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Sent via e-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms; PCAOB Rulemaking Docket Matter No. 046

Dear Office of the Secretary:

We agree that it is appropriate to revise existing Public Company Accounting Oversight Board (PCAOB or the Board) Quality Control (QC) standards to reflect developments within the profession. Specifically, we believe that a risk- and principles-based approach—aligned with the new International Auditing and Assurance Standards Board (IAASB) and American Institute of Certified Public Accountants (AICPA) quality management standards—will have a positive incremental impact on audit quality. While we believe that the proposed standard generally achieves this objective, we have feedback on specific aspects of the proposal that we believe are necessary to clarify important definitions and concepts, to make the standard more scalable, and to enable firms to implement it more effectively.

General Observations

We generally support the objectives of the proposal as set forth by the Board. Nevertheless, we have concerns about specific requirements that we encourage the Board to address when adopting a final standard. Our specific concerns are explained in detail below and generally stem from certain requirements unnecessarily deviating from other, recently adopted quality management standards and the lack of scalability within the proposed standard.

Existing Quality Management Standards

Nearly all firms that will adopt QC 1000 are also subject to other quality standards, including the recently revised IAASB and AICPA quality management standards. We appreciate the PCAOB aligning with the basic structure and components of the International Standard on Quality Management 1 (ISQM 1) and the Statements on Quality Management Standards 1 (SQMS 1). Alignment between PCAOB standards and existing standards will allow firms to build on the significant time and resources already invested in compliance with the existing quality management standards from other standard-setting bodies. We strongly agree with the statement by the Board in the 2019 Concept Release that "unnecessary differences in QC standards could even detract from audit quality by diverting firms' efforts from focusing on matters of fundamental importance to effective QC systems."

We believe, however, that there are several areas in the proposed standard where the Board introduces unnecessary differences - including incremental specified quality responses. These differences inhibit the scalability of the standard and firms' ability to implement it effectively.

Additionally, we believe that the differences in the structure and definitions, particularly definitions relating to the evaluation of the QC system, will result in unnecessary differences in firms' operations, evaluations, and conclusions on the effectiveness of their QC systems. As proposed, we believe that the PCAOB's standard may lead us to reach different conclusions about the design and operation of our QC system than we would reach under the IAASB and AICPA quality management standards, despite the presence of the same facts and circumstances. This ultimately will promote unnecessary confusion among stakeholders without any clear benefit to audit quality.

We elaborate on our concerns in our responses to the questions below.

Scalability

Scalability is a key component of the proposed QC standard; firms adopting the standard will have vastly different characteristics and risks to consider when applying it to their unique practices. Therefore, it is crucial that the requirements within the proposed standard be scalable to allow individual firms to address the specific risks associated with their practices. A principles-based standard is inherently scalable and should allow firms to identify quality risks unique to their firm and provide responses appropriate to meet the stated quality objectives.

Unfortunately, throughout the proposal, there are numerous prescriptive requirements that not only hinder scalability, but also impose barriers to entry for smaller firms, or continued participation by registered smaller firms, including those seeking to expand their practice beyond 100 issuers. We do not believe that these requirements take into account the unique risks, facts, and circumstances of individual firms or that they necessarily enhance audit quality. Although the proposed prescriptive requirements, such as certain specified quality responses, could be considered good practices for firms to consider during their implementation of the PCAOB's updated standard, they should not be requirements for all firms. We encourage the PCAOB to consider limiting the number of specified quality responses and, if necessary, converting certain specified quality responses to quality objectives, to allow each firm to develop quality responses appropriate to the circumstances and risks for their firm.

We also offer suggestions to improve the scalability of the standard in our responses to specific questions below.

Responses to Specific Questions

Q3. Are the proposed definitions of "firm personnel," "other participants," and "third-party providers" sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.

Other Participants

While the definition of "Other Participants" is sufficiently clear, we believe with respect to the extent of a firm's responsibility over Other Participants the definition is too broad. We recommend that the Board modify the standard to remove Other Participants from specified quality responses, as they are subject to their own QC systems. Instead, the Board should allow individual firms to tailor their quality objectives to cover Other Participants, and then identify the quality risks that arise from the use and participation of Other Participants within the individual firm's audit practice. This would allow firms to consider the specific risks to the achievement of the quality objective and

design appropriate responses based on the level of risk and nature of involvement of Other Participants, as well as other relevant factors.

Q5. Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.

No. We do not see any incremental benefit to the audit quality of engagements within the scope of the PCAOB, and there would certainly be additional costs for firms in that situation to comply with QC 1000, particularly requirements which are incremental to those of other quality management standards. It would likely cause firms with no near-term intention to perform audits under PCAOB standards to deregister with the PCAOB. Additionally, the requirement would add another barrier to entry for potential new firms in the marketplace. A careful study of PCAOB registration statistics further shows a lengthy, sustained, and substantial decline in both the number of registered firms and the number of firms that audit issuers' financial statements. This requirement will only accelerate that decline and thereby reduce competition and incentives to innovate.

Q9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?

As noted above, throughout the proposal there are many prescriptive requirements that could become a barrier to entry for smaller firms, including those seeking to expand their practice beyond 100 issuers. That barrier to entry furthers existing marketplace concentration in audit firms, and thereby reduces incentives for firms to innovate and compete for clients based on audit quality. Additionally, we believe that these prescriptive requirements not only limit scalability, but they also do not necessarily enhance audit quality.

We encourage the PCAOB to consider limiting the number of specified quality responses, and while we believe these items are already addressed with the quality objectives, if the Board insists on specifically addressing these items in the standard, we recommend adjusting the quality objectives within the proposed standard to include these specifics such that each firm can develop quality responses appropriate to the complexity and risks of the firm. By enhancing the quality objectives, we believe the PCAOB will better achieve its objective of scalability and ensure that firms appropriately identify risks and responses to enhance quality within the unique circumstances of their audit practice.

Throughout our responses below, we have noted several specific areas where we find the requirements under QC 1000 to be unnecessarily prescriptive and thus not scalable.

Q12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?

No, we do not believe that the requirements are appropriate as proposed. The proposed QC standard requires that one person have operational responsibility for compliance with ethics and independence requirements as well as monitoring and remediation. While we support the standard requiring these important components of a Firm's QC system, the requirement is overly

prescriptive as drafted. We believe firms with the capacity and resources to bifurcate these responsibilities should be given the option to do so. By requiring firms to limit these roles to a single individual, there may be an unintended consequence of hindering audit quality. Firms should be able to assign operational responsibility for a component to more than one individual. Allowing flexibility will permit individual firms to better align these important QC components with their unique operational structures and will thereby ensure each firm can place accountability at an appropriate level.

Q13. Would firms have difficulty filling the specified roles in light of the proposed requirements?

Yes, particularly for firms with smaller issuer or broker-dealer practices. The release explains that a primary reason animating the requirement that firms designate particular individuals to perform the specified roles is so that PCAOB can directly pursue enforcement actions against the designated individuals for quality control violations. Currently, the PCAOB can only sanction a firm for quality control violations or individuals based on a knowing and reckless contribution to a firm's violation or a failure to reasonably supervise. The proposed standard would lower the threshold for pursuing enforcement sanctions against individuals.

Contrary to the PCAOB's assumption, this approach will have a detrimental effect on audit quality. By coupling the defined responsibilities with an explicitly lowered enforcement threshold, the Board provides an extremely powerful disincentive for the most qualified individuals to accept the specified roles. This concern is not merely theoretical. The PCAOB has a long, well-documented history of focusing the majority of its enforcement actions and sanctions against triennially inspected firms and individuals associated with such firms. Further heightening the risk of enforcement for individuals within these firms will make it harder for them to find talented staff willing to take on the specified roles.

To promote audit quality, the PCAOB should want to incentivize smaller firms to identify those auditors who are best positioned—through their knowledge, skills, and experience—to fulfill and succeed in the specified roles. As envisioned, the proposed standard discourages such individuals from taking on the roles. This is true regardless of whether such individuals will discharge their responsibilities in good faith and with reasonable judgment. It raises the prospect that they will be either investigated for engagement-level failures or, worse, held liable for engagement-level deficiencies cloaked in a quality control robe. The mere threat of heightened enforcement is sufficient to raise the prospect of a career-ending investigation or sanction[1]. Why should qualified auditors be willing to expose themselves personally to such risks by taking on one of the specified roles?

Q16. Should the proposed definition of "quality risks" explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?

Yes. We believe that risks associated with intentional misconduct need to be addressed, and that it is therefore appropriate to include them within the definition of quality risks.

However, as further noted in response to Q17, we believe the current threshold for considering risks of intentional misconduct (i.e., every act of intentional misconduct that could adversely

[1] As the PCAOB is aware, many firms remove individuals who are under investigation by PCAOB enforcement from their roles pending the outcome of the PCAOB's investigation.

impact the achievement of one or more quality objectives) is too low of a threshold and that it should be modified to address the likelihood of potential intentional misconduct. See further discussion below.

Q17. In the proposed definition of "quality risks" should the threshold of "reasonable possibility of occurring" also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?

Yes, the threshold of "reasonable possibility of occurring" should apply to all risks, including risks of intentional misconduct by firm personnel and other participants, and we strongly encourage the Board to modify the proposed definition as such. The PCAOB Release suggests that "limiting risks of intentional misconduct to only those that have a reasonable possibility of adversely affecting achievement of the firm's quality objectives would result in the firm concentrating its efforts on more pervasive and larger risks and not on every conceivable act of misconduct." We believe, however, that focusing quality responses on those quality risks that have a reasonable possibility of occurring, whether due to intentional acts or not, would result in a more effective system of quality control. If firms must address every possible quality risk due to intentional acts, resources and attention could be spread to many risks that are highly improbable. This will detract from the resources and attention given to risks that are much more likely to occur. Alternatively, we suggest the Board define quality risks as, "risks that, whether due to intentional misconduct or unintentional acts, individually or in combination with other risks, have a reasonable possibility of adversely affecting the firm's achievement of one or more quality objectives if the risks were to occur and have a reasonable possibility of occurring."

Q21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

Yes, we generally support the proposed quality objectives for governance and leadership. Additionally, as mentioned throughout our responses, we believe that the specified quality responses defined in governance and leadership are too prescriptive and do not allow for appropriate scalability for firms. As such, we recommend the Board limit the specified quality responses and, if necessary, adjust the quality objectives accordingly, which will allow firms to establish quality responses based on their design, complexity, and risk.

Q22. For the proposed specified quality response related to the firm's governance structure, is the threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, what is an appropriate threshold?

As we address in our response to Q23 below, we do not believe a specified quality response requiring independent oversight as part of the firm's governance structure is appropriate. However, if the specified quality response remains a part of the final standard, we have concerns with the threshold proposed of 100 issuers.

The PCAOB should consider whether defining a specific numeric cutoff for this or other specified quality responses is sensible over the long term. The proposed numeric cutoff—100 issuers—appears to derive from Section 104(b)(1) of the Sarbanes-Oxley Act and PCAOB Rule 4003, which defines inspection frequency requirements for the PCAOB. The Board may, however, modify the inspection frequency requirements by rule at any time, for example, by raising the threshold to more than 100 issuer audits. Rather than having potentially different numeric thresholds for different PCAOB rules, the PCAOB should consider using a non-numeric threshold

for this and similar proposed requirements if they are to remain in the final standard. Thus, rather than applying the specified quality response to firms with 100 issuers or more, the PCAOB could consider specifying that the response applies to firms that are subject to annual inspection under the PCAOB's rules.

We also encourage the PCAOB to develop a specified annual cut-off date (such as six months before the evaluation date) for firms to evaluate if they are above the stated threshold. Further, we recommend that the PCAOB allow for a transition period (such as 12 months from the cut-off date) for firms that have crossed the threshold to apply the incremental requirements, as it may take firms time to develop a response that is compliant with the requirements of QC 1000. A cut-off date and transition period are similar to the concepts in existing SEC rules for issuers determining their filer status in Rule 12b-2 under the Securities Exchange Act of 1934. With ongoing mergers and market activity, it is reasonably possible that a firm may cross the threshold during a given year. Adding additional clarity on the transition period and cut-off date would be useful for firms who are close to the threshold.

Notwithstanding the foregoing suggestions, we note that this requirement, like several other proposed specified quality responses, imposes a barrier to entry for firms that wish to expand their audit practices beyond 100 issuers and thereby further contributes to marketplace concentration and reduces incentives to innovate and compete on audit quality. Why should a firm with 101 issuer clients be treated differently than a firm with 99 such clients?

Q23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?

No, we do not support the independent oversight function as written in the proposal. An independent oversight function is a broad role with no clear definition or defined benefit to audit quality. A firm may hire independent advisors to provide guidance on certain areas of the system of quality, but those advisors should be determined by the risk and complexity of the firm and not a specified quality response in the proposed standard.

The specified quality response is prescriptive in nature and does not allow for the firm to apply appropriate risk factors when determining if or when an independent advisor is warranted. For example, based on risk factors, the firm may determine that more than one independent advisor is warranted to consult in different areas of focus. The PCAOB should consider removing the requirement in the specified quality response and, if necessary, draft a quality objective for firms to respond to based on their own unique risks, circumstances, and characteristics.

Additionally, requiring this specified quality response for firms that issue audit reports for more than 100 issuers serves as a disincentive for firms to approach or exceed the defined threshold. It thereby furthers the already problematic marketplace concentration in firms that audit issuers and reduces the incentive for firms to innovate and compete based on audit quality.

Q27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?

No, we do not believe the specified quality responses for ethics and independence requirements are appropriate as proposed.

First, the specified response in .34a(1) would require firms with more than 100 issuers to have an automated process for identifying direct and material indirect financial relationships that may impair a firm's independence. We believe that this specified response would require significant resources to implement and maintain a process, without necessarily providing a benefit to quality. The PCAOB should consider adjusting the proposal to remove the specified quality response and, if necessary, implement a quality objective that firms could address through their risk assessment process. We believe that the cost to implement and maintain an automated system may deter firms from growing their practice up to and over the threshold. We also believe that some firms that may be subject to this requirement will consider decreasing the size of their practice due to the cost of this specified quality response.

Second, the specified quality response in .34b requires updating and communicating the list of restricted entities at least monthly to firm personnel and others performing work on behalf of the firm who are subject to independence requirements. While we believe that the list should be updated for known changes and always made available, we believe that monthly communication may not be an appropriate quality response for all firms. Some firms may not have frequent changes to the list, or if they do have frequent changes, they may have other quality responses that are more valuable and accretive to audit quality than simply communicating the changes monthly. We believe that the PCAOB should consider removing the specified quality response and, if necessary, implement a quality objective where firms may determine the appropriate response based on their unique risks, circumstances, and practices.

Q28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?

No, we do not believe that the proposed specified quality response is appropriate as written, as identified in Q28 above. The best way to promote audit quality and scalability would be for the PCAOB to remove the specified quality response and, if necessary, implement a quality objective for firms to develop a quality response appropriate for the size, complexity, and risks of their firm. Implementation of this specified quality response may be costly for firms and discourage them from growing their public company practice.

Additionally, the SEC already has certain automated independence requirements for firms that audit more than 500 issuers in SEC Regulation S-X Rule 2-01(d)(4).[2] If this specified quality response remains a part of the final standard, we encourage the PCAOB to align the requirements in QC 1000 with the existing SEC requirement by increasing the threshold to 500 issuers. Firms below the 500-issuer threshold could still be encouraged to implement this quality response based on their risk assessment, but it should not be mandatory.

Moreover, requiring this specified quality response for firms that issue audit reports for more than 100 issuers will serve as a disincentive for firms to approach or exceed the defined threshold. It

[2] Regulation S-X Rule 2-01(d)(4)(ii) states:

> *For an accounting firm that annually provides audit, review, or attest services to more than 500 companies with a class of securities registered with the Commission under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), a quality control system will not provide such reasonable assurance unless it has at least the following features: … (ii) With respect to partners and managerial employees, an automated system to identify their investments in securities that might impair the accountant's independence; …*

thereby furthers the already problematic marketplace concentration in firms that audit issuers, which in turn reduces incentives to innovate and compete based on audit quality.

Q29. Is the proposed specified quality response related to communication of changes to the list of restricted entities at least monthly (and more frequently, if appropriate) to firm personnel and others performing work on behalf of the firm who are subject to independence requirements appropriate? Could communication to a more limited group accomplish the goal of alerting all individuals whose actions and relationships are relevant to independence? If so, to whom should changes be communicated?

No, a specified quality response related to communication of changes to the list of restricted entities at least monthly to firm personnel and others performing work on behalf of the firm who are subject to independence requirements is not appropriate as currently proposed, as identified in Q27 above. We encourage the PCAOB to remove the specified quality response, and if necessary, implement a quality objective in order to promote scalability and allow firms to implement an appropriate quality response.

However, if the PCAOB maintains the specified quality response, we suggest at a minimum that the response be changed to limit the monthly communication to "additions to the list of restricted entities" rather than "changes to the list of restricted entities." Communication also should be limited to potential covered persons affected by the additions to the list of restricted entities.

Q30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?

No. It should not be necessary for a firm to adopt a specific quality response that includes a certification process for ethics requirements and procedures. Firms should be permitted to adopt a quality response that addresses the risks within their own practice and that fits within the culture, risk, and complexity of their firm. A certification requirement that applies to all firm practice staff on this topic could turn into a "check-the-box" compliance exercise that would not benefit audit quality.

Q34. Should we include specified quality responses for the engagement performance component? If so, what should they be?

No. We believe that the quality objectives and other requirements in the proposal provide sufficient guidance for firms to perform a detailed risk assessment and develop appropriate quality responses, without the need for specified quality responses.

Q38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?

We agree that consideration of the competencies of an engagement partner is an important element of a QC system. As a QC system is designed to provide reasonable assurance that engagements are completed in accordance with applicable professional and legal requirements and the firm's policies and procedures, it is redundant to include the specific engagement partner

competencies listed in paragraph .47. Further, by listing such competencies, the standard may risk omitting consideration of other important competencies necessary to promote audit quality, such as client specific risks or processes. As stated in QC40.08, "the kinds of competency requirements that a firm should establish for the practitioner-in-charge of an engagement are necessarily broad and varied in both nature and number." Lastly, the proposed language is unclear as to the specific expectation to "obtain and maintain the competence…including an *understanding* of…," emphasis placed on understanding, rather than using the language in QC40 to "address the following competencies."

We recommend that the paragraph be rewritten to state that "the firm should design, implement, and maintain policies and procedures for the engagement partner and, commensurate with their responsibilities, others participating in an engagement to obtain and maintain the competence to fulfill their respective assigned engagement roles" and consider incorporating .47a – h in the objectives. Additionally, paragraph .47 should include consideration or acknowledgment of other factors that could also be relevant in fulfilling assigned engagement roles in order to promote completeness, similar to the language in QC40; "should also address other competencies as necessary in the circumstances."

Q39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients? If yes, what should the requirement be?

No. Technological resources are used to enable the operation of the firm's QC system and the performance of its engagements, as described in .44h. As part of planning and executing an audit, the client's information technology systems are considered in assessing risk and responding to such risk. By implementing a specified quality response requiring the use of technological resources by the firm to respond to the risks related to the use of client technology, the proposed standard would limit firms' ability to adequately respond to identified risks.

Q40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

No, the proposed quality objectives for information and communication are not appropriate. Refer to response to Q41 below for suggested changes.

Q41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?

Given that the PCAOB has a current research project on firm and engagement performance metrics, we recommend that this requirement be removed from the proposed standard so that it can be considered through the ongoing research project. We believe that it is important to address the completeness and accuracy of a firm's public external communications regarding firm-level and engagement-level information and believe that additional clarification on the scope of such communications is needed. We also recommend that the scope of the requirement be limited to metrics related to audit quality that are required to be communicated under applicable professional, legal, or other regulatory requirements and are communicated publicly.

Q43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.

Yes, we believe that requiring other participant firms to share the most recent evaluation of their QC system and a brief summary of remedial actions is inconsistent with the Congressional intent behind Sarbanes-Oxley Section 105(b)(5)(A).[3] However, this concern would be alleviated if the definition of QC deficiency were updated, as we suggest in our response to Q53. We also have practical concerns regarding the application of this requirement to other participants that are not registered with the PCAOB (e.g., network firms that are not registered with the PCAOB).

Q47. Is it appropriate to require monitoring of in-process engagements by firms that issue audit reports with respect to more than 100 issuers during a calendar year? If not, is there a more appropriate threshold?

We agree that monitoring of in-process engagements can be beneficial, not only by providing timely feedback to the specific engagement team, but also by providing the firm early warning of developing quality risks and/or responses that may not be operating effectively. We are also supportive of the scalability described in the Release, allowing firms to design their in-process monitoring based on the nature and circumstances of the firm. Given the ability of firms to determine the extent of their in-process monitoring activities, we do not believe a threshold based on the number of issuers is necessary.

Q53. Are the proposed definitions for "engagement deficiency," "QC finding," and "QC deficiency" sufficiently clear and appropriate? If not, what changes should be made and why?

As discussed above, we have concerns regarding the definitions as currently proposed. The definitions should be part of the basic framework of our system of quality, however, the definitions in QC 1000 differ from those in ISQM 1 and SQMS 1, such that the standards differ at a foundational level. These differences are unnecessary and will promote confusion in application.

Due to the differences in the definitions between QC 1000 and the existing standards, firms will experience differences in both the operation of the QC system, as well as potentially the conclusion on the overall effectiveness of the QC system. Different conclusions on the effectiveness of the QC system under different standards will be confusing to stakeholders (for example, in communications to the audit committee), particularly those who do not understand the nuances of the standards, and therefore ultimately will not serve the public interest. Additionally, we do not believe that the differences in the definitions provide any benefit to audit quality that would outweigh the difficulties for the firm and the potential confusion for the public. As such, we strongly recommend that the PCAOB align the definitions of QC finding and QC deficiency with ISQM 1 and SQMS 1.

<u>QC Finding</u>

The proposed QC 1000 definition includes the statement that "engagement deficiencies are QC findings."

[3] https://pcaobus.org/About/History/Documents/PDFs/Sarbanes_Oxley_Act_of_2002.pdf

Not only does this not align with ISQM 1 and SQMS 1, but the Board itself has recently adopted the position that not all engagement deficiencies that it finds in inspections rise to the level of a QC finding. Thus, the definition appears to contradict even the Board's approach to evaluating engagement deficiencies. Additionally, it removes the firm's ability to apply judgment in evaluating engagement deficiencies and their root causes. We believe that there can and will be instances where engagement deficiencies should not rise to the level of a QC finding after appropriate root cause analysis is performed. We recommend this portion of the proposed definition of QC finding be removed in the final standard.

QC Deficiency

The proposed definition of a QC deficiency in QC 1000, states that a QC finding that results in a "reduced likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives" would rise to the level of a QC deficiency. The definition of a QC deficiency under ISQM 1 and SQMS 1 indicates that a response, or combination of responses that does not "reduce to an acceptably low level" the likelihood of a related quality risk occurring because the response(s) is not properly designed, implemented, or operating effectively would indicate a QC deficiency. We believe that reduce "to an acceptably low level" is an appropriate threshold to apply in evaluating whether a QC finding rises to the level of a QC deficiency. This is consistent with the reasonable assurance objective and the overall risk-based approach to quality control. Conversely, the proposed definition implies that even an insignificant reduction in likelihood of achieving the reasonable assurance objective would be a QC deficiency, even if the firm concludes that responses collectively still reduce likelihood to an acceptably low level.

Another deviation in the proposed definition of QC deficiency in QC 1000 from the definition in ISQM 1 and SQMS 1 is the statement that "noncompliance with requirements of this standard, other than those under 'Documentation' would automatically rise to the level of a QC deficiency." We believe that there may be instances where the firm may not comply with a requirement in the standard, but the quality objectives and specified quality responses were met, and a firm should be able to apply judgement to determine whether a QC deficiency exists under the circumstances.

Based on the lower threshold for a QC finding to rise to the level of a deficiency under the proposed QC 1000 than under ISQM 1 and SQMS 1, we believe firms would have more QC findings rising to the level of a QC deficiency under QC 1000. This could result in firms reaching different conclusions about the effectiveness of their systems of quality control under QC 1000 and ISQM 1/SQMS 1. As stated above, this could lead to confusion among stakeholders and does not serve the public interest.

Finally, as we compare QC 1000 to SOX, we believe that a QC deficiency should be comparable to a significant deficiency under SOX, and we encourage the Board to revise the proposed definition to meet this objective.

Q57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?

No, an evaluation date as of November 30th is not appropriate. We believe this is another unnecessary deviation from ISQM 1 and SQMS 1 without any commensurate benefit to quality. The evaluation date should not be prescribed by the PCAOB and should instead be up to each individual firm to select based on the design and operation of their system of quality. Some firms

have already implemented ISQM 1 and selected evaluation dates different from November 30th and many have used their fiscal year-ends or quality year-ends as the evaluation date. Requiring a specific evaluation date could lead firms to perform assessments twice in one year, as monitoring and remediation may cross reporting periods, creating unnecessary complexity, or resulting in a detrimental impact to audit quality.

We believe that any required evaluation date may be problematic for firms, as all firms are unique in the design and operation of their system of quality. Under ISQM 1 and SQMS 1, firms select an evaluation date that best fits their quality management processes and response structures, which are typically aligned to the firm's fiscal year-end and business cycle.

Additionally, specific to the November 30th date, for some firms there may be a conflict with the timing of external inspections field work, which would make it difficult for the firm to consider external inspection results in the overall assessment of the system of quality. Additionally, internal inspections finish for some firms around that time, and firms would not have sufficient time to perform root cause analysis or determine any remedial actions prior to evaluation and certification deadlines. The quality control standards are intended to improve audit quality and we therefore believe that this unintended negative impact to audit quality should be carefully considered by the Board. The prescribed evaluation date is an unnecessary difference between QC 1000 and other standards that would cause additional work and create complexities for firms implementing the standard.

Based on the above, we suggest that the proposal should allow firms to select their own evaluation dates, as is permitted under ISQM 1 and SQMS 1. Firms will be able to select a date that fits best with their business cycle, allowing them to align to compensation and performance decisions, inspections cycles, and engagement performance, monitoring and remediation activities, among other benefits. We believe that this would enhance QC system effectiveness and further the public interest.

Q58. Is the proposed definition of "major QC deficiency" clear and appropriate? If not, what changes should be made and why?

We agree with the concept of a major QC deficiency, which would prevent a firm from concluding that its QC system is effective. Although ISQM 1 and SQMS 1 do not include the category of a major QC deficiency, we believe that if the Board aligns the definitions of QC finding and QC deficiency with those in ISQM 1 and SQMS 1, as recommended above, then the definition of a major QC deficiency is incremental and would not impact the foundation of the standard.

The concept of a major QC deficiency should be like a material weakness under SOX and should encompass severe and pervasive QC deficiencies that prevent the firm from concluding that the QC system is effective. Therefore, when determining if a major QC deficiency exists, a firm should evaluate the severity and pervasiveness, which is consistent with the concepts for evaluating QC deficiencies in ISQM 1 and SQMS 1.

We propose that the major QC deficiency definition be updated to "a severe and pervasive un-remediated QC deficiency or combination of un-remediated QC deficiencies, based on the evaluation under paragraph .78, that prevents the firm from concluding that the firm has achieved the reasonable assurance objective of one or more quality objectives."

Q59. Is it appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist? Are the circumstances described in the proposed definition appropriate? Should there be other circumstances that give rise to such a presumption? If so, what are they?

No, we do not believe it is appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist. We believe that this requirement is too prescriptive and does not allow for firms to apply appropriate judgement to evaluate the potential issue. We recommend that the proposed definition be updated to remove the language.

Q61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

We support the proposed requirement to report the firm's evaluation of its QC system to the PCAOB, and we agree with the proposal to make the contents of the new Form QC nonpublic for the reasons stated in the proposal. Although we support the proposed Form QC, we believe the PCAOB should make one critical change to the proposed standard. The PCAOB should clarify that firms submit Form QC "in connection with an inspection under [SOX] Section 104." Because Form QC is to be non-public and will be used by the PCAOB to facilitate its inspections-based oversight of registered firms, Form QC should receive the same confidentiality protections of SOX Section 105(b)(5)(A) that other inspections-based documents and information receive.

Q62. Should we require individual certifications of the evaluation of the QC system? Is the language in Appendix 2 regarding the certifications appropriate? If not, why not?

We support the requirement for firm leadership to demonstrate their ultimate responsibility for the QC system through individual certification. The proposal does not specify the standard by which the PCAOB could hold an individual liable for making a certification on Form QC that is later determined to be inaccurate. It is our understanding that for certification by senior executives under SOX, courts have decided that a SOX Section 302 certifier can be held personally liable for an inaccurate statement in a certification only if they made the statement knowing it was false or recklessly not knowing it was false. Given the complexities inherent in the design, operation, and assessment of a QC system, we believe it would be appropriate for the Board to clarify that the same legal standard applies to certifications made on Form QC. That would be consistent as well with the current general standard under Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*.

Q63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?

No, the proposed reporting date of January 15th is not appropriate, nor is any reporting date 45 days after the evaluation date. We do not believe that 45 days provides firms with sufficient time to complete their evaluations and documentation. Performing the evaluation of the QC system will take time and resources, as well as compiling the detailed reporting of QC deficiencies and related remedial actions to the PCAOB and audit committees, which needs to be completed prior to the evaluation date.

Moreover, the period from November 30th to January 15th includes time over the winter holidays, during which many firms are closed and, December and January are key periods for performing

engagement performance activities as well as monitoring and remediation activities. QC resources would need to be involved in those key activities during the December and January period. We believe that the evaluation date of January 15th would ultimately be detrimental to audit quality.

We support a period of 90 days between the evaluation date and reporting date (as proposed in Q64). This would be a better alternative to allow firms to perform thorough and detailed evaluations.

Q64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?

As described above in our response to Q57, we believe the best approach is for firms to select their own evaluation date with a 90-day reporting period, which would likely require a Form QC for reporting.

Q66. Are proposed Rule 2203A, Report on the Evaluation of the Firm's System of Quality Control, and the proposed Form QC instructions included in Appendix 2, clear and appropriate? If not, why not?

The proposed Rule 2203A and the proposed Form QC instructions included in Appendix 2 would be appropriate if the PCAOB revises the definition of a QC deficiency and major QC deficiency as described in responses in Q53 and Q58, respectively.

Further, we recommend that the PCAOB provide guidance regarding amendments to Form QC. We believe that guidance is needed regarding matters for which an amendment would be required, and we encourage the PCAOB to develop a materiality threshold for potential amendments.

Q69. In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?

No, we do not support public reporting of QC matters outside of what is already required by Sarbanes-Oxley (i.e., certain PCAOB Part II inspections comments). To require public reporting would be inconsistent with the delicate balance that Congress struck in Sections 104(g)(2) and 105(b)(5) of the Sarbanes-Oxley Act. A firm should have the flexibility to determine when and how it is appropriate to communicate with external parties regarding QC matters. This allows firms to provide sufficient context about QC matters and their relation to PCAOB Part II inspection reports, if applicable, such that external parties can fully understand the QC matters and are not misled. The needs of external parties vary, and firms should have the ability to tailor communications based on those needs.

Q70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?

No. Requiring firms to communicate to audit committees about their most recent annual QC system evaluations is inconsistent with the Congressional balance struck in Sarbanes-Oxley Section 104(g)(2). Through that section, Congress envisioned that criticisms of or potential

defects in a firm's quality control system would not be subject to public disclosure unless firms failed to remediate them within a period of time. By requiring direct disclosure of such issues to audit committees, the proposed requirement circumvents the careful balance that Congress struck.

Additionally, the requirement to communicate with audit committees on this topic indirectly regulates the actions of audit committees. Whether intended or not, the requirement will impose a fiduciary duty of care on audit committees to understand their specific audit firm's QC system and related deficiencies and to follow-up, as appropriate, with the audit firm. This is regardless of whether potential quality control issues relate in any way to the firm's engagement-level performance for the client or to the client's financial statements. Establishing such a requirement is beyond the scope of the PCAOB's jurisdiction. It also stands in stark contrast to other required audit committee communications, each of which relate directly to the client's financial statements and associated audit and are squarely within the existing duties of an audit committee under the federal securities laws.

If the Board ultimately decides to require communications with audit committees, we believe the communication should be limited to major QC deficiencies. Communication of major QC deficiencies would appropriately direct the focus of the audit committee to significant issues that could impact the auditor's performance and provide decision-useful information for oversight of the auditor.

Q71. Are the proposed documentation requirements appropriate? If not, what changes should be made?

No. We have two recommendations with respect to the proposed documentation requirements.

First, documentation should only be required to be maintained for the period of time necessary to meet its purpose. Most firms, including ours, have instituted policies to minimize unneeded data as an important pillar of our cybersecurity programs. Data minimization is also critical for compliance with various data privacy regulations. In addition, there is a cost to collecting and storing data. This cost may be appropriate if there is a benefit to maintaining that information, but the proposed retention requirements would require firms to maintain data far beyond the period of time it would be relevant, as further described below. We have included this item as a cost of key provisions not considered in the cost analysis within the Release, as further discussed in Q88.

We suggest there be a difference in required retention periods between (a) documentation of design, implementation, and annual evaluation of the QC system, and (b) documentation evidencing the operation of the QC system. Documentation evidencing the operation of the QC system would include documentation of every instance of a quality response activity occurring for the firm during the quality control year. We agree this documentation should be maintained in sufficient detail to meet the experienced auditor threshold. The period for retention of such documentation, however, should only extend until the firm has completed its annual evaluation of the QC system. Some quality response activities occur in the course of performing audit engagements. This documentation is included in the engagement file documentation and is already subject to the audit documentation retention requirements of AS 1215 *Audit Documentation*. Nevertheless, many quality response activities occur outside of the performance of audit engagements. Such information will include potentially sensitive client and employee information, among other potentially sensitive data. For example, the operation of a firm's client acceptance processes may include a background check for key executives. As another example,

the operation of a firm's individual independence processes may include an employee's personal loan and other financial information. We have concerns with maintaining all such documentation, which will likely include sensitive data, for a period of time beyond which it has continuing relevance. This would be inconsistent with the controls most firms would have to address cybersecurity risks and data privacy regulations.

For documentation of design, implementation, and annual evaluation of the QC system, we recommend the required retention period be limited to the time period necessary for the quality control year to be subject to inspection. A period of three years from the documentation completion date should be sufficient.

The PCAOB Release notes that the benefits of retaining documentation for seven years include the fact that remediation activities may span multiple years and actions taken by the firm may be informed by prior actions. In addition, it is noted, such documentation may also be useful for training purposes, ensuring the retention of organizational knowledge, and providing a history of the basis for decisions. Rather than requiring all documentation to be maintained for an extended period of time, firms should determine what documentation has continuing relevance based on the circumstances. Documentation related to matters that have ongoing relevance should continue to be maintained as long as relevance continues.

Second, the proposed standard requires the QC documentation completion date to be the same date as the reporting date (January 15th, as currently proposed). We believe that the documentation completion date should be 45 days after the reporting date, consistent with the documentation completion requirements for audit engagements in AS 1215 *Audit Documentation.* The 45-day documentation completion period would be for the audit firm to assemble the complete and final set of documentation for retention.

Q74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?

Yes, we support the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits. Assessment of omitted procedures/deficiencies related to the ICFR audit is an important procedure to ensure a firm's opinion over an issuer's internal control environment, relied upon by investors, is materially and factually accurate. We believe that this will enhance audit quality and promote the public interest.

Q75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported? If not, why not?

No. We agree with the principle behind this change to AS 2901 as it is intended to promote audit quality. In current practice, most identified engagement deficiencies are remediated, even when the auditor's opinion is not unsupported. But we do not believe that remedial action should be prescribed for all identified engagement deficiencies. It should be left to the firm, based on its understanding of all relevant facts and circumstances, whether to take remedial action and what remedial action, if any, to take. We suggest that there may be some instances, for example, when the issuing of the subsequent year's report is imminent, that remedial actions at the engagement level may not be necessary and thus should not be prescribed by the standard.

As we note in our response to Q53, we do not agree with the proposal that an engagement deficiency should automatically be a firm-level QC finding, which would require firm-level

remediation. We support the remediation of engagement deficiencies at the appropriate level, and to the extent that engagement deficiencies rise to the level of a QC finding or QC deficiency, we support remedial action at the firm level.

Q84. Should we consider any additional academic studies or data related to the need for standard setting?

We recommend the Board perform further outreach with small to medium size firms and small to medium size issuers to determine the cost of the proposed standard in relation to the relative benefits to quality. We agree with the statement included in special consideration for emerging growth companies (EGC) that the indirect costs of the proposal disproportionately impact EGCs relative to their competitors. While we do not believe EGC's should be excluded from the scope of the proposed standard, we do believe that this further enhances the argument for scalability in implementing the requirements of the standard as discussed throughout our responses.

Q87. Does our analysis appropriately capture the potential costs of the proposal? If not, please explain.

No. The analysis provides general information about increased costs for firms to implement. However, we would encourage the Board to evaluate the cost-benefit equation for individual provisions of the proposal, particularly for those requirements which are incremental to ISQM 1 or SQMS 1.

Q88. Are there additional potential costs that should be considered? If so, what are they?

Yes. Under the "Costs of key provisions," the Release does not address two provisions which we think would have significant costs. The requirement for firms with more than 100 issuers to implement an automated process to identify firm and personal relationships with restricted entities would require significant upfront and ongoing investment in technology and other overhead to operate such a process, which we suggest should be considered, specifically in the analysis. In addition, the requirements related to retention of documentation will add technology cost for data storage, and significant other costs related to the capturing and storing of data. Our response to Q71 includes recommendations which would help to minimize the cost (while keeping the benefit of maintaining data for the time period it is useful). The documentation requirements as proposed would cause firms to incur significant additional costs which we suggest should also be specifically included in the analysis.

Additionally, as we addressed in our comments above, as there are several basic differences between the proposed QC 1000 and existing quality management standards ISQM 1 and SQMS 1, we believe that there would be significant incremental operational costs to manage separate systems of quality unless key differences such as definitions and scalability are addressed.

Q90. Are there other potential unintended consequences of the proposal that we have not identified? If so, what are they?

No. We did not identify other unintended consequences beyond those identified in the Release or otherwise discussed in this comment letter. We would like to emphasize, however, the potential negative effect of firms exiting or reducing their extent of participation in the public company audit market or deterring other firms from future entry. We anticipate this will be a likely outcome of the proposed standard, given the significant additional costs all firms will incur with respect to

requirements of the proposal that are incremental to other quality standards. In addition, the costs associated with requirements that incrementally apply to firms with more than 100 issuers could be expected to result in firms resigning from existing audit engagements until they are under that threshold and other firms declining to accept additional engagements that would cause them to be over that threshold. These incremental requirements thereby reinforce existing marketplace concentration in firms that audit issuers, which in turn reduces economic incentives to innovate and compete based on audit quality. We expect it would also lead to increased audit fees for all issuers, which may not have a commensurate increase in benefits through higher audit quality.

The Release suggests that there may be some audit quality benefits as a result of firms exiting the market, by reducing the risk of opinion shopping. We have not experienced significant issues with issuers opinion shopping and would expect that any potential reduction in opinion shopping by limiting the options in the marketplace would be minimal. Additionally, opinion shopping only occurs, if at all, at the very bottom of the marketplace; it is not widespread among even small and medium-sized firms. The Release also suggests that the market is highly competitive. This may not be as true in the current environment as it may have been in the past, given the limited human capital resources available across the entire audit profession.

Q93. Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

Yes, the effective date will likely create challenges for auditors. The proposal sets forth an effective date of "December 15 of the year after approval by the SEC." As the standard may be approved by the SEC as early as 2023, the effective date could be December 15, 2024, with the first evaluation occurring in 2025 (as currently proposed, as of November 30, 2025). This effective date would be difficult for firms, especially for smaller firms that did not implement ISQM 1. As the effective date of the AICPA's SQMS 1 is December 15, 2025, we suggest that the PCAOB propose an effective date that would be 18 months after approval by the SEC and no sooner than December 15, 2025. This would provide firms with sufficient time to implement the proposed standard. Our firm implemented ISQM 1 as of December 15, 2022, and through our experience, it took almost two years to determine and evaluate our quality risks and develop appropriate quality responses. We recognize that many aspects of the proposal align with or are similar to ISQM 1, and much of the same risks and responses would apply to QC 1000, but believe this experience provides us with relevant experience to provide input on the timeline necessary to implement a new quality control standard thoughtfully, thoroughly, and effectively. It is important that the proposed effective date provides sufficient time for all firms to implement the standard appropriately.

If the PCAOB continues with the approach of having incremental requirements for firms with more than 100 issuers, we also encourage the PCAOB to consider a phased implementation for the incremental required quality responses. We believe that firms will need additional time to implement the responses as required in the proposal, particularly the firms which fall just above the 100-issuer threshold. We propose that the PCAOB provide an additional year to implement those incremental requirements (no earlier than December 15, 2026).

We appreciate the opportunity to comment on the proposed QC standard and related amendments. As the Board gathers feedback from other parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter.

Please address any questions to either Christina Moser (christina.moser@plantemoran.com) or Carole McNees (carole.mcnees@plantemoran.com).

Sincerely,

Plante & Moran, PLLC

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