



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

PCAOB Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

16 March 2020

PCAOB Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards (PCAOB Release No. 2019-003; Rulemaking Docket No. 046)

Dear Office of the Secretary:

Ernst & Young LLP is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on Release 2019-003: Concept Release on Potential Approach to Revisions to PCAOB Quality Control Standards.

We believe a firm's system of quality control is foundational to audit quality. We agree that revising the PCAOB quality control (QC) standards is necessary because they were developed and issued by the American Institute of Certified Public Accountants (AICPA) before the PCAOB was established. The auditing environment has changed significantly since the PCAOB adopted the AICPA standards in 2003, and the standards do not reflect these developments.

The comments below highlight our general support for the PCAOB's approach, our key concerns and our recommendations. The appendix to this letter contains our responses to the questions in the Concept Release.

ISQM 1 is the appropriate starting point

Overall, we support the PCAOB's efforts to revise its QC standards. We agree that the PCAOB should follow the risk-based approach to quality management the International Auditing and Assurance Standards Board (IAASB) has proposed in 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* (proposed ISQM 1). This will focus firms' attention on proactively identifying and responding to quality risks that may affect engagement quality.

We note that our comments address only the requirements the IAASB has proposed for ISQM 1. They do not address any changes the IAASB may make to the proposal before issuing a final standard later this year.

Importance of globally converged standards

We commend the Board's efforts to collaborate with other standard setters on this important topic. Quality control standards that can be consistently implemented and applied by firms will enhance audit quality and, therefore, benefit the public.

Because many firms are subject to the standards of the PCAOB, the IAASB and other international standard setters, we strongly encourage the Board to avoid creating unnecessary differences between its QC standards and those of the IAASB. Unnecessary differences may require firms to develop different systems, policies and controls and divert resources that could otherwise be focused on quality control. This could have the unintended consequence of adversely affecting engagement quality.

Importance of a risk-based approach

We support a risk-based approach and believe that proposed ISQM 1 provides a comprehensive risk-based framework. We believe this approach is consistent with the top-down, risk-based approach that the Securities and Exchange Commission (SEC) describes in SEC Release No. 33-8810, *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, relating to a registrant's assessment of its internal control over financial reporting (ICFR).

We believe a principles-based standard built on a risk-based framework would enable firms to appropriately tailor their system of quality control to their size and complexity, the nature of the engagements they perform and the risks to quality. Therefore, we believe that if any incremental requirements were added by the PCAOB, they should be principles-based and support a risk-based approach.

Reporting considerations

Reporting on the effectiveness of a firm's system of quality control

We support the requirement in proposed ISQM 1 for firms to make an annual evaluation about the effectiveness of their system of quality control. However, instead of requiring firms to report to the Board or to report publicly about their annual evaluation, we believe the PCAOB should require firms to communicate information about their annual evaluation to the audit committee of each of the issuers they serve. We believe issuers and the public interest would be best served by having audit committees consider this information, along with all other relevant information, in executing their responsibilities for hiring, retaining, compensating or terminating the audit firm. We believe this would generate robust dialogue between the auditor and the audit committee about this important topic.

We are concerned that reporting to the public or to the Board would create additional costs for firms without a providing a benefit to investors and other stakeholders. Unlike a registrant's report on ICFR, which is specific to that registrant, a firm's report on its QC system is broader and not specific to a particular engagement and, therefore, may not provide investors with information useful for their investment decisions.

We believe the public reporting mechanism for quality control deficiencies that currently exists through the PCAOB's inspection process is sufficient and provides relevant information to the public about a firm's quality control deficiencies that have not been remediated timely. We believe the threat of public reporting of quality control deficiencies serves as an incentive for firms to remediate their deficiencies timely and, therefore, enhances engagement quality. Importantly, through the inspection process, the Board would be made aware of the results of the firm's annual evaluation.

Certification by the firm's top leadership

We support the concept of the firm's top leadership being responsible and accountable for quality. This responsibility and accountability could be demonstrated through the firm's top leadership and professionals involved in the system of quality control internally certifying to the effectiveness of a firm's system of quality control. We believe such an internal certification could contribute to audit quality because it would create greater accountability for professionals involved in the firm's system of quality control and serve as another incentive for firms to devote adequate resources and attention to the system's design, implementation and operation. However, we do not support mandatory public reporting or certifications because firms should have the flexibility to determine a response that demonstrates responsibility and accountability.

Quantifiable performance measures

We believe the PCAOB should encourage but not require firms to use performance measures to drive enhancements to engagement quality and give firms the flexibility to choose the measures that are most relevant to their practices. Further, for the reasons discussed below, we have concerns with the PCAOB establishing a requirement for firms to disclose publicly any performance measures that were important to their conclusion about the effectiveness of their quality control system. However, some firms are voluntarily highlighting the importance of quality in their public materials and using their focus on quality as a competitive differentiator.

We do not believe it would be possible or effective to establish a standard set of quantifiable performance measures that would address the unique risks of each firm resulting from factors such as (1) the size and complexity of the firm, (2) the leverage model (i.e., the ratio of staff to partner), (3) the client base and the degree of specialization in certain industries, (4) the management and organization structure, (5) the systems and processes that support the system of quality control, and (6) the investments in audit quality. We are also concerned that any prescribed performance measures would need to evolve to address changes in the profession.

In addition, we are concerned that focusing exclusively on quantifiable performance measures will not tell the whole story. They need to be considered with qualitative factors, such as tone set by leadership, professional judgment and skepticism, that affect engagement quality but are difficult to measure.

We note that audit firms, audit committees, regulators and investors are continuing to consider the use of Audit Quality Indicators (AQIs). As a result, we believe that the Board should continue to support efforts to determine which AQIs are useful and how they should be communicated rather than mandate reporting on a set of quantifiable performance measures.

Extent of QC documentation

We believe the documentation requirements in proposed ISQM 1 are sufficient and the PCAOB should not require a firm's QC documentation to meet the reperformance standard in PCAOB Auditing Standard 1215, *Audit Documentation*. If the PCAOB were to establish a reperformance requirement, the QC documentation would need to contain sufficient information to enable an experienced auditor who understands a system of quality control but has no experience with the design and implementation of a firm's system of quality control, to understand the basis for the firm's assessment of the effectiveness of the system of quality control, including its evaluation and remediation of quality control deficiencies.

We believe the costs to comply with such a requirement would outweigh the benefits and would not result in a demonstrable improvement to engagement quality. We are concerned that this requirement could impede a firm's ability to properly scale the standard to the firm's facts and circumstances and could adversely affect audit quality because firms may need to spend a disproportionate amount of time documenting their system of quality control rather than performing control activities.

If the Board decides to go beyond the documentation requirements in proposed ISQM 1, we believe that the requirements should align with those in Item 308 of Regulation S-K that relate to a registrant's documentation of its ICFR. That is because we believe a firm's documentation of its system of quality control is more like a registrant's documentation of its ICFR than audit documentation that must comply with PCAOB AS 1215.

The instructions to Item 308 of Regulation S-K state that registrants "must maintain evidential matter, including documentation, to provide reasonable support for management's assessment of the effectiveness of the registrant's internal control over financial reporting." In SEC Release No. 33-8810, the SEC states that the nature of the evidential matter may vary based on the assessed level of ICFR risk of the underlying controls and other circumstances.

The SEC also states that in determining the nature of supporting evidential matter, management should consider the degree of complexity of the control and the level of judgment required to operate the control. It then gives an example of how smaller companies may have limited documentation for the evaluation of ICFR when management's daily interaction with its controls provides the basis for its assessment. In this example, the SEC clarifies that management would need to consider whether reasonable support for its assessment would include documentation of how its interaction provided it with sufficient evidence.

We believe a "reasonable support" documentation threshold would address our concerns. In addition, we believe a reasonable support threshold would be more appropriate than a "reperformance" threshold because there tends to be less turnover among the executives who oversee a firm's system of quality control than on individual audit teams, where engagement partners and engagement quality reviewers are subject to rotation requirements and staff turnover is generally higher.

We observe that the Board stated in its adopting release for PCAOB AS 1215 that "good audit documentation is very important in an environment in which engagement staff changes or rotates.

Due to engagement staff turnover, knowledgeable staff on an engagement may not be available for the next engagement.”

Implementation period

We believe an extended implementation period is necessary to give firms sufficient time to design and implement an effective system of quality control that complies with any final PCAOB QC standard.

Firms will need this time to develop new systems, perform proper risk assessments, design and implement additional controls, design and implement additional monitoring and remediation processes, and conduct training for their professionals.

For a global organization like the EY network, this is a significant undertaking, due to differences in the size of the various member firms, the nature and complexity of their practices, and the complexity of their organization structure, among other considerations. We are concerned that a short implementation period would threaten a firm’s ability to reassess the design and implement an effective system of quality control.

Given the pervasiveness of a firm’s system of quality control, we believe an extended implementation period is important to allow firms to perform robust field testing to help identify unintended consequences, ambiguities or the potential for inconsistencies in application. Field testing would also provide information about the effort necessary to implement a system of quality control that complies with the standard and the related costs for firms of varying sizes. We believe a careful consideration of the results of field tests would improve the quality of any final standard.

We learned from the successful implementation of the PCAOB’s new auditor reporting model that having an opportunity to perform dry runs of reporting on critical audit matters and receive feedback from the PCAOB along the way was critical.

When setting an effective date, the PCAOB should also consider the scope of any new QC standard. That is, if the future PCAOB QC standard were to apply to audits and other engagements, we believe the effective date should be stratified to allow firms to focus on implementation for audits first, before they focus on implementation for other services.

Broker-dealer considerations

We do not believe any future PCAOB quality control standard should have requirements that apply only to broker-dealers. We believe a QC standard that is risk-based could be appropriately tailored regardless of the type of audit. However, we strongly encourage the PCAOB to take this opportunity to implement, after appropriate due process, a permanent broker-dealer inspection program no later than the effective date of any future PCAOB quality control standard so firms can concurrently align their quality control policies.



Other considerations

We believe the PCAOB should provide guidance that is similar to the application material included in proposed ISQM 1. We believe that guidance is essential to make sure auditors consistently interpret and apply the requirements.

We encourage the PCAOB to continue to monitor and support the IAASB's work as it moves toward finalizing proposed ISQM 1 and then conduct additional outreach, as necessary, on areas of significant change in the final standard that could influence the PCAOB's direction.

* * * * *

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

cc:

PCAOB

William D. Duhnke III, Chairman
J. Robert Brown, Jr., Board Member
Duane M. DesParte, Board Member
Rebekah Goshorn Jurata, Board Member
James G. Kaiser, Board Member
Megan Zietsman, Chief Auditor and Director of Professional Standards

SEC

Jay Clayton, Chairman
Hester M. Peirce, Commissioner
Elad L. Roisman, Commissioner
Allison Herren Lee, Commissioner
Sagar Teotia, Chief Accountant
Marc A. Panucci, Deputy Chief Accountant

Appendix

Our responses to the questions in the Concept Release are set out below.

Introduction

Q1: Should PCAOB QC standards be revised to address developments in audit practices and provide more definitive direction regarding firm QC systems? Are there other reasons for changes to the QC standards that we should take into account?

We agree that revising the PCAOB QC standards is necessary because they were developed and issued by the AICPA before the PCAOB was established. The auditing environment has changed significantly since the PCAOB adopted the AICPA standards in 2003, and the standards do not reflect these developments. We also support the Board's recognition of the important role that risk assessment and governance and leadership play in meeting the objectives of quality control.

Q2: Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard? Are there alternative approaches we should consider?

We agree that the PCAOB should base any new QC standard on the risk-based approach to quality management in proposed ISQM 1 to focus firms' attention on proactively identifying and responding to quality risks that may affect engagement quality. As discussed in our cover letter, we commend the Board's efforts to collaborate with other standard setters to largely align the quality control standards, so they can be consistently implemented and applied by firms. We believe this will enhance engagement quality and, therefore, benefit the public.

Q3: Are the reasons provided for differences between ISQM 1 and a future PCAOB QC standard appropriate? Are there other potential reasons for differences that we should consider?

We recognize there may be differences between the final version of ISQM 1 and a future PCAOB QC standard, but our view is that these differences should be minimal.

We believe some of the reasons cited in the Concept Release for differences between proposed ISQM 1 and a future PCAOB QC standard could be addressed in a principles-based standard that promotes scalability and flexibility. For instance, the risk assessment process that would be required by proposed ISQM 1 would require firms to consider the legal and regulatory framework in which they operate.

As discussed in our cover letter, we are concerned that unnecessary differences between the PCAOB's QC standards and those of the IAASB could have the unintended consequence of adversely affecting engagement quality. This should be a consideration for the PCAOB when drafting a future QC standard so that firms can design and implement QC systems that are responsive to their quality risks, and the standard is sufficiently flexible to address quality risks that may arise in the future.

Background and considerations for potential revisions to QC standards

Q4: Are there other developments affecting audit practices we should consider addressing in a future PCAOB QC standard?

We are not aware of other developments affecting audit practices that the Board should consider addressing in a future PCAOB QC standard. We believe the risk-based approach in proposed ISQM 1 sufficiently addresses the developments affecting audit practices and QC systems that were highlighted in the Concept Release and could address any future developments in these areas.

Q5: To the extent that audit firms are already updating or making enhancements to their QC systems to align with international developments, can you characterize the nature and extent of those changes and related efforts? What benefits do you anticipate from updates to QC systems?

While some firms have begun updating their QC systems to align with international developments, we believe the extent of these efforts varies, depending on the size and complexity of the firm. For example, member firms in the EY network, with coordination from the leaders of our global organization, have begun to reassess their systems of quality control to varying degrees. Steps being taken include:

- ▶ Addressing the role of the global network in member firms' design, implementation and operation of QC systems
- ▶ Enhancing the documentation of existing quality control processes
- ▶ Considering the overall effect of the governance and leadership component and risk assessment component of proposed ISQM 1
- ▶ Designing and implementing a globally consistent risk assessment process enabled by a global technology solution for implementation and operation by member firms
- ▶ Redesigning a global monitoring approach enabled by a global technology solution
- ▶ Considering the proposed requirements for an annual evaluation of quality controls

Refer to our response to question 12 for the benefits of implementing and maintaining a system of quality control.

Q6: Please provide references to any academic studies or data we should consider, including academic studies or data that might address costs and benefits relevant to an economic analysis of potential revisions to PCAOB QC standards.

While we are not aware of any such academic studies or data, we believe it is important for the Board to perform an economic analysis of any potential revisions to its future PCAOB QC standard. Refer to our response to question 12 for discussion of additional costs we anticipate as a result of updates to future PCAOB QC standards.

Potential standard-setting approach based on proposed ISQM 1

Q7: Would the approach to quality control standards described in this concept release be preferable to the current PCAOB quality control standards?

We believe the approach to QC standards described in this Concept Release is preferable to the current PCAOB QC standards. We support an approach that uses the proposed ISQM 1 as a starting point to create a risk-based PCAOB QC standard that is scalable to all firms, regardless of their size and complexity and the nature of their engagements and risks to quality.

However, we strongly encourage the Board to avoid creating unnecessary differences between its QC standards and those of the IAASB. Unnecessary differences may require firms to develop different systems, policies and controls and divert resources that could otherwise be focused on quality control. This could have the unintended consequence of adversely affecting engagement quality.

Q8: Would the objective of a quality management system provided in Proposed ISQM 1 be an appropriate objective for a QC system under PCAOB standards? Are there additional objectives that a quality control system should achieve?

We believe the objective of a QC system in paragraph 18 of proposed ISQM 1 is appropriate. In addition, we agree that a firm's QC system should provide reasonable assurance (not absolute assurance) that the objective has been achieved, which is consistent with the current PCAOB QC standards.

Q9: Would the potential revisions to PCAOB QC standards described in this concept release improve QC systems and audit quality?

We believe a future PCAOB QC standard that is based on proposed ISQM 1 would improve QC systems and audit quality. However, as discussed in our cover letter and responses to other questions, we strongly encourage the Board to avoid creating unnecessary differences between its QC standards and those of the IAASB.

Q10: Would the potential revisions to PCAOB QC standards described in this concept release enhance firms' ability to prevent audit deficiencies? Are there additional revisions to PCAOB QC standards that we should consider to support a preventive approach to managing quality?

We believe that by focusing on a risk-based approach and firms' governance and leadership, the potential revisions to PCAOB QC standards described in the Concept Release would enhance firms' ability to prevent audit deficiencies. Through this approach, we believe that audit deficiencies can be better mapped to elements of a QC system that failed to prevent audit deficiencies and better inform the responses a firm develops to address audit deficiencies.

Q11: Should a future PCAOB QC standard have additional or alternative requirements for firms that audit brokers and dealers? If so, what?

As discussed in our cover letter, we do not believe a future PCAOB QC standard should have additional or alternative requirements for firms that audit brokers-dealers.

Specific aspects of a QC system and potential changes to PCAOB standards

Q12: What would be the costs and benefits of implementing and maintaining an integrated QC system as described in this concept release? Are there particular costs and benefits associated with specific components that we should consider? What, if any, unintended consequences would there be?

We believe the costs of implementing and maintaining an integrated system of quality control that would comply with proposed ISQM 1 and the potential changes to the PCAOB QC standards would be significant. Such costs would include:

- ▶ Hiring new personnel or reallocating existing personnel to:
 - ▶ Identify and document the design and implementation of new or modified quality controls
 - ▶ Document the operation of quality controls in a manner to provide reasonable support, not a reperformance standard as noted in our cover letter
 - ▶ Perform monitoring procedures over the QC system, perform root cause analysis on control deficiencies identified and execute remedial actions to address such deficiencies
 - ▶ Coordinate these efforts across the entire network
 - ▶ Make an annual evaluation of the firm's system of quality control
- ▶ Determining whether an information technology (IT) solution is necessary and, if so, implementing the solution across the entire organization/network, which may require hiring third parties, and operating and maintaining the IT applications to facilitate the activities noted above
- ▶ Devoting resources to promote consistency in the performance of engagements, including, for example, writing a firm's policies or procedures

As discussed in our cover letter, we are concerned that the incremental or alternative requirements the Board is considering including in a PCAOB QC standard would create additional costs for firms without a demonstrable benefit to audit quality. We also believe it is important to retain the risk-based framework in proposed ISQM 1 and avoid prescriptive requirements to make sure any future PCAOB QC standard is scalable and, therefore, can be implemented in a cost-effective manner. It is also important for firms to have sufficient time to implement any future PCAOB QC standard.

We believe a firm's system of quality control serves as a foundation for engagement quality, and, therefore, we support the PCAOB's efforts to revise its QC standards. The benefits of a risk-based QC system include:

- ▶ Improving audit quality by proactively identifying and responding to quality risks and considering the results of monitoring and remediation activities as part of the risk assessment process
- ▶ Providing an opportunity to improve the effectiveness and efficiencies of processes by creating clear ownership and accountability
- ▶ Providing an opportunity to continuously challenge and improve firm processes
- ▶ Providing relevant and reliable information about the firm's QC system to applicable stakeholders

Firm governance and leadership

Q13: Is the approach to firm governance and leadership appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q14: Would more clarity in the assignment of firm supervisory responsibilities enhance supervision and positively affect QC systems and audit quality?

We believe the guidance in proposed ISQM 1 is sufficient so that a firm's organization structure promotes appropriate assignment of roles and supervisory responsibilities. We believe the flexibility provided by proposed ISQM 1 is important, given the myriad ways in which firms may be structured and how they assign roles and responsibilities. We are concerned that overly prescriptive requirements about the assignment of roles and responsibilities would impede the scalability of any final standard.

Q15: Should a future PCAOB QC standard address quality considerations in the appointment of a firm's senior leadership? If so, how?

We do not believe additional requirements are necessary, given that firms are focused on the appointments of individuals to senior leadership roles. Our view is that proposed ISQM 1 already sets out the principles related to assigning ultimate responsibility and accountability for the QC system to a firm's chief executive officer, managing partner or equivalent who has the appropriate experience and knowledge to fulfill the assigned responsibility.

Q16: Allocation of financial resources is one aspect of firm governance and leadership under Proposed ISQM 1. Should this be given greater emphasis in a future PCAOB QC standard than it is given in Proposed ISQM 1? For example, should a future PCAOB QC standard emphasize the importance of counterbalancing commercial interests that may lead to underinvestment in the audit and assurance practice, particularly in firms that also provide non-audit services?

The resources required to support an appropriate system of quality control vary by firm, based on each firm's facts and circumstances. While we agree that the allocation of sufficient financial resources is one of the most important drivers of engagement quality, we believe this issue is sufficiently addressed in proposed ISQM 1, which gives firms flexibility in how they plan for resources, including financial resources, to support their commitment to engagement quality.

Q17: Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms' QC systems (e.g., boards with independent directors or equivalent)? If so, what criteria should be used to determine whether and which firms should have such independent oversight (e.g., firm size or structure)? What requirements should we consider regarding the qualifications and duties of those providing independent oversight?

Independent perspective can enhance stakeholder confidence in audit firms by providing valuable insights about matters that can affect a firm's audit quality, such as its business, operations, culture, talent, strategy, governance and risk management. However, we do not believe the PCAOB should require independent oversight of a firm's QC system in a future QC standard. Today, there are a variety of ways that firms gather perspectives from an independent body as a means to strengthen audit quality. We believe firms should continue to have this flexibility.

The firm's risk assessment process

Q18: Is the approach to the firm's risk assessment process appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q19: Are principles-based requirements sufficient to prompt firms to appropriately identify, assess, and respond to risks, or is supplemental direction needed? If supplemental direction is needed, what requirements would assist firms in identifying, assessing, and responding to risks?

We believe principles-based requirements are sufficient to prompt firms to appropriately identify, assess and respond to risks.

Q20: Should a future PCAOB QC standard specify certain quality risks that must be assessed and responded to by all firms? If so, what should those risks be?

We support giving firms the flexibility to identify and assess their own quality risks and not having the PCAOB prescribe these risks in a future QC standard. This would allow firms to tailor their specific quality risks to their own facts and circumstances and implement appropriate responses to address the risks. We believe that requiring firms to address specific risks would be contrary to the Board's goal of having each firm address its own unique risks. Any example quality risks or factors to consider that the Board believes may be useful in firms' efforts to implement a future PCAOB QC standard could be included in PCAOB staff guidance.

Q21: Should firms be required to establish quantifiable performance measures for the achievement of quality objectives? If so, how should such measures be determined and quantified (see also Question 46)?

As discussed in our cover letter, we believe the PCAOB should encourage but not require firms to use performance measures to drive enhancements to engagement quality and give firms the flexibility to choose the measures that are most relevant to their practices.

Relevant ethical requirements

Q22: Is the approach to relevant ethical requirements appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q23: Should a future PCAOB QC standard extend detailed requirements for independence quality controls (formerly SECPS member requirements) to all firms? How would this affect the costs and benefits of a QC system?

Maintaining independence from the companies that a firm performs audits and other assurance services for is foundational to providing trust and confidence to the capital markets. For large global networks, the QC system must be sufficiently scalable to support the regulatory requirements of the audit and assurance practices of their member firms. We believe a future PCAOB QC standard should be principles-based to give firms the flexibility to design and implement systems, processes and controls to address the risks that the firm and its personnel are not complying with the applicable independence rules. We believe the principles-based approach in proposed ISQM 1 is sufficient and, importantly, can be scaled to firms of all sizes.

The QC system for most large firms will likely comprise a combination of network controls and member firm controls. We believe networks that develop systems, processes and controls that can be consistently applied across their member firms operate more efficiently and, most importantly, more effectively to strengthen and protect their independence. For example, the requirement for each member firm to maintain a database (“Restricted Entity List”) does not need to be implemented by each member firm if a database is maintained by the network.

Acceptance and continuance

Q24: Is the approach to acceptance and continuance of clients and engagements appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Engagement performance

Q25: Is the approach to engagement performance appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q26: Should a future PCAOB QC standard expressly address firm responsibilities and actions to support and monitor the appropriate application of professional skepticism and significant judgments made by engagement teams? If so, how?

We do not believe incremental or alternative requirements are needed to support and monitor application of professional skepticism and significant judgments made by engagement teams. Many aspects of a firm’s QC system support the exercise of professional skepticism by engagement teams. We believe the guidance in proposed ISQM 1 is sufficient and gives firms the flexibility to develop a QC system that supports the exercise of professional judgment and, if applicable, professional skepticism by engagement teams.

The requirements in proposed ISQM 1 related to the firm’s culture and tone set by leadership as well as the allocation of appropriate resources also support this objective.

Q27: Should a future PCAOB QC standard expressly address the use of other audit participants? If so, should the scope of the requirements include affiliated and non-affiliated entities and individuals, including specialists and service delivery centers? Should we consider any changes to the scope of the potential requirements described? If so, what changes would be necessary?

We support the objective of addressing quality controls over a firm's use of other audit participants and agree there are quality risks associated with the use of component auditors, specialists and service delivery centers. We believe the principles-based requirements in proposed ISQM 1 related to networks and service providers, which include auditor-engaged specialists, sufficiently address quality risks associated with the broader population of audit participants identified by the PCAOB.

If the PCOAB decides to address service delivery centers and a firm's supervisory responsibilities for work performed at these centers, we believe that the Board should address this topic in its ongoing project related to the supervision of audits involving other auditors.

Q28: Should the Appendix K requirements be retained? Should the scope or application of the Appendix K requirements be changed, for example to extend the requirements to all audits in which a non-U.S. firm issues an audit report on the financial statements of an issuer, or to exempt certain audits from one or more requirements? Should the individual requirements in Appendix K for filing reviews, inspection procedures, or disagreements be revised or updated? If so, how? Is it clear how the responsibilities of an Appendix K reviewer differ from the role of the engagement quality reviewer?

We support the objective of SEC Practice Section (SECPS) member requirements in Appendix K to enhance the quality of SEC filings by SEC registrants whose financial statements are audited by non-US public accounting firms, by requiring that a knowledgeable reviewer focus on the quality of the SEC filing document, the competency of the audit engagement team and whether issues identified in the audit have been addressed appropriately.

However, we note that Appendix K was developed before the dissolution of the SECPS, the creation of the PCAOB, registration with the PCAOB of all firms that audit SEC issuers and the enhancements the PCAOB has made to the auditing standards. We believe the QC standard the PCAOB is contemplating would require a firm's QC system to appropriately address the Appendix K objectives, just as proposed ISQM 1 would require a firm to consider the nature of engagements it performs when doing its assessment of risks. In the context of financial statement audits that involve US requirements, any registered public accounting firm should have sufficient procedures to address and monitor compliance with the applicable US requirements (i.e., PCAOB standards, US GAAP or IFRS as issued by the IASB, and SEC disclosure rules and regulations).

A registered firm's QC system should be designed to address the risks posed by different types of engagements. For example, audits of financial statements to be used in the US capital markets that are performed under PCAOB standards by non-US registered public accounting firms may involve higher or different risks, given that the firms would need to comply with different sets of accounting, auditing and regulatory requirements than those required and predominantly used in the jurisdiction where the firms are domiciled. Procedures to address these risks should be part of a firm's QC system. The nature and extent of such procedures may vary by firm and by engagement. That is, the appropriate response should not involve prescriptive, one-size-fits-all requirements such as those in Appendix K.

Requiring firms to address the objectives of Appendix K in their QC system, consistent with the approach of proposed ISQM 1, would result in requirements that are scalable and broadly applicable to all registered public accounting firms (rather than limited to non-US firms that were formerly members of the SECPS, as they are today).

Q29: Should a future PCAOB QC standard require firms to adopt engagement monitoring activities (e.g., performance measures, engagement tracking tools, or reviews of in-process engagements) that would prompt them to proactively prevent or detect engagement deficiencies? What are examples of less formal, but effective, engagement monitoring activities that could be adopted by smaller firms?

We believe the guidance in proposed ISQM 1 is sufficient and would require firms to perform an appropriate combination of ongoing and periodic monitoring activities that would help firms to be proactive in preventing and detecting engagement deficiencies timely. We believe firms should have the flexibility to choose the monitoring activities that are most relevant to their practice. For example, as discussed in our cover letter, we believe the PCAOB should encourage but not require firms to use performance measures to drive enhancements to engagement quality.

We are concerned that any prescriptive guidance on monitoring activities may become outdated as technology continues to evolve and more innovative monitoring techniques become available.

We also encourage the PCAOB to provide observations of best practices that firms could deploy to proactively prevent or detect engagement deficiencies in any report that summarizes its inspection findings.

Q30: How should a future PCAOB QC standard expressly address firms' actions to support the fulfillment of the auditor's responsibilities under Section 10A of the Exchange Act, including:

- a. With respect to fraud?
- b. With respect to other illegal acts?
- c. With respect to going concern consideration?

We do not believe the PCAOB needs to include requirements in a future QC standard to address the items in Section 10A of the Exchange Act because the risk-based approach in proposed ISQM 1 would require firms to consider the legal and regulatory framework in which they operate and develop appropriate responses to these types of risks. In addition, the guidance in proposed ISQM 1 would require firms to hire professionals who have the competency and capabilities to consistently perform quality engagements, which includes an understanding of the laws and regulations relevant to the engagement.

Resources

Q31: Is the approach to resources appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard. However, as discussed in our response to question 33, we support including required competencies for the engagement partner and engagement quality reviewer in a future PCAOB QC standard.

Q32: Should a future PCAOB QC standard continue to expressly address technical training on professional standards and SEC requirements? Are there other subjects for which training should be expressly required? Which firm personnel should be covered by the training requirements? Should the standards set minimum requirements for the extent of training? If so, what should those requirements be based on?

With the increasing complexity of financial reporting, we support requiring firms to provide technical training on professional standards and SEC requirements to mitigate the risk that individuals in engagement and QC roles might not have the appropriate competencies to carry out their responsibilities.

However, we believe firms should have the flexibility to develop training programs that are commensurate with the needs of professionals serving in engagement or QC roles while at the same time making sure they comply with the professional education requirements in local laws and regulations. For example, due to greater specialization of individuals who participate in the audit, firms may need to tailor their training to the needs of these professionals (e.g., specific training for IT specialists who help the engagement team audit automated controls).

Q33: Should a future PCAOB QC standard continue to expressly address required competencies of engagement partners? Are the competencies discussed in this concept release appropriate? Are there other competencies that should be added?

Because the engagement partner is responsible for the performance of the engagement and for the report that is issued on behalf of the firm, we support including required competencies for the engagement partner in a future PCAOB QC standard. In general, we agree with the clarifications and additions to the current list of competencies that the PCAOB is considering.

However, it is unclear whether the competency for the engagement partner to obtain an understanding of technology used in obtaining or evaluating audit evidence relates to the use of IT by the client, the firm or both. If the PCAOB decides to include this competency, we believe it should not be limited to audit engagements and should focus on the engagement partner's competency to assess the risks arising from the use of IT by the client, when it is appropriate to involve IT specialists in the engagement, and the appropriate level of supervision and review of the work of IT specialists involved in the engagement.

We do not believe this competency needs to address a firm's automated solutions used in the engagement. We believe that as part of a firm's QC system required by proposed ISQM 1, firms would provide adequate training and guidance on the use of automated solutions, including those that have been developed and certified by the firm and those developed and used by the engagement team.

In addition, we do not believe a competency relating to attestation engagements is necessary because the existing competency that requires the engagement partner to understand professional standards already captures this. We believe that as part of a firm's QC system, a firm will assign engagement partners to attestation engagements who are familiar with the attestation standards and have knowledge of the subject matter of the assertion on which the engagement is based.

We believe similar competencies would apply to engagement quality reviewers.

Q34: Should the competencies of individuals in engagement or QC roles, in addition to the engagement partner and engagement quality reviewer, be addressed in a future PCAOB QC standard?

We do not believe a future PCAOB QC standard needs to address the competencies of individuals in engagement or quality control roles other than the engagement partner and the engagement quality reviewer. We believe firms should have the flexibility to establish the skills, competencies and experiences of individuals other than the engagement partner and the engagement quality reviewer who serve in these roles.

Q35: Should a future PCAOB QC standard expressly address the use of emerging technology in QC systems or engagements? Should a future PCAOB QC standard expressly require firms to design and implement controls to prevent unauthorized access to technology and data? Are there any other requirements we should consider related to the use of technology on engagements?

We believe the guidance in proposed ISQM 1 is sufficient to address the use of emerging technology, including unauthorized access to such technology and data, in a firm's system of quality control.

However, given the rapid changes in technology and the increased use of technology-based tools by auditors and preparers, we believe additional engagement-specific guidance in this area is needed and would be best addressed in a separate auditing standard. Therefore, we encourage the PCAOB to accelerate its research project on data and technology and to work with the IAASB to develop converged guidance on this important topic.

Q36: Ensuring that firm personnel in QC and engagement roles have sufficient time to properly carry out their responsibilities is one aspect of firm resources under Proposed ISQM 1. Should a future PCAOB QC standard place greater emphasis on this requirement than Proposed ISQM 1 does? If so, how?

We believe the guidance in proposed ISQM 1 is sufficient to make sure firm personnel in QC roles and in engagement roles have sufficient time to properly carry out their responsibilities.

Q37: Should a future PCAOB QC standard expressly address how the firm's incentive system, including compensation, incorporates quality considerations? If so, how?

We believe a firm's incentive system, including compensation, is a powerful and cost-effective mechanism to achieve engagement quality. By requiring firms to address how compensation and incentives incorporate quality considerations, the PCAOB can help all firm personnel understand how quality bears on their compensation. However, we believe the guidance in proposed ISQM 1 is sufficient.

Information and communication

Q38: Is the approach to information and communication appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q39: Should a future PCAOB QC standard require public disclosure by firms about their QC systems? If so, what should be the nature and timing of such disclosures (e.g., information about the firm's governance structure)? (see also Question 46)

As discussed in our cover letter, we do not believe the PCAOB should require firms to communicate information about their QC system to the public. We believe communication of a firm's annual QC assessment is best done with the audit committee of each of the issuers they serve.

Refer to our response to question 46 for our views about firms reporting on the effectiveness of their QC system and whether such reports should be made public.

The monitoring and remediation process

Q40: Is the approach to the monitoring and remediation process appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our response to question 2, we believe the requirements in proposed ISQM 1 are sufficient for a future PCAOB QC standard.

Q41: Would the requirements related to monitoring and remediation discussed in this concept release prompt firms to develop an appropriate mix of ongoing and periodic monitoring activities? Would the requirements create an appropriate feedback loop to prevent future engagement deficiencies?

We believe the guidance in proposed ISQM 1 is sufficient and would require firms to perform an appropriate combination of ongoing and periodic monitoring activities. In addition, under a risk-based approach, we believe the feedback loop that the PCAOB refers to in its Concept Release already exists because firms would consider the results of their monitoring and remediation activities on a timely basis as part of their risk assessment processes.

Q42: Should a future PCAOB QC standard provide additional direction regarding determining appropriate monitoring procedures, appropriate root cause analysis, and remediation of QC and engagement deficiencies? If so, what type of direction is needed?

We do not believe a future PCAOB QC standard should include incremental requirements or guidance for determining appropriate (1) monitoring procedures, (2) root cause analysis, and (3) remediation of quality control and engagement deficiencies. We believe the guidance in proposed ISQM 1 is sufficient and provides firms with the flexibility to determine appropriate procedures in these areas based on risk.

As noted in our response to question 29, we encourage the PCAOB to provide observations of best practices in these areas in any report that summarizes its inspection findings.

Q43: Should all firms, as part of their monitoring procedures, be required to have internal inspections of their completed engagements? If not, which firms should not be required to have inspections of their completed engagements, and what alternative measures should be required for those firms?

We do not believe the PCAOB should require internal inspections of completed engagements. We believe this would be contrary to a risk-based framework for monitoring engagement quality. As technology continues to change, firms may develop more innovative, efficient and effective ways to monitor engagement quality. Thus, a requirement to perform internal inspections of completed engagements could divert resources from performing monitoring activities that would be more effective.

We agree with the existing guidance in PCAOB QC Section 30.03 that says a firm's monitoring procedures may include pre-issuance or post-issuance reviews of selected engagements. However, as a matter of practice, we expect many firms to continue to perform internal inspections of completed engagements as a basis for evaluating engagement quality and to identify areas where the firm may need to design actions to improve engagement quality.

Q44: Should a future PCAOB QC standard establish requirements for internal inspection selection criteria? Should a future PCAOB QC standard specify minimum or cyclical thresholds for inspections of completed engagements by the firm? If so, what should the threshold(s) be (e.g., one engagement for each engagement partner, and/or the audit of each issuer, broker, and dealer on a specified basis)? Should we require selection of engagements for internal inspection to include either random selection or an element of unpredictability?

We do not believe that a future PCAOB QC standard should (1) establish criteria for selecting internal inspections, (2) specify a minimum or cyclical threshold for internal inspections of completed engagements, or (3) require selection of engagements for internal inspection to include either random selection or an element of unpredictability. We believe firms should have the flexibility to select engagements and determine the frequency of their internal inspections based on risk and other factors. We are concerned that setting prescriptive selection criteria would impede scalability and may preclude firms from being able to sufficiently tailor their approach based on risk.

Q45: Should firms be required to perform an annual evaluation of their QC system's effectiveness? If so, should the required evaluation be as of a specified date or for a specified period? How should the date or period be determined?

As discussed in our cover letter, we support the requirement in proposed ISQM 1 for firms to make an annual evaluation about the effectiveness of their QC system.

We believe the annual evaluation date should be as of a specified date. For example, the firm's annual evaluation may coincide with the fiscal year end of the firm, which is the same date that registrants are required to make their annual evaluation about the effectiveness of their ICFR pursuant to Item 308(a) of Regulation S-K.

Q46: Should firms be required to report to the Board on their annual evaluations of QC system effectiveness? If so, what should be included in the report? Should firms be required to disclose any performance measures that were important to their conclusion about their QC system's effectiveness? Should firm reports be publicly available (see also Question 39)?

As discussed in our cover letter, we do not believe a future PCAOB QC standard should require firms to report to the Board or to report publicly about their annual evaluation of the effectiveness of their QC system. In addition, we do not believe firms should be required to disclose any performance measures that were important to their conclusion about their QC system's effectiveness.

Instead, we believe the PCAOB should require firms to communicate information about their annual evaluation to the audit committee of each of the issuers they serve. We believe issuers and the public interest would be best served by having audit committees consider this information, along with all other relevant information, in executing their responsibilities for hiring, retaining, compensating or terminating the audit firm.

Q47: Should we require the firm's top leadership to certify as to their QC system's effectiveness, either as part of or in addition to the firm's report on their QC system's effectiveness?

As discussed in our cover letter, we do not support mandatory public reporting or certifications because firms should have the flexibility to determine an appropriate response that demonstrates responsibility and accountability.

Documentation

Q48: Is the approach to documentation appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As discussed in our cover letter, we believe the documentation requirements in proposed ISQM 1 are sufficient and the PCAOB should not require a firm's QC documentation to meet the reperformance standard in PCAOB AS 1215. If the Board decides to go beyond the documentation requirements in proposed ISQM 1, we believe that the requirements should align with those in Item 308 of Regulation S-K that relate to a registrant's documentation of its ICFR.

Q49: Are the potential sufficiency and retention period requirements described in this concept release appropriate for a QC system? Why or why not? If not, what alternatives should we consider?

We support requiring a seven-year document retention period, unless a longer period is required by law or regulation, to align the QC document retention requirements with those in the current PCAOB standards and SEC rules.

Q50: Should we require firms to document their understanding of network or third party provided methodology and tools, including how such methodology and tools are responsive to the requirements of the professional standards and applicable legal and regulatory requirements?

It is important for firms to obtain an understanding of network or third-party methodology and tools, including how they are responsive to requirements of professional standards and legal and regulatory requirements. However, we believe the guidance in proposed ISQM 1 is sufficient and gives firms appropriate flexibility to satisfy these requirements.

Roles and responsibilities

Q51: Should a future PCAOB QC standard specify roles and responsibilities of firm personnel in relation to the firm's QC system?

We do not believe the additional prescriptive roles and responsibilities that the PCAOB is considering for the individual responsible for independence are necessary. We support the principles-based requirement in proposed ISQM 1 to identify an individual with operational responsibility for compliance with independence requirements because it gives firms the flexibility to establish the responsibilities that are specific to the

risks of the firm. Further, the principles-based requirement allows the firm to establish an appropriate structure and reporting lines to make sure the firm and its personnel are complying with relevant independence requirements. We believe this flexibility is important for firms of all sizes.

As large global firms have various organizational structures and many firm personnel who do not participate in PCAOB engagements, we encourage the Board to consider whether all firm personnel should be responsible for adhering to the potential incremental responsibilities included in the Concept Release. We believe it is appropriate to limit the scope of such responsibilities to firm personnel who participate in PCAOB engagements.

Q52: Are the roles and responsibilities described in this concept release appropriate? Are there other roles that should be added (e.g., chief ethics officer, chief technology officer)? Are there further responsibilities that should be added?

We do not believe the PCAOB should require other roles and responsibilities beyond those in proposed ISQM 1. See our response to question 51 for additional discussion. We believe that as long as a firm meets the objectives and requirements of the QC standard, it should have the flexibility to establish roles and responsibilities in its organization that are responsive to the firm's risks.

Related potential changes to other PCAOB standards

Q53: Are the potential amendments to AS 2901 appropriate? Are there other approaches we should consider to prompt firms to appropriately respond when there are indications calling into question the sufficiency of audit procedures performed and/or audit evidence obtained?

We support the technical clarifications the PCAOB is considering to AS 2901 to make it clear that external inspections are one of the circumstances that may cause an auditor to determine that its previously issued auditor's report may not have been supported by sufficient appropriate evidence. As discussed in the Concept Release, the standard was originally issued by the AICPA years ago in the era of self-regulation and peer review, and firms have since become subject to external inspection by regulators.

However, we believe the Board's proposed change to require auditors to "apply procedures to obtain sufficient appropriate evidence if persons are relying, or likely to rely, on the auditor's report" is not necessary because this guidance is already reflected in AS 2901.05 as follows (emphasis added):

.05 If the auditor concludes that the omission of a procedure considered necessary at the time of the audit in the circumstances then existing impairs his present ability to support his previously expressed opinion regarding the financial statements taken as a whole, **and he believes there are persons currently relying, or likely to rely, on his report, he should promptly undertake to apply the omitted procedure or alternative procedures that would provide a satisfactory basis for his opinion.**

As noted in our response to question 29, if the Board is concerned that firms are not taking appropriate action when they become aware that a previously issued auditor's report may not have been supported by sufficient appropriate audit evidence, the Board should consider making this observation in any report that summarizes its inspection findings.

Q54: Does AS 1110 provide helpful direction to auditors, or should it be rescinded? Please provide explanation for your answer.

We support retaining AS 1110 because it helps clarify the relationship between the auditing standards and the QC standards. Because the QC standards and the auditing standards are separate sections within the PCAOB standards, we believe this guidance helps link the two standards.

While we do not share the PCAOB's concerns about the last sentence in AS 1110.03, we believe it is more important to focus on the effect that a deficient audit would have on a firm's overall system of quality control, and, therefore, we propose the following changes:

~~However, deficiencies in an audit or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a firm's system of quality control is insufficient to provide the firm with reasonable assurance that its professionals comply with professional standards a particular audit engagement was not performed in accordance with the auditing standards.~~

Q55: Are there other PCAOB standards for which substantive changes might be needed to align with a future PCAOB QC standard?

As discussed in our cover letter, if the PCAOB were to follow our recommendation to require firms to communicate information about their annual evaluation to the audit committee of each of the issuers they serve, this would require the PCAOB to amend PCAOB AS 1301, *Communications with Audit Committees*. In addition, we believe the Board should review its staff guidance on matters affecting a firm's QC system to determine whether any changes would be necessary.

Scalability

Q56: We intend that a future PCAOB QC standard developed using this approach would be applicable to all firms and scalable based on their size and complexity and the nature of their engagements. What factors should we consider when developing a future PCAOB QC standard to ensure that its requirements are appropriately scalable?

We support the Board's objective of developing QC standards that are scalable. A principles-based standard built on a risk-based framework is critical to achieve that objective. Both small and large firms require the flexibility to develop a QC system that is scalable based on their unique risks, size and complexity and the nature of their engagements. Therefore, if the PCAOB were to include any incremental requirements in a future PCAOB QC standard, we encourage the Board to make sure they are principles-based so that the standard is appropriately scalable.

We believe this approach is consistent with the top-down, risk-based approach that the SEC describes in SEC Release No. 33-8810. In that Release, the SEC encourages smaller public companies to take advantage of the flexibility and scalability to conduct an evaluation of ICFR that is both efficient and effective at identifying material weaknesses.

In addition, we believe an extended implementation period would allow firms to perform robust field testing that could provide important information about whether any final standard is appropriately scalable.

Q57: Are there aspects of the approach described in this concept release that would disproportionately affect smaller firms? If so, which areas, and what steps could the PCAOB consider to mitigate those effects?

We believe the following incremental requirements described in the Concept Release may disproportionately affect smaller firms: (1) requiring firms to monitor in-process engagements, (2) extending the SECPS membership requirements to all firms, and (3) requiring the QC documentation to satisfy the reperformance requirement in PCAOB AS 1215.

Q58: Should we have additional, more specific requirements regarding certain components or areas (e.g., governance and leadership) for larger, more complex firms or based on the nature of engagements performed by the firm (e.g., broker and dealer engagements or engagements for issuers in specialized industries)? If so, what should those be?

We do not believe more specific requirements regarding certain components or areas are needed for larger, more complex firms or based on the nature of engagements performed by the firm. In our view, a risk-based framework eliminates the need to develop specific requirements for any type of firm. Further, unless there is a clear definition of a complex firm, we believe that any such requirements could create operational challenges for firms to determine whether they are complex as the size of their firm and client base evolves over time.