Public Comment by Robert A. Conway, CPA in Response to the PCAOB's Proposed System of Quality Controls (Docket No. 046)

January 4, 2023

The Circumstances Warrant a Prescriptive Standard for Large Audit Firm Resource Management and Monitoring

The mismanagement of human capital by the largest audit firms is an age-old problem that undermines audit quality and threatens the long-term sustainability of the auditing profession. Allowing the audit firms to each use their own risk-based approach to controls over the management and monitoring of their human capital will not drive serious change. Rather, it will allow the largest audit firms to perpetuate the status quo by enabling those firms to set a low bar on resource management and monitoring that the audit firms will satisfy despite the checkered realities of how the largest audit firms mismanage their human capital.

To achieve a suitable level of profitability in a commodity pricing environment, the audit firms have demanded high levels of productivity from their professionals. The heavy workloads cause high turnover that undermines experience levels and year-over-year engagement continuity – factors that academia have demonstrated are linked to audit quality. Heavy workloads at the partner and manager level (as evidenced by high ratios of staff to partners and managers) threaten the quality of supervision and review. **In summary, there is a heightened risk that inexperienced staff will be inadequately supervised**. **This staffing model is a complete mismatch with the complexity that auditors need to master in order to achieve a suitable level of audit quality.** A risk-based approach will simply provide cover for the existing flawed human resource model followed by the largest audit firms.

In the pages that follow, I will describe what a prescriptive approach to human resource management and monitoring would look like. But first, I want to be sure we are on the same page with respect to the current state of the audit firm staffing model and how the largest audit firms mismanage their human resources.

Flashing Red Lights Point to Audit Firm Mismanagement of Human Capital as a Threat to Audit Quality and the Long-Term Sustainability of the Auditing Profession

The PCAOB's proposed QC standard leaves me wondering if this standard was crafted in a vacuum. I see no indication that the PCAOB considered the following flashing red lights:

- In April 2022, EY Germany "promised staff an improvement of working conditions after receiving the recommendations of an independent advisory commission tasked with improving internal governance **in the wake of the Wirecard scandal**. In a briefing document for staff, which was seen by the FT, the firm said it would address "**permanent occupational stress and overburdening" among its audit staff**, in part by hiring more people and trying to limit after-hours work.[1]

- On June 28, 2022, an SEC Order fined Ernst & Young $100 million for employee cheating on CPA Ethics exams. The order noted that, "Many professionals acknowledged during the firm's investigation that they knew their conduct violated EY's Code of Conduct, but **they cheated because of work commitments** or an inability to pass training exams after multiple attempts."[2]
- The AICPA 2021 Trends Report[3] ("AICPA Trends Report") published in 2022 monitors many things including trends in new CPA candidates and annual graduations with degrees in accounting. Here are two basic facts from the AICPA Trends Report that are alarming:

  - The number of new CPA candidates has declined from 48,004 candidates in 2016 to 36,670 candidates in 2019 (pre-pandemic).[4] This is a 24% decline.[5]
  - Total annual accounting degree completions have declined from 79,854 in the 2015-2016 academic year to 72,923 in the 2019-2020 academic year.[6] This is an 8.7% decline.

  The AICPA has many good programs to try to draw more people into public accounting, but none of those programs deal with the central issue – the mismanagement of human capital by the largest CPA firms. Complaints about long hours in public accounting and the absence of work-life balance travel fast via social media from young audit professionals to those in the college ranks that are considering accounting majors. This messaging is driving college students away from careers in public accounting.

  The audit firms will naturally pay higher salaries to get their share of a smaller a pool of future auditors. But higher salaries will not solve the root cause issue. The AICPA cannot be counted on to rectify this situation because of the influence the largest audit firms have over the AICPA. If the AICPA will not act, who will? **Spoiler alert: The PCAOB needs to step up. The shortage of qualified professionals is a serious threat to audit quality and investor protection.**

- A January 2018 article published by Reuters[7] about the FDIC's claim against PwC in the Colonial Bank matter highlighted a quality control failure with respect to PwC's human capital management as follows:

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1 See Financial Times article at https://www.ft.com/content/b4c603a9-d4f7-4f24-b27c-ad5f7f16a880
2 See paragraph 20 of the SEC Order at https://www.sec.gov/litigation/admin/2022/34-95167.pdf
3 See 2021 Trends report | Professional Insights | AICPA
4 See page 52 of the AICPA 2021 Trends Report
5 New CPA candidates subsequently declined to even lower levels of 30,385 candidates in 2020 and 32,186 candidates in 2021
6 See page 15 of the AICPA 2021 Trends Report.
7 See At heart of FDIC's win v. PwC, an unsettled theory | Reuters by Alison Frankel.

"Among PwC's shortcomings, according to Judge Rothstein: The auditor relied on the chief architect of the fraud, Taylor Bean chair Lee Farkas, to verify key information about the collateral underlying a Colonial credit facility for Taylor Bean. PwC also signed off on Colonial's audit without ever understanding the third and most complex iteration of the fraud, which involved a credit facility based on phantom mortgage securitizations. ***After an auditor who was supposed to make sense of the transactions gave up, saying they were "above his pay grade," PwC assigned a college-aged intern to evaluate the nearly $600 million asset****.*

Judge Rothstein was distinctly harsh about PwC's failings. Basing Colonial's certification on Farkas' account of Taylor Bean's collateral was "quintessentially the same as asking the fox to report on the condition of the hen house," she wrote. ***And charging an intern to decipher a loan facility beyond the expertise of a senior auditor was a "truly astonishing" departure from PwC's mandate, the judge wrote.****"*

PwC settled the claim by the FDIC on the Colonial Bank matter for $335 million. This was not PwC's only settlement with respect to its audit of Colonial Bank.

- An academic study and survey titled "Auditor Perception of the Audit Workplace, Audit Quality, and the Auditing Profession"[8] sets off several alarms about the ill-effects on audit quality caused by the Big Four audit firm business model. The executive summary from that study is repeated below:

"In this study, we use a survey instrument to obtain perspectives from over 700 auditors about present-day audit workloads and the relationship between audit workloads, audit quality, and job satisfaction. Our findings indicate that auditors are working, on average, five hours per week above the threshold at which they believe audit quality begins to deteriorate ***and often 20 hours above this threshold at the peak of busy season****. Survey respondents perceive deadlines and staffing shortages as two of the primary reasons for high workloads and further believe* ***that high workloads result in decreased audit quality via compromised audit procedures (including taking shortcuts), impaired audit judgment (including reduced professional skepticism), and difficulty retaining staff with appropriate knowledge and skills. We also find that auditors' job satisfaction and their excitement about auditing as a career are negatively impacted by high audit workload, particularly when the workload exceeds a threshold that is perceived to impair audit quality****. Overall, our findings provide support for the PCAOB's recent concern that heavy workloads are continuing to threaten audit quality and suggest that the primary drivers of workload (i.e.,*

[8] See https://pdfs.semanticscholar.org/a029/ecca4757286cf68b3548a03244907354f24c.pdf for "Auditor Perceptions of Audit Workloads, Audit Quality, and the Auditing Profession" by Persellin, Schmidt, and Wilkens; December 2014

deadlines and staffing problems) might be the actual "root cause" of workload-related audit deficiencies."

While this study is admittedly eight years old, recent anecdotal evidence tells me that these findings are just as relevant today as they were eight years ago.

- Another relevant and more recent study published in 2019 is titled, "How Do Audit Team Workloads and Audit Team Staffing Affect Audit Outcomes?"[9] The executive summary from that study is repeated below:

  "Using U.S. data from a global accounting firm, we investigate whether two key elements of audit teams – team workloads and staffing continuity – affect audit outcomes. ***We find that greater team workloads are associated with lower audit quality, particularly when team members spend more time on other concurrent clients, have lower performance ratings, and have total workloads that exceed the common industry benchmark. This detrimental effect is especially observable for senior and staff auditors. We also find that greater year-over-year team staffing continuity improves audit quality, efficiency, and profitability.*** *These effects are strongest when senior and staff auditor continuity is high, when returning team members are highly rated, and in smaller audit offices where quality typically is lowest. Our study provides important new evidence about audit teams and audit outcomes as called for by academics and audit regulators."*

- **Do Not Be Deceived by the Inclusion of the Big Four in Fortune's 100 Best Places to Work**. Yes, the Big Four are all in the top 50 of Fortune Magazine's Best Places to Work. How could that be? Fortune Magazine explains that the "Best Places to Work" list is compiled by its research partner, a company called Great Places to Work. Survey data is compiled from five broad categories: 1) perks, 2) diversity, 3) paid time off, 4) compensation, and 5) applicants per opening. As best I can tell, work-life balance does not factor into the Fortune list.

  Vault.com conducts an annual survey of accounting firms using criteria identified as important to job seekers. Those criteria, followed by their weighting in the survey results, are as follows: prestige (35%), firm culture (20%), job satisfaction (10%), compensation (10%), work-life balance (10%), business outlook (5%), formal training (5%), and informal training (5%). The Big Four do well in this survey [generally in the top four] because of the heavy weighting given to prestige. However, commentary from a recent survey reveals that, "**The Big Four … regularly score much lower (usually in 20th place or below) along the dimensions that are most indicative of their desirability as places to work, most notably firm culture, work-life balance, and job satisfaction. … It suggests that the Big Four may be more desirable as resume-building stopovers in a career path pointed elsewhere than as long-term destinations**."[10]

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9 Christensen, Brant E. and Newton, Nathan J. and Wilkins, Michael S., How Do Audit Team Workloads and Audit Team Staffing Affect Audit Outcomes? Archival Evidence from U.S. Audits (July 11, 2019). Available at SSRN: https://ssrn.com/abstract=3418533 or http://dx.doi.org/10.2139/ssrn.3418533

10 See https://www.thebalancecareers.com/best-accounting-firms-to-work-for-1286650

- I don't believe it is well understood that corporate America is largely audited by non-CPAs with limited experience in the field of auditing. As I mentioned earlier, there is a heightened risk that inexperienced professionals will be inadequately supervised. To be sure everyone understands this reality, I compiled the table below using data from a 2018 Deloitte Audit Quality Report. The relevant assumptions underlying this data are summarized in the relevant footnotes at the bottom of this page.

			Engagement Level Data		
Job Title	Average Tenure at Deloitte after CPA Licensing (in years)		Author's Estimated Percentage Distribution of Chargeable Hours by Level		Tenure After CPA Licensing Weighted by Percentage of Chargeable Hrs.
Partners and managing directors	20.0 yrs.	x	10%[11]	=	2.0
Senior managers	9.2	x	5%	=	0.5
Managers	4.3	x	10%	=	0.4
Seniors	1.4	x	25%	=	0.3
Staff	0.0[12]	x	50%	=	0.0
			100%		

Est. Audit Team Weighted Ave. Years of Experience After CPA Licensing	**3.2 years**
The same statistic excluding the Partner and Managing Director experience	**1.3 years**

There are a few key takeaways from this data. First, you can see the "high leverage" in the large audit firm staffing . The true experts at the top of the organization account for only a small percentage of the hours expended on each audit. Second, a near majority of the audit hours come from professionals who are not yet licensed as CPAs. This distribution of audit hours accounts for common criticisms of from corporate controllers and CFOs about 1) being a training ground for young auditors, 2) being asked the same questions over and over, and 3) not seeing enough of the partner and manager assigned to the audit. Lastly, the weighted average experience of the team (excluding partner and managing director time) is only 1.3 years after certification. The reality is that corporate American is largely audited by a lot of young people just out of college.

If there is any remaining doubt about the staffing model issues I have described, please confer with the ex-Big Four professionals currently at the PCAOB. I am confident they will acknowledge that the staffing model and high demands for productivity are real problems in much need of attention.

[11] Deloitte reports a 1 to 8.0 headcount ratio of partners and managing directors to all other audit personnel. The percentage of partner and manager time to total time of 11.1% [(1/(1+8))x100%] was adjusted downward slightly to 10% since lower-level staff tend to have higher total chargeable hours.

[12] This data point from the 2018 Deloitte Audit Quality Report was 1.3 years of average experience before I subtracted the typical two-year time lag to become a licensed CPA. In other words, it would be rare to find anyone at the staff level with an active CPA license.

Lastly, I'll refer you to a recent Wall Street Journal article that is getting a lot of attention titled "Why So Many Accountants Are Quitting -- Even Some Accounting Majors Don't Want Accounting Jobs."

What Would a Prescriptive Approach to Human Resource Management and Monitoring Look Like?

This is not rocket science. It's actually quite simple. A prescriptive approach to the quality controls over human capital management and monitoring might look like the following:

- For each partner and manager, monitor all engagement assignments and time requirements at the office level to prevent excessive peak-period workloads that might undermine each professional's ability to provide appropriate supervision and review. Define parameters that would signal the need for remedial action to assure audit quality is not compromised.

- Monitor and manage audit staff utilization on a real time basis to prevent and remedy situations that threaten to undermine audit quality. Define parameters for staff utilization that would signal the need for remedial action to assure audit quality is not compromised.

- Monitor and identify engagements where the workloads, high turnover, low experience levels, and low year-over-year staff continuity, or insufficient industry expertise threaten to undermine audit quality. Define parameters that would signal the need for remedial action to assure audit quality is not compromised. Ideally, the parameters would be more stringent for engagements that are determined to be higher risk.

- Modify the Engagement Quality Review standard (which is essentially a quality control activity) to give the Engagement Quality Reviewer (EQR) visibility as to how the audit firm's human capital was deployed on the engagement under review. The EQR partner should understand whether the audit under review was conducted under conditions conducive to audit quality or was conducted under conditions that threaten to undermine audit quality. If the circumstances threaten audit quality, the EQR needs to be satisfied that appropriate remedial action was undertaken by the engagement team to assure audit quality was not compromised due to the audit firm's mismanagement of its human capital.

- In certain cases where the EQR partner is not satisfied that appropriate remedial action has been undertaken, the EQR partner should withhold his or her signoff until appropriate remedial action can be undertaken. Under these circumstances, the audit firm may need to advise the issuer that the audit cannot be completed within the specified time frame. As it stands currently, some audits move down the conveyer belt and are signed off on, not because a suitable level of quality has been achieved, but because the auditor has simply run out of time. We know from the post-mortem on many failed audits that time pressures and client pressures can undermine good judgment. Giving the EQR expanded responsibilities can help to mitigate the risks associated with time pressures and over-bearing clients.

The metrics I favor for monitoring are easy to calculate and supported by academia as being relevant to audit quality:

- **Staff and Manager Workload Metric**
  Average audit staff and manager chargeable hours in excess of 40 hours per week as a percentage of total hours per week.

- **Partner Workload/Capacity**
  Total partner hours managed across all of the partner's engagements according to the workload system (actual year-to-date plus projected).

- **Supervision**
  Partner, Managing Director, and EQR hours as a percentage of total hours.

- **Engagement Team Continuity Metric**
  Engagement team continuity year-over-year (all prior year personnel returning = 100%).

- **Experience Metric**
  Weighted average years of experience post-CPA certification.

Reporting to the audit committee of these metrics should identify any instances where the metrics fall outside of predetermined parameters. If such instances occur, there should be an explanation of the steps taken by the engagement team to assure that audit quality was not compromised. The audit firm should be encouraged to supplement the reported data with its own discussion and analysis of the information presented.

Letting the Audit Firms Define How They Evaluate Themselves? Really?

The draft QC standard gives the audit firms the latitude to conduct their own risk assessment and design their own control structure to manage the assessed risk. As it relates to the "Resources" component (the human capital component), my risk assessment says there is a heightened risk that the largest firms will set the bar abysmally low. How else can the largest audit firms give themselves a passing grade in resource management? The PCAOB's proposed quality control standard reads like a return to the pre-SOX days of self-regulation which was a complete failure.

Evaluating the Cost-Benefit of the Proposed QC Standard

The PCAOB should look at the baseline of the where the Big Four are at today in terms of their quality controls and judge whether the proposed QC standard will materially improve audit quality at the Big Four. In general, the Big Four process are mature for all components of quality control covered by the PCAOB's proposed standard – with the notable exception of human resource management where they fail miserably. I am concerned that the largest audit firms will set a low bar for compliance on human resource management and remediation because of the potential adverse effect on firm profitability. **The audit firms will assert that the completion of supervisory review by the senior accountant, the manager, the partner, and the EQR are sufficient evidence that the engagement was completed in conformance with PCAOB standards and GAAP (irrespective of whether human resource management on the engagement was chaotic as evidenced by high turnover, low year-over-year continuity, low experience levels, and high partner and manager workloads that threaten to undermine appropriate supervision and review).**

This is precisely why the monitoring and remediation of how human capital is deployed at the Big Four is so important. **Absent incorporating prescriptive requirements into the QC standard for the monitoring and remediation of human resources, I doubt that very little improvement in Big Four audit quality will result from the PCAOB's proposed standard.**

It is important to bear in mind that the audit firm's profitability is the highest when the audit ranks are understaffed. There is a financial incentive to operate lean that undermines audit quality. The use of metrics regarding the management of human capital creates the opportunity for those tasked with managing human resources to be held to account when audit operations evidence mismanagement of human resources.

The Utility of a Firmwide Focus on Audit Quality Versus an Engagement Level Focus?

Businesses like Hilton Hotels, Hertz, or even McDonalds are able to achieve a uniform level of quality across locations. In the auditing profession, however, audit quality varies considerably from audit to audit (even within the same firm and within the same office). I know this to be true from my personal experience, but it is also evident in the PCAOB inspection results of each of the largest audit firms. Some inspected audits have no part 1 deficiencies while other audits have multiple deficiencies. Some audits become audit failures resulting in restatements while others do not.

Each issuer audit presents a unique set of challenges that contribute to the variability of audit quality. Each company under audit has challenges that are driven by economic issues, industry challenges, competitive challenges, the adequacy of financing to operate as a going concern, complex business transactions, asset impairment issues, etc. Yes, no two audits are alike.

Another source of variability comes from the individual skill levels of audit team members, the year-over-year continuity of engagement team members, industry expertise needs when relevant, and the capacity of each auditor to focus on the task at hand without being distracted by competing priorities. The level of supervision and review will also depend on the skill level of the reviewers and their ability to focus on the task at hand without interference from competing priorities.

Individual audits are not staffed with uniform levels of industry experience, year-over-year engagement continuity, or professionals with equally balanced workloads. A whole host of factors drive this type of variability. One significant factor might be the actual or perceived pressure to produce profits at the local office level. The thirst for profits can affect just how lean the audit ranks are staffed going into each busy season. Each audit in an office may be affected differently by unpredictable factors such as 1) staff turnover, 2) a sudden increase in new work as a result of proposal win or 3) the acquisition of a business in the local area by a firm client located elsewhere.

The PCAOB's draft QC standard is built around a risk-based approach that yields a firmwide report on audit quality to the PCAOB. **How much utility does such a report have for each individual audit committee? I would argue very little. Wouldn't there be more interest in understanding the level of audit quality delivered by the audit firm to produce each audit overseen by each audit committee?** This gets to the heart of the PCAOB's Mission to protect the investors – not collectively, but one audit at a time.

Each audit committee needs to understand whether the quality of their audit was threatened by human resource issues, and if so, what did the audit firm do to assure that audit quality was not compromised.

The Decoupling of the QC Standard from the Engagement Performance Metrics Initiative

As it stands currently, the quality control standard is progressing toward becoming a reality while Engagement Performance Metrics initiative is in a holding pattern on the PCAOB's Research Agenda. This is unfortunate because the Quality Control Standard and Engagement Performance Metrics are very much interrelated (as I will explain below).

For the sake of discussion, think of Engagement Performance Metrics as a large coin. One side of the coin is inward facing for the benefit of audit operations management. The Engagement Performance Metrics are used to monitor audit operations so that situations where audit quality might be compromised get identified and remediated (i.e., audits with excessive turnover, low experience levels, excessive workloads, inadequate industry experience, insufficient specialist involvement, and inadequate supervision and review).

The other side of the Engagement Performance Metrics coin is outward facing for the benefit of each audit committee so they can understand whether audit quality on their audit was potentially compromised; and if so, what did the audit firm do to assure audit quality was not compromised?

Instead of an integrated approach between QC standards and Engagement Performance Metrics, the PCAOB is positioning them to be non-integrated. In my mind, this is akin to an IT strategy that fails to migrate to a point in the future where the company's hardware and software systems operate in harmony. There is an opportunity to realize synergy between the Engagement Performance Metrics and the Quality Control Standard – but that is not the path that the PCAOB is on.

PCAOB's Standards and Emerging Issues Advisory Group (SEIAG) and Investor Advisory Group (IAG) each convened twice in 2022 to discuss Engagement Performance Metrics (formerly referred to as Audit Quality Indicators). The webcasts of those meetings reflect resounding support for Engagement Performance Metrics as a mechanism to drive improvements in audit quality. The PCAOB needs to reconsider its non-integrated approach to Quality Controls and Engagement Performance Metrics. If there was ever a time for these two initiatives to be integrated, this is it.

If the PCAOB does not integrate these two initiatives, the PCAOB needs to explain why a non-integrated approach benefits investors more than an integrated approach.

A Troubling Passage in the Draft QC Standard Warrants Discussion

Repeated below is paragraph .44 of the proposed standard discussing controls over resources:

Resources Quality Objectives

.44 The quality objectives established by the firm with respect to the firm's resources should include the following:

a. Firm personnel are hired, developed, and retained who have the competence to perform activities and carry out responsibilities for the operation of the firm's QC system and the performance of the firm's engagements in accordance with applicable professional and legal requirements and the firm's policies and procedures.

Note: Competence consists of having the knowledge, skill, and ability that enable individuals to act in accordance with applicable professional and legal requirements and the firm's policies and procedures. ***The measure of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained by firm personnel over time.***

The passage in bold strikes me as very prescriptive in what the PCAOB has otherwise characterized as a risk-based approach. I realize that this wording is a carryover from the existing Quality Control Standard 40. I do not understand why the PCAOB chose to carry this wording forward. It seems to preclude the use of metrics that could be instrumental in any monitoring activity over the deployment of human resources in audit operations. For example, an audit firm can have very competent professionals, but if those professionals are over-worked or inadequately supervised, the benefits of a high level of competence are severely diminished.

We know that the large audit firms all have a performance evaluation process that is geared toward giving people more responsibility as they demonstrate success at the current responsibilities. That is an important quality control process. But it should not be the only control process. That process needs to supplemented by monitoring processes using data points on workloads (at the staff, partner, and manager levels), team experience levels, year-over-year engagement continuity, industry experience when relevant, and the capacity of managers and partners to provide appropriate supervision and review.

The bottom line is that a meaningful quality control system needs to evaluate far more than just competence. If a new quality control standard is somehow limited to qualitative aspects of competence, I fear that the PCAOB will have merely paved the cow path with no benefit to investors.

Keeping Pace with the AICPA on Integrity and Objectivity

The AICPA's Integrity and Objectivity standards have always forbidden the subordination of judgment when differing views arise among AICPA members over a material issue. In other words, a subordinate with a differing view is obligated to speak up on material matters. This construct is critical to audit quality. **The AICPA, recognizing that it is not easy for subordinates to challenge overbearing supervisors, added provisions to its Integrity and Objectivity Standards in 2013 prohibiting supervisors (including audit partners) from exercising undue influence over subordinates. In other words, a partner should not apply undue influence to override a subordinate and bypass appropriate dispute resolution protocols**. These enhancements to the AICPA standards were made by the AICPA after the PCAOB adopted the AICPA standards in 2003. It is important that the PCAOB at least catch up to the AICPA in this regard so that subordinates auditing public companies know that their PCAOB professional standards fully support their responsibility to voice their concerns, **especially in the face of an over-bearing supervisor.** This is the same recommendation I made in my public comment in response to the PCAOB's December 2019 Concept Release on Potential Changes to the QC Standard.

Other Advances by the AICPA that Should Be Considered by the PCAOB

After the PCAOB adopted the AICPA standards in 2003, the AICPA made some useful amendments to their QC standards that were never adopted by the PCAOB. Specifically, the AICPA modified its QC Standard in 2007 to "strongly emphasize the responsibility of audit firm leadership to set the proper "tone at the top." … Each audit firm is required to design and implement quality control procedures that support that message and promote a quality-oriented culture." **The AICPA policy requires that the audit firm "assign management responsibilities so that commercial considerations do not override the quality of the work performed." … Perhaps most importantly, QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.**"[13]

[13] Comments are from "Audit Watch" dated July 28, 2008

The 100 Issuer Audit Threshold

I appreciate that "100 issuer audits in total" is the threshold the PCAOB uses to determine whether an audit firm is inspected annually versus triennially. I have often thought that the criteria for annual inspection should consider the market capitalization of individual issuers and issuers in the aggregate. A small audit firm auditing a company with a large market capitalization should not be able to fly under the radar because that audit firm simply has a small number of clients. Think for a moment about the small audit firms that audited Madoff or FTX. Philosophically, I think the highest responsibilities associated with any comprehensive reporting on quality controls should be based on a measure like market capitalization audited (individually and/or in the aggregate) rather than the number of issuers audited.

Closing Thought

I will close by repeating a thought I shared when I responded to the PCAOB's request for comment on its December 2019 Concept Release regarding potential changes to the quality control standards. At the time, I said:

> I like the risk assessment approach. However, I think it is important for the PCAOB to be very prescriptive about the expectations for the management of human capital given 1) the poor past performance of large firms managing human capital and 2) the potential benefits to audit quality that can be achieved from improved management of human capital.

My responses to the 93 questions the PCAOB is seeking input on are attached to this document.

Respectfully submitted,

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About the Author -- My 360° Perspective on the Auditing Profession

I am a retired KPMG audit partner. I worked at KPMG for 26+ years, including 17 years as an audit partner. After retiring from KPMG, I joined the PCAOB where I worked from 2005 to 2014. During my last six years at the PCAOB, I was the Regional Associate Director with leadership responsibility for the PCAOB's Orange County and Los Angeles offices. Like virtually everyone else that joins the PCAOB, I was inspired by the PCAOB's important Mission to improve audit quality.

After leaving the PCAOB, I became the Professional Practice Director at CNM LLP, an 85-person regional CPA firm in Southern California that focuses exclusively on technical accounting consultations and SOX 404 outsourcing. My responsibilities put me in regular contact with Big

Four audit partners, public company CFO's, Chief Accounting Officers, audit committees, and SOX Compliance Leaders. I worked at CNM for three years.

In 2019, I started serving as an expert witness in matters involving accounting, auditing, and internal controls over financial reporting.

In 2020, I published a book titled, "The Truth About Public Accounting – Understanding and Managing the Risks the Auditors Bring to the Audit."

My recommendation in 2007 to the US Treasury Department's Advisory Committee on the Auditing Profession (ACAP) was widely credited with providing the impetus for ACAP's final report recommendation that the PCAOB evaluate the feasibility and potential benefits of providing public transparency to audit firm input and output measures that may be indicators of audit quality (AQIs). The PCAOB ultimately published a Concept Release on Audit Quality Indicators in June 2015. A project to study "Engagement Performance Metrics" was added to the PCAOB's Research Agenda in 2022.

Robert Conway Responses to Specific Questions Posed by the PCAOB

1. Is the proposed definition of "applicable professional and legal requirements" appropriate? Are there elements that should be excluded, or other requirements that we should include? If so, what are they?

> I think the definition is reasonable.

2. Is the proposed definition of "engagement" clear and appropriate? If not, why not? Should the definition be narrower (e.g., limited to engagements required to be performed under PCAOB standards) or broader? If so, how?

> I think the definition is reasonable.

3. Are the proposed definitions of "firm personnel," "other participants," and "third-party providers" sufficiently clear and comprehensive, or is additional direction necessary? Please explain what additional direction may be necessary.

> I think the definitions are reasonable.

4. Is the other terminology used in QC 1000 clear and appropriate? Are there other terms that should be defined?

> I think it would help to define the components referred to as "Resources" and "Engagement Performance" in the definitions section. I eventually understood the distinction as I read on, but it would help to make the distinction clear in the definitions section.

5. Is it appropriate for the proposed standard to require firms that have not and do not plan to perform engagements pursuant to PCAOB standards to design a QC system in accordance with QC 1000? Why or why not? Would this requirement impose disproportionate costs on small firms? Please provide data or estimates, if available, on such costs.

> The criteria for the application of this standard should be based on the whether the engagements individually or in the aggregate involve a material amount of market capitalization. If the firm does not plan to perform engagements pursuant to PCAOB standards, the firm should not be required to comply.

6. Is the proposed distinction between the obligation to design a QC system and the obligation to implement and operate a QC system appropriate? Is the proposed threshold for full applicability of QC 1000—having obligations under applicable professional and legal requirements with respect to a firm engagement—appropriate?

I understand the distinction. I think it would be simpler to say that, if I firm is going conduct an issuer audit above a certain market cap threshold, the firm needs to have the QC system designed and operating before such services are rendered. The requirement to operate the QC system could be optional for registered firms auditing smaller market cap companies below a specified threshold. You may want to consider an aggregate market cap threshold for all issuer audits done by one firm if the aggregate market cap of all issuer audits exceeds a specified aggregate threshold.

For firms conducting audits of smaller market cap companies, I think it is reasonable for them to demonstrate how the quality control concepts described herein were incorporated into the design of the audit firm's processes, applying the scalable and risk-based concepts described in your proposed standard.

I don't believe an audit firm that does not intend to conduct PCAOB audits should be required to do anything.

7. Is it clear how a firm's responsibilities under QC 1000 may change depending on the extent of "applicable professional and legal requirements" to which the firm is subject at a particular time? Please explain what additional direction may be necessary.

I think it is clear.

8. Are there other provisions of QC 1000 that should apply to all firms? If so, which other provisions should we consider?

See above.

9. We intend the proposed standard to be scalable for all firms based on their nature and circumstances. Are there additional factors we should consider so that the proposed standard is scalable for all firms? If so, what are those factors? Should the standard be revised to make it more scalable? If so, how?

See page 11 of my response where I suggest an alternative to the "100 Issuer" threshold that I think better focuses the effort in proportion to the market cap at risk.

10. Is the reasonable assurance objective described in the proposed standard appropriate? If not, why not? Are there additional objectives that a QC system should achieve? If so, what are they?

I think the "reasonable assurance" terminology is appropriate.

11. Are the proposed requirements regarding design of the QC system appropriate? Are there other aspects of QC 1000 that should be required as part of the design of the QC system? If so, what are they?

> **I feel strongly that the QC requirements pertaining to "Monitoring and Remediation" of "Resources" should be prescriptive and reported on at the engagement level.** I am fine with the other components being risk-based and scalable with the focus at the firm-wide level. Please see my specific comments on pages 1 through 10.

12. Are the proposed requirements related to roles and responsibilities described in the standard clear and appropriate? If not, how should they be clarified or modified?

> In 2007, the AICPA introduced into their QC standard the concept that "QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals." See my detailed commentary at the bottom of page 11.

13. Would firms have difficulty filling the specified roles in light of the proposed requirements?

> I don't believe this should be a problem.

14. Are the proposed definitions of "quality risks," "quality objectives," and "quality responses" sufficiently clear and comprehensive? If not, why not?

> I understood them.

15. Is the threshold of "adversely affecting" set out in the proposed definition of quality risk clear, or would more guidance and examples be helpful?

> More examples serve as helpful interpretive guidance to those tasked with implementing any new standard.

16. Should the proposed definition of "quality risks" explicitly address risks of intentional misconduct by firm personnel and other participants? If not, please explain why. Should the definition explicitly address other risks? If so, what are the other risks?

> Nothing specific to add here.

17. In the proposed definition of "quality risks" should the threshold of "reasonable possibility of occurring" also apply to all risks, including risks of intentional misconduct by firm personnel and other participants? If so, why?

> No specific comment.

18. Are the proposed requirements for the firm's risk assessment process appropriate? Are changes to the requirements necessary for this process? If so, what changes?

> The risks specific to the "Monitoring and Remediation" of "Resources" are so great that I believe a very prescriptive approach is warranted. Otherwise, I doubt that the new QC standard will drive any meaningful improvement in audit quality. I have commented on this at length on pages one through nine of my public comment.

19. Are the proposed requirements sufficient to prompt firms to appropriately identify, assess, and respond to quality risks, or is supplemental direction needed? If supplemental direction is needed, what would assist firms in identifying, assessing, and responding to quality risks?

> **I strongly believe the requirements need to be prescriptive as it relates to "Monitoring and Remediation" of Resources (as described in my public comments on pages one through ten herein).**

20. Are the specific examples included in Appendix B helpful in assisting the firm in identifying and assessing quality risks? Should additional examples or guidance be provided? If so, what additional examples or guidance would be helpful?

> Appendix B is helpful.
>
> In 2007, the AICPA introduced into their QC standard the concept that "QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals." Something like this needs to be incorporated into the new QC standard if it is not already there. See my detailed commentary on page 11.

21. Are the proposed quality objectives for governance and leadership appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

> Refer to my response to the preceding question (#20).

22. For the proposed specified quality response related to the firm's governance structure, is the threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, what is an appropriate threshold?

> I can appreciate that the "100 issuer" threshold is well understood, but I think a threshold that is based on market capitalization would be a better risk-based manner for establishing a threshold. See my comments on page 11 of my public comment.

23. Is the proposed specified quality response to incorporate an oversight function for the audit practice for firms that issue auditor reports with respect to more than 100 issuers appropriate? If not, why not?

> I support the concept of independent oversight for the audit practice. I can appreciate that the "100 issuer" threshold is well understood, but I think a threshold that is based on market capitalization would be a better risk-based manner for establishing a threshold. See my comments on page 11 of my public comment.

24. Is the proposed specified quality response related to the firm's policies and procedures on receiving and investigating complaints and allegations appropriate? Are there any other specified quality responses in this area that we should consider, and if so, what are they?

> The AICPA made specific changes to its Integrity and Objectivity standards in 2013 that should be incorporated into the PCAOB's standards. The specific standard I am referring to prohibits supervisory personnel from applying undue influence over subordinates who express a contrary view. See page 10 of my public comment letter for further details.

25. Are there any other specified quality responses for the governance and leadership component that we should consider? If so, what are they?

> In 2007, the AICPA introduced into their QC standard the concept that "QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals." Something like this needs to be incorporated into the new QC standard if it is not already there. See my detailed commentary at the bottom of page 11.

26. Are the proposed quality objectives for ethics and independence requirements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

> The AICPA made specific changes to its Integrity and Objectivity standards in 2013 that should be incorporated into the PCAOB's standards. The specific standard I am referring to prohibits supervisory personnel from applying undue influence over subordinates who express a contrary view. See page 10 of my public comment letter for further details.

27. Are the proposed specified quality responses for ethics and independence requirements appropriate? If not, what changes to the specified quality responses are necessary for this component?

> Refer to my response to the preceding question (#26)

28. Is the proposed specified quality response to have an automated process for identifying direct or material indirect financial interests appropriate? If not, why not? Is the proposed threshold (firms that issued audit reports with respect to more than 100 issuers during the prior calendar year) appropriate? If not, why not?

No specific comment.

29. Is the proposed specified quality response related to communication of changes to the list of restricted entities at least monthly (and more frequently, if appropriate) to firm personnel and others performing work on behalf of the firm who are subject to independence requirements appropriate? Could communication to a more limited group accomplish the goal of alerting all individuals whose actions and relationships are relevant to independence? If so, to whom should changes be communicated?

No specific comment.

30. In addition to the annual written independence certification, should the proposed standard require an annual written certification regarding familiarity and compliance with ethics requirements and the firm's ethics policies and procedures? Why or why not? Should firms be required or encouraged to adopt firm-wide codes of ethics or similar protocols? Why or why not? Are there other specific policies that QC 1000 should require or encourage to promote ethical behavior?

Annual affirmation is always a good. Most public companies already do something like this.

31. Are the proposed quality objectives for acceptance and continuance of client relationships and specific engagements appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

In addition to considering whether the firm has or can obtain the necessary resources to service new work, consideration should be given to the availability of industry specific resources at the partner and manager level and whether the incremental work might adversely affect the firm's ability to provide quality services to existing clients.

I think specific circumstances should be identified that require an immediate reconsideration of client continuance. Such circumstances could include newly discovered facts that call into question the integrity and honesty of management. Such facts would include illegal acts, fraud, material omissions of fact, and false representations provided by management.

32. Are the proposed specified quality responses for acceptance and continuance of client relationships and specific engagements appropriate? If not, what changes to the specified quality responses are necessary for this component?

See above response to question #31.

33. Are the proposed quality objectives for engagement performance appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

> Policies should be adopted that identify situations where national office consultation is required.

34. Should we include specified quality responses for the engagement performance component? If so, what should they be?

> See above response to question #33.

35. We are proposing to eliminate the current Appendix K requirement and rely exclusively on a risk-based approach. Should the standard include specified quality responses explicitly directed to non-U.S. firms that audit issuers? If so, what are they?

> This is another situation where I think the requirements should be more prescriptive because the risks are generally very high.

36. Are the proposed quality objectives for resources appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

> **I feel very strongly that the risks associated with the "resources" component (including the related monitoring and remediation) are so great that a prescriptive approach is warranted. I have explained the basis for this view at length in my public comment letter (pages one through ten).**

37. Does the proposed quality objective and specified quality response related to technological resources provide sufficient direction to enable the appropriate use of emerging technologies? If not, what additional direction is necessary?

> No specific comment.

38. Are the proposed specified quality responses for resources appropriate? If not, what changes to the specified quality responses are necessary for this component?

> See my response to question #36.

39. Should the proposed standard include a specified quality response that would require the use of technological resources by the firm to respond to the risks related to the use of certain technology by the firm's clients? If yes, what should the requirement be?

> No specific comment.

40. Are the proposed quality objectives for information and communication appropriate? Are changes to the quality objectives necessary for this component? If so, what changes?

> As noted earlier, I strongly favor monitoring of resources as each audit progresses so that timely corrective action can be undertaken to assure audit quality is not compromised. In order for this to happen, there needs to be adequate information and communication to occur to enable timely monitoring and remediation.

41. Is the proposed quality objective addressing the firm's external communications about firm-level and engagement-level information appropriate? If not, what changes to the quality objective are necessary?

> The objectives are quite broad and may be reasonable for situations where the expectations are also broad (in other words, not prescriptive). As I have already indicated, the circumstances favor more prescriptive requirements for monitoring and remediation of the human resources component at the engagement level. This would require more prescriptive requirements for communications. The PCAOB also needs to be mindful of trying to achieve a degree of comparability across the largest audit firms. If the metrics lack comparability, there should be adequate disclosure as to how and why certain disclosures deviate from prescribed measures and the effect on comparability of the metrics to those used by other firms.

42. Are the proposed quality objective and specified quality response addressing information and communication related to other participants appropriate? If not, why not, and what changes are necessary?

> Same response as above to question #41.

43. Are there legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system and a brief overview of remedial actions taken and to be taken? If so, please specify.

> The audit firms monitor the quality of member firms but have typically been reluctant to share negative information about a member firm. Requiring transparency to such information would be beneficial to all constituents over the longer term.

44. Are the proposed specified quality responses for information and communication appropriate? If not, what changes to the specified quality responses are necessary for this component?

> Same response as provided above to question #41.

45. Are the proposed requirements for the monitoring and remediation process appropriate? Are changes to the requirements necessary for this process? If so, what changes should be made and why?

As I have already mentioned, the monitoring and remediation process should be prescriptive **at the engagement level** and should make use of basic engagement performance metrics. The metrics I favor are easy to calculate and supported by academia as being relevant to audit quality:

- **Staff and Manager Workload Metric**
  Average audit staff and manager chargeable hours in excess of 40 hours per week as a percentage of total hours per week

- **Partner Workload/Capacity**
  Total partner hours managed across all engagements according to the workload system (actual year-to-date plus projected).

- **Supervision**
  Partner, Managing Director, and EQR hours as a percentage of total hours
- **Engagement Team Continuity Metric**
  Engagement team continuity year-over-year (all prior year personnel returning = 100%)

- **Experience Metric**
  Weighted average years of experience post-CPA certification

Reporting to the audit committee of these metrics should identify any instances where the metrics fall outside of predetermined parameters. If such instances occur, there should be an explanation of the steps taken by the engagement team to assure that audit quality was not compromised. The audit firm should be encouraged to supplement the reported data with its own discussion and analysis of the information presented.

46. Is the proposed requirement to inspect engagements for each engagement partner on a cyclical basis appropriate? If not, why not?

This requirement is reasonable.

47. Is it appropriate to require monitoring of in-process engagements by firms that issue audit reports with respect to more than 100 issuers during a calendar year? If not, is there a more appropriate threshold?

I have suggested that a market capitalization threshold would more appropriately match the effort to the amount of market capitalization at risk (see page 11 of comment letter). I appreciate the desire for a scalable standard, but the PCAOB should not let scalability concerns or costs to small firms get in the way of producing a standard that meaningfully drives change and improvement in audit quality **among the largest audit firms**. That is where the risk is.

Yes, it is good to have all of the audit firms working to improve their quality controls. But please don't let smaller firm considerations get in the way of doing the right thing for the largest audit firms. I continue to believe that monitoring and remediation as it relates to the deployment of human capital is the biggest opportunity for the PCAOB to make a difference.

48. Are the purposes of in-process monitoring (as proposed within this standard) clear and appropriate, including how in-process monitoring differs from the requirements of engagement quality reviews under AS 1220? If not, what additional direction is needed?

See my response to question #50.

49. Is it appropriate to require firms to consider performing monitoring activities on work they perform on other firms' engagements? If not, why not?

Yes, if the threshold is met for a substantial role under the PCAOB definitions, the monitoring activities should apply. There is often a heightened risk that referred work gets the last call on resources. This risk makes monitoring all the more important.

50. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which engagements to select, appropriate? If not, what other factors should be specified?

I am concerned that there is some blurring between quality controls, engagement monitoring, engagement performance, and engagement inspection. Here is my view of how this would play out:

Firmwide Resources and Methodologies -- From a big picture perspective, the largest audit firms have mature audit methodologies and tools, performance evaluation processes, well defined policies, processes to assign professionals to individual audit engagements and monitor workloads, consultation protocols, national office resources, engagement quality reviews, client continuance processes, independence functions, internal inspections, etc. These activities are the equivalent of creating an environment that enable auditors to be successful. They don't guarantee success, but they provide the fundamentals to be successful.

With the exception of the process to assign professionals to individual engagements and monitor workloads, these activities (the non-human resource activities) generally operate with a degree of regularity. From a QC perspective, the focus would be on making sure that these processes evolve in response to new accounting and auditing standards, that these functions are appropriately staffed and that any policy or audit methodology changes are approved and rolled out effectively to the field. From a quality control perspective, it would be important to know that these activities exist, they are appropriately designed, and they operate effectively.

Human Capital Management – My risk assessment says this is where most of the problems lie (apart from all the issues that stem from the auditor being hired and paid by the entity they are passing judgment on, i.e., the core auditor independence problem). This is where the in-process monitoring needs to be prescriptive. This is where audit committees need to understand that, if human resources have been mismanaged, what did the audit firm do to assure audit quality was not compromised?

Engagement Performance Activities -- Apart from all of the above, there are the engagement performance activities. These activities involve supervision and review to assure audits are conducted in accordance with firm methodology and policy and in accordance with professional standards. They also involve the Engagement Quality Reviewer. Except in specific situations I'll discuss in a moment, I believe the audit firms would find it cost prohibitive to build in "in process" controls that would be akin to doing an inspection of an audit in process. I say, "except in specific situations" because there may be a new standard or a new tool where additional quality controls are necessary to assure engagement teams are contemporaneously doing the right thing and coming to the right conclusions.

Internal Inspections -- Internal inspections are important to make sure audit teams are compliant with firm methodologies and professional standards. These are cost-effectively done on sampling basis and can provide important feedback on common mistakes made by engagement teams that may mean changes need to be made to training, tools, or methodologies.

From a time-phased perspective, I see the quality control work rolling out for one cycle as follows (subject to change if specific risks are identified):

> **Firmwide Resources and Methodologies –** Tested throughout the year to assure these activities are appropriately designed and operate effectively. This may involve a combination of testing at the national level and at a sample of audit engagements for specific attributes (i.e., Were the current tools and approved methodologies applied? Did audit professionals comply with training requirements?).
>
> **Human Capital Management –** As described on pages 6 and 7 of my comment letter, monitoring of human resource management should be conducted for **all public company engagements above a specific market capitalization.** The monitoring would use metrics such as staff workload utilization, year-over-year engagement continuity, experience levels, use of professionals with relevant industry experience when relevant, partner and manager workloads, staff to partner leverage ratios, etc.) If the metrics suggest an unacceptable risk that audit quality may have been compromised, remedial procedures would be deployed to assure audit quality was not compromised. Reporting would follow to audit committees of such "reportable events" in a format that could be tallied and reported firmwide.
>
> **Engagement Performance While in Progress –** I would expect that the efforts here

would be limited to those instances where the firm felt that supplemental reviews or QC procedures were necessary to assure proper compliance with new tools, new auditing or accounting standards, or challenging emerging issues.

Internal Inspections – These inspections would be conducted during the spring, summer, and fall of audits of companies with year-ends falling during the preceding year. The results of these inspections would inform audit committees and investors as to the quality of the audit firm's **Engagement Performance Activities**.

Reporting -- This would lead to firmwide reporting by April 1 of the succeeding year – in time for consideration during the April/May proxy season.

51. Are the proposed factors for firms to take into account when determining the nature, timing, and extent of QC system-level monitoring activities appropriate? If not, what other factors should be specified?

Please refer to my description in the preceding question about the timing and nature of the QC activities, including monitoring activities.

52. Are the proposed requirements for firms that belong to a network that performs monitoring activities appropriate? If not, what changes should be made?

No comment.

53. Are the proposed definitions for "engagement deficiency," "QC finding," and "QC deficiency" sufficiently clear and appropriate? If not, what changes should be made and why?

No comment at this time.

54. What, if any, additional direction is needed regarding:
a. Evaluating information to determine whether QC findings exist;
b. Evaluating QC findings to determine whether QC deficiencies exist; or
c. Responding to engagement and QC deficiencies?

No comment at this time.

55. Should firm personnel be allowed to inspect engagements or QC activities in which they are involved? If so, please explain why and provide examples of mechanisms that could reduce to an appropriate level the risk that noncompliance with PCAOB standards or the firm's policies and procedures would not be detected.

The testing of QC should not involve anyone testing their own work or the work of an engagement team they were part of.

56. Are the proposed requirements related to monitoring and remediation sufficiently scalable for smaller firms? Are there aspects of the proposed requirements that could be further scaled?

I appreciate the desire for a scalable standard, but the PCAOB should not let scalability concerns or costs to small firms get in the way of producing a standard that meaningfully drives change and improvement in audit quality **among the largest audit firms**. That is where the market cap risk is.

Yes, it is good to have all of the audit firms working to improve their quality controls. But please don't let smaller firm considerations get in the way of doing the right thing for the largest audit firms. I continue to believe that monitoring and remediation as it relates to the deployment of human capital is the biggest opportunity for the PCAOB to make a difference.

Yes, these things are scalable. Just don't let scalability get in the way of doing what is needed for the largest firms – such as a more prescriptive approach to monitoring the management (or mismanagement) of human capital.

57. Is November 30 an appropriate evaluation date for firms to conclude on the effectiveness of the QC system? Is there another specific date that would be more appropriate and if so, what date? Should firms be permitted to choose their own evaluation date?

No. See the time frame I outlined my response to question #50.

58. Is the proposed definition of "major QC deficiency" clear and appropriate? If not, what changes should be made and why?

No comment at this time.

59. Is it appropriate to include in the proposed definition circumstances when a major QC deficiency is presumed to exist? Are the circumstances described in the proposed definition appropriate? Should there be other circumstances that give rise to such a presumption? If so, what are they?

No comment at this time.

60. Are the proposed factors for determining whether an un-remediated QC deficiency is a major QC deficiency appropriate? If not, what other factors should be specified?

No comment at this time.

61. Should firms be required to report on the evaluation of the QC system to the PCAOB? If not, why not?

> I see some merit in reporting to the PCAOB. I might be hesitant to report such results publicly until experience showed there was a reasonable degree of comparability and integrity across the largest firms. Please consider that we are asking the audit firms to police themselves. Absent a suitable degree of comparability, I could see the reporting as potentially problematic and misleading.
>
> I will separately express my views about reporting on **Human Capital Management** matters. As I described in my comment letter, monitoring of human resource management should be conducted for **all public company engagements above a specific market capitalization.** The monitoring would use metrics such as staff workload utilization, year-over-year engagement continuity, experience levels, use of professionals with relevant industry experience when relevant, partner and manager workloads, staff to partner leverage ratios, etc.) If the metrics suggest an unacceptable risk that audit quality may have been compromised, remedial procedures would be deployed to assure audit quality was not compromised. Reporting would follow to audit committees of such "reportable events" in a format that could be tallied and reported firmwide.

62. Should we require individual certifications of the evaluation of the QC system? Is the language in Appendix 2 regarding the certifications appropriate? If not, why not?

> No specific comment at this time.

63. Is the proposed date for reporting on the evaluation of the QC system (January 15) appropriate? Is there another specific date that would be more appropriate and if so, what date? Is 45 days after the evaluation date an appropriate reporting date?

> My recommendation on the timing of procedures and reporting is described in my answer to question #50.

64. Rather than reporting on Form QC, should firms report on the evaluation of the QC system, as of March 31 on a non-public portion of Form 2, which is due on June 30?

> I mentioned earlier in my response to question #50 that the reporting should be in advance of the April / May proxy season. Reports could be submitted by April 1 perhaps using an "as of date" of February 28.

65. Is the information required on proposed Form QC in Appendix 2 appropriate? Why or why not?

> No comment.

66. Are proposed Rule 2203A, *Report on the Evaluation of the Firm's System of Quality Control*, and the proposed Form QC instructions included in Appendix 2, clear and appropriate? If not, why not?

> No comment.

67. Are there any non-U.S. laws that would prohibit reporting the information required about the firm's QC system to the PCAOB on Form QC?

> None that I am aware of.

68. Some of the PCAOB's reporting forms are permitted to be filed in XML format. Should we permit proposed Form QC to be filed in XML or another machine-readable format? Why or why not?

> No comment.

69. In light of the legal constraints of Sarbanes-Oxley with respect to public reporting regarding QC matters, are there other public reporting alternatives that should be considered? What would be the potential costs and benefits of such alternatives?

> Reporting to audit committees currently requires the auditor to report on whether the audit firm executed the audit in accordance with its plan and whether any particular problems were encountered during the conduct of the audit. The reporting I envision with respect human capital management fits squarely within existing requirements for the auditor to report to the audit committee.

70. Are the proposed amendments to AS 1301 that require the auditor to communicate to the audit committee about the firm's most recent annual evaluation of its QC system appropriate? If not, why not?

> The auditor should report relevant human resource metrics to the audit committee and should explain what the audit firm did to assure audit quality was not compromised in instances where the metrics raised concern that audit quality may have been compromised.

71. Are the proposed documentation requirements appropriate? If not, what changes should be made?

> No comment.

72. Is the "experienced auditor QC threshold" set out in the in the proposed documentation requirement appropriate? If not, what threshold is appropriate?

> Seems reasonable.

73. Are there additional specific matters that the firm should be required to document about its QC system? If so, what are they?

As I have mentioned already, I think it is very important for the PCAOB to set forth prescriptive requirements for reporting to audit committee on human resource mismanagement issues and what the auditor did to assure audit quality was not compromised.

74. Is the proposal to expand the scope of AS 2901 to include engagement deficiencies on ICFR audits appropriate? If not, why not?

No basis to comment at this time.

75. Is it appropriate for remedial action to be required for all identified engagement deficiencies, not just in situations where the auditor's opinion may be unsupported? If not, why not?

I think the existing guidance in this area is sufficient.

76. Is the proposal to rescind ET 102 and replace it with EI 1000 appropriate in light of the changes proposed in QC 1000 and developments since 2003? If not, why not?

Keeping Pace with the AICPA on Integrity and Objectivity

The AICPA's Integrity and Objectivity standards have always forbidden the subordination of judgment when differing views arise among AICPA members over a material issue. In other words, a subordinate with a differing view is obligated to speak up on material matters. This construct is critical to audit quality. **The AICPA, recognizing that it is not easy for subordinates to challenge overbearing supervisors, added provisions to its Integrity and Objectivity Standards in 2013 prohibiting supervisors (including audit partners) from exercising undue influence over subordinates. In other words, a partner should not apply undue influence to override a subordinate and bypass appropriate dispute resolution protocols**. These enhancements to the AICPA standards were made by the AICPA after the PCAOB adopted the AICPA standards in 2003. It is important that the PCAOB at least catch up to the AICPA in this regard so that subordinates auditing public companies know that their PCAOB professional standards fully support their responsibility to voice their concerns, **especially in the face of an over-bearing supervisor.**
This is the same recommendation I made in my public comment in response to the PCAOB's December 2019 Concept Release on Potential Changes to the Quality Control Standards.

77. Are the terms used in EI 1000 clear? Should additional terms be defined or additional guidance provided?

No specific observations.

78. Is the proposal to amend ET 191, including the proposed rescission of certain paragraphs, appropriate? Should any of the proposed interpretations be retained in our standards?

No comment.

79. Are the proposed amendments to other PCAOB standards and rules appropriate? If not, why not? Are there additional amendments to other PCAOB standards or rules that the Board should consider?

Other Advances by the AICPA that Should Be Considered by the PCAOB

After the PCAOB adopted the AICPA standards in 2003, the AICPA made some useful amendments to their QC standards that were never adopted by the PCAOB. Specifically, the AICPA modified its QC Standard in 2007 to "strongly emphasize the responsibility of audit firm leadership to set the proper "tone at the top." … Each audit firm is required to design and implement quality control procedures that support that message and promote a quality-oriented culture." **The AICPA policy requires that the audit firm "assign management responsibilities so that commercial considerations do not override the quality of the work performed." … Perhaps most importantly, QC leaders should possess the necessary authority to implement [QC] policies and procedures and to ensure that others within the firm will not override those policies to meet short-term financial goals.**"[14]

80. Are the proposed amendments to Form 1 and Form 2 in Appendix 5 appropriate? If not, why not?

No comments at this time.

81. Are there additional academic studies or data related to the baseline for measuring the potential impacts of the proposed requirements? If so, what are they?

The footnotes to my public comment letter refer to various academic studies that support the need for prescriptive reporting on human capital mismanagement issues.

82. Are there additional academic studies or data available related to the resources employed by NAFs or foreign affiliates of GNFs in the design, implementation, and operation of their QC systems? If so, what are they?

None that I am aware of.

[14] Comments are from "Audit Watch" dated July 28, 2008

83. Are there additional academic studies or data available that could help us approximate the number of firms that will be implementing ISQM 1 or SQMS 1? If so, what are they?

No comment.

84. Should we consider any additional academic studies or data related to the need for standard setting?

Please refer to the academic studies cited and footnoted in my public comment letter.

85. Does our analysis appropriately capture the potential benefits of the proposal? If not, please explain.

The PCAOB should look at the baseline of the where the Big Four are at today in terms of their quality controls and judge whether the proposed QC standard would materially improve audit quality at the Big Four. I am concerned that much of the improvement in audit quality will not occur at the Big Four, but more likely at the smaller and regional firms.

This is precisely why I believe the monitoring and remediation of how human capital is deployed at the Big Four is so important. Absent incorporating such requirements into the QC standard, I doubt that very little improvement in Big Four audit quality will result from the PCAOB's proposed standard.

86. Are there additional potential benefits that should be considered? If so, what are they?

The use of metrics regarding the management or mismanagement of human capital creates the opportunity for those tasked with managing human resources to help to account is audit operations frequently occur outside of predetermined thresholds.

It is important to understand that the audit firm's profitability is the highest when the audit ranks are understaffed. There is a financial incentive to operate too lean that undermines audit quality.

87. Does our analysis appropriately capture the potential costs of the proposal? If not, please explain.

I did not see a detailed quantification of the costs, but I expect they will be considerable. Considering that this will be a costly undertaking, it is incumbent upon the PCAOB to demonstrate that there will be appropriate benefits. If the PCAOB is not prescriptive about how the largest audit firms should monitor and remediate instances of human capital mismanagement, I believe the costs to implement the QC standard will far outweigh the potential benefits, particularly as it relates to the largest audit firms that audit the lion's share of the large cap issuers.

88. Are there additional potential costs that should be considered? If so, what are they?

> No specific comment at this time.

89. Are there additional academic studies or data related to the potential benefits and costs of the proposed requirements? If so, what are they?

> Not that I am aware of.

90. Are there other potential unintended consequences of the proposal that we have not identified? If so, what are they?

> No comment at this time.

91. Are any alternative approaches to addressing the need for standard setting preferable to the proposed approach? If so, why?

> Please refer to the comments in my public comment letter about the importance of monitoring and reporting at the engagement level of metrics relevant to human resource management.

92. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

> No comment at this time.

93. Would the effective date as described above provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

> No comment at this time.