



# CENTER FOR CAPITAL MARKETS

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## COMPETITIVENESS.

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Ms. Phoebe W. Brown  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**Re: PCAOB Concept Release on *Potential Approach to Revisions to PCAOB Quality Control Standards* (PCAOB Release No. 2019-0031; Rulemaking Docket No. 046)**

Dear Secretary Brown:

The U.S. Chamber of Commerce’s (“the Chamber”) Center for Capital Markets Competitiveness (“CCMC”) appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB” or the “Board”) Concept Release on “Potential Approach to Revisions to PCAOB Quality Control Standards” (the “Concept Release”).

CCMC is pleased that the Board is undertaking the process of updating the PCAOB’s quality control standards. Quality controls (“QCs”) are foundational, as they provide an essential framework for effective audits. The PCAOB’s current quality control standards were issued by the American Institute of Certified Public Accountants (“AICPA”) before the Sarbanes-Oxley Act of 2002 (“SOX”) transformed oversight of public company audits with the creation of the PCAOB.<sup>1</sup> Since then, many changes have occurred in both the environment and practice of auditing. Thus, updating the quality control standards is an important project for the PCAOB. We appreciate that the Board’s due process includes this Concept Release to solicit stakeholder perspectives at an early stage in the project.

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<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) added broker-dealer audits to the PCAOB’s oversight responsibilities.

The Concept Release acknowledges that over the past two decades audit firms, in particular firms annually inspected by the PCAOB, have made significant investments in their quality control systems, including to incorporate technological advances. These investments can be expected to continue as technology evolves. As an overarching matter, CCMC strongly recommends that updated PCAOB quality control standards not only consider, but facilitate, the incorporation of technological developments.

Our comments below provide perspective on issues discussed in the Concept Release framed around core principles for the PCAOB’s potential approach to crafting revised quality control standards (convergence, reasonable assurance, risk-based, and scalable), along with other matters.

### ***Core Principles of Potential Approach***

The Concept Release outlines a potential approach for revising the PCAOB’s quality control standards. Several core principles appear to condition this approach, including convergence, reasonable assurance, risk-based, and scalable. CCMC strongly supports these principles. They are essential components for developing PCAOB quality control standards in order to meet cost-benefit considerations. In this section, we comment on the Concept Release in the context of each of these core principles.

#### *Convergence of QC Standards*

The Concept Release recognizes that many audit firms overseen by the PCAOB (whether large or small, and whether part of a global network or not) are also subject to other quality control standards, including those of the International Auditing and Assurance Standards Board (“IAASB”) and the AICPA’s Auditing Standards Board (“ASB”). The IAASB is likewise in the process of updating its quality control standards and, in February 2019, proposed an International Standard on Quality Management 1 (“Proposed ISQM 1” or “ISQM 1”).<sup>2</sup>

The Concept Release explains that the PCAOB is considering an approach based on the Proposed ISQM 1 as the starting point for potential revisions in

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<sup>2</sup> The proposed ISQM 1 is entitled *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or other Assurance or Related Services Engagements*. The comment period ended in July 2019 and the IAASB is in the process of considering comments and making revisions to the proposal, with the objective of voting on a final standard in 2020.

PCAOB quality control standards. In turn, the Concept Release is framed around this approach. The Concept Release states:

*Due to the foundational nature of QC systems, we believe it would not be practical to require firms to comply with fundamentally different QC standards. Unnecessary differences in QC standards could even detract from audit quality by diverting firms' efforts from focusing on matters of fundamental importance to effective QC systems.<sup>3</sup>*

CCMC strongly agrees with these perspectives and applauds the PCAOB for applying a core principle of “converged” standards. CCMC has long supported the convergence of auditing standards.<sup>4</sup> As the Concept Release recognizes, minimizing differences among standards takes on added importance for quality control<sup>5</sup>

Nonetheless, while the Concept Release outlines a potential approach to developing PCAOB quality control standards in the context of the Proposed ISQM 1, the Concept Release likewise describes a number of potential differences between ISQM 1 that the PCAOB could consider for its future quality control standards. Indeed, the discussion in the Concept Release of each aspect of a potential quality control system includes a section outlining numerous “Potential Differences Between ISQM 1 and a Future PCAOB QC Standard.”

CCMC appreciates the robustness of this discussion of potential differences for providing transparency and enabling feedback at this early stage in the project. Further, we understand that PCAOB quality control standards need to align with U.S. federal securities law, SEC rules, and perhaps extant PCAOB standards and rules (that would be impractical or undesirable to revise).

However, CCMC strongly encourages the PCAOB to be guided by the essential core principle of convergence and avoid unnecessary differences with the quality control standards of others. This is the only way, the PCAOB can meet its expressed intent “to enable firms to build a single QC system to support engagements under both PCAOB and other applicable standards.”<sup>6</sup>

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<sup>3</sup> See the Concept Release, page 9.

<sup>4</sup> For example, see the letter dated February 18, 2009 from the CCMC to the PCAOB on the PCAOB’s *Proposed Auditing Standards Related to the Auditor’s Assessment of and Response to Risk* (PCAOB Rulemaking Docket Matter No. 026).

<sup>5</sup> The ASB has established a task force to monitor the IAASB’s quality management projects and consider revisions to the AICPA’s analogous standards once the IAASB’s standards are finalized.

<sup>6</sup> See the Concept Release, page 13.

### *Reasonable Assurance*

Reasonable assurance underpins current PCAOB quality control standards. Under current PCAOB standards, a system of quality control is broadly defined as:

*[A] process to provide a firm with **reasonable assurance** that its personnel comply with professional standards applicable to its accounting and auditing practice and the firm's standards of quality.<sup>7</sup> (emphasis added)*

PCAOB registered audit firms are required to design and implement a system of quality control to provide reasonable assurance.

Reasonable assurance likewise underpins the objective of the IAASB's Proposed ISQM 1, as described in the Concept Release.<sup>8</sup> CCMC strongly supports maintaining this core principle in the definition and objective of a system of quality control and for framing the requirements of the system.

### *Risk-Based*

The Proposed ISQM 1 takes a risk-based approach to quality management for firms performing financial statement audits and reviews or other assurance or related services. As noted in the Concept Release:

*Proposed ISQM 1 is designed to focus firms' attention on proactively identifying and responding to quality risks that may affect engagement quality.<sup>9</sup>*

Under the approach in the Proposed ISQM 1, firms would be required to establish quality objectives, identify and assess risks to the achievement of the firm's quality objectives ("quality risks"), and design and implement responses to address the assessed quality risks,<sup>10</sup> all in order to provide the firm with reasonable assurance that it meets the overall objective of the system of quality management in accordance with the standard.<sup>11</sup>

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<sup>7</sup> See the Concept Release, page 5.

<sup>8</sup> See the Concept Release, page 11.

<sup>9</sup> See the Concept Release, page 5.

<sup>10</sup> See the Concept Release, page 12.

<sup>11</sup> Under Proposed ISQM 1, the objective of the system of quality management is to provide reasonable assurance that: (a) The firm and its personnel fulfill their responsibilities in accordance

A risk-based approach to quality controls seems eminently sensible. It allows firms to focus on what matters most for audit quality. In addition, it facilitates the promulgation of a scalable standard, consistent with the core principle subsequently discussed.

However, it is worth emphasizing that risk in the Proposed ISQM 1 is at the engagement level. The risks that are the focus of this approach are those related to whether audit engagements are performed effectively – essentially, in accordance with applicable standards and requirements and with reports rendered being appropriate in the circumstances. This means that the requirements in revised PCAOB quality control standards should be closely tethered to engagement-level quality risks, and avoid straying off into other areas, including overall business risks.

For example, while quality control standards may involve a component for governance and leadership, PCAOB standards should not require audit firms to have boards with independent directors or the equivalent.<sup>12</sup> Further, quality controls over the allocation of investments to lines of firms' services (including requirements to direct firms to allocate sufficient financial resources to the audit and assurance practice<sup>13</sup>) are not supportable from this perspective either. PCAOB quality control standards should not take on the role of "counterbalancing commercial interests" that somehow may be thought to lead to underinvestment in the audit and assurance practice in the many firms that are not "audit-only."<sup>14</sup> Lastly, as an aside, other practical measurement considerations arise, too. Synergies occur across service lines from investments. For example, technology-related investments within a consulting line of practice can benefit audit and assurance services.

### *Scalable*

The PCAOB oversees audits of both issuers and broker-dealers performed by audit firms of all sizes and complexities and located both in the U.S and abroad. Since revised PCAOB quality control standards would apply to all such audit firms, CCMC

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with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances (see the Concept Release, page 11).

<sup>12</sup> See the Concept Release, page 16.

<sup>13</sup> See the Concept Release, page 17.

<sup>14</sup> See the Concept Release, page 16.

appreciates the PCAOB's recognition of scalable as a core principle. For example, the Concept Release states:

*We believe that any revisions to the QC standards the PCAOB may adopt should be appropriately scalable, so a firm can tailor its QC system appropriately based on the firm's size and complexity and the nature of the engagements performed, commensurate with applicable quality risks.<sup>15</sup>*

A principles-based approach to standard-setting facilitates scalability. Thus, an approach based on the core principles of convergence, reasonable assurance, and risk is an important step in supporting revised PCAOB quality control standards that are scalable.

Nonetheless, CCMC understands guidance in certain areas (for example, evaluation of control deficiencies) will be necessary for clarity and to avoid confusion in order for firms and auditors to comply with PCAOB quality control standards. In providing such guidance, we encourage the PCAOB to avoid becoming overly prescriptive.

To illustrate, there are different approaches for obtaining independent *input* on audit quality matters. Firms should have the ability to decide the nature and extent of independent input, if any, based on their individual facts and circumstances. In addition, the efficacy of having independent *oversight* of a firm's quality control system is an open question. It may not be cost-benefit effective for all firms – even firms of similar sizes or structures – especially considering that the PCAOB inspection process includes a focus on quality controls.<sup>16</sup> Thus, CCMC does not support including requirements for independent input on and/or oversight of a firm's quality control system in revised PCAOB quality control standards.

Further examples of overly prescriptive guidance in quality control standards would include (1) a requirement for firms to establish quantifiable performance measures for the achievement of quality objectives;<sup>17</sup> (2) mandating establishing and tracking performance measures, using engagement tracking tools, and performing reviews of in-process engagements,<sup>18</sup> and (3) maintaining quality control

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<sup>15</sup> See the Concept Release, page 13.

<sup>16</sup> See the Concept Release, page 17.

<sup>17</sup> See the Concept Release, page 18.

<sup>18</sup> See the Concept Release, page 25.

documentation that satisfies the reperformance requirement in PCAOB Auditing Standard (“AS”) 1215.<sup>19</sup>

Overly prescriptive PCAOB quality control standards would also undermine the ability of the standards to accommodate technological developments and otherwise serve the test of time.

### ***Other Matters***

#### *Reporting*

The Concept Release discusses that the PCAOB is considering whether to add incremental or alternative quality control reporting requirements, including an annual report to the PCAOB on the firm’s evaluation of the effectiveness of its QC system, and whether to make such reports publicly available.<sup>20</sup> Such added requirements seem unnecessary, and could even cause confusion, given existing PCAOB requirements and audit firm external reporting on the effectiveness of quality controls.

For example, the PCAOB, in accordance with SOX, has established a structure for external communications on QC-related matters with regulators and others through the PCAOB inspection reporting process. Auditors likewise communicate on these matters with audit committees. In addition, a number of audit firms, particularly the largest firms, publish annual audit quality reports that speak to quality control matters. Many of these audit quality reports are very robust. Importantly, annual audit firm quality reports have evolved over time and continue to do so. Cementing incremental or alternative PCAOB requirements for external reporting on quality controls into revised QC standards could result in a “checklist” approach to reporting and actually impede the evolution and “quality” of this reporting.

#### *Relationship Between Auditing and QC Standards*

Extant PCAOB Auditing Standards discuss the relationship between auditing standards and quality control standards. In this regard, it is important for the PCAOB to maintain the current language in PCAOB Auditing Standards (AS 1110.03), as follows:

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<sup>19</sup> See the Concept Release, page 41.

<sup>20</sup> See the Concept Release, page 39.

*[D]eficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular audit engagement was not performed in accordance with auditing standards.<sup>21</sup>*

While the Concept Release acknowledges that these statements are rather obvious and suggests deleting them,<sup>22</sup> any such deletion in promulgating revised quality control standards could be misinterpreted as conveying the PCAOB no longer agrees with the language.

### *Other Matters Regarding ISQM 1*

Two other matters in regards to Proposed ISQM 1. First, the structure of IAASB standards differs from those of the PCAOB, in that each of the former standards contain “Application and Other Explanatory Material” for auditors to understand and consider in the context of the standard. The Concept Release does not discuss how the PCAOB intends to handle this material. For example, the PCAOB could either provide application guidance or, in furtherance of convergence, allow utilization of application materials in ISQM 1. The CCMC appreciates that issues may arise under either approach and encourages the PCAOB to solicit public comment on this matter.

The other matter is that ISQM 1 is not yet final. The Concept Release states that the PCAOB will monitor the IAASB’s work as ISQM 1 is finalized.<sup>23</sup> However, the Concept Release public comment process provides an opportunity for the PCAOB to do more than just monitor. CCMC encourages the PCAOB to utilize feedback on the Concept Release in proactively engaging with the IAASB, as the IAASB proceeds to finalize ISQM 1. We hope that standard-setters will work together to achieve the most cost-benefit effective converged quality control standards that will benefit all stakeholders.

Further, the open status of ISQM 1 as the basis for comment on the Concept Release means that the PCAOB will need a robust due process going forward to provide for further public dialogue and feedback.

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<sup>21</sup> See the Concept Release, page 46, quoting from AS 1110, *Relationship of Auditing Standards to Quality Control Standards*.

<sup>22</sup> See the Concept Release, page 46.

<sup>23</sup> See the Concept Release, page 5.

*Extended Implementation Period*

Lastly, CCMC recommends that the PCAOB consider an extended implementation period for any revised quality control standards. An extended implementation period is necessary to give audit firms sufficient time to design and implement an effective system of quality control that complies with any final standards. For example, audit firms would need to develop new systems; perform proper quality risk assessments; design and implement additional controls; design and implement additional monitoring and remediation processes; and conduct training for their professionals.

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Thank you for your consideration of CCMC's comments and suggestions and we stand ready to discuss them with you further.

Sincerely,

A handwritten signature in black ink, appearing to read "Erik Rust".

Erik Rust