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

2 January 2025

Re: File Reference No. PCAOB-2024-06

Dear Ms. Countryman:

Ernst & Young LLP (EY or EY US) is pleased to provide comments to the Securities Exchange Commission (SEC or Commission) on the final rule that was adopted by the Public Company Accounting Oversight Board (PCAOB or Board) (PCAOB- 2024-06) and filed with the SEC in Release No. 34-101724, *Notice of Filing of Proposed Rules on Firm and Engagement Metrics and Related Amendments to PCAOB Standards*. We appreciate the opportunity to participate in the comment process to share our perspectives with the Commission.

We have been and continue to be supportive of the PCAOB's efforts to modernize its standards and rules. While we appreciate the changes that the Board has incorporated into the final rule from the April 2024 proposal, we continue to have concerns about the metrics and other requirements created by this rule.

The rule introduces a new public oversight model to issuer audits that, in our opinion, has not been adequately studied and is based on metrics susceptible to misinterpretation and misuse that will be costly to produce. The rule also has the potential of disrupting the model established by the Sarbanes-Oxley Act of 2002 (SOX) for auditor oversight by an independent audit committee and also does not properly address the information needs of audit committees.

We and other stakeholders had raised serious concerns in comment letters to the PCAOB on the proposed rule that were not properly evaluated. We believe that any rulemaking that requires audit firms to incur substantial costs and potentially changes the competitive landscape and behavior of auditors, as well as influence the decisions of audit committees, investors, regulators and others, needs to be carefully evaluated. It also should follow an evidence-based approach and consider all reasonable alternatives.

We believe alternatives to the PCAOB's final rule, such as those proposed in our comment letter, [1] could provide meaningful benefits that are consistent with and support the historically successful oversight model established under SOX.

Therefore, we respectfully request that the SEC disapprove the rule and further refer the Commission to our views expressed in our comment letter to the PCAOB.

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1 EY US comment letter to the PCAOB on its proposed rule on firm and engagements metrics.

Metrics without adequate context are misleading

We have historically supported the concept of publicly reporting firm metrics through voluntary disclosure. The metrics we include in our annual audit quality report are accompanied by robust context to help readers understand how they relate to our purpose, commitment to audit quality and business strategy. More disaggregated engagement metrics, such as those in the PCAOB rule, require far more context, making it challenging to understand how the metrics are tied to audit performance or quality.

We have consistently expressed our views to the PCAOB that engagement metrics require significant context to promote understanding, especially by readers not entirely familiar with the audit process or the relevant details of a company under audit.[2] We believe that users of this information cannot make better and more informed decisions if they do not have the appropriate context to interpret the metric and understand its relationship to audit performance or audit quality.

Based on our experience, understanding an engagement metric and its implications on audit performance or quality requires a robust two-way dialogue between the audit committee and the auditor, as well as accompanying details that provide the necessary context. Audit committees have access to a significant amount of nonpublic information about the company, which helps them evaluate auditor performance. Further, their assessment of audit quality frequently is based on qualitative factors that are not clearly measurable quantitatively.

Based on interviews and surveys referenced in the rule, the audit committee evaluates the firm's reputation and the auditor's conduct during the audit, including the audit partner's accessibility and ability to address accounting issues on a timely basis and liaise with the firm's national office. While the audit committee may also use related quantitative metrics, they are not as important as qualitative characteristics.[3]

We believe that a metric without the necessary context and background about the audit process provides information that is incomplete and, as such, increases its susceptibility to misinterpretation. One-way, limited narrative disclosure accompanying an engagement metric, as provided in the rule, tasks auditors with an impossible feat, to contextualize a metric to an unknown public audience.

Further, the narrative accompanying the metric may inadvertently include nonpublic information about the issuer or competitive information about the firm.[4] The rule inappropriately dismisses concerns about disclosing sensitive information in the narrative by expecting auditors to tailor the narrative to somehow avoid the issue or exclude the narrative altogether.[5] In both cases, necessary contextual information will be absent and may compound the misinformation problem by leading to more questions

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2 EY comment letters on the Concept Release (2015) and the Proposed rule (2024), PCAOB Rulemaking Docket Matter No. 041.

3 PCAOB Release No. 2024-012, page 159.

4 For example, an increase in lead partner time due to a sensitive and technically complex legal or compensation matter that is determined to not require disclosure but nonetheless impacts the metrics, such as resulting in a decrease in partner involvement the following year. This may put the auditor in the position of having to avoid disclosing confidential information but needing to explain the decrease in partner involvement.

5 PCAOB Release No. 2024-012, Page 139, footnote 173.

that cannot be resolved due to the limited information available to the users. The potential for an adverse impact created by introducing public metrics that are not understood or easily misinterpreted has not been addressed, studied or quantified.

The PCAOB said in its adopting release, "We agree that, as with other financial information made available to investors, some investors may misunderstand the metrics and make poor decisions as a result."[6] We believe the analogy to other financial information is inappropriate and suggests that the Board hasn't sufficiently evaluated the rule's potential to harm investors and other stakeholders.

The connection of financial information to the underlying economics and performance of an issuer is based on broadly accepted financial and economic principles that are accompanied by robust disclosure requirements and involve regular public outreach and dialogue, such as earnings calls or Q&A sessions. The contextual information and access to management to resolve questions provide the public with critical context related to the financial information. Without sufficient context, the information could be misleading and susceptible to misuse.

The rule lacks comparable mechanisms for auditors to provide critical context to the public.[7] Therefore, some investors could be more prone to misunderstanding engagement metrics than financial information and make poorer decisions as a result. We believe this potential impact would significantly detract from the benefits of this rule.

The adopting release dismisses our concerns about the limitations of providing sufficient context for engagement metrics and reiterates the belief that these metrics will benefit decision-making. However, it does not address our concern that the relationship between the metrics and audit performance or quality won't be broadly understood without significant context beyond what the rule contemplates.[8]

The impact of implementing a new oversight model was not fully evaluated

High-quality standards and rules should be evidence-based and finalized only after sufficient outreach to affected stakeholders. As discussed in our comment letter to the PCAOB, the rule should be subject to further study by the Board to address unintended consequences so reasonable safeguards can be incorporated to minimize those risks.[9] This study should seek to substantiate the potential benefits, adequately quantify and justify the costs, or assess the magnitude of unintended consequences and whether there are reasonable alternatives that may be preferable.

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[6] Id. Page 248.

[7] Id. Page 179. This suggests that investor outreach programs could be used to "… raise investors' awareness of the metrics, provide an opportunity for two-way conversation, and encourage them to vote on corporate governance matters or raise concerns outside of the voting process." However, such programs exclude the auditor. There are no outreach programs that are appropriate or have a statutory basis allowing for discussions about individual audits between the auditor and the public. The economic analysis does not address the problem of providing critical context of engagement metrics that is comparable to the disclosure and reporting requirements for financial metrics.

[8] Id. Page 267. Discussion that dismisses our concern that engagement metrics requires a two-way dialogue and relevant information to adequately contextualize to promote understanding. Without addressing the concern, the analysis states, "We believe public disclosure will provide the benefits associated with investor decision-making as well as some benefits related to improved audit committee decision-making."

[9] EY comment letter, page 1.

The rule's scope is significant because it creates a new public reporting and investor oversight model of each issuer's audit process without a statutory basis.[10] This could potentially disrupt the auditor oversight by an independent audit committee established by SOX. The Board believes metrics will influence public decisions, such as proxy votes for audit committee members and auditor ratification, auditor selection by the audit committee and investment decisions.

We believe the use of metrics in such instances represent a significant change in the SOX oversight model, which should be based on considerably more outreach, pilot testing and study. Consequently, more robust and direct evidence gathering should be undertaken to support and justify the implementation of the rules.

The Board had rejected further study of this model and the metrics, saying it would not have meaningful utility and referring to the studies and outreach on audit quality indicators conducted since the 2008 Advisory Committee on the Auditing Profession (ACAP) report.[11, 12] We believe further study is essential before the rule is approved, because there has not yet been any sufficient evidence-based study among stakeholders about the benefits of mandating the public reporting of firm and engagement metrics to facilitate a new investor oversight function through metric analysis.[13]

The PCAOB also indicates that the full impact of this rule may not be realized for years. We believe this is a reason for more prudent study, rather than a reason to rush to adopt a rule.[14] The potential for unintended consequences should be well understood before a rule's adoption. In addition, the evolution of wide-ranging discussions and research over the history of the audit quality indicators project should not serve as the basis for adopting the rule in its final state in lieu of directly studying its potential impact.

Without further study and outreach, it is uncertain how the public and stakeholders will be impacted. We are concerned that the public will assume that regulator-mandated metrics are a reliable proxy for audit quality on which it will base its decisions. The adopting release states that the metrics are imperfect proxies, and they cannot directly measure audit quality and are not intended to do so. However, the public may not appreciate this nuance.[15, 16]

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10 PCAOB Release No. 2024-012, page 167 and 168.

11 Id. Page 261. The analysis also suggests that studying the impact of publicly reporting these metrics could delay the benefits. While accurate, it also has a more important role to avoid unintentional harms such that any final rule does not perpetuate undue damage that may be contrary to the public interest.

12 Id. Page 54. "We do not believe further study is necessary or that our investor protection mission would be served by delaying adoption of the final rules." Note that all the study and comments related to different subject matter and evolving views on audit quality indicators. None of these directly address the impact of a mandated US public reporting model of firm and engagement metrics like the one contemplated in the rule.

13 Id. Page 167. The September 2024 Investor Advisory Group meeting shows that investors are divided about whether investors should oversee the audit at all.

14 Id. Page 261.

15 Id. Page 221. "We acknowledge that the final metrics are imperfect proxies for audit quality."

16 Id. Page 187. "The desired outcomes of the framework depend (to some extent) upon the stakeholders involved, even if there are certain consistent areas of focus. As a result, the final metrics cannot directly measure audit quality. And they are not intended to do so, as — without additional context — it is unlikely they can be interpreted directly as measurements of audit quality. The final metrics are not intended to imply that an increase (decrease) in a particular metric, or a group of metrics, necessarily relates to an increase (decrease) in audit quality. Lastly, we do not believe that the final metrics, individually or taken together, could be appropriately used in isolation to ascertain audit quality at an audit firm or for an audit engagement. For example, some of the most important elements of a high-quality audit, such as application of due care and professional skepticism, are not capable of being entirely measured and quantified directly."

Comments from several investor-related groups have indicated that the metrics will be meaningful to assess audit quality and could increase competition among firms.[17] This demonstrates that even the most engaged investors view these metrics as a picture of audit quality to the degree that they are a good basis for competition. This is a concerning indicator of how these metrics are likely to be misunderstood, which could lead to more confusion about the audit itself. The potential for the rule to cause harm or confusion should be studied before adoption, rather than relying on post hoc monitoring by the PCAOB.

Furthermore, if these metrics become a basis for competition, they could profoundly impact the public perception of individual audits, auditors (including the listed engagement partner) and the issuer. Competitive pressure may lead to a focus on public perception of an ideal or acceptable range and avoiding being seen as an "outlier." This could influence auditor, audit committee and other stakeholders' behavior in unforeseen ways, potentially acting as a distraction or disincentive in decision-making that undermines audit quality.

While the adopting release refers to competition based on the metrics as a benefit, competition could also cause harm by focusing on or rewarding behavior based on misaligned incentives. Moreover, the rule assumes that the capital markets will associate the metrics with greater financial reporting quality, but this has not been studied.[18] In our opinion, a more thorough economic analysis is required to adequately support the suggested benefits of the rule.

Sufficient evidence should be obtained to support the case for the change in the oversight model of issuer audits. There are many unanswered questions about the model's implications, including whether the public has recourse to resolve questions that may arise when interpreting the metrics. The rule specifies that "the new [engagement metrics] will allow users to draw inferences about audits" and provides examples showing that a "heavy" workload for a particular engagement team relative to the firm's average may raise questions about the quality of the work performed or that more industry-specific experience may be a positive signal.[19]

However, user's questions about audit quality like these, and other questions that could arise, may go unaddressed. It is not clear how a potential user would be able to confidently and accurately resolve doubts. For example, how will users determine the deviation that warrants concern or interpret complex interactions of mixed signals, such as a higher workload but more industry experience? If workload was lower because the firm responded to the lead partner taking leave for a month to attend to a family matter by reducing the partner's other responsibilities, is it in the public interest for the partner to disclose a personal matter for context to avoid the possibility of negative public perception and scrutiny?

Also, how influential will users' inferences be to decision-making regarding whether to support the audit committee or divest due to lack of confidence in the audit report? As audits change from year to year, does this mean-based or outlier analysis as described in the adopting release raise ongoing

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[17] Id. Page 29. "Several commenters generally agreed with the PCAOB's rationale for the metrics, including increasing competition among audit firms, including on the basis of audit quality; promoting auditor accountability, which will lead to greater audit quality…"

[18] Id. Page 205.

[19] Id. Page 6.

questions and doubts about the audit and the audit committee? What are the long-term effects of this doubt with respect to the trust and perception of the usefulness of audits? What is the real net benefit or harm at issue?

The economic analysis should squarely address these types of questions. However, the analysis in the final rule avoids these questions. The PCAOB states, "The outcomes of misinterpretation or misuse are difficult to predict because they would be rooted in complex aspects of human psychology."[20] While the analysis recognizes that users will misunderstand or misuse the metrics, this reality is dismissed by the "belief" that the benefits will, on average, improve investors' decision-making and that the PCAOB has "chosen to acknowledge improved decision-making as a benefit."

Evidence-based analysis should be required for a rule of such significance in order to examine its potential impact.

There is insufficient data to adequately assess the costs and benefits to evaluate alternatives

The magnitude of the unintended consequences from adopting this rule remains unclear because there is insufficient data to support the conclusion of the Board's economic analysis that the benefits are worth the associated risks and costs. As explained in our comment letter, we believe the characterization and estimate of the costs in the economic analysis are broadly understated. For example, the Board believes that because firms track and collect data that is similar to the data necessary for the calculations, it will not be too costly to report these metrics. We and several commenters stated that the costs were significantly underestimated and welcomed further engagement.[21] Instead, the quantification of costs remains inadequately supported, relying on indirect evidence of limited relevance.[22] The rule also does not adequately consider whether other recently adopted standards and rules may impart some benefits that could decrease the need for certain metrics or oversight under the rule. For example, the PCAOB's new quality control standard is expected to significantly increase the effectiveness of an audit firm's system of quality control in delivering audits. However, there is not enough time to allow the quality control standard to become effective and assess its impact after implementation, which may dilute the benefits or change the needs of this rule.

While the costs to implement the metrics will be significant, the demand for them is uncertain. There are conflicting views among investors, academics and audit committees on the usefulness of the metrics and the benefits of mandating public reporting. Further, the objective data cited in the economic analysis supports relatively modest or low demand compared to the estimated cost, which may be hundreds of millions of dollars.[23] We believe that there are less costly alternatives for providing broader benefits more directly related to audit quality and enhancing the existing SOX oversight model, including the alternatives we suggested in our comment letter to the PCAOB.

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[20] Id. Page 247.

[21] EY comment letter, Page 12.

[22] PCAOB Release No. 2024-012, Page 227. Section IV.C.2 outreach focuses on indirect evidence from Implementation of Critical Audit Matters requirements from several years ago.

[23] Id. Page 155. The demand for these metrics is unclear. The economic analysis refers to the PCAOB website data, which includes 23,000 unique users during 2023. Some users are PCAOB staff or auditors from a registered firm and some portion who are interested in Form AP information. While there may be more interest in engagement metrics, the current demand for Form AP is relatively low at less than 23,000 users to justify such significant costs.

The rule lacks analysis of the material needs of the potential users

Our comment letter to the PCAOB also expressed the need for the rule to incorporate the concept of materiality and provide related guidance. We believe this is a fundamental principle for public reporting on this scale. However, the PCAOB did not incorporate materiality into the final rule, which requires the use of actual amounts, unless unavailable, that are rounded to the nearest whole number or two decimal places where relevant.[24]

Under the rule, firms must amend filings to correct any inaccurate or omitted information, which creates no tolerance for even de minimis errors. This adds further to the costs and is not aligned with the intended use of the metrics.[25]

The Board said its reason for not including materiality and de minimis thresholds is based on historical experience related to other forms filed with the PCAOB. However, we believe historical experience does not appreciate the significant expansion and potential uses of the reported information. The Board believes that post hoc materiality guidance is a better solution.[26] Therefore, challenges relating to implementing the rule without materiality considerations will not be addressed until after most costs have been incurred.

The final rule inadequately explains whether and how the Board explored the precision needs of the intended users beyond the possibility that precision may be important in certain unspecified cases. The Board acknowledges that "It is possible that the precise numerical values of metrics may be important in some cases, but in general we believe the metrics will be more useful to convey a sense of whether a particular engagement or firm appears fairly typical or is an outlier in one or more respects."[27] Using the metrics to obtain a general "sense" does not seem to align with the high-precision requirements.

A mean-based or outlier analysis does not necessitate the need for high precision. Such an analysis may also limit the usefulness of precise engagement metrics, because most of them will be typical rather than outliers. Therefore, the benefits of the rule may be overstated by the PCAOB and should be subject to further study to align the costs with the material needs of the users.

The precision also seems misaligned with the nature of the subject matter being measured (e.g., estimates and assumptions inherently underlie certain metrics that may appear on their face to be precisely measured). The rule provides no meaningful analysis about the materiality of metrics when considered individually or collectively to support whether or what metrics require higher or lower precision. For example, some metrics may provide sufficient information in the form of ranges or bands that would simplify reporting and incorporate materiality.

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24 Id. Page 50.

25 Id. Page 134.

26 Id. Page 136.

27 Id. Page 44.

We are unaware of any mandatory reporting models of firm and engagement metrics comparable to the one in this rule with which benefits could be reasonably estimated. Without understanding the benefit of actual usage, the economic analysis does not justify the costs associated with high-precision reporting. The Board said it declined to conduct further study, such as pilot programs or stakeholder outreach, that could have been helpful to understand users' material information needs, because it would delay the adoption of final rules.[28] We believe such a study is essential to developing high quality rules, and adequate study and outreach should be undertaken to justify the rule's costs and requirements of precision.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Sincerely,

Ernst + Young LLP

[28] Id. Page 54.