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By email: comments@pcaobus.org

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

Re: PCAOB Rulemaking Docket No. 046, Release No. 2019-003

Dear Office of the Secretary:

We are pleased to provide comments to the Board and Staff on PCAOB Release No. 2019-003: Concept Release: *Potential Approach to Revisions to PCAOB Quality Control Standards*. We commend the Staff and Board on taking up this very important project. The proposed enhancements to the Quality Control Standards will, we believe, be beneficial in improving audit quality.

Baker Tilly Virchow Krause, LLP (Baker Tilly), is a large accounting firm operating primarily in the Midwest and Mid-Atlantic regions, with clients in more than 20 states. We have approximately 3,900 total staff including over 400 partners and 1,100 CPAs. We have fewer than 100 issuers and are a triennially inspected firm. Our issuer practice consists primarily of smaller, non-accelerated filers in various industries, including financial institutions as well as a substantial complement of 11-K audits. Although we are a top 15 ranked firm, our organization is substantially different from a big four firm.

In addition to providing general observations, we have included additional detailed responses to certain questions.

General Observations

Effective and relevant quality control standards are a necessary component for improving audit quality. We are supportive of the Board's efforts in this area as PCAOB QC standards are somewhat dated. As noted in the Release, the QC standards were adopted by the Board at its inception and derived from standards produced by the former SECPS of the AICPA. These standards are dated, having first been issued in 1997. In the interim, both the AICPA and the IAASB have issued revised QC standards. Most recently the IAASB has issued a proposal on updating its QC standards, ISQM 1.

We are especially supportive of the approach that the Board has taken, in basing its potential approach on ISQM 1 with suitable increments as necessary to address issues considered unique to audits of US issuer entities. Converging QC standards, in and of itself, is a welcome development. One of the challenges faced by practitioners, especially in small and medium sized auditing firms is the need to switch gears between

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standards, quality control as well as audit standards. This can contribute to misunderstanding when planning and performing audits of public companies. We understand that the Auditing Standards Board is also evaluating the convergence of US QC standards with ISQM1, as well. If this is accomplished, the three primary global audit standard setters will be substantially aligned and this will be a significant accomplishment and perhaps this project will serve as model for further convergence within the audit standards as well.

As we consider the Concept Release several overarching themes emerge. These are:

- To the extent possible the QC standards should be principle based and limited in proscriptive requirements.
- The application of the requirements should be risk-based.
- The requirements should be scalable to the size and composition of the audit firms' public company audit practice.
- Incremental requirements to the ISQM 1 should be limited to the extent possible.

Specific Responses

Q. 1. 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 more definitive QC standards should be adopted by the PCAOB. The current standards are outdated and less effective and relevant to the current state with respect to QC standards. Striving for convergence with IAASB proposed standards should be the starting point.

Q. 2. Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard? Are there alternative approaches we should consider?

ISQM 1 appears to be the most relevant basis for the PCAOB standard. We see no other viable approaches.

Q. 3. 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?

The reasons provided appear reasonable, but care should be taken in determining whether those differences need to be spelled out, or whether or not they can effectively be addressed by firms within a principle based framework.

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Q. 4. Are there other developments affecting audit practices we should consider addressing in a future PCAOB QC standard?

The impact of new technologies in the conduct of an audit should be a consideration. It would not be useful if the QC and the audit standards are trailing the adoption of these technologies.

Q. 5. 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?

Most smaller and medium size firms tend to not be at the leading edge of the adoption of international developments. While many firms monitor what is occurring internationally as a practical matter the firms choose to wait for standard setting from the ASB and the PCAOB rather than front-running. With this approach the firms can also monitor what the larger firms are doing and have an opportunity to observe and learn from their experiences.

Q. 6. 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.

No comment.

Q. 7. Would the approach to quality control standards described in this concept release be preferable to the current PCAOB quality control standards?

Yes as noted in our introduction the alignment with other standard setters should make adoption easier. Also the current QC standards contain relatively little guidance. Hopefully the new standard will provide application guidance to assist the firms.

Q. 8. 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?

Yes; none noted

Q. 9. Would the potential revisions to PCAOB QC standards described in this concept release improve QC systems and audit quality?

We believe improved QC standards have the potential to improve audit quality over time.

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Q. 10. 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?

Possibly, but each firm will need to adopt the standards in a manner that will lead to positive results. The adoption of the new standards will not in of itself radically change the audit process. But over time, the principles will begin to reveal themselves in improved methodologies.

Q. 11. Should a future PCAOB QC standard have additional or alternative requirements for firms that audit brokers and dealers? If so, what?

We do not believe this is necessary or desirable. The differences related to brokers and dealers relate primarily to reporting issues (attestation) and should be handled in the audit and attest standards.

Q. 12. 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?

There will be substantial costs incurred by firms at the outset to adopt and implement the new standards. Careful consideration should be given to the documentation requirements, and the standard should be scalable for smaller and medium sized firms.

Q. 13. Is the approach to firm governance and leadership appropriate (i.e., use of ISQM 1 requirements as a starting point, incremental or alternative requirements)? Are changes to the approach necessary for this component?

Generally we believe the approach being considered may be too prescriptive. While it is appropriate for firms to designate an individual ultimately responsible for quality, having specifically designated personnel down through the organization would be cumbersome and probably not be particularly effective in the smaller firm environments.

Q. 14. Would more clarity in the assignment of firm supervisory responsibilities enhance supervision and positively affect QC systems and audit quality?

Not necessarily.

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Q. 15. 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 this is necessary or appropriate. Providing the principles related to QC should be sufficient for firms to develop their own approaches as to what it will work.

Q. 16. 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?

We do not believe this is a necessary requirement.

Q. 17. 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?

This approach should not be a requirement. Firms have developed different forms of governance that are suitable for them. To prescribe some sort of required structure would be contrary to a risk-based approach and probably unsuitable for the smaller firms.

Q. 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)? Are changes to the approach necessary for this component?

This appears appropriate.

Q. 19. 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?

Application guidance, particularly, for how a smaller firm may approach risk assessment would be helpful. This was an approach taken up by COSO, as it provided guidance for how smaller organizations could adopt the principles.

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Q. 20. 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 do not believe specifying certain quality risks should be required. Providing examples of types of quality risks in application guidance may be useful.

Q. 21. 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)?

We strongly disagree with this being a requirement. Especially at the outset of adopting the new approach. The PCAOB and the profession have struggled to adopt and develop truly effective quality measures, and there does not appear to be any empirical study that can connect which measures actually improve quality. Moreover, from time to time it might be necessary for firms to emphasize one area over another to address specific issues. Firms should be provided with the flexibility to measure what is important to them.

Q. 22. 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?

This seems to be appropriate and something that firms with a mixed practice undertake as part of their ethics monitoring today.

Q. 23. 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?

Yes we believe that the same independence requirements should apply to all auditors subject to PCAOB oversight.

Q. 24. 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?

This is appropriate.

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Q. 25. 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?

Yes this approach is appropriate.

Q. 26. 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 believe this is activity that should be handled within the audit standards using a risk-based approach.

Q. 27. 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 believe these issues are best left to the audit standards.

Q. 28. 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?

No comment.

Q. 29. 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 do not believe this should be a requirement. Rather using a risk-based approach, firms can determine how much monitoring is necessary based on their practice.

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Q. 30. 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 believe these matters are better left addressed in the audit standards.

Q. 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?

We do not agree with the incremental requirements. They appear to be too prescriptive.

Q. 32. 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?

The training requirements should be scalable to the risk associated with a firm's issuer practice and current regulatory requirements.

Q. 33. 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?

We believe audit engagement partners should have required competencies but are concerned about the approach here as being too prescriptive. Care should be taken to maintain a risk-based approach.

Q. 34. 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 this is necessary.

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Q. 35. 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?

Yes, the QC standard should address emerging technologies and address a potential approach that firms may adopt in evaluating and implementing such technologies.

With regard to unauthorized access to technology and data, we support a principles-based approach to prevention, but individual firms will need to determine their own risks and controls.

With regard to other technology requirements, the concept release refers to the engagement partner having a “sufficient understanding of the relevant technology, including the use of firm-approved technology...” Firms use a variety of technologies, many of which are vetted at the firm level as part of the firm’s QC system. We recommend clarifying the meaning of this statement and the extent to which the engagement partner would be responsible for understanding each technology application used in the performance of an audit. In most cases, we believe it would be appropriate for an individual engagement partner to rely on a firm’s central process in designing and performing audit procedures in accordance with PCAOB standards.

Q. 36. 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 do not believe incremental requirements are necessary.

Q. 37. Should a future PCAOB QC standard expressly address how the firm’s incentive system, including compensation, incorporates quality considerations? If so, how?

We support a principles-based approach to acknowledging the importance of aligning economic incentives with audit quality, but we do not believe a prescriptive approach is necessary or scalable.

Q. 38. 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?

No comment.

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Q. 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)?

There should not be a requirement for public disclosures. We believe the current public disclosure system related to inspections, Form AP, and other public information is sufficient.

Q. 40. 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?

We believe the proposed ISQM 1 requirements are sufficient.

Q. 41. 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?

No comment.

Q. 42. 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 believe application guidance may be useful, particularly in the areas of identification of QC deficiencies, a principles-based evaluation framework, root cause analysis, and effective remediation.

Q. 43. 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?

Firms should develop monitoring procedures which are responsive to the risk in their practices, rather than using a prescribed approach.

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Q. 44. 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 agree with prescribing internal inspection selection criteria or frequency as it may negatively affect the scalability of the standard.

Q. 45. 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?

We believe the evaluation of a QC system's effectiveness is a continuous, iterative activity for firms, but would not recommend a formal conclusion as of or for a specified period. If such a requirement were part of a future PCAOB QC standard, we recommend more guidance on the evaluation framework and remediation process.

Q. 46. 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)?

We do not believe this requirement is scalable to smaller and medium sized firms for the following reasons:

1. We believe the reviews conducted as part of triennial inspections are sufficient for communicating QC system effectiveness to the Board.
2. As the Board is aware, remediating quality control deficiencies takes time, hence the provision in Section 104(g)(2) of the Sarbanes-Oxley Act of 2002 that quality control criticisms are not made public provided they are addressed by the firm to the satisfaction of the Board within 12 months of the date of the inspection report. Based on this provision, we believe the Board is in the best position to evaluate a firm's QC system effectiveness through an objective review of evidence submitted by registered firms.
3. We further believe that the majority of firms take the Rule 4009 remediation process very seriously. In recent years, the Board has encouraged and supported dialogue in the

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remediation process¹, and the Staff has provided remediation guidance at Small Business Forums. We believe all firms – particularly the triennially inspected firms – have greatly benefited from this dialogue. Consequently, we believe that a new requirement for interim QC reporting to the Board may divert attention from the Rule 4009 remediation process.

Q. 47. 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?

No. We believe ISQM 1 places sufficient emphasis on tone at the top for firm leadership and additional certifications would not affect audit quality.

Q. 48. 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?

We do not believe incremental requirements are necessary.

Q. 49. 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 believe this will be difficult to apply in practice. Firms use many methods to structure and document their QC systems. As a result the systems tend to be dynamic with changes occurring as necessary for firms to adapt to the risk in their practices. This is a beneficial activity. To require firms to somehow maintain a version of the QC documentation for seven years would be burdensome and may cause unintended consequences. Such as a firm deciding not to make needed changes because the record keeping is too onerous.

Q. 50. 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?

This is an appropriate activity.

¹ See, e.g., PCAOB Release No. 104-2006-077, *The Process for Board Determinations Regarding Firms' Efforts to Address Quality Control Criticisms in Inspection Reports*, March 21, 2006; and *Staff Guidance Concerning the Remediation Process*, November 18, 2013.

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Q. 51. 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 specifying roles and responsibilities is necessary, given the principles-based framework of ISQM 1. We do not believe specifying particular roles is scalable for smaller firms.

Additionally, to the extent a future PCAOB QC standard uses the phrase "all firm personnel" in describing the scope of certain QC requirements, we recommend clarification. Firms have many personnel who do not participate in PCAOB audits or are subject to different firm protocols; a broad QC policy for "all firm personnel" might not be appropriate. Existing PCAOB definitions in Rule 1001 may be appropriate to consider, such as "Person Associated With a Public Accounting Firm" or "Accountant". Form 2 also separately reports accountants from the total number of firm personnel which may be a helpful data point to consider.

Q. 52. 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?

Please refer to our response to Question 51.

Q. 53. 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 do not believe amendments to AS 2901 are necessary.

Q. 54. Does AS 1110 provide helpful direction to auditors, or should it be rescinded? Please provide explanation for your answer.

We believe AS 1110 has some benefits and should be retained.

Q. 55. Are there other PCAOB standards for which substantive changes might be needed to align with a future PCAOB QC standard?

No comment.

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Q. 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?

The standard setters should limit the prescriptive requirements and emphasize a risk-based approach, while providing application guidance that firms can consider when developing and updating their QC systems.

Q. 57. 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 have noted above several instances where smaller firms will be negatively affected by the approach as provided in the concept release. These firms should have the opportunity to develop systems that address the inherent principles and are appropriately scaled to their practices.

Q. 58. 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?

No comment.

We appreciate the opportunity to comment on the potential approach to revisions to PCAOB QC standards as outlined in the Board's Concept Release. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer any questions that the Board may have regarding the views expressed in this letter.

Sincerely,



BAKER TILLY VIRCHOW KRAUSE, LLP