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1 February 2023

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

submitted via email to comments@pcaobus.org

Re.: PCAOB Rulemaking Docket Matter No. 046
PCAOB Release No.2022-006 of November 18, 2022 "A FIRM'S SYSTEM OF QUALITY CONTROL AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS, RULES, AND FORMS"

Dear Madam, dear Sir,

Following the submission of our comments on the Rulemaking Docket Matter No. 046, Concept Release "Potential Approach to Revisions to PCAOB Quality Control Standards", in a letter to you dated 16 March 2020, we would like to thank you for the opportunity to provide the PCAOB with comments on the PCAOB Release No. 2022-006 (hereinafter "the Release").

In this letter, we express our support for the degree of alignment to, in particular, the international standard ISQM 1 and provide comments on selected matters addressed in the Release, with which our members have concerns. We have chosen not to respond to specific questions; however, we have indicated where our comments are relevant to specific questions.

Alignment of proposed QC 1000 with "other" quality management or quality control standards (No question)

In our letter dated 16 March 2020, we had noted that, whilst legally required specifics may be unavoidable, we fully supported the Board's acknowledgement that requirements going beyond those of the international standards should be kept to a minimum. In particular, we had expressed our support for the PCAOB exploring the possibility of building on the requirements of ISQM 1 by adding or

amending specific requirements. We are thus pleased to acknowledge the PCAOB's stated belief that building on a common basic structure with other audit standard setters, with appropriate differences, would enable its regulatory objectives to be accomplished more effectively, as well as more efficiently and at a lower cost to the firms the PCAOB regulates, than if the PCAOB developed an entirely different structure of its own. This belief notwithstanding, we urge the PCAOB to reduce the differences between ISQM 1 and QC 1000 to the maximum degree possible. In particular, in the context of achieving an efficient evaluation process to drive improvements to firms' QM/QC systems, we find the use of different definitions of the term "deficiency" extremely counterproductive. Subsequently in this letter we suggest specific changes to the definition of "QC deficiency" and would support the PCAOB providing an express clarification that certain specific terms are to be understood as equivalent between the two sets of standards.

Whilst we note that the PCAOB further acknowledges that the structure it is proposing for QC 1000 is similar to the structure of ISQM 1 and that proposed QC 1000 incorporates the same eight components as ISQM 1 and aligns the objective of the QC system to that of the other standard setters, we are disappointed that differences between proposed QC 1000 and ISQM 1 are not (notwithstanding the comparison paper prepared by PCAOB staff) readily apparent. Although the Release contains sections headed "key differences", these have to be read in conjunction with preceding related explanations for readers to fully appreciate the differences and to evaluate these in practical terms. The staff comparison paper also demands thorough scrutiny to identify those differences that make a difference in practice and are relevant for the design of a system of QC. In our opinion, a clear and concise depiction of differences would aid PCAOB-registered firms in adapting the design of their current systems such that they can also comply with QC 1000.

In finalizing QC 1000, we would urge the PCAOB, within its remit of enhancing investor protection, to develop a succinct practically-oriented outline of the "add-ons" and any further differences in comparison to ISQM 1.

PCAOB-registered firms that do not perform engagements under PCAOB standards every year (Question 5)

Pursuant to paragraph .06 of QC 1000, all PCAOB-registered firms would be required to design a QC system that complies with QC 1000 and to document its design. However, unless they meet the requirement of paragraph .07a of QC 1000, PCAOB-registered firms that do not perform engagements under

PCAOB standards every year would, generally, not be required to implement and operate this QC system.

The Release notes: “As of June 30, 2022, up to 59% of firms do not meet this criterion (i.e., 59% of PCAOB-registered firms were not required to comply with applicable professional and legal requirements with respect to any of the firms’ engagements) but would be required to design a QC system in compliance with proposed QC 1000.3.” Thus, many registered firms (that already have systems under other standards) would have to design a QC 1000-compatible system and document it, but neither implement nor operate that system.

Page 63 of the Release explains: “The design of the QC system would be based on the quality **risks the firm likely would face if it performed engagements**.” The Release also acknowledges that firms may not have lengthy advance notice before responsibilities arise under applicable professional and legal requirements with respect to an engagement and that registered firms would have to stand ready to have their QC system implemented and operating over such responsibilities whenever they arise. Para. .02 explains: “… A QC system is a continual and iterative process that is responsive to changes in the nature and circumstances of the firm and its engagements. …”. This implies that a firm undertaking relevant work for the first time will need to follow this iterative process.

Logically, **a stand-ready-design based on hypothetical engagement work and assumed associated risks may be expected to differ from the design of a system based on actual risks at the time the firm accepts and performs relevant work**. We do not see that preparing and documenting a stand-ready-design is an efficient use of resources. Equally we do not see how this can be beneficial to the actual delivery of quality engagements, so we do not view this as being in the public interest.

In our opinion, especially as this aspect of the proposal affects such a large number of firms, the potential political impacts deserve further consideration.

On the one hand, this aspect of the proposal could lead some firms and networks to either withdraw their PCAOB registration (as the PCAOB acknowledges). However, to the extent that such foreign firms could see this as accelerator to a decision not to service specific audit markets, the PCAOB’s proposal potentially impacts audit markets beyond the US. The pros and cons of a possible further market concentration as discussed in the Release may not be viewed in the same light elsewhere, such as the European Union, where policy makers continue to have significant concerns as to concentration in the PIE audit market.

On the other hand, rather than running two QC systems in parallel, firms or networks might decide to implement and operate a QC 1000 compliant system of QM/QC across all their engagements. This is of huge political significance beyond the US, given the number of foreign PCAOB-registered firms likely to be impacted.

Furthermore, as explained above, a practically-oriented overview of differences between QC 1000 and ISQM 1 could be especially helpful to the efficiency of foreign PCAOB-registered firms in designing systems that are fit for purpose on accepting relevant engagements, but based on the risk identification and assessment at that time. The notion that an entire QM/QC system can be "switched on or off" depending on whether at a specific point in time a particular type of engagement is to be performed is in denial of the reality that a QM/QC system is (as the PCAOB points out) an iterative process. In our opinion, achieving a minimum of differences between ISQM 1 and QC 1000 is the most appropriate way to ensure firms have QM/QC systems to ensure appropriate quality for all the engagements the firm performs, which is in the public interest regardless of the jurisdiction. Requiring firms to take regard to a limited number of specific jurisdictional quality control particularities when PCAOB Standards are applicable should not be such as to necessitate a different design and documentation for their existing systems.

Requirement to include "other participants" in the reasonable assurance objective (Question 42 and 43)

A key difference between proposed QC 1000 and ISQM 1 is the proposal to include the activities of "other participants" in the reasonable assurance objective. According to the diagram on page 46 of the Release the term "other participants" will be understood as including, amongst others, external experts (i.e., specialists engaged by the firm). In contrast, the IAASB has specifically excluded external experts in defining "engagement team".

In this regard, we are concerned that the PCAOB does not appear to have explored whether this aspect of the proposal may give rise to any practical hindrances for firms. We understand that the IAASB excluded e.g., external experts for good reasons. In some fields there may be a limited availability of experts who possess the ability to provide the necessary quality of service so clarification of how a firm might be expected to address the practicalities involved in the firm using an external expert is essential. For example, designing responses to the proposed (required) risks of intentional misconduct by certain other participants could be challenging depending on the strength of influence

the firm is in a position to exert in terms of access to information pertaining to an expert's behavior. We note that – in line with the prevailing US requirements – para. 31 specifically scopes out external experts from the firm's ethics and independence quality objectives and would urge the PCAOB to give further consideration as to the need to address potential further practicalities that could result from the proposed inclusion of "other participants" in the reasonable assurance objective. In terms of audit quality –it will generally be preferable for the auditor to engage a highly-qualified subject matter expert than to forgo obtaining the necessary quality of expertise.

From a political perspective we are also concerned that the selection of firms to perform referred work (i.e., in determining if they are fit for purpose) and so-called "other participants" could be influenced by the fact that they (but only firms; not other types of "other participants") will be asked to provide information on their QM/QC system (see para. .52 g. (2): "Information is obtained from the other participants, such that those engagements can be performed in accordance with applicable professional and legal requirements – Note: With respect to other participants that are firms, information to be obtained should include the conclusion of the most recent evaluation of the QC system of the other participant firm and a brief overview of remedial actions taken and to be taken.").

We note that the PCAOB asks whether there are legal or regulatory concerns regarding other participant firms sharing the most recent evaluation of their QC system. As far as Germany is concerned, confidentiality legislation may be an issue for firms, when reporting clients' or individuals' personal information is concerned.

There are, in any case, concerns that those firms applying QC 1000 fully and reporting thereunder may be selected in preference to those using other standards (despite the Release stating that evaluations under other QM/QC standards may be obtained (see footnote 42: "The most recent evaluation of the other participant firm's QC system refers to that firm's evaluation under paragraph .77 of this standard as of the most recent November 30, if such an evaluation was performed. If the other participant firm did not evaluate its QC system under paragraph .77 of this standard as of the most recent November 30, then this provision refers to the most recent QC evaluation performed by the other participant firm under any professional standard.")). This may also constitute a political impact discussed above, whereby firms and networks elect to comply with QC 1000 voluntarily.

Clarification of when firms must implement and operate a system of QC (Q 6-7)

We agree with the PCAOB's preliminary view that, whenever a firm has responsibilities under applicable professional and legal requirements with respect to an engagement, those responsibilities should be performed under a fully implemented and operating QC system that complies with PCAOB standards. Under the proposal firms would be required to implement and operate the QC system in compliance with QC 1000 (only) when they perform an engagement under PCAOB standards, play a substantial role in the preparation or furnishing of an audit report (as defined in PCAOB rules), or have current responsibilities under applicable professional and legal requirements regarding any such engagement.

We are concerned that the circumstances that trigger the need for a firm to implement and operate a QC system in compliance with QC 1000 may not be sufficiently clear – in particular, regarding the latter (have current responsibilities under applicable professional and legal requirements regarding any such engagement).

Footnote 3 to para. .07 a. provides examples of circumstances when a firm has current responsibilities under applicable professional and legal requirements regarding the issuance of an audit report. The discussions on pages 50 and 63 of the Release also explain some circumstances under which responsibilities may arise with respect to completed engagements long after the issuance of the auditor's report. Other than the statement that "Once a firm no longer has any responsibilities under applicable professional and legal requirements with respect to any firm engagements, the firm would be required to continue operating the QC system until the next November 30 (the next date as of which the firm would be required to evaluate the QC system)" no examples of current responsibilities are provided relative to other engagements performed under PCAOB standards. It is unclear to us whether these explanations purport to constitute a definitive list of all potential circumstances in which a firm may have responsibilities under applicable professional and legal requirements.

In our view, targeted guidance would be helpful outlining the circumstances under which a firm that is not yet, or is no longer, performing an engagement under PCAOB standards or playing a substantial role in the preparation or furnishing of an audit report may have current responsibilities under applicable professional and legal requirements.

Responsibilities of certain individuals – Form QC certification (Q 12 – 13 and 62, 65 and 67).

Proposed QC 1000 requires the firm assign certain responsibilities to individuals and would, for many but not all firms, require two of those individuals to sign the required item 3.2 "Certification of the Report on the Annual Evaluation of the Firm's QC System" on proposed Form QC. These are: the individual responsible for ultimate responsibility and accountability for the firm's QC system as a whole (this must be the firm's principal executive officer (i.e., the highest-ranking executive, regardless of formal title)) – see para. .11, and the individual responsible for operational responsibility and accountability for the QC system as a whole – see para. .12.

According to the note below para. .12 firms may, depending on the nature and circumstances of the firm (including its size and structure) and its engagements, assign one individual to more than one of the roles identified in paragraphs .11 and .12. Accordingly, these factors will determine that for some firms, Form QC may include the certification of a single individual being the firm's principal executive officer, whereas other firms may determine that they have to require two individuals sign this certification.

The PCAOB explains its reasoning for the proposed certification as: "Under proposed QC 1000, **the individuals** who are assigned specific responsibilities with respect to the QC system **could be charged with violations** if they fail to comply with those responsibilities, as well as for knowingly or recklessly contributing to firm violations or failing reasonably to supervise. We believe that providing another basis for enforcement against responsible individuals could enhance their accountability for the QC system." Whilst we acknowledge that the proposal may sharpen an individual's sense of accountability, we would like to point out that this does not necessarily lead to and cannot guarantee enhanced engagement quality.

We are concerned that proposed QC 1000 requires **the firm** to make evaluations (see para. .77 and .78) and to report annually to the PCAOB on Form QC (see para. .79) whereas potentially two **individuals** are (personally) required to certify that they have evaluated the effectiveness and presented (the firm's) conclusions. We accept that it is appropriate for a firm's principal executive officer to sign the proposed certification, however we are concerned that in the event there are differences of opinion, it is "the firm" that will be in a position to overrule an additional individual's evaluation such that that individual (i.e., the individual responsible for the operational responsibility and accountability for [Firm]'s quality control system, who may not be the highest-

ranking executive) could be subject to excessive pressure by the firm. We believe this might mean that a separate role with responsibility for the operational responsibility and accountability for the QC system as a whole could be a difficult role to fill and also that the certification requirement might be an issue under law in some jurisdictions.

In view of the above we suggest the Form QC certification be required only of the individual who bears the ultimate responsibility and accountability for the firm's quality control system since this individual is required to be the firm's principal executive officer (i.e., the highest-ranking executive, regardless of formal title).

Determining the existence of a QC deficiency or a major QC deficiency (Q. 53, 58-60)

Proposed QC 1000 includes definitions of the terms: "QC deficiency" and "major QC deficiency". Paragraphs .72 and .78 of the Release list certain factors upon which the firm should base its respective determinations. These definitions differ from those used in ISQM 1.

An appropriate determination of these terms is extremely important given the proposed requirement for firms to communicate deficiencies to the audit committee and to file Form QC with the PCAOB on their evaluation of their QC systems and because – as discussed in more detail above – certain individual(s) would be required to furnish certifications in this regard.

The proposal requires the firm to report the firm's conclusion on whether, as of the evaluation date, the firm's QC system:

a. Is effective with no unremediated QC deficiencies; or

b. Is effective except for one or more unremediated QC deficiencies that are not major QC deficiencies; or

c. Is not effective (one or more major QC deficiencies exists).

In our view, the proposed definition of QC deficiency: "… A QC finding that, based on the evaluation under paragraph .72, individually or in combination with one or more other QC findings, results in: (1) A reduced likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives…" sets an overly low threshold that would result in relatively minor issues being communicated to the audit committee (proposed changes to AS 1301.04 b.) and reported to the PCAOB – and in view of the reasonable assurance objective would not merit a modification were the firm to be required

to express a reasonable assurance opinion on the effectiveness of its QC system.

Whilst such a threshold could be helpful to the firm itself to act quickly in remediation, we believe it is too low for external communication purposes. We would therefore suggest alignment with ISQM 1 in this regard. Failing this, we suggest that the wording of the proposed definition governing deficiencies for external communication purposes be revised to read: "… A significantly reduced likelihood of the firm achieving the reasonable assurance objective ~~or one or more quality objectives~~ …" and the PCAOB confirming its equivalence to the ISQM 1 threshold: "to reduce to an acceptably low level the likelihood of a […] quality risk occurring".

The need for a new Form QC (Q. 57, 63 and 64)

Whilst we agree that from the perspective of a firm it might be administratively simpler to use an existing form (a non-public portion of the annual report on Form 2) that is already required to be completed annually, we note that this would change the proposed evaluation and filing dates to 31 March and 30 June respectively. The disadvantage would rest with firms that would have to complete their evaluations as at 31 March, which in many cases would fall within a "busy season", thus adding unnecessary challenge.

Subject to our comments above regarding PCAOB-registered firms that do not perform engagements under PCAOB standards every year, we have no issues with the proposal that, as part of their publicly available annual reporting on Form 2, all registered firms would be required to provide an annual confirmation with regard to the design of their QC system and whether they were required to implement and operate the QC system.

However, we do not see the necessity to prescribe the proposed date of 30 November (with the submission of Form QC by 15 January of the subsequent year). We therefore suggest this aspect of the proposal be revised such that firms are allowed flexibility to set the annual deadline and report within a set time frame if the firm has QC deficiency findings indicating that reasonable assurance that its system is operating effectively has not been obtained.

Proposed non-public reporting (Q 91)

For the reasons discussed on page 211 et seq. of the Release, we support the proposal that Form QC be nonpublic and support this being anchored in proposed Rule 2203A.

We also acknowledge that the proposed rule expressly provides that Form QCs and their contents may be publicly disclosed in enforcement proceedings. We also accept that the proposed rule also provides that the Board may publish Form QC information in summaries, compilations, or other general reports, provided that the firm or firms to which particular Form QC information relates is not identified.

Effective date (Question 93)

The PCAOB is considering an effective date of 15 December of the year after approval by the SEC with all the provisions of QC 1000 taking effect on the same day. The PCAOB argues that the proposed evaluation a date of 30 November builds in an almost one-year delay between the effective date and the first evaluation date and that this is coupled with the assumption that almost all firms will also be required to comply with broadly similar QC requirements under IAASB or AICPA standards.

Subject to our comments on the proposed evaluation deadline of 30 November above in which we suggest the PCAOB allow flexibility as to the date of firms' annual evaluations of their system of QC, we agree that the proposed effective date should be reasonable in practical terms. In this context, we also refer to our suggestion that the PCAOB develop a clear and concise depiction of differences between QC 1000 and ISQM 1 to support PCAOB-registered firms required compliance with both standards.

Communication to the PCAOB

Proposed Rule 2203A: "If a registered public accounting firm is required to perform an evaluation of its QC system under paragraph .77 of QC 1000, A Firm's System of Quality Control, the firm must file with the Board a report on such evaluation on Form QC, by following the instructions to that form. …"

The Release explains that the PCAOB believes that annual reporting to the Board would provide the PCAOB with important information about firm QC systems to inform the PCAOB's inspections process, including focusing its inspection resources on those firms and engagements with the greatest risk.

Additionally, the PCAOB believes that a formal reporting process may result in enhanced accountability of firm leadership for QC and an additional incentive for prompt remediation of identified QC deficiencies.

ISQM 1. A115 acknowledges: In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally.

> *Examples of when the firm may be precluded from communicating information externally*
>
> - Privacy or secrecy law or regulation prohibits disclosure of certain information.
> - Law, regulation or relevant ethical requirements include provisions addressing the duty of confidentiality.

We are unclear as to whether the required reporting on Form QC would lead to a follow-on request from the PCAOB to furnish more detailed information as to specific findings. To the extent this were the case, we note that confidentiality legislation may be an issue for firms, when information pertaining to clients' or individuals' personal information is concerned.

We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

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