Comment Letter Analysis

CAQ Analysis of PCAOB Proposed Auditing Standard - A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms (QC 1000)

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CAQ

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We welcome your feedback!

Please send your comments or questions to info@thecaq.org

As of this publishing, the PCAOB received 43 comment letters in response to QC 1000. The CAQ has summarized the comment letters by theme. See the Appendix for a detailed summary by stakeholder type for more information.

Who responded?

Stakeholder Type	Submitted Comment Letter	% of Total Comment Letters
Investors	9	21%
Accounting Firms (and Related Groups)	24	56%
Other	6	14%
Academics	4	9%
Total	**43**	**100%**

General Themes

Based on our analysis, we believe all stakeholders are looking toward the same goal: improved audit quality to best serve investors. As we would expect, views on how that goal should be achieved vary.

1. How scalable should the QC 1000 be?

- At one end of the spectrum of views, investors appear to favor more prescriptive requirements.
- On the other hand, accounting firms and accounting-related organizations want more scalability to allow firms to tailor responses to their specific risk assessments.
- Academics advocate for a balance of prescriptiveness and flexibility.

2. Should QC 1000 align with ISQM 1?

- Accounting firms and accounting-related organizations want more alignment with ISQM 1 on key areas such as definitions that impact the operation and evaluation of the QC system.
- Some investors believe that close alignment with ISQM 1 is not in the best interest of investors as it does not sufficiently reflect the unique market considerations and needs of US investors.
- Other stakeholders generally support alignment with ISQM 1 noting that there are certain deviations from ISQM 1 in the proposed standard that are problematic.

3. Investors want public disclosure and state reporting to the audit committee is not enough

- Investors strongly encourage a requirement for public disclosures related to a firm's system of quality control. Only reporting to the audit committee does not meet their needs.
- Accounting firms and accounting-related organizations generally support disclosure to the audit committee with some modifications to what is reported to provide meaningful and decision-useful information.
- Some other stakeholders note that such disclosures may violate the confidentiality constraints under the Sarbanes-Oxley Act.

THE WAY WE SEE IT

Unnecessary differences between the PCAOB's QC standard and IAASB's quality management standard (ISQM 1) are not in the best interest of audit quality. Many firms are subject to multiple QC standards, including ISQM 1. A key component of alignment is that the standards are built on a common foundation.

THE WAY WE SEE IT

Whether the final standard will incorporate further requirements for public disclosure related to a firm's system of quality control remains to be seen. In the meantime, public accounting firms are already voluntarily communicating valuable information about their systems of quality control. Check out this CAQ resource, *Audit Quality Reports Analysis: A Year in Review* to learn more.

4. Incremental Requirements for Firms Auditing More than 100 Issuers

+ Is auditing 100 issuers the right threshold?
    - Some investors and other stakeholders commented that the threshold for incremental requirements should be based on market capitalization of issuers audited rather than number of issuers.
    - Some accounting firms question whether the 100-issuer threshold is appropriate and encourage the PCAOB to consider performing additional outreach. Some firms and also the U.S. Chamber of Commerce recommend that the threshold be increased to 500 issuers for certain incremental requirements.
    - One academic commented that requiring these incremental responses for only certain firms may give rise to audit quality differences between large and small firms.
+ Independent Oversight
    - Investors commented that simply having one independent advisor would not necessarily be sufficient to drive change at firms.
    - One academic agrees with this view.
+ Automated Independence Requirements
    - Smaller accounting firms are concerned about the investment that would be required to implement such a system would not derive a corresponding benefit to audit quality.

5. Evaluation and Reporting Dates

+ Accounting firms and accounting-related organizations want to be able to select their own evaluation dates based on their specific business cycles and other facts and circumstances and do not support the proposed evaluation date of November 30. They also advocate for a period longer than the proposed 45 days between the evaluation and reporting dates to complete their evaluations and prepare required reporting.

THE WAY WE SEE IT

The evaluation date should not be prescribed by the PCAOB. There should be flexibility in choosing the evaluation date selected by each individual firm based upon their own cadence for activities related to evaluating their system of quality control, business cycle, and other relevant factors.

6. Definition of Deficiency

+ Accounting firms and accounting-related organizations generally disagree with the definition of a QC deficiency as proposed in QC 1000. They overwhelmingly support aligning the definition with ISQM 1.

THE WAY WE SEE IT

QC 1000 could result in more QC findings rising to the level of a QC deficiency under QC 1000 than under ISQM 1. The similar yet different definitions between QC 1000 and ISQM 1 could lead to confusion by stakeholders, which does not serve the public interest.

Appendix

Summary of Responses by Stakeholder Type

INVESTORS:

+ Members of the IAG
+ Council of Institutional Investors (CII)
+ Jon Lukomnik
+ Public Citizen
+ Ceres Accelerator for Sustainable Capital Markets
+ Consumer Federation of America (CFA)
+ AARP; American Federation of State, County and Municipal Employees (AFSCME); Americans for Financial Reform Education Fund; Better Markets; Consumer Federation of America; Public Citizen; 20/20 Vision
+ American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)
+ California State Teachers' Retirement System

Key Issues:

1. Disclosures related to a firm's system of quality control should be made public (100% commented).

2. Audit Quality Indicators (AQIs)/ firm and engagement performance metrics should be integrated with the QC standard project (56% commented).

3. Independent oversight requirement (only one independent individual who does not need to be in the "chain of command") is not sufficient as currently proposed (56% commented).

Summary:

1. Lack of public disclosure

+ There needs to be public disclosure related to a firm's system of quality control. Reporting to the PCAOB and the Audit Committee is not enough (All **9 investors**).

2. AQI action wanted

+ Investors want PCAOB action on the firm and engagement performance metrics (or AQIs) project [**5 investors** (Members of the IAG, CII, California State Teacher's Retirement System, CFA, and AFL-CIO)].

+ Several commented that the project closely aligns with the QC project.

3. Independent oversight proposal is not enough

+ The proposed independent oversight requirement (only one independent individual who does not need to be in the "chain of command") is not sufficient to drive meaningful change as currently proposed [**5 investors** (CII, California State Teacher's Retirement System, Ceres Accelerator for Sustainable Capital Markets, CFA, and AFL-CIO)].

4. Scalability

+ Not supportive of the emphasis on scalability in the proposal [**1 investor** (Members of the IAG)].

+ The 100-issuer threshold for certain incremental requirements in QC 1000 should be based on market capitalization, rather than number of issuer clients [**3 investors** (Members of the IAG, CII, and California State Teacher's Retirement System)].

5. Not all want alignment with ISQM 1

+ Close alignment with ISQM 1 is not in the best interest of investors as it does not sufficiently reflect the unique considerations of US markets and investors [**2 investors** (CFA and AFL-CIO)].

6. Some want specific evaluation and reporting dates

+ Firms should not be allowed to select their own evaluation dates [**1 investor** (Members of the IAG)].

+ November 30 (proposed evaluation date) and January 15 (proposed reporting date) are appropriate dates [**1 investor** (Members of the IAG)].

7. Some want more required audit committee communications

+ The requirement to only report to the audit committee the firm-wide evaluation of the QC system is insufficient. It would be more beneficial to provide independent verification of the QC system and engagement specific information, such as AQIs [**1 investor** (Members of the IAG)].

+ The proposed requirement to communicate to the audit committee is reasonable [**2 investors** (CII and California State Teacher's Retirement System)].

ACCOUNTING FIRMS (AND RELATED GROUPS) (INCLUDES 16 ACCOUNTING FIRMS, 6 ACCOUNTING ORGANIZATIONS, AND 2 CONSULTING FIRMS):

Accounting Firms:

+ Baker Tilly US, LLP
+ BDO USA, LLP
+ Crowe LLP
+ Deloitte & Touche LLP
+ Eide Bailly LLP
+ Ernst & Young LLP
+ FORVIS, LLP
+ Grant Thornton LLP
+ KPMG LLP
+ Mazars USA LLP
+ MNP LLP
+ Moss Adams LLP
+ Plante & Moran, PLLC; Plante Moran, P.C.
+ PricewaterhouseCoopers LLP
+ RSM US LLP
+ CohnReznick

Accounting Organizations:

+ Accountancy Europe
+ Center for Audit Quality
+ ICAEW
+ Institut der Wirtschaftsprüfer
+ National Association of State Boards of Accountancy
+ Texas Society of Certified Public Accountants

Consulting Firms:

+ Auvana Accountancy Corporation
+ Johnson Global Accountancy

Key Issues:

1. Importance of alignment with ISQM 1 (92% commented)

2. Firms should be able to select their own evaluation date (88% commented)

3. Disagree with definition of QC deficiency (67% commented)

Summary:

1. Scalability

+ **Not sufficiently scalable**

  - Support the concept of scalability but some aspects of the proposal are not sufficiently scalable to firms of all sizes [**13 accounting firms**].

  - Elements of the proposal are not sufficiently scalable to smaller firms [**1 consulting firm** (Johnson Global Accountancy)].

  - Support the concept of scalability in the proposal but expressed concern that the proposal is not necessarily scalable to all firms [**3 accounting organizations** (Texas Society of CPAs, CAQ, and NASBA)].

+ **Sufficiently scalable**

  - Support the risk-based approach in QC 1000, which allows for scalability of the requirements [**1 accounting firm** (MNP LLP)].

+ **100-issuer threshold**

  - Question the appropriateness of the 100-issuer threshold for some or all of the incremental requirements in QC 1000 (**12 accounting firms**). Some firms recommended the threshold be increased (for some or all requirements) to 500 issuers.

  - Recommends the threshold be based on the market capitalization of the firm's issuer clients, instead of number of issuers [**1 consulting firm** (Auvana Accountancy)].

  - Question whether 100 issuers is an appropriate threshold and suggested that other factors, such as the nature of issuers audited may also be relevant to consider in establishing a threshold [**4 accounting organizations** (Accountancy Europe, CAQ, NASBA, and ICAEW)].

2. **Unnecessary differences between QC 1000 and ISQM 1**

   + **Importance of alignment with ISQM 1**

     - It is important for QC 1000 to align with ISQM 1 [**15 accounting firms**].

     - Support alignment of QC 1000 and ISQM 1 [All **6 accounting organizations**].

   + **Foundation/unnecessary differences**

     - There are differences between QC 1000 and ISQM 1 that are unnecessary, foundational to the standards, and/or otherwise problematic and contrary to the concept of alignment between the standards [**13 accounting firms** and **4 accounting organizations** (Accountancy Europe, CAQ, Institut der Wirtschaftsprüfer, and ICAEW)].

     - There are differences between QC 1000 and ISQM 1 that will impose challenges on smaller firms without a commensurate benefit to audit quality [**1 consulting firm** (Johnson Global Accountancy)].

3. **Definitions - Differences in QC 1000 and ISQM 1**

   + **QC finding definition**

     - Disagree with the definition of QC finding, particularly, that all engagement deficiencies are considered QC findings [**8 accounting firms** and **1 accounting organization** (CAQ)].

     - Disagree with the definition of QC finding for reasons other than the inclusion of engagement deficiencies in the definition [**2 accounting firms**].

     - Agree with the definition as proposed [**1 accounting firm** (KPMG) and **1 accounting organization** (NASBA)].

   + **QC deficiency definition**

     - Disagree with the definition of QC deficiency and highlighted the definition differs from ISQM 1 and may result in firms arriving at different conclusions under each standard [**12 accounting firms** and **3 accounting organizations** (Accountancy Europe, CAQ, and Institut der Wirtschaftsprüfer)].

     - The definition of QC deficiency in QC 1000 differs from ISQM 1 but did not recommend that the definition should be updated [**1 accounting firm** (MNP LLP)].

   + **Quality risk definition**

     - Disagree with the definition of quality risks, noting that the threshold of “reasonable possibility of occurring” should apply to all risks [**13 accounting firms** and **1 accounting organization** (CAQ)].

     - Recommends that the PCAOB provide additional guidance regarding how firms should deal with remote risks of deception or violations i.e., those that have less than a reasonable possibility of occurring [**1 accounting organization** (ICAEW)].

4. **Evaluation date should not be specified by the PCAOB**

   + Disagree with the proposed November 30th evaluation date [All **16 accounting firms** and **4 accounting organizations** (Accountancy Europe, CAQ, Institut der Wirtschaftsprüfer, and ICAEW)].

   + Recommend that firms should be able to select their own evaluation date [**13 accounting firms, 1 consulting firm** (Johnson Global Accountancy), and **4 accounting organizations** (Accountancy Europe, CAQ, Institut der Wirtschaftsprüfer, and ICAEW)].

   + Suggest that the evaluation date should be September 30 or October 31 [**1 accounting organization** (NASBA)].

5. **Additional time needed between evaluation and reporting dates**

   + Disagree with the proposed January 15th reporting date (or any reporting date that is 45 days after the evaluation date) because it does not provide firms sufficient time [**15 accounting firms**].

   + Suggest the reporting date should be:

     - 90 days after the evaluation date [**10 accounting firms** and **2 accounting organizations** (Accountancy Europe and CAQ)].

- 60 days after the evaluation date [**1 accounting firm** (Crowe) and **1 accounting organization** (ICAEW)].

6. Additional documentation completion period needed

+ Additional time should be provided after the reporting date to complete documentation [**11 accounting firms** and **1 accounting organization** (CAQ)].

7. Audit committee reporting requirements should be scaled back

+ Disagree with certain aspects of the requirement to communicate with audit committees [**13 accounting firms**].
  - The communication threshold should be increased from QC deficiencies to major QC deficiencies [**6 accounting firms** (BDO, Plante Moran, RSM, Crowe, Mazars, Eide Bailly) and **1 accounting organization** (CAQ)].
  - Firms should only communicate the overall conclusion (no communications regarding deficiencies) [**3 accounting firms** (Deloitte, Moss Adams, and Grant Thornton)].
  - Firms should only be required to communicate to the audit committee when the firm concludes that the QC system is not effective [**2 accounting firms** (PwC and EY)].
  - Disagree with any requirement to report to the audit committee [**1 accounting firm** (MNP LLP)].
  - Communicating at the QC deficiency level is an overly low threshold to communicate with audit committees [**1 accounting organization** (Institut der Wirtschaftsprüfer)].
+ Agree with the proposed audit committee reporting requirement [**1 accounting firm** (CohnReznick)].

OTHER

+ Monte A. Jackel
+ Institute of Management Accountants (IMA)
+ U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (CCMC)
+ PCAOB Office of Economic and Risk Analysis
+ Robert A. Conway
+ American Bar Association, Business Law Section

Key Issues:

1. Importance of alignment with ISQM 1 (33% commented)

Summary:

1. Alignment with ISQM 1

+ Support alignment with ISQM 1 (**2 commenters**).
  - Support the proposal's approach to align with ISQM 1 (**IMA**).
  - Support alignment with ISQM 1 but there are significant deviations from ISQM 1 within the proposed standard, which are problematic **(U.S. Chamber of Commerce)**.

2. Scalability

+ The 100-issuer threshold for incremental requirements should be based on market capitalization audited rather than the number of issuers audited **(Robert Conway)**.
+ The 100-issuer threshold should be increased to 500 issuers **(U.S. Chamber of Commerce)**.

3. Differences in definitions in QC 1000 and ISQM 1

+ The definitions of QC finding and QC deficiency should be aligned with ISQM 1 **(U.S. Chamber of Commerce)**.
+ Disagrees with the proposed definition of quality risks and recommends the threshold of "reasonable possibility of occurring" apply to all risks **(U.S. Chamber of Commerce)**.

4. Differing views on evaluation and reporting dates

+ The evaluation date should be September 30, with a reporting date of November 15 **(IMA)**.
+ Firms should be able to select their own evaluation dates and should not be required to report to the PCAOB (no reporting date) **(U.S. Chamber of Commerce)**.

5. Differing views on audit committee reporting requirements

+ Support the requirement to communicate to the audit committee **(IMA)**.

+ The proposed communication requirement to the audit committee may violate the confidentiality constraints under SOX and does not add any incremental benefit beyond the voluntary audit quality reporting firms already share with the audit committee **(U.S. Chamber of Commerce)**.

6. Independent oversight

+ Support the proposed independent oversight requirement **(IMA)**.

+ The proposed independent oversight requirement should be eliminated **(U.S. Chamber of Commerce)**.

7. Annual reporting to PCAOB

+ Support non-public reporting of the annual QC evaluation to the PCAOB **(IMA)**.

+ The annual reporting requirement is not necessary as information regarding the firm's QC system is available to the PCAOB through the inspections process **(U.S. Chamber of Commerce)**.

+ The PCAOB should clarify the standard for liability for individual certifiers and explicitly state that Form QC would be privileged from disclosure pursuant to Section 105(b)(5)(A) of the Sarbanes-Oxley Act **(American Bar Association)**.

8. AQI action wanted

+ The QC project should be integrated with the PCAOB's ongoing project on firm and engagement performance metrics **(Robert Conway)**.

ACADEMICS

+ Melissa Carlisle, PhD, CPA, Assistant Professor; John D. Keyser, PhD, CPA, Assistant Professor, Case Western Reserve University, Weatherhead School of Management
+ Dina El Mahdy, PhD, CFE, Associate Professor of Accounting, Morgan State University, Graves School of Business and Management
+ Auditing Standards Committee, Auditing Section - American Accounting Association (ASC)
+ Mark E. Peecher, Deloitte Professor of Accountancy; Christie Hayne, Assistant Professor of Accountancy; Yuepin (Daniel) Zhou, Assistant Professor of Accountancy; and Jeff Pickerd, Assistant Professor in Accounting, University of Illinois at Urbana-Champaign; and The University of Mississippi

Key Issues:

None

Summary:

1. Scalability

+ It is important to balance prescriptiveness and flexibility of the QC standards. Academic research has pointed to benefits of both prescriptiveness and scalability of standards **(Mark Peecher, et al.)**.

+ The proposed 100-issuer threshold is not appropriate as it could give rise to audit quality differences between large and small firms. Incremental requirements should be applicable to all firms **(ASC)**.

2. Definition of quality risks is not appropriate

+ The proposed definition of quality risks should *not* explicitly address risks of intentional misconduct by firm personnel and other participants. If the definition continues to address risks of intentional misconduct, then the "reasonable possibility of occurring" threshold should apply to those risks **(ASC)**.

3. Lack of public disclosure

+ If the PCAOB can require firms to disclose QC information to the audit committee, the PCAOB should also require public disclosure **(Melissa Carlisle, et al.)**.

4. Independent oversight proposal not enough

+ One independent member/advisor in an oversight function may not be able to drive meaningful change given the balance of other non-independent members **(ASC)**.

About the Center for Audit Quality

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 auditors and audits to dynamic market conditions.