March 16, 2020

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

RE: PCAOB Rulemaking Docket Matter No. 046

Dear Madam Secretary:

We[1] appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Concept Release: *Potential Approach to Revisions to PCAOB Quality Control Standards* included in PCAOB Release No. 2019-003 (the "concept release"). While this response has been developed by the US member firm of the PwC global network, we have solicited feedback from other member firms within our network that would also be subject to revised PCAOB quality control (QC) standards in order to inform our response.

Overview

Audit quality is core to our purpose - to build trust in society and solve important problems - and our strategy. Our purpose drives everything we do. While we continuously evolve in response to changing technological, demographic, social, and economic environments, we vigilantly maintain our focus on enhancing audit quality. We therefore support the PCAOB's consideration of revisions to its QC standards aimed at continuous improvement to firms' QC systems.

As noted in the concept release, effective QC systems are crucial to supporting consistently high-quality audits and other engagements under PCAOB standards. Firms' QC systems have evolved since the AICPA developed what are currently the PCAOB's QC standards, which were adopted as interim standards in 2003. This change is the product of the clarification of QC standards by the International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board (ASB), as well as firms' own investments in strengthening their QC systems in light of the environment in which they operate.

The PwC global network is in the process of implementing a more proactive approach to quality management. This approach is objectives based, rather than prescriptive, and is structured with defined quality objectives to be achieved. The network and its member firms have invested significantly in recent years to redesign their QC systems to focus on quality management, and we expect these systems to continue to evolve due to the pace of change in the environment in which audits are conducted. From a US perspective, this has meant tailoring our system to the risks we face as a firm operating in the US legal and regulatory environment, and building upon our existing ecosystem of policies and controls that enable us to achieve our quality objectives and demonstrate compliance with PCAOB QC standards.

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[1] Reference to "we" and "our" in this letter are to PricewaterhouseCoopers LLP, the US member firm of the PwC global network. References to the "PwC global network" are to the PwC network, which consists of firms that are separate legal entities. Firms in the PwC network are members in, or have other connections to, PricewaterhouseCoopers International Limited (PwCIL), an English private company limited by guarantee. PwCIL does not practice accountancy or provide services to clients. The PwC network is not one international partnership and PwC member firms are not otherwise legal partners with each other. A member firm cannot act as an agent of PwCIL or any other member firm, and cannot obligate PwCIL or any other member firm. Similarly, PwCIL cannot act as an agent of any member firm and cannot obligate any member firm.

PricewaterhouseCoopers LLP, 400 Campus Drive, Florham Park, NJ 07932
T: (973) 236 4000, F: (973) 236 5000, www.pwc.com

We are pleased with the progress we have made on our quality journey, as outlined in our 2019 *Audit Quality Report*.[2] We seek to prevent audit deficiencies by considering the risks to quality and the design and operation of appropriate processes and controls to address those risks. We are also focused on enhancing our robust root cause analysis to help us monitor whether our processes and controls are working effectively and addressing any identified deficiencies in a timely manner. Elements of our QC system have been and will continue to be reimagined to take into account the impact of technology, data, and the changing business environment – including changes in our own business and those of our clients. Other key aspects of our system include pre-issuance reviews of certain audit engagements to provide engagement teams with timely feedback prior to the issuance of their audit reports; a recognition and accountability framework; and performance measures, which are embedded in the system to support monitoring and measurement of success in achieving our quality objectives. Our firm culture and values contribute to the effective functioning of our quality management system. We continue to evolve our QC system in light of the modern environment.

The PCAOB's proposal to use proposed ISQM 1 as a starting point

Many registered firms are subject to the PCAOB's QC standards as well as those of the IAASB or national standards that use the IAASB's standards as a base. We agree with the PCAOB's statements that "it would not be practicable to require firms to comply with fundamentally different QC standards" and that "unnecessary differences in QC standards could even detract from audit quality by diverting firms' efforts from focusing on matters of fundamental importance to effective QC systems." We therefore support the PCAOB's proposal to leverage the IAASB's work to develop proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

We also think it is important to recognize that, while PwC in the US conducts a significant number of audits of issuers,[3] within the PwC network there are a number of firms that perform a much more limited number of engagements in accordance with PCAOB standards (including work supporting multilocation audits of US issuers). These firms may ultimately be required to comply with PCAOB QC standards and proposed ISQM 1. There may also be national laws or regulations, including more specific requirements related to QC standards that may differ in some respects from proposed ISQM 1 or revised PCAOB QC standards. Accordingly, allowing flexibility in the design of a firm's QC system is critical to the success of revised PCAOB QC standards, as well as proposed ISQM 1. Without such flexibility, there may be unintended consequences, including conflicts with national laws or regulations governing confidentiality and many other substantive matters. In moving forward with standard setting and considering the need for incremental or alternative requirements, the PCAOB should solicit feedback as to whether practical challenges, including those related to scalability, are truly outweighed by benefits to quality. This is especially true to the extent that the PCAOB is considering prescriptive rules that run the risk of undermining the principles-based approach in proposed ISQM 1 to tailor the firm's quality risks and responses to the firm's facts and circumstances and the scalability that such an approach provides to firms of all sizes and circumstances.

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2 See our 2019 Audit Quality Report and our February 2020 update.

3 The concept release uses the term "issuer" as defined in Sarbanes-Oxley. Under Sarbanes-Oxley Sec. 2(a)(7), an "issuer" means "an issuer (as defined in section 3 of the Securities Exchange Act of 1934), the securities of which are registered under section 12 of that Act, or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn."

In our view, refocusing QC standards to be based on an objective-driven and risk-based approach will encourage a more proactive focus on quality management, while allowing a firm's QC system to be tailored to the jurisdiction in which the firm operates. This model is more reflective of how firms should be managing quality, and more aligned to risk management frameworks used by other organizations.

Proposed ISQM 1 presents a useful framework for establishing this approach.[4] The IAASB is in the process of considering feedback received on its proposal, including concerns about the scalability, complexity, and prescriptiveness of the standard. Each firm may structure its system differently to effectively manage and support quality based on the circumstances of the firm, or may use different terminology or frameworks to describe the components of a QC system. We believe scalability could be negatively impacted if the flexibility in the PCAOB's revised QC standards differs from that provided in proposed ISQM 1.

To further support scalability, we understand the IAASB is exploring introducing factors that firms would be required to take into account in identifying and assessing quality risks. We believe this is a pragmatic compromise that avoids prescribing specific risks that may be viewed as incomplete (or not applicable to all firms), while providing useful direction for firms to assist in the determination of potential risks. We encourage the PCAOB to continue to monitor the IAASB's work as it moves towards the finalization of ISQM 1 and then conduct additional outreach with firms, as necessary, on areas of significant change in the final standard and any perceived implementation challenges that could influence the PCAOB's direction. It is essential to acknowledge the continuously changing environment in which firms will conduct audits and the possibility of changes in firm circumstances and quality risk over time. These considerations highlight the need for QC standards that are appropriately flexible and principles based.

Although principles based, proposed ISQM 1 includes a significant amount of application material, which provides context relevant to a proper understanding of the standard and application of its requirements. In our view, aspects of this guidance may help firms consider how to apply the principles underpinning the new quality management framework and scale the requirements to their circumstances. In addition, if the requirements in the revised PCAOB QC standards are substantially similar to those in proposed ISQM 1, questions are likely to arise in practice as to whether the IAASB's application material should be considered when applying the revised PCAOB QC standards. We encourage the PCAOB to consider where relevant guidance from proposed ISQM 1 may be appropriate in the revised PCAOB QC standards (for example, as Notes to specific requirements or Appendices). Alternatively, the PCAOB may need to explore whether additional guidance is needed to clarify and implement its revised QC standards.

The need for incremental or alternative requirements in revised PCAOB QC standards

We agree there may be valid reasons for PCAOB QC standards to have additional or more specific requirements or risk factors than those set out in proposed ISQM 1 – for example in areas that are not expressly covered in the IAASB's standard. Nevertheless, it is important that the PCAOB's QC standards remain principles-based such that firms' QC systems can be tailored to their individual facts and circumstances, including those of firms whose audits are generally not subject to PCAOB standards. We believe there is a risk that an overly prescriptive standard that goes well beyond proposed ISQM 1 could have unintended consequences, such as unnecessary cost and other disincentives for smaller firms, both domestic and international, to continue conducting audits in accordance with PCAOB standards.

4 See the PwC global network response to the IAASB's exposure draft of proposed ISQM 1.

We believe proposed ISQM 1 provides a comprehensive, risk-based framework, that can be adapted to be responsive to territory- and firm-specific circumstances, including applicable laws and regulations, types of clients served, and organizational structures. Any additions or changes to the proposed ISQM 1 requirements should be consistent with this principles-based approach.

The concept release refers to the possibility that the PCAOB may consider "incremental or alternative quality objectives or responses, or quality risk factors for firms to take into account." In our view, focusing on quality risk factors for firms to take into account would be preferable to setting out incremental or alternative requirements that may conflict with the principles-based approach in proposed ISQM 1. For example, a firm's response to its risk assessment in accordance with proposed ISQM 1 should take into account the legal and regulatory framework in which it operates (including auditor confidentiality obligations). This would include responses to support the fulfilment of the auditor's responsibilities under Section 10A of the Exchange Act (including with respect to fraud, other illegal acts, and going concern consideration). In practice, these responsibilities are contemplated in firms' QC systems through audit methodology, required consultation policies, and other potential actions by engagement teams and at the firm level. Accordingly, we believe that incremental requirements to expressly address matters such as compliance with the auditor's responsibilities under Section 10A of the Exchange Act or other aspects of US federal securities laws or SEC rules would be unnecessary.

Regarding scalability, we note that certain incremental requirements could disproportionately affect smaller firms. For example, requirements for firms to have mechanisms for independent oversight over their QC systems could prove challenging for smaller firms – whether due to an inability to remunerate suitable candidates competitively with other firms or finding individuals willing to be subject to a firm's independence requirements. Prescriptive requirements in revised PCAOB QC standards related to governance and leadership could also conflict with applicable laws or regulations in jurisdictions outside the US addressing firm structure and independent oversight (e.g., national corporate governance codes).

Industry-specific requirements, including for firms that audit brokers and dealers

We do not see a need for additional or alternative requirements for firms that audit brokers and dealers, or issuers in specialized industries. The types of entities that a firm audits should be addressed as part of the firm's setting of quality objectives and consideration of the risks to quality arising in these audits. Legal and regulatory requirements, as well as professional standards, would be taken into account in developing appropriate responses. If the PCAOB believes there are specific quality risks related to certain types of audits, this could be addressed by providing specific quality risk factors for firms to consider.

A continued focus on reasonable assurance, while recognizing the benefits of a continuous feedback loop

Proposed ISQM 1 sets out the view that "the purpose of a system of quality management is to support the consistent performance of quality engagements, by providing the firm with reasonable assurance that the quality objectives of the firm's system are achieved." In the context of proposed ISQM 1, it is intended that the operation of the system *as a whole* provides the firm with such reasonable assurance. Revised PCAOB QC standards should continue to be based on this reasonable assurance objective. We therefore support the IAASB's proposed objective of the firm's system of quality management – that it "provides the firm with reasonable assurance that (a) the firm and its personnel fulfill their responsibilities in accordance 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."

It is through this lens that our response to the concept release has been developed. In revising its QC standards, the PCAOB should focus on those actions that directly relate to strengthening firms' QC systems, bearing in mind the objective of those systems. While considerations like the allocation and sufficiency of financial resources and an appropriate incentive program are important to audit quality, the firm's QC system will need to be designed to enable the firm to effectively manage and support quality based on the firm's circumstances. We believe establishing requirements related to how the firm should do business, including mandating a specific organizational structure, is not necessary and may also fall outside of the PCAOB's mandate.

Reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a QC system. Additionally, it is neither reasonable nor cost effective for an enhanced QC system to be designed to achieve absolute assurance. Instead, a robust monitoring and remediation process can provide a continuous feedback loop to enable firms to address any items that have come to the firm's attention through monitoring.

Key aspects of the concept release and the need for further outreach to inform standard setting

We acknowledge the possibility that the IAASB's final standard may differ significantly from proposed ISQM 1. In addition, a number of topics within the concept release are, in our view, exploratory in nature. Accordingly, we are unable to fully comment on certain topics without greater insight into the alternatives the PCAOB may be considering. Future outreach and consultation will likely be necessary as the PCAOB moves forward with standard setting, including as the PCAOB develops its required economic analysis. We encourage the PCAOB to obtain input from a wide range of stakeholders, including domestic firms of all sizes and international firms where the majority of their audits are not conducted in accordance with PCAOB standards.

We have organized our observations in the Appendix into the following topical areas to provide additional context to our views:

I. Firm governance and leadership
II. The firm's risk assessment process
III. Engagement performance and resources
IV. Independence and other relevant ethical responsibilities
V. The monitoring and remediation process
VI. The annual evaluation of the effectiveness of the firm's QC system and potential reporting
VII. Documentation
VIII. Other matters

Conclusion

We stand ready to engage with the PCAOB and urge the Board to consider conducting roundtables, forming a Task Force, or considering other ways to engage with the audit profession as the Board advances its standard-setting proposal. Due to the transformational nature of standards that mandate a more proactive approach to quality management, it is essential that the PCAOB understands whether its proposals will achieve its objectives, being mindful of the costs and benefits of doing so. The concept release is a useful first step in this regard, but we anticipate significant efforts by the PCAOB and its stakeholders will be needed over the course of standard setting to fully consider issues related to scalability, practical challenges, and the development of QC standards that are capable of being adapted in an environment that will continue to evolve.

In our view, revised QC standards will likely require a significant implementation period. This would allow the PCAOB the opportunity to seek real-time feedback from firms on implementation experiences as well as to potentially understand how firms are developing and documenting their quality objectives, risks, and responses. The PCAOB applied a similar approach when implementing critical audit matters requirements. Considering a phased implementation program that differentiates between those registered accounting firms that are annually inspected and all other firms may also be appropriate.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Jorge Milo or Brian Croteau regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Appendix

I. Firm governance and leadership

A firm's culture and leadership creates an environment that supports quality – and quality audit engagements serve to enhance financial reporting, to the benefit of all stakeholders. We therefore agree that there is a need in a firm's QC system for a governance and leadership component to support the operation of the QC system, through the firm's culture, decision-making processes, actions, communications, organizational structure, and leadership.

Proposed ISQM 1 appropriately recognizes the importance of governance and leadership, including establishing an appropriate tone at the top. The requirements strike an appropriate balance between setting out principles and expectations of firm leadership, and detailed requirements, recognizing that different jurisdiction legal or regulatory requirements may exist relating to audit firm governance. We believe the principles of (1) appropriately assigning roles, responsibilities, and authority that supports the firm's commitment to quality and the design, implementation, and operation of the firm's QC system; and (2) assigning resources who have the appropriate experience, knowledge, and sufficient time to achieve the quality objectives; are already sufficiently addressed in proposed ISQM 1. It is therefore unnecessary for the PCAOB to specifically address quality considerations in the appointment of a firm's senior leadership.

Assignment of supervisory responsibilities

A firm's organizational structure and management philosophy should support the effective operation of QC policies and procedures. It is therefore important that a firm assigns supervisory responsibilities commensurate with the firm's size and circumstances to promote shared accountability for quality. Many firms, including PwC, already have supervisory structures to support quality on engagements, but these structures vary. For example, some firms may establish leadership responsibilities by geography or region, industry or sector, or may have a more matrix-like structure. Firms may choose a combination of approaches – for example, a central national office function to support the audit practice, or decentralized structures to provide advice on technical matters. Other firms may need to engage external resources to perform functions that support quality (e.g., to perform engagement quality reviews).

We support the PCAOB's desire to provide more clarity relating to the assignment of various supervisory responsibilities within a firm. Given the diversity of the firms and differences in operating policies and procedures, any incremental requirements should be sufficiently flexible to allow appropriate and practical implementation by firms of all sizes, structures, and complexity. We are concerned that any effort to prescribe specific rules to be followed by all firms, regardless of size or structure, could have unintended consequences.[5] A prescriptive, hierarchical approach is simply not possible in light of the disparity among the sizes of firms and their respective structures. We believe that prescribing specific requirements related to the assignment and documentation of supervision may result in defining supervisory responsibilities in a linear, top-down manner, which is inconsistent with how decision-making among engagement teams and "supervisory personnel" actually occurs. We find engagement teams benefit significantly from our collaborative culture, utilizing firm specialists from our multiple lines of service (e.g., valuation, tax, information technology) as well as our quality support network, including technical accounting, auditing, financial reporting, and quality management specialists.

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5 See also our response to PCAOB Rulemaking Docket Matter No. 031, *Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comments on Rulemaking Concepts*.

Similarly, a legal requirement for "supervision" by others not directly responsible for an audit, purportedly in order to detect and prevent violations of law and/or professional standards by the engagement team, is unlikely to materially advance the objectives of existing professional standards. Rather, the assignment of an engagement leader to an audit engagement may take into account information about the qualifications, performance, tenure, existing engagement staffing, and geographic location that may require input from several individuals in supervisory roles. This fluid and collaborative approach enhances audit quality by facilitating the right combination of professional input at the right time, but the mix will necessarily vary in different situations. A linear chain of direct responsibility may discourage this important group dynamic in decision making by encouraging only narrow involvement of a designated individual "supervisor." Additionally, it may discourage free exchange and consultation with others in the firm if those persons believe that by doing so they may be deemed "supervisory personnel."

Finally, we are concerned that a potential lack of a clear definition of "supervisory personnel" creates the possibility that many people within the firm – including geographic or sector leadership, senior management, national office personnel, engagement quality review partner, or in-house counsel – can be held legally responsible. We do not think such an open-ended scope for failure to supervise is appropriate or warranted.

Mechanisms for independent oversight over firms' QC systems

Perspectives from independent third parties can add an important dimension of input to a firm's internal assessments and can benefit audit quality by enhancing a firm's governance and decision-making processes. This approach is consistent with widely-accepted governance best practices. We recognize the value of outside-in perspectives and advice and have proactively taken steps to gain such perspectives as follows:

- Our Board of Partners and Principals, which is responsible for overseeing the strategic direction of the firm, includes three external independent directors who bring additional insights, expertise, and objective perspectives into our governance process as we consider the firm's strategy, growth, and service offerings.
- We are in the process of establishing an independent Assurance Quality Advisory Committee, which will consist of up to three members who have collective experience and deep understanding of the interests of the preparer, auditor, investor, standard-setting, and regulatory communities. We expect this committee to provide perspectives and advice to assurance leadership on aspects of the business, operations, culture, governance, and risk management of the assurance line of service reasonably expected to impact audit and assurance quality.

We have put these mechanisms in place because we believe they help us to address the risks to quality we face as a firm of our size in performing audits of the largest companies in the US capital markets. Although we place great value on these mechanisms, we do not view these mechanisms as directly serving as oversight of our QC system or otherwise enabling us to obtain reasonable assurance that our QC system is operating effectively.

It is important for firms to have flexibility to consider whether independent oversight is necessary and, if so, what is most appropriate based on the structure of their firm and where they operate. Requirements for firms to have mechanisms for independent oversight over their QC system could make it challenging, especially for smaller firms, to attract suitable candidates – whether due to an inability to remunerate them competitively with other firms or difficulty finding individuals willing to be subject to relevant aspects of a firm's independence requirements. Prescriptive requirements in revised PCAOB QC standards related to governance and leadership could also conflict with national corporate governance codes or other applicable laws or regulations addressing firm structure and independent oversight.

In light of these views, we support the PCAOB exploring how firms could benefit from independent, external advice and insight. We encourage the PCAOB to further explore what various firms' practices are today and the reasons for the structures they have chosen. However, we do not support adding a requirement in revised PCAOB QC standards that mandates independent oversight, or that specifies the qualifications and duties of those providing independent oversight.

II. The firm's risk assessment process

To achieve the transformational benefits of a more proactive approach to quality management, we believe it is important for a firm to take a top-down approach to assessing its specific risks to delivering audit quality. We support the framework set out in proposed ISQM 1 that would require the firm to establish quality objectives, which set the context for appropriately identifying and assessing the risks to achieving them. We understand the IAASB is exploring introducing factors that firms would be required to take into account, which we support. This approach will result in a more robust and tailored risk assessment.

If the PCAOB finds it necessary to include incremental or more prescriptive quality objectives than proposed ISQM 1, these should be at a sufficiently high level in order to encourage firms to give greater thought to potential risks that are more specific to their firm. We do not believe revised PCAOB QC standards should specify quality risks that must be assessed and responded to by all firms, as this may result in unnecessary documentation for risks that are not applicable to the firm's circumstances. Consistent with PwC global network's feedback to the IAASB, we believe the PCAOB could accomplish its objectives by developing specific quality risk considerations to be taken into account.

For example, the concept release highlights the need to address specific emerging risks and problems the PCAOB observed through its oversight activities and provide more definitive direction to prompt appropriate implementation of certain requirements by firms that are subject to PCAOB standards and rules. The PCAOB should consider whether implementation materials could illustrate quality risk considerations that might reasonably be expected to apply to firms of certain sizes, industries, or circumstances (e.g., a firm with only a few audits conducted in accordance with PCAOB standards), based on the PCAOB's observations of best practices of those firms who have moved towards a more proactive approach to quality management.

We support requiring firms to identify and assess their own quality risks, and the principles-based requirements in proposed ISQM 1 allow flexibility for firms to appropriately tailor risks and design the appropriate responses. However, the manner in which the risk assessment process is applied to each component may differ depending on the nature of the component. The PwC global network letter to the IAASB provided feedback on proposed ISQM 1's articulation of a two-step process for identifying and assessing quality risks. In our view, the revised PCAOB QC standards should focus on the outcome – the identification of risks that, were they to occur, may result in the firm not achieving its quality objectives. The PwC global network letter suggests that additional guidance could be included in proposed ISQM 1 to explain how the firm may consider the likelihood and magnitude of quality risks that may occur in order to assist in the determination of which risks could potentially have a significant effect on the achievement of a quality objective. We continue to monitor how the IAASB is responding to this feedback.

Quantitative performance measures

Although we support the principle of firms using quantifiable performance measures to monitor audit quality, we do not believe prescribed performance measures are necessary in revised PCAOB QC standards, in part because it may not be possible to determine what measures are appropriate or relevant to all of the diverse firms subject to the standards. Having prescribed quantifiable measures may narrow the firm's focus to only those prescribed measures and detract from a firm identifying and utilizing more appropriate or relevant performance measures as determined by the design of each firm's QC system. Each firm should determine the best measures of whether it is meeting the achievement of a quality objective. While some measures may be common among firms, different firms may choose to monitor different measures, depending on their unique quality risks and responses. Additionally, qualitative measures are often important in assessing audit quality; a focus on only quantitative measures could result in incorrect or inappropriate inferences about audit quality. Finally, since a firm's QC system needs to be capable of adapting over time as the environment in which the firm operates evolves, the importance of certain measures will likely change over time.

Accordingly, we believe firms should be able to use their discretion as to what measures, quantitative or qualitative, are part of their overall monitoring process in light of their assessed risks and the responses they have developed. Providing flexibility will allow the standard to be scaled for smaller firms and will also enable the quality management approach to be applied in a more meaningful way across a network of firms.

III. **Engagement performance and resources**

We believe proposed ISQM 1 provides an appropriate basis to prompt firms to consider quality objectives, risks, and responses related to engagement performance and resources, including the appropriate application of professional skepticism. We agree that firm personnel having sufficient time to properly carry out their responsibilities in QC and engagement roles is important to achieving quality. However, we believe this would be a difficult concept for firms to measure in order to evaluate whether their quality objectives are being achieved. We suggest that references to "sufficient time" in the standard be accompanied by more specific attributes or examples related to this concept. Some examples of mechanisms firms may use include policies and controls in place around annual engagement partner schedules, ongoing monitoring of partner and staff capacity to ensure workloads are appropriately managed, phasing of audit engagements, and using technology in the audit.

Professional skepticism

A firm's culture and leadership are instrumental to creating an environment that supports quality and reinforces the importance of professional skepticism. Many aspects of a firm's QC system support the exercise of professional skepticism by engagement teams, for example, responses that address the risk that engagement teams do not reach appropriate conclusions (such as required consultations, engagement quality reviews, pre-issuance monitoring). A firm's root cause analysis and other monitoring activities can help the firm evaluate whether inappropriate conclusions were a result of a lack of professional skepticism, and consider additional actions that may promote engagement teams to approach complex areas of the audit with a challenging or questioning mindset. Finally, training can also educate personnel on conscious and unconscious biases that may impede the exercise of professional skepticism and professional judgment and provide best practices where professional skepticism is most essential (e.g., in conducting risk assessment and evaluating audit evidence). Accordingly, we believe the emphasis in proposed ISQM 1 related to professional skepticism is adequate and incremental requirements in a revised PCOAB QC standard would not be necessary.

Roles and responsibilities of individuals

We do not believe revised PCAOB QC standards should specify roles and responsibilities other than the individuals responsible for independence QCs, given the importance and complexity of independence rules. Prescribing specific roles and responsibilities may limit the scalability of revised PCAOB QC standards. As long as a firm meets the objectives and requirements of the revised PCAOB QC standards, it would be beneficial for firms to have flexibility in establishing roles and responsibilities within their organization.

Use of other participants in the audit

We agree there are potential quality risks associated with the use of component auditors, specialists, and service delivery centers that should be considered in a firm's risk assessment process. However, based on the evolving and varying use of other audit participants, and the functions that they perform, and the differing requirements that apply to different participants, we believe it would be difficult to set out incremental requirements in revised PCAOB QC standards. If the PCAOB does establish incremental requirements, it is important that they be scalable and take account of the fact that many participants may be part of another registered firm subject to the revised PCAOB QC standards, or subject to common policies and procedures as part of the firm's network.

Importantly, when other participants are used in the audit, there are likely actions that should be taken at both the firm and the individual engagement level to support quality. We encourage the PCAOB to consider how its ongoing work to address other auditors would interact with the revised QC standards, as well as the potential that the revised QC standards could potentially conflict with PCAOB auditing standards if a more holistic revision of certain standards is not undertaken.

Engagement monitoring activities

We support an approach that prompts firms to proactively prevent or detect engagement deficiencies. However, the objective and forms of ongoing engagement monitoring activities likely vary by firm based on the size and risk of the firm's client base. Firm systems may track information in different ways, using different terminology, metrics, and processes. We believe this variability presents significant challenges in prescribing specific, quantifiable, and uniform performance measures. Further, the required use of engagement tracking tools presents scalability issues – even more basic measures, such as monitoring of the timely completion of the planning phase of an engagement, requires tools that may not be practical for all firms.

We encourage the PCAOB to consider the best practices it has observed and provide examples of how such engagement monitoring may be used, without prescribing incremental requirements. For example, monitoring of completed portions of certain in-process engagements is a means of providing engagement teams with timely feedback that can be incorporated into their audit prior to the completion of fieldwork. These types of reviews can be particularly helpful in evaluating how engagements teams are addressing the implementation of new standards and policies, audit methodology enhancements, and matters noted during inspection cycles. This practice is one of many tools available to firms to monitor the QC system.

However, when a firm audits only a small number of issuers, there may not be enough suitably qualified and objective personnel to perform reviews of certain in-process engagements.

Technical training

For the reasons explained in the concept release, we support the need for technical training on professional standards and SEC requirements (replacing "subjects related to accounting and auditing") for all firm personnel who work on audits conducted in accordance with PCAOB standards or are assigned to QC roles that relate to compliance with professional standards and SEC requirements. We believe this would be an appropriate response to the quality objectives of assigning an engagement partner and human resources (at the engagement level and those who perform activities within the QC function) who have appropriate competence and capabilities. If the PCAOB plans to extend the SECPS member requirements for training to all registered firms, additional outreach would likely be needed to understand the costs of doing so and the interaction of these requirements with the requirements for local professional certifications.

We believe technical training should focus on new and existing standards that are determined to be relevant to firm personnel and commensurate with their level of experience. The results of the firm's root cause analysis are an important input to a firm's training curriculum, because it may identify instances where enhancements to guidance and additional training may promote more consistent execution in accordance with the professional standards.

Industry training is an important element of technical training, although the nature and extent of training that may be necessary depends on the industry. However, we believe it would be difficult for the PCAOB to establish specific requirements related to industry training. In accordance with proposed ISQM 1, a firm might identify the implications of performing engagements in certain industries as one or more quality risks and develop appropriate responses, including the need for specific training. There are also other mechanisms a firm can employ to ensure the appropriate industry expertise is brought to an engagement when it is necessary to do so, including assignment of the engagement partner and engagement quality reviewer and consideration of the use of specialists.

Professional competencies

We believe a firm's QC system in accordance with proposed ISQM 1 would likely address professional competencies for both engagement partners and individuals in engagement or QC roles by (1) considering the risk that personnel are not sufficiently competent and (2) developing appropriate responses to mitigate those risks (which includes training, consideration of the complement of the engagement team, etc.). If the PCAOB believes it is necessary to retain existing requirements in its extant QC standards, we encourage the PCAOB to consider whether these could be articulated as quality risk factors. It is important to bear in mind that personnel in jurisdictions outside the US may be subject to other professional standards that specify expected competencies, like the International Education Standards or other national standards.

Impact of technology

The addition of technological resources in proposed ISQM 1 is worthwhile. We support addressing the use of emerging technology in QC systems and engagements in revised PCAOB QC standards. For large complex firms, the use of technology in a firm's QC system may be pervasive and affect many components of the system (e.g., acceptance and continuance, independence, resources, and engagement performance, including audit methodology and tools). On the other hand, in some jurisdictions or smaller firms, technology may not be as advanced or widely used.

Given the increasing importance and evolving nature of technology in performing audits, there may be a need for guidance in the PCAOB's standards to explain how auditors are expected to consider relevant technology when used in an audit. This may be relevant in the revised PCAOB QC standards, through revisions to AS 1105, *Audit Evidence*, or changes to other standards addressing supervision and review. In our view, the nature and extent of required knowledge and skill may depend on the type of technology used, whether the firm has developed the technology and requires its use, and whether its functionality and outputs can be customized by the engagement team. In our view, the firm is responsible for setting appropriate policies and procedures governing the use of technology, which are often supported by specific training on the tools to be used in an audit.

We also agree that consideration of data security and detection of unauthorized access to technology and data is important, and support the PCAOB exploring how best to address this in its revised QC standards.

IV. **Independence and other relevant ethical responsibilities**

The required quality objectives described in proposed ISQM 1 are appropriate as a starting point to address the fulfillment of firm and individual responsibilities under relevant ethical requirements, including independence requirements.

We support the PCAOB's plans to explore further revisions that would require firms to expressly address controls over the existing responsibilities for communications with audit committees regarding independence matters. We believe firms should have policies and procedures that specify when pre-approval for services is necessary, how to evaluate potential violations, and how and what to communicate to the audit committee. However, we note that controls at the firm level are complemented by controls at the engagement level that rely on individuals taking appropriate action, including involving specialists and consulting on these matters, when necessary.

We also encourage the Board to revisit the SECPS member requirements as detailed in Appendix L and determine whether they require updating or clarification as to whether they apply to all registered firms.

V. **The monitoring and remediation process**

We believe the potential revisions described in the concept release would encourage a more proactive approach to monitoring and likely enhance firms' ability to prevent audit deficiencies. Accordingly, we support the premise of the requirements in proposed ISQM 1 as a starting point for revisions to the PCAOB's QC standards. Developing a robust monitoring and remediation process will likely require a significant investment for those firms that do not already have innovative monitoring techniques in place – and could present particular challenges to smaller firms or those that perform only a small number of engagements subject to PCAOB standards.

It is important for firms to develop an appropriate mix of ongoing and periodic monitoring activities. Many firms have been enhancing their processes to include both ongoing and periodic monitoring activities. These monitoring activities include performing pre-issuance reviews, robust internal inspections of completed engagements, and examination of identified deficiencies to determine root causes. The proper mix can drive quality and enhance the feedback loop to prevent future engagement deficiencies. We encourage the PCAOB to consider whether it should highlight the best practices for monitoring and remediation that it has observed without mandating them as one-size-fits-all approaches. Future standard setting and communications should acknowledge that no single approach makes sense for all firms, that innovation and experimentation should be encouraged, and that smaller firms may not find the benefits of such approaches commensurate with the costs.

Internal inspections of completed engagements

Over time, we expect more internal inspections to shift from completed engagements to the practice of pre-issuance reviews. However, we continue to support the requirement for internal inspections of completed engagements on a schedule to be determined by the firm based on the monitoring mechanisms and approaches that it has established.

Because responses should be tailored to the firm's circumstances and risks, we do not support the establishment of requirements for internal inspections selection criteria. Alternatively, we believe the PCAOB could develop quality risk factors for firms to consider in setting their own criteria. By way of illustration, such factors might include engagement leader review history, industry consideration, or engagement-specific facts and circumstances that may indicate a heightened quality risk.

Root cause analysis

We support including in the revised PCAOB QC standards the principles-based requirements in proposed ISQM 1 for firms to perform a root cause analysis and design and implement remedial actions to address QC deficiencies. A robust root cause analysis provides valuable insights into the potential causal factors of engagement deficiencies to enable the firm to take remedial actions as necessary. What is considered appropriate depends on the nature and volume of the engagements (e.g., number of PCAOB audit engagements, number of other audit engagements, number of other attestation engagements). We expect that root cause analysis will continue to evolve as firms adopt new technologies and new methods of performing audits in response to changes in their clients' business and the external environment. Prescriptive requirements addressing root cause analysis could quickly become outdated and undermine the objective of establishing an effective continuous feedback loop.

Evaluating deficiencies

Consistent with proposed ISQM 1, we believe a firm should have policies and procedures addressing the evaluation of the relative severity and pervasiveness of any identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the firm's QC system.

Having a principles-based requirement such as that in proposed ISQM 1 enables the firm to consider deficiencies that have been identified in the context of the firm's overall design of its QC system. Evaluating deficiencies in a firm's QC system is very subjective and involves considerable judgment, taking into account the firm's specific quality objectives, the related risks, and the connection between different components of the QC system.

Evaluating when deficiencies, individually or in aggregate, preclude a firm from concluding that its QC system achieved reasonable assurance requires judgment. For example, matters identified at the individual engagement level (e.g., from external inspections or financial statement issues such as restatements) are not always indicative of a deficiency and cannot necessarily be used to draw conclusions about the overall effectiveness of the QC system. As acknowledged in proposed ISQM 1, evaluating whether the firm's QC system provides reasonable assurance also involves evaluating whether the remedial actions are (1) appropriately designed to address the identified deficiencies and their related root causes and (2) have been implemented.

Each firm's quality responses and monitoring and remediation process are expected to be tailored to its identified quality risks. We do not think it is necessary for the PCAOB to provide further direction on evaluating the severity of QC deficiencies or to attempt to establish specific thresholds that would preclude a firm from concluding that its QC system was effective.

VI. **The annual evaluation of the effectiveness of the firm's QC system and potential reporting**

Our process to annually evaluate the effectiveness of our QC system and report externally

We operate our QC system with a focus on continuous improvement. Our process is designed to identify opportunities for enhancement in a timely manner and then to respond quickly. As part of this process, we monitor the results of pre-issuance reviews and internal and external inspections and conduct our root cause analysis on these results (referred to as "ongoing monitoring" for purposes of this section). Other inputs into our root cause analysis include results of PCAOB inspections (and, in the case of non-US firms, results of other external inspection regimes) and peer reviews. This process is designed to be fully aligned with the objectives of the monitoring and remediation process described in proposed ISQM 1.

To supplement this ongoing monitoring, we perform an annual evaluation of our QC system's effectiveness. We monitor the effectiveness of controls through the year, and test selected controls annually. Results of this testing, as well as PCAOB inspections (and, in the case of non-US firms, results of other external inspection regimes), internal inspections, peer reviews, and other firm monitoring activities, are reported to assurance leadership to enable them to form a view about whether our QC system continues to be designed to meet its reasonable assurance objectives.

For the US firm, we communicate information about our QC system and our evaluations through a quality report published annually, which helps us to engage with our stakeholders about quality and highlight how we vigilantly maintain our focus on audit quality. This report provides a window into our QC system and helps stakeholders understand how we have delivered on our audit quality objectives. For example, we explain how we are taking action in a number of key areas, including communication/training; planning and executing the audit; conducting in-process/pre-issuance reviews; considering feedback from internal/external inspection; analyzing quality drivers; and revising our guidance or further developing tools.

Our quality report also provides insight into areas of focus based on our most recent internal and external inspection results. We use our quality report as an opportunity to set out our perspectives about the effectiveness of our QC system.

Requiring firms to annually evaluate their QC systems and communicate about this evaluation

In line with proposed ISQM 1, we support requiring the firm to evaluate at least annually whether the system provides reasonable assurance that the objectives of the system have been achieved. If a requirement to perform an annual evaluation is adopted, firms should have flexibility in determining when to perform the annual evaluation.

How transparency about this evaluation may best be achieved is a more complex consideration. We believe the objective of applying a risk-based approach to the firm's QC system as set out in proposed ISQM 1 is similar in principle to the COSO Enterprise Risk Management framework. The concept release sets out a view that reporting on the firm's annual evaluation of the effectiveness of its QC system is analogous to management's assessment of internal control over financial reporting (ICFR). We believe there are important distinctions that would need to be recognized in determining whether annual public reporting, including the possibility of a certification, would be appropriate.

Evaluating the impact of deficiencies relating to ICFR involves a direct link to judgments about the potential of the financial statements being materially misstated, with consideration given to account-level activities at a point in time. Evaluating deficiencies in a firm's QC system can be far more subjective given the nature of certain components and their relationship to the overall objective of the system. Additionally, audits and other engagements are performed and our reports are issued throughout the year. As acknowledged in proposed ISQM 1, the firm's QC system supports the consistent performance of quality engagements. The intent is therefore for the QC system (in particular, the monitoring and remediation process) to continuously provide for ongoing improvement.

All the components of a firm's QC system are important. However, some components (like engagement performance) have more direct relevance to achieving the QC system's reasonable assurance objective. Deficiencies in these components of the QC system may weigh more heavily than deficiencies in other components in evaluating the QC system (for example, depending on the nature of the deficiency and the characteristics of the firm). The nature and extent of responses a firm develops to its identified quality risks, across all components, and how effective those responses are in combination, are considered in the firm's overall evaluation of whether the QC system as a whole provides reasonable assurance that the firm's quality objectives have been achieved.

While an annual evaluation provides a perspective on the effectiveness of a QC system as a whole, ongoing monitoring activities add critical insights on whether the objectives of the QC system are being achieved. Communicating more holistically about how a firm maintains quality could be more informative to users, and provide more meaningful context. We believe our annual quality report achieves this objective.

Recommendations

As part of its information and communication component, proposed ISQM 1 takes a principles-based approach to requiring firms to consider communicating to external parties. We would not object to a principles-based requirement that a firm communicates publicly about its QC system, with flexibility as to the contents of such a report in light of the firm's circumstances. To complement any changes to its QC standards, the PCAOB could also consider whether there may be value in requiring incremental communications with audit committees about quality matters specific to the engagement or to promote a dialogue about matters addressed in the firm's quality report.

A number of firms already take steps to communicate to external parties as a means of being transparent with their external stakeholders. Such reports include descriptions of various elements of firm governance and leadership, key aspects of the firm's QC system and, in some cases, actions the firm is taking to address deficiencies and to maintain or enhance audit quality. We believe these mechanisms collectively provide the necessary transparency to inform stakeholders of important quality matters in the context of the firm's circumstances. In addition, the PCAOB has access to a firm's QC system documentation, including its testing, through the inspection process.

On the other hand, requiring a firm's top leadership to certify their QC systems in a public report would likely be complicated by the current inspection process and timing under which inspections are conducted (given the delay between when engagements are performed and inspected, and when those inspection results are made public). This may cause confusion for external parties who may find it difficult to reconcile any Part I or II comments that may be released by the PCAOB with statements made by the firm, as remedial actions are likely to have already been undertaken when the PCAOB inspections reports are released. This could lead to an unintended consequence of an unwarranted decrease in public confidence in completed audits.

More specific insight as to what any potential reporting (whether to the PCAOB or publicly) or certification would entail is necessary for stakeholders to be able to weigh the benefits and consequences of doing so. Moreover, there are likely to be relevant considerations from a legal perspective, such as the potential need for confidentiality and privilege protections under Section 105(b) of Sarbanes-Oxley if the firm were to file a non-public report with the PCAOB.

Scalability

We acknowledge the level of detail in our US quality report may not be necessary for all firms, in part based on the firm's circumstances. We and other firms are also required to communicate about our QC system to certain audit committees in accordance with New York Stock Exchange rules. It is also important to keep in mind that non-US registered firms may already be subject to transparency reporting and/or corporate governance reporting requirements under local laws or regulations.

From a practical standpoint, we believe the most effective way for the PCAOB to balance the desire for transparency about firms' QC systems with the challenges explained above is to set forth a requirement for firms to consider the appropriate mechanism to communicate about their QC systems to external parties. This flexibility would enable firms to tailor their reporting to the nature of the firm, the relevant issues that might be presented, what each firm believes is important to measure, and the interests of the firm's external stakeholders. Larger firms may continue to develop quality reports for a wider audience, while smaller firms may communicate externally to their clients' audit committees.

VII. **Documentation**

The concept release notes the PCAOB is considering "requiring QC documentation to be sufficient to enable an experienced auditor that understands QC systems, but has no experience with the design and implementation of the firm's QC system, to understand the basis for the firm's assessment of the effectiveness of the QC system, including evaluation and remediation of QC deficiencies." It is unclear what incremental documentation beyond proposed ISQM 1 requirements would be necessary to enable an experienced auditor to understand the firm's QC system. We are concerned that the PCAOB might expect firms to document and maintain evidence of their risk assessment procedures, walkthroughs of controls that have been designed, and evidence from testing of those controls to a reperformance standard comparable to that of companies in an audit of ICFR. In our view, this is unnecessary and impracticable given the differences in the nature of such systems. We also believe the need for much more detailed documentation than that required to comply with extant PCAOB QC standards would present particular challenges for smaller firms.

From a US perspective, we would not object to the potential sufficiency and retention periods described in the concept release, but there may be other considerations to be taken into account in relation to establishing requirements that would apply to firms operating in other jurisdictions. It is unclear what incremental requirements in relation to network or third-party provided methodology and tools the PCAOB is considering.

VIII. **Other matters**

Appendix K requirements

Appendix K was put into place for SECPS member firms at a time when the regulatory regime was substantially different than it is today. Therefore, we are supportive of the PCAOB's refreshed review of Appendix K requirements in relation to Foreign Private Issuer (FPI) audits in the current environment. With these considerations in mind, we would welcome the opportunity to engage in a productive dialogue on the contemplated changes to Appendix K requirements.

Potential changes to other PCAOB standards

With regard to the possible need to change other PCAOB standards, we offer the following perspectives:

- Focus in the future on whether possible enhancements to engagement-level requirements similar to the IAASB's other current projects may be necessary to complement the enhancements to firms' QC systems.
- We would not object to the potential amendments to AS 2901 as described.
- We believe AS 1110 should be rescinded, as the concepts it addresses could be incorporated into revised PCAOB QC standards. If it is retained, we would not support removing the following sentence: "However, deficiencies 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 the auditing standards." We believe that this statement remains accurate, but could be supplemented with additional language that explains the need to evaluate deficiencies through the firm's monitoring and remediation process and respond appropriately, such that the risk that the deficiency would adversely affect future audit engagements is reduced to an acceptably low level.