EideBailly

CPAs & BUSINESS ADVISORS

February 1, 2023

Via Email: 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:

Eide Bailly LLP welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) proposed Quality Control (QC) standard, *A Firm's System of Quality Control* (QC 1000) and related amendments. Eide Bailly is a registered public accounting firm serving mid-sized and smaller issuers. We have provided general comments, followed by more specific comments on certain topics raised in the proposal, as well as providing detailed responses to certain of the Board's questions.

General Comments

We are appreciative of the Board's issuance of this proposed standard as a means to improve audit quality by strengthening the quality control processes of the firms performing those audits and agree that the interim standards that have been in place need to be updated. We believe that a risk-based approach aligned with recently issued quality management issued by the International Auditing and Assurance Standards Board (IAASB) and the US Auditing Standards Board (ASB) will achieve the objective of overall improvements in audit quality. While we believe the proposed standard incorporates requirements that will achieve that objective, we also have concerns about certain aspects of the proposal, as described in our following Overall Observations and responses to various specific questions posed in the release.

While we understand and appreciate there are appropriate incremental requirements beyond those in the quality management standards issued by other standard setters for firms performing audits of issuers, we believe that the lack of alignment with those standards results in additional challenges in implementing the standards. This is particularly true for smaller firms that do not have dedicated quality control departments or personnel. Not only do we believe the burden on smaller firms is not offset by a corresponding benefit to audit quality; more importantly, we are concerned this will lead to quality firms exiting the public company audit practice.

Overall Observations

We support the objectives of the proposal as set forth by the Board but have some overarching concerns we believe warrant the attention of the Board prior to the approval and issuance of a final standard.

Scalability

The proposal release include a statement that the quality control standard "should be sufficiently principles-based and scalable that firms could pursue an approach to QC that is appropriate in light of their specific circumstances."[1]

We fully support that statement; however, find numerous instances in which the standard is not principles-based and scalable, rather unnecessarily prescriptive. For example, in addition to the inclusion of quality objectives, consistent with the approach of the above-referenced standard setters, the proposed standards also include a number of "specified quality responses" that would presumably apply to every firm. The notion of a specified quality response suggests that every firm has the same or similar quality risks and that the responses to those risks will also be the same or similar. Given the wide variety of firms registered with the PCAOB and performing issuer audits, we do not believe that to be the case.

We certainly agree that many, if not most, of the referenced specified quality responses should be considered by firms; however, a risk-based, scalable standard would not require them for every firm. As an alternative, we suggest the Board consider additional quality objectives for firms to evaluate that would achieve the Board's objective of the types of risks that the Board believes should be identified and appropriate responses developed. This approach would allow firms to more effectively identify and evaluate the risks and develop responses to those risks that are commensurate with the specific nature and complexity of their firm and specific engagements.

Alignment With IAASB ISQM 1, Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements and ASB SQMS No. 1, A Firm's System of Quality Management

Upon the effective date and adoption of the above-referenced standards and a new PCAOB standard, a substantial number of firms will be subject to at least two quality management/quality control standards. As noted in the Board's statement in the 2019 Concept Release, "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."[2]

The proposed standard includes variances in areas fundamental to a system of quality control that we believe are unnecessary, and while impacting scalability as noted above, we also believe these differences will result in additional costs in the implementation of the standards that are not offset by improvements in audit quality.

[1] PCAOB Release No. 2022-006, page 6

[2] PCAOB Release No. 2019-003, page 5

For example, in addition to the inclusion of specified quality objectives noted above, there are material differences in the definitions of quality risks, quality control findings and quality control deficiencies; which may not only require additional tailoring and time in the implementation and operation of the proposed standard, but also result in confusion for the various stakeholders in this process.

Similarly, the inclusion of a specified evaluation reporting date that does not exist in the other quality management standards results in an additional level of complexity as firms implement these standards, particularly for those firms that have already adopted ISQM 1 with an evaluation date and reporting timeline already in place.

As noted in our general comments, we recognize that in some instances, it may be necessary for the PCAOB's quality control standard to have incremental requirements beyond other existing standards due to the nature of being registered with the PCAOB and performing public company audits. However, we believe the objectives are more adequately achieved if those differences are reflected as incremental requirements, rather than in substantive fundamental differences.

Please see our response to certain of the specific questions for with the Board requested specific comment on the following pages. We have not responded to all of the questions, rather only those for which we have comments for the Board to consider.

Once again, we appreciate the opportunity to comment on these proposed standard. We would be pleased to discuss our comments with the Board or its staff. Please direct any questions on our comments to Brian Bluhm, Chief Quality Officer, bbluhm@eidebailly.com or by phone at 612.253.6590.

Sincerely,

Eide Bailly LLP

Eide Bailly LLP

Responses to Specific Questions in the PCAOB Release

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.

We believe that the definition of "firm Personnel" as currently proposed is too broad as it encompasses "Individual proprietors, partners, shareholders, members or other principals, accountants, and professional staff of a registered public accounting firm whose responsibilities include assisting with (1) the performance of the firm's engagements; and (2) the design, implementation, or operation of the firm's QC system, including engagement quality reviews." As proposed, this definition could be interpreted as including a variety of non-engagement administrative personnel who we don't believe should be included in this definition; accordingly, recommend the Board consider a further clarification of this definition.

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 think it is necessary 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. Alternatively, we recommend that such firms acknowledge their adoption of one of the other two relevant standards (IAASB ISM 1 or AICPA/ASB SQMS 1). This alternative would alleviate the additional burden on firms who are registered with the PCAOB, but not performing or planning to perform engagements under its standards. We do believe that this alternative could be reasonably accompanied by a requirement where should such firms decide to perform an engagement under PCAOB standards, they not do so until they have designed and implemented QC 1000.

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?

Please see our comments on *Scalability* above.

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, specifically in that paragraph .12 of the proposed standard appears to require that only one individual should have operational responsibility for each area highlighted in the standard:

- Operational responsibility and accountability for the QC system as a whole;
- Operational responsibility for the firm's compliance with ethics and independence requirements;
- Operational responsibility for the monitoring and remediation process; and
- If appropriate based on the nature and circumstances of the firm, operational responsibility for other components of the QC system.

While we agree that that operational responsibilities for these components of a firm's system of quality control are appropriate, we believe there are likely individual firm circumstances in which the implementation of the firm's system of quality control may well be more effective if more than a single individual is responsible. Therefore, we believe that the standard should *allow for* more than one individual to be assigned to these roles, as may be appropriate based on the nature and complexity of the firm's practice.

We do support that the standard as currently proposed allows for one person to hold multiple responsibilities, as this is critical for smaller firms with fewer qualified resources to assume these responsibilities.

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 encourage the Board to modify the proposed definition as such.

However, under the proposed definition, it appears that firms would also be required to address risks related to intentional acts by firm personnel and other participants at a threshold lower than a "reasonable possibility of occurring", which is contrary to the core concept of risk assessment and identifying responses to risks. Additionally, we do not believe the time and resources required to address any risk at a threshold this low will result in a corresponding benefit to audit quality; rather could have the opposite effect in that firm resources will be diverted to areas having a "less than reasonability 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?

We agree with the proposed quality objectives for governance and leadership; however as noted in our Overall Observations regarding scalability, we believe that the specified quality responses should be reframed as quality objectives.

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 noted elsewhere in our comments, we believe the nature, size and complexity of a firm's issuer practice should be considered in conjunction with a quality objective, rather than tied to a bright-line threshold based upon a number of issuer engagements. To illustrate, for a specific firm, the difference between 99 and 101 issuer engagements does not likely result in an increased risk in the firm's practice; however, the standard as proposed would require significantly higher administrative and monetary burdens simply resulting from the existence 2 additional engagements. Similarly, a firm having 25 issuer engagements, with those engagements being of higher risk and complexity may benefit from some of the quality control considerations included in the proposed standard for firms with more than 100 issuers.

We believe that establishing such a threshold could result in the unintended consequence of quality firms intentionally managing their practice to stay below the 100-issuer threshold simply to eliminate the burden of some of these requirements; with the possible result of those incremental engagements moving to firms not performing issuer engagements at the same level of quality.

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 – see our response to Q22 above regarding the scalability considerations related to the 100-issuer threshold. Additionally, with respect to this specific requirement, we suggest the Board consider whether this separate requirement is necessary given the existing SEC rules requiring certain automated independence requirements for firms that audit more than 500 issuers.

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

No, as we have noted in other responses, we do not believe specified quality responses are necessary in any of the components, including engagement performance, rather firms should be allowed to develop quality responses based upon their risk assessment.

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

No, we believe that the specified quality responses should be reframed as quality objectives.

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?

We do not have a specific objection to this quality objective; however, believe that additional clarity is needed with respect to the definition of "firm-level and engagement-level information". We believe that an appropriate scope for this type of information would involve various audit quality metrics developed by a firm, but it is unclear if the proposed standard is intended to be limited to that type of information.

Q46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?

Yes, we agree with the proposed requirement to monitor completed engagements and inspect on a "cyclical basis" at least one completed engagement for each engagement partner.

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?

No – see our response to Q22 above regarding the scalability considerations related to the 100-issuer threshold.

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?

Most notably, we believe the Board should align the definitions of "QC finding" and "QC deficiency" with those in ISQM 1. Given the underlying significance of these key definitions to a quality control standard, we believe it is imperative that these definitions be consistent across the principal standard setting bodies.

Inconsistent definitions may not only in differences in the operation of a firm's system of quality control, but more importantly, we believe they may result in varying conclusions regarding the effectiveness of a firm's system of quality control, which we do not believe to be in the best interests of the various stakeholders.

Specific to the proposed definition of a "QC finding", the principal difference between the proposed QC 1000 definition and the ISQM 1 definition is the inclusion of all engagement deficiencies as QC findings. We believe there are likely situations in which a firm may appropriately evaluate an engagement deficiency and conclude it does not rise to the level of a QC finding; as such, the proposed definition does not allow for that level of judgement.

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?

We do not believe the proposed standard should require a specific evaluation date, rather that individual firms be allowed to determine their evaluation date based upon the specific circumstances of their firm. Additionally, as a number of firms have already implemented ISQM, and thus selected evaluation dates, having multiple evaluation dates or having to change those dates upon the implementation of this standard will result in a burden not offset by a corresponding benefit to overall audit quality.

Additionally, a November 30 effective date and corresponding reporting date in January will overlap a critical time for many firms, which are performing significant planning and risk assessment activities for calendar year-end audit engagements. This will have a disproportionate impact to all but the largest firms; i.e., those firms for which the individuals serving as engagement partners and staff on audit engagements will also be fulfilling these important quality control functions. As a result, mandating a November 30 effective date may result in the unintended consequence of being detrimental to audit quality.

Accordingly, we strongly encourage the Board to allow firms to select their own evaluation date. If the Board feels compelled to require a specific evaluation date for all firms, we believe that a March 31 date is preferable as that date is better aligned with a natural business cycle for many firms. This date is also aligned with the Form 2 reporting date.

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?

We do not believe it is appropriate to identify specific circumstances where are major QC deficiency would be presumed to exist. Similar to our responses to a number of other questions, such a presumption is overly prescriptive and does not allow for the exercise of judgement by the firm as a part of their evaluation.

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 quality control system to the PCAOB.

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?

We do not believe a period of 45 days after the evaluation date allows firms sufficient time to complete their evaluations, and accordingly will result in less comprehensive and effective evaluations, which ultimately will limit the effectiveness of the overall quality control process.

We appreciate that the reporting date should also be within a reasonable amount of time from the evaluation date, therefore recommend the Board consider a period of 90 days between the evaluation date and reporting date. We believe this allows for a sufficient period of time for firms to complete a thoughtful and effective evaluation while still reporting within a reasonable timeframe.

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 noted in our response to Q57, we believe that firms should be allowed to select their own evaluation date, which then by necessity would result in a separate reporting mechanism than on Form 2.

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?

We support the amendments to AS 1301 requiring the auditor to communicate the firm's conclusion on its most recent evaluation to the audit committee. However, we believe the requirement to communicate remedial actions be limited to those actions related to *Major QC Deficiencies*, as those deficiencies are the most critical to the firm's evaluation and most likely of the greatest interest to audit committees.

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

We believe that the Documentation Completion Date should be as of a date following the reporting date, not dissimilar to the documentation completion requirements in AS 1215 *Audit Documentation.* This would allow for firms to be focused on the evaluation and reporting processes through the reporting date, followed by a period of time to complete and assemble the final documentation of the quality control process and evaluation. We believe a similar 45-day period would be appropriate.

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

Given our belief that the Board will issue a final standard in 2023, and presumably also approval by the SEC as early as 2023, the standard could be effective as December 15, 2024, with the initial evaluation in 2025. We believe this effective date will be difficult for firms, particularly for small and medium sized firms that were not required to adopt ISQM 1. Those firms will adopt the AICPA's SQMS 1 standard as of December 15, 2025. Accordingly, we recommend an effective date no earlier than December 15, 2025, as that will allow that large group of firms sufficient time to appropriately implement the standard.

Additionally, a longer implementation period will enable the firms and staff/Board to discuss potential implementation issues and inform additional guidance.