The Association of
Accountants and
Financial Professionals
in Business

February 26, 2020

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

Re: PCAOB Release No. 2019-003, Concept Release, *Potential Approach to Revisions to PCAOB Quality Control Standards*

Dear Secretary:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to express its views on the PCAOB's Concept Release (Release), *Potential Approach to Revisions to PCAOB Quality Control Standards*, PCAOB Release No. 2019-003.

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

While the IMA includes many members from public accounting firms, and the FRC has representatives from the largest firms, most IMA members are managerial accountants in the corporate world. Auditing standards do not apply directly to those corporate accounting functions, but we believe it is important for the IMA to actively participate in the PCAOB's standard-setting process. Any new PCAOB (Board) standards affect corporations though external audit requirements and the related costs. In addition, new requirements often impact internal control processes and procedures for corporations. We are, therefore, pleased with and encourage the Board's further efforts in line with its strategic goal of enhancing stakeholder engagement, including as it relates to standard setting.

We support the approach the PCAOB lays out in the Release to update and improve the quality control (QC) standards that provide a framework for accounting firms to perform high quality audits. As the Release notes, current PCAOB QC standards were those earlier established by the American Institute of Certified Public Accountants (AICPA) and adopted by the Board. It is both efficient and effective for the Board to use the analogous firm-level QC standards being developed by the International Auditing and Assurance Standards Board (IAASB) as a starting point for the Board's new QC standards. In particular, the larger accounting firms that are most affected by PCAOB standards are multi-national organizations using world-wide auditing practices. Many of our FRC members' companies are multi-national corporations that seek uniformity in external audit practices.

We recognize that there are specific matters where the PCAOB may need to supplement the IAASB's standards or require alternatives due to securities laws, Securities and Exchange Commission (SEC) rules, or other matters unique to the United States. However, to assist in making final QC standards more scalable as explained further below, we urge the Board to limit such supplements or alternatives as much as possible.

Rather than respond to each of the 58 questions raised in the Release, we are limiting our responses to the key matters where we believe our views may be most helpful at this point of the project. Our nonresponse to the large number of questions that ask whether the PCAOB should include QC requirements in addition to those in ISQM 1 should not be interpreted as agreement with those additions.

Question 1 − Should PCAOB QC standards be revised to address developments in audit practices and provide more definitive direction regarding firm QC systems?

As the Release notes, the auditing environment has changed significantly since 2003 when the current QC standards were adopted. We fully agree that this is an appropriate time for the PCAOB to update its QC standards to reflect the changed environment and other developments in the auditing profession, including the increased use of technology and service delivery centers due to their impact on audit engagements. It is important, however, that any new requirements in these areas be principles-based so that they do not impede or detract from progress to improve the effectiveness and efficiency of audits.

Question 2 − Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard?

We agree completely with the statement in the Release, "Due to the foundational nature of QC systems, we believe it would not be practical to require firms to comply with fundamentally different QC standards." Thus, we fully support "piggy backing" new PCAOB QC standards on the ones being developed by the IAASB. Consistent standards within the US also become important if the AICPA's Auditing Standards Board updates its QC standards to reflect what is in ISQM 1, which is likely given that Auditing Standards Board's agreement to converge whenever possible.

Question 17 − Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms' QC systems (e.g., boards with independent directors or equivalent)?

We acknowledge that various practices have emerged in recent years including independent directors on firms' boards of directors and separate audit advisory boards comprised of independent individuals. It is too early to know which form of oversight, if any, will be most effective in improving firm-wide audit quality. Likewise, it would be premature to specify duties for such oversight. We believe that best practices for such oversight will develop in the marketplace.

This is like the evolution of audit committees within the corporate governance system. For decades, such committees were considered a good practice, but few companies established them, and the existing committees had widely varied practices. Only in relatively recent years has it become accepted that such committees are an essential element of corporate governance, should be required, and should follow at least a minimum list of required procedures.

We would support disclosure of the composition and the general responsibilities of such independent audit oversight activities in the quality control reports mentioned in Question 39 below.

Question 18 − 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)?

Question 19 − Are principles-based requirements sufficient to prompt firms to appropriately identify, assess, and respond to risks, or is supplemental direction needed?

Question 20 – Should a future PCAOB QC standard specify certain quality risks that must be assessed and responded to by all firms?

"The proposed standard's (ISQM 1) approach to quality management involves a risk-based approach, which includes requirements for firms to focus on identifying and responding to quality risks." While supporting the "risk-based approach" suggested in ISQM 1 that the Release suggests would be incorporated in new PCAOB QC standards, we urge caution. Neither the Release nor ISQM 1 provides much guidance on how firms would implement and apply a risk-based approach. We support a generalized, or principles-based, approach and believe that firms should be allowed to determine their own best practices in this area.

Some commentators may suggest that eventual PCAOB QC standards should specify exactly how a risk-based approach should be developed and applied. They may base such suggestions on their experience with PCAOB inspections that take issue with firm judgments about similar decisions. Commentators may feel that it is better to have very specific rules in this area to avoid later second guessing by inspectors. Views influenced by historical experience through application of dated standards may limit the effectiveness and adaptability of new QC standards.

Risk management practices are by their nature subjective and firms should be given latitude to develop approaches, within broad guidelines, that best suit their own circumstances. Those approaches are certain to change frequently given changes in technology, economic conditions, etc.

Consistent with the above comments, we would not support requiring specification of risks that must be considered by all firms. If the Board does decide to identify certain risks that must be considered, we believe that firms should be allowed to design the appropriate responses in their circumstances. In other words, specified responses should not be mandated to any risks that must be considered.

Question 31 – 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?

The discussion on pages 23-27 of the Release covering Engagement Performance appears to suggest a much more expansive and detailed approach to firm-wide quality control than at present. In fact, many of the incremental requirements the Board is considering relate to quality control at the engagement level, which may be more appropriately addressed by auditing standards than QC standards. We certainly support audit quality at the engagement level. In fact, companies through their audit committees and management typically are much more interested in accounting firms' quality controls as they apply to their specific company rather than to the firm as a whole. Thus, we believe that any new standards in this area must preserve judgment and the ability of the engagement team to apply principles as the team best decides based on that judgment. For example, the Board should avoid prescriptive requirements for such things as in-process reviews and consultations, which could lead to unintended consequences, including for companies.

Question 35 – Should a future PCAOB QC standard expressly require firms to design and implement controls to prevent unauthorized access to technology and data?

Yes, this is one area where we support a specific requirement. To perform quality audits, firms are provided unfettered access to company financial systems and data. In return, it is essential that they maintain controls that protect against any unauthorized access.

Question 39 − 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)?

For the past few years, the largest accounting firms have each been issuing annual reports describing quality controls over their audit practices. These reports have increasingly included audit quality indicators (AQI), many of which have now become generally accepted in the sense that they are being reported by most firms. Our September 28, 2015 comment letter to the PCAOB on the Concept Release on Audit Quality Indicators noted that this "(v)oluntary disclosure by the largest accounting firms is already occurring and the marketplace will ensure that others follow." We are pleased to see that this has happened.

The time probably has come for there to be a requirement for an annual quality control report to be issued by at least the largest accounting firms – perhaps, initially, for those firms that audit more than 100 registrants. However, this is an area where scalability should be considered; the public interest in such a report would be much less for smaller firms and need not be required at this time. We do continue to believe that firms should be given wide discretion in the form and content of such reports. At this time, it is possible that agreement could be reached on a few AQIs that should be included in all reports. But indicators should continue to evolve as research and the marketplace determine which ones provide truly useful information.

See also our comment in response to Question 17 suggesting that firm QC reports should include information about any independent oversight activities.

Question 56 − 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 agree that PCAOB standards should, in general, be applicable to all firms. Audits should be performed in a relatively consistent manner so that auditor reports have the same meaning to investors. At the same time, the QC system of one of the largest firms will necessarily be different than a small firm with only a couple of partners and only one or a few registrant clients. Thus, it is appropriate for the Board to find ways to introduce scalability into new QC standards.

We make one modest suggestion above – to require only the largest firms to publish annual audit quality control reports. Beyond that we found few specific areas in the Release that suggested opportunities for scalability. More generally, we think that there are two ways in which the Board can help ensure that new QC standards are not overly burdensome, particularly on smaller firms.

First would be to avoid a rules-based approach as much as possible in finalizing QC standards. Instead, use a principles-based approach that will allow firms to apply judgment and adapt the standards to their own circumstances in a cost-effective manner.

Second would be to limit additions to the international standards as much as possible. Certainly, the Board will feel obligated to add requirements that are already specified by securities laws or SEC regulations. But many, if not most, of the remaining supplemental matters suggested in the Release might better be described as best practices rather than necessary requirements. The general standards in those areas may be sufficient and could help avoid an overload situation for the smaller firms.

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

Sincerely,

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Institute of Management Accountants
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