CAQ

February 1, 2023
By 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:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditor firm and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Support for the Objective of the Proposal

The CAQ appreciates the opportunity to share our views and provide input 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. The CAQ is supportive of the Board issuing this proposed standard as a way to strengthen auditing practices and continuously improve audit quality. The CAQ and our member firms are committed to promoting audit quality and appreciate the thoughtful proposal set forth by the Board.

A firm's system of quality control is foundational to audit quality. As we have previously articulated in our March 2020 response to the Board's QC Concept Release,[1] we agree it is appropriate to revise existing PCAOB QC standards to reflect the experience of the Board and its Staff, as well as developments within the profession, both domestically and internationally. Specifically, we believe that a risk- and principles-based approach, aligned with recently enhanced quality management standards issued by international

[1] https://www.thecaq.org/pcaob-revisions-to-quality-control-standards/

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standard setters, will have a positive impact on audit quality. While we believe that the proposed standard generally achieves this objective, we have feedback on certain aspects of the proposal. We believe changes are necessary to important definitions and concepts to make the standard more scalable and more closely aligned to other quality management standards. These changes will enable firms to more effectively implement the standard and ultimately achieve our shared objective of maintaining strong standards of audit quality. Further, we believe our recommendations reduce the burden on smaller accounting firms where there is not a commensurate benefit to audit quality which could place a barrier to entry. Our comments are intended to be constructive in nature and we welcome the opportunity to discuss our comments with the Board and staff.

In addition to providing the following general observations, we have included detailed responses to certain of the Board's questions in the Appendix. Certain of our responses in the Appendix are intentionally duplicative for ease of reference.

Overall Observations

We support the objectives of the proposal as set forth by the Board but have some overarching concerns that we encourage the Board to address in the final standard.

Prescriptiveness Without Commensurate Benefit to Audit Quality

We agree with the PCAOB's statement that the QC 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."[2] Scalability is of particular importance given the wide variety among the approximately 1,700 firms who are registered with the PCAOB that would be subject to these new requirements.[3] These firms have vastly different characteristics, complexities, and risks to consider in applying the QC standard.

Generally, we find certain aspects of the proposed standard to be prescriptive, without an apparent commensurate benefit to audit quality. The volume of prescriptive requirements, such as specified quality responses, make the standard inherently less scalable. While certain proposed specified quality responses may be considered good practices, they should not necessarily be required for all firms, or even for a subset of firms who audit more than 100 issuers, without consideration of each firm's specific risk, complexity, and structure. Further, reliance on prescribed specified responses could discourage firms from performing robust risk assessments with tailored and innovative responses. Quality objectives can be achieved through a range of potential quality responses that firms may then calibrate further through their monitoring.

We encourage the PCAOB to consider a different approach. Instead of including prescriptive specified quality responses, we recommend that the standard include more specified quality objectives. Including specified quality objectives will achieve the PCAOB's objective of ensuring that firms identify risks and develop appropriate responses, while providing firms more flexibility to tailor the response, as necessary based on their size, complexity, risk, and nature of their engagements. We believe that this would reduce

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

[3] PCAOB Release No. 2022-006, page 49

barriers to entry by promoting scalability and will lead to improvements in audit quality. Further, we believe that adding incremental quality objectives will not detract from or preclude alignment with the International Auditing and Assurance Standards Board's (IAASB) recently revised quality management standard, *International Statement on Quality Management* (ISQM 1), at a foundational level.

Foundational Differences Between QC 1000 and ISQM 1

Nearly all firms are subject to multiple QC standards, including ISQM 1 which is now effective.[4] Alignment among the multiple standards that firms are subjected to is important. We support Chair Williams' statement that "when developing proposed standards, we consider the IAASB's efforts as part of our analysis. If possible, we try to avoid unnecessary differences" and that "it is imperative that we are mindful when there are differences and that such differences are justified and do not create unintended consequences."[5] From a practical standpoint, alignment allows firms to effectively and efficiently implement the proposed PCAOB QC standard, building on the significant investments of time and resources needed to comply with other standards. This is consistent with the Board's view that "firms that are subject to both PCAOB standards and IAASB or AICPA QC standards … could leverage the investments they make to comply with the requirements of the IAASB and AICPA, and would avoid the additional costs that would be associated with fundamentally different, and potentially conflicting, approaches to QC."[6]

A key component of alignment is that the standards are built on a common foundation. We are concerned that QC 1000 and ISQM 1 do not have the same foundation.

We believe that a significant part of the foundation of a QC standard is the structure (for example, the eight components of the standard and the use of quality objectives/quality risks/quality responses) and the definitions which provide the basis for identifying risks, developing responses, and performing the evaluation of the QC system (for example, the definitions of quality risks, QC findings, and QC deficiencies). Differences in either the structure or definitions could manifest as differences in the operation of the QC system and the conclusion on the overall effectiveness of the QC system under different standards. The ramification of such differences are significant; most notably, we believe that different conclusions on the effectiveness of the QC system under different standards when the facts and circumstances are the same may be confusing to stakeholders, such as the audit committee, when both conclusions are required to be reported. Additionally, differences could result in incremental work to evaluate QC findings and QC deficiencies under two (or more) frameworks, leading to incremental costs that are not commensurate with any perceived benefits.

We recognize that in some instances it may be necessary for the PCAOB's QC standard to have *incremental* considerations or provisions beyond a common foundation because of the unique regulatory environment for publicly listed entities in the US and firms registered with the PCAOB. We believe incremental

[4] ISQM1 was effective as of December 15, 2022. In addition, the US Auditing Standards Board has issued its standard, *Statement on Quality Management Standards 1*, effective December 15, 2025, for firms that perform audits under AICPA standards, which is based on ISQM1. Therefore, nearly all accounting firms in the US will implement a system of quality management based on ISQM 1.

[5] As discussed in her speech at the PCAOB International Institute on Audit Regulation

[6] PCAOB Release No. 2022-006, page 35

considerations or provisions can be achieved by the inclusion of additional quality objectives, instead of additional specified quality responses.

Parallels Between QC 1000 For Audit Firms and Sarbanes-Oxley for Issuers

We observe that the requirements under QC 1000 for auditors are similar in certain ways to the requirements related to internal control over financial reporting under Sarbanes-Oxley (SOX) for public companies (issuers) and the Securities and Exchange Commission's rules and interpretive guidance thereunder. We are supportive of requirements that improve audit quality and drive accountability within audit firms as SOX has done for issuers.

There are key differences between an issuer's internal control over financial reporting and a firm's system of quality control. The objective of a QC system is different and broader than the objective of internal control over financial reporting. However, the underlying principles are similar. We believe that requirements related to documentation, accountability, and certain other matters should also be similar and recommend revisions to the proposed standard to align with SOX requirements where appropriate.

Further, we anticipate the impact of QC 1000 on auditors will be similar to the impact SOX had on issuers. Through the issuers' experience of implementing SOX and initially being audited under PCAOB Auditing Standard (AS) No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, we believe lessons can be learned to help improve QC 1000 as currently proposed. After AS 2 became effective, the Board "closely monitored the progress registered firms have made in implementing its requirements…[and] two basic propositions emerged. First, the audit of internal control over financial reporting has produced significant benefits, including an enhanced focus on corporate governance and controls and higher quality financial reporting. Second, these benefits have come at a significant cost. Costs have been greater than expected and, at times, the related effort has appeared greater than necessary to conduct an effective audit of internal control over financial reporting."[7] To alleviate this situation, the Board replaced PCAOB AS No. 2 with AS No. 5 which focused on "encouraging auditors to use professional judgement in the 404 process, particularly in using risk-assessment."[8] Coupled with additional guidance for management, AS 5 supported a more risk-based, scalable approach to the audit of internal control over financial reporting, focused consideration of risks most important to relevant and reliable financial reporting, and eliminated requirements that were unnecessary to achieve the intended benefits.

We encourage the PCAOB to consider those lessons, particularly around scalability, emphasis on risks, and costs to implement and operate relative to the benefits achieved. To the extent those lessons can be applied to QC 1000, we believe that it will serve the public interest by allowing firms to realize the benefits of an enhanced system of quality control upon initial implementation, and it will reduce the likelihood that later revisions to the standard are needed. In its release of AS 5, the Board stated its belief that changes made to the proposal reflect refinements, rather than significant shifts in approach. We believe

[7] PCAOB Release No. 2007-005A, June 12, 2007, PCAOB Rulemaking Docket Matter No. 021, Page 2

[8] Ibid, Page 4

our suggestions herein will enable the profession to use professional judgment to implement QC 1000 using an AS 5-like approach.

Key Issues and Recommendations

We highlight and bring to your attention the following key issues and recommendations. Please see the Appendix for additional comments in response to certain questions.

Definitions – QC Finding, QC Deficiency, Major QC Deficiency, and Conclusion

As discussed above, definitions are critical to the foundation of the QC standard. As currently proposed, the definitions in QC 1000 differ from those in ISQM 1, such that the standards differ at a foundational level. Differences in the definitions may manifest as differences in the operation of the QC system and the conclusion on the overall effectiveness of the QC system. The ramification of such differences could be significant; most notably, we believe that these foundational differences could lead to different conclusions on the effectiveness of the QC system under different standards, which could be confusing to stakeholders (for example, in communication to the audit committee) and does not serve the public interest. Further, we do not believe that these differences will improve audit quality. Therefore, we strongly recommend that the PCAOB align the definitions of QC finding and QC deficiency with ISQM 1.

QC Finding

The key difference between the proposed QC 1000 definition of QC findings and the definition under ISQM 1 is the inclusion of the statement in QC 1000 that "engagement deficiencies are QC findings."

We appreciate the need to consider whether engagement deficiencies are QC findings. However, the proposed definition removes the firm's ability to apply professional judgment in evaluating engagement deficiencies and their root causes. Upon evaluation, there may be certain engagement deficiencies that do not rise to the level of a QC finding; for example, an engagement deficiency related to an isolated human error may not indicate there is a more than remote likelihood of the firm not achieving the reasonable assurance objective or a quality objective. We recommend this portion of the proposed definition of QC finding in .A9 be removed from the definition in the final standard.

QC Deficiency

The proposed definition of a QC deficiency in QC 1000, paragraph .A8 (1) 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 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.[9]

In our view, the proposed definition of a QC deficiency in QC 1000 could result in more QC findings rising to the level of a QC deficiency under QC 1000 than under ISQM 1 because "a reduced likelihood" represents a lower threshold than to "reduce to an acceptably low level;" that is, under proposed QC

[9] See PCAOB Comparison of Proposed QC 1000 with ISQM 1 and SQMS 1, Page 84

1000, any reduction in the likelihood of the firm achieving the reasonable assurance objective, regardless of the severity of the reduction, would equate to a QC deficiency. We believe this is problematic.

Ultimately, these differences in definitions could result in firms reaching different conclusions about the effectiveness of its system of quality control under QC 1000 and ISQM 1 (e.g., under ISQM 1, a matter may only be a QC finding but under QC 1000 that same matter could rise to the level of a QC deficiency because of the differences in the definitions). As stated above, these similar yet different definitions could lead to confusion among stakeholders, which does not serve the public interest.

While we appreciate the desire to align terminology with COSO, we do not believe there is a compelling reason to deviate from the definition of a QC deficiency in ISQM 1. We suggest the ISQM 1 definition be used, with additional guidance developed if the PCAOB considers it necessary to illustrate when a response does not reduce the likelihood of a risk occurring to an acceptably low level.

This approach would be consistent with the reasonable assurance objective[10] and the overall risk-based approach to quality control. Additionally, we believe that the requirement in paragraph .72 sets out an appropriate framework to enable firms to make consistent judgments about when QC findings rise to the level of a QC deficiency. For ease of reference, we include the following side-by-side comparison of the definitions discussed above:

Definition of QC deficiency	
QC 1000	ISQM 1
.A8 QC deficiency – A QC finding that, based on the evaluation under paragraph .72, individually or in combination with one or more other QC findings, results in: (1) A reduced likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives; Note: The likelihood could be reduced if, for example, a quality objective is not established, a quality risk is not properly identified or assessed, or a quality response is not properly designed or implemented or is not operating effectively.	(a) Deficiency in the firm's system of quality management (referred to as "deficiency" in this ISQM) – This exists when: (Ref: Para. A10, A159–A160) (i) A quality objective required to achieve the objective of the system of quality management is not established; (ii) A quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: Para. A11) (iii) A response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the response(s) is not properly

[10] See note to paragraph .05 of Proposed QC 1000 which states, in part: "Reasonable assurance is obtained when a firm's QC system **reduces to an appropriately low level** the risk that the objectives set forth in a. and b. are not achieved." (emphasis added)

Definition of QC deficiency	
QC 1000	ISQM 1
(2) Noncompliance with requirements of this standard, other than those under "Documentation"; or (3) Noncompliance with requirements of this standard under "Documentation" that adversely affects the firm's ability to comply with any of the other requirements of this standard.	designed, implemented or operating effectively; or (iv) An other aspect of the system of quality management is absent, or not properly designed, implemented or operating effectively, such that a requirement of this ISQM has not been addressed. (Ref: Para. A12)

Major QC Deficiency

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 does not include the category of a major QC deficiency, we believe that if the definitions of QC finding and QC deficiency are aligned between QC 1000 and ISQM 1, then having an additional category of major QC deficiency would not impact the foundation of the standard.

In our view, a major QC deficiency should encompass severe and pervasive QC deficiencies that prevent the firm from concluding that the QC system is effective, which is consistent with the concepts for evaluating QC deficiencies in ISQM 1. We encourage the Board to consider updating the definition of a major QC deficiency to "a severe and pervasive unremediated QC deficiency or combination of unremediated QC deficiencies, based on the evaluation under paragraph .78, that prevents the firm from concluding that the firm has achieved the reasonable assurance objective."

Further, we believe that instead of including circumstances when a major QC deficiency is presumed to exist in the proposed definition, those factors should be framed as indicators that a major QC deficiency may exist, thereby enabling a firm to use professional judgment in their evaluation.

Conclusion

As we describe above, we strongly encourage the Board to revise definitions of QC finding and QC deficiency to align with ISQM1. We believe that the definitions as currently proposed could result in a firm reaching a different conclusion about the effectiveness of the QC system under ISQM 1 and QC 1000 with the same fact pattern. We do not think that this furthers the public interest or benefits overall audit quality.

Evaluation Date, Reporting Date, and QC Documentation Completion Date

One of our key concerns with QC 1000 is the proposed evaluation date, reporting date, and documentation completion date. The standard proposes an evaluation date of November 30th and a

reporting date and documentation completion date of January 15th (45 days after the evaluation date). Overall, we believe it is critical to allow firms to choose their own evaluation dates (and therefore related reporting and documentation completion dates).

Prescribed Evaluation Date of November 30th

In our view, the evaluation date should not be prescribed by the PCAOB. The evaluation date should be decided by each individual firm based on their cadence for activities related to evaluating their system of quality control, business cycle, and other relevant factors (as is allowed under ISQM 1).

Many firms have already implemented ISQM 1 as of December 15, 2022 (in particular, those firms that belong to a global network), and have selected evaluation dates other than November 30th. Prescribing an evaluation date would lead many firms to perform a quality control effectiveness assessment twice in one year. We encourage the Board to consider that this difference creates additional work for firms without a commensurate benefit to audit quality.

Many firms have chosen their fiscal year-end as the evaluation date because quality management processes are aligned to the firm's fiscal year-end, business cycle, and other statutory requirements (such as issuance of transparency reports). If firms were required to evaluate their system of quality control as of November 30th, certain responses may cross reporting periods and create unnecessary complexity or impact audit quality. Additionally, many firms use their fiscal year-end as it aligns with the firms' evaluation and compensation adjustment dates, allowing firms to consider quality-oriented evaluations in compensation adjustments (consistent with paragraph .49). As one of the overarching concepts in the Release is emphasizing the importance of quality in audits, we believe allowing firms to facilitate timely quality-oriented information in the compensation process further emphasizes the importance of audit quality and is in the public interest.

We believe that any prescribed evaluation date will be problematic for firms. For some firms, the proposed November 30th evaluation date provides additional challenges given that the date would conflict with the timing of field work of the PCAOB's external inspection. While engagement inspections are only one part of monitoring the firm's QC system, this timing could make it very difficult for a firm to consider the results of external inspections in their assessments, perform root cause analysis, and implement and test remedial actions. November 30th is also around the time that internal inspections finish for some firms, and the timing would not allow for firms to perform a robust root cause analysis, identify remedial actions, and implement and test those remedial actions.

Finally, a November 30th date could detract from other important audit quality matters as November - March is a key period for firms in relation to engagement performance activities as well as monitoring and remediation activities. Also, it is often the case that firm personnel with roles in the firm's QC system are conducting or supporting the performance of audit engagements. Towards the end of the calendar year, firms concentrate on providing important updates to their audit practice in preparation for audits of calendar year-end companies, similar to the sharing by PCAOB Staff of the "Update and Preview of Inspection Observations." We believe resource constraints could have an unintended negative impact to audit quality, and therefore we strongly encourage the Board to allow firms to choose the evaluation date.

Reporting Date

We believe that a reporting date that is only 45 days after the evaluation date does not provide firms with sufficient time to complete their evaluations. Performing a thoughtful and detailed evaluation of the QC system takes time and resources. Additionally, compiling the detailed reporting of QC deficiencies and related remedial actions to report to the PCAOB will require additional time and effort and also needs to be completed prior to the reporting date. We believe that in order to promote high quality, thoughtful evaluations and related reporting, firms need a longer period between the evaluation date and reporting date. We encourage the PCAOB to allow a period of at least 90 days between the evaluation date and reporting date (as proposed in Q64, which suggests a March 31st evaluation date and June 30th reporting date).

Documentation Completion Date

The proposed standard establishes the QC documentation completion date as 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*.[11] Consistent with the requirements of AS 1215, we recommend that the PCAOB require that all necessary procedures to support the QC evaluation be completed prior to the reporting date. The 45-day documentation completion period would be for the audit firm to assemble the complete and final set of documentation for retention. This better aligns with the current audit documentation requirements and will allow firms to focus their efforts on the evaluation and reporting requirements in advance of the reporting date.

Reporting to the Audit Committee

Under the proposed amendments to AS 1301 paragraph .04b, auditors would be required to report to the audit committee "the conclusion of the firm's most recent annual evaluation of its QC system under paragraph .77 of QC 1000, *A Firm's System of Quality Control*, and a brief overview of remedial actions taken and to be taken."[12]

We are supportive of a requirement for the auditor to communicate to the audit committee the firm's conclusion on its most recent annual evaluation of its QC system and believe that this could promote beneficial dialogue between the auditor and audit committee regarding major QC matters.

However, we believe that the requirement to communicate a "brief overview of remedial actions taken and to be taken" should be specifically limited to remedial actions related to *major QC deficiencies.* We

[11] Per AS 1215 paragraph .15: "Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (documentation completion date). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased."

[12] PCAOB Release No. 2022-006, page A5-17

believe that the *major QC deficiency* level is the appropriate level to communicate to the audit committee as major QC deficiencies are deficiencies that are severe and pervasive to the overall system of quality control. Major QC deficiencies would impact the majority of the firm's engagements. We believe that communicating all QC deficiencies to the audit committee is too low a threshold because QC deficiencies are not severe and pervasive to the overall system of quality control and are likely relevant to only a subset of the firm's engagements. If auditors are required to communicate at the QC deficiency level, the communications may not be relevant to the audit committee.

We believe that communication related only to major QC deficiencies would appropriately direct the focus of the audit committee to major issues that could impact the auditor's performance and provide decision-useful information for effective oversight of the auditor.

Quality Risks and the Consideration of Intentional Misconduct

Under the proposed standard, when evaluating quality risks, the threshold of "reasonable possibility of occurring" would not apply to risks of intentional misconduct by firm personnel and other participants. Respectfully, we do not agree with the definition as currently proposed and recommend that the threshold of "reasonable possibility of occurring" apply to all risks, including risks of intentional misconduct by firm personnel and other participants.

Under the proposed definition, firms would be required to consider any risks of intentional misconduct that have a reasonable possibility of adversely affecting the firm's achievement of one or more quality objectives, including risks that do not have a reasonable possibility of occurring. We believe this threshold is too low. 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."[13] There are many ways that intentional misconduct could adversely impact the achievement of one or more quality objectives; however, many have only a remote likelihood of occurring. We do not think it is a practical or efficient use of time and resources to design and implement quality responses to risks that have a remote likelihood of ever occurring and such responses will not have a commensurate benefit to audit quality. Further, responding to every possible risk that could adversely impact the achievement of one or more quality objectives could result in scattering firm resources, which may in turn harm audit quality. In addition, the inclusion of "other participants" in addressing every conceivable risk of intentional misconduct may be impractical for firms to implement. In most cases, firms are legally restricted from accessing information on conduct of other participants (such as accessing human resources files) that would need to be considered to address any and every (even remote) risks of intentional misconduct from other participants.

Accordingly, we suggest defining quality risks as follows:

> Quality risks – Risks that**, whether due to unintentional acts or intentional misconduct to deceive or to violate applicable professional and legal requirements by firm personnel and other participants,** individually or in combination with other risks, have a reasonable possibility of

[13] PCAOB Release No. 2022-006, page 84

adversely affecting the firm's achievement of one or more quality objectives if the risks were to occur~~,~~ and ~~are either:~~

~~(1) Risks that~~ have a reasonable possibility of occurring~~; or~~

~~(2) Risks of intentional acts by firm personnel and other participants to deceive or to violate applicable professional and legal requirements~~.

We believe that this updated definition matches the consideration of quality risks under ISQM 1 and appropriately focuses on the objective of obtaining reasonable assurance of compliance with applicable laws and regulations. As we discuss above, we believe that it is critical for QC 1000 to align with ISQM 1 on key concepts and definitions that are foundational to the system of quality control. Under ISQM 1 firms are able to concentrate quality responses on risks that have a higher likelihood of occurring, allowing firms to focus their efforts most effectively and efficiently to prevent and detect intentional misconduct that could adversely impact the achievement of one or more quality objectives. Firms also, through their monitoring and remediation activities, consider new information throughout the course of the year that may indicate a change in the likelihood of a certain risk occurring, allowing the firm to implement an appropriate mitigating response. Further, when considering the potential severity and pervasiveness of a deficiency, firms consider the root cause of the issue. If the root cause is related to intentional misconduct, that would impact the remediation efforts and would potentially trigger a change in risk assessment, both in the component that it arose and in other quality objectives that could be impacted by a similar intentional act, given the root cause identified.

We analogize this to PCAOB AS 2110 *Identifying and Assessing Risks of Material Misstatement*, which requires auditors to identify risks of material misstatement whether due to error or fraud. In that case, the "reasonable possibility of occurring" threshold applies to both risks of error and fraud. Auditors perform fraud brainstorming to consider all possible fraud risk factors and then determine whether, individually or in combination with each other, those risk factors indicate a fraud risk. We encourage the Board to apply a similar concept here.

Consideration of Other Participants

While we appreciate the importance of Other Participants, we do not believe that Other Participants are part of the firm's QC system nor included in the reasonable assurance objective, as they are included in their own firm's QC system. Instead, we believe the use of Other Participants should be a specified quality objective (which could, for example, be included in the *Resources* component). To the extent that firms use Other Participants, they would need to identify the quality risks that arise from the use of Other Participants in engagements or the design, implementation, and operation of the QC system. 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, nature of involvement of Other Participants, and other relevant factors.

Please see additional comments in the Appendix in response to certain questions included in the proposal.

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The CAQ appreciates the opportunity to comment on the proposed QC standard and related amendments, and we look forward to future engagement. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org), Dennis McGowan (dmcgowan@thecaq.org), Erin Cromwell (ecromwell@thecaq.org) or Taylor Harris (tharris@thecaq.org).

Sincerely,

Vanessa Teitelbaum, CPA
Senior Director, Professional Practice
Center for Audit Quality

cc:

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SEC
Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant

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.

Firm Personnel

We do not agree with the definition of Firm Personnel as currently proposed. We have concerns that the proposed definition treats non-employee contractors and consultants as firm employees. Non-employee contractors and consultants differ from the other groups included in the definition of Firm Personnel. For example, firms cannot provide performance feedback to non-employee contractors and consultants (as they are not employees of the firm). Therefore, we believe that it is not appropriate to include these groups in the definition of Firm Personnel and they more appropriately belong in the definition of Other Participants.

Additionally, we believe that the definition of Firm Personnel as currently proposed is too broad because it encompasses any individual proprietors, partners, shareholders, members or other principals, accountants, and professional staff, including non-employee contractors and consultants, of a registered public accounting firm who assist with the performance of the firm's engagements or the design, implementation, and operation of the firm's QC system. We believe that including anyone who "*assists with"* either of those activities would broadly include certain administrative staff. We do not believe such staff should be included in the definition, particularly as the definition is applied in paragraph .34b. Instead, we recommend that the definition could exclude administrative staff or revise the phrase "assist with" to either "used in" or "contribute to".

**Other Participants*

*For reference, this response has been repeated from our comments in the cover letter.

While we appreciate the importance of Other Participants, we do not believe that Other Participants are part of the firm's QC system nor included in the reasonable assurance objective, as they are included in their own firm's QC system. Instead, we believe the use of Other Participants should be a specified quality objective (which could, for example, be included in the *Resources* component). To the extent that firms use Other Participants, they would need to identify the quality risks that arise from the use of Other Participants in engagements or the design, implementation, and operation of the QC system. 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, nature of involvement of Other Participants, and 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.

We do not agree with the proposal 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. As stated in the PCAOB

Release, risk to investor protection is minimal if firms are not performing or playing a substantial role in engagements for issuers.[14]

We appreciate that the Board has acknowledged the scalability of the proposed standard for all firms registered with the PCAOB. As the PCAOB Release states, many firms registered with the PCAOB have never performed an engagement in accordance with PCAOB standards and may not plan to perform such engagements in the future.[15] Nearly all of these firms are also subject to IAASB or AICPA QC standards. Therefore, as an alternative to the design requirement, we suggest that the Board consider allowing firms that have not and do not plan to perform engagements pursuant to PCAOB standards to comply with another comparable recognized QC framework (e.g., ISQM 1 or the AICPA's Statement on Quality Management Standards 1 (SQMS 1)). We recognize that this would mean changing the registration requirements, to require compliance with ISQM1 (or equivalent) upon registration. QC 1000 builds on this standard, with certain differences for firms that perform engagements under PCAOB standards.[16] Therefore, we believe that, for registered firms not performing engagements under PCAOB standards, complying with a comparable standard should suffice. This alternative would alleviate any additional burden on smaller firms who are registered with the PCAOB, but not performing or planning to perform engagements under its standards. If in the future, they will be performing an engagement under PCAOB standards, they should not do so until they have designed and implemented QC 1000. The Board can make clear in its final QC standard that any firm issuing an audit report under PCAOB auditing standards or playing a substantial role in a PCAOB engagement for an entity within the jurisdiction of the PCAOB must comply with 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?

*For reference, this response has been repeated from our comments in the cover letter.

Generally, we find certain aspects of the proposed standard to be prescriptive, without an apparent commensurate benefit to audit quality. The volume of prescriptive requirements, such as specified quality responses, make the standard inherently less scalable. While certain proposed specified quality responses may be considered good practices, they should not necessarily be required for all firms, or even for a subset of firms who audit more than 100 issuers, without consideration of each firm's specific risk, complexity, and structure. Further, reliance on prescribed specified responses could discourage firms from performing robust risk assessments with tailored and innovative responses. Quality objectives can be achieved through a range of potential quality responses that firms may then calibrate further through their monitoring.

[14] PCAOB Release No. 2022-006, page 34

[15] PCAOB Release No. 2022-006, page 49

[16] PCAOB Release No. 2022-006, page 35

We encourage the PCAOB to consider a different approach. Instead of including prescriptive specified quality responses, we recommend that the standard include more specified quality objectives. Including specified quality objectives will achieve the PCAOB's objective of ensuring that firms identify risks and develop appropriate responses, while providing firms more flexibility to tailor the response, as necessary based on their size, complexity, risk, and nature of their engagements. We believe that this would reduce barriers to entry by promoting scalability and will lead to improvements in audit quality. Further, we believe that adding incremental quality objectives will not detract from or preclude alignment with the International Auditing and Assurance Standards Board's (IAASB) recently revised quality management standard, *International Statement on Quality Management* (ISQM 1), at a foundational level.

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?

We recommend minor changes to the proposed requirements related to roles and responsibilities for the Board's consideration to reflect current practice. Specifically, paragraph .12 proposes 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 support requiring firms to identify individual(s) who are responsible and accountable for these important areas of a Firm's QC system, challenges may arise in assigning responsibility to *only one* individual for ethics and independence and for monitoring and remediation. For example, for the firm's compliance with ethics and independence requirements, there are inherent differences in auditor independence rules related to providing services vs. ethics and personal independence and for some firms, it may create challenges if oversight can only be assigned to one individual. Similarly, for large firms with complex structures and control environments, monitoring and remediation responsibilities may be better shared by two individuals. 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 a firm's nature and complexity. The responsibilities of each individual should be clearly delineated to drive accountability. Accordingly, we recommend that in paragraphs .16 and .17 the term "individual" be replaced with "individual(s)" to allow firms flexibility to assign responsibility to more than one individual. We believe that this change will not detract from the importance of accountability for these roles as currently proposed in the standard.

We 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 take on these 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 agree that the definition of "quality risks" should explicitly address risks of intentional misconduct. We recognize that by explicitly addressing risks of intentional misconduct in the definition of quality risks, the PCAOB intends for those risks to be considered by firms in the risk assessment process. We agree that these risks need to be considered and therefore, we find it appropriate that the definition of quality risks explicitly includes risks of intentional misconduct.

However, as we discuss further in our response at Q17, we believe the current threshold for considering risks of intentional misconduct (every act of intentional misconduct that could adversely impact the achievement of one or more quality objectives) is too low a threshold and that it is critical for likelihood of occurrence to also be considered. 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?***

*For reference, this response has been repeated from our comments in the cover letter.

Under the proposed standard, when evaluating quality risks, the threshold of "reasonable possibility of occurring" would not apply to risks of intentional misconduct by firm personnel and other participants. Respectfully, we do not agree with the definition as currently proposed and recommend that the threshold of "reasonable possibility of occurring" apply to all risks, including risks of intentional misconduct by firm personnel and other participants.

Under the proposed definition, firms would be required to consider any risks of intentional misconduct that have a reasonable possibility of adversely affecting the firm's achievement of one or more quality objectives, including risks that do not have a reasonable possibility of occurring. We believe this threshold is too low. 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."[17] There are many ways that intentional misconduct could adversely impact the achievement of one or more quality objectives; however, many have only a remote likelihood of occurring. We do not think it is a practical or efficient use of time and resources to design and implement quality responses to risks that have a remote likelihood of ever occurring and such responses will not have a commensurate benefit to audit quality. Further, responding to every possible risk that could adversely impact the achievement of one or more quality objectives could result in scattering firm resources, which may in turn harm audit quality. In addition, the inclusion of "other participants" in addressing every conceivable risk of intentional misconduct may be impractical for firms to implement. In most cases, firms are legally restricted from accessing information on conduct of other participants (such as accessing

[17] PCAOB Release No. 2022-006, page 84

human resources files) that would need to be considered to address any and every (even remote) risks of intentional misconduct from other participants.

Accordingly, we suggest defining quality risks as follows:

> Quality risks – Risks that**, whether due to unintentional acts or intentional misconduct to deceive or to violate applicable professional and legal requirements by firm personnel and other participants,** 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 ~~are either:~~
>
> > ~~(1) Risks that~~ have a reasonable possibility of occurring~~; or~~
> >
> > ~~(2) Risks of intentional acts by firm personnel and other participants to deceive or to violate applicable professional and legal requirements~~.

We believe that this updated definition matches the consideration of quality risks under ISQM 1 and appropriately focuses on the objective of obtaining reasonable assurance of compliance with applicable laws and regulations. As we discuss above, we believe that it is critical for QC 1000 to align with ISQM 1 on key concepts and definitions that are foundational to the system of quality control. Under ISQM 1 firms are able to concentrate quality responses on risks that have a higher likelihood of occurring, allowing firms to focus their efforts most effectively and efficiently to prevent and detect intentional misconduct that could adversely impact the achievement of one or more quality objectives. Firms also, through their monitoring and remediation activities, consider new information throughout the course of the year that may indicate a change in the likelihood of a certain risk occurring, allowing the firm to implement an appropriate mitigating response. Further, when considering the potential severity and pervasiveness of a deficiency, firms consider the root cause of the issue. If the root cause is related to intentional misconduct, that would impact the remediation efforts and would potentially trigger a change in risk assessment, both in the component that it arose and in other quality objectives that could be impacted by a similar intentional act, given the root cause identified.

We analogize this to PCAOB AS 2110 *Identifying and Assessing Risks of Material Misstatement*, which requires auditors to identify risks of material misstatement whether due to error or fraud. In that case, the "reasonable possibility of occurring" threshold applies to both risks of error and fraud. Auditors perform fraud brainstorming to consider all possible fraud risk factors and then determine whether, individually or in combination with each other, those risk factors indicate a fraud risk. We encourage the Board to apply a similar concept here.

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, we believe that the specified quality responses (in paragraphs .27 - .29) are not necessary. As we discuss above, we believe that specified quality responses should be re-written in the standard as specified quality objectives. We

believe that specified quality objectives will allow firms to appropriately tailor their quality responses based on the firm's size, complexity, and risk.

As it relates specifically to establishing and maintaining clear lines of responsibility and supervision (paragraph .27), we believe that the quality objective in paragraph .25e is sufficient for firms to identify risks and develop appropriate responses related to the assignment of roles and responsibilities that will allow firms sufficient flexibility to tailor their response to their unique organizational structures. Further, we recommend that within these supervisory structures, the standard for liability for individuals throughout the organization in supervisory roles should match the standard for liability described in our response at Q62.

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?

In order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address. We believe that the best way to promote scalability, while requiring firms to develop and implement quality responses related to a specific topic, is to frame the requirements as quality objectives.

If the specified quality response remains, we encourage the PCAOB to consider that the number of issuer audit reports issued during a given year may not necessarily be indicative of the size, structure, and complexity of a firm. We encourage the PCAOB to conduct outreach to firms that would be impacted by this incremental requirement to consider if an increased threshold may be more appropriate. For example, the quantitative threshold of auditing more than 100 issuers does not take into consideration the vast differences among issuers. In other words, auditing 99 issuers may reflect a substantial public company audit practice and warrant certain quality responses due to the size and complexity of the issuer audit practice if such issuers are extremely large and complex. On the other hand, 101 issuers could all be 11-K audits or smaller-size issuers. In other words, we challenge the belief that the number of issuer clients is indicative of the firm's size and the complexity of its practice.

If the final standard includes a specified, quantitative threshold, we also encourage the PCAOB to develop an annual cut-off date (for example, a cut-off date could be set at six months before the evaluation date or it could be the point in time that is used by the PCAOB to determine if a firm will be annually inspected) 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 and execute 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. Additional guidance could also be given for a firm that is above the threshold but acquires a firm below the threshold. We believe that a transition

period should be allowed to integrate the acquiree into the firm and implement the incremental requirements.

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?

As discussed above, in order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address. We believe that the best way to promote scalability, while requiring firms to develop and implement quality responses related to a specific topic, is to frame the requirements as quality objectives. Framing this as a quality objective would allow firms to determine how to best implement oversight within their existing governance structures. As the PCAOB Release notes, many of the largest firms already have some form of non-employee involved in their governance structure.[18] If the proposed requirement in paragraph .28 is retained in the final standard, we believe that it is crucial to continue to allow for flexibility in how a firm would establish its governance structure and assign authority as noted in the Release text.

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?

As discussed above, in order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address. We believe that the best way to promote scalability, while requiring firms to develop and implement quality responses related to a specific topic, is to frame the requirements as quality objectives.

Additionally, we note that existing SEC rules related to quality control have certain automated independence requirements for firms that audit more than 500 companies in SEC Regulation S-X Rule 2-01(d)(4).[19] We recommend that the PCAOB consider if the SEC requirement is sufficient such that no additional PCAOB requirement is needed.

Prior to lowering the threshold from the current SEC requirement, we encourage the PCAOB to conduct outreach to firms that would be impacted by the proposed incremental requirement. This proposed requirement in paragraph .34a.(1) may be especially costly to implement without a commensurate benefit

[18] PCAOB Release No. 2022-006, page 98 FN 163

[19] 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; …*

to audit quality. Until there is a larger scale of issuer audit clients, an investment in automation may not be warranted.

If the final standard includes a specified, quantitative threshold, we encourage the PCAOB to develop an annual cut-off date and transition period as described in our response to Q22.

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?

As discussed above, in order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address. We believe that the best way to promote scalability, while requiring firms to develop and implement quality responses related to a specific topic, is to frame the requirements as quality objectives.

We suggest that the standard could include a quality objective (in paragraph .31) that addresses updates to and availability of the restricted entity list as there may be more effective ways for firms to accomplish the objective of the requirement than having a static list that is periodically updated. Many larger firms already have systems that update restricted entity information on a real-time basis and produce notifications of any issues, thereby removing the need for discrete periodic communications about updates.

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

We do not believe that specified quality responses for the engagement performance component are necessary. Firms will develop quality responses to support quality engagement performance based on their risk assessment. The requirements in the proposal are sufficiently robust for firms to perform a detailed risk assessment and develop appropriate quality responses. Further, specified quality responses may not be appropriate for all firms given their specific facts and circumstances. Therefore, we support that the proposal does not include specified quality responses for the engagement performance component.

Q35. We are proposing to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. Should the standard include specified quality responses explicitly directed to non-U.S. firms that audit issuers? If so, what are they?

We do not believe that the standard should include specified quality responses explicitly directed to non-U.S. firms that audit issuers.

We support the proposal to eliminate the current Appendix K requirement and rely on a risk-based approach. Under the proposed standard, U.S. and non-U.S. firms will identify quality risks related to staff

being knowledgeable of, and complying with, PCAOB and SEC requirements. Firms will develop appropriate quality responses to address such risks, such as specific training, consultations and reviews, or other quality controls/policies and procedures deemed necessary. The nature and extent of the response will depend on the firm's risk assessment and circumstances. Therefore, specified quality responses are not needed.

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

As discussed above, in order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address.

Additionally, as it relates to the engagement partner competencies in paragraph .47 of the proposed standard, we recommend that a quality objective related to engagement partner competencies refer to AS 1201 *Supervision of the Audit Engagement*, where we believe that engagement partner competencies are already sufficiently addressed. 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.

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 these considerations be taken up as part of that project. We believe that it is important to address the completeness and accuracy of the firm's public external communications about firm-level and engagement-level information, such as firm and engagement performance metrics, but additional clarification on the scope of such communications is needed. For example, we 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 to a wide stakeholder group. We believe that additional information regarding scope may come to light through the ongoing research project. Therefore, we recommend that this requirement be removed from QC 1000 so that it can be thoroughly considered through the PCAOB's ongoing research project.

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.

We believe that requiring other participant firms to share the most recent evaluation of their QC system and a brief summary of remedial actions may present challenges, for example related to confidentiality

provisions in relevant laws and regulations.[20] We recommend that other participant firms only be required to communicate what is shared with the audit committee (see our response to Q70).

We also have practical concerns regarding the application of this requirement (paragraph .53g) for other participants who are not registered with the PCAOB (e.g., network firms that are not registered with the PCAOB). It is not clear that the PCAOB has the authority to mandate a non-registered firm to share their most recent QC evaluation (also a non-registered firm is not required to complete an evaluation). Instead, we recommend that the PCAOB could require that registered firms who use other participant firms *request* the evaluation from non-registered firms or permit firms to take a risk-based approach to determine what information is needed from other participants to determine whether the usage of other participants is appropriate.

If the requirement to obtain the evaluation continues to exist in the final standard, we encourage the Board to provide guidance to clarify how registered firms should address a possible situation where QC requirements or disclosures may violate or conflict with national law or regulation, including confidentiality restrictions, or other unintended consequences.

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

We support the proposed requirement in paragraph .62 to monitor completed engagements and inspect on a "cyclical basis" at least one completed engagement for each engagement partner. However, we believe that firms should be able to cycle through each engagement partner's entire portfolio of engagements, not only PCAOB engagements, as the firm operates a single QC system. We also do not agree with the Note, which states, "A firm that uses a cycle longer than three years should demonstrate how that cycle is adequate to provide a reasonable basis for detecting engagement deficiencies and QC deficiencies, taking into account the factors in paragraph .64. Firms should consider incorporating a level of unpredictability in their selection of completed engagements, such that an engagement partner would not be certain which engagement would be selected or when an engagement would be selected."

Consistent with our response to Question 44 in our March 2020 comment letter related to the PCAOB's QC Concept Release, we do not believe any selection criteria for inspections of completed engagements, including specific minimum or cyclical thresholds or random selection, should be included in a future PCAOB QC standard. Such requirements would impede scalability and may not be sufficiently tailored to the firm's risks. Firms should develop internal inspection criteria based on risk.

While it may be true that three years is often the cadence in practice, there may be circumstances where a longer cycle could be appropriate for the reasons noted above.

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?

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

As discussed above, in order to promote scalability, we suggest that the PCAOB re-frame any specified quality responses as specified quality objectives that all firms would be required to address. We believe that the best way to promote scalability, while requiring firms to develop and implement quality responses related to a specific topic, is to frame the requirements as quality objectives.

If the specified quality response in paragraph .63a. remains, we encourage the PCAOB to consider that the number of audit reports issued during a given year may not necessarily be indicative of the size, structure, and complexity of a firm. We encourage the PCAOB to conduct outreach to firms that would be impacted by this incremental requirement to consider if an increased threshold may be more appropriate.

Additionally, if the final standard includes a specified, quantitative threshold, we encourage the PCAOB to develop an annual cut-off date and transition period as described in our response to Q22.

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?

*For reference, this response has been repeated from our comments in the cover letter.

As discussed above, definitions are critical to the foundation of the QC standard. As currently proposed, the definitions in QC 1000 differ from those in ISQM 1, such that the standards differ at a foundational level. Differences in the definitions may manifest as differences in the operation of the QC system and the conclusion on the overall effectiveness of the QC system. The ramification of such differences could be significant; most notably, we believe that these foundational differences could lead to different conclusions on the effectiveness of the QC system under different standards, which could be confusing to stakeholders (for example, in communication to the audit committee) and does not serve the public interest. Further, we do not believe that these differences will improve audit quality. Therefore, we strongly recommend that the PCAOB align the definitions of QC finding and QC deficiency with ISQM 1.

<u>QC Finding</u>

The key difference between the proposed QC 1000 definition of QC findings and the definition under ISQM 1 is the inclusion of the statement in QC 1000 that "engagement deficiencies are QC findings."

We appreciate the need to consider whether engagement deficiencies are QC findings. However, the proposed definition removes the firm's ability to apply professional judgment in evaluating engagement deficiencies and their root causes. Upon evaluation, there may be certain engagement deficiencies that do not rise to the level of a QC finding; for example, an engagement deficiency related to an isolated human error may not indicate there is a more than remote likelihood of the firm not achieving the reasonable assurance objective or a quality objective. We recommend this portion of the proposed definition of QC finding in .A9 be removed from the definition in the final standard.

<u>QC Deficiency</u>

The proposed definition of a QC deficiency in QC 1000, paragraph .A8 (1) 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 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.[21]

In our view, the proposed definition of a QC deficiency in QC 1000 could result in more QC findings rising to the level of a QC deficiency under QC 1000 than under ISQM 1 because "a reduced likelihood" represents a lower threshold than to "reduce to an acceptably low level;" that is, under proposed QC 1000, any reduction in the likelihood of the firm achieving the reasonable assurance objective, regardless of the severity of the reduction, would equate to a QC deficiency. We believe this is problematic.

Ultimately, these differences in definitions could result in firms reaching different conclusions about the effectiveness of its system of quality control under QC 1000 and ISQM 1 (e.g., under ISQM 1, a matter may only be a QC finding but under QC 1000 that same matter could rise to the level of a QC deficiency because of the differences in the definitions). As stated above, these similar yet different definitions could lead to confusion among stakeholders, which does not serve the public interest.

While we appreciate the desire to align terminology with COSO, we do not believe there is a compelling reason to deviate from the definition of a QC deficiency in ISQM 1. We suggest the ISQM 1 definition be used, with additional guidance developed if the PCAOB considers it necessary to illustrate when a response does not reduce the likelihood of a risk occurring to an acceptably low level.

This approach would be consistent with the reasonable assurance objective[22] and the overall risk-based approach to quality control. Additionally, we believe that the requirement in paragraph .72 sets out an appropriate framework to enable firms to make consistent judgments about when QC findings rise to the level of a QC deficiency. For ease of reference, we include the following side-by-side comparison of the definitions discussed above:

Definition of QC deficiency	
QC 1000	ISQM 1
.A8 QC deficiency – A QC finding that, based on the evaluation under paragraph .72, individually or in combination with one or more other QC findings, results in:	(a) Deficiency in the firm's system of quality management (referred to as "deficiency" in this ISQM) – This exists when: (Ref: Para. A10, A159–A160)
(1) A reduced likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives;	(i) A quality objective required to achieve the objective of the system of quality management is not established;

[21] See PCAOB Comparison of Proposed QC 1000 with ISQM 1 and SQMS 1, Page 84

[22] See note to paragraph .05 of Proposed QC 1000 which states, in part: "Reasonable assurance is obtained when a firm's QC system **reduces to an appropriately low level** the risk that the objectives set forth in a. and b. are not achieved." (emphasis added)

Definition of QC deficiency	
QC 1000	ISQM 1
Note: The likelihood could be reduced if, for example, a quality objective is not established, a quality risk is not properly identified or assessed, or a quality response is not properly designed or implemented or is not operating effectively. (2) Noncompliance with requirements of this standard, other than those under "Documentation"; or (3) Noncompliance with requirements of this standard under "Documentation" that adversely affects the firm's ability to comply with any of the other requirements of this standard.	(ii) A quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: Para. A11) (iii) A response, or combination of responses, 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; or (iv) An other aspect of the system of quality management is absent, or not properly designed, implemented or operating effectively, such that a requirement of this ISQM has not been addressed. (Ref: Para. A12)

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?

*For reference, this response has been repeated from our comments in the cover letter.

We do not believe the proposed evaluation date of November 30th is appropriate. In our view, the evaluation date should not be prescribed by the PCAOB. The evaluation date should be decided by each individual firm based on their cadence for activities related to evaluating their system of quality control, business cycle, and other relevant factors (as is allowed under ISQM 1).

Many firms have already implemented ISQM 1 as of December 15, 2022 (in particular, those firms that belong to a global network), and have selected evaluation dates other than November 30th. Prescribing an evaluation date would lead many firms to perform a quality control effectiveness assessment twice in one year. We encourage the Board to consider that this difference creates additional work for firms without a commensurate benefit to audit quality.

Many firms have chosen their fiscal year-end as the evaluation date because quality management processes are aligned to the firm's fiscal year-end, business cycle, and other statutory requirements (such as issuance of transparency reports). If firms were required to evaluate their system of quality control as of November 30th, certain responses may cross reporting periods and create unnecessary complexity or impact audit quality. Additionally, many firms use their fiscal year-end as it aligns with the firms' evaluation and compensation adjustment dates, allowing firms to consider quality-oriented evaluations

in compensation adjustments (consistent with paragraph .49). As one of the overarching concepts in the Release is emphasizing the importance of quality in audits, we believe allowing firms to facilitate timely quality-oriented information in the compensation process further emphasizes the importance of audit quality and is in the public interest.

We believe that any prescribed evaluation date will be problematic for firms. For some firms, the proposed November 30th evaluation date provides additional challenges given that the date would conflict with the timing of field work of the PCAOB's external inspection. While engagement inspections are only one part of monitoring the firm's QC system, this timing could make it very difficult for a firm to consider the results of external inspections in their assessments, perform root cause analysis, and implement and test remedial actions. November 30th is also around the time that internal inspections finish for some firms, and the timing would not allow for firms to perform a robust root cause analysis, identify remedial actions, and implement and test those remedial actions.

Finally, a November 30th date could detract from other important audit quality matters as November - March is a key period for firms in relation to engagement performance activities as well as monitoring and remediation activities. Also, it is often the case that firm personnel with roles in the firm's QC system are conducting or supporting the performance of audit engagements. Towards the end of the calendar year, firms concentrate on providing important updates to their audit practice in preparation for audits of calendar year-end companies, similar to the sharing by PCAOB Staff of the "Update and Preview of Inspection Observations." We believe resource constraints could have an unintended negative impact to audit quality, and therefore we strongly encourage the Board to allow firms to choose the evaluation date.

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

*For reference, this response has been repeated from our comments in the cover letter.

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 does not include the category of a major QC deficiency, we believe that if the definitions of QC finding and QC deficiency are aligned between QC 1000 and ISQM 1, then having an additional category of major QC deficiency would not impact the foundation of the standard.

In our view, a major QC deficiency should encompass severe and pervasive QC deficiencies that prevent the firm from concluding that the QC system is effective, which is consistent with the concepts for evaluating QC deficiencies in ISQM 1. We encourage the Board to consider updating the definition of a major QC deficiency to "a severe and pervasive unremediated QC deficiency or combination of unremediated QC deficiencies, based on the evaluation under paragraph .78, that prevents the firm from concluding that the firm has achieved the reasonable assurance objective."

See also discussion below regarding the circumstances when a major QC deficiency is presumed to exist.

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 that it is appropriate to include circumstances when a major QC deficiency is presumed to exist in the proposed definition. We recommend that these circumstances when a major QC deficiency is presumed to exist be removed from the definition and be replaced as indicators of a major QC deficiency, which is similar to how AS 2201 *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* describes material weaknesses. We believe that this allows firms to use professional judgment in determining whether a major QC deficiency exists.

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.

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?

With respect to the certification requirement relating to Form QC, that senior leaders of the firm make a certification regarding the design and effectiveness of the QC system, it appears that the Board intends to establish a requirement that parallels the requirement under SOX for senior executives of public companies to certify the accuracy of financial statements and effectiveness of internal control over financial reporting. The Board's proposal does not specify the standard at which an individual could be 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, it has been decided in court 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.[23] We believe it would be appropriate for the Board to clarify that the same 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*.[24]

****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?***

*For reference, this response has been repeated from our comments in the cover letter.

[23] See SEC v. Miller, 2:17-cv-897-CBM, 2019 WL 1460615 (C.D. Cal. Feb. 6, 2019)

[24] PCAOB Rule 3502 states, "A person associated with a registered public accounting firm shall not take or omit to take an action knowing, or recklessly not knowing, that the act or omission would directly and substantially contribute to a violation by that registered public accounting firm of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards."

We believe that a reporting date that is only 45 days after the evaluation date does not provide firms with sufficient time to complete their evaluations. Performing a thoughtful and detailed evaluation of the QC system takes time and resources. Additionally, compiling the detailed reporting of QC deficiencies and related remedial actions to report to the PCAOB will require additional time and effort and also needs to be completed prior to the reporting date. We believe that in order to promote high quality, thoughtful evaluations and related reporting, firms need a longer period between the evaluation date and reporting date. We encourage the PCAOB to allow a period of at least 90 days between the evaluation date and reporting date (as proposed in Q64, which suggests a March 31st evaluation date and June 30th reporting date).

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 and in the cover letter, the best approach is for firms to select their own evaluation date (which likely necessitates using the proposed Form QC for reporting instead of Form 2) with a 90-day reporting period. The second-best option for most, but not all, firms would be reporting using the nonpublic portion of Form 2 due on June 30th (with a March 31st evaluation date), which is preferable to a November 30th evaluation date and January 15th reporting date. As stated in our response to Q63, 90 days would allow firms more time to perform thorough and detailed evaluations prior to reporting to the PCAOB.

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, *Report on the Evaluation of the Firm's System of Quality Control*, 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 the cover letter (and repeated in our 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 how firms should handle circumstances in which they become aware of information after the evaluation and reporting date that is relevant to the firm's conclusion on Form QC, specifically when an amendment may be required. We recommend that the PCAOB state that inconsequential matters would not drive the need for revising and refiling a Form QC.

****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?***

*For reference, this response has been repeated from our comments in the cover letter.

We are supportive of a requirement for the auditor to communicate to the audit committee the firm's conclusion on its most recent annual evaluation of its QC system and believe that this could promote beneficial dialogue between the auditor and audit committee regarding major QC matters.

However, we believe that the requirement to communicate a "brief overview of remedial actions taken and to be taken" should be specifically limited to remedial actions related to *major QC deficiencies.* We believe that the *major QC deficiency* level is the appropriate level to communicate to the audit committee as major QC deficiencies are deficiencies that are severe and pervasive to the overall system of quality control. Major QC deficiencies would impact the majority of the firm's engagements. We believe that communicating all QC deficiencies to the audit committee is too low a threshold because QC deficiencies are not severe and pervasive to the overall system of quality control and are likely relevant to only a subset of the firm's engagements. If auditors are required to communicate at the QC deficiency level, the communications may not be relevant to the audit committee.

We believe that communication related only to major QC deficiencies would appropriately direct the focus of the audit committee to major issues that could impact the auditor's performance and provide decision-useful information for effective oversight of the auditor.

If the Board determines that all QC deficiencies should be reported to the audit committee (as currently proposed), we strongly encourage the Board to update the definition of QC deficiencies as described in our response at Q53.

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

*Documentation Completion Date

*For reference, this response has been repeated from our comments in the cover letter.

The proposed standard establishes the QC documentation completion date as 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*.[25] Consistent with the requirements of AS 1215, we recommend that the PCAOB require that all necessary procedures to support the QC evaluation be completed prior to the reporting date. The 45-day documentation completion period would be for the audit firm to assemble the complete and final set of documentation for retention. This better aligns with the current audit documentation requirements and will allow firms to focus their efforts on the evaluation and reporting requirements in advance of the reporting date.

Documentation Retention Requirements

[25] Per AS 1215 paragraph .15: "Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (documentation completion date). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased."

The proposal requires that "the firm must prepare and retain documentation of the design, implementation, and operation of the QC system and of the annual evaluation of the QC system."[26] The PCAOB Release further elaborates that:

> The documentation of the operation of the firm's QC system would enable the firm to determine if the policies and procedures were operated in the manner that the firm intended. This specific documentation requirement would also provide evidence of compliance with the specified quality responses and other proposed requirements of QC 1000. For example, it would provide evidence of how the firm complied with specific communication requirements related to the operation of the firm's QC system and the performance of its engagements and whether the procedures implemented by the firm were operated as designed.[27]

We believe that the requirement to maintain all documentation evidencing the operation of the QC system is extremely broad and would require firms to retain a significant volume of evidence to demonstrate that all responses operated as designed in every instance throughout the year. We suggest that the documentation requirements for firms complying with QC 1000 be comparable to the documentation requirements that SOX imposes on issuers and be limited to the evidence to support results of monitoring and the annual evaluation.

Specific to documentation that supports a firm's evaluation of its system of quality control and the related testing, a seven-year retention requirement is acceptable and consistent with SEC document retention requirements.[28] However, if the documentation requirement is interpreted more broadly, we disagree that this requirement would not be burdensome for firms. There are costs to firms to retain significant amounts of data (for example, physical and electronic data warehousing costs and maintaining licenses to sunset technology platforms). We do not think documentation of all quality control activities is appropriate to retain for seven years. Retaining sensitive information, for example, related to personnel or ethics, introduces heightened cybersecurity risks for firms, firm personnel, clients, and other stakeholders. Firms have made concerted efforts to reduce risk by being careful stewards of information, retaining information for only as long as necessary. We strongly encourage the Board to clarify the scope of what is intended to be retained for seven years.

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. We believe that this will enhance audit quality and promote the public interest.

[26] QC 1000 para. .81

[27] PCAOB Release No. 2022-006, page 220

[28] See S-X Rule 2-06(a)

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?

We agree with the principle behind this change to AS 2901 as it is intended to promote audit quality, however we suggest exceptions be considered. In current practice, most identified engagement deficiencies are remediated, even when the auditor's opinion is not unsupported. 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 deficiency, we support remedial action at the firm level.

The PCAOB Release states that certain circumstances may suggest that the auditor's report is no longer being relied upon, including when "so much time has elapsed that the financial statements covered by the auditor's report are no longer required to be included in SEC periodic reports."[29] We suggest that there may be some instances, for example, when the issuance of the subsequent year's report is imminent and the impacted financial statements would not be included in that SEC filing, such that remedial actions at the engagement level may not be necessary. We suggest that the Board consider if there should be exceptions in such circumstances.

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

We believe that the effective date could create challenges for auditors. The proposal sets forth an effective date of "December 15 of the year after approval by the SEC." Operating under the assumption that 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 were not required to implement ISQM 1. The effective date of the AICPA's SQMS 1 is December 15, 2025. We therefore 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 (in alignment with the effective date of the SQMS 1). Providing firms, particularly smaller firms not subject to ISQM 1, with sufficient time to implement the standard will allow firms to thoughtfully identify quality risks and develop and document robust quality responses. This is critical to generate the intended transformational benefits of an enhanced QC standard.

Through the CAQ's nearly two years of experience working with firms on the implementation of ISQM 1, we have observed that firms need time to thoughtfully evaluate the specific risks to their business and related responses. To achieve the best results from this process, firms should be taking a top-down approach to evaluating risks, which takes time. It is important that the proposed effective date provides sufficient time for all firms, including those who have not implemented ISQM 1, to perform such evaluations. Additionally, a longer implementation period will enable the firms and staff/Board to discuss potential implementation issues and inform additional guidance.

If the PCAOB keeps the proposed specified quality responses, we encourage the Board to consider an initial phased implementation for those incremental quality responses for firms that issued audit reports

[29] PCAOB Release No. 2022-006, page 231

with respect to more than 100 issuers during the prior calendar year (or the updated threshold as deemed appropriate based on the PCAOB's outreach). We observe that some 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).