Consumer Federation of America

March 16, 2020

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

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

To the Secretary:

I am writing on behalf of the Consumer Federation of America (CFA)[1] in response to the request for comment regarding potential revisions to audit quality control standards. The goal of the project – to focus firms on improving their quality control (QC) systems – is laudable. And we agree that, "Effective QC systems are crucial for consistent high quality audits and other engagements under PCAOB standards." Unfortunately, a review of staff inspection briefs and other evidence from recent years suggests that existing quality control systems at many firms are not achieving an even minimally acceptable level of quality control, let alone the high level of audit quality that investors have a right to expect and on which the reliability of our financial reporting system depends. While we appreciate the PCAOB's focus on this important topic, we do not believe the proposed approach is sufficiently rigorous to achieve its intended goal.

1) **Evidence, including from PCAOB Inspection Briefs, suggests serious short-comings exist in firms' Quality Control systems.**

A review of the PCAOB's Staff Inspection Briefs from recent years suggests that significant progress is needed with regard to firms' quality control systems. Perhaps most disturbing is the regularity with which the inspection staff finds deficiencies related to auditor independence and professional skepticism, the fundamental foundations on which audit quality depends. As the Board indicated in its December 2018 Staff Inspection Brief, "These recurring deficiencies suggest that some firms and their personnel either do not sufficiently understand applicable independence requirements or do not have appropriate controls in place to prevent violations."[2] Inspection staff also "continue to raise concerns about whether some auditors

[1] CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was established in 1968 to advance the consumer interest through research, advocacy, and education.
[2] Inspections Outlook for 2019, Staff Inspection Brief, December 6, 2018, https://pcaobus.org/Inspections/Documents/Inspections-Outlook-for-2019.pdf. *See also,* PCAOB Staff Inspection

appropriately apply professional skepticism in the course of their audits, particularly in those areas that involve significant management judgments or transactions outside the normal course of business, as well as the auditor's consideration of fraud." [3] In other words, where skepticism is most needed, auditors are falling down on the job. And, year after year, inspection staff continue to identify frequent audit deficiencies related to matters that are critical to audit quality, including Internal Control Over Financial Reporting (ICFR), assessing and responding to risks of material misstatements, and auditing accounting estimates.[4] Inspection staff also regularly report that "engagement quality review continues to be an area of frequent deficiencies."[5]

Meanwhile, in September 2019, the Securities and Exchange Commission (SEC) filed a cease and desist order against PricewaterhouseCoopers LLP (PwC) in which it cited the firm for improper professional conduct related to 19 engagements for 15 SEC registered issuers from 2013 through 2016.[6] The Commission cited PwC for both performing prohibited non-audit services and failing to comply with PCAOB Rule 3523, which requires an auditor to describe in writing to the audit committee the scope of the work, discuss with the audit committee the potential effects of the work on independence, and document the substance of the independence discussion. The Commission found, moreover, that the violations were, "in part, the result of breakdowns in its system of quality control to provide reasonable assurance that PwC maintained independence." The fact that one of the Big Four audit firms would engage in such egregious

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Brief, Vol. 2016/3, July 2016, https://pcaobus.org/Inspections/Documents/Inspection-Brief-2016-3-Issuers.pdf ("Deficiencies observed in 2015 included instances in which some auditors provided impermissible non-audit services during the period under audit, and instances in which auditors did not obtain pre-approval from the audit committee prior to performing non-audit services."); PCAOB Staff Inspection Brief, Vol. 2017/4, November 2017, https://pcaobus.org/Inspections/Documents/inspection-brief-2017-4-issuer-results.pdf ("Inspections staff continued to identify deficiencies related to non-compliance with PCAOB rules and/ or SEC rules and regulations related to auditor independence. Examples include instances in which auditors: …conclude[d] inappropriately that a covered person's lack of independence … had not resulted in impairment of the firm's independence; … Entered into agreements through which their audit client agreed to indemnify the auditor against any liability or expense arising out of the engagement; Provided impermissible non-audit services during the period under audit … Some deficiencies were also identified that indicated certain firms did not have a quality control system that provided sufficient assurance that outside firms or auditors involved in issuer audit engagements or the firm's personnel were in compliance with the independence requirements.").

[3] Staff Inspection Brief 2016. ("For example, Inspections staff continues to observe situations in which auditors seek to obtain only evidence that would support significant judgments or representations made by management, rather than to critically assess the reasonableness of management's judgments or representations, taking into account all relevant evidence, regardless of whether it confirmed or contradicted management's assertions."

[4] *See* PCAOB Staff Inspection Brief 2016; PCAOB Staff Inspection Brief 2017; Inspections Outlook for 2019, Staff Inspection Brief 2018; and PCAOB Staff Preview of 2018 Inspection Observations, Staff Inspection Brief 2019.

[5] Staff Inspection Brief 2016 ("Deficiencies were observed in areas of the audit in which the auditor identified significant risks of material misstatement and where an engagement quality reviewer reviewed, or should have reviewed, the audit work and related conclusions, but those reviews were ineffective at identifying significant engagement deficiencies.")

[6] United States of America before the Securities and Exchange Commission, in the matter of PricewaterhouseCoopers LLC, Respondent, Order Instituting Public Administrate and Cease-and-Desist Proceedings Pursuant to Sections 4c and 21c of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Securities and Exchange Act of 1934 Release No. 87052, Accounting and Auditing Enforcement Release No. 4084, Administrative Proceeding File No. 3-19490, Sept. 23, 2019 https://www.sec.gov/litigation/admin/2019/34-87052.pdf.

independence violations suggests not only that there are serious weaknesses in the firm's quality control system, but also that those weaknesses in quality control exist at the highest leadership levels of the firm. After all, having previously settled an enforcement action with the SEC for independence violations that spanned a five-year period from 1996 to 2001, the firm should have understood better than most the importance of having a state-of-the-art quality control system to ensure compliance with independence standards.[7]

While the PCAOB inspection staff has reported some improvement in firms' quality control systems in recent years, a firm that isn't getting these basic building blocks of a quality audit right is, by definition, in need of a major upgrade to its quality control systems. This view was affirmed in the 2017 Staff Inspection Brief, which stated that, despite "incremental progress" at many firms, "The number and significance of the recurring audit deficiencies … suggest that firms need to consider whether additional or different steps need to be taken in order to improve and sustain audit quality."[8] Similarly, the Staff Preview of 2018 Inspection Observations states that many of the deficiencies identified during inspections occurred in areas reviewed by engagement quality reviewers (EQRs) who failed to identify relevant deficiencies. The failures identified, such as placing "too much reliance on discussions with the engagement team" or limiting their review by "reading summary memos that did not provide sufficient detail to allow for a review with due professional care," suggest that the quality reviews may, in some instances, be superficial and cursory affairs.[9]

In short, the deficiencies that inspection staff describe year after year don't simply involve arcane, highly technical issues that could trip up even the most experienced, ethical auditor. They involve basic foundational issues of critical importance to a high quality audit. As such, they provide compelling evidence both that the project to enhance quality controls is badly needed, and that the new standard must be rigorous. In particular, it must be designed to overcome the economic incentives that too often can work against a high quality audit, including the conflicts inherent in an issuer-pays business model and a business interest in minimizing costs that eat into firm profits. Consistent with the adage often repeated in auditing circles, "we manage what we measure," quality control can't be a check-the-box exercise. It must be back by concrete analysis of the results on audit quality. Firms and, in particular, firm leadership must be held accountable for the outcomes of their quality control efforts, and that accountability must be built into the standard.

2) The PCAOB should not simply tweak the proposed IAASB standard.

The Board appears to have decided, if it acts in this area, to use the proposed International Standard on Quality Management 1 (Proposed ISQM 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* from the International Auditing and Assurance Standards Board (IAASB)

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[7] Securities and Exchange Commission, Press Release, PricewaterhouseCoopers Settles SEC Auditor Independence Case, July 17, 2002 https://www.sec.gov/news/press/2002-105.htm.
[8] Staff Inspection Brief 2017. (It encouraged forms to "continue to evaluate the effectiveness of their systems of quality control," particularly in areas where they've had recurring deficiencies, and to perform "detailed and comprehensive root cause analyses of recurring deficiencies."
[9] https://pcaobus.org/Inspections/Documents/Staff-Preview-2018-Inspection-Observations.pdf

as the starting point for any future revisions to its own quality control requirements. This decision is premature at best, since the IAASB has not even completed its project, let alone had a chance to test its effectiveness. Furthermore, while the Concept Release states that the IAASB "received broad support for the overall risk-based approach of Proposed ISQM 1," the overview of feedback received in response to the exposure draft makes clear that a number of concerns were raised during the comment process.[10] As a result, the proposal could be significantly altered before it is finalized. For example, the IAASB is, according to the Concept Release, "considering changes to the structure of its standard, the firm's risk assessment process, and monitoring and remediation." We are frankly concerned about the possible direction any such changes could take, not least because the makeup of the IAASB suggests that it lacks the independence that Congress intended when it established PCAOB and endowed it with standard-setting authority.[11]

Furthermore, the PCAOB does not appear to have adequately researched other quality control systems, such as ISO 9001, as a starting point for its proposed approach. ISO 9001 sets out criteria for a quality management system that is designed to be "used by any organization, large or small, regardless of its field of activity."[12] The standard appears to have gained wide acceptance, with more than a million companies and organizations in more than 170 countries reportedly having been certified to ISO 9001. An important difference between proposed ISQM 1 and ISO 9001 is that ISO 9001 starts by highlighting the importance of QC to *customers* (in this case, the end users of audited financial statements), with a focus not just on basic compliance, but on producing high-quality products and services. We strongly believe that this must be the focus of an effective QC standard. We understand, moreover, that members of the PCAOB's Investor Advisory Group suggested using ISO 9001 as the basis for a new PCAOB quality control standard when they discussed this issue. At the very least, instead of prejudging the issue, the PCAOB should consider whether this (or other) widely adopted quality control systems offer a better alternative to proposed ISQM 1.

Another potential source of insights that could inform the direction the PCAOB takes in designing a quality control system are industry best practices. The Concept Release notes that, "some firms have significantly increased their focus on quality control, especially in areas such as firm governance and leadership, incentive systems, and accountability. Some firms have also augmented their monitoring and remediation processes, including through implementing or enhancing ongoing monitoring activities and internal inspection processes, establishing processes for considering PCAOB inspection findings, performing root cause analysis, and increasing remediation efforts."[13] It goes on to note that, "Observations from our oversight activities have shown that improvements in quality controls can enhance the quality of audits," but that "not all firms have made such improvements to their QC systems or have done so to the same degree."

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[10] IAASB, ISQM 1: Overview of Feedback from the Exposure Draft, presented by Karin French, ISQM Task Force Chair, IAASM Meeting September 2019, https://www.ifac.org/system/files/meetings/files/20190916-IAASB-Agenda-Item-4-A-ISQM-1-Presentation-Overview-of-Feedback-from-the-ED.pdf.
[11] *See* IAASB website, About IAASB, https://www.iaasb.org/about-iaasb.
[12] ISO website, Why ISO 9001? https://www.iso.org/iso-9001-quality-management.html. Based on our quick review of the bios of IAASB board members, a large majority appear to come from or have strong ties to audit firms, and many were nominated by industry groups
[13] Concept Release at 8.

These findings are echoed in recent Staff Inspection Briefs,[14] which also list additional steps certain firms have taken to improve audit quality.[15] To the degree that certain firms appear to have superior quality control systems, particularly where they can show measurable results in the form of improved audit quality and decreased audit deficiencies, the Board should explore whether their "best practices" would serve as the basis for a strengthened QC standard, regardless of whether they are consistent with or diverge from proposed ISQM 1.

The PCAOB offers an insufficient rationale for deferring to an incomplete and untested international standard, proposed ISQM 1, as the starting point for its efforts. It states merely that it "would not be practical" for firms to implement QC systems that comply with both PCAOB standards and other standards, such as those from the IAASB's or the AICPA. If the PCAOB had compelling evidence that these other standards are effective, this would be a compelling reason for the Board to base its approach on those standards. But the Concept Release offers no such evidence. (In other words, uniformity is a good reason not to adopt "unnecessary differences," but not a sufficient reason to adopt what may prove to be a deficient standard.) Furthermore, experience tells us that firms can cope with standards that are different, as long as those standards aren't in direct conflict with each other (i.e., where compliance with one standard causes the firm to be out of compliance with another). That, rather than uniformity for uniformity's sake, should be the PCAOB's goal. If, instead of sending the message that it will follow IAASB's lead wherever it leads, the PCAOB were to make clear that it is going to pursue a rigorous standard regardless of the extent to which it diverges from the international standard, it could not only benefit U.S. investors, it might even help to limit the extent to which IAASB is prepared to water down its proposal in response to industry concerns.

Ironically, having discussed the impracticality of adopting differing standards, the Concept Release acknowledges that "incremental or alternative requirements would be necessary for firms performing engagements under PCAOB standards." And it offers several reasons why this might be necessary, including to align with U.S. federal securities laws and other PCAOB standards and rules, to retain important topics in the current PCAOB standard that are not included in the international proposed standard, to address specific emerging risks and problems observed through the Board's oversight activities, and to provide more definitive direction to promote appropriate implementation of certain requirements. In other words, the Concept Release makes clear that the standards are likely to be far less uniform than its reliance on the

[14] The 2017 Staff Inspection Brief states, for example, that "some firms monitor audit deficiencies identified and perform root cause analysis on a continual basis. Some firms also link their remedial actions with root causes and the relevant quality control objectives and monitor the progress of the actions taken. As a result, these firms obtain information that allows them to react more timely and implement remedial actions to reduce recurring deficiencies in other audits." It goes on to identify additional positive steps firms have taken to improve audit quality, such as implementing.

[15] These include: implementing pre-issuance reviews to help auditors understand the required procedures to audit accounting estimates and test the design and operating effectiveness of controls; enhancing or modifying audit guidance and tools for engagement teams to enforce a more detailed understanding of the issuer's processes, transactions, and controls, and the associated risks of material misstatement; developing interactive training sessions to reinforce professionals' understanding of the auditing standards and facilitate discussion among auditors regarding audit challenges and solutions through case studies; providing additional real-time coaching and assistance to auditors in areas of recurring deficiencies; increasing supervision, including review, of other auditors through onsite visits and/or review of audit documentation; expanding accountability for audit quality beyond the lead engagement partner, and providing new or enhanced audit tools in areas of significant judgment.

ISQM 1 model as its starting point would imply. All the more reason, then, to start this project with a sole focus on developing the most effective QC standard possible, rather than mirroring an international standard that hasn't even been finalized.

Finally, the Concept Release discussion of proposed ISQM 1 suggests that it includes both positive features and serious deficiencies. In particular, its focus on governance and leadership and firms' risk assessment process, neither of which is highlighted in the current PCAOB standards, is important, as far as it goes. On the other hand, proposed ISQM1 seems to set a very low standard for "success." According to the proposal, the object of the system of quality management is to provide the firm with reasonable assurance that the firm and its personnel meet their basic legal obligations and issue reports that are "appropriate in the circumstances." While it is certainly true, as discussed above, that PCAOB inspection reports suggest that many firms struggle to meet even this low bar, surely we should be setting a higher goal for firm's QC systems. The objective of ISO 9001, in contrast, is to ensure high quality processes, products and services. If the PCAOB isn't willing to set that higher bar, in terms of the objective of the standard, it should stop calling this a quality control system and label it instead as what it is, a basic compliance system.

For all these reasons, the PCAOB should not simply assume that any new standard-setting in this area would use proposed ISQM 1 as its starting point. Instead, PCAOB should start this project with an open mind about the best approach; consider a wider range of quality control system models, including ISO 9001, to determine which is likely to be most effective; and design a standard that, while it seeks to avoid *unnecessary* conflicts with other standards, has as its clear objective providing a high level of assurance that audit firms will rigorously maintain their independence, approach audits with a high degree of professional skepticism, comply with all applicable audit standards and rules, meet their obligations to identify fraud and other material legal violations, and conduct the high quality, independent audits upon which the integrity of our financial system depends. If the PCAOB does insist on using ISQM 1 as its starting point, it should clarify that "reasonable assurance" is a very high level of assurance, include a stronger statement regarding the objective of the standard, as discussed above, and adjust the standard itself in ways that go beyond those outlined in the Concept Release.[16]

3) **CFA strongly supports including governance and leadership in the Quality Control standards, but it needs to be backed up by real accountability.**

As noted above, one area where proposed ISQM 1 appears to offer a meaningful improvement over existing PCAOB standards is its inclusion of requirements concerning firm governance and leadership. As the Concept Release states, a "firm's governance and leadership component establishes the environment in which the QC system operates." This is particularly important when it comes to maintaining independence and promoting professional skepticism, the bedrocks of effective quality control. The question is whether the proposed standard will actually serve to promote "a commitment to quality," something audit firms already give lip service to. Given the incentives firms have to under-invest in quality control, we believe that goal is most likely to be achieved where there is independent oversight of the quality control

[16] We are not suggesting that these are the only revisions to the proposed standard that are needed, but that they are among the highest priorities.

system, where there is transparency around the outcome in the form of publicly disclosed audit quality indicators (AQIs), and where firm leaders are held accountable for results achieved.

In 2008, the bipartisan Advisory Committee on the Auditing Profession (ACAP) made a number of recommendations the ultimate goal of which were to improve audit quality.[17] Among them was a recommendation urging "the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms."[18] The Committee, which was "particularly intrigued by the idea of independent board members with duties and responsibilities similar to those of public company non-executive board members," expressed the view that "such advisory boards and independent board members could improve investor protection through enhanced audit quality and firm transparency." Since that time, as the Concept Release notes, some of the largest firms have appointed independent directors to their boards "or have established equivalent or alternative means of external oversight," but with varying levels of authority, responsibility, and influence.

With an appropriately high standard for board member independence, such an approach could help to bring appropriate focus to key issues that are priorities for investors, such as independence and professional skepticism. Independent oversight also has the potential to help counteract economic incentives to under-invest in audit quality or to view retaining customers, rather than protecting investors, as the firm's top focus. For that reason, we believe more can and should be done to implement this policy change, at least at the larger firms. A review of quality control systems offers a perfect opportunity to do so. Much as an independent board committee is required to oversee the public company audit, an independent board committee of the audit firm should have responsibility for overseeing the firm's quality control system. For smaller firms that do not have independent boards or advisory committees, responsibility for maintaining a robust QC system should reside with top firm leadership. In addition, for firms both large and small, senior leadership within the firm should be required to certify that the system complies with all relevant standards and should be held accountable for results. The results of the quality control system should be measured, and those responsible for its oversight should be evaluated and compensated based on those results.

All those responsible for overseeing the quality control system would benefit from objective data that enables them to measure the effectiveness of that system. Audit quality indicators can help to provide that data. Indeed, failure to incorporate AQIs in the quality control standard would seriously undermine its likely effectiveness. As we have noted above, firms have a financial incentive to under-invest in audit quality, when it comes at the expense of firm profits, and to gloss over any shortcomings in their QC system. (This is roughly comparable to the incentive public companies have to paint an excessively rosy picture of their financial health, which is a key reason for the independent audit mandate.) In its 2008 report, the Advisory Committee on the Auditing Profession recommended that PCAOB seek to develop audit quality

[17] Department of the Treasury, Advisory Committee on the Auditing Profession, Final Report, Oct. 6, 2008 https://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf. (ACAP Final Report)
[18] *Id.* at VII:8-11.

indicators and that audit firms publish these indicators, as a way both to improve audit quality and to encourage firms to compete based on audit quality.[19] Although the Board issued a Concept Release on audit quality indicators in 2015, and adoption of AQIs has received strong support from investors, the Board has as yet failed to act on this important priority.

It is frankly inconceivable to us that the Board would update its quality control standards without including a requirement on AQIs. If AQIs are developed and publicly *disclosed*, audit committees will have important information to factor into their selection of audit firms, shareholders will have data they can use to hold audit committees accountable for those selections, and firms will have an incentive to develop and maintain rigorous QC systems in order to be able to compete more effectively on quality. For example, in a system that includes transparency around AQIs, where quality conveys a competitive advantage, firms are more likely to develop incentive systems that reward quality. Similarly, if firms are required to publish information about audit deficiencies, they are more likely to conduct the in-depth root-cause analysis needed to identify and eliminate flaws in their audit practice.[20] Without a mechanism for measuring the outcome of the QC system, on the other hand, quality control is all too likely to devolve into an empty exercise with little actual impact of the quality of audits.

4) CFA supports including the firm's risk assessment process in the quality control system standard.

Requiring firms to include risk assessment in their quality control system could help to ensure that firms focus on the right issues, design their systems to address those risks, and regularly reassess the effectiveness of the steps they've taken. This should include, for example, robust root cause analysis related to audit deficiencies and audit failures as well as a required focus on how incentives within the firm do or do not reward audit quality. We are concerned, however, that firms may succeed in getting IAASB to water down its proposed standard in this area, and that a system based only on general principles is likely to be ineffective. ISO 9001 requires documentation of the risk assessment and how each of those risks is to be the addressed. It also requires measurement of whether the identified risks were adequately addressed and evaluation of those responsible based on the results of that measurement. This approach should be incorporated into the PCAOB standard. Here again, AQIs can be helpful. Requiring firms to disclose AQIs has the potential to create a financial incentive, in the form of a competitive advantage, for implementing a robust risk assessment process. It would also give the firms better data to use in identifying and assessing quality risks and evaluating those responsible for addressing those risks

[19] ACAP Final Report at VIII:15. ("The Committee believes that requiring firms to disclose indicators of audit quality may enhance not only the quality of audits provided by such firms, but also the ability of smaller auditing firms to compete with larger auditing firms, auditor choice, shareholder decisionmaking related to ratification of auditor selection, and PCAOB oversight of registered auditing firms.)

[20] Staff inspection briefs have identified significant variations in the level of root cause analysis among firms. *See, e.g.*, 2017 Staff Inspection Briefing ("Inspections staff has observed significant diversity in root cause analysis practices across firms, depending largely on firm size. Some firms perform little or no root cause analysis, while other firms perform more extensive root cause analysis procedures. Root cause analysis can be an important process for improving audit quality. When firms can properly understand why a deficiency is occurring, they can better design remedial actions that are sufficiently targeted to address the root of the problem."

5) **Maintaining independence and professional skepticism should be given a higher priority in the quality control system.**

Proposed ISQM 1 includes independence among the generic "ethical requirements" for which firms would be required to develop quality objectives. It doesn't directly mention professional skepticism at all as an ethical requirement firms must address. While we agree that firms' ethical obligations extend beyond independence and professional skepticism, we nonetheless view these as first among equals. As such, we believe they require greater focus in the standards than they are given in proposed ISQM 1. Retaining the existing language from PCAOB standards regarding both independence and objectivity, along with the associated obligation "to be impartial, intellectually honest, and free of conflicts of interest," is a good place to start, but more needs to be done

Both the recent SEC enforcement action against PwC and the fact that inspection staff continues to find numerous deficiencies related to these basic building blocks of a quality audit suggests that the current standards are not adequate. For example, we support the suggestion in the Concept Release that QC requirements from SECPS should be updated and refined and extended to all firms. In addition, AQIs focused on audit deficiencies in these areas would provide an added degree of accountability, as would oversight by an independent board committee. Indeed, at least at large firms, we believe an independent board committee should bear responsibility for independence, alongside senior members of the leadership team. While it may be appropriate to assign supplemental responsibilities in this area to other qualified individuals within the firm, when it comes to maintaining the firm's independence, the buck should stop in the executive suite. Compensation of firm leaders should be based on their success or failure in maintaining the independence of firm audits and the quality of those audits.

6) **Proposed ISQM 1 does not adequately address the need to communicate information about the QC system to investors.**

The proposed standard on Information and Communication in proposed ISQM 1 does not appear to require communication with investors, except where that is explicitly required by law. For the reasons discussed above, we believe transparency is critically important to providing the accountability necessary to keep quality control from being an empty process. Unfortunately, the "Potential Incremental or Alternative Requirements for PCAOB Standards" discussed here suggest only that PCAOB might include requirements that expressly address required communications by the firm or engagement teams to audit committees, the SEC, the PCAOB "or otherwise as required by law, regulation, and PCAOB standards and rules." Under this approach, as with the Board's earlier staff guidance on auditor communications regarding independence violations, the investing public would be left in the dark.[21] That is not acceptable.

Instead, firms should be required to provide disclosures regarding audit quality and quality control to the public. This should include information on AQIs and how the firm is responding to identified deficiencies. With regard to engagement performance, firms should be

[21] Letter from Consumer Federation of America, AFL-CIO, Better Markets, Center for American Progress, and Americans for Financial Reform to SEC Chairman Jay Clayton, Nov. 21, 2019, https://consumerfed.org/wp-content/uploads/2020/03/Letter-to-SEC-on-PCAOB-aud-ind-guidance-11.21.19.pdf.

required to identify and document the quality factors they will use to measure the quality of audits, both at a firm level and at an individual audit level. They should be required to disclose that information to investors as part of a mandatory annual firm report on audit quality, for firm-level information, and in the audit report, for audit-specific information.

7) Including a strong requirement for monitoring, remediation and enforcement within the firm is essential.

We agree with the Concept Release statement that, "Monitoring and remediation is a crucial part of an effective QC system because it creates a feedback loop to inform the firm's risk assessment process to drive continual improvement." But it must not stop there. For QC to be effective, firms must be required to hold individuals accountable for results. We appreciate that some firms have recently reportedly made strides in this area. Given evidence, however, that not all firms have made meaningful improvements in this area, a new proposed standard should include a clear mandate for monitoring and remediation. Toward that end, we support suggested changes to proposed ISQM 1 to require monitoring procedures to be more proactive, to ensure that requirements to conduct root cause analysis are clear and robust, to apply the requirement to QC deficiencies identified by both internal and external sources, to include a "presumptively mandatory obligation to design and implement remedial actions to address QC deficiencies," and to require the evaluation of "both internal and external inspection findings for the purpose of determining the need for action in accordance with AS 2901 and AS 2905 and for monitoring such remedial actions." To ensure an appropriate degree of accountability, individuals within the firm who are responsible for quality control must be evaluated based on results of the QC system. Moreover, as noted above, we strongly support requiring firms to report annually on their assessment of the firm's QC system, as well as the basis for that assessment. For the reasons discussed above, we believe these reports should also be made available to the public.

8) The need for scalability should not become an excuse for weak procedures at small firms.

The Concept Release correctly notes that, "A wide variety of firms are subject to the PCAOB's quality control standards, ranging from large firms with thousands of partners that are members of global networks, to small firms of just one or two partners with a local practice." It goes on to note that, as a result, the processes and controls necessary to achieve the basic objectives of the quality control system will vary significantly from firm to firm. It concludes that, "Any future PCAOB QC standard would have to be scalable, so that firms could appropriately design their quality control systems to address the risks associated with their own practice." We agree. We do not agree, however, that it automatically follows that "less formal processes and controls" will always be appropriate for small, less complex firms. There are quality control areas where these firms are likely to pose greater risks, precisely because they may be understaffed, be less well trained, or lack relevant expertise to perform a particular audit. Before concluding that standards for smaller firms should be less rigorous, the Board should more carefully evaluate the particular risks associated with such firms and ensure that they are accounted for in the QC standards.

Conclusion

Upgrading audit firms' quality control systems is a laudable goal, and the Concept Release includes suggestions that could help to achieve that goal. We are not convinced, however, that using proposed ISQM 1 as the starting point is an appropriate approach, not least because ISQM 1 is still a work in progress. We are concerned, moreover, that neither proposed ISQM 1 nor the Concept Release sets an appropriately high bar for what improvements to firms' quality control systems should be designed to achieve. The goal should not simply be to ensure compliance with applicable laws and standards, it should be designed to promote audits of the highest quality. Toward that end, the PCAOB should seek to develop a standard that has as its clear objective providing a high level of assurance that audit firms will rigorously guard their independence, approach audits with a high degree of professional skepticism, comply with all applicable audit standards and rules, meet their obligations to identify fraud and other material legal violations, and conduct the high quality, independent audits upon which the integrity of our financial system depends.

Respectfully Submitted,

Barbara Roper

Barbara Roper
Director of Investor Protection