INSTITUT DER WIRTSCHAFTSPRÜFER

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

submitted via email to comments@pcaobus.org

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

Telefonzentrale:
+49 (0) 211 / 45 61 - 0

Fax Geschäftsleitung:
+49 (0) 211 / 4 54 10 97

Internet:
www.idw.de

E-Mail:
info@idw.de

Bankverbindung:
Deutsche Bank AG Düsseldorf
IBAN: DE53 3007 0010 0748 0213 00
BIC: DEUTDEDDXXX
USt-ID Nummer: DE119353203

Re.: PCAOB Rulemaking Docket Matter No. 046
Concept Release "Potential Approach to Revisions to PCAOB Quality Control Standards"

Dear Madam, dear Sir,

We would like to thank you for the opportunity to provide the PCAOB with our comments on the Rulemaking Docket Matter No. 046, Concept Release "Potential Approach to Revisions to PCAOB Quality Control Standards", hereinafter referred to as "the Concept Release".

In this letter, we provide some general comments on the Concept Release. We have chosen to respond to selected questions in the appendix to this letter.

Significant Acknowledgements of Recent Progress

The IDW welcomes the PCAOB's acknowledgement that some firms have significantly improved their focus on audit quality and have made notable advances in internal control, quality management and audit firm governance. We are equally pleased to note the PCAOB's observations from its oversight activities that have shown that improvements in quality control can enhance audit quality.

We are especially pleased to note the PCAOB's acknowledgement that since many firms are subject to quality control requirements of other standard setters such as the IAASB and AICPA it would not be practicable to require firms to comply with fundamentally different QC standards. We welcome the PCAOB's

Geschäftsführender Vorstand:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

sensitivity to the issue of unnecessary differences of QC standards as a key practical aspect, which we have consistently raised with the PCAOB in our previous comment letters.

Cost Implications

In terms of cost implications, we note the likely state of transition from quality control approach to quality management approach for firms in Germany in our response to q.5, which have already resulted in substantial expense for the firms.

In this context, whilst legally required specifics may be unavoidable, we fully support the Board's acknowledgement that requirements going beyond those of the international standards should be kept to a minimum.

Scalability

The IDW continues to believe that PCAOB standards should be scalable, especially given their impact on firms of all sizes, including those that even though they may not be required to register with the PCOAB, are impacted.

We agree that in taking appropriate account of both the firm's size and complexity as well as risks to quality, the proposals discussed in the Concept Release should allow scalability. Flexibility fosters firms' thinking about quality, whereas excessive prescriptiveness focuses effort on adherence, encouraging a box-ticking mentality.

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,

Melanie Sack Executive Director	Gillian Waldbauer Head of International Affairs

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Appendix

Responses to Selected Questions

Q1. Should PCAOB QC standards be revised to address developments in audit practices and provide more definitive direction regarding firm QC systems? Are there other reasons for changes to the QC standards that we should take into account?

The IDW supports the modernization of the now old PCAOB quality control standards, and in particular the adoption of the risk-based approach tailored to individual firms' circumstances and client portfolios.

We also support the PCAOB's stated intention to take note of good practices that have emerged in the intervening years and to draw on information on emerging risks and problems observed through its oversight activities.

Q2. Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard? Are there alternative approaches we should consider?

In its comment letters to the PCAOB, the IDW has consistently supported alignment of the PCAOB's standards with international standards, pointing out the benefits in terms of firms' adherence success rates and thus improved focus on achieving quality from which dealing with the detail of differences in requirements might detract.

Subject to the satisfactory finalization of the IAASB's project on quality management, the IDW fully supports the PCAOB's proposal for using the IAASB's new quality management standards together with a revised ISA 220 as a basis for aligning to PCAOB's quality control standards.

Q3. Are the reasons provided for differences between ISQM 1 and a future PCAOB QC standard appropriate? Are there other potential reasons for differences that we should consider?

We support the PCAOB exploring the possibility of building on the requirements of ISQM 1 by adding or amending specific requirements.

In this context, we appreciate that changes will be needed to align with U.S. federal securities law, Securities and Exchange Commission (SEC) rules and other PCAOB standards and rules. Whilst it also makes sense to address specific emerging risks and problems particular to the audit of U.S. issuers observed through the PCAOB's oversight activities, we are at a loss to understand what these might be. Therefore, we presume that this exercise would primarily involve changes aimed at fostering appropriate application where a clear need for clarification becomes apparent as opposed to the creation of additional requirements. The strength of a quality management approach lies in the firm giving serious thought to quality in determining the risks that it needs to address in its individual circumstances.

However as far as further differences are concerned, retaining requirements from current PCAOB standards should not necessarily be a given; instead we suggest a case by case consideration would be appropriate

Q4. Are there other developments affecting audit practices we should consider addressing in a future PCAOB QC standard?

We are not aware of any further developments that warrant consideration.

Q5. To the extent that audit firms are already updating or making enhancements to their QC systems to align with international developments, can you characterize the nature and extent of those changes and related efforts? What benefits do you anticipate from updates to QC systems?

Many of the larger German firms are already in the process of adapting their quality management to align with the expected IAASB quality management standards, and so further adaptions necessitated by the PCAOB would result in further costs. Medium-sized firms may not have started such an adaption process as yet, given the fact that the final IAASB standards are unavailable. However, recent changes to the relevant German standard (*IDW QS 1 "Anforderungen an die Qualitätssicherung in der Wirtschaftsprüferpraxis" [Requirements for Quality Assurance applicable to German Auditing Practices]*) governing quality control mean that German firms will generally have moved toward a quality management approach. The process of adaptation is both time and resource intensive.

Q7. Would the approach to quality control standards described in this concept release be preferable to the current PCAOB quality control standards?

Yes. The relevant German standard (IDW QS 1) follows a quality management approach, having moved form a quality control approach. In our view a proactive approach is superior to a reactive approach.

Q8. Would the objective of a quality management system provided in Proposed ISQM 1 be an appropriate objective for a QC system under PCAOB standards? Are there additional objectives that a quality control system should achieve?

We refer to our comment letter submitted to the IAASB is respect of ED ISQM 1 in which we expressly commented on this aspect of the exposure draft.

Q9. Would the potential revisions to PCAOB QC standards described in this concept release improve QC systems and audit quality?

We refer to our response to q7.

Q 16. Allocation of financial resources is one aspect of firm governance and leadership under Proposed ISQM 1. Should this be given greater emphasis in a future PCAOB QC standard than it is given in Proposed ISQM 1? For example, should a future PCAOB QC standard emphasize the importance of counterbalancing commercial interests that may lead to underinvestment in the audit and assurance practice, particularly in firms that also provide non-audit services?

In general, German auditing firms have recently invested heavily in their audit and assurance practices. An allocation of the level of investment between different areas of practice may not always be possible, since for example investments in certain areas such as technology may benefit e.g., consulting services as well as audit and assurance services. It is not feasible for a standard setter such as the PCAOB to set parameters for what should constitute an appropriate level of investment, not least because the circumstances and service lines will vary between firms. In addition to the impact of oversight authorities' inspection regimes, reputational considerations and market forces provide incentives to individual firms to ensure their respective levels of investment are appropriate.

Consequently, we believe that individual firms are best placed to determine their investment needs.

Commercial interests are likely to be less of an issue in Germany than in some other jurisdictions because of the legal requirements relating to the profession's ownership within firms. Therefore, from our perspective it would be inappropriate for the PCAOB to develop specific requirements to "force" investment in audit and assurance.

In our view the PCAOB might consider raising awareness of the potential impact on quality of underinvestment instead. More importantly, the PCAOB could advocate the importance of high-quality auditor services in its communication with investors, as they ultimately drive demand since it is also in their interests for audits of SEC issuers to be of high quality.

Q17. Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms' QC systems (e.g., boards with independent directors or equivalent)? If so, what criteria should be used to determine whether and which firms should have such independent oversight (e.g., firm size or structure)? What requirements should we consider regarding the qualifications and duties of those providing independent oversight?

We do not believe that a further mechanism along the lines discussed in the Concept Release is sensible, not least as such bodies are unlikely to possess sufficient competence in respect of such systems.

The information in respect of their quality management systems that German firms already provide by means of a publicly available "Transparency Report" together with the audit documentation available for inspection by the German auditor oversight authority (in conjunction with the PCAOB) works sufficiently well to alert a firm to potential deficiencies.

Q19. Are principles-based requirements sufficient to prompt firms to appropriately identify, assess, and respond to risks, or is supplemental direction needed? If supplemental direction is needed, what requirements would assist firms in identifying, assessing, and responding to risks?

We agree that principles-based requirements should be sufficient. However, as we have previously commented in the past, inclusion of appropriate guidance is generally helpful.

Q 20. Should a future PCAOB QC standard specify certain quality risks that must be assessed and responded to by all firms? If so, what should those risks be?

In this context, we support close alignment to ISQM 1. Whilst certain risks will be common to all firms, individual firms' circumstances dictate the level of risk and risk assessment serves to focus the firm on addressing the quality aspects as needed for that firm.

A rebuttable presumption approach to the most common risks might be an appropriate approach to consider, but we would caution against measures that detract firms' attention from a proper evaluation of their own quality risks.

Q 21. Should firms be required to establish quantifiable performance measures for the achievement of quality objectives? If so, how should such measures be determined and quantified (see also Question 46)?

Currently various firms report a number of different KPIs, some of which may be helpful, others less so. Some KPIs are open to various interpretations e.g., just counting hours charged etc. Others do not allow users to draw proper conclusions.

On balance, we are not convinced that establishing KPIs would necessarily be truly helpful.

Q 22. Is the approach to relevant ethical requirements appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As one such example, we believe that the proposal (ref. page 21) to revise a requirement (assigned responsibility for independence) currently applicable to a senior-level partner to accommodate a qualified individual with appropriate knowledge is a meaningful development that is capable of being equally effective in practice, when applied appropriately.

Q23. Should a future PCAOB QC standard extend detailed requirements for independence quality controls (formerly SECPS member requirements) to all firms? How would this affect the costs and benefits of a QC system?

In our opinion, the PCAOB should not extend these requirements to all firms. Whilst the list of requirements on page 20 partially reflects current practice for many German firms, not all have e.g., established automated systems, which, were this required for all firms, would result in considerable costs.

Q32. Should a future PCAOB QC standard continue to expressly address technical training on professional standards and SEC requirements? Are there other subjects for which training should be expressly required? Which firm personnel should be covered by the training requirements? Should the standards set minimum requirements for the extent of training? If so, what should those requirements be based on?

We do not see the need for additional precision within (new) requirements, as these could not generally be expected to enhance audit quality. An individual's unique training needs need to be determined for that individual, not prescribed by requirements.

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

In our view this is a matter of independence and so should not be addressed in a future quality control standard.

Q 39. Should a future PCAOB QC standard require public disclosure by firms about their QC systems? If so, what should be the nature and timing of such disclosures (e.g., information about the firm's governance structure)? (see also Question 46)

Q 46. Should firms be required to report to the Board on their annual evaluations of QC system effectiveness? If so, what should be included in the report? Should firms be required to disclose any performance measures that were important to their conclusion about their QC system's effectiveness? Should firm reports be publicly available (see also Question 39)?

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German firms already publish information about their quality control/ management systems within Transparency Reports as required in accordance with European legislation.