firms would help investors assess a firm's capacity, incentives, and constraints to provide quality audit services, it would, by extension, help investors assess financial reporting quality.¹⁸² Investors would therefore be able to incorporate the proposed disclosures into their portfolio selection decisions.¹⁸³

Issuers audited by firms whose characteristics capital markets associate with higher financial reporting quality may experience reduced cost of capital or other capital market benefits and investors may reallocate their capital accordingly. Taken in isolation, this could

¹⁷⁸ Economic theory suggests that additional information generally improves market outcomes. See, e.g., Bengt Holmström, *Moral Hazard and Observability*, 10 *The Bell Journal of Economics* 74 (1979) (finding that efficiency improves when contractable information about an agent's performance is available to the agent's principal).

¹⁷⁹ See, e.g., Richard A. Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385 (2007) (concluding that improving the quality of accounting disclosures can influence the cost of capital and under certain conditions can unambiguously lower the cost of capital).

¹⁸⁰ See, e.g., Richard A. Lambert, Christian Leuz, and Robert E. Verrecchia, *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 *Review of Finance* 1, 16–18 (2011) (discussing the theoretical link between financial reporting quality and cost of capital).

¹⁸¹ Based on results from academic literature, the Firm and Engagement Metrics proposal quantifies that a single basis point reduction in the weighted average cost of capital would imply at least \$91.6 billion in welfare gains. See *Firm and Engagement Metrics*, PCAOB Rel. No. 2024-002 (April 9, 2024) for the calculations and related discussion.

¹⁸² See Section IV.C.1.ii.a above for a discussion regarding the association between audit quality and financial reporting quality.

¹⁸³ There is an extensive body of academic literature suggesting that financial markets incorporate information into securities prices. See, e.g., Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 *The Journal of Finance* 383 (1970).

tend to result in a reallocation of capital from issuers with perceived less reliable financial reporting quality to issuers with perceived higher financial reporting quality.

These capital market reactions could provide audit committees with a stronger incentive to appoint an audit firm whose operating characteristics capital markets associate with higher financial reporting quality. These effects could lead to increases in audit fees for firms that experience increased demand for their services. The opposite could result for other firms. Facing capacity constraints, some firms may turn down engagements or recruit additional staff to expand capacity.

2) Audit Firm Competition

Against the backdrop of capital market reactions to the proposed disclosures and as firms become better able to monetize their reputations, firms would have an incentive to compete on some of the proposed operating characteristics. As described above, some firms may seek to manage their characteristics by establishing or strengthening governing boards, participating more in networks, or integrating cybersecurity policies and procedures into risk management systems. This competitive dynamic would enhance audit quality and, by extension, financial reporting quality.¹⁸⁴

Economic theory suggests that reductions in search costs can lead to increased competition,¹⁸⁵ which may result in lower audit fees or higher audit quality.¹⁸⁶ In the process of selecting a firm, audit committees and investors incur search costs associated with finding information and comparing and evaluating firms. The proposed disclosures would reduce search costs and provide audit committees and investors with greater insights into which firm could best meet investor needs regarding the audit.

We note that the benefits linked to competition among audit firms could vary between audits conducted by larger and smaller firms. In particular, the benefits could be reduced for

¹⁸⁴ See Section IV.C.1.ii.a above for a discussion regarding the association between audit quality and financial reporting quality.

¹⁸⁵ See, e.g., Jean Tirole, *The Theory of Industrial Organization* 294 (1988); Helmut Bester, *Bargaining, Search Costs and Equilibrium Price Distributions*, 55 *The Review of Economic Studies* 201 (1988).

¹⁸⁶ The positive relationship between increased competition and lower audit fees is well-established. See, e.g., Wieteke Numan and Marleen Willekens, *An Empirical Test to Spatial Competition in the Audit Market*, 53 *Journal of Accounting and Economics* 450 (2012); Andrew R. Kitto, *The Effects of Non-Big 4 Mergers on Audit Efficiency and Audit Market Competition*, 77 *Journal of Accounting and Economics* 1 (2024). The relationship between increased competition and audit quality is less conclusive. See, e.g., Pan et al., *The Dark Side 1*; Andrew Kitto, Phillip T. Lamoreaux, and Devin Williams, *Do Entry Barriers Allow Low Quality Audit Firms to Enter the Public Company Audit Market?* (2023) available on SSRN: <https://papers.ssrn.com/abstract=3572688>.

the larger issuer segment of the market because larger issuers have fewer firms available to choose from that are able to perform large, complex audits.¹⁸⁷

iii. Academic Literature Related to the Proposed Disclosures

In the following discussion, we review academic research and other considerations related to each of the areas of proposed disclosures—i.e., financial, governance, network, special reporting, cybersecurity—and the updated description of QC policies and procedures to consider how the disclosures might function as useful information to enable investors and audit committees to more efficiently and effectively differentiate among individual firms. We note five caveats. First, some of the studies rely on proxies for the proposed disclosures or use data from foreign jurisdictions. The relevance of the studies is therefore limited to the extent that the proxies are not equivalent to the proposed disclosures or to the extent that results may not be applicable to the U.S. audit market more generally. Second, while the studies may draw conclusions regarding a particular characteristic’s relationship to publicly available proxies for audit quality, this does not imply that the characteristic would provide any new insights to investors and audit committees incremental to the insights already provided by the publicly available proxies for audit quality. Third, those relationships may be too indirect or difficult to fully evaluate. Moreover, the proposed disclosures would not directly measure audit quality. Audit quality is an abstract concept, and there is no single comprehensive measure of audit quality. Fourth, we note that benefits related to any proposed disclosure would be reduced to the extent the same reliable measures are publicly available from other sources. Fifth, benefits related to any proposed disclosure may vary between larger firms and smaller firms.

a. Financial Information

The proposed disclosures regarding disaggregation of fees would help investors and audit committees assess dimensions of a firm’s audit practice—such as size, audit versus non-audit focus, or attention to issuer audits versus broker-dealer audits—to determine whether the firm has the technical and operating capacity to perform the audit. In addition, disaggregation of fees would help assess whether the firm may be reliant on revenue in a manner that could influence the firm’s independence or decision-making. The proposal to revise the instructions to Form 2 to delete the language permitting foreign registered firms to seek confidential treatment of fees billed to issuer audit clients in Form 2, Item 3.2 would level the playing field for domestic and foreign firms with respect to the required reporting.

Academic research suggests that audit firm risk profiles can be reasonably assessed by insurers who set premiums for audit firms based, at least in part, on information contained in

¹⁸⁷ Economic research identifies three features of the audit market that may impact the market’s competitive dynamics: (i) its role in preserving transparency and improving the functioning of capital markets; (ii) high degree of mandated demand; and (iii) concentrated supply. See, e.g., Gerakos and Syverson, *Competition in the Audit Market* 726.

fees—such as firm size or revenue growth.¹⁸⁸ Firm size could be determined based on total fees, and revenue growth could be calculated from total fees (or by service line) reported consistently over time. Moreover, research suggests that the percentage of non-audit service fees to total fees could be used to inform investors' views of firm independence.¹⁸⁹

b. Governance Information

The proposed disclosures regarding a firm's principal executive officer and all direct reports to that officer, executive officers who are responsible for various components of the QC system, governing boards or management committees, and executive officer of the audit practice would provide investors and audit committees with consistent and comparable information to understand incentives at the firm level based on who is responsible for establishing work culture, tone at the top, and mechanisms for accountability.¹⁹⁰ The proposed disclosures regarding legal structure, ownership, governance processes, changes in form of organization, and the EQCF oversight role would facilitate differentiation among firms based on criteria that could help assess whether a firm is properly incentivized or faces any constraints to continuously provide quality audit services.¹⁹¹

Academic research suggests that stronger governance at U.S. national offices results in improved audit quality for U.S. local offices.¹⁹² In addition, academic research indicates that information contained in governance disclosures required of Australian firms—such as legal and governance structure—is useful to assess audit quality for large firms.¹⁹³ Literature also finds

¹⁸⁸ See, e.g., Jeffrey R. Casterella, Kevan L. Jensen, and W. Robert Knechel, *Litigation Risk and Audit Firm Characteristics*, 29 *Auditing: A Journal of Practice & Theory* 71, 80 (2010).

¹⁸⁹ See, e.g., Mishra, et al., *Do Investors' Perceptions Vary?*; Cunningham, *Auditor Ratification* 174.

¹⁹⁰ See, e.g., Ken Tysiac, *Audit Quality Indicators Show Importance of Tone at the Top*, *Journal of Accountancy* (Apr. 21, 2022) (explaining that a firm's tone at the top and appropriate deployment of personnel are among the most important indicators of audit quality, according to an AICPA survey of public accounting firms).

¹⁹¹ See, e.g., Henry L. Tosi, Jeffrey P. Katz, Luis R. Gomez-Mejia, *Disaggregating the Agency Contract: The Effects of Monitoring, Incentive Alignment, and Term in Office on Agent Decision Making*, 40 *Academy of Management Journal* 584 (1997) (finding that incentive alignment in company governance is a powerful mechanism to ensure agents act in the best interests of principals); Levin and Tadelis, *Profit Sharing and the Role of Professional Partnerships* 163; IOSCO, *Transparency of Firms that Audit Public Companies* (Sep. 2009) (explaining that governance, including the organizational structure, of firms is perceived to have a significant influence on audit quality and a firm's ability to continuously provide audit services to the market).

¹⁹² See, e.g., Jade Huayu Chen and Preeti Choudhary, *The Impact of National Office Governance on Audit Quality* (2020), available on SSRN: <https://ssrn.com/abstract=3702083> (2020) (finding that closer proximity between a national office and a local office strengthens national office governance through monitoring and knowledge transfer, resulting in improved audit quality at the local office).

¹⁹³ See, e.g., Johl, et al., *Audit Firm Transparency Disclosures* 508.

that governance disclosures—such as legal structure, ownership, and governance processes—positively affect investor confidence and reduce the cost of capital for some European Union companies.¹⁹⁴ Finally, research suggests that the information contained in European firms' current governance disclosures is of low value and could potentially be resolved through efforts by oversight bodies and the auditing profession to improve information value.¹⁹⁵ Since U.S. institutions differ from other countries and governance measures vary widely across the studies, the results from these studies may not directly relate to all PCAOB-registered firms.

c. Network Information

The proposed disclosures regarding network-related legal and ownership structure, financial arrangements, and governing boards would provide investors and audit committees with consistent and comparable information to understand incentives and constraints at the network level as compared to the firm level. The proposed disclosures regarding sharing of training materials and audit methodologies would facilitate differentiation among firms based on factors that could help assess how much technical capacity a firm has to provide quality audit services.

Academic research suggests that information contained in the proposed network disclosures—such as audit methodologies and technical resources—would be useful to assess audit quality.¹⁹⁶ In addition, research indicates that information regarding a firm's network would help assess the firm's technical capacity to perform an audit.¹⁹⁷ Moreover, research finds that information contained in network disclosures in general would be particularly useful to assess audit quality and fees charged by smaller firms.¹⁹⁸ Since network membership may tend to be chosen by firms that are more inclined to focus on audit quality, the results from these studies may not generalize equally to all PCAOB-registered firms.

¹⁹⁴ See, e.g., La Rosa, et al., *Corporate Governance of Audit Firms* 19, 30 (finding that the cost of equity of public interest entities in the European Union tends to decrease after the release of audit firm transparency reports as a result of increases in investor confidence).

¹⁹⁵ See, e.g., Deumes et al., *Audit Firm Governance* 207-208.

¹⁹⁶ See, e.g., Juan Mao, *Non-Big 6 Audit Firms' Access to External Resources through Inter-Organizational Relationships (IORs): Insights from the PCAOB*, University of Texas at San Antonio Working Paper Series WP# 0231ACC (2019) (finding for smaller audit firms that audit quality is improved when the firms have access to audit manuals and technologies through network relationships).

¹⁹⁷ See, e.g., Bills et al., *Small Audit Firm Membership* 767 (explaining that smaller firm membership in accounting networks provides the firm with access to expertise and technical trainings among other resources).

¹⁹⁸ See, e.g., Bills et al., *Small Audit Firm Membership* 767 (finding that smaller firms that are members of networks have fewer PCAOB inspection deficiencies, fewer financial statement misstatements, and higher audit fees than their non-member peers).

d. Special Reporting

The proposed accelerated filing deadline for Form 3 from 30 days to 14 days would facilitate a timelier alert to investors and audit committees regarding disclosed specified events. For example, as shown in Figure 2, the top reason firms filed Form 3 for the 2023 filing year was because they became aware of changes related to certain legal proceedings. Investors would benefit from timelier reporting of these changes because they may distract or improperly incentivize firms and could have implications for a firm's attention and efforts dedicated to audit engagements.

e. Cybersecurity Information

The proposed disclosures regarding integration of cybersecurity policies and procedures into risk management systems, engagement of third parties in relation to cybersecurity risks, and policies and procedures to oversee and identify threats associated with third-party service providers would provide investors and audit committees with information to understand efforts taken to protect an issuer's confidential data.¹⁹⁹ The proposed disclosures would also facilitate differentiation among firms based on information that could help investors and audit committees assess a firm's vulnerability to cyberattacks, which could impact a firm's operations and ability to continue delivering quality audit services.²⁰⁰

Academic research suggests that information contained in the proposed disclosures would be useful to assess whether a firm has policies and procedures in place to manage the risk of a potential cyberattack that could impact a firm's reputation,²⁰¹ which investors rely on to infer audit quality since they cannot assess quality by casual observation.²⁰² In addition,

¹⁹⁹ See, e.g., Nick Hopkins, *Deloitte Hit by Cyberattack Revealing Client's Secret E-mails*, Guardian (Sep. 25, 2017) (discussing consequences for issuers' data that resulted from a cyberattack at one of the largest firms).

²⁰⁰ See, e.g., Patrick Münch, *The Importance of Cybersecurity in Accounting*, Accounting Today (Feb. 21, 2023) (explaining that accounting firms should regularly evaluate their cybersecurity processes and policies to ensure they are taking full advantage of the latest tools and techniques to protect against cyberattacks). For examples of business operations that have been disrupted by cyberattacks, see, e.g., David E. Sanger, Clifford Krauss, and Nicole Perlroth, *Cyberattack Forces a Shutdown of a Top U.S. Pipeline*, The New York Times (May 8, 2021); Reuters, *Estee Lauder Hit by Cyberattack, Some Business Operations Affected* (July 20, 2023).

²⁰¹ See, e.g., Barri Litt, Paul Tanyi, and Marcia Weidenmier Watson, *Cybersecurity Breach at a Big 4 Accounting Firm: Effects on Auditor Reputation*, 37 Journal of Information Systems 2 (2023) (concluding that significant cyberattacks can negatively impact the reputation of any of the largest firms).

²⁰² See, e.g., Karen M. Hennes, Andrew J. Leone, and Brian P. Miller, *Determinants and Market Consequences of Auditor Dismissals after Accounting Restatements*, 89 The Accounting Review 1051, 1055 (2014) (explaining that corporate boards and investors rely heavily on audit firm reputation to infer audit quality).

research suggests that information contained in a firm’s cybersecurity disclosures may help investors more efficiently price an issuer’s securities to the extent they are confident that a firm’s policies and procedures provide sufficient protection against a potential cyberattack.²⁰³

f. Updated Description of QC Policies and Procedures

The proposed one-time disclosure of a firm’s policies and procedures pursuant to proposed QC 1000 (if the Board’s proposal, subject to any amendments, is adopted and approved) would enable investors and audit committees to more efficiently understand differences among firms’ quality control policies and procedures and, thus, help assess a firm’s capacity to deliver high-quality audit services for firms that provide audit services.²⁰⁴

Questions:

55. Have we appropriately described the benefits, including potential benefits for smaller firms or issuers and including potential benefits that would accrue to investors and audit committees? If not, how can we improve the analysis?
56. Is the literature regarding benefits fairly represented? If not, please explain.
57. Are there additional studies or data that would inform our analysis of the benefits? If yes, please direct us to them and explain how they would inform the analysis.
58. Are there any quantifiable benefits? If yes, please: (i) identify them; (ii) describe a methodology to quantify them; (iii) explain why the methodology is appropriate and relevant to the proposal; and (iv) direct us to any studies or data on which the methodology relies.

2. Costs

In the following discussion, we consider direct and indirect costs related to the proposal. We have attempted to quantify costs where possible. However, quantification would generally be too imprecise to be reliable, particularly the indirect costs.

- First, firms would incur direct costs developing a reporting infrastructure or updating existing infrastructure.

²⁰³ See, e.g., Litt et al., *Cybersecurity Breach 2* (finding evidence of negative market returns for a large firm’s issuer clients after a major cybersecurity incident at the firm was disclosed by a third party); Richardson et al., *Much Ado about Nothing* 249.

²⁰⁴ See, e.g., Daniel Aobdia, *The Economic Consequences of Audit Firms’ Quality Control System Deficiencies*, 66 *Management Science* 2883 (2020) (finding a negative association between performance-related quality control deficiencies identified during PCAOB inspections and audit quality).

- Second, firms would incur direct costs complying with the requirements to complete Form 2 and Form 3 and file them with the PCAOB.
- Third, market participants would incur indirect costs updating their decision-making and monitoring frameworks.
- Fourth, there would be indirect costs linked to competition resulting from the new requirements.

Costs would be mitigated to the extent that information provided by firms in response to the proposed reporting changes overlaps with voluntary *ad hoc* reporting by firms or with supplemental information that firms already report to PCAOB through the inspection process. Firms may either pass their costs on to issuers, and ultimately investors, through higher audit fees, or they may choose to absorb costs. Larger firms would be able to take advantage of economies of scale by distributing any fixed costs over a higher number of audit engagements. Smaller firms would distribute any fixed costs over a lower number of audit engagements, which would make implementation relatively more costly for smaller firms.²⁰⁵

i. Direct Costs

a. Firm Infrastructure Costs

Infrastructure includes systems for data collection, reporting processes, controls, and documentation. Firms would likely incur one-time costs related to infrastructure that is necessary to comply with the proposal. There would also likely be some recurring costs to maintain infrastructure. The one-time infrastructure costs would depend on the extent to which firms already have infrastructure in place and would be able to modify the infrastructure to comply with the proposal. Most firms are likely to have some infrastructure in place for existing reporting requirements related to Form 2 and Form 3, as described in Section IV.A, but those systems may require modifications and testing before they can be used to comply with the proposal.

GNFs and large non-affiliate firms (“NAFs”)²⁰⁶ may have existing advanced infrastructure and greater capability to modify the infrastructure. Smaller NAFs may need to make large

²⁰⁵ See, e.g., Michael Minnis and Nemit Shroff, *Why Regulate Private Firm Disclosure and Auditing?*, 47 *Accounting and Business Research* 473, 498-499 (2017) (explaining that increased financial reporting regulation is disproportionately costly for smaller companies because complying with regulation has large fixed costs, and unlike larger companies, smaller companies do not benefit from economies of scale).

²⁰⁶ NAFs are U.S. or non-U.S. accounting firms that are registered with the Board but are not GNFs. Some NAFs belong to international networks other than GNF networks.

modifications to existing infrastructure or invest in entirely new infrastructure. Smaller firms may not be able to benefit from economies of scale as they would need to spread fixed costs over fewer audit engagements.²⁰⁷

The costs associated with developing or updating infrastructure would depend on the choice of automated or manual systems. Some firms may find it efficient to automate some or all of their systems, which would likely increase the one-time costs associated with infrastructure. In addition, recurring costs from operating manual systems are likely to be higher as scale increases, which may cause some firms to invest in automated systems.

Infrastructure costs would include any costs associated with training personnel on how to use the systems. Training may be needed for operating activities related to data collection and reporting processes as well as for administrative activities related to documentation and proper control over the systems.

b. Firm Compliance Costs

Compliance activities would include preparation, review, certification, and filing of forms. Firms would incur one-time costs and recurring costs related to compliance with the proposal. The compliance costs would depend on the extent to which firms already engage in compliance activities related to Form 2 and Form 3 and would, thus, be able to modify their existing compliance activities. The relative magnitude of the compliance costs may depend on the size of the firm and whether the firm has chosen manual or automated systems.

GNFs and large NAFs may have existing advanced compliance practices and greater resource flexibility to modify existing compliance practices. Smaller NAFs may face resource constraints that could make modifications to such practices relatively more costly. To the extent that compliance activities include any fixed features, smaller firms may not be able to benefit from economies of scale as they would need to spread fixed costs over fewer audit engagements.²⁰⁸

Firms would incur personnel costs to prepare, review, and certify their filings, which would contain more information and be made more often and on an accelerated basis in the case of Form 3. Preparation would require additional time associated with drafting narrative disclosures. Review would require additional time to validate expanded information and narrative disclosures and would potentially include more robust legal review. One-time costs for the additional reporting on Form 2 and Form 3 would include training of firm personnel regarding the new reporting requirements. One-time costs for proposed Form QCPP would include gathering and documenting information related to the quality control policies and procedures that have been developed pursuant to proposed QC 1000. Recurring costs for the additional reporting on Form 2 and Form 3 would include compliance activities associated with

²⁰⁷ See, e.g., Minnis and Shroff, *Why Regulate* 498-499.

²⁰⁸ See, e.g., Minnis and Shroff, *Why Regulate* 498-499.

periodic reporting. There would be no recurring costs for the one-time reporting of policies and procedures on proposed Form QCPP.

The proposal to accelerate the filing deadline for Form 3 from 30 days to 14 days would allow less time for firms to gather data and complete the reporting process. As discussed in Section III.D, reporting within 14 days is a practice with which audit firms are already familiar under certain SEC reporting requirements. The costs of shorter deadlines for Form 3 would include potential processing changes, expedited review, and revised administrative efforts for filing. The costs may be mitigated to the extent that firms choose automated processes, which could be more likely for larger firms, or already file Form 3 within 14 days after a reportable specified event, which as noted in Section IV.A.1.ii was 12.1 percent of specified events reported during the period 2018-2022. The costs associated with the accelerated filing deadlines are likely to be greater for firms that, due to operating circumstances, currently take all of the 30-day period to complete and file Form 3. These firms may have to allocate additional resources—such as in-house personnel or capital investment in automated filing processes—to comply with the proposed accelerated deadlines.

We expect that the compliance costs associated with the proposed changes would be most significant for the initial filings under the proposal because firm personnel would need to familiarize themselves with new reporting requirements and forms. In subsequent reporting periods, we anticipate that firms would incur lower costs because of any efficiencies related to the compliance activities already being operationalized.²⁰⁹

The compliance costs associated with the proposed confidential reporting of financial statements would include personnel, technology, and processing costs incurred to compile financial statements in accordance with the applicable financial reporting framework (e.g., U.S. GAAP or IFRS). These costs would be limited to the subset of large firms that are subject to the confidential reporting of financial statements. The costs would also be mitigated to the extent that firms currently compile financial statements in accordance with an applicable financial reporting framework.

To the extent that firms currently compile financial statements on a basis other than an applicable financial reporting framework—such as partnership agreements or agreements with lenders—the firms would incur costs to compile financial statements in accordance with an applicable financial reporting framework. Firms would also incur costs to the extent that they maintain two sets of financial records—e.g., one in accordance with an applicable financial reporting framework and one in accordance with another basis. The proposed extended

²⁰⁹ See, e.g., PCAOB Rel. No. 2022-007 (finding that auditors of large accelerated filers realized efficiencies in developing and communicating critical audit matters in the second year of implementation, reporting that they generally spent the same or less time on critical audit matters compared to the initial year of implementation).

transition period for providing financial statements would enable firms to spread their costs over the proposed three-year period provided that they comply with the specified criteria.

The compliance costs associated with the proposed special reporting of specified events would include costs incurred to identify specified events that are newly subject to the reporting requirements. We anticipate that these costs would be mitigated to the extent that firms already maintain risk management frameworks to actively identify, monitor, and assess risk. For example, PCAOB staff observations of the largest firms indicate that those firms already have systems for monitoring and responding to the occurrence of cybersecurity incidents. In addition, the proposed special reporting is subject to the “materiality” and “substantially likely” limiting principles that are intended to scope events to those that warrant reporting. The subsequent compliance costs would depend on the occurrence of reportable events and the frequency with which those events occur. Compliance costs would be limited to the extent that reportable events occur infrequently because firms would not be required to file Form 3 in the absence of events. The compliance costs associated with the proposed changes, however, would increase with the frequency of reportable events at firms.

We considered quantification of the compliance burden that firms would incur to complete the proposed disclosures on Form 2 and Form 3 using a methodology similar to the methodology used by federal agencies under the Paperwork Reduction Act.²¹⁰ The methodology requires an estimate of burden hours imposed on respondents. In the case of Form 2 and Form 3, respondents are audit firms. We explored five potential options to estimate burden hours. First, we considered whether information has already been reported by firms to PCAOB regarding burden hours, but no information regarding burden hours has been reported by firms. Second, we explored the availability of burden hours imposed by comparable federal forms but based on the unique nature of Form 2 and Form 3, PCAOB staff was not aware of any comparable federal forms. Third, we inquired about PCAOB staff experience working with firms to complete Form 2 and Form 3 to assess the possibility of estimating burden hours based on expert judgment. However, PCAOB staff has not worked directly with firms to complete the forms, and the time burden could vary across firms based on factors such as: (i) the size of a firm’s audit practice; (ii) the use of manual or automated processes to complete Form 2; and (iii) the nature and complexity of events reported on Form 3. Fourth, we analyzed PCAOB data generated during the filing of Form 2 and Form 3, including length of time to submit the forms calculated from time stamps collected when the forms are first initiated and when the forms are finally filed. We concluded that the wide variation in length of time across firms would serve as an indicator of the duration the forms are open but not necessarily firm effort to complete the forms. Finally, we considered a survey of firms to directly collect data regarding burden hours and decided to include a question in this proposal.

²¹⁰ See *A Guide to the Paperwork Reduction Act*, available at <https://pra.digital.gov/burden/estimation>.

ii. Indirect Costs

As discussed in Section IV.C.1.ii, enhanced transparency of audit firms may prompt some firms to manage their operating characteristics in anticipation of investor and audit committee reactions to the proposed disclosures. Firms would incur costs to make changes related to their operating characteristics. For example, firms would incur costs to establish or strengthen governing boards, seek network membership, or more actively participate in networks. Likewise, firms would incur costs to improve integration of cybersecurity policies and procedures into their risk management systems or to hire cybersecurity consultants. Firms would only choose to incur these costs if the firms expected the associated benefits to justify the costs, and costs may be disproportionately higher for smaller firms to the extent that the costs include a fixed component that would be spread over fewer audit engagements. We next discuss indirect costs associated with updating decision-making and monitoring frameworks and indirect costs linked to competition.

a. Updating Decision-Making and Monitoring Frameworks

Once the proposed disclosures are available to investors and audit committees, investors and audit committees would incur one-time costs to understand and incorporate the new information into their decision-making and monitoring frameworks. In addition, investors and audit committees would incur recurring costs to continually monitor the new information. Investors may begin to incorporate the new information into their investment decisions or into their evaluation of the firm for their vote regarding the ratification proposal, which may generate costs associated with reviewing information and understanding potential trends. Audit committees may begin to incorporate the new information into their search activities for a firm and into their ongoing monitoring activities. Audit committees may also spend time discussing the new information with the firm, which would cost both the audit committees' and the firms' time.

Investors and audit committees would only choose to incur the one-time and recurring costs of incorporating the new information if they expected the associated benefits to justify the costs. Institutional investors may be more inclined than retail investors to incur the costs because of economies of scale.

Audit firms may incur costs to monitor their own information and to review and understand their competitors' information. GNFs and large NAFs may be able to deploy more resources for research and understanding the overall market. Smaller NAFs may have fewer resources to fully evaluate the information contained in the new disclosures, and as a result, may incur costs to retain a competitive knowledge base compared to GNFs and large NAFs. Firms would only choose to incur these costs if the firms expected the associated benefits to justify the costs.

b. Competition

As discussed in Section IV.C.1.ii, the proposed disclosures may lead audit firms to compete on some of the proposed operating characteristics. This could lead some firms to devote more resources to governance efforts, network participation, and cybersecurity risk management.

To the extent that increased competition results in reduced audit fees, it could also reduce profitability for audit firms. Lower audit fees could be particularly costly for smaller firms in light of fixed infrastructure costs and any fixed component of compliance costs that would be spread over fewer audit engagements and further reduce profitability. Although lower audit fees may constitute a cost to firms, lower fees would directly benefit issuers and indirectly benefit investors.

Economic theory suggests that firms may pass on to issuers certain costs in the form of higher audit fees.²¹¹ The degree to which increases in variable costs, such as firm compliance costs, are expected to be passed on would vary based on how wide-spread the costs are across competitors. Increases in variable costs that impact all sellers in an imperfectly competitive market are more likely to be passed on than cost increases that impact only a subset of sellers.²¹² If compliance costs have a greater impact on a subset of firms, such as smaller firms, those firms may be less inclined to pass on the incremental costs in order to stay competitive with larger firms.

Questions:

59. Have we appropriately described the costs, including potential costs for smaller firms or issuers? If not, how can we improve the analysis?
60. Is the literature regarding costs fairly represented? If not, please explain.
61. Are there additional studies or data that would inform our analysis of the costs? Are there any data regarding burden hours to complete Form 2 or Form 3? If yes, please direct us to the additional studies or data and explain how they would inform the analysis.
62. Are there any quantifiable costs? If yes, please: (i) identify them; (ii) describe a methodology to quantify them; (iii) explain why the methodology is appropriate and

²¹¹ Economic theory suggests that fixed costs are less likely to be passed on. Only changes to variable costs are generally expected to impact sellers' pricing decisions. *See, e.g.,* Mankiw, *Principles of Economics* 284, 307 (showing that the profit-maximizing price is a function of marginal cost rather than fixed costs).

²¹² *See, e.g.,* Erich Muehlegger and Richard L. Sweeney, *Pass-Through of Own and Rival Cost Shocks: Evidence from the U.S. Fracking Boom*, 104 *Review of Economics & Statistics* 1361 (2022).

relevant to the proposal; and (iv) direct us to any studies or data on which the methodology relies.

3. Unintended Consequences

In addition to the benefits and costs discussed above, the proposal could have unintended economic consequences. The following discussion describes potential unintended consequences we have considered and, where applicable, any mitigating or countervailing factors.

i. Negative Externalities

The proposed disclosures could generate negative externalities. For example, a firm that inadvertently discloses incorrect information may cause other firms in the audit market to make suboptimal decisions based on the incorrect disclosures. In addition, disclosures could be used differently than intended or could be misinterpreted and therefore generate unexpected outcomes for market participants.²¹³ Potentially incorrect information would be mitigated by the requirement and the potential enforcement of the requirement that the information reported on the form be certified by a partner or authorized officer of the firm that to their knowledge, the form does not contain any untrue or misleading statement of a material fact. Potential misuse or misinterpretation would be mitigated as investors and audit committees iteratively select and monitor firms and advance their understanding of the information content of the proposed disclosures.

ii. Cybersecurity Vulnerability

The potential cybersecurity vulnerability of a firm could increase via disclosures of cybersecurity policies and procedures.²¹⁴ If cybersecurity disclosures are sufficiently detailed, the disclosures may provide meaningful information to malicious actors to target the firm. Malicious actors could use information from disclosed policies and procedures to target weaker firms. This potential unintended consequence would be mitigated by this release's clarification that the proposed requirement is not intended to elicit detailed, sensitive information. The potential unintended consequence would also be mitigated to the extent that a firm decides to enhance its cybersecurity risk management in anticipation of the proposed disclosures. In

²¹³ See, e.g., Michael Mowchan and Philip M.J. Reckers, *The Effect of Form AP on Auditor Liability when Engagement Partner Disclosure Shows a History of Restatements*, 35 Accounting Horizons 127 (2021) (finding that jurors' assessments of audit firm liability increase following firms' audit-quality-related interventions designed to address audit failures).

²¹⁴ See, e.g., Roland L. Trope and Sarah Jane Hughes, *The SEC Staffs 'Cybersecurity Disclosure' Guidance: Will it Help Investors or Cyber-thieves More?*, Business Law Today 1, 6 (2011) (concluding that cybersecurity disclosures that are meaningful enough to enable investors to accurately price companies' securities may also contain information of value to cybercriminals seeking to exploit a cybersecurity vulnerability).

addition, academic research that studies cybersecurity vulnerabilities suggests that detailed cybersecurity disclosures do not lead to more attacks.²¹⁵ However, we acknowledge that findings from the research may not be generalizable to the proposed cybersecurity disclosures.

iii. Audit Firms May Exit the Market

If the benefits linked to competition in the audit market, discussed in Section IV.C.1.ii, more broadly involve distributional impacts for some market participants, firms that are less able to compete could lose market share or be forced to lower their audit fees, resulting in strains on their profitability. Profitability could also be negatively impacted by the costs of the proposal. In some cases, firms that are less able to compete on the proposed operating characteristics may be forced to exit the market. This could reduce the overall capacity of the audit market, thereby reducing competition. This consequence could disproportionately affect smaller firms and the issuers they audit compared to larger firms.

This potential unintended consequence would be mitigated to the extent that more competitive firms in the smaller issuer audit market could expand their market share, perhaps by acquiring additional capacity from exiting firms. In addition, competition may increase among smaller firms to the extent that any firms exiting the larger issuer audit market redeploy capacity to the smaller issuer audit market.

Questions:

63. Have we appropriately described the potential unintended consequences? If not, how can we improve the analysis?
64. Is the literature regarding unintended consequences fairly represented? If not, please explain.
65. Are there additional studies or data that would inform our analysis of unintended consequences? If yes, please direct us to them and explain how they would inform the analysis.

²¹⁵ See, e.g., He Li, Won Gyun Non, and Tawei Wang, *SEC's Cybersecurity Disclosure Guidance and Disclosed Cybersecurity Risk Factors*, 30 *International Journal of Accounting Information Systems* 40 (2018) (finding that measures of specificity of incidents do not have a statistically significant relation with subsequent cybersecurity incidents); Tawei Wang, Karthik N. Kannan, and Jackie Rees Ulmer, *The Association between the Disclosure and the Realization of Information Security Risk Factors*, 24 *Information Systems Research* 201, 215 (2013) (finding that companies that disclose risk-mitigating information are less likely to be associated with cybersecurity incidents).

D. Alternatives Considered

The development of the proposal involved considering a number of alternative approaches to address the problems described above. This section explains: (i) why rulemaking is preferable to other policy approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other rulemaking alternatives that were considered; and (iii) key policy choices made in determining the details of the proposed rulemaking approach.

1. Why Rulemaking is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to rulemaking, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of auditing standards. We considered whether providing guidance or increasing inspection or enforcement efforts would be an effective mechanism to address the information gaps in the extant PCAOB reporting framework.

Interpretive guidance inherently provides additional information about existing rules and forms. Encouraging additional disclosure via interpretive guidance without amending the forms through rulemaking would be difficult because there would be no mechanism for the disclosure. Moreover, interpretive guidance, as opposed to line-item requirements, would reduce the standardization and comparability of the information. Inspection and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to interpretive guidance, inspections, or enforcement activities, without enhancing the current PCAOB reporting framework would not provide the benefits discussed in Section IV.C.1 associated with the proposed reporting changes.

2. Other Rulemaking Alternatives Considered

We considered, but are not proposing, enhancing our collection of supplemental information through the inspection process, including the collection instruments, procedures for collection, and the data storage infrastructure. This approach would yield benefits to PCAOB statutory oversight. However, the approach would yield no public benefits associated with the enhanced information environment as described in Section IV.C.1. We believe more extensive disclosures, as proposed above, are warranted and would accomplish more than what would be accomplished by enhancing existing tools for supplemental information.

3. Key Policy Choices

During the development of the proposal, we considered different approaches to addressing key policy choices.

i. Disclosure versus Confidential Reporting

We considered whether the proposed reporting should be made publicly available or reported confidentially. We explicitly allow confidential reporting for financial statements and

material specified events, but we believe public availability of the remaining information would promote the best transparency of firms and protection of investors while at the same time protecting the confidentiality of the firm's information. As noted in Section II.D.1, the Board intends to analyze the information reported in firms' financial statements to better understand whether the reporting requirements should be further amended to make some or all of the reported financial information public.

ii. Financial Statements

We considered whether the confidential provision of financial statements should be required for all firms or just the largest firms. We limited the requirement for financial statements to firms with more than 200 reports issued for issuer audit clients and more than 1,000 personnel because of the role those firms play in the audit market and the value of having their financial statements available for the Board's immediate use under certain circumstances, such as staff observing detectable unexplained changes in a firm's financial health.

iii. Changing Form 2 Reporting Deadline

We considered revising the Form 2 reporting period (April 1 through March 31) and filing deadline (June 30) to align with the proposed reporting period for Form FM (October 1 through September 30) and filing deadline (November 30) in order to have a single firm-level reporting period and filing deadline. This approach could benefit some Form 2 users because the firm-level metrics would all be prepared for the same period and therefore the synergies between the two sets of metrics may be increased. It may also benefit firms to prepare all firm-level metrics for the same reporting period. However, we considered that firms may also have existing systems in place to prepare and report existing Form 2 information for the current Form 2 reporting period, and altering those systems may incur costs. Moreover, the current period allows firms 90 days following the end of the reporting period to file Form 2, while the proposed filing deadline for Form FM is 61 days following the end of the reporting period. Thus, the change would represent an acceleration of the filing deadline, which may also increase firms' costs.

Questions:

66. Have we appropriately described the alternatives considered? If not, how can we improve the analysis?
67. Are any alternative approaches preferable to the proposed approach? If yes, please describe them and explain why they are preferable.
68. Are there studies or data that would inform our analysis of alternatives? If yes, please direct us to them and explain how they would inform the analysis.

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups (“JOBS”) Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies (“EGCs”), as defined in Section 3(a)(80) of the Exchange Act, unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.”²¹⁶ As a result of the JOBS Act, the proposals that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.²¹⁷

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.²¹⁸ As of the November 15, 2022 measurement date, PCAOB staff identified 3,031 companies²¹⁹ that self-identified as EGCs and filed audited financial statements with the SEC between May 16, 2021, and November 15, 2022, that included an audit report signed by a firm.

In general, any new PCAOB rules determined not to apply to audits of EGCs would require audit firms to address differing requirements with respect to audits of EGCs and non-

²¹⁶ See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (i) mandatory firm rotation or (ii) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The proposed standard does not fall within either of these two categories.

²¹⁷ The proposal does not impose any additional requirements on EGC audits. Nevertheless, we are providing this analysis of the impact on EGCs to assist the SEC in making the determination required under Section 104 to the extent that the requirements apply to “the audit of any emerging growth company” within the meaning of Section 104 of the JOBS Act.

²¹⁸ See PCAOB, *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2022* (Feb. 20, 2024) (“EGC White Paper”), available at <https://pcaobus.org/resources/other-research-projects>.

²¹⁹ The EGC White Paper uses a lagging 18-month window to identify companies as EGCs. Please refer to the “Current Methodology” section in the EGC White Paper for details. Using an 18-month window enables staff to analyze the characteristics of a fuller population in the EGC White Paper but may tend to result in a larger number of EGCs being included for purposes of the present EGC analysis than would alternative methodologies. For example, an estimate using a lagging 12-month window would exclude some EGCs that are delinquent in making periodic filings. An estimate as of the measurement date would exclude EGCs that have terminated their registration or that have exceeded the eligibility or time limits.

EGCs.²²⁰ This is not practical in the context of the proposed firm reporting rule because the proposed disclosures and confidential reporting are firm-wide and would not be differentiable for different types of audits.

The discussion of the economic impacts of the proposal in Section IV.C is generally applicable to all audits performed pursuant to PCAOB standards, including audits of EGCs. The proposed disclosures may impact the audit market for EGCs more than the audit market for non-EGCs to the extent EGCs are more likely to be audited by smaller firm.²²¹ As discussed in Section IV.C.2, smaller firms may incur higher costs per issuer because smaller firms do not experience economies of scale associated with information production and dissemination. However, we also expect the benefits of enhanced selection and monitoring to be higher for smaller firms to the extent that smaller firms currently provide fewer and less informative disclosures. Therefore, all else equal, both the benefits and costs of the proposed reporting may be higher for the EGC audit market than for the non-EGC audit market.

The benefits linked to financial reporting quality articulated in Section IV.C.1.ii may be especially relevant to EGCs. EGCs are more likely to be newer companies, which are typically smaller in size, receive less analyst coverage, and have a shorter SEC financial reporting history than the broader population of public companies.²²² The proposed disclosures are expected to enhance transparency of firms in the EGC audit market and contribute to an increase in the credibility of financial reporting by EGCs. To the extent that the proposal improves EGCs' financial reporting quality, the proposal may also improve the efficiency of capital allocation, enhance capital formation, and lower the cost of capital. For example, investors may improve their capital allocation by reallocating capital toward EGCs with the strongest prospects for generating future risk-adjusted returns. Investors may also perceive less risk in the EGC capital markets generally, leading to an increase in the supply of capital to EGCs. This may increase capital formation and reduce the cost of capital to EGCs. The proposed disclosures could reduce competition in an EGC's product market if the indirect costs to audited companies disproportionately impact EGCs relative to their competitors.

Accordingly, and for the reasons explained above, the Board believes that, if it adopts the proposed disclosures, it would request that the SEC determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the

²²⁰ See EGC White Paper, at 17. Based on staff analysis as of the November 15, 2022 measurement date, 86 percent of the 263 firms that issued audit reports for EGCs performed audits for both EGC and non-EGC issuers while 14 percent performed issuer audits only for EGCs.

²²¹ PCAOB staff analysis indicates that, compared to exchange-listed non-EGCs, exchange-listed EGCs are approximately 2.6 times as likely to be audited by an NAF and approximately 1.3 times as likely to be audited by a triennially inspected firm. Source: EGC White Paper and S&P.

²²² See EGC White Paper, at Figure 9 and Figure 12 (indicating that exchange-listed EGCs have lower market capitalization and revenue than exchange-listed non-EGCs).

action would promote efficiency, competition, and capital formation, to apply the proposed disclosures to firms that audit EGCs.

Questions:

69. Have we appropriately considered the impacts of the proposal on EGCs, including impacts on efficiency, competition, and capital formation?

VI. EFFECTIVE DATE

For the enhanced reporting requirements discussed in Sections III.A.1, B, and C and III.E.2, we are proposing phased implementation to give smaller firms more time to develop and implement the necessary tools. For the first phase, the Board is considering making the requirements effective as of March 31, 2026, or one year after approval of the requirements by the SEC, whichever occurs later. The first phase would apply to the largest firms as defined in proposed rule 2208. The second phase, which would begin reporting one year after the first phase, would cover the remaining firms subject to reporting requirements.

For the requirements discussed in Section III.D and III.E.1 the Board is considering making the requirements effective as of 90 days after approval of the requirements by the SEC for all firms because these requirements are not periodic in nature and the events would be reported infrequently and/or have urgent importance. For the requirement discussed in Section III.F, the Board is considering aligning the effective date for Form QCPP with the effective date for QC 1000, if QC 1000 is adopted by the Board and approved by the SEC.

Finally, for the financial statement requirements discussed in Section III.A.2, we propose to make the interim requirements effective March 31, 2026, or one year after approval of the requirements by the SEC, whichever occurs later. The final requirement for compliance with the applicable financial reporting framework would be effective March 31, 2028 or three years after approval by the SEC, whichever is later.

On the 9th day of April, in the year 2024, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

April 9, 2024

APPENDIX 1 – PROPOSED REPORTING RULES AND FORMS 2, 3 AND QCPP

Language that would be deleted by the proposed amendments is ~~struck through~~. Language that would be added by the proposed amendments is **underlined** and **bolded**. Sections of existing form text that are omitted because there are no changes are indicated by * * *.

Rule 2203. Special Reports

(a) A registered public accounting firm must file a special report on Form 3 to report information to the Board as follows –

(1) Upon the occurrence, on or after December 31, 2009, of any event specified in Form 3, a registered public accounting firm must report the event in a special report filed **promptly, but no later than ~~thirty~~ thirty fourteen days after the occurrence of the event, except as indicated on Form 3**;

(2) No later than **thirty fourteen days, except as indicated on Form 3**, after receiving notice of Board approval of its application for registration, a registered public accounting firm that becomes registered after December 31, 2009 must file a special report to report any event specified in Form 3 that occurred after the date used by the firm for purposes of General Instruction 9 to Form 1 and before the date that the Board approved the firm's registration; and

(3) No later than January 30, 2010, a registered public accounting firm that is registered as of December 31, 2009, must file a special report to report, to the extent applicable to the firm, certain information described in General Instruction 4 to Form 3 and current as of December 31, 2009.

(b) A registered public accounting firm required to file a special report shall do so by filing with the Board a special report on Form 3 in accordance with the instructions to that form. Unless directed otherwise by the Board, a registered public accounting firm must file such special report and exhibits thereto electronically with the Board through the Board's Web-based system.

Rule 2208. Financial Statement Reporting for the Largest Accounting Firms

Each registered public accounting firm that has issued more than 200 audit reports for issuers and has more than 1,000 personnel during the preceding Form 2 reporting period must confidentially file with the Board financial statements, for the fiscal year ended during the 12-month period between April 1 to March 31, no later than June 30 of each year; provided, however, that a registered public accounting firm that has its application for registration

approved by the Board in the period between and including April 1 and June 30 of any year shall not be required to furnish financial statements for that one reporting period.

For the first two years after this rule is effective, firms would be permitted to provide financial statements that do not conform to the applicable financial reporting framework, provided that they (1) identify the information that is not readily available but is required to produce GAAP or IFRS statements, and (2) provide notes that would reconcile non-conforming financial statements to the applicable financial reporting framework.

Note: Financial statements for purposes of this rule should include a balance sheet, income statement, cash flow statement, and notes to the financial statements for the entity registered with the Board, and should delineate by service line (i.e., audit services, other accounting services, tax services, and non-audit services subject to PCAOB oversight). Further, financial statements should be prepared in accordance with the applicable financial reporting framework in the firm's jurisdiction (i.e., US GAAP or IFRS). For example, firms should consult applicable financial reporting requirements when delineating financial information by service line for rules on segment reporting.

Rule 2203B. Report on the Firm's Quality Control Policies and Procedures Under [QC 1000]

A registered public accounting firm that is registered as of December 15, 2025 must file with the Board a report on Form QCPP by December 15, 2025. A registered public accounting firm required to file a Form QCPP shall do so by filing the form in accordance with the instructions to that form. Unless directed otherwise by the Board, the registered public accounting firm must file such report and exhibits thereto electronically with the Board through the Board's Web-based system.

Rule 2204. Signatures

Each signatory to a report on Form 2, Form 3, ~~or~~ Form QC, **or Form QCPP** shall manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic submission. Such document shall be executed before or at the time the electronic submission is made and shall be retained by the filer for a period of seven years. Upon request, an electronic filer shall provide to the Board or its staff a copy of all documents retained pursuant to this Rule.

Rule 2205. Amendments

Amendments to a filed report on Form 2, Form 3, ~~or~~ Form QC, or Form QCPP shall be made by filing an amended report on the applicable form in accordance with the instructions to that form concerning amendments. Amendments shall not be filed to update information in a report that was correct at the time the report was filed, but only to correct information that was incorrect at the time the report was filed or to provide information that was omitted from the report and was required to be provided at the time the report was filed.

Rule 2206. Date of Filing

(a) An annual report shall be deemed to be filed on the date on which the registered public accounting firm submits a Form 2 in accordance with Rule 2200 that includes the signed certification required in Part X of Form 2.

(b) A special report on Form 3 shall be deemed to be filed on the date that the registered public accounting firm submits a Form 3 in accordance with Rule 2203 that includes the signed certification required in Part ~~XVIII~~ of Form 3.

(c) A report on the evaluation of the firm's system of quality control on Form QC shall be deemed to be filed on the date that the registered public accounting firm submits a Form QC in accordance with Rule 2203A that includes the signed certifications required in Parts III and V of Form QC.

(d) A report on Form QCPP shall be deemed to be filed on the date on which the registered public accounting firm submits a Form QCPP in accordance with Rule 2203B that includes the signed certification required in Part V of Form QCPP.

Form 2 – Annual Report Form

GENERAL INSTRUCTIONS

1. **Submission of this Report.** A *registered public accounting firm* must use this Form to file with the *Board* the annual report required by Section 102(d) of the *Act* and Rule 2200 and to file any amendments to an annual report. Unless otherwise directed by the *Board*, the Firm must file this Form, and all exhibits to this Form, electronically with the *Board* through the *Board's* Web-based system.
2. **Defined Terms.** The definitions in the *Board's rules* apply to this Form. Italicized terms in the instructions to this Form are defined in the *Board's rules*. In addition, as used in the instructions to this Form, the term "the Firm" means the *registered public accounting firm* that is filing this Form with the *Board*.
3. **When Report is Considered Filed.** Annual reports on this Form are required to be filed each year on or before June 30, subject to the qualification in Rule 2201 concerning any firm that has its application for registration approved by the *Board* in the period between and including April 1 and June 30. An annual report is considered filed when the Firm has submitted to the *Board* a Form 2 in accordance with Rule 2200 that includes the signed certification required in Part X of Form 2.
4. **Period Covered by this Report.** Annual reports on this Form shall cover a 12-month period from April 1 to March 31, subject to the qualification in Part VIII of Form 2 relating to the first annual report filed by a firm that becomes registered after December 31, 2009. In the instructions to this Form, this is the period referred to as the "reporting period."
5. **Amendments to this Report.** Amendments shall not be filed to update information in a filed Form 2 that was correct at the time the Form was filed, but only to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required to be provided at the time the Form was filed. When filing a Form 2 to amend an earlier filed Form 2, the Firm must supply not only the corrected or supplemental information, but must include in the amended Form 2 all information, affirmations, and certifications that were required to be included in the original Form 2. The Firm may access the originally filed Form 2 through the *Board's* Web-based system and make the appropriate amendments without needing to re-enter all other information.

Note: The *Board* will designate an amendment to an annual report as a report on "Form 2/A."

6. **Rules Governing this Report.** In addition to these instructions, the *rules* contained in Part 2 of Section 2 of the *Board's rules* govern this Form. Please read these *rules* and the instructions carefully before completing this Form.

7. Requests for Confidential Treatment. The Firm may, by marking the Form in accordance with the instructions provided, request confidential treatment of any information submitted, Part VI, Part VII, or Exhibit 99.3 of this Form that has not otherwise been publicly disclosed and that either contains information reasonably identified by the Firm as proprietary information or that is protected from public disclosure by applicable laws related to confidentiality of proprietary, personal, or other information. See Rule 2300. ~~Foreign registered public accounting firms may also request confidential treatment for Item 3.2 and Exhibit 3.2, though U.S. firms may not do so.~~ If the Firm requests confidential treatment, it must identify the information in Part VI, Part VII, or Exhibit 99.3 ~~(or, for a foreign registered public accounting firm, Item 3.2 and Exhibit 3.2)~~ that it desires to keep confidential, and include, as Exhibit 99.1 to this Form, a representation that, to the Firm's knowledge, the information for which confidential treatment is requested has not otherwise been publicly disclosed, and a detailed explanation of the grounds on which the information is considered proprietary or a detailed explanation of the basis for asserting that the information is protected by law from public disclosure and a copy of the specific provision of law that the Firm claims protects the information from public disclosure. If the Firm fails to include Exhibit 99.1, or includes an Exhibit 99.1 that fails to comply with Rule 2300(c)(2), the request for confidential treatment may be denied solely on the basis of the failure. The *Board* will normally grant confidential treatment requests for information concerning non-public disciplinary proceedings. The *Board* will determine whether or not to grant other confidential treatment requests on a case-by-case basis. See Rule 2300(c).
8. Assertions of Conflicts with Non-U.S. Law. If the Firm is a *foreign registered public accounting firm*, the Firm may, unless otherwise directed by the *Board* pursuant to Rule 2207(e), decline to provide certain information and affirmations required by this Form if the Firm could not provide such information or affirmations without violating non-U.S. law and the Firm proceeds in accordance with Rule 2207. The Firm may withhold responsive information and affirmations on that basis from any Part of the Form other than Part I **(with the exception of Items 1.4(e) and (f))**, II, and X and Items 3.1.a, 3.1.b, 3.1.d, and 4.1. If the firm withholds responsive information or affirmations, the Firm must indicate, in accordance with the instructions in the relevant Part of the Form, the particular Items with respect to which the Firm has withheld responsive information or a required affirmation. The Firm may not use the Form to make any general assertion that a particular requirement may conflict with non-U.S. law, but only to indicate that, on the basis of an asserted conflict, the Firm has in fact withheld from this Form required information or a required affirmation.
9. Language. Information submitted as part of this Form, including any exhibit to this Form, must be in the English language.

PART I - IDENTITY OF THE FIRM AND, CONTACT PERSONS, AND GOVERNANCE INFORMATION

* * *

Item 1.4 Audit Firm Governance Information

a. Identify the principal executive officer of the Firm and all direct reports to that officer, including names and titles.

b. State whether the Firm has a governing board or management committee to which the principal executive officer reports and, if so, identify the members of that board or committee.

c. Identify executive officer(s) who oversee(s) the Firm's audit practice.

d. Provide a description of the legal structure, ownership, and governance of the firm, including processes that would govern a change in the form of the organization (e.g., what are the relevant governing bodies, voting rights, and approval requirements relevant to such an organizational change). In addition, indicate any change in the form of organization specified on Form 1, Item 1.4.

e. Identify the individuals who have the roles and responsibilities described in paragraphs [.11] and [.12] of [QC 1000].

f. Provide a description of the Firm's independent oversight function for the audit practice, or state that none exists, and whether it is comprised of any person who is not a partner, shareholder, member, other principal, or employee of the firm and does not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system. Identify each person or persons and provide an explanation for the basis of the firm's determination that each such person is independent (including the criteria used for such determination) and the nature and scope of each such person's responsibilities.

Item 1.5 Statement on Policies and Procedures to Identify and Manage Cybersecurity Risks

If the Firm has policies and procedures to identify and manage cybersecurity risks, indicate by checking this box and provide a brief description of such policies and procedures as Exhibit 1.5, including (i) whether and how any such policies and procedures have been integrated into the registrant's overall risk management system or processes; (ii) whether the firm engages assessors, consultants, auditors, or other third parties in relation to cybersecurity risks; and (iii) whether the firm has policies and procedures to oversee and identify such risks from cybersecurity threats associated with its use of any third-party service provider.

* * *

PART III - INFORMATION CONCERNING THE FIRM

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Item 3.2 Fees Billed to ~~Issuer Audit~~ Clients and Other Financial Information

a. ~~Of the t~~Total fees billed by the Firm to all clients for services that were rendered in the reporting period, ~~state the percentage (which may be rounded, but no less specifically than to the nearest five percent) attributable to fees billed to issuer audit clients~~ for-

1. *Audit services*

a. Audit services for issuers;

b. Audit services for broker-dealers; and

c. Audit services for others

2. *Other accounting services;*3. *Tax services; and*4. *Non-audit services.*

Note: In responding to Item 3.2(a)(1)(c), please indicate the nature of other audit clients (e.g., private company audits, custody rule audits) and fees billed for each category of other audit client.

~~Indicate, by checking the appropriate box, which of the following two methods the Firm used to calculate the percentages reported in Item 3.2.a—~~

~~1. The Firm used as a denominator the total fees billed to all clients for services rendered during the reporting period and used as numerators (for each of the four categories) total fees billed to issuer audit clients for the relevant services rendered during the reporting period.~~

~~2. The Firm used as a denominator the total fees billed to all clients in the Firm's fiscal year that ended during the reporting period and used as numerators (for each of the four categories) total issuer audit client fees as determined by reference to the fee amounts disclosed to the Commission by those clients for each client's fiscal year that ended during the reporting period (including, for clients who have not made the required Commission filings, the fee amounts required to be disclosed).~~

~~c. If the Firm has used a reasonable method to estimate the components of the calculations described in Item 3.2.b, rather than using the specific data, check this box and attach Exhibit 3.2 briefly describing the reasons for doing so and the methodology used in making these estimates.~~

eb. Indicate by checking this box that the Firm is subject to the requirements of Rule 2208 and has complied with the rule to confidentially file with the Board financial statements for the fiscal year ended during the reporting period.

Note: In responding to Item 3.2, careful attention should be paid to the definitions of the italicized terms, which are found in *Board Rules* 1001(i)(iii) (*issuer*), 1001(a)(v) (*audit*), 1001(a)(vii) (*audit services*), 1001(o)(i) (*other accounting services*), 1001(t)(i) (*tax services*), and 1001(n)(ii) (*non-audit services*). The definitions of the four categories of services correspond to the *Commission's* descriptions of the services for which an *issuer* must disclose fees paid to its auditor. Compare the descriptions of services in Item 9(e) of *Commission* Schedule 14A (17 C.F.R. § 240.14a-101) under the headings "Audit Fees," "Audit-Related Fees," "Tax Fees," and "All Other Fees" with, respectively, the *Board's* definitions of *Audit Services*, *Other Accounting Services*, *Tax Services*, and *Non-Audit Services*.

* * *

PART V - OFFICES AND AFFILIATIONS

In Part V, the Firm should provide information that is current as of the last day of the reporting period.

Item 5.1 Firm's Offices

List the physical address and, if different, the mailing address, of each of the Firm's offices.

Item 5.2 *Audit*-related Memberships, Affiliations, or Similar Arrangements

a. State whether the Firm has any:

1. Membership or affiliation in or with any network, arrangement, alliance, partnership or association that licenses or authorizes *audit* procedures or manuals or related materials, or the use of a name in connection with the provision of *audit services* or accounting services;
2. Membership or affiliation in or with any network, arrangement, alliance, partnership or association that markets or sells *audit services* or through which joint *audits* are conducted; or
3. Arrangement, whether by contract or otherwise, with another entity through or from which the Firm employs or leases personnel to perform *audit services*.

b. If the Firm provides an affirmative response to Item 5.2.a, identify, by name and address, the entity with which the Firm has each such relationship, and provide a brief description of each

such relationship. **The description should include the legal and ownership structure of the network, network-related financial obligations of the registered firm (e.g., loans and funding arrangements to or from the network member firm), information-sharing arrangements between the registered firm and the network (including both sharing of such information as training materials, audit methodologies, etc. and sharing of audit client information), and network governing boards or individuals to which the registered entity may be accountable.**

Note: Item 5.2.b does not require information concerning every other entity that is part of the network, arrangement, alliance, partnership or association, but only information concerning the network, arrangement, alliance, partnership, or association itself, or the principal entity through which it operates.

* * *

PART XI - EXHIBITS

To the extent applicable under the foregoing instructions or the *Board's rules*, each annual report must be accompanied by the following exhibits:

Exhibit 1.5 Statement on Policies and Procedures to Identify and Manage Cybersecurity Risks

Exhibit 3.2	Description of Methodology Used to Estimate Components of Calculation in Item 3.2 and Rea Using Estimates
Exhibit 99.1	Request for Confidential Treatment
Exhibit 99.3	Materials Required by Rule 2207(c)(2)-(4) - <i>Submit Only as an Exhibit to an Amended Form 2 in Response to a Request Made Pursuant to Rule 2207(d)</i>

Form 3 - Special Reporting Form

GENERAL INSTRUCTIONS

1. Submission of this Report. Effective December 31, 2009, a *registered public accounting firm* must use this Form to file special reports with the *Board* pursuant to Section 102(d) of the *Act* and Rule 2203 and to file any amendments to a special report. Unless otherwise directed by the *Board*, the Firm must file this Form, and all exhibits to this Form, electronically with the *Board* through the *Board's* Web-based system.
2. Defined Terms. The definitions in the *Board's rules* apply to this Form. Italicized terms in the instructions to this Form are defined in the *Board's rules*. In addition, as used in the instructions to this Form, the term "the Firm" means the *registered public accounting firm* that is filing this Form with the *Board*.
3. When this Report is Required and When It is Considered Filed. Upon the occurrence of any event specified in Part II of this Form, the Firm must report the event on this Form by following the instructions to this Form. With respect to events that occur on or after December 31, 2009 and while the Firm is registered, the Firm must file the Form no later than **thirty fourteen** days after the occurrence of the event reported, **except as designated below for Item 9.1**. Certain additional requirements apply, but they vary depending on whether a firm was registered as of December 31, 2009. A firm that becomes registered after December 31, 2009, must, within **thirty fourteen** days of receiving notice of *Board* approval of its registration application (**except as designated below for Item 9.1**), file this Form to report any reportable events that occurred in a specified period before approval of the firm's application for registration. See Rule 2203(a)(2). A firm that was registered as of December 31, 2009, must, by February 1, 2010, file this Form to report certain additional information that is current as of December 31, 2009. See Rule 2203(a)(3) and General Instruction No. 4 below. A special report shall be deemed to be filed on the date that the Firm submits a Form 3 in accordance with Rule 2203 that includes the signed certification required in Part ~~XVIII~~ of Form 3.
4. Required Filing to Bring Current Certain Information for Firms Registered as of December 31, 2009. If the Firm is registered as of December 31, 2009, the Firm must file a special report on this Form no later than February 1, 2010, to report the information specified below, to the extent that it has not been reported on the Firm's Form 1 filing. The Firm must make this Form 3 filing to report the following information even if the Firm has previously informally disclosed the information to the *Board* or its staff-
 - a. Information responsive to Items 2.4 through 2.9 and Item 4.1 if (1) the proceeding is pending as of December 31, 2009, and (2) the defendants or respondents as of that date include either the Firm or a person who is a partner,

shareholder, principal, owner, member, or *audit* manager of the Firm as of that date;

b. Information responsive to Items 2.10 and 4.2 if (1) the conclusion of a proceeding as to any party specified there occurred after the date used by the firm for purposes of General Instruction 9 to Form 1 and before December 31, 2009, and (2) the proceeding resulted in any conviction of, judgment against, imposition of any liability or sanction on, or *Commission* Rule 102(e) order against the Firm or any person who is a partner, shareholder, principal, owner, member, or *audit* manager of the Firm as of December 31, 2009;

c. Information responsive to Items 2.11 and 4.3 if the Firm is the subject of a petition or proceeding described there as of December 31, 2009;

d. Information responsive to Items 2.12 through 2.14 and Part V if (1) the relationship commenced after the date used by the firm for purposes of General Instruction 9 to Form 1, (2) the specified disciplinary sanction or *Commission* Rule 102(e) order continued to be in effect as of December 31, 2009, and (3) the specified relationship continues to exist as of December 31, 2009;

e. Information responsive to Items 2.15 and 6.1 if (1) the loss of authorization relates to a jurisdiction or authority identified in Item 1.7 of the Firm's Form 1 and, (2) as of December 31, 2009, the Firm continues to lack the specified authorization in that jurisdiction;

f. Information responsive to Items 2.16 and 6.2 if the license or certification is in effect as of December 31, 2009; and

g. Information responsive to Items 2.17 and 2.18 and Part VII that is current as of December 31, 2009 to the extent that it differs from the corresponding information provided on the Firm's Form 1.

5. Completing the Form. A firm filing this Form must always complete Parts I, II, and ~~XVIII~~ of this Form. Parts III through VII should be completed to the extent applicable, as described more fully in the instructions to Part II of the Form.
6. Amendments to this Report. Amendments shall not be filed to update information in a filed Form 3 that was correct at the time the Form was filed, but only to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required to be provided at the time the Form was filed. When filing a Form 3 to amend an earlier filed Form 3, the Firm must supply not only the corrected or supplemental information, but must include in the amended Form 3 all information, affirmations, and certifications that were required to be included

in the original Form 3. The Firm may access the originally filed Form 3 through the *Board's* Web-based system and make the appropriate amendments without needing to re-enter all other information.

[Note: The *Board* will designate an amendment to a special report as a report on "Form 3/A."]

7. *Rules* Governing this Report. In addition to these instructions, the *rules* contained in Part 2 of Section 2 of the *Board's rules* govern this Form. Please read these *rules* and the instructions carefully before completing this Form.
8. Requests for Confidential Treatment.> The Firm may, by marking the Form in accordance with the instructions provided, request confidential treatment of any information submitted in Item 3.1.c, Part IV, Part V, Item 6.1.d, Item 7.1.d, or Exhibit 99.3 of this Form that has not otherwise been publicly disclosed and that either contains information reasonably identified by the Firm as proprietary information or that is protected from public disclosure by applicable laws related to confidentiality of proprietary, personal, or other information. See Rule 2300. If the Firm requests confidential treatment, it must identify the information in Item 3.1.c, Part IV, Part V, Item 6.1.d, Item 7.1.d, or Exhibit 99.3 that it desires to keep confidential, and include, as Exhibit 99.1 to this Form, a representation that, to the Firm's knowledge, the information for which confidential treatment is requested has not otherwise been publicly disclosed, and a detailed explanation of the grounds on which the information is considered proprietary or a detailed explanation of the basis for asserting that the information is protected by law from public disclosure and a copy of the specific provision of law that the Firm claims protects the information from public disclosure. If the Firm fails to include Exhibit 99.1, or includes an Exhibit 99.1 that fails to comply with Rule 2300(c)(2), the request for confidential treatment may be denied solely on the basis of the failure. The *Board* will normally grant confidential treatment requests for information concerning non-public disciplinary proceedings. The *Board* will determine whether or not to grant other confidential treatment requests on a case-by-case basis. See Rule 2300(c).
9. Assertions of Conflicts with Non-U.S. Law. If the Firm is a *foreign registered public accounting firm*, the Firm may, unless otherwise directed by the *Board* pursuant to Rule 2207(e), decline to provide certain information required by this Form if the Firm could not provide such information without violating non-U.S. law and the Firm proceeds in accordance with Rule 2207. The Firm may withhold responsive information on that basis from any Part of the Form other than Parts I, II, and ~~XVIII~~, and Items 7.1.a, 7.1.b, 7.1.c, and 7.2. If the firm withholds responsive information, the Firm must indicate, in accordance with the instructions in the relevant Part of the Form, the particular Items with respect to which the Firm has withheld responsive information. The Firm may not

use the Form to make any general assertion that a particular requirement may conflict with non-U.S. law, but only to indicate that, on the basis of an asserted conflict, the Firm has in fact withheld from this Form required information.

10. Language. Information submitted as part of this Form, including any exhibit to this Form, must be in the English language.

* * *

Part VIII – MATERIAL EVENT REPORTING

Item 8.1 Any event or matter that poses a material risk, or represents a material change, to the firm’s organization, operations, or provision of audit services.

If there has been any event or matter that poses a material risk, or represents a material change, to the firm’s organization, operations, liquidity or financial resources, or provision of audit services, indicate by checking this box and provide a brief description of the event. Such events or matters would include, but would not be limited to:

- **Any event or matter that has or is reasonably likely to materially impact the firm’s total revenue as reported in its last Form 2 filing;**
- **A determination that there is substantial doubt about the firm’s ability to continue as a going concern;**
- **Planned or anticipated acquisition of the firm, change in control, or restructuring, including external investment and planned acquisition or disposition of assets or of an interest in an associated entity;**
- **Entering into or disposing of a material financial arrangement that would affect the firm’s liquidity or financial resources (such as a line of credit, revolving credit facility, revolver, loan, or other financing), or group of related arrangements;**
- **Any actual or anticipated non-compliance with loan covenants;**
- **Material changes in the insurance or loss reserves of the firm and material changes related to captive insurance or reinsurance policies including events that triggered material claims on such policies;**
- **Material changes in the amount of unfunded pension liabilities;**
- **The firm has entered into, or plans to enter into, a definitive agreement or other arrangement that would cause a material change to the firm’s operations or provision of services (e.g., spinning off consulting business or severing a portion of the business for private equity involvement);**

- That the firm has obtained a license or certification authorizing the firm to engage in the business of auditing or accounting and which has not been identified on any Form 1 or Form 3 previously filed by the firm, or there has been a change in a license or certification number identified on a Form 1 or Form 3 previously filed by the firm;
- A change in principal executive officer; or
- Any other planned or anticipated material amendments or changes to the firm's organization, legal structure, or governance.

Item 8.2

With respect to Form 2, Item 1.4(f), if such a person as is described in Form 2, Item 1.4(f) is appointed, resigns, is dismissed, ceases to meet the criteria to be a person designated in Item 1.4(f), or changes roles, report the date of such event, and whether the change was recommended or approved by any governing board or management committee.

Part IX – SIGNIFICANT CYBERSECURITY INCIDENT REPORTING

Item 9.1 If there has been a cybersecurity incident, or related group of incidents, that have significantly disrupted or degraded the firm's critical operations, or are reasonably likely to lead to such a disruption or degradation; or those that have led, or are reasonably likely to lead, to unauthorized access to the electronic information, communication, and computer systems (or similar systems) ("information systems") and networks of interconnected information systems of the firm in a way that has resulted in, or is reasonably likely to result in, substantial harm to the audit firm or a third party, such as companies under audit or investors, indicate by checking this box and providing a brief description of the event. Such incidents or related group of incidents are deemed "significant cybersecurity incidents."

Note: The filing deadline for Item 9.1 item is five business days. For purposes of responding to Item 9.1, the five business days begins to run on the day the firm determines that the cybersecurity event is significant. This item is confidentially reported.

PART ~~X~~ VIII- CERTIFICATION OF THE FIRM

Item ~~8~~10.1 Signature of Partner or Authorized Officer

This Form must be signed on behalf of the Firm by an authorized partner or officer of the Firm including, in accordance with Rule 2204, both a signature that appears in typed form within the electronic submission and a corresponding manual signature retained by the Firm. The signer must certify that -

- a. the signer is authorized to sign this Form on behalf of the Firm;

- b. the signer has reviewed this Form;
- c. based on the signer's knowledge, this Form does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading; and
- d. either -
- 1 based on the signer's knowledge, the Firm has not failed to include in this Form
 - . any information or affirmation that is required by the instructions to this Form, with respect to the event or events being reported on this Form, or
 - 2 based on the signer's knowledge -
 - .
 - (A) the Firm is a *foreign registered public accounting firm* and has not failed to i the event or events being reported on this Form, except for information or ;
 - (B) with respect to any such withheld information or affirmation, the Firm has r 2207(c); and
 - (C) the Firm has indicated, in accordance with the instructions to this Form, each

{The signature must be accompanied by the signer's title, the capacity in which the signer signed the Form, the date of signature, and the signer's business mailing address, business telephone number, business facsimile number, and business email address.}

PART ~~XI~~ - EXHIBITS

To the extent applicable under the foregoing instructions, each special report must be accompanied by the following exhibits:

Exhibit 99.1	Request for Confidential Treatment
Exhibit 99.3	Materials Required by Rule 2207(c)(2)-(4) - <i>Submit Only as an Exhibit to an Amended in Response to a Request Made Pursuant to Rule 2207(d)</i>

Form QCPP [new]

General Instructions

1. **Submission of this Report.** A *registered public accounting firm* must use this Form to file with the *Board* the report on quality control policies and procedures required by Rule 2203B and to file any amendments to such report. Unless otherwise directed by the *Board*, the Firm must file this Form, and all exhibits to this Form, electronically with the *Board* through the *Board's* Web-based system.
2. **Defined Terms.** The definitions in the Board's rules and in [QC 1000], *A Firm's System of Quality Control*, apply to this Form. Italicized terms in the instructions to this Form are defined in the Board's rules or [QC 1000], as the case may be. In addition, as used in the instructions to this Form, the term "the Firm" means the registered public accounting firm that is filing this Form with the Board.
3. **When Report is Required and Considered Filed.** The report on this Form is required to be filed on or before the date specified in Rule 2203B. This Form shall be deemed to be filed on the date that the Firm submits a Form QCPP in accordance with Rule 2203B that includes the signed certification required in Part IV of Form QCPP.
4. **Amendments to this Report.** Amendments shall not be filed to update information in a filed Form QCPP that was correct at the time the Form was filed, but only to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required to be provided at the time the Form was filed. When filing a Form QCPP to amend an earlier filed Form QCPP, the Firm must supply not only the corrected or supplemental information, but also must include in the amended Form QCPP all information and certifications that were required to be included in the original Form QCPP. The Firm may access the originally filed Form QCPP through the Board's Web-based system and make the appropriate amendments without needing to re-enter all other information.
[Note: The Board will designate an amendment to a Form QCPP as a report on "Form QCPP /A."]
5. **Rules Governing this Report.** In addition to these instructions, the rules in Part 2 of Section 2 of the *Board rules* govern this Form. Read these *rules* and the instructions carefully before completing this Form.
6. **Language.** Information submitted as part of this Form, including any exhibit to this Form, must be in the English language.

PART I – IDENTITY OF THE FIRM

Item 1.1 Name of the Firm

- a. State the legal name of the Firm.
- b. If different than its legal name, state the name or names under which the Firm issues audit reports, or issued any audit report during the reporting period.

Part II – GENERAL INFORMATION CONCERNING THIS REPORT

Item 2.1 Amendments

If this is an amendment to a report previously filed with the Board -

- a. Indicate, by checking the box corresponding to this item, that this is an amendment.
- b. Identify the specific Item numbers of this Form (other than this Item 2.1) as to which the Firm's response has changed from that provided in the most recent Form QCPP or amended Form QCPP filed by the Firm.

PART III – FIRM'S QUALITY CONTROL POLICIES AND PROCEDURES

Item 3.1 Quality Control Policies and Procedures under [QC 1000]

Furnish, as Exhibit 3.1, a narrative, summary description, in a clear, concise and understandable format, of the quality control policies and procedures of the Firm pursuant to [QC 1000].

Note: The Firm should not provide the Board with its entire internal quality control manual in response to this Item, but should prepare a brief document that addresses its quality control policies and procedures as they relate to [QC 1000]. Specifically, the description should provide an overview of the Firm's policies with respect to roles and responsibilities; the firm's risk assessment process; governance and leadership; ethics and independence; acceptance and continuance of engagements; engagement performance; resources; information and communication; the monitoring and remediation process; evaluating and reporting on the QC system; and documentation.

PART IV – CERTIFICATION OF THE FIRM

Item 4.1 Signature of Partner or Authorized Officer

This Form must be signed on behalf of the Firm by an authorized partner or officer of the Firm including, in accordance with Rule 2204, both a signature that appears in typed form within the electronic submission and a corresponding manual signature retained by the Firm. The signer must certify that -

- a) the signer is authorized to sign this Form on behalf of the Firm;

- b) the signer has reviewed this Form;
- c) based on the signer's knowledge, this Form does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading; and
- d) based on the signer's knowledge, the Firm has not failed to include in this Form any information or affirmation that is required by the instructions to this Form.

The signature must be accompanied by the signer's title, the capacity in which the signer signed the Form, the date of signature, and the signer's business mailing address, business telephone number, and business email address.

PART V – EXHIBITS

Each report must be accompanied by the following exhibit:

Exhibit 3.1 Statement of Quality Control Policies [and Procedures]

Note: Where an exhibit consists of more than one document, each document must be numbered consecutively (e.g., Exhibit 3.1.1, Exhibit 3.1.2, Exhibit 3.1.3, etc.), and the firm must provide a list of the title or description of each document comprising the exhibit.