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**STANDING ADVISORY GROUP MEETING**

**QUALITY CONTROL:  
GOVERNANCE AND LEADERSHIP**

**NOVEMBER 9, 2018**

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In a registered accounting firm, quality control ("QC") is the process through which the firm administers its audit practice such that engagement teams perform their audits in accordance with PCAOB and SEC requirements and the firm's internal policies and procedures. PCAOB QC standards require a firm to have a system of quality control for its audit practice to provide reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality.<sup>1</sup> Existing PCAOB QC standards also set forth elements of a system of quality control and establish certain requirements for firms' quality control policies and procedures.

Currently, PCAOB QC standards set forth the following required elements of a firm's system of quality control:

- Independence, integrity, and objectivity;
- Personnel management;
- Acceptance and continuance of clients and engagements;
- Engagement performance; and
- Monitoring.

**Quality Control Research Project**

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<sup>1</sup> See QC sec. 20.01 and .03.

This paper was developed by the staff of the Office of the Chief Auditor as of November 9, 2018 to foster discussion among the members of the Standing Advisory Group. It is not a statement of the Board; nor does it necessarily reflect the views of the Board, any individual Board member, or PCAOB staff.

The PCAOB is exploring whether there is a need for changes to the PCAOB's QC standards that would prompt firms to improve their quality control systems and more proactively identify and address emerging risks and deficiencies, thereby enhancing audit quality.

In reviewing the PCAOB quality control standards, the PCAOB staff is evaluating whether its standards provide an adequate framework for an effective system of quality control. As part of this evaluation, the PCAOB staff is considering whether the PCAOB QC standards should more expressly address firm governance and leadership with respect to its auditing practice ("governance and leadership") as an element of a firm's QC system.

We are seeking the SAG member's input on how PCAOB QC standards could address governance and leadership. SAG members not directly familiar with the quality control systems of audit firms are encouraged to draw from their experience with quality control, internal control, compliance programs, or enterprise risk management. Additionally, SAG members may want to refer to the work of other organizations below. While the focus of this discussion is on governance and leadership, during the breakout sessions, SAG members are welcome to provide input on other areas related to firm QC systems.

### *Governance and Leadership*

Governance and leadership relates to how the firm is organized and governed with respect to its audit practice under PCAOB standards. Similar to the control environment component of COSO,<sup>2</sup> this includes senior management's effect on firm culture, organization, assignment of authorities and responsibilities, establishment of incentives and accountabilities. Other standard-setters include leadership as an element of the quality control system.<sup>3</sup>

Existing PCAOB standards contain limited references to firm leadership and their responsibilities toward audit quality. The PCAOB staff is considering whether additional or more specific direction in the quality control standards with respect to governance and leadership would lead to enhancements in firm quality control systems. Examples of matters that could be addressed in a revised quality control standard include:

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<sup>2</sup> Committee of Sponsoring Organization's *Internal Control-Integrated Framework* (originally published in 1992 and revised in 2013) is recognized as a leading framework for designing, implementing, and conducting internal control and assessing the effectiveness of internal control.

<sup>3</sup> See, e.g., ISQC 1, *Quality Control for Firms That Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.

1. *Culture* – developing values, policies, practices, and appropriate behaviors to support audit quality and demonstrating through communications and actions of leadership (and middle management) a commitment to audit quality, integrity, and appropriate standards of conduct.
2. *Organization* – establishing and maintaining firm organizational structures to support audit quality.
3. *Assignment of authority and responsibilities* – defining and assigning authority and responsibilities, including accountabilities and supervisory roles, to support the effective design and operation of the QC system.
4. *Accountability / Incentives* – establishing appropriate standards of conduct, evaluating individuals' adherence to them, and holding individuals accountable for fulfilling their engagement and QC responsibilities.

Other organizations have published material that may be relevant to governance and leadership in quality control standards (links have been provided). These other sources are provided for your reference in considering how governance and leadership could be considered in PCAOB QC standards.

- [COSO Internal Control – Integrated Framework \(Revised 2013\), control environment](#)
- [UK's FRC Audit Firm Governance Code – Revised 2016](#)
- [UK's FRC Audit Culture Thematic Review – May 2018](#)
- [Japan's Financial Services Agency "Principles for Effective Management of Audit Firms" \(the Audit Firm Governance Code\)](#)

#### QUESTIONS:

1. Are the areas of 1) culture; 2) organization; 3) assignment of authorities and responsibilities; and 4) accountability/incentives appropriate areas to address related to governance and leadership? Are there others?
2. To what extent should the QC standards present governance and leadership principles as compared to detailed requirements or direction? What benefits or challenges would there be from presenting principles or detailed requirements?
3. Should there be a difference between the requirements for large and small firms with respect to governance and leadership? If so, how should they differ?

4. To what extent and how should PCAOB standards address the qualifications and responsibilities of leadership positions within the firm?
5. To what extent and how should firm incentive systems be addressed in the quality control standards?

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