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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

PCAOB Release No. 2019-003, *Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards (December 17, 2019)*

This letter provides GAO's comments on the Public Company Accounting Oversight Board's (PCAOB) concept release regarding revising the PCAOB's quality control standards. GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support the PCAOB's efforts to improve its quality control standards and the concept release's approach of using the International Auditing and Assurance Standards Board's International Standard on Quality Management (ISQM) 1 as a basis for the PCAOB's quality standard. We understand that the PCAOB will need to make changes to ISQM 1 because of the legal and regulatory environment in which firms that use PCAOB standards operate. However, we believe that the PCAOB should not be overly prescriptive with the requirements in its future quality control standard and should focus on making the requirements as principle based as possible. We believe that the PCAOB addressing emerging issues, such as the use of network firms and cybersecurity, could improve firms' quality. Finally, we believe that identified changes would significantly improve the PCAOB's standards.

The PCAOB seeks comment on 58 specific questions. Our responses to the questions follow in the enclosure to this letter.

Thank you for the opportunity to comment. If you have questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov.

A handwritten signature in black ink, appearing to read 'James R. Dalkin'.

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

Enclosure

Responses to Questions on the Public Company Accounting Oversight Board's *Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards*

- 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 believe that the International Auditing and Assurance Standards Board's discussion regarding International Standard on Quality Management (ISQM) 1 and the American Institute of Certified Professional Accountants' discussion of changes in quality control standards should be taken into account in the updating of the Public Company Accounting Oversight Board's (PCAOB) quality control standards. This update will help expand on quality control practices and provide consistency between the standard setters as audit firms develop and modify their quality control practices.

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

We believe that it is reasonable to use ISQM 1 as a basis for a future PCAOB quality control standard.

- 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?**

We understand that differences will occur, especially given laws and regulations that firms using the PCAOB standards are required to follow.

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

We believe that emerging issues that firms are facing should be addressed as part of the quality control standard. We believe that this includes firms' use of networks and cybersecurity issues.

- 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?**

We are not providing a response regarding what changes firms are making based on the exposure draft of ISQM 1. We believe that one benefit is that it helps ensure that member firms have quality control systems. Also, we believe that it will ensure more consistency in quality control among firms.

- 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.**

We are not providing a response to this question.

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

We support the quality control standards approach described in this concept release. We encourage the development of quality control standards that are more robust and consistent with ISQM 1.

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?

We support the objective in proposed ISQM 1, and we believe that it is appropriate to use as the objective for a quality control system under the PCAOB standards.

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

We believe that the potential revisions described in the concept release could improve quality control systems and audit quality.

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?

We believe that the revisions identified in this concept release will enhance firms' ability to prevent audit deficiencies.

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

We are not providing a response on whether the PCAOB quality control standard should have additional or alternative requirements for firms that audit brokers and dealers.

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?

We believe that it is in the public interest for the PCAOB to develop a quality control standard. We believe that firms will need to spend additional capital on developing and maintaining an integrated quality control system, but the benefits to the public interest are more valuable than the costs incurred.

13. 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?

The decision to approach firm governance and leadership by using ISQM 1 requirements is reasonable. We believe that making incremental or alternative requirements as described in the

concept release may be necessary to meet the PCAOB's needs, but the changes should be scalable to firms and should ensure the standard remains principles-based.

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

We believe that clarifying the assignment of firm supervisory responsibilities could enhance supervision and positively affect quality control systems and audit quality. We believe that it is important to be principles-based, so the PCAOB should be cautious about explicit assignments of supervisory responsibilities.

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

We believe that a future PCAOB quality control standard should not be overly prescriptive about firm structure.

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 believe that the PCAOB should not provide greater emphasis in a future PCAOB quality control standard than is proposed under ISQM 1. We believe that the PCAOB quality control standard should be risk-based. We believe that investment can vary on multiple factors including risk, so providing more emphasis for one interest over another in the standard may not be appropriate for the diversity of firms that follow the PCAOB's standards.

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?

We believe that a future PCAOB quality control standard should consider mechanisms for independent oversight of firms' quality control systems, but the PCAOB should not be too prescriptive in this area given the broad variety of size and structure of firms.

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?

We support the PCAOB's approach to the firm's risk assessment process, and we do not have any suggested changes to the requirements.

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?

We believe that principles-based requirements should be used for the risk assessment section of the quality control standards. This should allow firms to identify, assess, and respond to risks appropriately. There may be need for additional application guidance to provide firms with guidance on how to implement the risk assessment process requirements.

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?

The decision to require certain quality risks be assessed and responded to by all firms may be too prescriptive; however, given how relatively new the concept of a risk-based quality control standard is, the creation of application guidance about quality risks may be appropriate.

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 believe that qualitative factors, along with the quantitative factors, should be considered in ensuring that quality objectives are met.

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?

We believe that the ethical requirements should be principles-based. We believe that ISQM 1, as drafted, dictated too precisely how firms met the requirements related to relevant ethical requirements, including independence. The use of ISQM 1 requirements as a basis may be a difficult place to start. We believe that starting with the PCAOB's existing ethics requirements and assessing where ISQM 1 requirements would improve and clarify those requirements may be a better approach.

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?

The harmonization of independence quality controls across all firms that follow the PCAOB's standards should be considered, but the cost for those firms that do not use the current independence quality controls should be assessed to ensure that it does not significantly affect them.

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?

We believe that it is reasonable to start with ISQM 1 requirements and address the incremental and alternative requirements outlined in the concept release.

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?

We support the approach and the potential incremental or alternative requirements.

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 a principles-based approach should be used. We believe that the requirements should not be overly prescriptive.

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 that regardless of whether the PCAOB issues a future quality control standard, other audit participants should be addressed. The scope should include affiliated and nonaffiliated entities and individuals, in particular service delivery centers. We understand the need for the standards related to service delivery centers to be principles based because of the continued evolution of the area.

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?

We are not providing a response regarding whether the appendix K requirements should be retained.

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 believe that in-process reviews are part of engagement performance. Unless a firm's established quality management process, including completion of engagement quality reviews or the equivalent, is permitted to fully function to completion, monitoring procedures such as inspections cannot determine if a potential finding or deficiency would have been rectified through the quality management process. In addition, inspecting in-process engagements could blur the distinction between quality management within individual engagements and the quality objective related to the monitoring and remediation process. Thus, we believe that permitting inspections of in-process engagements will cause additional difficulties in applying the standard.

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 are not responding regarding how a future PCAOB quality control standard should fulfill the auditor's responsibilities under section 10A of the Exchange Act.

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 support the approach to resources outlined in the concept release. We believe that an incremental requirement that firms design and implement controls to prevent unauthorized access to technology and related data used on an engagement should be addressed regardless of whether an updated quality control standard is developed. We believe that cybersecurity is an emerging issue that should be addressed to ensure that firms can be relied upon to properly maintain client information and firm records.

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?

We believe that if the PCAOB continues to identify, through its inspection process, training deficiencies related to professional standards and Securities and Exchange Commission requirements, then it should continue to expressly address these types of training. In regard to other training topics, we believe that there should be a focus on ensuring that the auditors are competent, which means that training will vary depending on each auditor's role and the organizations audited.

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 that competency is important for auditors at all levels. Addressing competencies in a future quality control standard should limit the number of competencies specifically required under this standard and ensure that the requirements are principles-based. Over time, specific competencies may become more or less important. We believe that the identified competencies are appropriate.

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 believe that identifying competencies for individuals on engagement and quality control roles is important to include in a future quality control standard. As noted in our response to question 33, the standard should not be overly prescriptive in identifying of competencies.

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?

We believe that a future quality control standard should expressly address emerging technology. We believe that an incremental requirement that firms design and implement controls to prevent unauthorized access to technology and related data used on an engagement should be developed even if the PCAOB's quality control standards are not updated.

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 support the PCAOB quality control standard having the same emphasis as the proposed ISQM 1 standard for the firm personnel in quality control and engagement roles having sufficient time to carry out their responsibilities.

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

We are not providing comments related to a firm's incentive system.

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?

We support the approach to information and communication, including the consideration of the incremental and alternative requirements.

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)? (see also Question 46)

We are not providing comments related to public disclosure by firms regarding their quality control systems.

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 support the approach to the monitoring and remediation process; however, see our responses to questions 43 and 44 related to monitoring and inspections for additional information.

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?

We believe that the requirements discussed in the concept release provide the potential for firms to develop an appropriate mix of ongoing and periodic monitoring activities. In addition, we believe that the requirements will create an appropriate feedback loop, which could prevent future engagement deficiencies.

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 support the PCAOB considering additional monitoring procedures, root cause analysis, and remediation of quality control and engagement deficiencies. We believe that the PCAOB's quality control standard should be principles-based.

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?

We believe that this requirement may be inconsistent with the intention to promote more proactive and effective monitoring activities. We do not believe that there should be a requirement to have internal inspections of completed engagements as it may be inconsistent with the risk assessment that a firm performs. For instance, a firm may have started a new practice area that focuses on engagements with higher risk and greater inherent uncertainties. Using resources to inspect completed engagements may divert resources that could otherwise be used on monitoring activities for higher-quality risks.

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?

See our response to question 43. The intention of ISQM 1 is to use a risk-based structure to address risks in a firm's quality control system. We believe that a future PCAOB quality control standard should use risk-based determinations for inspection that are principles based.

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 that a future PCAOB quality control standard should include a required annual evaluation of a firm's quality control system's effectiveness. The standard should include some flexibility in determining the date of a firm's evaluation.

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 that firms should report to the PCAOB on their annual evaluations of its quality control system effectiveness. We believe that the focus of the monitoring and evaluation of system effectiveness should be on identifying and addressing deficiencies and not on creating a public reporting requirement.

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?

We agree with this requirement, but we believe there should be sufficient time to implement a firm's quality control system and evaluated to determine its effectiveness. In order for individuals who are assigned ultimate responsibility and accountability for a quality management system to fulfill their responsibilities appropriately, they must be able to rely on that system to provide accurate and reliable information. From the point of implementation of a firm's quality management system, it may take more than one period for the firm's quality management system to generate accurate and reliable information, especially if there are substantial changes to the system as a result of implementing the future PCAOB quality control standard. We believe that these challenges should subside as a new quality management system is evaluated and refined.

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 support the PCAOB's approach to start with ISQM 1 and consider potential incremental or alternative requirements.

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 are not providing comments related to the potential sufficiency and retention period requirements.

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?

We are not providing a response regarding whether firms should document their understanding of network or third party-provided methodology and tools.

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

We believe that a future PCAOB quality control standard should specify roles and responsibilities of firm personnel. We believe that the future standard should be principle-based and should not try to include all roles and responsibilities of firm personnel.

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?

We believe that the roles and responsibilities described in the concept release are appropriate. As noted in our response to question 51, the standard should be principle-based and should not try to include all roles and responsibilities of firm personnel.

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 are not providing responses regarding potential amendments to AS 2901.

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

We are not responding regarding whether AS 1110 provides helpful direction to auditors.

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

We are not providing a response to whether other PCAOB standards will need substantive changes to align with a future PCAOB quality control standard.

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 believe that scalability for the ISQM 1 is more important because of the varying types of firms to which it would apply. We believe that firms that engage in PCAOB engagements should be of sufficient size to be able to implement and manage a quality control system sufficient to meet a PCAOB quality control standard.

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?

See our response to question 56 for our response to this question.

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?

We are not providing a response regarding whether there should be additional requirements for larger, more complex firms or for firms that perform audits for specific issuers.