PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Staff Guidance – Insights for Firms

QC 1000: A Firm's System of Quality Control

Updated as of September 15, 2025

This guidance was prepared by PCAOB staff to help firms when implementing QC 1000 requirements. This staff guidance document sets forth the staff's views on issues related to the implementation of the rules and standards of the PCAOB. It does not constitute rules of the Board, nor has it been approved by the Board. It relates to PCAOB Release No. 2024-005, *A Firm's System of Quality Control and Other Amendments to PCAOB Standards, Rules, and Forms* (May 13, 2024) and *Form 19b-4*, PCAOB File No. 2025-01 (Aug. 28, 2025).

SUMMARY OF SEPTEMBER 15, 2025 UPDATES

Below is a summary of the updates made to this guidance from the previous version issued in November 2024. Clicking a linked update description will direct you to the updated material.

Section	Update
XII.C.2 Timing of the firm's report and the reporting period covered	Revised the first reporting period due to the delayed effective date.
XII.C.3 How and where to file Form QC	Revised when instructions on how to file Form QC will be available due to the delayed effective date.

This update also includes technical corrections at pages 25, 60, and 82.

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I. INTRODUCTION

This publication provides an overview of the requirements of QC 1000, A Firm's System of Quality Control ("QC 1000" or "the standard"), and guidance for firms about how to comply with the standard. For other guidance and resources on QC 1000 and related amendments made to other PCAOB standards, visit the Quality Control implementation page on the PCAOB website.

Who is affected?

All firms registered with the PCAOB, including those that do not audit issuers or SEC-registered brokers and dealers, are affected by QC 1000, but not all requirements of QC 1000 apply to every firm. We encourage all firms that are registered with the PCAOB to read this publication to understand the requirements that apply to them. Firms should also familiarize themselves with QC 1000 itself. Reading this guidance is not a substitute for reading the requirements of QC 1000.

How does QC 1000 differ from the Board's previous QC standards?

QC 1000 is an integrated standard that:

- Emphasizes accountability, firm culture and the "tone at the top," and firm governance through requirements for specified roles within and responsibilities for the QC system, including at the highest levels of the firm; quality objectives that link compensation to quality; and, for the largest firms, the requirement of an independent perspective on firm governance;
- Strikes the right balance between a risk-based approach to QC—which should drive firms to proactively identify and manage the specific risks associated with their practice—and a set of mandates, including mandatory quality objectives; mandatory processes for risk assessment, monitoring and remediation, and QC system evaluation; and specific requirements in key areas—which should assure that the QC system is designed, implemented and operated with an appropriate level of rigor;
- Addresses changes in the audit practice environment, including the increasing participation of other firms and other outside resources, the role of firm networks, the evolving use of technology and other resources, and the increasing importance of internal and external firm communications;
- Broadens responsibilities for monitoring and remediation of deficiencies to encourage an ongoing feedback loop that drives continuous improvement; and
- Requires a rigorous annual evaluation of the firm's QC system and related reporting to the PCAOB, certified by key personnel, to underscore the importance of the annual evaluation of the QC system, reinforce individual accountability, and support PCAOB oversight.

What is included in this publication?

In addition to providing guidance on specific requirements of QC 1000, this publication highlights other important implementation matters related to the basic structure of the firm's QC system, certain terminology used in QC 1000, and specific considerations related to scalability of the requirements.

How to read this publication?

To facilitate firms' QC 1000 implementation efforts, this publication is structured to be generally consistent with the structure of QC 1000. It provides guidance related to two process components, six components of a firm's QC system that address aspects of the firm's organization and operations, requirements related to evaluation and reporting, and other requirements of QC 1000 (e.g., requirements related to individual roles and responsibilities in the QC system and documentation requirements).

Light blue text in call-out boxes include key information to remember.

Guidance on the six components that address the firm's organization and operations describes the quality objectives that QC 1000 requires for each component and, if applicable, the specified quality responses, and includes a "Highlighted Topics" section that provides more guidance on one or more aspects of the component.

The examples included throughout the publication are meant to be illustrative and will not be applicable to every firm. Firms are required to consider their own circumstances when designing and, if applicable, implementing and operating a QC system under QC 1000.

SCALABILITY CONSIDERATIONS

QC 1000 contains provisions that enable tailoring based on the size and complexity of a firm's PCAOB audit practice as well as provisions that only pertain to firms with larger PCAOB audit practices. These provisions focus on risks related to the practices of such firms. Some sections of this guidance include specific considerations related to these provisions and provide examples. These considerations and related examples are provided in text boxes labeled as scalability considerations.

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A. Defined Terms

QC 1000 – Appendix A

QC 1000 contains a number of defined terms and understanding of these terms is critical to understanding the requirements of the standard. These terms are listed below and defined as follows:

1. Applicable professional and legal requirements (or "APLR")

   (1) Professional standards, as defined in PCAOB Rule 1001(p)(vi);

   (2) Rules of the PCAOB that are not professional standards; and

   (3) To the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the QC system, rules of the SEC, other provisions of U.S. federal securities law, ethics laws and regulations, and other applicable statutory, regulatory, and other legal requirements.

2. Engagement – Any audit, attestation, review, or other engagement performed under PCAOB standards:

   (1) Led by a firm; or

   (2) In which a firm "play[s] a substantial role in the preparation or furnishing of an audit report" as defined in PCAOB Rule 1001(p)(ii).

3. Engagement deficiency – An instance of noncompliance with applicable professional and legal requirements by the firm, firm personnel, or other participants with respect to an engagement of the firm, or by the firm or firm personnel with respect to an engagement of another firm.

4. Firm personnel – Individual proprietors, partners, shareholders, members or other principals, accountants, and professional staff of a registered public accounting firm whose responsibilities include assisting with:

   (1) The performance of the firm's engagements; or

   (2) The design, implementation, or operation of the firm's QC system, including engagement quality reviews.

   Professional staff includes employees as well as individuals, such as non-employee contractors and consultants, who work under the firm's supervision or direction and control and function as the firm's employees. These individuals include, for example, secondees and leased staff who work under the supervision or direction and control of the firm. Professional staff does not include persons engaged only in clerical or ministerial tasks.

5. Major QC deficiency – An unremediated QC deficiency or combination of unremediated QC deficiencies, based on the evaluation under QC 1000.78, that severely reduces the likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives.

6. Other participants – With respect to work performed in connection with the firm's QC system or the performance of its engagements, other participants are accounting firms (foreign or domestic, registered or unregistered), accountants, and other professionals or organizations, other than firm personnel, whose responsibilities include assisting with:

   (1) The performance of the firm's engagements; or

   (2) The design, implementation, or operation of the firm's QC system, including engagement quality reviews.

7. QC deficiency – A QC observation that, based on the evaluation under QC 1000.72, individually, or in combination with one or more other QC observations, evidences:

   (1) That the likelihood of the firm not achieving the reasonable assurance objective or one or more quality objectives has not been reduced to an acceptably low level;

   Note: The likelihood of not achieving the reasonable assurance objective or one or more quality objectives would be above an acceptably low level if, for example, a quality objective is not established, a quality risk is not properly identified or assessed, or a quality response is not properly designed or implemented or is not operating effectively.

   (2) Noncompliance with requirements of this standard, other than those under "Documentation"; or

   (3) Noncompliance with requirements of this standard under "Documentation" that adversely affects the firm's ability to comply with any of the other requirements of this standard.

8. QC observation –

   (1) An engagement deficiency; or

   (2) Any other observation about the design, implementation, or operation of the firm's QC system that may indicate one or more QC deficiencies exist.

9. Quality objectives – The desired outcomes in relation to the components of the QC system to be achieved by the firm.

10. Quality responses – Policies and procedures designed and implemented by the firm to address quality risks:

    (1) Policies are statements of what should, or should not, be done to address an assessed quality risk.

    (2) Procedures are actions to implement and comply with policies.

11. Quality risks – Risks (whether or not related to intentional acts by firm personnel or other participants to deceive or to violate applicable professional and legal requirements) that, individually or in combination with other risks, have a reasonable possibility of occurring and, if they were to occur, a reasonable possibility of adversely affecting the firm's achievement of one or more quality objectives.

12. Third-party providers – Individuals or organizations, other than other participants, that provide resources or services to the firm that are designed specifically for use in the performance of engagements (e.g., purchased methodologies, related templates, and IT applications) or to assist with the operation of its QC system (e.g., broker and dealer monitoring systems to track personal financial interests of firm personnel).

B. The Firm's QC System - Overview **QC 1000.01-.04**

The standard provides a framework for the QC system that is grounded in an ongoing process of proactively identifying and managing risks to the quality of engagements the firm performs in accordance with applicable legal and regulatory requirements, with a feedback loop from ongoing monitoring and remediation that will drive continuous improvement; an explicit focus on firm governance and leadership, firms culture, and individual accountability; and specific direction in a number of areas.

QC 1000 consists of the following areas:

Two process components

- The firm's risk assessment process
- The monitoring and remediation process

Six components that address aspects of the firm's organization and operations

- Governance and leadership
- Ethics and independence
- Acceptance and continuance of engagements
- Engagement performance

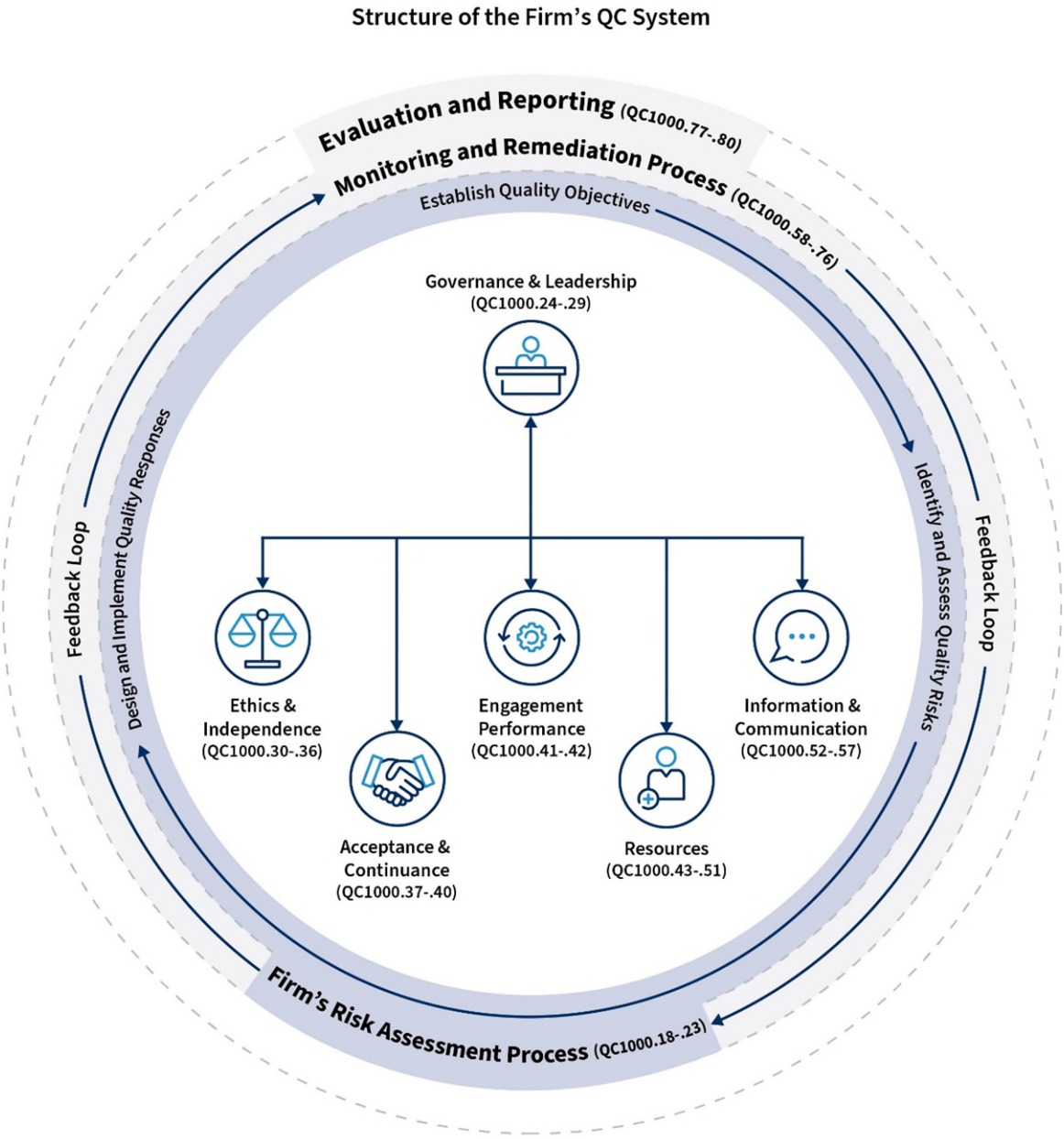
- Resources
- Information and communication

Requirements for evaluation of and reporting on the QC system

- Annual evaluation of the effectiveness of the QC system
- Reporting to the PCAOB on the QC system evaluation

The standard also includes requirements regarding individual roles and responsibilities in the QC system and documentation requirements.

The following diagram illustrates the structure of the firm's QC system under QC 1000:



Quality objectives, quality risks, and quality responses, including specified quality responses. The firm's risk assessment process applies to the six components of the QC system, requiring firms to:

- Establish outcome-based "quality objectives," including those specified throughout the standard (i.e., the desired outcomes to be achieved by the firm with respect to that component). QC 1000 specifies required quality objectives for each of the six components to which the risk assessment process applies.

- Annually identify and assess "quality risks" to the achievement of the established quality objectives. QC 1000 does not specify quality risks that must be assessed and responded to by all firms; rather it includes factors for the firm to consider in its risk assessment process.

- Design and implement "quality responses" (i.e., policies and procedures to address quality risks). Quality responses would typically be specific to the firm, to respond to its particular assessed quality risks; and

A firm is not required to implement and operate quality responses if it is not required to implement and operate its QC system (see section II.A for scaled applicability vs. full applicability discussion).

- Establish policies and procedures to monitor internal and external changes that may require modifications to the quality objectives, quality risks, or quality responses.

See section IV for guidance on the requirements of the firm's risk assessment process.

In addition to the quality responses that firms design on their own through the risk assessment process, QC 1000 also includes specified quality responses. Specified quality responses are mandated policies and procedures that apply in some cases to all firms, and in other cases only to firms with a larger PCAOB audit practice. QC 1000 includes specified quality responses for each component except for engagement performance and the process components (i.e., firm's risk assessment process and monitoring and remediation process).

The Relationship Between Quality Responses and Specified Quality Responses

The specified quality responses are not intended to be comprehensive. As a result, the specified quality responses alone are not sufficient to enable the firm to achieve all established quality objectives; firms are required to include their own quality responses as well. Both the specified quality responses and the quality responses the firm designs and implements on its own are critical in addressing the firm's quality risks.

Firms are required to design and implement their own quality responses in addition to the specified quality responses.

C. Objective of QC System

QC 1000.05

QC 1000 specifies that an effective QC system is designed, and, if applicable, implemented and operated in such a way that the firm has reasonable assurance that each

individual who performs work on behalf of the firm and each engagement the firm undertakes will comply with applicable professional and legal requirements, or APLR. This is referred to as the reasonable assurance objective.

To satisfy the reasonable assurance objective, an effective QC system has to consistently provide a firm with reasonable assurance that:

- The firm, each member of firm personnel, and each other participant conduct each engagement and fulfill their other responsibilities that are part of or subject to the firm's QC system in accordance with APLR, and

- Each engagement report issued by the firm is in accordance with APLR.

Under QC 1000, an engagement includes issuer and broker-dealer audit engagements as well as all other audit engagements performed under PCAOB standards. The definition also covers not only circumstances in which the firm serves as the lead auditor or the "practitioner" for an attestation engagement, which is what is customarily meant by the term engagement, but also any substantial role work the firm undertakes. Broadly speaking, and as defined in Rule 1001(p)(ii), a firm plays a substantial role in an engagement if it either (1) provides services for which the engagement hours or fees constitute 20% or more of total engagement hours or fees; or (2) performs the majority of the audit procedures with respect to a subsidiary or component of any issuer, broker, or dealer, the assets or revenues of which constitute 20% or more of consolidated assets or revenues.[1]

The definition of an engagement covers not only circumstances in which the firm serves as the lead auditor or the "practitioner" for an attestation engagement, but also any substantial role work the firm undertakes.

APLR captures all professional and legal requirements specifically related to engagements of issuers and SEC-registered broker-dealers, including relevant accounting, auditing, and attestation standards and PCAOB rules, as well as SEC rules, other provisions of federal securities law, other relevant laws and regulations (e.g., state law and rules governing accountants), applicable ethics law and rules, and other legal requirements related to the obligations and responsibilities of accountants or auditors in the conduct of the firm's engagements or in relation to the QC system. For example, APLR would include legal obligations related to professional licensing imposed by a state or national licensing authority to the extent such obligations pertain to engagements of issuers and SEC-registered broker-dealers. It is important to note that, beyond PCAOB requirements, APLR only includes requirements "to the extent related to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the QC system." Therefore, APLR does not encompass

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1 *See* PCAOB Rule 1001(p)(ii).

requirements that apply to businesses generally, such as tax laws, safety regulations, and employment law, but only those that relate to the obligations and responsibilities of accountants or auditors in the conduct of engagements or in relation to the QC system.

References to "each member of" firm personnel, "each" other participant, "each" engagement, and "each" engagement report clarify that the QC system provides reasonable assurance, not just over the pool of firm personnel, the pool of other participants, and the portfolio of engagements, but over each individual and each engagement.

Under QC 1000, firms determine whether the QC system meets the reasonable assurance objective by determining whether any "major QC deficiencies" exist (see section XII.B for guidance on major QC deficiencies). The existence of major QC deficiencies indicates that the QC system does not provide reasonable assurance, whereas the existence of QC deficiencies that do not meet the definition of a major QC deficiency does not.

D. Risk-Based Approach **QC 1000.08-.09**

Firms are required to employ a risk-based approach to quality control, such that the firm proactively manages its QC system and the quality of the work it performs on engagements.

QC 1000 requires firms to design, implement, and operate a QC system that reflects and responds to the firm's particular risks through two process components.

- The firm's risk assessment process—establishing quality objectives necessary to achieve the reasonable assurance objective, identifying and assessing quality risks to the achievement of those objectives, and designing and implementing quality responses to address the identified quality risks—is applied to all of the aspects of the firm's organization and operations that are covered by the QC system and thus is tailored to each firm's specific facts and circumstances.

- The monitoring and remediation process is carried out in a way that is informed by and responsive to risks—for example, quality risks influence both the selection of engagements to monitor and the design and extent of monitoring activities.

The requirement to evaluate the effectiveness of the QC system supports continued improvement in these risk assessment and monitoring and remediation processes by requiring the firm to evaluate and report on whether the quality objectives and the reasonable assurance objective have been achieved.

SCALABILITY CONSIDERATIONS

The aspects of QC 1000 that are risk-based are inherently scalable. In applying a risk-based approach, the firm is required to tailor its QC system to the firm's specific facts and circumstances, including the size and complexity of the firm, the types and variety of engagements it performs, the types of companies for which it performs engagements, and whether it is a member of a network (and if so, the nature and extent of the relationship

between the firm and the network). Accordingly, a large, complex firm that performs a wide variety of engagements will have a more complex QC system than a small firm that performs a small number of less complex engagements.

II. GENERAL IMPLEMENTATION MATTERS

A. Design, Implement, and Operate QC System

All firms are required to design a QC system that complies with QC 1000. QC 1000.06 sets out the requirements for designing a QC system in more detail. The table that follows summarizes these requirements, includes references to relevant QC 1000 provisions, and references sections of this document where additional guidance can be found.

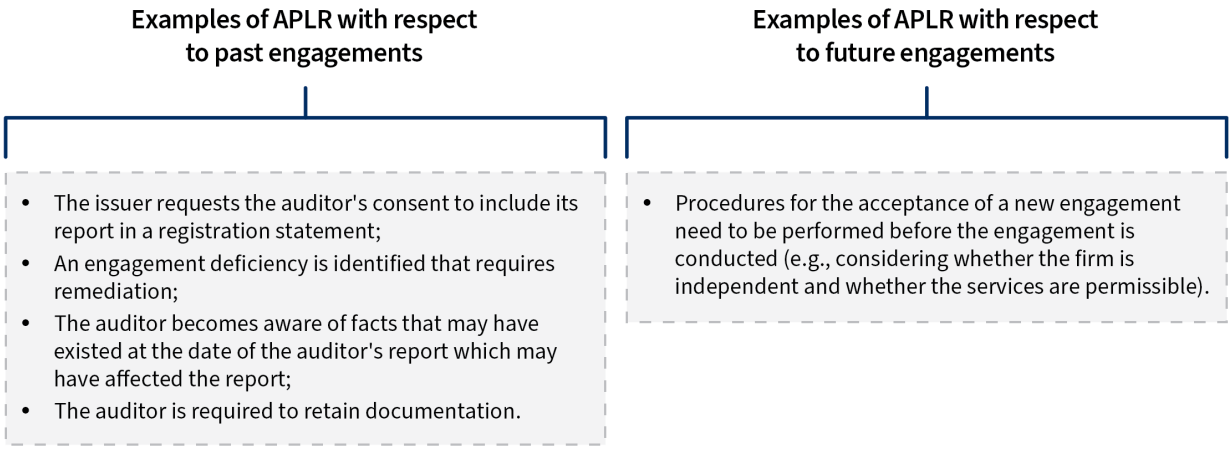
Requirement	Relevant paragraphs of QC 1000	Relevant sections of this guidance
Assign QC-related roles and responsibilities	**QC 1000.10-.17**	Section III, *Roles and Responsibilities*
Establish quality objectives, annually identify and assess quality risks to the achievement of those objectives, and design quality responses to address those risks	**QC 1000.18-.57**	Section II.A.1, *Scaled applicability* Section IV, *The Firm's Risk Assessment Process*
Design a monitoring and remediation process that, upon implementation, would comply with QC 1000	**QC 1000.58-.76**	Section XI, *The Monitoring and Remediation Process*
Document the design of the QC system	**QC 1000.81-.86**	Section XIII, *Documentation*

While all firms are required to design a QC system that meets the requirements of QC 1000, only firms that are required to comply with APLR with respect to any of the firm's engagements are required to also implement and operate an effective QC system in accordance with QC 1000. This is referred to as full applicability. Scaled applicability refers to firms that do not have responsibilities under APLR with respect to engagements and are only required to design a QC system.

When determining whether a firm is subject to scaled or full applicability of QC 1000 requirements, it will need to determine if it has any obligations under APLR with respect to any of its engagements.

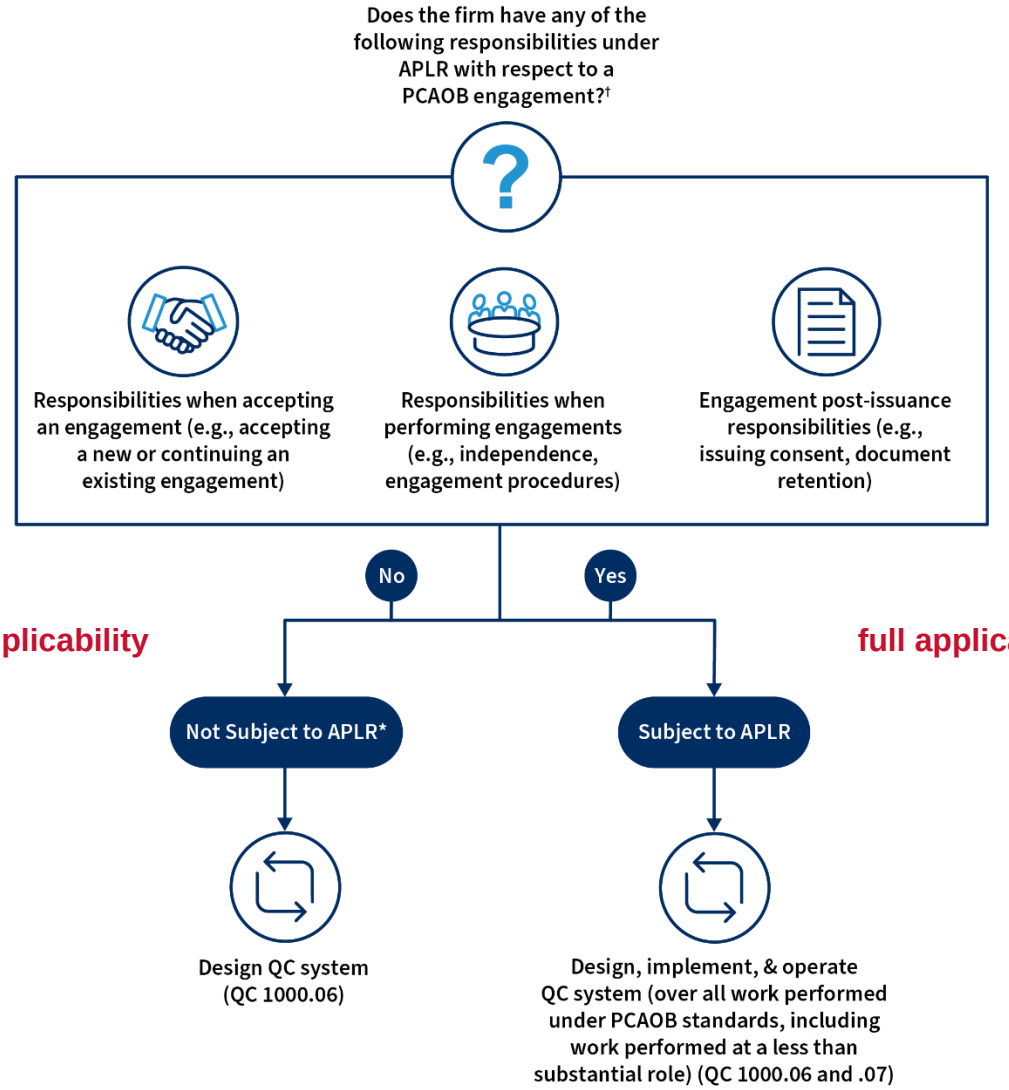
APLR with respect to any engagements

A firm that is not currently performing any engagements may nevertheless have to comply with APLR with respect to a previous or future firm engagement. The following graphic illustrates examples of such scenarios:



If a firm does not have any responsibilities under APLR with respect to any firm engagements, including any responsibilities relating to the retention of engagement-related documentation, the firm is required only to design its QC system. The chart that follows illustrates the decision tree for the requirements of the QC system.

Decision Tree for Requirements of QC System



†An engagement under PCAOB standards performed by the firm or in which the firm plays a substantial role.
*APLR — Applicable professional and legal requirements.

The sections that follow provide additional guidance for scaled applicability and full applicability.

1. Scaled applicability QC 1000.06

The design of the firm's QC system under scaled applicability is based on the quality risks the firm likely would face if it performed engagements, taking into account the size and complexity of the firm. For example, if a firm is contemplating performing an engagement in a specific industry, a quality risk could be not having enough competent resources to perform an engagement in that specific industry in accordance with APLR and the firm's policies and procedures. Another quality risk a firm could identify is not having sufficient and appropriate knowledge about the PCAOB rules and standards and the SEC's independence requirements that a firm would be subject to once it starts performing PCAOB engagements. If a firm that is concentrated in one geographical location contemplates taking on engagements in another location, quality risks could relate to the firm's potential inability to obtain people resources or to properly supervise them. There may be other quality risks depending on the number and kind of engagements the firm plans to pursue in the future and the nature and circumstances of the firm.

A firm is required to design quality responses that address quality risks but is not required to implement and operate them under scaled applicability.

The firm is required to design quality responses that address its quality risks and review its initial quality risks at least annually as part of the firm's risk assessment process. For example, a firm that had never performed a PCAOB engagement would likely lack knowledge of the requirements that apply to PCAOB engagements. The firm would have to establish policies and procedures to address that risk, such as requiring the firm to develop or purchase methodology and practice aids and to deliver training for its personnel on PCAOB rules and standards and SEC independence rules.

The documentation would reflect the design of the firm's risk assessment process, including documentation of quality objectives, quality risks related to the quality objectives, and the basis for the assessment of quality risks and quality responses and how the quality responses are designed to address the quality risks.

2. Full applicability (design, implement, and operate) QC 1000.06-.07

While all firms are required to design a QC system that complies with QC 1000, a firm is required to implement and operate an effective QC system (i.e., comply with all provisions of the standard) at all times when the firm is required to comply with APLR with respect to any of the firm's engagements, and thereafter through the following September 30.

Implementing and operating a QC system means that (1) assigned personnel are fulfilling their QC-related roles and responsibilities under QC 1000, (2) the relevant quality responses (i.e., policies and procedures) and monitoring and remediation process that the firm has designed are operational, (3) the firm is annually evaluating its QC system as of September

30 and reporting on that evaluation on Form QC, and (4) the firm is documenting the implementation and operation of its QC system.

Scope of APLR. An effective QC system provides reasonable assurance that the firm is complying with "applicable" professional and legal requirements. The extent of "applicable" requirements could change depending on the firm's circumstances, and the QC system policies and procedures that the firm would have to implement and operate could change in response. As a result, if a firm is required to implement and operate an effective QC system, it is not necessarily required to implement and operate every QC policy or procedure that it has designed—only the policies and procedures that are relevant to the requirements that apply to the firm and its activities.

Example
If a firm serves as lead auditor or plays a substantial role in PCAOB engagements, APLR will include all of the requirements applicable to such engagements. But if a firm last performed an engagement five or six years ago and no longer performs substantial role work on other firms' engagements, it might be subject only to requirements regarding the retention of certain engagement-related documentation. In such a circumstance, an effective QC system—i.e., a system that provides reasonable assurance that the firm is complying with APLR regarding such documentation—would only have to operate over engagement-related documentation retention, as well as ongoing evaluation, reporting, and documentation requirements. In this example although the operating requirements apply to this limited circumstance, the firm would need to continue to maintain the design of its QC system in accordance with QC 1000 and perform the annual risk assessment.

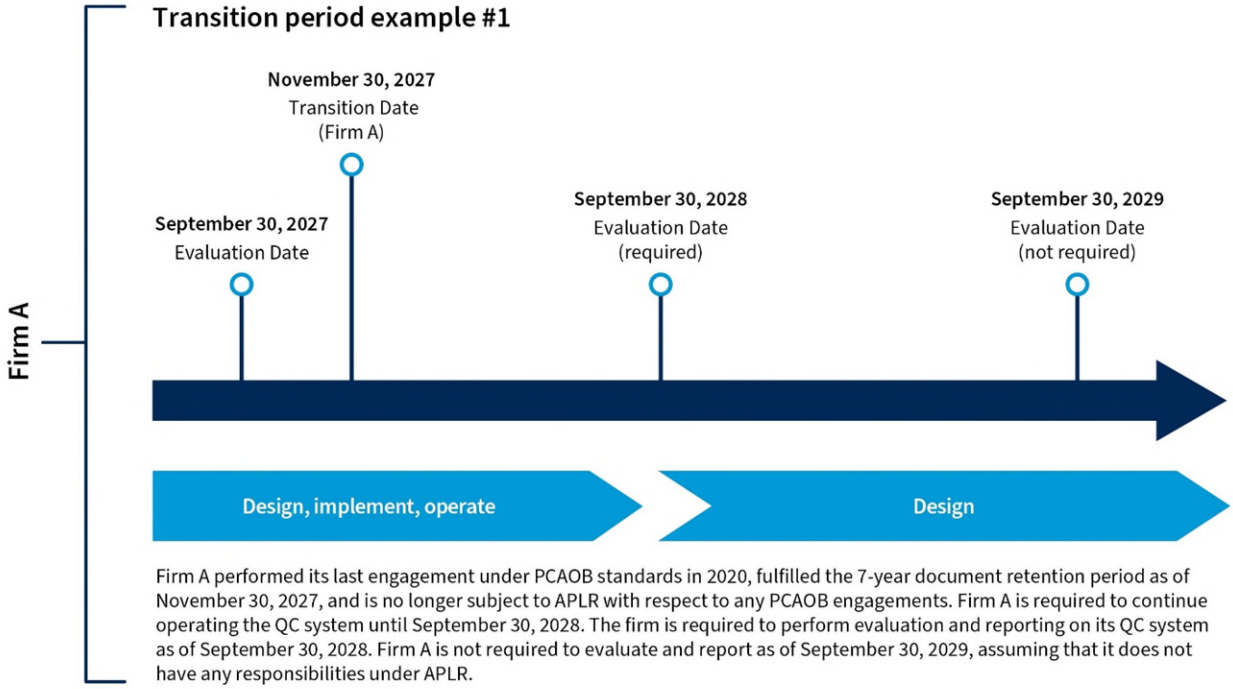
3. Transitioning between scaled and full applicability QC 1000.06-.07

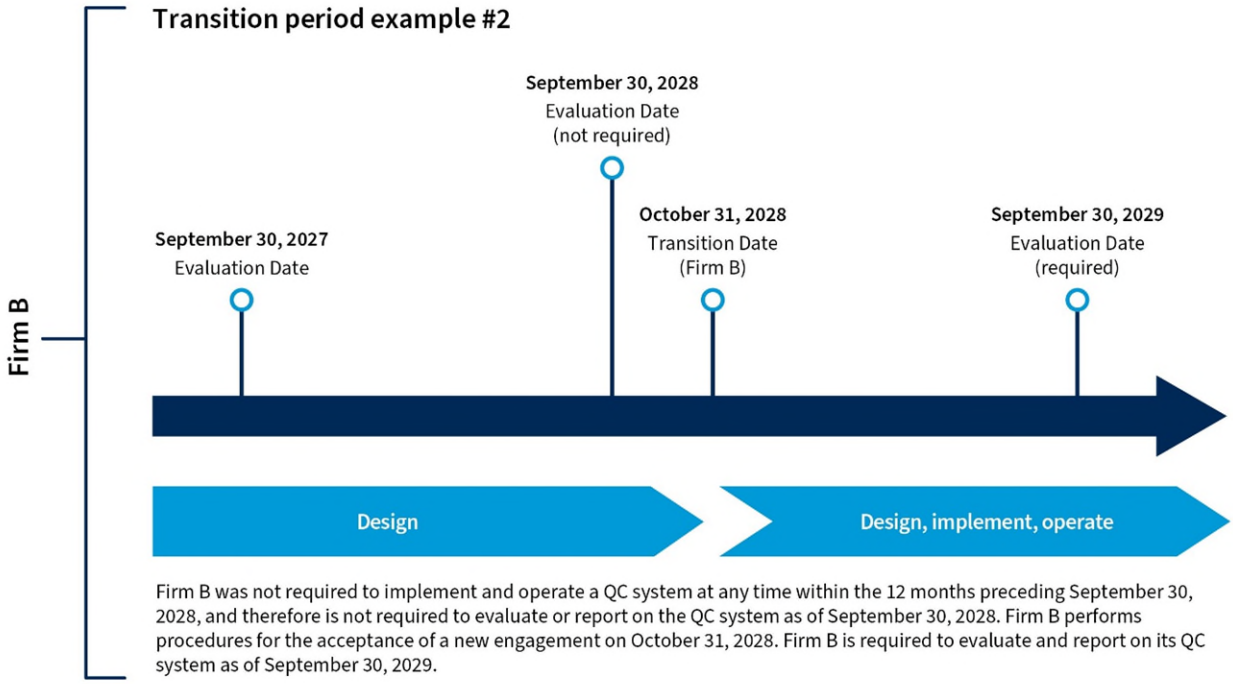
Scaled to full applicability. Firms may not have lengthy advance notice before responsibilities arise under APLR with respect to an engagement. For example, a firm may be contacted by an affiliated firm to play a substantial role in an engagement. Registered firms will have to stand ready to have their QC system implemented and operating over such responsibilities whenever they arise.

Full to scaled applicability. Once a firm no longer has any responsibilities under APLR with respect to any firm engagements, including any responsibilities relating to the retention of engagement-related documentation, the firm will be required to continue operating the QC system until the next September 30 (the next date as of which the firm is required to evaluate the QC system). This ensures that the firm will evaluate and report on the QC system for any year during which the QC system was required to operate. Firms that were not required to implement and operate a QC system at any time during the 12 months ended September 30 in any year would not be required to evaluate and report on their QC system for that year. See guidance on evaluation and reporting on the QC system in section XII. As part of their annual reporting on Form 2, firms would indicate on the form that they were not required to implement and operate the QC system.

If a firm transitions from full to scaled applicability, any existing obligations under QC 1000 would continue (for example, reporting obligations with respect to prior periods when the firm was required to implement and operate the QC system). Otherwise, it would be subject to the scaled-applicability requirements summarized above as long as it remains registered, unless the firm once again became subject to APLR with respect to a PCAOB engagement.

The following chart illustrates possible transition scenarios and the underlying requirements to evaluate and report on the firm's QC system.





4. Work performed at less than substantial role on other firms' PCAOB engagements

The definition of "engagement" under QC 1000 does not include work performed on other firms' PCAOB engagements where the extent of such work is at less than a substantial role. However, QC 1000 contains provisions specifically applicable to such work, which are

tailored to reflect the relevant responsibilities and risks. These provisions are summarized below with references to QC 1000 where the complete text of provisions can be found:

The firm's QC system	QC 1000.7b

- During the time the firm's QC system is required to be operating effectively, the firm's QC system must operate over any audit, attestation, review, or other work performed under PCAOB standards by the firm, regardless of the level of the firm's participation in such work (i.e., even if the firm plays less than a substantial role).

Firm's risk assessment process	QC 1000.20 and Appendix B

- Firms are required to consider the firm's work in other firms' engagements in their risk assessment process, focusing on the nature and extent of the firm's participation.
- Appendix B of QC 1000 provides an example relevant to a firm's participation in other firms' engagements when obtaining an understanding of the nature and circumstances of the firm and its engagement as part of identifying and assessing quality risks (see .B10).

Engagement performance	QC 1000.42

- The quality objectives established by the firm with respect to engagement performance address work performed on other firms' engagements.

Resources	QC 1000.44d

- Firm personnel who are assigned to participate in another firm's engagement have the competence, objectivity, and time to perform such activities in accordance with APLR and the firm's policies and procedures.

Information and communication	QC 1000.53h

- If the firm participates in another firm's engagement, information is communicated to and obtained from the other firm such that the firm's work on the engagement is performed in accordance with APLR.

Monitoring and remediation process	QC 1000.63c, .68d(3), .72b

- If the firm participates at a level below a substantial role in another firm's engagements, the firm should consider performing monitoring activities on such work.
- When an engagement deficiency exists, the firm should evaluate whether similar engagement deficiencies exist on work performed by the firm on other firms' engagements.
- When determining whether QC deficiencies exist, the firm's determination should be based on the likelihood that the matter(s) that gave rise to the *QC observation* could affect work performed on other firms' *engagements*, and the severity of such an effect if it were to occur.

Work performed on other firms' PCAOB engagements at less than a substantial role, by itself, does not trigger the requirement to implement and operate the QC system under QC 1000. However, once a firm is required to implement and operate the QC system, the system has to operate over all work performed by the firm under PCAOB standards, including work performed on other firms' PCAOB engagements at less than a substantial role. If a firm is required to implement and operate a QC system under QC 1000, the QC system should address every engagement under PCAOB standards in which the firm participates.

The chart that follows illustrates how the QC system has to address work performed on other firms' PCAOB engagements at less than a substantial role under different scenarios.

	Examples of scenarios	Design QC system only	Design, implement, operate QC system over all work performed under PCAOB standards, including over work on other firms' PCAOB engagements at less than a substantial role
Firm A	Only does work on other firms' PCAOB engagements at less than a substantial role and is not required to comply with APLR with respect to any of the firm's past or future engagements.	X	
Firm B	Performs engagements, including engagements where it plays substantial role. The firm also does work on other firms' PCAOB engagements at less than a substantial role.		X
Firm C	Performs engagements, but does not perform substantial role work on engagements of other firms. The firm also does work on other firms' PCAOB engagements at less than a substantial role.		X
Firm D	Performs only engagements where it plays substantial role and does work on other firms' PCAOB engagements at less than a substantial role.		X

B. Other Scalability Considerations

Firms with a larger PCAOB audit practice. Some provisions of QC 1000 impose incremental requirements on firms that issued audit reports with respect to more than 100 issuers during the prior calendar year. Throughout this guidance we refer to these firms as firms with a larger PCAOB audit practice. The specific provisions are summarized below with references to QC 1000 where the complete text of provisions can be found:

Governance and leadership	QC 1000.28-.29d

- An external oversight function for the QC system composed of one or more persons who are not partners, shareholders, members, other principals, or employees of the firm and do not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system (an "External QC Function" or "EQCF").
- A program for collecting and addressing complaints and allegations involving potential noncompliance with APLR and protecting the confidentiality of individuals and entities that made a complaint or allegation during the investigation.

Ethics and independence	QC 1000.34a(1)

- An automated system for identifying investments in securities that might impair independence.

Monitoring and remediation	QC 1000.63a

- A requirement to perform in-process monitoring of engagements.

These incremental requirements specifically target and respond to potential quality risks that are more likely to arise in audit practices of a certain size and complexity. Firms with a smaller PCAOB audit practice may still determine that the incremental requirements are an appropriate quality response for quality risks that they have identified to their firm, but these are not mandatory for all firms with a smaller PCAOB audit practice.

Firms with a smaller PCAOB audit practice may still determine that the incremental requirements are necessary or appropriate.

QC 1000 specifies a measurement cut-off date for the 100-issuer threshold of the prior calendar year-end. Therefore, if a firm has issued audit reports with respect to more than 100 issuers in the period January 1 to December 31 in any given year, the firm must implement the incremental requirements beginning the following January 1 and evaluate compliance with the incremental requirements as of the following September 30.

It is recommended that firms track the size of their issuer audit practice so they have an informed and timely view as to whether they will need to design, implement, and operate the incremental requirements for the following year.

Firms with a smaller PCAOB audit practice. Some provisions of QC 1000 focus particularly on firms with a smaller PCAOB audit practice. These provisions are summarized below with references to QC 1000 where the complete text of provisions can be found:

Roles and responsibilities	Note to QC 1000.12

- Depending on the nature and circumstances of the firm (including its size and structure) and its engagements, a single individual may be assigned to more than one of the QC system oversight roles required under QC 1000.11 and .12.

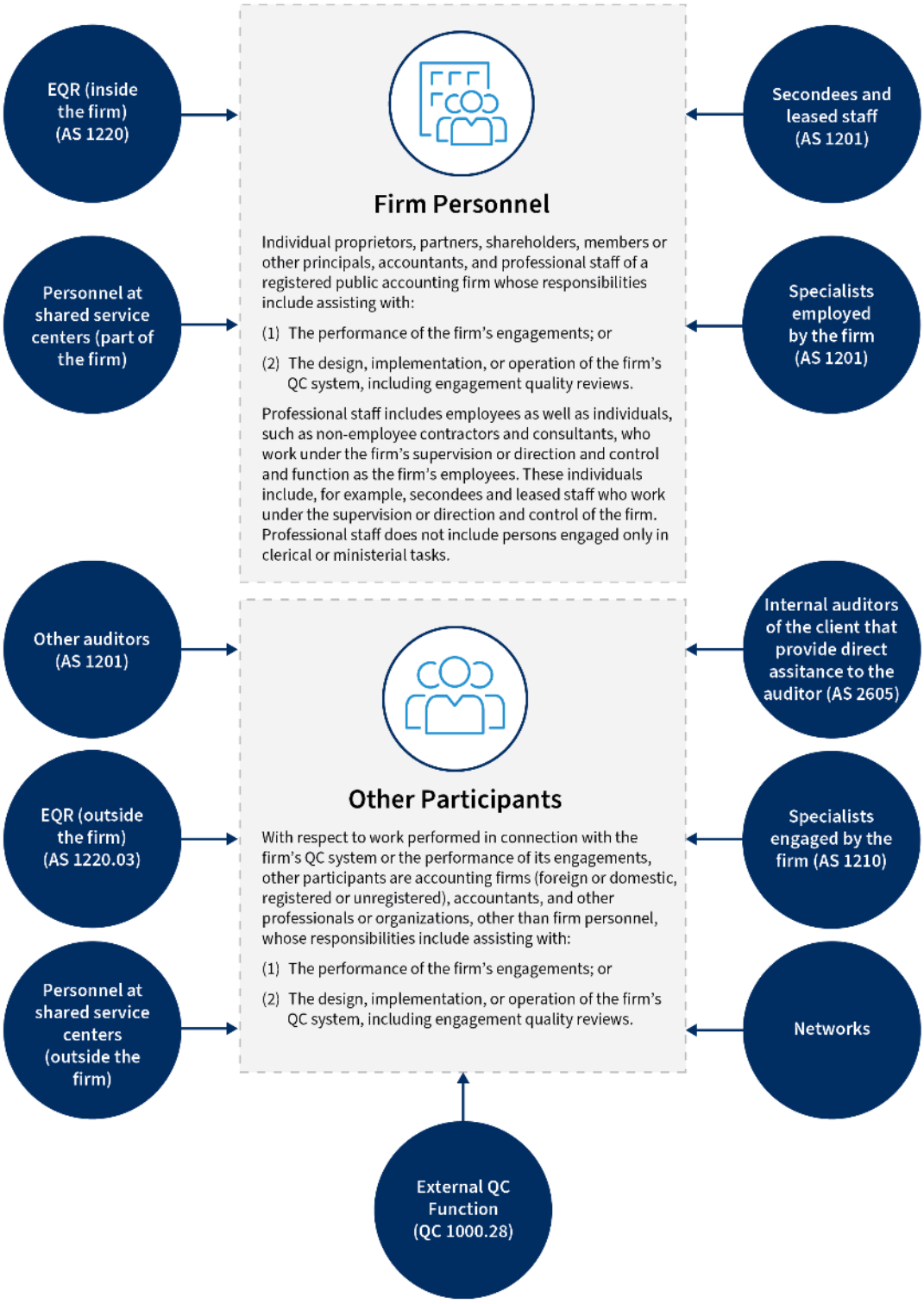
Monitoring and remediation	QC 1000.61

- If the firm issued engagement reports with respect to five or fewer engagements for issuers, brokers, and dealers during the prior calendar year, engagement monitoring activities may include monitoring audits not performed under PCAOB auditing standards.

C. Other Participants

QC 1000 includes references to other participants in a tailored and context-specific way that recognizes the key roles they play.

The following diagram provides the definitions and examples of firm personnel and other participants.



The following chart illustrates references to other participants throughout the standard. Please refer to QC 1000 for the complete text of the requirements.

Firm's QC system	QC 1000.05
• The objective of the firm's QC system covers other participants.	
Roles and responsibilities	**QC 1000.10**
• Other participants involved in the design, implementation, and operation of the QC system are required to exercise due professional care.	
The firm's risk assessment process	**QC 1000.20 and .B9 of Appendix B**
• Firms are required to consider the use of other participants in their risk assessment process, focusing on the nature and extent of their involvement. • Appendix B to QC 1000 provides an example of other participants relevant to obtaining an understanding of the nature and circumstances of the firm and its engagement.	
Governance and leadership	**QC 1000.29**
• Specified quality responses requiring the firm to design, implement, and maintain policies and procedures for addressing potential noncompliance with APLR and with the firm's policies and procedures with respect to the QC system, the firm's engagements, firm personnel, and other participants. Such policies and procedures should be made available to all firm personnel and other participants.	
Ethics and independence	**QC 1000.31**
• The quality objectives address compliance with ethics and independence requirements not just by firm personnel, but also by others who may be subject to ethics and independence requirements in relation to work they perform on behalf of the firm.	
Engagement performance	**QC 1000.42**
Quality objectives related to: • Understanding and fulfilling responsibilities in accordance with APLR, including properly supervising the work performed by other participants; and • Differences in professional judgment related to the engagement that arise among firm personnel, among other participants, or between firm personnel and other participants.	
Resources	**QC 1000.44**
Quality objectives related to: • Individuals who are other participants assigned to engagements have the competence, objectivity, and time needed to fulfill their responsibilities; and • Individuals who are other participants assigned to perform activities within the QC system have the competence, objectivity, authority, and time needed to perform such activities.	
Information and communication	**QC 1000.53 and .55**
• Quality objective related to information to be communicated to other participants and information to be obtained from other participants. • Specified quality response requiring the firm to communicate in writing its policies and procedures related to the operation of the firm's QC system and the performance of its engagements to other participants.	
Monitoring and remediation process	**QC 1000.65**
• In determining the nature, timing, and extent of QC system-level monitoring activities, the firm is required to take into account the services or resources provided by other participants in the firm's QC system, when applicable.	

D. References to Timing

Several requirements in QC 1000 refer to actions being taken on a "timely basis." In each of these cases, what constitutes "timely" would depend on the underlying matter to which the action relates, including the matter's nature, scope, and impact. Timely action should be sufficiently prompt to achieve its objective. In some cases, for example, where there is a high

risk of a severe or pervasive problem, action may have to be immediate to be timely. Some sections of this guidance include specific examples of timely action.

III. ROLES AND RESPONSIBILITIES

Expectations of individuals within the QC system are established through the assignment of roles and responsibilities that are essential to a well-functioning QC system. This aspect of a firm's QC system involves clear lines of communication and decision-making authority, and accountability for those assigned to such roles.

A. Due Professional Care **QC 1000.10**

QC 1000 requires all firm personnel and other participants involved in the design, implementation, and operation of the QC system to exercise due professional care in all matters related to the QC system. Due professional care concerns what those individuals do and how well they do it. Due professional care means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with APLR. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of the relevant information.

B. Assignment of Roles and Responsibilities **QC 1000.11-.13**

QC 1000 requires the firm to assign ultimate responsibility and accountability for the QC system as a whole to the firm's principal executive officer.

Ultimate responsibility and accountability for the QC system

- A firm's highest-ranking executive, regardless of formal title or qualifications, bears ultimate responsibility and accountability for the QC system as a whole.
- If the firm has co-principal executive officers, each of them is ultimately responsible for the QC system as a whole.

QC 1000 requires the firm to assign other roles and responsibilities with respect to the QC system to firm personnel. The following chart illustrates the assignment of roles and responsibilities within the QC system for other roles:

Other roles and responsibilities for the QC system

- Firm personnel fulfilling these roles are required to have the experience, competence, authority, and time needed to enable them to carry out their assigned responsibilities
- Only one individual may be assigned responsibility for each role
- The firm may assign one individual to more than one of the roles
- The firm is required to establish a direct line of communication from each individual assigned operational responsibilities to the individual assigned ultimate responsibility and accountability for the QC system as a whole

In addition to assigning individuals to each role, a large, complex firm may have multiple individuals or multiple layers of personnel supporting these roles, but the responsibility for the assigned role may not be delegated and will remain with the one assigned individual.

Only one individual may be assigned responsibility for each role.

Example

A firm could assign one person to ethics-related matters and another person to independence-related matters, as long as both of these individuals report or have a direct communication line to the person with operational responsibility for the firm's compliance with ethics and independence requirements. As another example, some firms might seek assistance from their network or other participants in performing some of their QC-related activities. Nevertheless, a single individual within the firm is required to remain responsible for the operational responsibilities of the assigned roles.

1. Ultimate responsibility and accountability for the QC system as a whole QC 1000.14

Ultimate responsibility and accountability for the firm's QC system as a whole is established at the highest level within the firm to underscore the critical importance of QC.

Demonstrates a commitment to quality. Regardless of the size or structure of a firm, the individual assigned ultimate responsibility and accountability for the QC system as a whole is required to demonstrate a commitment to quality through their own actions, behaviors, and communications. This includes recognizing and reinforcing the importance of professional ethics, values, and attitudes, and establishing the expected behavior of firm personnel related to activities within the firm's QC system and the performance of its engagements.

Example
The individual with ultimate responsibility and accountability for the QC system as a whole can demonstrate their commitment to quality in different ways. They can demonstrate it by "walking the walk," for example through their personal behavior, how they carry out their own duties, and how they articulate and implement the strategy of the firm. When mistakes are made or bad behavior is uncovered, the individual with ultimate responsibility and accountability for the QC system as a whole acknowledges those mistakes, takes corrective action, and shares lessons learned with firm personnel. They can also "talk the talk" to demonstrate their commitment to quality. For example, they may have regular in-person interactions with firm personnel during which the individual reinforces the importance of ethical behavior. At another firm, in addition to in-person interactions with some firm personnel, the individual with ultimate responsibility and accountability for the QC system may also reinforce the importance of ethical behavior more indirectly, for example, via messages delivered in internal webcasts and town hall meetings.

Establish structures, reporting lines, and authorities and responsibilities. The individual with ultimate responsibility and accountability for the QC system as a whole is required to establish, or direct the establishment of, structures, reporting lines, and authorities and responsibilities for the roles involving operational responsibility for aspects of the QC system and the QC system as a whole.

Example
For each firm, the approach to fulfilling these responsibilities will be dependent on the firm's nature and circumstances. For example, in a firm where there are fewer individuals with assigned roles, structures do not have to result in a complex organizational chart. Conversely, for another firm, it may be necessary to have multiple individuals or multiple layers of personnel supporting these roles. However, ultimate responsibility and accountability cannot be delegated.

Accountability for the firm's QC system. The individual with ultimate responsibility and accountability for the QC system as a whole is accountable for the design, implementation, and operation of the firm's QC system in accordance with APLR and the firm's policies and procedures, as well as for the firm's annual QC system evaluation (see guidance on the annual evaluation of the firm's QC system in section XII.A).

Example
The functions performed by the individual with ultimate responsibility and accountability for the QC system as a whole may vary across firms. For example, in a smaller firm, the individual assigned ultimate responsibility and accountability may be directly involved in aspects of the QC system, such as the firm's monitoring and remediation process. In a larger firm, this person may supervise others who perform these activities. Regardless of the functions performed, the individual with ultimate responsibility and accountability for the QC system as a whole has to be the highest-ranking executive in the firm.

Certify the firm's annual evaluation of its QC system. The individual with ultimate responsibility and accountability for the QC system as a whole is required to certify the firm's annual evaluation of its QC system on Form QC filed with the PCAOB (see guidance on reporting to the PCAOB on Form QC in section XII.C). If a firm has co-principal executive officers, the references to "the individual assigned ultimate responsibility and accountability for the QC system as a whole" apply to each of the co-principal executive officers and each of them is required to certify the firm's annual evaluation of its QC system on Form QC.

2. Other assigned roles and responsibilities for the QC system

QC 1000.15-.17

Operational responsibility and accountability for the QC system as a whole

This individual is required to supervise the design, implementation, and operation of the firm's QC system in accordance with APLR and the firm's policies and procedures. This includes overseeing the operation of the QC system in achieving the reasonable assurance objective.

In carrying out their responsibilities, the individual with operational responsibility and accountability for the QC system as a whole may be supported by the individuals assigned operational responsibility for the firm's compliance with ethics and independence requirements, the monitoring and remediation process, or other components of the QC system. For example, they might rely on information from these individuals regarding violations of ethics and independence requirements and the results of the monitoring and remediation process.

This individual is also required to certify the firm's annual evaluation of its QC system on Form QC (see guidance on reporting to the PCAOB on Form QC in section XII.C).

Operational responsibility for the firm's compliance with ethics and independence requirements

This individual is required to supervise the design, implementation, and operation of the firm's ethics and independence component, including the firm's risk assessment process for

ethics and independence and the design, implementation, and maintenance of the firm's policies and procedures related to ethics and independence.

This individual is also required to communicate ethics and independence violations, on a timely basis, to the individuals assigned operational responsibility for the monitoring and remediation process and operational responsibility and accountability for the QC system as a whole. Ethics or independence violations may take a variety of forms, and therefore the nature and extent of the communication may also take a variety of forms commensurate to the severity and pervasiveness of the violation.

Timely communication needs to be sufficiently prompt to achieve its objective. In some cases, for example, where there is a high risk of a severe or pervasive problem, communication may have to be immediate to be timely. For example, the identification of sharing answers on internal exams required to maintain Certified Public Accountant ("CPA") licenses that goes beyond isolated instances is a significant enough matter to warrant immediate communication. Conversely, a firm might identify that a single professional has an expired CPA license or did not complete a mandatory training session. Such violations might be considered lower risk and, consequently, communication of the violations to the individual with operational responsibility and accountability for the QC system as a whole and individual with operational responsibility for the monitoring and remediation process may be less immediate and still be considered timely.

Operational responsibility for the monitoring and remediation process

This individual is required to supervise the design, implementation, and operation of the monitoring and remediation process component and the evaluation of the QC system, including:

- The evaluation of the results of the monitoring activities;
- The evaluation of whether remedial actions are implemented as designed and operate effectively to remediate QC deficiencies and, if not, the taking of timely action until such QC deficiencies are remediated; and
- The firm's other policies and procedures with regard to monitoring and remediation.

This individual is responsible for overseeing actions taken to respond to identified engagement deficiencies, QC deficiencies, and major QC deficiencies.

This individual is also required to communicate, on a timely basis, matters related to monitoring and remediation to the individuals assigned ultimate responsibility and accountability for the QC system as a whole and operational responsibility and accountability for the QC system as a whole. These communications address key aspects of the monitoring

and remediation process, including the monitoring activities performed, results of the monitoring activities, and the actions taken to address engagement deficiencies, QC deficiencies, and major QC deficiencies.

Operational responsibility for other components of the QC system (e.g., resources component)

The firm has flexibility to assign operational responsibility for other components within the firm's QC system based on the nature and circumstances of the firm. For example, a larger or more complex firm might assign an individual with operational responsibility over the firm's resources component.

SCALABILITY CONSIDERATIONS

Depending on the nature and circumstances of the firm (including its size and structure) and its engagements, the firm may:

- Assign one individual to more than one of the QC system oversight roles; and
- Add additional roles and responsibilities, if appropriate.

For example, in a smaller or less complex firm, the individual with ultimate responsibility and accountability for the QC system as a whole may be the same person that is assigned operational responsibility and accountability for the QC system as a whole. That individual may also be assigned other operational responsibilities (such as for ethics and independence and/or monitoring and remediation).

IV. THE FIRM'S RISK ASSESSMENT PROCESS

The risk assessment process is the basis for a risk-based approach to the design, implementation, and operation of the firm's QC system. QC 1000 requires the identification and assessment of quality risks annually. The following chart illustrates elements of the firm's risk assessment process and related requirements.

The process for establishing quality objectives, identifying and assessing quality risks, and designing and implementing quality responses is iterative, and firms do not necessarily need to address the requirements of the risk assessment process in a linear manner. For example, in identifying and assessing quality risks, the firm may determine that one or more additional quality objectives are required; in designing and implementing quality responses, the firm may identify additional quality risks. The risk assessment process is also intended to be iterative and ongoing, so that new or developing risks are identified and addressed as they emerge.

The firm's risk assessment process is tailored to the size and complexity of the firm, the types and variety of engagements it performs, and the APLR that the firm is subject to if the firm does not perform any engagements.

A firm that qualifies for scaled applicability is required to identify and assess quality risks that the firm believes would exist if it were to perform engagements. This identification and assessment of quality risks is required to take place annually. See section II.A.1 for a discussion on how to identify and assess quality risks under scaled applicability. In addition, such a firm is required to design, but is not required to implement or operate, quality responses that address

quality risks and establish policies and procedures to monitor, identify, and assess changes to conditions, events, and activities that indicate modifications may be needed to quality objectives, quality risks, or quality responses.

SCALABILITY CONSIDERATIONS

There are a number of ways to approach the design and implementation of the risk assessment process. When considering how to meet the general requirements of the firm's risk assessment process, firms may wish to consider who might be involved in the process and how often they have to be involved to enable a proactive and effective process that is responsive to changing circumstances. For smaller and less complex firms, the risk assessment process may be centralized and involve only a few individuals and infrequent meetings. For larger and more complex firms, the risk assessment process may be more structured and decentralized, involving multiple layers and groups, and periodic meetings to analyze the necessary information that may require modification of the firm's quality risks or quality responses.

A. Establish Quality Objectives **QC 1000.19**

QC 1000 requires a firm to establish the quality objectives necessary for the firm to achieve the reasonable assurance objective, consisting of (1) the quality objectives specified in the standard and (2) any other quality objectives that are necessary to achieve that objective.

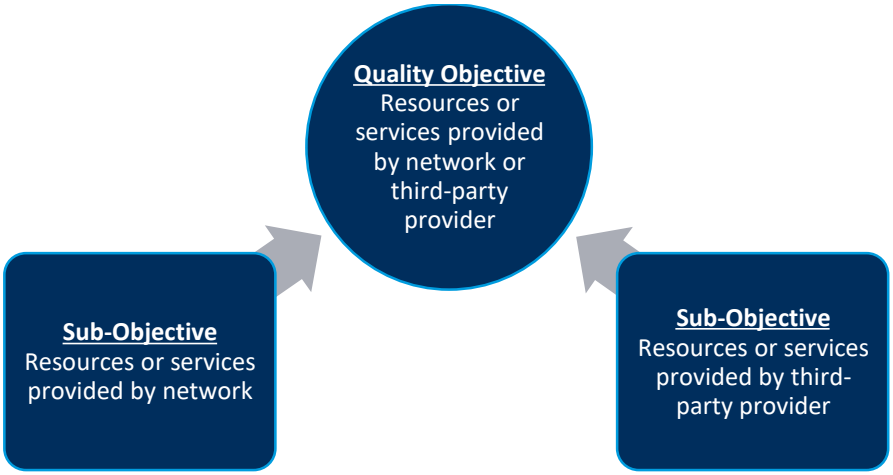
QC 1000 specifies quality objectives for six components of the firm's QC system.

For many firms, the quality objectives specified in the standard are likely to be comprehensive and additional quality objectives would generally not be necessary. However, the nature and circumstances of a firm and its engagements may vary and conditions may change. Accordingly, a firm is required to establish additional quality objectives, if necessary, to achieve the reasonable assurance objective. Quality objectives apply to all firms and are specified in the standard for each of the six components to which the risk assessment process applies.

- Governance and Leadership
- Ethics and Independence
- Acceptance and Continuance of Engagements
- Engagement Performance
- Resources
- Information and Communication

A firm may determine that it is necessary to establish quality objectives for its monitoring and remediation process. In those circumstances, the firm's risk assessment process would also apply to the monitoring and remediation process. The quality objectives are outcome-based and the risk assessment process provides a framework for firms to identify and respond to risks such that quality objectives will be achieved.

If a firm determines that its quality objectives need to be more specific, it could establish additional objectives or sub-objectives to provide a more direct link to quality risks and support the development of more comprehensive or better-targeted responses. For example, a quality objective related to the resources provided by a network or a third-party provider can be established as two sub-objectives, and the firm may identify multiple quality risks and develop multiple quality responses for each sub-objective that relate to a single quality objective.



The standard also recognizes that some quality objectives apply only in specific circumstances. These objectives need to be achieved by the firm if the specific circumstances apply, e.g., if the firm belongs to a network or if the firm uses other participants.

B. Identify and Assess Quality Risks

QC 1000.20

QC 1000 requires a firm to obtain an understanding of the conditions, events, and activities that may adversely affect the achievement of the firm's quality objectives, which includes an understanding of (1) the nature and circumstances of the firm; (2) the nature and circumstances of the firm's engagements; and (3) other relevant information. This understanding underpins the firm's identification and assessment of the quality risks that are most relevant to the achievement of the firm's quality objectives. Quality risks are specific to the firm and the engagements it performs. Identifying quality risks as an inverse of the quality objective (i.e., the identified quality risk is that the quality objective will not be met) generally

Quality risks are specific to the firm and the engagements it performs.

would not be specific to a firm and its engagement and may result in a firm designing quality responses that are not effective in achieving the quality objective. The standard does not specify quality risks that must be assessed and responded to by all firms. It includes a list of considerations related to the nature and circumstances of the firm and its engagements and other relevant information for the firm to consider in its risk assessment process.

The following table lists considerations and examples relevant to obtaining an understanding of the nature and circumstances of the firm and its engagements (*see also* Appendix B of QC 1000).

Consideration and examples relevant to obtaining an understanding of the nature and circumstances of the firm and its engagements	
The complexity and operating characteristics of the firm	The size of the firm, the geographical distribution of the firm's operations, how the firm is structured, and the extent to which the firm concentrates or centralizes its processes or activities. For example, the complexity of the organizational structure, including the number of managerial levels or the changes in the firm structure and firm ownership (e.g., a firm reorganization to form an alternative practice structure).
The firm's business processes and strategic and operational decisions and actions	Decisions about financial and operational matters, including the firm's strategic goals. For example, mergers, acquisitions, and divestitures or changes in firm business strategy or goals affecting the firm's audit practice.
The characteristics and management style of leadership	The composition of firm leadership, leadership tenure, distribution of authority among leadership, and how leadership motivates and encourages firm personnel. For example, changes in firm leadership (e.g., senior leadership turnover).
The extent to which a culture of integrity and a commitment to audit quality, including ethics and independence, is promoted within the firm and embraced by firm personnel across all levels	How a commitment to quality is embedded in the firm's culture and exists throughout the firm. For example, emphasizing the importance of professional ethics, values and attitudes and establishing and adhering to a code of conduct.
The resources of the firm	People, financial, technological, and intellectual resources and the characteristics and availability of such resources. As it relates to people resources, a firm would think about how the firm acquires the resources and whether people are hired, contracted, loaned, or work within a shared services environment.
The environment in which the firm operates, including APLR	Economic stability; social and technological factors; laws and regulations directly relevant to the firm; and APLR affecting engagements performed by the firm. For example, changes to the external environment (e.g., economic, political, or technological) affecting the firm and its QC system.
If the firm belongs to a network, the characteristics of the network and the network's resources and services and the nature and extent of resources and services used by the firm	The nature of the network, the nature and extent of the requirements established by the network, and the resources and services provided by the network. For example, how the network is organized and operates and the extent and frequency of communication from the network to the firm related to resources and services provided by the network.
If the firm uses other participants, the nature and extent of their involvement	The types of and extent to which the firm uses other participants on its engagements or within its QC system and the characteristics of such other participants. For example,

Consideration and examples relevant to obtaining an understanding of the nature and circumstances of the firm and its engagements	
	information regarding the reliability and quality of the services performed and the experience and competence of the individuals performing those services.
If the firm participates in other firms' engagements, the nature and extent of the firm's participation	The nature of the procedures performed, the extent of participation, and other characteristics, including characteristics of the other firms (e.g., the reputation of the other firms).
If the firm uses resources or services obtained from third-party providers, the nature and extent of those resources or services	The types of and extent to which the firm uses third-party providers and the characteristics of such third-party providers. For example, observations from monitoring activities regarding the design of the services performed and their use by the firm.
The nature and circumstances of the firm's engagements	The types of engagements performed by the firm and the types of companies for which such engagements are undertaken. For example, size, industry, complexity, and risk profile of the companies for which the firm's engagements are performed, including the potential need for external resources (e.g., specialists, valuation reports, analyst or short-seller reports).

There are different ways a firm could approach its risk assessment process and use examples of considerations from Appendix B to identify quality risks. It could start with developing a list of conditions, events, and activities that may affect the firm's QC system and then use examples in Appendix B to understand how these conditions, events, and activities might threaten the achievement of the established quality objectives. For example, suppose that during the year, a firm adds new engagements to its portfolio. The firm could review Appendix B as part of forming an understanding of how entering into new engagements might give rise to quality risks that potentially threaten the achievement of the firm's established quality objectives. For example, in reviewing examples in QC 1000.B6, the firm is prompted to consider whether new engagements may require additional resources, thus potentially threatening the achievement of the quality objectives in the resource component. Whether or not this event ultimately results in a quality risk being identified within the resource component will depend on whether the risk meets the definition of a quality risk.

A firm could also start with reviewing examples of considerations from Appendix B to form an understanding of the conditions, events, and activities that can have an effect on the established quality objectives. For example, one of the considerations focuses on involvement of a network in the operation of the firm's QC system or the performance of its engagements. If such an arrangement exists, the firm considers the nature and extent of the relationship between the firm and the network (e.g., the nature and extent of such resources and services provided by the network and used by the firm) and how this arrangement can affect the firm's established quality objectives.

Another consideration focuses on changes in a firm's structure, which may be relevant for a firm that has recently reorganized itself to form an alternative practice structure. This consideration may result in the identification of additional quality risks. For example, the firm may identify a quality risk that it fails to identify certain independence violations because of the complex relationships created by its alternative practice structure. In another example, a firm

that completed an acquisition of another firm, may identify a number of quality risks, such as quality risks that the audit methodology used by the acquired firm may not be compatible with the acquirer's methodology or a quality risk that the firm is unable to retain personnel post-acquisition, which may pose risks to quality objectives in areas like engagement performance and resources.

The list of considerations included above and in the standard is not intended to be exhaustive and the specific examples are meant to be illustrative rather than a checklist for every firm to consider. Whether a particular consideration is relevant, and results in one or more quality risks, depends upon the nature and circumstances of the firm and its engagements and how the conditions, events, and activities relate to or affect the operation of the firm's QC system and the performance of its engagements. The firm may also identify quality risks that do not relate to the list of considerations or to any of the specific examples included in Appendix B of QC 1000. The firm should exercise caution when using third-party provided risk assessment templates because the examples of quality risks provided in the template may not be specific enough or reflect the firm's circumstances or the nature of its engagements and may result in a firm designing quality responses that are not effective in addressing the firm's quality risks and achieving its quality objectives. Failure to identify and assess quality risks that are specific to the firm and the engagements it performs will result in noncompliance with QC 1000.

When identifying and assessing risks, firms should not discount the possibility that intentional misconduct may occur and omit or underweight these types of risks in their risk assessment process.

Example
A firm determines that there has been a higher rate of noncompliance with independence requirements in its engagements in the financial services sector compared to other engagements. In addition to identifying and assessing overall quality risks with regard to noncompliance with independence requirements, the firm identifies and assesses a more specific quality risk or risks relating to engagements in the financial services sector.

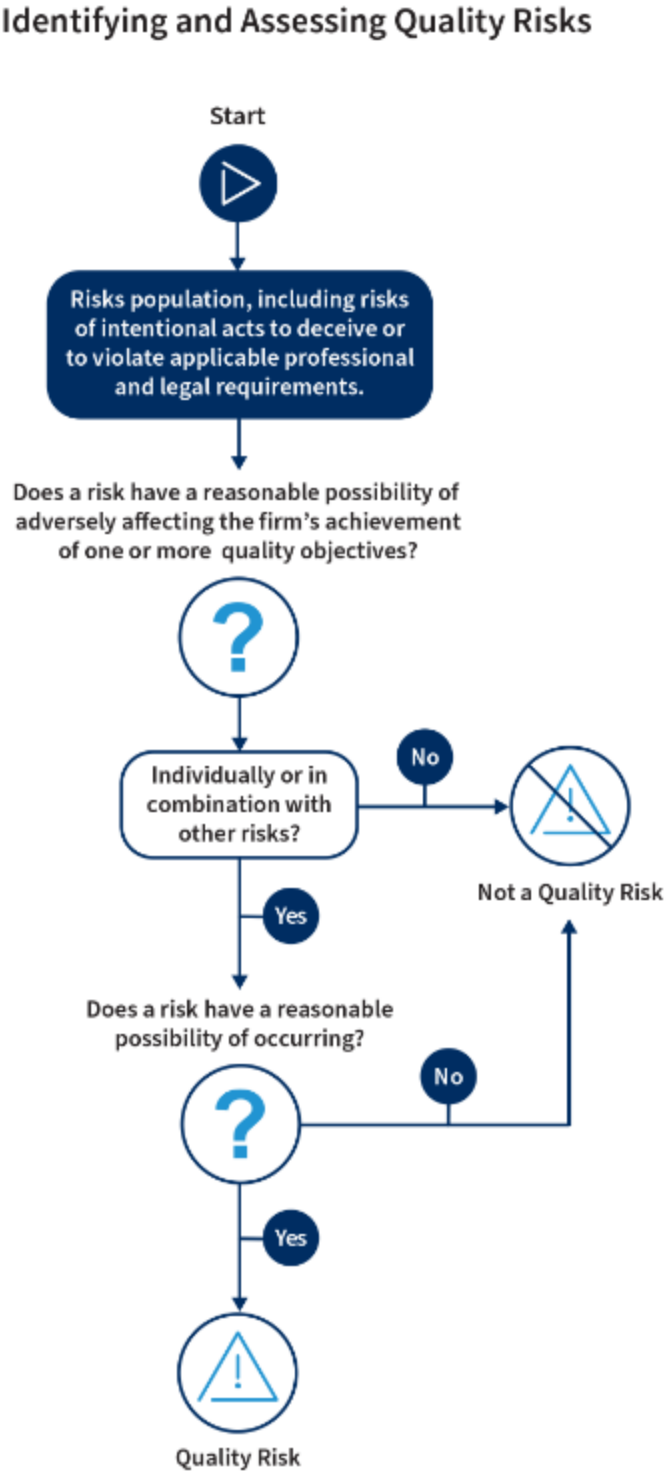
When identifying and assessing risks, firms should not discount the possibility that intentional misconduct may occur and therefore omit or underweight these types of risks in the risk assessment process.

Example
A firm may think that the risk of firm personnel inappropriately sharing answers for mandatory tests seems remote and not possible to occur. Nevertheless, given the prevalence of this problem across many firms, the firm concludes that it should not discount that this risk may occur and, therefore, carefully considers this risk during its risk identification and assessment.

Assessing the identified quality risks involves consideration of the frequency with which the quality risks may occur and the magnitude of the impact of the quality risks on the related quality objective(s). Identifying quality risks with the appropriate degree of specificity (not too narrowly or too broadly) will help the firm design quality responses that reduce to an appropriately low level the risk that the quality objective will not be achieved. Quality risks that are defined too broadly may result in quality responses that are not sufficiently targeted to the actual quality risk. Conversely, if quality risks are defined too narrowly, the quality responses may not sufficiently address the full extent of the quality risks.

The identification of quality risks takes into account individual risks as well as combinations of risks. For example, a risk that has a reasonable possibility of occurring but individually does not have a reasonable possibility of adversely affecting the achievement of the quality objective may meet the proposed definition of a quality risk when analyzed in combination with other risks.

The process of identifying and assessing quality risks is depicted below:



C. Design and Implement Quality Responses QC 1000.21

QC 1000 requires a firm to design and implement quality responses that (1) are based on the quality risks and the reasons for the assessments given to the quality risks, and (2) reduce to an appropriately low level the risk that quality objectives will not be achieved.

The nature, timing, and extent of quality responses depend on the underlying quality risks and the reasons why these risks were assessed as quality risks. For example, a quality risk that is tied to an event that is expected to occur multiple times per year, or that could have a very significant impact, requires a more extensive response than a quality risk tied to a specific event that is expected to occur only once and have a less significant impact. Quality responses would typically be specific to the firm, to respond effectively to its particular assessed quality risks, reducing to an appropriately low level the risks of not achieving the quality objectives.

Quality responses may address multiple quality risks related to one or more QC components.

Quality responses would typically be specific to the firm, to respond to its particular assessed quality risks.

Quality responses may address multiple quality risks related to one or more QC components. The firm may decide to implement quality responses at the firm level or the engagement level, or through a combination of responses at the firm and engagement levels, depending on the nature of the quality risk. For example, a firm may determine to implement quality responses at the firm level and the engagement level to address the risks of noncompliance with independence requirements. At a firm level, a firm may implement an annual independence confirmation for all firm personnel. In addition, the firm may identify a specific quality risk for engagements in the financial services industry due to a perceived increased likelihood of financial relationships between the company and individuals subject to the independence requirements. As a result, the firm may implement an additional more specific independence confirmation for those individuals that work on engagements in the financial services industry.

D. Modifying Quality Objectives, Quality Risks, Quality Responses QC 1000.22-.23

QC 1000 requires firms to take proactive measures to address new quality risks that may come up between the firm's periodic risk assessments by modifying its quality objectives, quality risks, and quality responses, as necessary. Policies and procedures that are forward-looking and designed to respond to dynamic changes in the environment will better enable the firm to anticipate and plan for significant changes.

To the extent practical, the firm's policies and procedures would be forward-looking, so the firm could anticipate and plan for significant changes.

Example
In anticipation of issuance of new accounting standards, a firm's policies and procedures could direct the firm to periodically monitor future updates from accounting standard setters. A new accounting standard may result in a firm identifying a new quality risk that firm personnel may misinterpret the new standard. Identifying this risk prior to the next annual risk assessment may prompt the firm to revisit its quality responses that address training and make sure the new accounting standard is included on the list of topics for mandatory training, and thus avoid potential problems in future engagements.

The timing for any modification depends on the nature and extent of the modification needed. In some circumstances, immediate action may be required, whereas in other cases, if the impact on risk is less urgent, immediate action may not be necessary. Modifications not implemented in a timely manner may fail to prevent quality risks from occurring and adversely affecting the quality objective. For example, in the case of a new accounting standard, the firm would need to implement any necessary modifications to its quality responses in time so that, once the standard became effective, firm personnel would be able to apply it properly.

Modifications to the quality objectives could include establishing additional quality objectives or creating sub-objectives to make the quality objective more specific, or eliminating a quality objective if it is no longer relevant. For example, the firm may decide that a quality objective related to using resources from a firm within a network is no longer relevant because the firm is no longer using those resources.

SCALABILITY CONSIDERATIONS

Policies and procedures related to the modification of quality objectives, quality risks, and quality responses, may also vary, depending on the size and complexity of the firm and the types and variety of engagements it performs. For a larger firm operating in a complex environment with a wide range of engagements in different industries, such policies and procedures could be extensive. For example, they could involve periodic meetings with teams across the firm to gather and analyze the necessary information to enable the firm to identify changes to conditions, events, and activities that may require modification of the firm's quality

objectives, quality risks, or quality responses. Smaller and less complex firms, operating in a less varied and more stable environment, may have a less extensive set of policies and procedures for determining when modifications are needed.

The requirements regarding the risk assessment process generally apply only to work performed under PCAOB standards. However, nothing prevents a firm from designing, implementing, and operating a single risk assessment process for its entire audit and assurance practice that satisfies both QC 1000 and the other quality control standards that apply to the firm.

V. GOVERNANCE AND LEADERSHIP

The governance and leadership component of the firm's QC system addresses the environment that enables the effective oversight and operation of the QC system and directs the firm's culture, decision-making processes, organizational structure, and leadership. A firm's culture and tone, as set by leadership, can and should promote the importance of quality.

A. Quality Objectives **QC 1000.25**

The firm's commitment to quality

- The firm's commitment to quality is communicated and promoted by leadership to recognize and reinforce:
    - The firm's role in protecting investors and the public interest by consistently fulfilling its responsibilities under APLR;
    - The importance of adherence to the appropriate standards of conduct by firm personnel;
    - The importance of professional ethics, values, and attitudes; and
    - The expected behavior and responsibility of firm personnel for quality relating to activities that are subject to APLR, including activities within the firm's QC system and the firm's performance on engagements.

To achieve an appropriate tone at the top, it is not enough for firm leadership to "talk the talk." They also have to "walk the walk."

- The firm clearly defines leadership's responsibility for quality and holds leadership accountable, including through their performance evaluation and compensation.
- Leadership demonstrates a commitment to quality through its actions and behaviors.
- The firm's strategic decisions and actions, including financial and operational priorities, are consistent with and support the firm's commitment to quality.

SCALABILITY CONSIDERATIONS

Frequent and consistent communication from leadership to firm personnel regarding the commitment to quality is important in order to create an appropriate tone at the top. The size or complexity of a firm may impact the ways that leadership communicates their commitment to quality. For example, leadership of a smaller firm might demonstrate its commitment to quality by reinforcing the importance of ethical behavior via regular in-person interactions with personnel. In contrast, leadership at larger or more complex firms might demonstrate this commitment more indirectly, for example, via messages delivered in internal webcasts, town hall meetings, social media, internal e-mails, and other broad-based communications.

Regardless of the size and structure of a firm, leadership at all levels demonstrate their commitment to quality through, at a minimum, their communications, actions, behaviors, and directives, by carrying out their responsibilities in compliance with APLR (including applicable ethical standards), and by not inappropriately emphasizing commercial goals over quality.

Organization and governance structure. The firm's organizational and governance structure and the assignment of roles, responsibilities, and authority enable the design, implementation, and operation of the firm's QC system and support performance of the firm's engagements in accordance with APLR.

Resources. Resource needs are planned for, and resources are obtained or developed and allocated or assigned, in a manner that enables the effective design, implementation and operation of the firm's QC system and the performance of its engagements in accordance with APLR. Resources include people, financial, technological, and intellectual resources, and resources from a network or third-party provider.

Resources include people, financial, technological, and intellectual resources, and resources from a network or third-party provider.

B. Specified Quality Responses

QC 1000.26-.29

Specified quality responses are not intended to be comprehensive and alone will not be sufficient to enable the firm to achieve all established quality objectives. Firms are required to design and implement their own quality responses.

Required of all firms

Clear lines of responsibility. Establish and maintain clear lines of responsibility and supervision within the QC system. This includes defining authorities, responsibilities, accountabilities, and supervisory and reporting lines for roles within the firm, up to and including the principal executive officer(s) or equivalent.

SCALABILITY CONSIDERATIONS

QC 1000 is not prescriptive about how to establish and maintain clear lines of responsibility and supervision within the QC system, which allows scalability. For example, at a smaller firm or a firm with a less complex structure, establishing and maintaining clear lines of responsibility and supervision might be less complicated and/or require less extensive documentation than at a larger or more complex firm.

Policies and procedures for addressing potential noncompliance. Design, implement, and maintain policies and procedures for addressing potential noncompliance with APLR and with the firm's policies and procedures with respect to the QC system, the firm's engagements, firm

personnel, and other participants. These policies and procedures are required to be made available to all firm personnel and other participants, and are required to address:

- Processes and responsibilities for receiving complaints and allegations from internal and external parties (for example, policies and procedures regarding a complaints mailbox or hotline or a whistleblower program);
- Protecting persons making complaints and allegations from retaliation; and
- Investigating and addressing complaints and allegations.

SCALABILITY CONSIDERATIONS

The required policies and procedures regarding investigation and resolution of complaints and allegations are intended to allow scalability. The nature, timing, and extent of the process to investigate and address complaints and allegations should be commensurate with and responsive to the significance of the related complaint or allegation.

Required of firms with larger PCAOB audit practices

EQCF. The governance structure of a firm with a larger PCAOB audit practice is required to incorporate an external oversight function (the "External QC Function" or "EQCF") for the QC system composed of one or more persons who:

- Are not partners, shareholders, members, other principals, or employees of the firm;
- Do not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system; and
- Have the experience, competence, authority, and time necessary to enable them to carry out the responsibilities assigned to EQCF by the firm.

The responsibilities of the EQCF are required to include, at a minimum, evaluating the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system.

Complaints and Allegations Program. For firms with larger PCAOB audit practices, the policies and procedures for addressing potential noncompliance are required to include a confidential and anonymous process for submitting complaints and allegations and protecting the confidentiality of the individuals and entities that made a complaint or allegation during the investigation.

Firms that are not explicitly required to adopt these specified quality responses will want to consider whether, in the circumstances of the firm, one or more of the specified quality responses would be appropriate or necessary.

C. Highlighted Topics

1. Leadership of the firm

The composition of leadership at the firm is not limited to the roles and responsibilities required by QC 1000 (see guidance on Roles and Responsibilities in section III) and will vary across firms based on the nature and circumstances of the firm and its engagements and how the firm chooses to organize itself. For example, leadership in a larger firm may include firm-wide leadership; the executive team; regional, office, and industry segment leadership; and any other levels of leadership the firm may establish. Conversely, leadership at a smaller firm may comprise all partners in the firm or some other level the firm may establish, like an Executive Committee or Board.

Not all partners or partner equivalents will necessarily be leadership of the firm; it will depend on the role of the individual.

2. Considerations when incorporating an EQCF

a. Composition of EQCF

Firms with larger PCAOB audit practices are required to incorporate an EQCF for the firm's QC system into their governance structure. The EQCF should be comprised of one or more persons who are not partners, shareholders, members, other principals, or employees of the firm and do not otherwise have a commercial, familial, or other relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system.

These criteria are analogous to the criteria applied to independent directors in the corporate context. For example, under Nasdaq Rule 5605(a), "Independent Director" is defined in relevant part as "a person other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director." When determining whether an individual meets the criteria to serve in an EQCF role, firms can consider the types of relationships that are and are not permissible for independent corporate directors.[2]

[2] The EQCF criteria contemplate that only individuals can serve in that role. For example, a legal entity, such as a consulting firm, cannot serve in the EQCF role, but individuals associated with a consulting firm could.

The EQCF can be composed of one person, or the firm may determine, based on its circumstances, that more than one person is needed to appropriately carry out the function. For example, a firm might conclude that multiple individuals are needed to be part of the EQCF in order for the EQCF to have the specific skillset the firm determines is necessary to carry out the requirements of the function. In that regard, firms may conclude that one or more persons appointed to the EQCF should be non-auditors to bring greater diversity of perspectives to the function. As another example, a firm that is pursuing an aggressive growth strategy (e.g., through acquisition of engagements and of other firms) may identify a number of areas of its QC system that would benefit from the input of an independent party experienced in integrating different aspects of acquired businesses. In that case, the firm might determine that multiple individuals with different areas of expertise need to be part of its EQCF.

The EQCF must consist of one or more individuals. These individuals can be one or more people from the same or different organizations, but an organization cannot itself be the EQCF.

QC 1000 does not specify where within the firm the EQCF must be housed or to whom the EQCF must report. These determinations are left to the discretion of the firm. This flexibility will allow an individual who serves in an EQCF role to also serve, for example, as an independent member of a firm's advisory committee or audit quality committee or governance body, including one that has a majority of non-independent members. Furthermore, to the extent that firms have existing QC advisory committees, nothing in the standard prevents independent members of those committees from serving as or as part of the EQCF, provided they meet the requirement to be able to exercise independent judgment with regard to matters related to the QC system and can discharge the assigned duties.

b. EQCF Responsibilities

The EQCF's responsibilities are required to include, at a minimum, evaluating the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system. There is no requirement for the EQCF to "reassess" the firm's judgments and conclusions; the EQCF evaluates the work performed by others but does not redo that work. There is also no requirement for the EQCF to provide concurring approval with respect to the firm's conclusions, though firms could choose to require that as a matter of policy.

The EQCF would evaluate the work performed by others but it would not redo that work.

The EQCF's mandated responsibility does not extend to all of the firm's QC-related judgments and conclusions, but only to significant ones made in connection with the firm's annual QC-system evaluation and reporting.

QC 1000 does not otherwise prescribe the role of the EQCF, which provides firms with substantial flexibility. Firms may designate a range of different responsibilities for the EQCF depending on their circumstances and needs. A firm can expand the responsibilities of the EQCF if and as it determines necessary, based on the facts and circumstances of the firm, as a quality response to one or more quality risks identified by the firm or to enable more effective oversight of the QC system as a whole.

c. Qualifications and Skillset of EQCF

The EQCF is required to have the experience, competence, authority, and time necessary to enable them to carry out their assigned responsibilities as described above.

QC 1000 does not mandate any other qualifications or skillsets a firm's EQCF should possess. The firm makes this determination based on its specific facts and circumstances, including the qualifications and skillsets needed for the EQCF to execute additional responsibilities the firm assigns to it, if any. For example, if a firm plans to assign the EQCF additional responsibilities with respect to reviewing its remediation efforts in the area of engagement performance, the firm would want to make sure that the EQCF consists of one or more individuals with the necessary competence (e.g., a former auditor) to enable the EQCF to fulfill those additional responsibilities.

d. Ethics and Independence Considerations

PCAOB ethics and independence rules are applicable to public accounting firms and their associated persons. The definition of "associated person" (as defined in PCAOB Rule 1001(p)(i)) includes independent contractors (among others) that receive compensation from the firm or participate in any activity of that firm. Because individuals serving in an EQCF role cannot be partners, shareholders, members, other principals, or employees of the firm, the Board expects that such individuals would be engaged as independent contractors. The Board thus expects that an individual who serves in an EQCF role will meet the definition of an associated person.[3] Therefore, PCAOB ethics and independence rules will generally be applicable to individuals serving in an EQCF role, as will other laws, rules, or standards applicable to them that the PCAOB is responsible for enforcing.

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[3] Such individuals would not necessarily be supervisory persons for purposes of Section 105(c)(6) of the Sarbanes-Oxley Act of 2002, which authorizes the PCAOB in certain circumstances to impose sanctions upon supervisory persons who failed to reasonably supervise another associated person who violated a law, rule, or standard that the PCAOB is charged with enforcing. These individuals would qualify as supervisory persons only if the firm afforded them the responsibility, ability, or authority to affect the conduct of other associated persons such that they serve in a supervisory capacity. The decision as to whether these individuals serve in such capacity is the firm's to make, as QC 1000 allows the firm to decide whether to bestow additional responsibilities on those individuals that make them supervisory persons.

However, individuals who serve in an EQCF role may not be subject to the SEC rule on auditor independence.[4] They could be, but are not required to be, in the "chain of command" for purposes of that rule. Individuals who are considered to be in the "chain of command" would be "covered persons," and therefore, subject to the SEC independence rule.

e. EQCF Practice Considerations

The following are illustrative examples of how the EQCF could function.

Evaluating Significant Judgments and the Related Conclusions. In fulfilling its responsibility to evaluate the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system, as a practical matter, the EQCF could start with the content of the Form QC and review significant judgments made in relation to items required to be included on the form (QC 1000.80a-c). For example, significant judgments made and the related conclusions reached would, at a minimum, include the conclusions about whether there are any major QC deficiencies. There could be other significant judgments depending on the complexity and subjectivity of judgments and the consequences they may have related to the evaluation of the QC system. Leading up to the reporting on the Form QC, there are other areas that could require significant judgments, including determining whether QC deficiencies exist, performing root cause analysis, and determining whether QC deficiencies have been remediated.

The table that follows provides some examples of significant judgments and related conclusions that could arise in connection with the firm's evaluation of and reporting on the effectiveness of the firm's QC system. It is not intended to be an all-inclusive list of significant judgments and conclusions and there could be others depending on the nature and circumstances of the firm and its engagements.

QC 1000 requirement	Significant judgment
Evaluate unremediated QC deficiencies to determine whether they are remediated (QC 1000.78)	The note to QC 1000.77 provides that an unremediated QC deficiency is one for which remedial actions that completely address the QC deficiency have not been fully implemented, tested, and found effective. Significant judgments may be made when determining whether the QC deficiency has been fully remediated or not.
Determine whether major QC deficiencies exist, including evaluating the presumptions for a major QC deficiency (QC 1000.78)	A major QC deficiency is an unremediated QC deficiency or combination of unremediated QC deficiencies that severely reduces the likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives. A major QC deficiency is presumed to exist if there is an unremediated QC deficiency or combination of unremediated QC deficiencies that (1) relates to the firm's governance and leadership that affect the overall environment supporting the operation of the QC system, or (2) results in or is likely to result in one or more significant engagement deficiencies that, taken together, are significant in relation to the firm's total portfolio of engagements (for example, because of the number of engagements or firm personnel affected or likely to be affected, the associated

[4] *See* Rule 2-01 of Regulation S-X, 17 C.F.R. § 210.2-01.

QC 1000 requirement	Significant judgment
	revenue or profit, the associated risks, or the relevant industry). Determining whether major QC deficiencies exist, including determining whether any major QC deficiencies are presumed to exist and, if so, whether the presumption can be rebutted, involves significant judgment.
Form QC Item 2.4 – Reporting on an Unremediated QC Deficiency	This section of Form QC requires disclosure of information about each unremediated QC deficiency including a description of the deficiency; whether it is a major QC deficiency; what area(s) of the firm's QC system, quality objective(s) or QC 1000 requirement(s) the QC deficiency relates to; the firm's basis for determining it was a QC deficiency as of the evaluation date; and a summary of remedial actions taken and planned to be taken to address it. Significant judgment may be involved when reporting information to the PCAOB about the QC deficiencies.

Differences in Judgment. QC 1000 does not require that the EQCF concur with the significant judgments made and conclusions reached by the firm in connection with the firm's evaluation of the effectiveness of the QC system. Unless the firm decides to require such concurrence as a matter of policy, the EQCF's evaluation is an input into the firm's assessment of its QC system(including monitoring, evaluation, and reporting) that may inform the firm's or individuals' actions, but it does not direct the firm's actions. For example, results of EQCF evaluations in previous years will be part of the information the firm evaluates under QC 1000.71 to determine whether QC observations exist. Beyond that, firms are generally free to design an approach to differences in judgment between the EQCF and the firm in the manner that they deem most appropriate for their firm.

Establishing Additional Responsibilities, if Any. The firm has the flexibility to assign additional responsibilities to the EQCF as it determines necessary, enabling the function to best respond to the nature and circumstances of the firm, or as a quality response to additional quality risk(s) identified by the firm. For example, if a firm has experienced an increase in recurring engagement deficiencies, the firm may charge the EQCF with reviewing and evaluating the firm's root cause analysis or remediation plans to provide objective feedback to help the firm improve its monitoring and remediation process. In another example, a firm might assign the EQCF with strategic responsibilities, such as maintaining situational awareness through the identification and monitoring of emerging risks or trends that could potentially affect the firm's QC system. In another example, a firm might charge the EQCF to review a new independence policy in light of APLR and provide feedback on the new policy commensurate with the EQCF's expertise.

f. EQCF Procedures

QC 1000 does not specify the procedures the EQCF is required to perform to fulfill its responsibility to evaluate the significant judgments made and related conclusions reached by the firm when concluding on the effectiveness of its QC system. The nature and timing of procedures will vary based on the responsibilities assigned to the EQCF by the firm. Like all persons performing QC functions under QC 1000, those in the EQCF role are required to exercise due professional care in performing their duties. This means acting with reasonable care and diligence, exercising professional skepticism, acting with integrity, and complying with APLR when performing their duties.

Those in the EQCF role are required to exercise due professional care in fulfilling their responsibilities.

The firm may identify certain procedures for the individuals in the EQCF role to perform to obtain a baseline understanding of the firm's QC system and the firm's process of evaluating, concluding, and reporting on it. For example, procedures may include:

Reviewing the firm's QC system policies and procedures. The EQCF may need to obtain an understanding of some or all of the firm's policies and procedures in their QC system, depending on the responsibilities that have been assigned.

Inquiring of firm leadership. The EQCF may inquire of individuals in firm leadership, including the individual assigned ultimate responsibility and accountability for the QC system or the individual assigned operational responsibility for the QC system, to obtain an understanding of the firm's QC system, including, for example:

- Details about the processes the firm follows to perform risk assessment procedures or monitoring and remediation;
- Results of the firm's previous monitoring and remediation efforts or its annual evaluation;
- Leadership's attitude towards an effective QC system;
- Current priorities related to the QC system, including current unremediated deficiencies and the firm's remediation efforts; and
- Areas of the firm's QC system that have experienced changes during the period (e.g., new or updated software technology, use of a new third-party audit methodology, and changes to ethics and independence policies).

Reviewing QC documentation from previous periods. The EQCF may review documentation from previous periods to obtain an understanding of the firm's QC system. For example, the EQCF may review documentation related to the performance and results of the firm's risk assessment process, which would help the EQCF to understand the types of quality risks the

firm has identified and the quality responses designed and implemented to address the quality risks. As another example, the EQCF may review documentation about the results of previous monitoring and remediation procedures, which could help the EQCF to understand how the firm identifies deficiencies and implements remediation efforts as well as understand the firm's monitoring of whether its remediation efforts are effective. The extent of documentation reviewed by the EQCF could vary and depend on the responsibilities assigned to the EQCF.

g. Other Considerations Related to the EQCF

Beyond the requirement for the EQCF to evaluate significant judgments made and related conclusions reached in the evaluation of and reporting on the firm's QC system, a firm has latitude to decide how to design the EQCF, including, for example:

The terms of service of the EQCF and how the EQCF should be compensated. QC 1000 does not impose specific limits on the term of service of the EQCF or dictate how the EQCF should be compensated. Firms will want to consider the potential for arrangements relating to the term of service, such as term limits and protections against removal, to prevent the creation of a relationship with the firm that impairs independent judgment. Similarly, firms will want to consider the potential that compensation arrangements, including the amount and structure of compensation, could impair independent judgment.

What lines of communication should be established from the EQCF to others. The firm may establish a direct line of communication from the EQCF to the individual assigned ultimate responsibility and accountability for the QC system as a whole, or the individual assigned operational responsibility for the QC system as a whole, or both. Or, depending on the scope of the EQCF's responsibilities as assigned by the firm, a direct line of communication may be established to a different individual or individuals.

Whether to require the EQCF to provide concurring approval. As previously noted, QC 1000 does not require that the EQCF provide concurring approval of the firm's reporting. However, firms may establish such concurring approval as a matter of policy.

Whether to require that the EQCF comply with independence requirements applicable to auditors. QC 1000 provides that persons serving in an EQCF capacity cannot have a relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system. However, those persons will not necessarily have to be subject to the SEC independence requirements applicable to auditors, which relate to independence from the companies the firm audits. Whether persons serving in the EQCF are subject to the SEC independence rule will generally depend on whether they are in the "chain of command" for purposes of that rule. The responsibilities that QC 1000 mandates for the EQCF would not, in and of themselves, necessarily result in the EQCF being in the "chain of command." However, the EQCF could be in the "chain of command," depending on the responsibilities assigned to the EQCF by the firm.

In addition, firms may choose to require the EQCF to comply with some or all of the SEC independence requirements as a matter of policy.

What authority to afford to the EQCF in light of its assigned responsibilities. The responsibilities assigned to the EQCF will drive decisions about the scope of the EQCF's authority. At a minimum, the EQCF will need to have sufficient access to information, documentation, and firm personnel and other participants (if applicable) to enable evaluation of the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its QC system. However, the EQCF's authority could be broader depending on the scope of the EQCF's responsibilities as assigned by the firm.

The level of external transparency of the EQCF's roles and responsibilities. QC 1000 does not require the results of the EQCF's evaluation to be publicly disclosed. The firm can choose to disclose publicly the EQCF's practices, methods, procedures, or the manner or results of its evaluation. However, investors, audit committees, and other stakeholders will likely benefit from the EQCF's evaluation, even in the absence of public disclosure.

In considering these matters, the firm should be mindful of the requirement that those that are part of the EQCF do not have any relationship with the firm that would interfere with the exercise of independent judgment with regard to matters related to the QC system.

h. Documentation requirements related to EQCF

QC 1000 includes an overarching documentation obligation that requires firms to prepare and retain documentation of the design, implementation, and operation of the QC system and of the annual evaluation of the QC system (QC 1000.81). The scope of that obligation is specified in QC 1000.82-.83. The documentation requirements for the EQCF are based on the fact that the EQCF is a "specified quality response" under QC 1000 (QC 1000.26-.29).

As with other quality responses, QC 1000 requires the firm to prepare and retain documentation in sufficient detail to enable an experienced auditor that understands QC systems but has no experience with the firm's QC system to understand how the EQCF is designed, implemented, and operated (QC 1000.83b). See section XIII for guidance on documentation.

As a quality response, the EQCF will consist of one or more policies (which state what should or should not be done) and procedures (the actions taken to implement or comply with those policies). The content of such policies will depend on, for example, how the firm structures the EQCF, including how the firm selects the individual(s) who comprise it, and what responsibilities the firm assigns to it, but the firm's documentation must facilitate an understanding of the EQCF's design and implementation. Additionally, with respect to the EQCF's operation, because the EQCF is responsible for, at a minimum, evaluating the firm's significant judgments and related conclusions with respect to evaluating and reporting on the effectiveness of the firm's QC system, the firm's documentation needs to be sufficiently

detailed to enable an experienced auditor, at a minimum, to understand how the EQCF determines what is a "significant judgment" or "related conclusion," which significant judgments and related conclusions were evaluated by the EQCF, how they were evaluated, and the results of that evaluation.

It is the responsibility of the firm, not of the individual(s) who comprise the EQCF, to prepare and retain documentation regarding the firm's EQCF. However, the firm's EQCF policies could provide guidance to those individual(s) about what they should or should not do to facilitate the firm's preparation and retention of appropriate documentation about the EQCF's operation.

3. Complaints and allegations program

Firms are required to include in their policies and procedures for addressing potential noncompliance a complaints and allegations program. For firms with larger PCAOB audit practices, similar to the requirements for audit committees under the Exchange Act, the program is also required to include:

- A confidential and anonymous process for submitting complaints and allegations; and
- A means to protect the confidentiality of the individuals and entities that made a complaint or allegation during the investigation.

For example, a firm may have a confidential and anonymous submission process through a website, toll-free number, or mobile app, and could manage the process in-house or through a third-party provider.

If the firm uses a third-party provider to manage its complaints and allegations program, the requirements of QC 1000 relating to obtaining resources from a third-party provider apply. For example, a firm needs to consider the use of a third-party provider in its risk assessment process. In addition, the firm needs to obtain an understanding of how the services provided by the third-party provider are developed and maintained and whether these services need to be supplemented and adapted such that their use enables the operation of the firm's QC system. See section IX.C.9 for more guidance regarding the use of third-party providers.

VI. ETHICS AND INDEPENDENCE

This component addresses the fulfillment of firm and individual responsibilities under relevant ethics and independence requirements. Under QC 1000, ethics and independence requirements include the PCAOB's ethics and independence standards and rules, the SEC's rule on auditor independence, and other applicable requirements regarding accountant ethics and independence that are relevant to fulfilling their obligations and responsibilities in the conduct of engagements or in relation to the QC system, such as those arising under state law or the law of other jurisdictions (e.g., obligations regarding client confidentiality).

A. Quality Objectives **QC 1000.31**

Understanding and complying with requirements. Ethics and independence requirements are understood and complied with by the firm and firm personnel and, with respect to work performed on behalf of the firm, by others subject to such requirements. Others subject to such requirements may include, for example, "associated persons" of a firm and "covered persons in the firm" (as defined in Regulation S-X Rule 2-01(f)(11), 17 C.F.R. § 210.2-01(f)(11)) that in each case are not firm personnel (e.g., an Engagement Quality Reviewer from outside of the firm, or individuals who are not employed by the firm that perform audit procedures in a current period audit).

Identifying, evaluating, and responding to violations. Conditions, events, relationships, or activities that could constitute violations of ethics and independence requirements are properly identified, evaluated, and responded to by the firm and firm personnel on a timely basis.

Communicating violations to leadership. Violations are communicated on a timely basis to the individual assigned operational responsibility for the firm's compliance with ethics and independence requirements.

B. Specified Quality Responses **QC 1000.32-.36**

Specified quality responses are not intended to be comprehensive and alone will not be sufficient to enable the firm to achieve all established quality objectives. Firms are required to design and implement their own quality responses.

Required of all firms

- Design, implement, and maintain policies and procedures that address ethics and independence requirements, including:
    - Identifying and addressing matters that may reasonably be thought to bear on the independence of the firm, firm personnel, and affiliates of the firm;

- Obligations of firm personnel to perform with integrity and objectivity all activities associated with the operation of the QC system and the performance of engagements (such as training and other professional development activities; engagement planning, performance, and supervision; and communication with companies for which the firm performs engagements, other firm personnel, and regulators);

- Obligations of associated persons of the firm, other than firm personnel, to perform work on behalf of the firm with integrity and objectivity;

- Consultations on ethics and independence matters, including identifying ethics and independence matters requiring consultation;

- Monitoring compliance (e.g., internal inspection of independence compliance at least annually) with applicable ethics and independence requirements and related firm policies and procedures by the firm, firm personnel, affiliates of the firm, and, with respect to work performed on behalf of the firm, others subject to such requirements; and

- With respect to violations and potential violations of ethics and independence requirements:

  - Identifying conditions, events, relationships, and activities that could constitute ethics or independence violations involving the firm, firm personnel, and, with respect to work performed on behalf of the firm, others subject to such requirements;

  - Taking preventive and corrective actions to address ethics or independence violations, as appropriate, on a timely basis;

  - Reporting requirements for firm personnel and others performing work on behalf of the firm who are subject to such requirements regarding ethics or independence violations of which they become aware that may affect the firm, including requirements for escalating reporting of such violations; and

  - Communicating, as appropriate, to external parties (for example, to audit committees).

- The firm's policies and procedures for matters that may reasonably be thought to bear on the independence of the firm, firm personnel, and affiliates of the firm must include:

  - Identifying firm and personal relationships and arrangements with restricted entities, including a process for identifying direct or material indirect financial interests that might impair the firm's independence of firm personnel that are managerial employees or partners, shareholders, members, or other principals;

- Maintaining and making available the list of restricted entities to firm personnel and others performing work on behalf of the firm who are subject to independence requirements;

- Requiring that the list of restricted entities be reviewed before the firm enters into any relationships, engagements to perform non-audit services, or fee arrangements that might affect compliance with independence requirements, and, if such review indicates that action is required under APLR or the firm's policies and procedures, taking required actions on a timely basis;

- Requiring firm personnel to review the list of restricted entities in certain situations specified by QC 1000.34d;

- Obtaining certifications from firm personnel regarding familiarity and compliance with (1) SEC and PCAOB independence requirements, applicable ethics requirements, and the firm's independence and ethics policies and procedures upon employment and at least annually thereafter, and (2) SEC and PCAOB independence requirements and the firm's independence policies and procedures upon any change in professional circumstances that is relevant to independence; and

- Identifying matters that require audit committee pre-approval and obtaining such pre-approval.

- Make available its ethics and independence policies and procedures to firm personnel and others performing work on behalf of the firm who are subject to ethics and independence requirements, including communicating any substantive changes to such policies and procedures on a timely basis.

- Provide mandatory training to firm personnel near the time of initial employment and periodically (at least annually) thereafter that addresses ethics and independence requirements and the firm's ethics and independence policies and procedures.

Required of firms with larger PCAOB audit practices

For firms with larger PCAOB audit practices, the ethics and independence component includes a requirement for an automated process to identify investments in securities that might impair the independence of the firm or firm personnel that are managerial employees or partners, shareholders, members, or other principals.

Firms with smaller PCAOB audit practices should consider automating this process, taking into account the quality risks and the nature and circumstances of the firm.

C. Highlighted Topics

1. Designing an automated process for tracking independence

Firms with larger PCAOB audit practices are required to implement an automated process to identify investments in securities that might impair the independence of the firm or firm personnel.

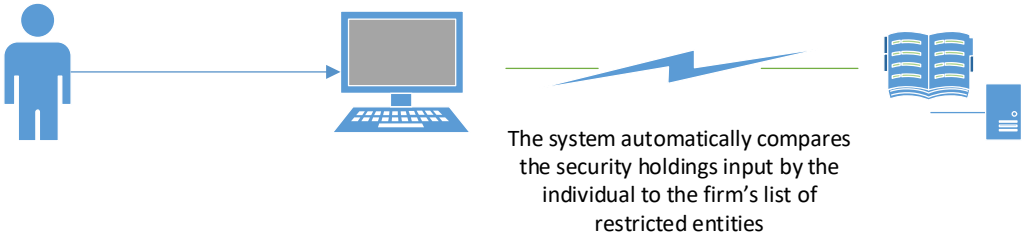
This specified quality response requires that firms develop a system that tracks audit engagements and financial investments held by professionals such that the conflict verification process is automated. The system could be automated in a variety of different ways. For example, such a system could rely on automated data feeds from brokers or on firm professionals accurately self-reporting and manually entering their investments into the system in a timely manner. Investments would automatically be compared to the list of restricted entities to identify any relationships with restricted entities that might impair independence.

Based on the size of the firm and other characteristics, a firm that is not subject to the specified quality response may determine that an automated identification of their professionals' security investment holdings is an appropriate quality response (e.g., if the firm's monitoring activities found high rates of non-compliance by firm personnel with the firm's policies and procedures for reporting financial investments).

The scenarios that follow illustrate what a QC 1000-compliant automated system could look like:

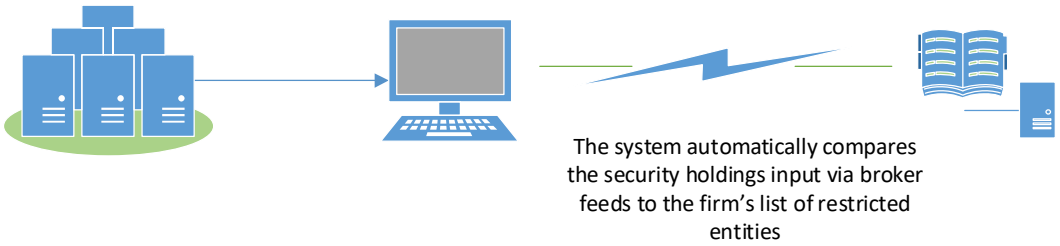
Scenario 1 – Firm personnel input security holdings

Firm professionals manually input their security holdings into the firm's software, including the respective unique identifiers, e.g., CUSIPs or ISINs.



Scenario 2 – Input of security holdings via a broker feed

Security holdings are directly fed from linked brokerage accounts into the firm's software, including the respective unique identifiers, e.g., CUSIPs or ISINs.



This figure illustrates two possible ways in which a QC 1000 compliant system may be designed. There may be other system designs not shown here that meet the requirement of the standard.

2. Maintaining and communicating the list of restricted entities

QC 1000 requires firms to maintain and make available the list of restricted entities to firm personnel and others performing work on behalf of the firm who are subject to independence requirements. This includes updating and communicating, at least monthly, additions to the list of restricted entities to firm personnel and others performing work on behalf of the firm whose relationships and arrangements, including security investments, with such additional restricted entities may reasonably be thought to bear on the independence of the firm.[5]

[5] Under the SEC's general standard of auditor independence, 17 C.F.R. § 210.2-01(b), an accountant is not independent if "the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement." In

QC 1000 does not prescribe a specific process for maintaining and making available the list of restricted entities to firm personnel and other individuals. Firms can determine the specific methods and tools needed to keep the list of restricted entities up to date and to ensure that any additions are communicated on a timely basis to firm personnel and other individuals for which they are relevant.

To meet this requirement, firms may choose to communicate additions to the list of restricted entities to all firm personnel via email as and when additions are made to the list. However, other methods may also be acceptable, if they result in an effective communication; for example, on an at least monthly basis, a firm might communicate that there have been additions to the list of restricted entities to all firm personnel via e-mail and include within the e-mail a link to an accessible website-hosted list of additions. If there are no additions, there is no required communication.

If a firm decides not to communicate additions to all firm personnel, then the firm needs to ensure that no individual who is left out from the communication has any relationship or arrangement that could reasonably be thought to bear on the independence of the firm.

In determining the group of individuals to whom additions to the restricted entity list will be communicated, the firm needs to consider, for example, the restrictions on financial, employment, and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non-audit services to an audit client as set forth in the PCAOB independence and ethics standards and rules, the SEC rule on auditor independence, and other applicable requirements regarding accountant ethics and independence that are relevant to fulfilling obligations and responsibilities in the conduct of engagements or in relation to the QC system.

While not a specific requirement under QC 1000, firms may determine that the most effective way to design the specified quality response would be to implement IT systems and processes that facilitate more targeted or automated communications of the additions to the list of restricted entities to the relevant individuals. Such systems may continuously perform automated comparisons of all engagements, business relationships, and financial relationships with their list of restricted entities, allowing the firm to make targeted communications to affected personnel including notification of how additions to the list of restricted entities apply to the affected personnel.

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considering this general standard, the SEC "looks in the first instance to whether a relationship or the provision of service: creates a mutual or conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or an employee of the audit client; or places the accountant in a position of being an advocate for the audit client." 17 C.F.R. § 210.2-01, preliminary note.

3. Independence and ethics certifications

QC 1000 requires firms to obtain certifications from firm personnel regarding familiarity and compliance with the relevant independence and ethics requirements as illustrated in the table that follows:

	Upon employment	At least annually	Upon any change in professional circumstances that is relevant to independence
SEC and PCAOB independence requirements	✓	✓	✓
Applicable ethics requirements	✓	✓	-
Firm independence policies and procedures	✓	✓	✓
Firm ethics policies and procedures	✓	✓	-

QC 1000 requires firms to obtain certifications every time firm personnel have a change in professional circumstances that is relevant to independence, such as a change in role or geographic location. Changes within the firm such as promotions, moving offices, or changing practice groups may have consequences under independence rules (e.g., changes to covered person status) and result in noncompliance. Although, there is no requirement to obtain certification with regard to changes in personal circumstances, such changes can have independence implications under SEC and PCAOB independence requirements, and a firm's QC system must provide reasonable assurance of compliance with those requirements.

The standard does not prescribe a checklist of specific content for the certifications, focusing instead on general concepts of familiarity and compliance.

4. Monitoring compliance

Under QC 1000, the firm is required to design, implement, and maintain policies and procedures to monitor compliance with applicable ethics and independence requirements and related firm policies and procedures. The standard does not prescribe specific activities to monitor compliance with ethics and independence requirements and the firm’s ethics and independence policies by firm personnel. Based on the firm’s size and specific circumstances, a firm can choose which monitoring activities are an effective response to meet the quality objective. This allows scalability based on the firm’s size and specific circumstances. While not required, through its oversight activities, the Board has observed that some firms audit brokerage statements on a sample basis to monitor independence compliance.

With respect to compliance with applicable ethics and independence requirements by the firm and its affiliates, firms may employ various manual and automated tools for evaluating

whether the firm and its affiliates comply with SEC and PCAOB independence requirements and the firm's independence policies and procedures. Some examples of such tools that have been observed through the Board's oversight activities include:

- Having a centralized process to monitor business relationships,
- Establishing an independence confirmation process that includes detailed guidance and questions related to independence and prohibited non-audit services, and
- Periodic review of the completeness and accuracy of information reported on independence confirmations.

Under QC 1000, the firm's evaluation of compliance covers applicable ethics and independence requirements as well as the firm's policies and procedures. A firm may establish ethics and independence policies and procedures that are more restrictive than the rules of the SEC and PCAOB—for example, to comply with requirements of other jurisdictions or to simplify compliance with SEC and PCAOB requirements by setting bright-line policies and reducing the range for individual judgment.

VII. ACCEPTANCE AND CONTINUANCE OF ENGAGEMENTS

This component addresses the firm's processes when considering whether to accept or continue an engagement. Acceptance and continuance of engagements is an aspect of a firm's compliance and risk management process, assisting the firm in mitigating reputational, business, and litigation risk. The quality objectives stress the importance of focusing their processes on the firm's ability to perform an engagement in accordance with APLR when considering whether to accept or continue an engagement.

A. Quality Objectives **QC 1000.38**

Accepting or continuing an engagement

Judgments about whether to accept or continue an engagement are:

- Initially made as part of or before performing preliminary engagement activities;
- Consistent with the firm's ability to perform the engagement in accordance with APLR, based on:
    - Whether the firm is independent;
    - Whether the services are permissible and any required audit committee pre-approval has been or will be obtained;
    - The extent to which the firm is or will be able to gain access to company information to perform the engagement, including company personnel who provide such information;
    - The extent to which the firm has or can obtain resources to perform the engagement; and
    - Other relevant factors associated with providing professional services in the particular circumstances; and
- Based on and supported by information about the nature and circumstances of the engagement and the integrity and ethical values of the company (including management and the audit committee).

Terms of an engagement. The terms of the engagement, including its objective and the responsibilities of the firm and management, are consistent with APLR and are understood by the firm and the company.

B. Specified Quality Response QC 1000.39-.40

Specified quality responses are not intended to be comprehensive and alone will not be sufficient to enable the firm to achieve all established quality objectives. Firms are required to design and implement their own quality responses.

Required of all firms

Design, implement, and maintain policies and procedures to address situations in which the firm becomes aware of information subsequent to accepting or continuing an engagement that would have caused the firm to decline such engagement had that information been known prior to acceptance or continuance.

C. Highlighted Topics

1. Evaluating the firm's ability to perform an engagement in accordance with APLR

The firm considers a number of factors when evaluating its ability to perform an engagement in accordance with APLR. The table below provides example considerations related to each factor that may be relevant to a firm that is determining whether to accept or continue an engagement:

Factor	Considerations
Independence, permissibility of services, and required audit committee pre-approval	The firm's ability to perform the engagement includes considering whether the firm is independent and whether the services are permissible. These are threshold considerations for acceptance and continuance, because in general, the firm is not allowed to accept an engagement unless it is independent of the company for which the engagement will be performed and the services are permissible under APLR (including obtaining audit committee pre-approval where that is required). The firm's policies for acceptance and continuance in the areas of independence, permissibility of services, and pre-approval relate to and, to some extent, overlap with the ethics and independence component. The requirements in the ethics and independence component more generally address the ongoing evaluation of compliance with APLR relating to the independence of the firm, firm personnel, and others subject to such requirements (e.g., "persons associated with a public accounting firm" as defined in PCAOB rules or "covered persons in the firm" under the SEC independence rule).
Access to company information and personnel	The firm's ability to perform an engagement in accordance with APLR depends on the firm's ability to obtain information from the company and gain access to individuals at the company who can respond to the firm's inquiries. Restricted or limited access to company information or personnel—for example, due to language differences, physical location, or local law restrictions—could impair the firm's ability to perform the engagement in accordance with APLR.
Resources to perform the engagement	It's important for a firm to have the right resources available so that engagements can be performed in accordance with APLR. This includes the availability of resources like the following, either internal or external to the firm: • **Firm personnel or other participants with competence to perform procedures** A firm needs to have enough resources with sufficient availability to meet audit timing requirements. When evaluating whether firm personnel have sufficient availability, the firm will need to consider their availability in light of all of their other work

Factor	Considerations
	commitments. In addition, an engagement could require individuals with specialized skills or experience, such as individuals with specific industry experience or experience related to new or specialized accounting pronouncements that apply to the company. • **Engagement partner** An engagement partner needs to have not only sufficient capacity to take on a new engagement, but also competence that is relevant to the engagement, which could include, for example, experience in the company's industry or with auditing a particular transaction or type of account that the engagement would require (e.g., a business combination or hard to value financial assets). • **Specialists** Different than individuals with specialized skills or experience, discussed above, an engagement could require involvement of specialists, such as actuaries or financial asset valuation specialists. In determining whether to accept or continue an engagement, a firm may need to consider whether they have access to the appropriate specialists, including any technological resources used by specialists, such as valuation models. Specialists could either be firm personnel or individuals external to the firm (i.e., other participants). • **Engagement quality reviewer** The engagement quality reviewer is required to be a partner or equivalent that has the relevant competence, independence, integrity, and objectivity relative to the engagement.[6] • **Intellectual and/or technological resources needed to perform engagements** The facts and circumstances of an engagement may require the use of particular intellectual resources in its performance, such as industry-specific audit programs or technical accounting publications applicable to the engagement, or the use of specific technological resources.
Other relevant factors	The firm's ability to perform engagements in accordance with APLR may also be affected by other factors associated with providing professional services in the particular circumstances. For example, a firm might determine that a potential engagement does not align with the firm's current strategic or operational decisions and actions.

2. Considering information about the nature and circumstances of the engagement

Information about the nature and circumstances of the engagement and the integrity and ethical values of the company, including management and the audit committee, is relevant when determining whether to accept or continue an engagement because it can help identify potential risks to performing the engagement that may result in the firm not being able to perform the engagement in accordance with APLR. For example, a firm deciding whether to accept a multilocation engagement with a significant subsidiary operated in a complex industry and located in a country where the firm does not have any operations or engagements may need to evaluate whether it can access specialized resources in a new country and perform the engagement in accordance with APLR.

Because members of management and the audit committee all have influence over the company's financial reporting, their integrity and ethical values are of particular importance when a firm decides whether to accept or continue an engagement. When obtaining

[6] *See* Paragraphs .03 - .08 of AS 1220, *Engagement Quality Review*.

information about integrity and ethical values of the company, a firm could identify a lack of management integrity that could affect the reliability of the company's accounting records.

Designing and implementing appropriate policies and procedures that direct and standardize the collection and evaluation of information about the nature and circumstances of the engagement and the integrity and ethical values of the company can help a firm to consistently make appropriate judgments about whether to accept or continue an engagement. These can include policies and procedures, for example, that require:

- Evaluating the nature of the company and the environment in which it operates, and documenting such evaluation;
- Reviewing public information about management and audit committee members from, for example:
  - Management and board member bios on the company's website and proxy statement;
  - Social media platforms; and
  - Press articles;
- Considering the firm's relevant history with the company (for example, difficulty in obtaining information or access or disagreement over accounting principles or judgmental areas of the audit);
- Obtaining and considering the results of background checks; and
- Conducting incremental acceptance and continuance procedures and/or obtaining additional approvals when an engagement or potential engagement meets certain criteria (e.g., if the company has a specific risk profile or is within a certain industry).

3. Becoming aware of information subsequent to accepting or continuing an engagement

A firm's policies and procedures are required to address situations in which the firm becomes aware of relevant contrary information after the firm's decision to accept or continue an engagement. A firm is deemed "aware" of information when any partner, shareholder, member, or other principal of the firm first becomes aware of such information. This is the same standard that applies with respect to reporting of specified events on Form 3, Special Reporting Form.[7]

A firm is deemed "aware" of information when any partner, shareholder, member, or other principal of the firm first becomes aware of such information.

This contrary information may have existed at the time of the decision to accept or continue an engagement but may not have been known by the firm at the time, or it may have

[7] This form is used by firms to file special reports with the Board pursuant to Section 102(d) of the Sarbanes-Oxley Act and PCAOB Rule 2203.

emerged subsequent to that decision. Depending on the circumstances, appropriate responses could include such actions as:

- Discussing the information with management and the audit committee to determine if the firm is able to continue the engagement;
- Including this information in the auditor's risk assessment procedures so that any additional risks are responded to during the audit;
- Consulting with legal counsel or others within the firm to determine if the firm is able to continue the engagement;
- Withdrawing from the engagement and notifying appropriate regulatory authorities as required under APLR; and
- Revisiting the firm's policies and procedures regarding the acceptance and continuance of engagements to determine if they need to be adjusted.

The above responses are not intended to be a checklist, nor are they an exhaustive list of procedures to perform in this circumstance. A firm's policies and procedures over acceptance and continuance of an engagement depend on the unique facts and circumstances of the firm and its engagements.

VIII. ENGAGEMENT PERFORMANCE

The engagement performance component of the firm's QC system encompasses the activities of firm personnel and other participants in all phases of the design and execution of the engagement – planning, performing, supervising, and documenting the engagement; conducting an engagement quality review; and making communications regarding the engagement.

A. Quality Objectives **QC 1000.42**

The quality objectives a firm establishes related to the engagement performance component of its QC system are applicable to the work performed both on a firm's own engagements and on other firms' engagements.

Engagement responsibilities. Responsibilities are understood and fulfilled by firm personnel and other participants in accordance with APLR, including, as applicable:

Exercising professional skepticism improves the quality of judgments made while performing the engagement and is key to performing an engagement in good faith and with integrity.

- The responsibilities of the engagement partner for an engagement and its performance;
- Responsibilities for planning and performing the engagement, including:
  - Exercising due professional care, including professional skepticism, such that conclusions reached are appropriate under APLR and supported by sufficient appropriate evidence; and
  - Properly supervising the work performed by firm personnel and other participants; and
- Responsibilities for reporting and other communications with respect to the engagement.

Consultations. Consultations on complex, unusual, or unfamiliar accounting and auditing matters are undertaken with qualified individuals from within or outside the firm, and conclusions are:

- Agreed to by the engagement partner and the parties consulted or addressed as a difference of professional judgment in accordance with the quality objective described under "Differences in professional judgment" below;

A qualified individual is someone who has the requisite knowledge, skill, and ability.

- In accordance with APLR; and
- Implemented before the issuance of the engagement report.

SCALABILITY CONSIDERATIONS

Consultations can be undertaken with qualified individuals from within or outside the firm. For example, a smaller and less complex firm may need to hire an external consultant to assist with an unfamiliar matter. In another example, a larger or more complex firm that is part of a network may have policies requiring consultation with regional or international qualified individuals.

Differences in professional judgment. Differences in professional judgment related to the engagement that arise among firm personnel, among other participants, or between firm personnel and other participants, including the engagement quality reviewer or those that provide consultation, are brought to the attention of the individual(s) with responsibility and authority for resolving such matters and are resolved before the engagement report is issued, such that the engagement is performed in accordance with APLR.

Engagement documentation. Engagement documentation is prepared, reviewed, assembled, and retained in accordance with APLR.

B. Specified Quality Responses

QC 1000 does not include specified quality responses related to the engagement performance component of a firm's system of QC. Nevertheless, the firm is still required to identify and assess quality risks and design and implement quality responses that address quality risks.

C. Highlighted Topics

1. Previous Appendix K requirements

The requirements of Appendix K, *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*, were eliminated as part of the adoption of QC 1000.[8] However, the

[8] The SECPS was a division of the AICPA for U.S. firms that audited public companies, which established incremental quality control requirements for its members. The SECPS member requirements

risks to a non-U.S. firm that it is not conducting engagements over SEC registrants in accordance with APLR remain applicable (to the extent a non-US firm conducts such engagements). Under the risk-based approach provided by QC 1000, firms need to assess and respond to quality risks including, if applicable, a relative lack of experience in performing engagements under U.S. professional and legal requirements.

The following table summarizes how the previous Appendix K requirements are contemplated as part of a firm's system of QC under QC 1000:

Previous Appendix K requirement	QC 1000 requirement
Incremental review by a filing reviewer knowledgeable in applicable U.S. accounting and auditing standards, independence requirements, and SEC rules and regulations	QC 1000 requires firms to establish quality objectives and specified quality responses related to individuals' competence. For example: • a quality objective in the engagement performance component is that responsibilities are understood and fulfilled by firm personnel and other participants in accordance with APLR; (QC 1000.42a) • a quality objective in the resources component is that individuals assigned to engagements (including engagement partner and engagement quality reviewer) have the competence, objectivity, and time needed to fulfill their responsibilities on such engagements; (QC 1000.44c) • a quality objective in the resources component is that firm personnel demonstrate a commitment to quality through development and maintenance of the competence needed to perform their roles; and (QC 1000.44b) • a specified quality response in the resources component requires firms to provide mandatory training on APLR. (QC 1000.48) A non-U.S. firm may identify a quality risk to the achievement of the quality objective about individuals' competence related to engagements for SEC registrants or performed in accordance with PCAOB standards. For example, a non-U.S. firm may identify a quality risk that audits of SEC registrants are not in accordance with applicable U.S. auditing standards, independence requirements, and SEC rules and regulations because resources do not have sufficient competencies in U.S. requirements. The firm's quality response to this risk may be to design and implement policies and procedures over the assignment of resources with applicable knowledge and experience to such engagements, which, depending on the firm's personnel, may need to be from outside of the firm.
The firm should have a dispute resolution policy that is applicable if the filing	As noted above, a difference of opinion can arise among firm personnel, among other participants, or between firm personnel and other participants,

originally applied to all U.S. firms that audited public companies under AICPA standards. The SECPS ceased to exist following the establishment of the PCAOB in 2002, but certain SECPS requirements still applied to firms that were members of the SECPS as of April 16, 2003, including the requirements of Appendix K – *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*.

Previous Appendix K requirement	QC 1000 requirement
reviewer and the engagement partner have conflicting views as to the resolution of a matter.	including the engagement quality reviewer or those that provide consultation. QC 1000 requires firms to establish the following quality objective: differences in professional judgment related to an engagement are brought to the attention of those with responsibility and authority for resolving such a matter. (QC 1000.42c)
Policies and procedures around monitoring engagements should address the review of a sample of audit engagements performed by foreign associated firms for clients that are SEC registrants.	QC 1000 requires firms to design, implement, and operate a monitoring and remediation process that includes, among other things, monitoring completed engagements and, for larger firms, monitoring in-process engagements. (QC 1000.62-.64)

IX. RESOURCES

This component addresses a firm's responsibilities for obtaining, developing, using, maintaining, allocating, and assigning resources to enable the design, implementation, and operation of the firm's QC system and the performance of its engagements. The firm's resources include people, financial, technological, and intellectual resources, and resources from a network or third-party provider.

A. Quality Objectives — QC 1000.44

People resources

Responsibilities and qualities of firm personnel

- 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 APLR and the firm's policies and procedures.

Competence consists of having the knowledge, skill, and ability that enable individuals to act in accordance with APLR and the firm's policies and procedures. Competence is measured both qualitatively and quantitatively.

- Firm personnel demonstrate a commitment to quality through (1) their actions and behaviors and (2) development and maintenance of the competence to perform their roles.

- Firm personnel comply with the firm's policies and procedures related to the operation of the firm's QC system and the performance of its engagements and the work performed on other firms' engagements.

- Firm personnel are: (1) evaluated at least annually; (2) incentivized to fulfill their assigned responsibilities and adhere to standards of conduct, including through compensation plans and decisions in which quality considerations play a critical part; and (3) held accountable for their actions and failures to act.

Assignment of people resources

- Firm personnel and individuals who are other participants assigned to engagements, including the engagement partner and engagement quality reviewer, have the competence, objectivity, and time needed to fulfill their responsibilities on such engagements in accordance with APLR and the firm's policies and procedures.

- Firm personnel who are assigned to participate in another firm's engagement have the competence, objectivity, and time to perform such activities in accordance with APLR and the firm's policies and procedures.

- Firm personnel and individuals who are other participants assigned to perform activities within the QC system have the competence, objectivity, authority, and time needed to perform such activities in accordance with APLR and the firm's policies and procedures.

Technological resources. Technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

Intellectual resources. Intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

Resources may include methodologies, applications, and tools used in the firm's QC system or the performance of its engagements.

Network or third-party resources. If the firm belongs to a network that provides or requires the use of network resources or if the firm obtains resources or services from a third-party provider:

- An understanding is obtained of how such resources or services are developed and maintained; and

- Such resources or services are supplemented or adapted as necessary such that their use enables the operation of the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

B. Specified Quality Responses **QC 1000.45-.51**

Specified quality responses are not intended to be comprehensive and alone will not be sufficient to enable the firm to achieve all established quality objectives. Firms are required to design and implement their own quality responses.

Required of all firms

- Design, implement, and maintain policies and procedures for firm personnel to adhere to appropriate standards of conduct, which include:

    - Fulfilling engagement and QC responsibilities with competence, integrity, objectivity, and due professional care; and

- Complying with APLR and the firm's policies and procedures.

- Design, implement, and maintain policies and procedures for the engagement partner and, commensurate with their responsibilities, other firm personnel participating in an engagement to obtain and maintain the competence to fulfill their respective assigned engagement roles, including an understanding of the following:

  - The importance of exercising sound judgment, including the ability to be objective and exercise professional skepticism;

  - The role of the firm's QC system in the performance of its engagements (e.g., engagement quality reviews, consultation process);

  - Their responsibilities with respect to the performance and supervision of the engagement;

  - For attestation engagements, the subject matter of the assertion on which the engagement is based;

  - The industry in which the company operates and its relevant characteristics (e.g., applicable standards, industry-specific risks, and industry-specific estimates);

  - The internal control framework used by the company;

  - The use of technology by the company in the preparation of its financial statements and related internal controls; and

  - The use of technological and intellectual resources in performing engagement procedures, including obtaining and evaluating evidence.

- At least annually, provide mandatory training, including training on APLR, to firm personnel to develop and maintain their competence and enable them to fulfill their assigned QC and engagement roles in accordance with APLR and the firm's policies and procedures.

- The firm's periodic performance evaluations of the individual(s) assigned (1) ultimate responsibility and accountability for the QC system as a whole and (2) operational responsibility and accountability for the QC system as a whole should take into account the outcome of the evaluation of the QC system.

- Design, implement, and maintain policies and procedures regarding licensure such that the firm and firm personnel hold licenses or other qualifications required by the relevant jurisdiction(s) under APLR.

- Design, implement, and maintain policies and procedures so that technological resources have the capacity, integrity, resiliency, availability, reliability, and security

necessary to enable the operation of the firm's QC system and the performance of its engagements in accordance with APLR.

C. Highlighted Topics

1. Demonstrating commitment to quality

A commitment to quality can be demonstrated through a person's actions and behaviors, including consistent adherence to firm policies and procedures, demonstrating key professional attributes like objectivity, integrity, and due professional care, and taking the initiative to develop and maintain competence. Conversely, a lack of commitment to quality can be seen through actions and behaviors such as inconsistent compliance with professional standards, cheating on professional development and compliance exams, or a "check the box" approach to professional development. Also see guidance on the governance and leadership component in section V, for discussion of tone at the top and commitment to quality by leadership.

2. Assignment of individuals

The quality objectives over the assignment of individuals to engagements focus on three key aspects of the ability to fulfill the assigned role:

- **Competence.** Individuals need to have competence to fulfill their assigned roles in accordance with APLR and the firm's policies and procedures. As described above, competence consists of having the knowledge, skill, and ability that enable individuals to act in accordance with APLR and the firm's policies and procedures. Competence is measured both qualitatively and quantitatively.

- **Objectivity.** The ability to maintain objectivity is essential to performing QC activities or engagements; a lack of objectivity may, for instance, create an unconscious bias that directly affects quality.

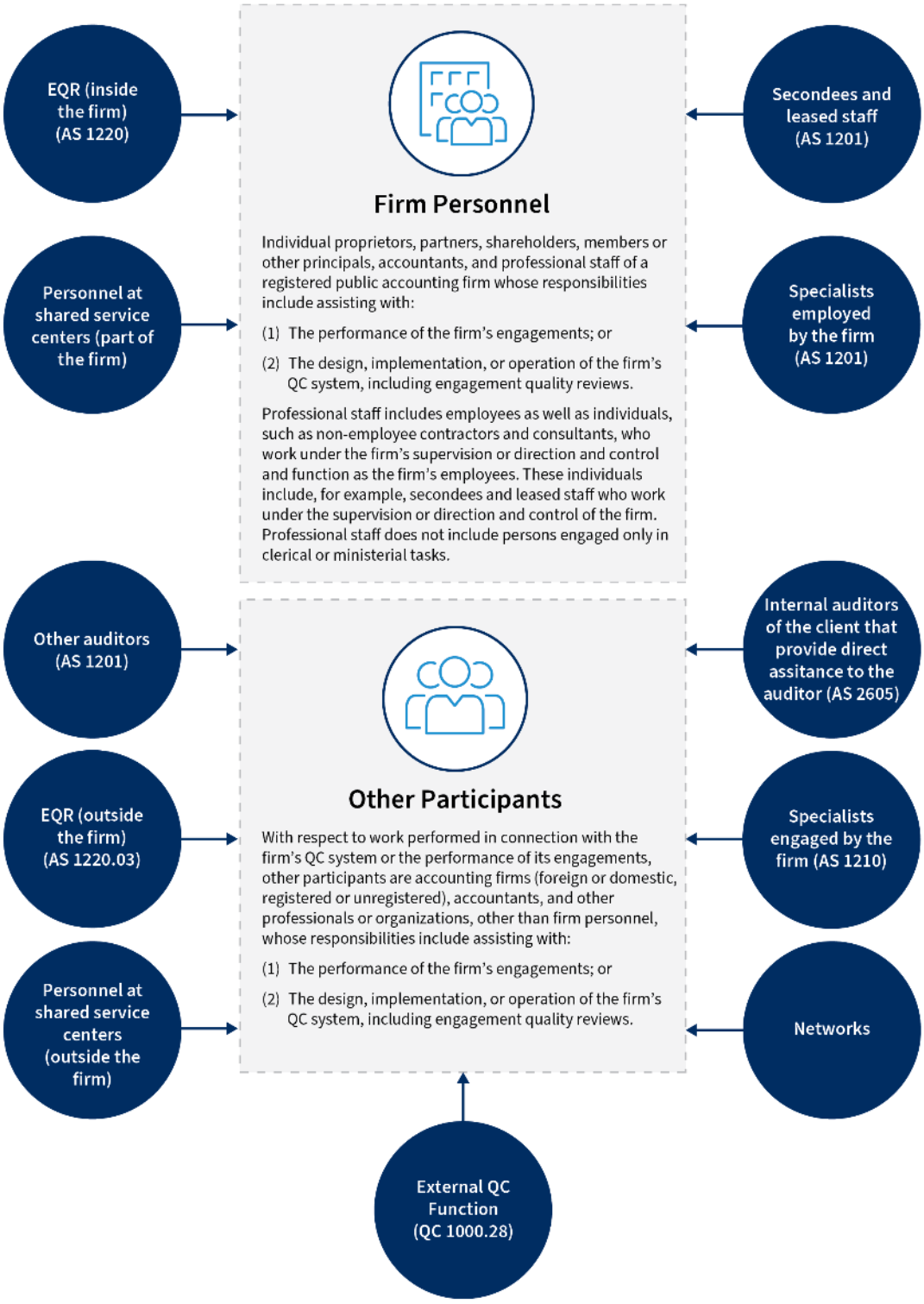
- **Time.** Individuals' ability to devote appropriate time to their assignments also affects quality.

In addition to the competence, objectivity, and time needed to perform engagement and QC activities, individuals need to have the requisite authority to perform effectively. In the context of engagement activities, the auditing standards already provide authority structures with respect to, for example, supervision and the responsibilities of the engagement partner, and those standards are augmented by firm policies on matters such as consultation. For QC activities, the standard specifies the need for appropriate authority in the quality objective.

3. Firm personnel and individuals who are other participants

In designing, implementing, and operating its QC system, the firm is required to address not only firm personnel but also individuals who are other participants (resources from outside the firm such as other auditors and other professionals or organizations) that the firm uses in connection with the firm's QC system or the performance of its engagements.

The following diagram (also presented in section II.C of this document) provides definitions and examples of firm personnel and other participants.



As noted in the diagram, the persons performing some roles, such as an engagement quality reviewer or personnel at shared service centers, may be either firm personnel or other participants, depending on their relationship to the firm. For example, an engagement quality reviewer employed by the firm would be considered firm personnel, whereas one that has been contracted from outside the firm that is not functioning as a firm employee would be an other participant. Similarly, personnel at shared service centers may be firm personnel (if they are employed by the firm or function as firm employees) or other participants (if they are employed by another organization, such as a network affiliate).

Considerations when using other participants. While it may be beneficial, and in many cases essential, to use other participants on engagements or in the firm's QC system, these arrangements can pose risks because other participants may not be subject to the same quality controls as firm personnel (for example, with regard to personnel assignments, training, supervision, and monitoring). While some other participants may be covered by their own firm's quality control system, the firm's own QC system is required to address all the work done on the firm's engagements and in connection with the design, implementation, and operation of the firm's QC system itself, regardless of who does it. A firm that uses resources from the network in many areas would have a number of quality risks and quality responses related to their use of resources from other participants. In this case, the firm may have policies and procedures around the use of other participants that differentiate based on the role of the other participant. To contrast, a smaller firm that only uses one individual from outside the firm as an engagement quality reviewer may have fewer quality risks and quality responses related to other participants. When designing quality responses, the firm will address the specific risks posed by the other participants and their responsibilities within the firm's engagements and QC system.

4. Considerations for training requirements

QC 1000 requires firms to provide mandatory training at least annually to firm personnel – including training on APLR – to develop and maintain their competence and enable them to fulfill their assigned roles in accordance with APLR and the firm's policies and procedures.

This specified quality response provides firms the ability to determine the type and extent of training necessary based on their personnel and the nature and circumstances of the firm and its engagements. For example, a firm may determine that training is necessary on a wide array of topics for a certain level of staff within the firm. Another firm may determine that training is necessary for one or more staff in a certain area due to a new engagement or as a result of an area of development identified as part of a performance evaluation. A firm may also decide that it is necessary to repeat training as a periodic reminder of existing requirements, such as those relating to internal control over financial reporting.

Ultimately, the type and extent of training needs to be directed at whatever is necessary to enable firm personnel to fulfill their assigned QC and engagement roles in accordance with APLR and the firm's policies and procedures. When designing their training programs and requirements, in addition to this specified quality response over providing mandatory training,

firms may want to consider whether additional training should be mandated as part of the firm's policies and procedures to address other topics of QC 1000. For example, in implementing policy and procedures regarding licensure, a firm may implement a training program that helps personnel comply with educational requirements for their licenses to remain valid. A firm could also consider recent engagement deficiencies and other QC deficiencies it has experienced when planning its training programs.

SCALABILITY CONSIDERATIONS

QC 1000 does not impose specific requirements over firms' training programs. The flexibility in the requirement provides firms the ability to determine the type and extent of training necessary based on their personnel and the nature and circumstances of the firm and its engagements.

5. Considerations for periodic performance evaluations

The quality objective contemplates that firms perform evaluations at least annually. Otherwise, QC 1000 does not specify the format of or approach to periodic evaluations. Many firms currently utilize an annual performance review process in order to facilitate such evaluations.

Evaluations help support and promote the continuous development of the competence of firm personnel.

A firm may have multiple quality responses to address the quality risks associated with the different types of firm personnel. For example, a firm's policies and procedures for performance evaluations may include provisions such as the following:

- Evaluations may differ based on the level of the firm personnel (e.g. engagement partner, manager, audit associate, etc.) or results of the firm personnel's previous performance evaluations.
- Evaluations may be conducted by different groups within the firm, or may be conducted in a different manner (e.g. may include different evaluation factors, may have different timing or frequency, may require approval by differing levels of seniority, etc.) depending on, for example, the type of specialist employed by the firm or whether an individual is part of a firm's shared service centers.
- Non-employee contractors and consultants, who work under the firm's supervision or direction and control and are considered firm personnel, may be evaluated through the contracting process to determine whether the firm should retain them.

Periodic performance evaluation for individuals in oversight role

Ultimate responsibility and accountability for the QC system as a whole

Operational responsibility and accountability for the QC system as a whole

- The firm's periodic performance evaluations of these individuals are required to take into account the results of the firm's evaluation of its QC system.
- Evaluation of a firm's QC system is addressed in **QC 1000.77-.78**.

SCALABILITY CONSIDERATIONS

QC 1000 is not prescriptive regarding the firm's periodic performance evaluation for individuals in oversight roles and a firm has flexibility in determining its approach to comply with this specified quality response. For example, the firm may set targets and measure the outcome of the evaluation of the QC system against those targets. As another example, the firm may consider the individual's actions taken in response to identified QC deficiencies or major QC deficiencies, including the timeliness and effectiveness of such actions. The periodic performance evaluation of these individuals may be informal in a less complex firm and involve a small group of people or be more formal and undertaken by a special committee in a more complex firm. In addition, based on its individual facts and circumstances, a firm may identify personnel in addition to those assigned ultimate responsibility and accountability and those assigned operational responsibility and accountability for the QC system as a whole whose performance evaluations need to consider the results of the firm's QC system.

6. Licensure or other required qualifications

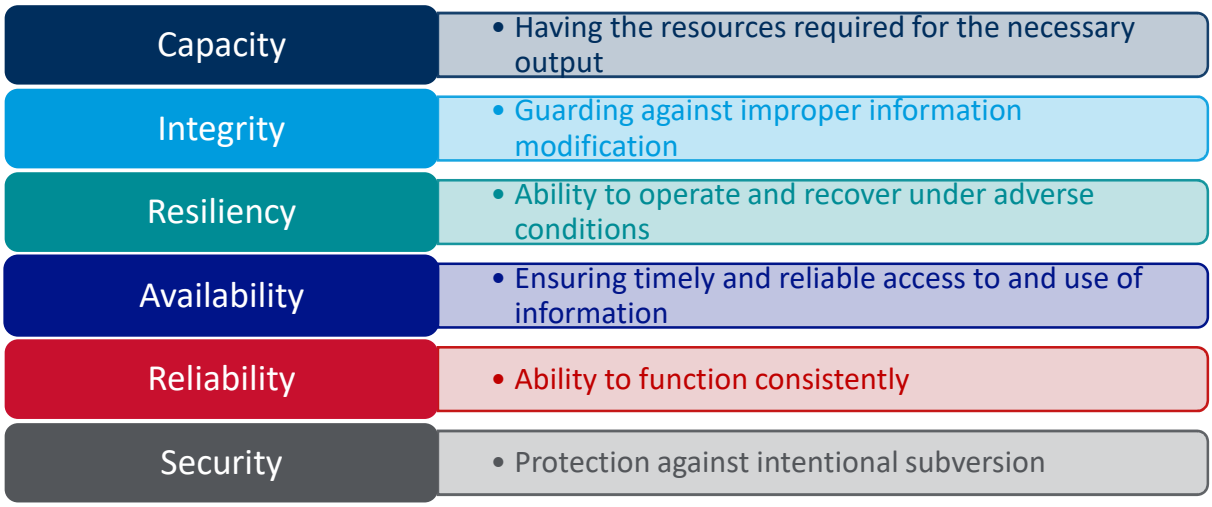
Laws or regulations may establish requirements for the professional licensing or other qualifications of the firm and firm personnel. Under this specified quality response, the firm is required to have policies and procedures regarding licensure such that the firm and firm personnel hold the required licenses or qualifications. The policies and procedures address such matters as (1) the jurisdiction(s) where firm and firm personnel are required to hold licenses or other qualifications and (2) whether the firm and such firm personnel comply with the jurisdictions' requirements.

7. Considerations related to technological resources

Technological resources cover many aspects that collectively comprise a firm's technological environment, including information technology (IT) applications, infrastructure, and processes (e.g., firm processes to manage access to the IT environment, program changes, changes to the IT environment, or IT operations). In addition to the quality objective, QC 1000 prompts firms to consider their access to and use of resources, including technological resources, as part of the firm's risk assessment process.

As part of the firm's quality response to this quality objective, the firm is required to have policies and procedures so that technological resources have the capacity, integrity, resiliency, availability, reliability, and security needed to enable the ongoing operation of the firm's QC system and performance of its engagements in accordance with APLR.

The chart that follows summarizes what it means to have these characteristics.[9]



The technology environment is dynamic, and firms' use of technological resources will likely continue to evolve in the future. QC 1000 does not have any prescriptive requirements related to how firms address emerging technology. Instead, it includes a risk factor to prompt consideration of technology as part of the firm's risk assessment process. Firms will need to assess their quality risks based on the evolving nature of their use of technology. Certain quality risks may remain constant (for example, the risk that engagement teams obtain audit evidence using technology that has not been determined to be reliable), while other risks may be identified or based on the changing use of technology (for example, risks relating to service organizations may become relevant if a cloud-based application is deployed or risks relating to algorithmic bias may be present if a firm develops software that uses generative artificial intelligence).

8. Considerations related to intellectual resources

Intellectual resources generally include resources that a firm makes available, or requires the use of, to enable the consistent operation of the firm's QC system and the performance of its engagements. These include, for example, the firm's policies and procedures, methodologies, guides, practice aids, and standardized documentation templates. Intellectual resources may be made available through a variety of media, including via written manuals or technological resources (e.g., the firm's methodology may be embedded in the

[9] *See* National Institute of Standards and Technology Glossary, *available at* https://csrc.nist.gov/glossary.

information technology application that enables the operation of the firm's QC system and facilitates the performance of the engagement).

Intellectual resources may be obtained or developed internally, or acquired externally (for example, a commercially available audit or QC methodology or a subscription data feed). Regardless of how intellectual resources are acquired, the firm remains responsible for ensuring they are fit for purpose, and for properly implementing and maintaining them.

Regardless of how intellectual resources are acquired, the firm is responsible for ensuring they are fit for purpose and properly implemented and maintained.

Example
A firm might perform the following procedures to help ensure its QC methodology is fit for purpose and properly implemented and maintained: • If a firm acquired its QC methodology from a vendor, the firm is responsible for choosing a methodology and implementing it (including appropriately identifying risks and designing, implementing, and operating appropriate responses) in a way that enables the firm's engagements to be properly performed and the firm's QC system to operate in accordance with QC 1000. • If a firm developed methodology to direct the performance of its engagements in accordance with APLR and a new auditing standard was issued after that methodology was implemented by the firm, the methodology would need to be updated to properly address the new requirements.

9. Resources from a network or third-party provider

Some firms use resources provided by a network or a third-party provider. Such resources may include methodologies, applications, and tools used in the firm's QC system or the performance of its engagements.

Networks. Many firms belong to a regional, national, or global network of firms. Since networks may involve a wide variety of arrangements and different degrees of coordination and cooperation across firms, rather than defining the term "network," QC 1000 describes these types of arrangements in more general terms.

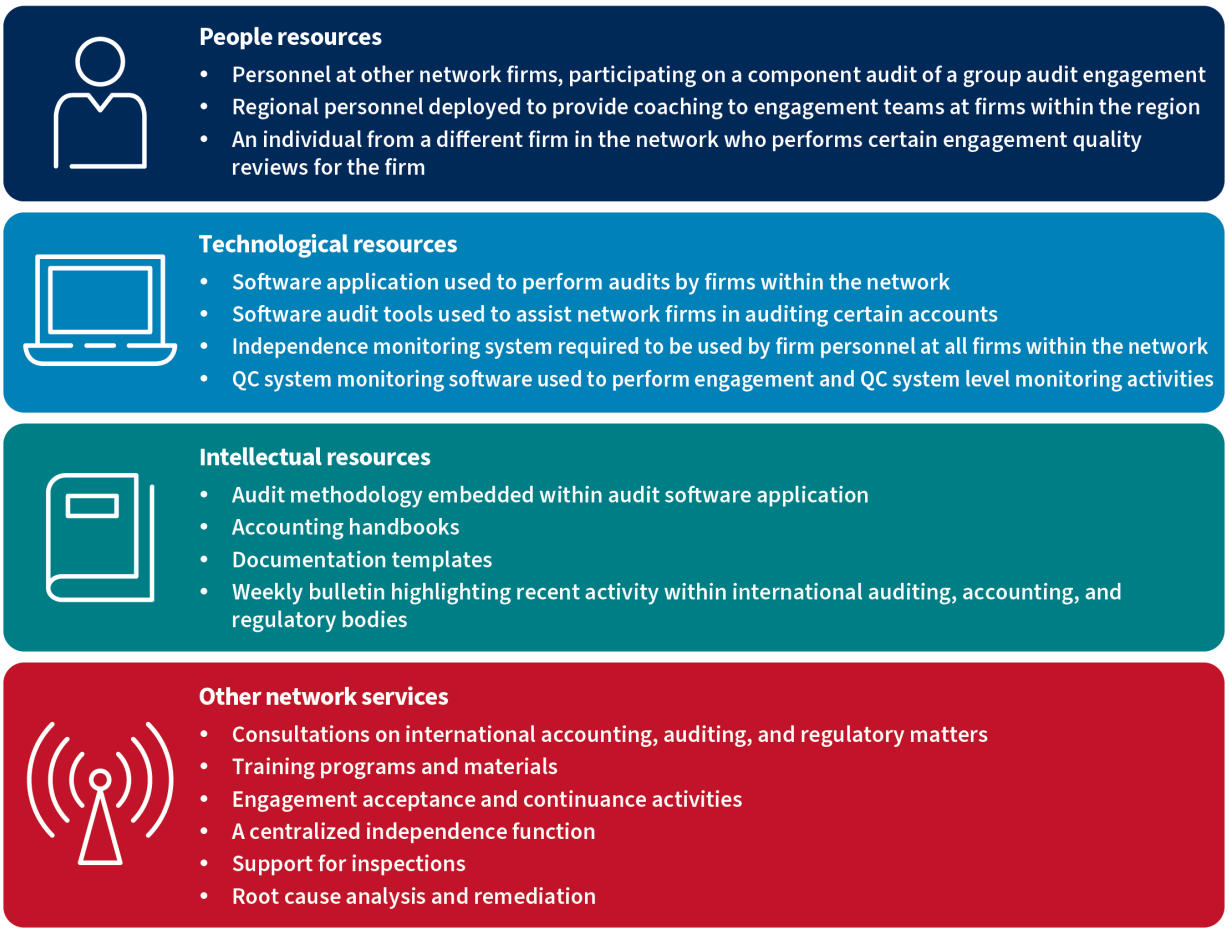
Networks may include a combination of registered and unregistered accounting firms and other entities.

Networks of firms may be structured in a variety of ways and could include arrangements between firms for sharing knowledge; developing and implementing consistent policies, tools, and methodologies; conducting multi-location engagements; or executing other types of business or administrative matters.

References to a network within QC 1000 encompass all memberships and affiliations that firms report to the PCAOB on Form 2.

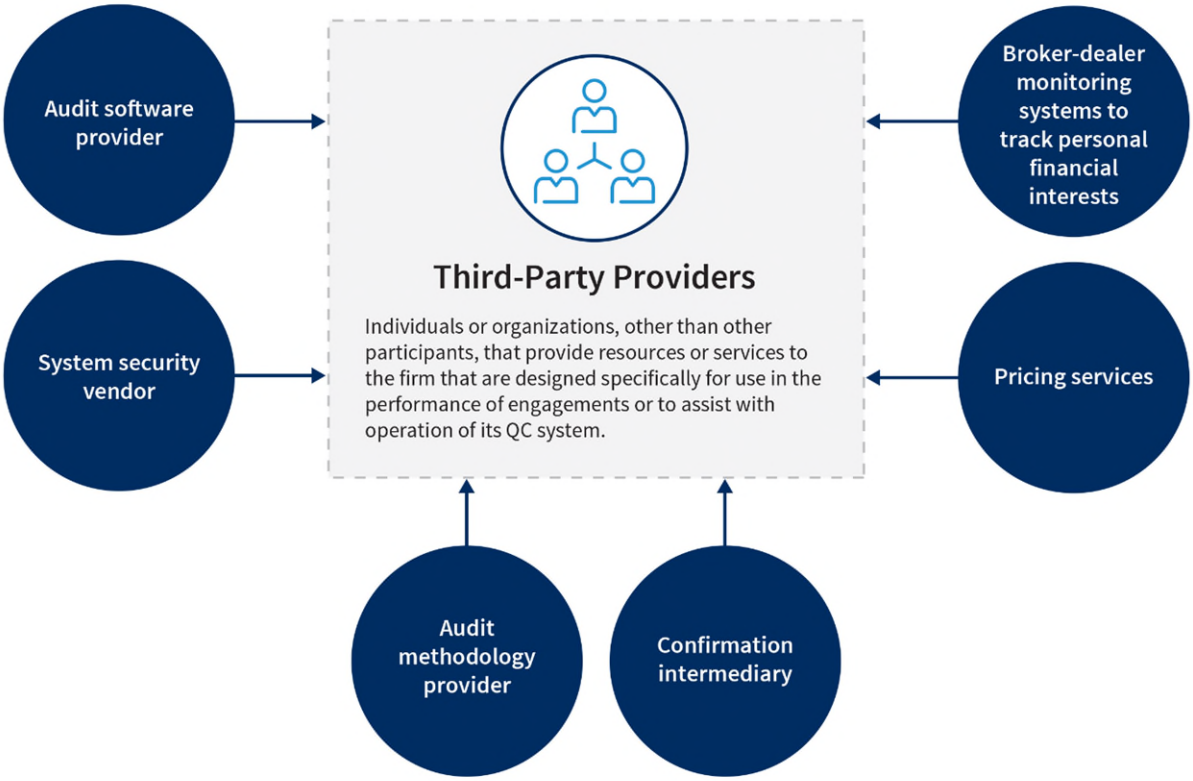
References to a network within QC 1000 encompass all of the memberships and affiliations that registered firms are required to report to the PCAOB in Item 5.2 of their annual report on Form 2, *Annual Report*, including arrangements, alliances, partnerships, and associations.

The following chart depicts some examples of resources and services that may be provided either among firms within a network of firms or by a group within the network that is not a firm.



Third-party providers. Some firms also use resources that are sourced from third-party providers.

The following diagram provides definition of third-party providers and provides several examples of them:



Considerations when using resources from a network or third-party provider. If a firm uses resources or services from the network it belongs to or from a third-party provider, the firm needs to obtain an understanding of how the network or third-party provider develops and maintains the resources or services. The firm may need to supplement or adapt the resources as necessary so their use enables the operation of the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

The firm remains responsible for the use of resources from a network or third-party provider in its engagements or QC system.

A firm may use multiple resources or services provided by the network or a third-party provider. As a result, the firm may identify multiple quality risks and develop multiple quality responses related to this quality objective.

For example, a firm may use multiple third-party providers for a variety of different resources, such as an audit methodology provider or a confirmation intermediary. If these different types of third-party providers or resources present different risks, the firm would be required to develop different quality responses. In that scenario, the firm could have different

policies and procedures applicable to different types of third-party providers and/or different types of resources.

A firm that is not affiliated with a network is not required to establish a quality objective related to network-provided resources and therefore would not identify quality risks or related quality responses.

Consideration of the nature of the resources provided by the network or third-party providers, how and to what extent the resources will be used, and the general characteristics of the third-party provider will assist the firm in determining whether it needs to supplement or adapt such resources.

Example
The firm may obtain its methodology from a third-party provider under an arrangement whereby the third-party provider agrees to update the methodology when new standards are issued. In this scenario, the firm remains responsible for verifying that such changes are incorporated into the methodology and supplementing the methodology if such changes are not made, so that the firm's resources support its performance of compliant engagements. As another example, the firm may obtain a service from a third-party provider that provides a System and Organization Controls 1 (SOC 1) report. The firm would be responsible for reviewing the report to determine whether controls at the organization are designed and operating effectively, and for designing and implementing any complementary user entity controls identified in the report.

The firm is also responsible for taking any necessary actions in using a resource from a network or third-party provider to enable the resource to function effectively. For example, the network or third-party provider may need information related to the firm's restricted entities so that it can facilitate independence confirmations. In addition, if the firm discovered a problem with the design or operation of the resource, it may need to communicate such problems to the network or third-party provider so that the resource can effectively operate.

X. INFORMATION AND COMMUNICATION

This component addresses the firm's processes for obtaining, generating, and using information to enable the design, implementation, and operation of the QC system and the performance of its engagements, and for communicating information within the firm and to external parties on a timely basis.

A. Quality Objectives **QC 1000.53**

Identifying, capturing, processing, and maintaining information. Information, whether from internal or external sources, is identified, captured, processed, and maintained by the firm's information system(s) to support the operation of the firm's QC system and the performance of its engagements in accordance with APLR.

Exchange of information

- The nature, timing, and extent of information communicated to firm personnel enables them to understand and carry out their responsibilities relating to activities within the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

- Firm personnel communicate information to the firm and other firm personnel to support the operation of the QC system and the performance of the firm's engagements in accordance with APLR.

External parties

- Information is communicated to external parties in accordance with APLR.

- If a firm communicates firm-level or engagement-level information with respect to the firm's audit practice, firm personnel, or engagements, such as firm or engagement metrics, to external parties, such information is accurate and not misleading and, with respect to any such metrics that are communicated in writing, the communication explains in reasonable detail how the metrics were determined and, if applicable, how the method of determining them changed since the metrics were last communicated.

External parties may include, for example, company management, audit committees, and boards of directors; the SEC; the PCAOB; and other regulators.

Networks and other participants

- If the firm belongs to a network, information is communicated to or obtained from the network to enable the operation of the firm's QC system and the performance of its engagements in accordance with APLR.

- If other participants are used in the firm's QC system or engagements:

  - The nature, timing, and extent of information communicated to other participants enables them to understand and carry out their responsibilities relating to activities within the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures; and
  - Information is obtained from the other participants, such that the aspects of the QC system and the engagements in which they are involved can be performed in accordance with APLR. 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.

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.

- If the firm participates in another firm's engagement, information is communicated to and obtained from the other firm such that the firm's work on the engagement is performed in accordance with APLR. This communication includes any instances of noncompliance with APLR that the firm identifies related to the other firm's engagements during the firm's monitoring and remediation procedures.

B. Specified Quality Responses **QC 1000.54-.57**

Specified quality responses are not intended to be comprehensive and alone will not be sufficient to enable the firm to achieve all established quality objectives. Firms are required to design and implement their own quality responses.

Required of all firms

- Communicate in writing its policies and procedures related to the operation of the firm's QC system and the performance of its engagements to firm personnel and other participants to the extent and in a manner that is reasonably designed and implemented to enable firm personnel and other participants to understand and carry out their responsibilities relating to activities within the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

- Communicate information related to the monitoring and remediation process to firm personnel to enable them to take timely action in accordance with their responsibilities, including, to the extent necessary, a description of:
    - Monitoring activities performed and the results of such activities, including, if applicable, monitoring activities performed by a network;
    - Identified engagement deficiencies and QC deficiencies, including the nature, severity, and pervasiveness of such deficiencies; and
    - Actions to address the identified engagement deficiencies and QC deficiencies.
- Communicate the result of the annual evaluation of the firm's QC system to the firm's partners, shareholders, members, or other principals, and the firm's board of directors or equivalent.

C. Highlighted Topics

1. Communicating firm-level or engagement-level information

Some firms make public communications about firm-level or engagement-level information, such as firm metrics and financial data. For example, some firms publish transparency or audit quality reports, either voluntarily or in response to the requirements of other jurisdictions, that contain data such as:

- Revenue breakdown by service line, by year, or by geographic segment;
- Professional staff ratios;
- Staff turnover ratios;
- Average training hours per professional; and
- Partner workload.

In addition to transparency or audit quality reports, firms may communicate these data via webpages or other media, such as promotional publications, social media, interviews, or presentations via webcast or video.

QC 1000 includes a quality objective that, if a firm communicates firm-level or engagement-level information, such as firm or engagement metrics, to external parties, such information is accurate and not misleading. In addition, with respect to any metrics relating to the firm's audit practice, firm personnel, or engagements that are communicated in writing, such information explains in reasonable detail how the metrics were determined and, if applicable, how the method of determining them changed since the metrics were last communicated.

The firm-level or engagement-level information is not limited to information relating to firm's audit practice and includes communications such as promotional publications, webcasts, and information available on the firm's website (for example, information communicated in speeches or statements by firm leadership or other individuals that are representing the views of the firm, and information communicated to external parties regarding the firm's investment in technology or staff well-being initiatives).

For metrics that are required or prescribed by regulatory authorities, such as the PCAOB, firms should comply with the calculation inputs or methods specified by those entities.

For written metrics relating to the firm's audit practice, including its firm personnel or engagements, the firm also has to disclose how those metrics were determined and, if applicable, how the method of determining them changed since the metrics were last communicated. This includes not only metrics reported in a firm's audit quality, transparency, and similar reports, but any metric related to the firm's audit practice that the firm publicly communicates in writing, for example metrics on the firm's website or metrics shared by the firm's social media accounts.

There are variations and complexities in how metrics are calculated by firms, as well as changes in the calculation method over time. Under QC 1000, the firm is required to explain how the metric was determined in reasonable detail. Generally, a description of the calculation including the formula applied by the firm would be appropriate, and to the extent that there are key assumptions or estimates in the inputs used, these could also be explained. For example, in a staffing related ratio, the firm may exclude certain professionals from the calculation, or incorporate a full-time equivalent measurement when calculating headcount data. The firm would need to explain this information in reasonable detail in order to meet the quality objective. For metrics that are required or prescribed by regulatory authorities, such as the PCAOB, firms should comply with the calculation inputs or methods specified by those entities.

If a firm changes the inputs or calculation method, the firm would have to explain the change made since the metric was last calculated and communicated. For example, if the firm decides on a going forward basis to include staff from its shared service centers that were previously excluded from staffing-related metrics, the firm needs to explain this change the next time the firm makes a communication of the staffing-related metrics.

While this provision applies both to voluntary metrics and to metrics that a firm is required to calculate and communicate pursuant to the rules of the regulatory authorities, as a practical matter firms will not have to provide such communications regarding required metrics if the formula to calculate the metric is publicly available. For example, if PCAOB rules require a firm to calculate and communicate a metric in a certain way, then the firm should calculate the metric following the required calculation method. If the calculation method for such a metric is revised by the PCAOB in a subsequent rulemaking, then the firm need not describe in the

required communication how the method of determining the metric changed since the metric was last communicated.

2. Information and communication within a network

Under QC 1000, if the firm belongs to a network, information is communicated to or obtained from the network to enable the operation of the firm's QC system and the performance of its engagements in accordance with APLR.

Example
If the network performs centralized monitoring procedures over certain resources that are used by the network member firms in either their engagements or their QC system, such as globally used technology platforms or methodologies, then the firm will need to obtain information from the network regarding the results of the monitoring procedures performed. This will enable the firm to evaluate whether it is able to rely on the operation of those resources for its engagements or QC system.

3. Communicating with other participants

Communicating the firm's policies and procedures to other participants. QC 1000 includes a quality objective that the nature, timing, and extent of information communicated to other participants enables them to understand and carry out their responsibilities relating to activities within the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

In addition, the standard includes a specified quality response requiring the firm to communicate in writing its policies and procedures related to the operation of the firm's QC system and the performance of its engagements to other participants to the extent and in a manner that is reasonably designed and implemented to enable other participants to understand and carry out their responsibilities relating to activities within the firm's QC system and the performance of its engagements in accordance with APLR and the firm's policies and procedures.

The firm would not necessarily have to communicate all of its policies and procedures to other participants to meet the requirements of the standard. The type of policies and procedures communicated would vary based on the roles other participants play in the operation of the firm's QC system and the performance of its engagements. For example, a firm would communicate to an externally contracted engagement quality reviewer the policies and procedures needed to appropriately perform an engagement quality review, for example regarding independence, objectivity, and documentation.

QC 1000 does not prescribe any specific format (e.g., narrative, flow chart, or other forms) that the firm needs to follow when communicating its policies and procedures. The policies and procedures are required to be in writing and in a manner that is reasonably designed to enable firm personnel and other participants to understand and carry out their

responsibilities relating to activities within the firm's QC system and the performance of its engagements. The format of these policies and procedures may vary depending on the specific responsibilities being addressed and how the firm wants to communicate them.

Obtaining information from other participants, including the conclusion of the most recent evaluation of the QC system. QC 1000 includes a quality objective that, if other participants are used in the firm's QC system or engagements, information is obtained from the other participants such that the aspects of the QC system and the engagements in which they are involved can be performed in accordance with APLR. A note in the standard states that with respect to other participants that are firms, the information to be obtained should include the conclusion of the most recent evaluation of the QC system of the other participant firm.

The most recent evaluation of the other participant firm's QC system refers to that firm's evaluation under QC 1000.77 as of the most recent "evaluation date" (as defined in QC 1000.77), if such an evaluation was performed. If the other participant firm did not evaluate its QC system under QC 1000.77 as of the most recent evaluation date, then this provision refers to the most recent QC evaluation performed by the other participant firm under any professional standard.

In practically all cases, the firm would be able to obtain the conclusion of the most recent evaluation of the other participant's QC system. If a firm is unable to obtain the other firm's evaluation of its QC system (for example, if the other participant has not performed an evaluation or if local laws forbid them from sharing it), then the firm should assess what other procedures are necessary to achieve the quality objective.

SCALABILITY CONSIDERATIONS

Information infrastructures vary from firm to firm and encompass various sets of activities involving people, processes, data, or technology, or some combination thereof. Some firms' information infrastructures may be heavily reliant on IT aspects while others may require more manual intervention. QC 1000 is not prescriptive in the methods of communications and firms are able to determine the information infrastructure necessary to achieve their quality objectives.

In addition, QC 1000 requires the firm to make certain communications with other participants. The nature and extent of communications necessary to meet the standard's requirements would be scalable with the size of the firm's PCAOB practice and the risks and complexities of their engagements.

XI. THE MONITORING AND REMEDIATION PROCESS

A. General Requirements QC 1000.58-.60

QC 1000 requires firms to design, implement, and operate a monitoring and remediation process. The standard specifies three goals for the monitoring and remediation process:

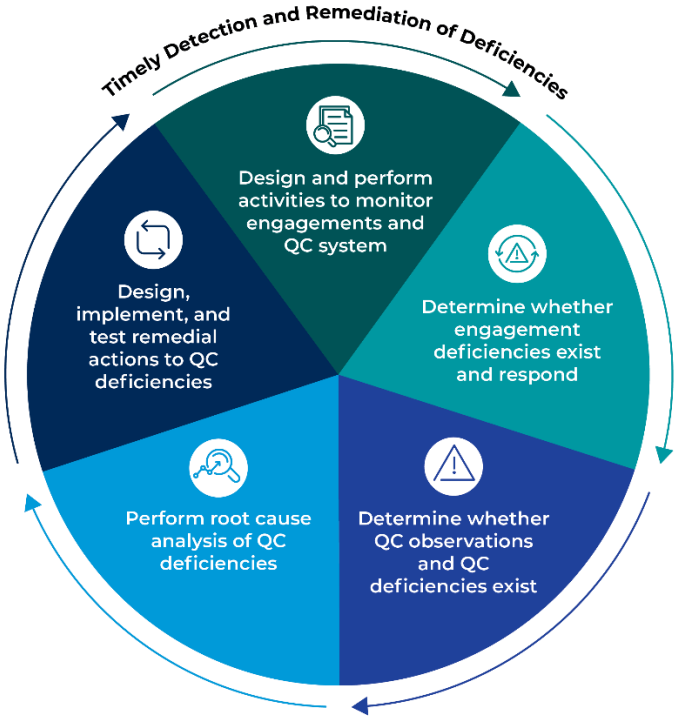
Relevant, reliable, and timely information. Monitoring and remediation must provide information about the design, implementation, and operation of the firm's QC system that is relevant, reliable, and timely. The information obtained from monitoring activities informs a firm about actions, behaviors, or conditions that contributed to issues that need to be addressed and may also provide insights as to factors that help prevent deficiencies from occurring. For example, information obtained about actions, behaviors, and conditions related to an engagement that was subject to internal or external monitoring activities where no deficiencies were identified may provide insights about good practices to use when addressing issues on similar engagements.

Reasonable basis for timely detection of engagement deficiencies and QC deficiencies. The standard uses the concept of "reasonable basis," which is present throughout PCAOB auditing standards, including the standards governing the auditor's report. "Timely" as it relates to the detection of engagement deficiencies means that the firm's monitoring activities are designed to identify deficiencies as promptly as practicable. For example, the firm's monitoring activities will generally enable the firm to identify deficiencies in calendar year-end engagements in time to include them in its evaluation of the QC system as of the following September 30.

The firm's monitoring activities will generally enable the firm to identify engagement deficiencies in calendar year-end engagements in time to include them in its evaluation of the QC system as of the following September 30.

Timely remediation. The firm's monitoring and remediation process must enable timely remediation of identified engagement deficiencies and QC deficiencies. What constitutes "timely" depends on the deficiency's nature, scope, and impact. For example, where there is a high risk of severity or pervasiveness, remedial actions may have to be immediate to be timely.

The monitoring and remediation process applies to the design, implementation, and operation of all QC system components, including monitoring and remediation. The following illustration depicts how a firm's monitoring and remediation process provides relevant, reliable, and timely information about the design, implementation, and operation of the firm's QC system, in order to provide a reasonable basis for timely detection of engagement and QC deficiencies, and timely remediation of these deficiencies.



Subsequent parts of this section provide guidance about each element of the firm's monitoring and remediation process.

SCALABILITY CONSIDERATIONS

There are a number of ways to approach the design and implementation of the monitoring and remediation process. When considering how to meet these general requirements of the monitoring and remediation process, firms may wish to consider who might be involved in the process and how often to enable a proactive and effective process. For smaller and less complex firms, the process may be centralized and involve only a few individuals. For larger and more complex firms, the process may be more structured and decentralized, involving multiple layers and groups.

B. Design and Perform Monitoring Activities QC 1000.61-.66

QC 1000 requires firms to include both engagement monitoring and QC system-level monitoring activities in their monitoring activities.

Engagement Monitoring Activities, which are directed at individual engagements, including in-process and completed engagements.

QC system-level Monitoring Activities, which are directed at the performance of activities under the requirements of QC 1000, including requirements relating to the components of the QC system, including the firm's risk assessment and monitoring and remediation processes.

A firm could design and perform dual-purpose monitoring activities – i.e., activities directed at individual engagements that also address aspects of the firm's QC system. For example, a firm could perform engagement monitoring activities related to acceptance and continuance of engagements that would also address the design, implementation, and operation of the acceptance and continuance of engagements component of the firm's QC system.

The frequency and timing of the firm's monitoring activities (e.g., a combination of ongoing and periodic monitoring activities) are important elements in achieving a monitoring and remediation process that is effective overall. Ongoing monitoring activities are generally those activities that are routine in nature, built into the firm's processes, and performed on a real-time basis. Periodic monitoring activities, by contrast, are conducted from time to time at set intervals. The use of ongoing and periodic monitoring activities will vary by firm and be influenced by the nature and circumstances of the firm.

Maintaining objectivity when performing monitoring activities. Allowing individuals to review their own work is inconsistent with a required quality objective that individuals assigned to perform activities within the QC system have the competence, objectivity, and time to perform them. Therefore, individuals generally cannot perform monitoring activities over their own work. The impact of this restriction will depend on the role that the individual played in the engagement.

Individuals generally cannot perform monitoring activities over their own work.

Example
Individuals who have consulted on a particular area of an engagement might be permitted to perform monitoring activities on other areas of an engagement that were unrelated to the consultation. However, individuals that served as the engagement quality reviewer on an engagement may not perform monitoring activities on that engagement, even if they did not review every area of the engagement, because they are required to evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report (*see* AS 1220.09).

SCALABILITY CONSIDERATIONS

Some firms may require additional resources to perform monitoring activities. Firms may use other participants (e.g., external consultants) to assist with responsibilities within the firm's monitoring activities if there are shortages of firm personnel available to perform monitoring activities and also maintain objectivity.

Consistent with the performance of engagements, the firm's own QC system is required to address all the work done in connection with the design, implementation, and operation of the

firm's monitoring activities, regardless of who does the work (i.e., firm personnel or other participants). See guidance on the use of other participants in section IX.C.3.

1. Engagement monitoring activities

Engagement monitoring activities provide valuable information to firms on whether engagement or QC system-level areas may require additional attention. For example, monitoring procedures may highlight an area on an audit engagement where insufficient audit evidence was obtained to support the auditor's opinion. More broadly, engagement monitoring activities may identify pervasive issues where a number of engagements have similar problems, possibly highlighting the need to revise methodology, provide additional training, or take other actions at the QC-system level.

Some requirements for engagement monitoring activities vary based on the size of the firm. These requirements are discussed in detail later in this section and can be summarized as follows:

- All firms are required to monitor completed engagements.
    - Firms with five or fewer issuer, broker, and dealer engagements are permitted to include non-PCAOB engagements in their engagement monitoring activities.
- Firms with larger PCAOB audit practices are required to monitor in-process engagements; all other firms are required to consider monitoring in-process engagements.
- All firms that participate at a level below a substantial role in another firm's engagements are required to consider performing monitoring activities on that work.

SCALABILITY CONSIDERATIONS

For firms that issued engagement reports with respect to five or fewer engagements for issuers, brokers, and dealers during the prior calendar year, engagement monitoring activities may include monitoring audits not performed under PCAOB auditing standards, provided that:

- Such audits are selected taking into account the factors in QC 1000.64 (see section XI.B.1.a); and
- Instances of noncompliance with applicable auditing standards identified through monitoring are treated as if they were:
    - Engagement deficiencies for purposes of evaluating whether similar engagement deficiencies exist (see section XI.C.2.d); and

- QC observations for purposes of determining whether QC deficiencies exist (see section XI.E).

Additionally, the firm is still required to inspect at least one completed engagement performed under PCAOB auditing standards for each engagement partner on a cyclical basis (see section XI.B.1.b).

a. Designing engagement monitoring activities, including selecting which engagements to monitor

QC 1000 includes factors that a firm is required to take into account when determining the nature, timing, and extent of engagement monitoring activities, including which completed or in-process engagements to select for monitoring. These factors reflect aspects of a firm and its engagements that could create a greater risk of noncompliance with APLR. The firm will need to tailor its monitoring activities to address the particular circumstances of the firm and select engagements for monitoring based upon their specific risks.

The following table includes a list of these factors (QC 1000.64), with related examples.

Factor	Example
Quality risks and the reasons they were assessed as such	The complexity of or changes to APLR and the firm's policies and procedures may present a quality risk that the firm may not timely communicate the required use of a practice aid for planning audit procedures when certain fraud risk factors are present. In response to this risk, the firm would design its engagement monitoring activities to verify the engagement team's use of the practice aid. The earlier these monitoring activities are performed, the more proactive the firm could be in planning audit procedures that address audit issues as they arise.
Quality responses, including their timing, frequency, scope, and operation	A firm's audit methodology may require certain milestones within each audit engagement to be completed by a certain date before the year-end of the company under audit (e.g., engagement planning) in order to be responsive to certain risks identified within the engagement performance component of the firm's QC system. The firm would consider this timing when determining the timing of in-process monitoring activities.
The nature, timing, extent, and results of previous monitoring activities (engagement and QC system monitoring activities) undertaken by the firm and, if applicable, a network	Engagement deficiencies related to inventory obsolescence testing that were identified by a firm through prior year engagement monitoring activities may prompt the firm to monitor the testing of inventory obsolescence on more engagements in the current year.
Information obtained from oversight activities by regulators, other external inspections or	This information provides a firm direction as to, for example, the type of procedures to perform or when to perform them. It

Factor	Example
reviews, and, if applicable, monitoring activities performed by a network	could also identify issues that may exist on other similar engagements of the firm, prompting a decision to monitor some or all of these other engagements. For example, if an engagement was recently inspected through network monitoring activities or an external review, a firm may determine that selecting the same engagement for internal inspection would be unnecessary. In another example, a firm may decide that it is necessary to design its in-process monitoring activities to focus on areas of increased external inspection findings identified in the firm's engagements. A firm cannot rely solely on monitoring activities performed by others without performing its own engagement monitoring activities. Regardless of whether a network performs engagement monitoring activities over a firm's engagements, the firm is ultimately responsible for its QC system and for evaluating any information it obtains from the network about any engagement monitoring activities the network performs. The firm will take into account the nature and extent of activities performed by a network in designing and implementing its own activities, but all firms are required to perform some level of engagement monitoring.
Characteristics of particular engagements, such as the industry, the type of engagement, the location(s) or jurisdiction(s) in which the company is located or the work is to be performed, whether it is a new engagement for the firm, and the experience and competence of the engagement team could affect conduct and outcomes of the engagement.	If the engagement team members are all new to the engagement, their lack of historical knowledge may present an additional risk for that engagement and provide a basis for its selection for monitoring.
Characteristics of particular engagement partners, such as their experience, their competence, the results of internal and external inspections of their work, and the firm's cycle for inspecting their engagements could affect the quality risks associated with an engagement, whether positively or negatively.	An engagement partner's lack of experience in an industry that a company under audit recently entered may create additional risks to complying with APLR. Therefore, performing engagement monitoring activities on such engagements might be appropriate.
Other information relevant to quality risks, such as emerging developments, changes in economic conditions, new accounting or auditing standards, circumstances in which the firm has withdrawn its engagement report, restatements, complaints and allegations of	As a result of rising interest rates, a firm may determine that there is increased audit risk related to the valuation and classification of investment securities. It may therefore determine that it is appropriate to increase the number of in-process and completed engagements in the financial services industry over which it performs monitoring activities.

Factor	Example
which the firm is aware, other events affecting one or more engagements.	

b. Monitoring completed engagements

Cyclical period. As one element of engagement monitoring, QC 1000 requires firms to inspect at least one completed engagement for each engagement partner over a cyclical period. Firms can choose any cyclical period that achieves their quality objectives, but can adopt a cycle longer than three years only if they are able to demonstrate how that cycle is adequate to provide a reasonable basis for detecting engagement deficiencies and QC deficiencies, taking into account the factors discussed in QC 1000.64. Regardless of the cyclical period used by the firm, risks or other circumstances related to an engagement or an engagement partner may trigger the need for the firm to inspect an engagement partner's completed engagement(s) more than once during the cyclical period.

The cyclical monitoring of engagement partners must be performed over "engagements" as defined in QC 1000.

Although firms with five or fewer issuer and broker-dealer engagements are permitted to include non-PCAOB engagements in their monitoring activities, the cyclical monitoring of engagement partners must be performed over "engagements" as defined in QC 1000. This will ensure that firms regularly evaluate the work of every partner under PCAOB standards to determine whether deficiencies have occurred and can design and implement appropriate remedial actions.

Incorporate an element of unpredictability. QC 1000 requires firms to incorporate a level of unpredictability in their selection and monitoring of completed engagements, such that an engagement partner would not be certain of at least one of:

- Which engagement would be selected;
- Which areas within the engagement would be selected; or
- When an engagement would be selected.

In order to allow sufficient flexibility for firms to determine how to incorporate unpredictability in the selection process, QC 1000 allows firms to select "at least one of" the elements listed above (note to QC 1000.62b).

c. Monitoring in-process engagements

QC 1000 requires firms with larger PCAOB audit practices to monitor in-process engagements. Firms with smaller PCAOB audit practices, under QC 1000, are not required to monitor in-process engagements but are required to consider doing so and may determine, in

light of their assessed quality risks, that in-process monitoring is a necessary or appropriate part of their QC system.

QC 1000 does not specify any particular in-process engagement monitoring activities, so the firm has discretion to select activities based on the nature and circumstances of the firm and its engagements and the scope and nature of its other monitoring activities. For example, when determining which engagements to select for in-process monitoring, a firm would leverage the factors presented in the table in section XI.B.1.a above, to identify engagements where there is a greater risk of noncompliance with APLR. Similarly, these factors will also assist a firm in determining the riskier areas of such engagements upon which to perform in-process engagement monitoring activities.

An individual that is the engagement quality reviewer on an engagement may not perform monitoring activities on that engagement, even if they did not review every area of the engagement, because they are required to evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.

The table below illustrates examples of in-process engagement monitoring activities:

In-process engagement monitoring activity	Example
Monitoring activities on a specific area of the audit after the engagement team has conducted certain audit procedures or used a specific tool or template.	An in-process reviewer may evaluate an engagement team's testing of management's earnings forecast used in an impairment analysis.
Engagement team coaching by an individual who is not part of the engagement team and is not the engagement quality reviewer.	A member of the firm's national office may work with an engagement team to review their audit approach, including the nature, timing, and extent of planned audit procedures.
Evaluating an engagement team's progress against certain defined milestones or metrics and taking appropriate action when such milestones or metrics are not achieved.	If an engagement partner did not review an engagement team's planning memo before interim audit procedures were to start, the firm may adjust the engagement team's schedule so that the document could be reviewed and comments addressed before starting interim work. If an engagement team's hours exceeded a certain weekly threshold, the firm may take action by identifying the issue and adding additional resources to the team.
Monitoring engagement team turnover during the engagement and taking appropriate action when issues arise.	If more experienced or senior personnel on the engagement, such as the manager or senior manager, leaves the firm during the engagement and prior to the completion of procedures, the firm may take actions to ensure the engagement team has the necessary resources to complete the engagement in accordance with APLR and the firm's policies and procedures.

SCALABILITY CONSIDERATIONS

Firms with larger PCAOB audit practices are required to monitor in-process engagements and firms with smaller PCAOB audit practices are required to consider monitoring in-process engagements. Differentiating a firm's monitoring obligation based on the size of audit practice is appropriate because firms with larger, more complex audit practices generally are subject to quality risks for which in-process monitoring is an appropriate quality response. This approach strikes an appropriate balance between prescriptiveness and scalability. Firms with smaller PCAOB audit practices are required to consider monitoring in-process engagements and are expected to reach a conclusion whether to monitor in-process engagements in light of identified quality risks and quality responses.

Example
Because of the adoption of a new auditing standard on the auditor's use of confirmation, a firm with a smaller PCAOB audit practice may decide to increase the frequency at which it selects confirmation of cash or accounts receivable as an inspection area as part of monitoring activities over completed engagements. In addition, although the firm issued audit reports with respect to 100 or fewer issuers in the previous calendar year, after consideration of the quality risks surrounding adoption of the new auditing standard, the firm may determine to also monitor the confirmation of cash or accounts receivable on a sample of in-process engagements in the year after adoption.

d. Monitoring activities over other work

If the firm participates at a level below a substantial role in another firm's engagements, QC 1000 requires the firm to consider performing monitoring activities over such work. When deciding whether to perform monitoring activities over referred work, and when deciding the nature, timing, and extent, firms are required to take into account the factors identified in section XI.B.1.a above, such as the firm's monitoring and external inspection history and the risks associated with the performance of the work. In addition, if a substantial portion of the firm's activities that are subject to the QC system relate to work performed on other firms' engagements at less than a substantial role, the firm would have to make that decision in light of the overall objectives of the QC system.

Example
While performing monitoring activities over engagements completed in the previous year, a firm may identify an increased number of engagement deficiencies in the area of auditing revenue. In response, the firm may plan to increase the frequency at which it selects revenue as an audit area of focus for monitoring completed engagements. At the same time, this firm may determine to also monitor revenue auditing procedures performed on a sample of work performed on other firms' engagements at less than a substantial role.

2. QC system-level monitoring activities

QC 1000 includes factors a firm is required to take into account when determining the nature, timing, and extent of QC system-level monitoring activities. Due to their nature, some of these factors are consistent with the factors a firm is required to take into account when determining the nature, timing, and extent of engagement monitoring activities.

Factor	Example
Quality risks and the reasons they were assessed as such.	A firm identified a quality risk related to firm personnel misinterpreting a new accounting standard that becomes effective soon. To address this quality risk, the firm may decide to implement various required trainings, update audit methodology, and publish practice aids. The firm may design its QC system-level monitoring activities to monitor the implementation of these efforts (e.g., monitor completion of required trainings within the established timelines or perform targeted engagement monitoring activities to assess the effectiveness of the updated audit methodology and published practice aids).
Quality responses, including their timing, frequency, scope, and operation.	A firm's quality responses related to acceptance and continuance of engagements might include a policy that firm personnel complete a checklist and assemble information evaluated by the engagement partner before making a recommendation to firm leadership on whether to continue with an engagement for the upcoming year. Based on this quality response, a firm might design QC system-level monitoring activities that include a review of the checklist and documentation for a selection of engagements.
For monitoring activities over the firm's risk assessment and monitoring and remediation processes, the design of those processes (including any metrics that the firm may have developed for its QC system). ***The design of these processes is relevant when designing monitoring activities to evaluate if such processes are implemented and operating effectively.***	A firm may monitor the cyclical basis determined by the firm for inspecting engagement partners' completed engagements. A firm's monitoring activities in this area could include determining whether the firm is complying with the established period for selecting completed engagements as well as evaluating whether changes to the period may be necessary based on the results of other monitoring activities. The firm could also develop metrics for its QC system and use them in its monitoring and remediation process.
Changes or anticipated changes in the QC system. ***As a firm's QC system is continuously evolving in response to changes in risks, the firm may consider whether and how such changes necessitate changes to the nature, timing, and***	A firm may decide to use another firm as an other participant in one of its engagements. As a result of this change, a firm would start monitoring compliance with all related provisions of QC 1000 that address the use of other participants. Even in the absence of changes in the QC system, for example in cases where the firm determines that there have been no changes related to a particular quality response, the firm needs to consider whether previous monitoring activities related to that quality response continue

Factor	Example
extent of QC system-level monitoring activities.	to provide the firm with a reasonable basis to evaluate the QC system, including the appropriateness of the firm's monitoring activities for the current period.
Services or resources provided by other participants or third-party providers in the firm's QC system, when applicable.	A firm may use other participants to assist with engagement quality reviews. The firm's QC system-level monitoring activities could include assessing other participants' compliance with PCAOB standards regarding engagement quality reviews.
The results of previous monitoring activities and remedial actions taken to address previously identified QC deficiencies.	The previous monitoring activities identified a bug in the software for the IT application used for checking the record of attendance at training events. The firm implemented a fix to the bug and increased the frequency of its QC system-level monitoring related to this IT application.
Information obtained from oversight activities by regulators, other external inspections or reviews, and, if applicable, monitoring activities performed by a network.	The network's monitoring activities identified QC deficiencies related to the development of updates to the audit software, which is required to be used by the firms in the network. When determining the nature, timing, and extent of its own QC system-level monitoring activities, the firm would take into account information about these QC deficiencies obtained from the network.
Complaints and allegations of which the firm is aware.	A firm received a number of whistleblower complaints regarding individuals manipulating the software used to take mandatory training exams and sharing answers. Because of these allegations, the firm implemented additional activities to monitor (1) individuals' use of the software used to participate in training and take exams and (2) monitor the firm's shared drives and e-mails for answer sharing.
Other relevant information of which the firm is aware. ***This could include factors such as emerging developments; changes in economic conditions; other events affecting the QC system of the firm.***	As a result of the increasing shortage of professionals in the auditing industry, a firm may implement additional QC system-level monitoring activities over the new quality response that tracks utilization and overtime rates of its professionals, and design appropriate actions to take when rates exceed a determined amount.

3. Monitoring activities performed by a network

In circumstances when a network performs monitoring activities relating to the firm's QC system or its engagements, the firm is required to:

- Request and, if provided, evaluate:
  - Information about the activities performed;
  - Results of such activities; and
  - Planned remedial actions by the network;

- Determine its responsibilities in relation to the monitoring activities of the network, such as assisting with monitoring activities or responding to the results of the activities performed by the network, and perform such responsibilities; and

- Adjust its monitoring activities as necessary.

Regardless of any QC monitoring activities that a network may perform on behalf of the firm, the firm is ultimately responsible for its QC system.

The nature and extent of a network's monitoring activities will inform a firm's approach to monitoring. To illustrate, if a firm used a network independence tracking system to identify matters that may bear on the independence of firm personnel, and if the network monitored the design and operation of the tracking system and provided the firm with relevant information about those activities, the firm is required to evaluate the monitoring activities performed by the network on the tracking system. In performing its evaluation, the firm needs to understand the scope of the network monitoring activities, such as whether the firm's personnel were selected for monitoring procedures, and if so, whether the population selected was sufficient to provide a reasonable basis for detecting engagement and QC deficiencies. To the extent provided, the firm is also required to evaluate the results of the testing performed by the network, and if deficiencies were identified, the remedial actions, if any, taken or proposed to be taken by the network. Under this example, the firm would also determine its responsibilities in assisting the network with any monitoring or remediation activities related to the tracking system.

Regardless of any QC monitoring activities that a network performs on behalf of a firm, the firm is ultimately responsible for its QC system.

Information about the network's monitoring activities requested but not provided. QC 1000 requires firms to adjust their monitoring activities as necessary, based on the scope of the network's monitoring activities and the information the firm receives (or does not receive) from the network about those activities. In situations where a firm does not receive information requested from the network about the monitoring activities the network performed, the firm would not be in a position to take such activities into account in planning its own activities.

Example
A network may provide information to a firm regarding the results of member firms' internal engagement monitoring activities, which the firm uses to evaluate the competence of other network firm personnel that participate in the firm's engagements. If, due to a change in a particular network firm's local privacy laws, the network is unable to provide such information regarding that member firm, the firm will need to evaluate that member firm's competence and ability using a different approach. To illustrate another case, if a firm requests but does not receive any information from the network regarding QC monitoring activities related to independence that the network performed on behalf of the firm, and the firm does not perform any monitoring activities related to its QC system in that area, the firm would have no basis for concluding that the quality objectives related to independence were achieved.

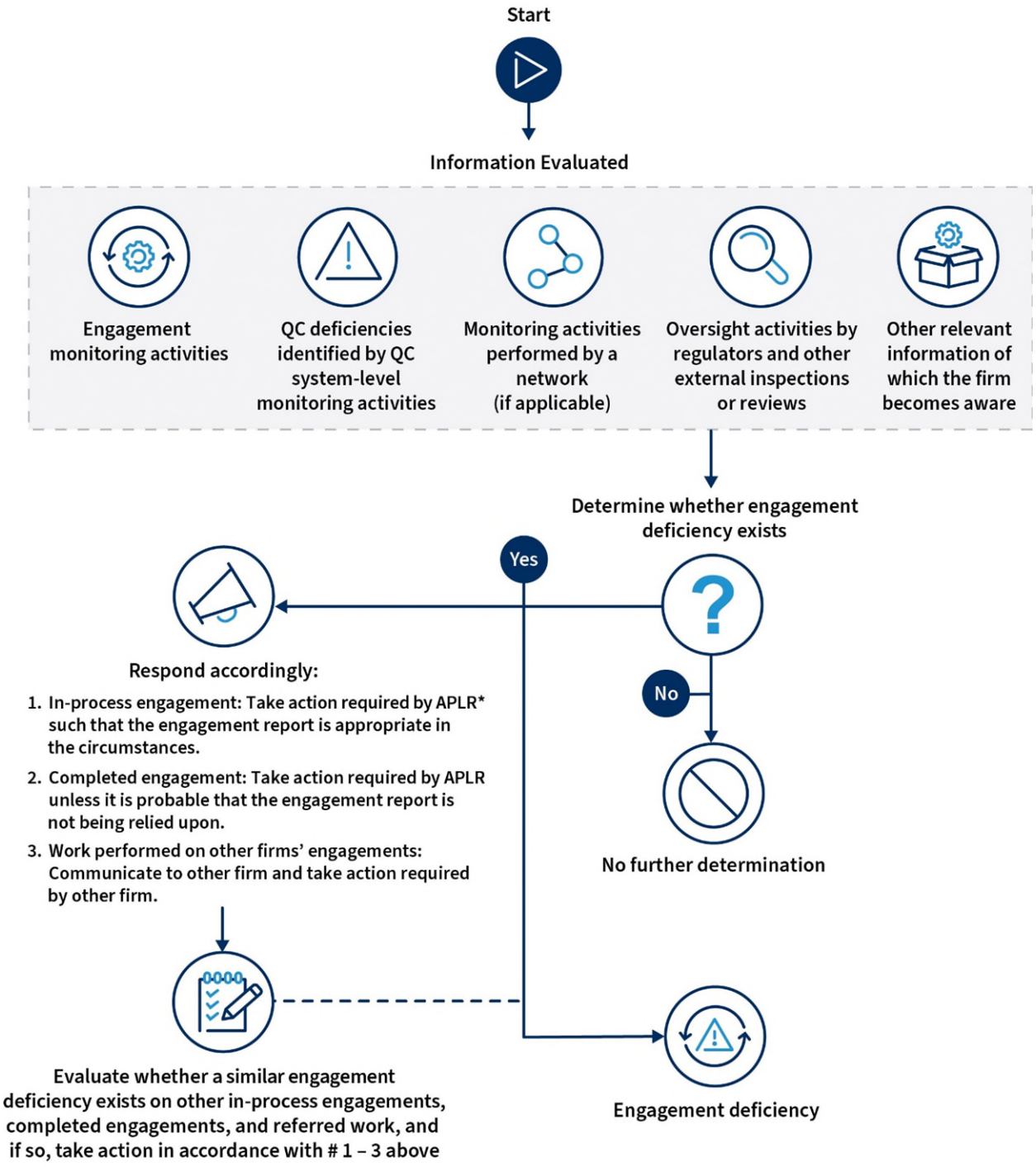
C. Identify and Respond to Engagement Deficiencies **QC 1000.67-.70**

QC 1000 requires firms to evaluate various information in a timely manner to determine whether engagement deficiencies exist, and to take action to respond to them as appropriate.

Engagement deficiencies include:		
Instances of noncompliance in which a firm did not adequately support its audit opinion	Instances in which the firm did not fulfill the objective of its role in the engagement	Other instances of noncompliance with APLR with respect to a firm's engagement
Because the firm did not: • Perform sufficient procedures; • Obtain sufficient appropriate evidence; or • Reach appropriate conclusions with respect to relevant financial statement assertions.	For example by not performing attestation services in accordance with AT No. 2.	For example: • Not satisfying applicable independence requirements; • Not making required communications to the audit committee; • Not filing Form AP timely.

The following chart depicts the process of determining the existence of and responding to engagement deficiencies. Additional information about the process is included in sections XI.C.1 and XI.C.2, below.

Determining the Existence of and Responding to an Engagement Deficiency



*APLR = Applicable professional and legal requirements

1. Determining whether engagement deficiencies exist

QC 1000 requires a firm to evaluate a variety of information in making its determination about whether an engagement deficiency exists, including internally developed information from monitoring activities, information from external parties like regulators and peer reviewers, and other relevant information of which the firm becomes aware. Beyond the sources specified in QC 1000, a firm is not expected to seek out other sources of information that may indicate an engagement deficiency exists. However, if the firm becomes aware of such information, the firm is expected to evaluate it. The firm is deemed "aware" of information when any partner, shareholder, member, or other principal of the firm first becomes aware of such information.

The firm is deemed "aware" of information when any partner, shareholder, member, or other principal of the firm first becomes aware of such information.

The firm may become aware of other relevant information through, for example: (1) documentation being assembled for retention; (2) procedures performed on the subsequent year's engagement; (3) post-balance sheet review activities in connection with a securities offering; (4) whistleblower or other complaints regarding either a company or the firm; and (5) restatements.

QC 1000 does not specify how a firm would evaluate information to determine whether an engagement deficiency exists. Rather, it provides firms with the ability to develop an approach for such evaluation.

Example
A determination that an engagement deficiency exists due to the firm not complying with a PCAOB reporting requirement may be relatively simple to make. For example, evaluating whether the firm filed a Form AP in accordance with PCAOB Rule 3211 would not require a significant amount of effort. However, evaluating information indicating the firm did not perform the necessary audit procedures for an issuer's revenue transactions to determine whether an engagement deficiency exists could be more complex, and therefore require a more in-depth analysis.

A firm's determination that an engagement deficiency exists may pertain to an in-process engagement, a completed engagement, or on work performed on another firm's engagement.

Potential deficiencies identified on in-process engagements. If a firm obtains information about a potential deficiency in an in-process engagement, whether from monitoring activities or other sources, the firm is expected to evaluate the information to determine whether an engagement deficiency exists before the engagement report is issued. In that regard,

identifying a problem while an engagement is in process may enable the firm to rectify the problem before an engagement deficiency could arise.

In relation to ongoing responsibilities (e.g., those responsibilities not completed until the engagement itself is completed), if a problem is identified in an in-process engagement but resolved before the engagement is completed, no engagement deficiency would arise.

Identifying a problem while an engagement is in process may enable the firm to rectify the problem before an engagement deficiency can arise.

Example

In-process monitoring of an engagement revealed that an engagement team initially failed to obtain sufficient appropriate audit evidence in its testing of revenue because it failed to perform a necessary procedure.

The engagement team could still perform the procedure at a later time during the engagement; as long as sufficient appropriate audit evidence was obtained prior to the issuance of the report, there would be no engagement deficiency.

QC 1000 does not have specific provisions to address remediation of this type of problem because the auditor's responsibility is already addressed by APLR. However, even in instances where an engagement deficiency does not arise because a problem was identified and corrected prior to issuance of an engagement report, a firm would still need to consider whether the existence of the problem constitutes a QC observation—an observation about the design, implementation, or operation of the firm's QC system that may indicate one or more QC deficiencies exist—and, ultimately, a QC deficiency.

In relation to requirements that are required to be complied with prior to or at the beginning of the engagement (e.g., preliminary engagement activities, including engagement acceptance procedures, and certain required communications to the audit committee), an engagement deficiency would arise if the required time for performance had passed and the required activities were not performed appropriately, even if the engagement was still in process.

Example

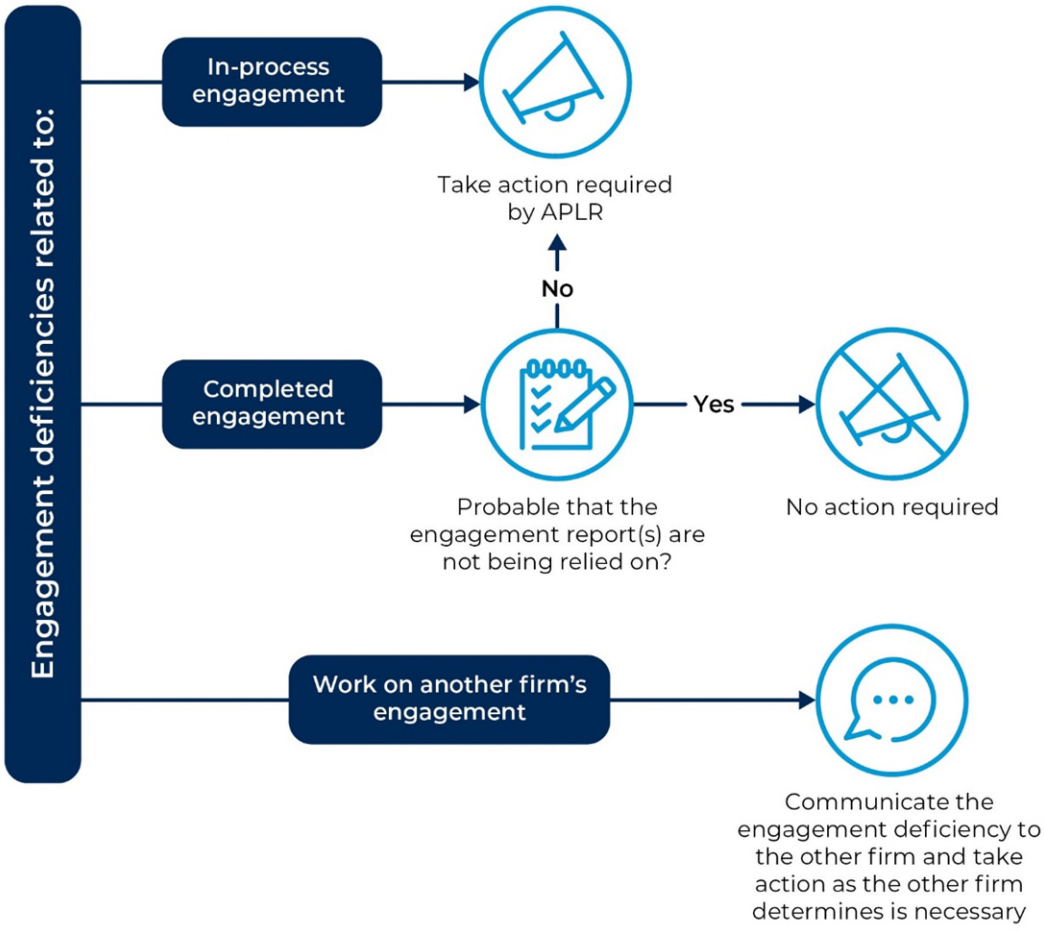
In-process monitoring of an engagement revealed that an engagement team did not obtain the required audit committee pre-approval of certain permissible tax services that the firm's tax practice performed earlier in the year.

Because the firm had already performed the services, the required pre-approval could not be obtained. This is determined to be an engagement deficiency.

Timeliness as it relates to identifying engagement deficiencies. QC 1000 requires determinations to be made on a timely basis. For completed engagements, the timeliness of the determination depends on the nature of the information subject to evaluation. For example, if the information suggested other engagements may present a similar issue, then the Board would expect that determination to be made sooner so that the risk of engagement deficiencies on other engagements—whether in-process or completed—is mitigated.

2. Responding to engagement deficiencies

When a firm determines that an engagement deficiency exists, QC 1000 requires the firm to take action to address the deficiency. The actions to be taken depend on whether the engagement deficiency relates to a completed engagement, an in-process engagement, or work performed on other firms' engagements. The chart that follows illustrates the various types of engagements that engagement deficiencies could relate to and required actions to be taken in each case.



a. Engagement deficiencies related to in-process engagements

For an engagement deficiency related to an in-process engagement, QC 1000 requires a firm to take appropriate action to address it in accordance with APLR (to the extent necessary, before the issuance of the related engagement report(s)), such that the engagement report(s) are appropriate in the circumstances.

The nature of the engagement deficiency will help the firm determine the nature and timing of the required action. If a deficiency is such that it could affect the auditor's report if unremediated, action to address the deficiency is required to be taken before the engagement report is issued, to the extent necessary, such that the engagement report issued is appropriate in the circumstances.

Example
During monitoring of an in-process engagement, a firm determined that an engagement team did not test the accuracy and completeness of information produced by the company that it used to perform substantive procedures over accrued expenses, as required by paragraph .10 of AS 1105, *Audit Evidence*. In response, the engagement team performed the required audit procedures before the auditor's report was issued.

In situations where the engagement deficiency does not affect the auditor's report, action would still be required to address the deficiency, but could be performed either before the report is issued or afterwards.

Example
During monitoring of an in-process engagement, a firm identified in the workpapers that the engagement team had incorrectly calculated the extent of another accounting firm's involvement in the audit for purposes of determining what to report on Form AP. The firm may choose to remediate this issue after the issuance of the auditor's report (but prior to the filing of Form AP).

If remedial action is taken after the report is issued, the provisions applicable to completed engagements (discussed in section XI.C.2.b below) become applicable.

b. Engagement deficiencies related to completed engagements

When an engagement deficiency is identified on a completed engagement, whether action needs to be taken depends on whether it is probable that the affected engagement report(s) are not being relied on.

Determine whether it is probable a report is not being relied on. In the absence of circumstances indicating that reliance is impossible or unreasonable (e.g., cessation of a trading market for issuer securities), inclusion of an engagement report in the most recent filing on an SEC form that requires inclusion of such an engagement report generally evidences that the report is being relied upon.

"Probable" is defined consistent with how it is used in FASB ASC Topic 450, *Contingencies,* which says an event is probable when it is likely to occur.

The determination that an auditor's report is not being relied upon would primarily be influenced by whether the auditor's report and related financial statements are readily available and whether a trading market exists for the company's securities. Circumstances that may suggest the engagement report is no longer being relied upon could include:

- So much time has elapsed that the financial statements covered by the auditor's report are no longer required to be included in SEC periodic reports.
- The issuer's or broker-dealer's business has been dissolved or gone into liquidation.

If an auditor's report is included in the company's most recent SEC filing, a firm should almost always conclude that the engagement report must be treated as being relied on. However, circumstances may exist where it is reasonable for the firm to conclude that reliance on the report is impossible or unreasonable, such as the cessation of a trading market for the issuer's securities.

The fact that the issuance of the subsequent year's auditor's report is imminent is not determinative of whether the report continues to be relied upon.

Probable the report is not being relied on. If a deficiency is identified on a completed engagement, but it is probable the report(s) associated with that engagement are not being relied upon, no action is required of the firm to address the engagement deficiency.

Despite the fact that no action is required to address the engagement deficiency, the firm would still include them in the population of QC observations to be evaluated to determine whether QC deficiencies exist.

These engagement deficiencies are still included in the population of QC observations to be evaluated to determine whether QC deficiencies exist.

More than remotely possible the report is being relied on. If it is *not* probable that the report is *not* being relied on – in other words, it is more than remotely possible that the report *is* being relied on – the firm is required to comply with the following PCAOB standards, as applicable:

- AS 2901 addresses auditor responsibilities with respect to engagement deficiencies on completed audit engagements. AS 2201.99 directs the auditor to comply with AS 2901 as it relates to audits of internal control over financial reporting. See *Staff Guidance – Insights for Firms AS 2901: Responding to Engagement Deficiencies After Issuance of the Auditor's Report*.

- AS 2905 deals with auditor responsibilities when, subsequent to the date of a report on audited financial statements, the auditor becomes aware of facts that might have affected the report had the auditor then been aware of such facts before issuing the report. AS 2201.98 is a similar provision relating to auditor's reports on internal control over financial reporting.

- AT No. 1 and AT No. 2 incorporate responsibilities similar to those required under AS 2901 for attestation engagements relating to certain broker-dealer reports.

c. Engagement deficiencies related to work on another firm's engagement

If the firm identifies an engagement deficiency related to work performed on another firm's engagement, it is required to communicate the deficiency to the other firm. This communication needs to be sufficient to enable the other firm to develop a response commensurate with the extent of noncompliance. The firm would also take any remedial action the other firm determines to be necessary.

Regardless of whether there are additional remedial actions for the firm to take related to the particular work performed, the engagement deficiencies would be included in the population of QC observations to be evaluated to determine whether QC deficiencies exist.

d. Evaluating whether similar engagement deficiencies exist

QC 1000 also requires firms to evaluate whether engagement deficiencies similar to those the firm has identified exist in other in-process engagements, completed engagements (unless it's probable that the engagement report is not being relied upon), and work performed on other firms' engagements. If similar engagement deficiencies exist, QC 1000 requires the firm to respond to these engagement deficiencies in the same manner as the firm would respond to any other engagement deficiency it may identify.

The results of this evaluation would provide useful information to the firm when determining whether a QC deficiency exists.

Understanding the nature of the engagement deficiency could assist the firm in determining the extent of the necessary evaluation.

Example
If the engagement deficiency was caused by an error in the firm's methodology for auditing a company's loan valuation allowance, the firm would evaluate whether similar engagement deficiencies exist on engagements that were also using that methodology. If engagement team members did not comply with PCAOB standards when auditing accounts receivable because they failed to perform certain procedures in the firm's audit program, the firm would evaluate whether the person(s) who were responsible for performing the procedures and the person(s) supervising the work participated in any other audit engagement's accounts receivable testing, and if so, whether similar engagement deficiencies exist.

e. Addressing engagement deficiencies

QC 1000 requires firms to respond to engagement deficiencies by taking into account the nature and severity of the engagement deficiency. In other words, the response needs to be targeted based on the nature of the problem and proportionate to the severity of the problem.

Understanding the nature and severity of an engagement deficiency can assist firms in:

- Developing an appropriate response to the engagement deficiency;
- Determining whether an engagement deficiency could relate to other engagements; and
- Assessing whether the engagement deficiency, which represents a QC observation, is also a QC deficiency.

Types of actions. The actions taken by the firm to respond to engagement deficiencies may include preventive or corrective actions (or a combination of these actions).

Corrective actions are taken to rectify an identified deficiency in either an in-process or a completed engagement, such as performing a procedure that had been omitted, designing and performing additional or alternative procedures if audit evidence is insufficient, or filing a required report.

Preventive actions are taken to prevent the occurrence of a deficiency in future engagements, such as training, developing audit tools, or enhancing audit methodology.

Example of corrective actions	Example of preventive actions
An engagement deficiency identified on an in-process engagement indicated that the engagement team used an outdated audit checklist. In response to the deficiency, the firm instructed the team to redo the checklist using an updated version and issued a firm-	In response to a high number of engagement deficiencies related to auditing revenue recognition, a firm could design various preventative remedial actions, including enhanced training, required consultations,

wide communication about using the updated checklist.	and enhancements to its audit methodology over auditing revenue.

D. Determine Whether QC Observations Exist

QC 1000.71

QC 1000 requires firms to, on a timely basis, evaluate (1) information from monitoring activities (including if applicable those performed by a network); (2) information from oversight activities by regulators and other external inspections or reviews; and (3) other relevant information of which the firm becomes aware. All engagement deficiencies are QC observations.

All engagement deficiencies are QC observations. QC observations can also be identified through monitoring activities, information from external parties, and other relevant information.

Any information that may indicate a problem with the design, implementation, or operation of the firm's QC system would be a QC observation. Because a QC system provides reasonable assurance that engagements are conducted in accordance with APLR, all engagement deficiencies would be QC observations. Examples of other QC observations include an error in the design or operation of a technology tool or methodology, or information suggesting that a firm may not have achieved a quality objective.

Results of all monitoring activities. Under QC 1000, the results of all monitoring activities performed by the firm, and if applicable, those performed by a network relating to the firm's QC system or its engagements, are required to be analyzed by the firm to determine if there are QC observations. It is possible that a firm's engagement monitoring activities could identify not only engagement deficiencies, but also QC observations that are not engagement deficiencies.

Example
As part of a firm's quality response related to technological resources, the firm's technology leader must review and approve all software audit tools used on engagements. The firm's engagement monitoring activities reveal that an engagement team did not receive the appropriate authorization to use a specific tool. This observation would be a QC observation, regardless of whether the use of the tool also gave rise to an engagement deficiency.

Oversight activities by regulators and external inspections or reviews. These include activities of the PCAOB and other regulators. Even if they relate to other aspects of a firm's practice, such as audits conducted under non-PCAOB standards, the results of inspections, reviews, and other oversight activities performed by external parties could be relevant to a firm's determination of whether QC observations exist.

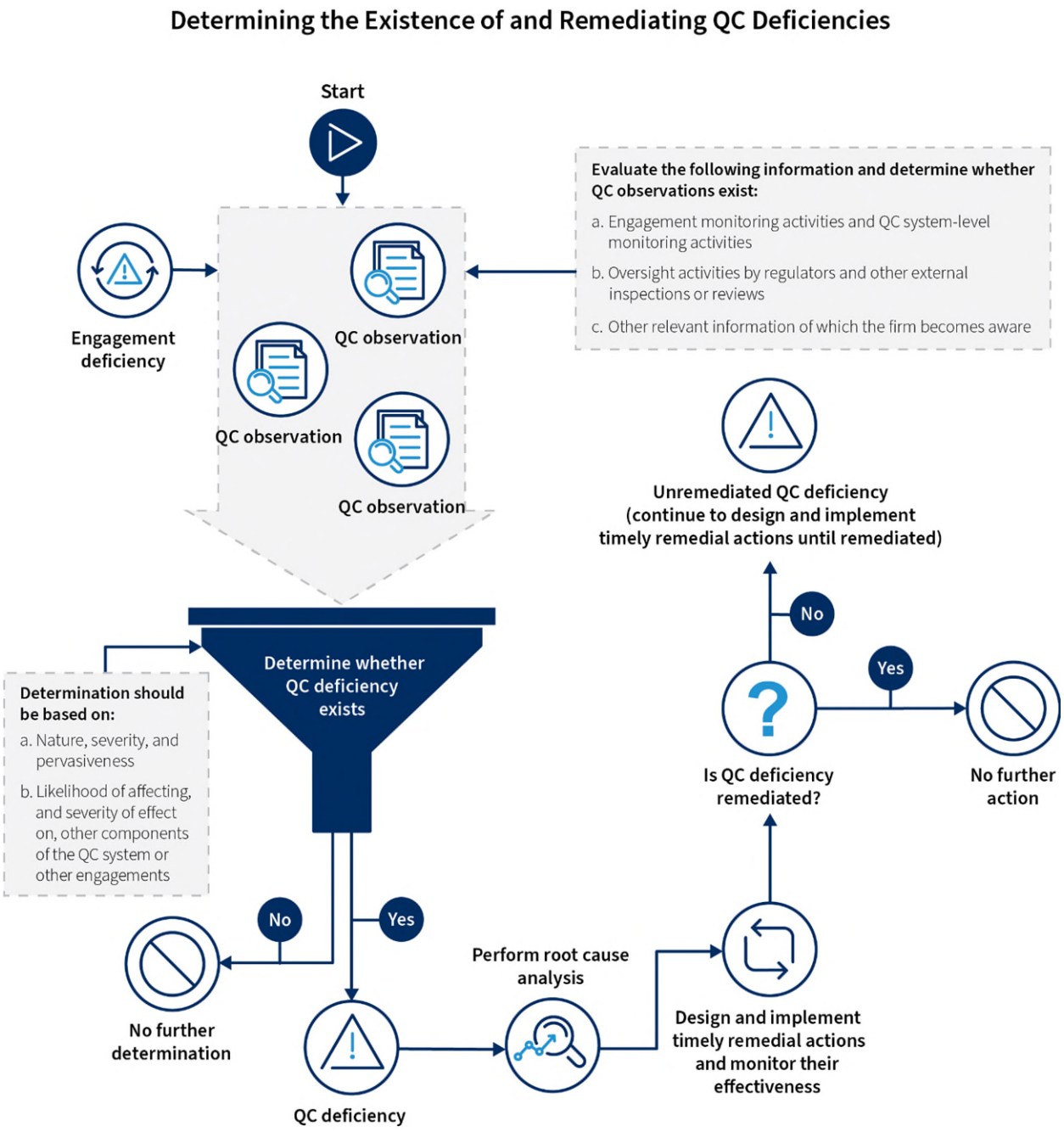
Other relevant information of which the firm becomes aware. This would comprise information obtained from within and outside the firm. A firm would not be expected to seek

out such other sources of information; however, if other relevant information came to the firm's attention, a firm is expected to determine whether it is a QC observation.

Example
The firm may become aware of an issue with a formula in a practice aid used to assist engagement teams in auditing stock-based compensation if a member of an engagement team communicates that issue to firm personnel supporting the firm's QC system.

E. Identify and Respond to QC Deficiencies **QC 1000.72-.76**

QC 1000 requires firms, on a timely basis, to evaluate QC observations to determine whether QC deficiencies exist. The chart that follows depicts the process of determining the existence of and remediating QC deficiencies.



The following table provides example considerations for each of the prongs of the definition of a QC deficiency.

Prong	Example
The likelihood of the firm not achieving the reasonable assurance objective or one or more quality objectives has not been reduced to an acceptably low level.	A quality objective is not established, a quality risk is not properly identified or assessed, or a quality response is not properly designed or implemented or is not operating effectively.

Noncompliance with requirements of QC 1000, other than those under "Documentation."	Noncompliance with the requirements related to roles and responsibilities, the firm's risk assessment process, the monitoring and remediation process, and the evaluation of the QC system.
Noncompliance with requirements of QC 1000 under "Documentation" that adversely affects the firm's ability to comply with any of the other requirements of QC 1000.	A QC deficiency may exist if a firm's documentation of its risk assessment process, including documentation of its quality objectives, quality risks, and quality responses is not in sufficient detail for firm personnel to understand their roles and responsibilities with respect to the firm's QC system. To contrast, a firm's failure to document some details of its monitoring activities, in a context where the firm otherwise sufficiently documents the evaluation of the results from its monitoring activities, would **not** meet the definition of a QC deficiency.

1. Determining whether QC deficiencies exist

The firm's determination of whether a QC deficiency exists is based on the following considerations:

- The nature, severity, and pervasiveness of the matter(s) that gave rise to the QC observation; and
- The likelihood that the matter(s) that gave rise to the QC observation could affect other components of the QC system, other engagements, future engagements, or work performed on other firms' engagements, and the severity of such effect if it were to occur.

a. Nature, severity, and pervasiveness of the matter

The nature, severity, and pervasiveness of the matter that gave rise to the QC observation should be taken into account when determining whether a QC deficiency exists. For a QC observation that is also an engagement deficiency, the results of the firm's evaluation of whether a similar engagement deficiency exists on other in-process and completed engagements would provide useful information to the firm when determining whether a QC deficiency exists.

QC 1000 explains that determining the nature, severity, and pervasiveness of the matter that gave rise to the QC observation includes an understanding of four factors, discussed below.

The component(s) of the QC system, quality objective(s), or quality risk(s) to which the QC observation relates. Depending on the quality risks that a firm identifies, some components may play a greater role in its QC system than others.

Example
For a small firm that audits one issuer and has no intention to expand its issuer audit practice, the engagement performance component would have a greater role than acceptance and continuance of engagements because the quality risks associated with the new engagement would be mitigated by the firm's policy of not taking on new issuer audit engagements.

Based on the firm's risk assessment, certain quality risks may pose a greater threat to the firm's QC system than others. In addition, some QC observations may relate to a single component of the QC system or a single quality objective, while others may relate to multiple components of the QC system or multiple quality objectives.

Example
An engagement deficiency may relate to the resource component (e.g., competence and training of firm personnel, firm methodology), the information and communication component (e.g., failure to communicate changes to the methodology), or the engagement performance component (e.g., failure to consult when required), or all three of those components.

Whether the QC observation is in the design, implementation, or operation of the QC system. For example, a matter that gave rise to a QC observation in the design of a process has a greater likelihood of being pervasive to a firm's audit practice than a process that did not operate as designed on one occasion.

The frequency with which the QC observation occurred. Frequency relates to the number of times the matter that gave rise to the QC observation occurred—for example, on engagements within a particular industry sector or practice group, a particular office, or firmwide. It might also relate to the number of times the observation was identified, the number of firm personnel involved, or the number of quality objectives affected. When related to the execution of a firm's quality response, it would also include relative frequency of QC observations compared to the number of times the procedure was executed properly.

The duration of time that the QC observation existed. Duration addresses how long the matter that gave rise to the QC observation existed. In order to understand duration, a firm would need to understand whether there were other instances prior to those initially identified by the firm as QC observations.

b. Likelihood the matter could affect other engagements or QC system components

Whether a QC observation is a QC deficiency also depends on the likelihood that the matter that gave rise to the QC observation could affect other QC system components or other engagements. Other engagements include in-process engagements, completed engagements, engagements to be performed in the future, as well as work performed on other firms' engagements.

Example
An engagement deficiency is identified because of an error in the firm's audit methodology, which is used on all engagements. This engagement deficiency is a QC observation that is likely to affect other engagements because the firm's audit methodology is used on all engagements. In contrast, if an error relates to an industry-specific audit tool only used on a few engagements, the likelihood that QC observation affects other engagements beyond those engagements related to the specific industry may be lower.

A firm may design and implement mitigating actions to address an engagement deficiency when such a deficiency comes to the firm's attention. When considering the likelihood that future engagements could be affected (for purposes of determining whether a QC deficiency exists), a firm would not take into account any mitigating actions, even if they have been implemented. This is because the determination of whether a QC deficiency exists must be made based on the nature, severity, and pervasiveness of the matter that gave rise to the QC observation, viewed on its own. Such information shows the extent to which the QC system failed in allowing the underlying matter to occur. Whether the firm was subsequently able to partially or fully remediate the QC deficiency does not eliminate the fact that the failure occurred.

When determining the likelihood that future engagements or QC components could be affected, a firm would not take into account any mitigating actions, even if they have been implemented.

In addition to the likelihood of a matter's recurrence, QC 1000 also requires a firm to evaluate the matter's severity if it were to affect other component(s) or engagements.

The following illustration provides example fact patterns suggesting when a QC observation may be less likely to be a QC deficiency, and when it may be more likely to be a QC deficiency.

Example of Considerations Relevant to Determining QC Deficiency

Engagement Deficiency
(e.g., failure to obtain sufficient appropriate audit evidence)

QC Observation

Less Likely a QC Deficiency ← → **More Likely a QC Deficiency**

Nature, severity, and pervasiveness of the matter/likelihood of affecting other QC system components or engagements, and the severity of any such affect:

- Engagement deficiency limited to one engagement
- No implications for QC components and quality objectives

Nature, severity, and pervasiveness of the matter/likelihood of affecting other QC system components or engagements, and the severity of any such affect:

- Similar engagement deficiencies across multiple engagements
- Two QC components and few quality objectives affected within each of the QC components (e.g., Resources – quality objectives related to competence, firm methodology, training; Engagement Performance – quality objectives related to supervision, due professional care)

Nature, severity, and pervasiveness of the matter/likelihood of affecting other QC system components or engagements, and the severity of any such affect:

- Similar engagement deficiencies in two engagements assigned to one partner
- One QC component and few quality objectives affected within the QC component (e.g., Resources – quality objectives related to competence and training)

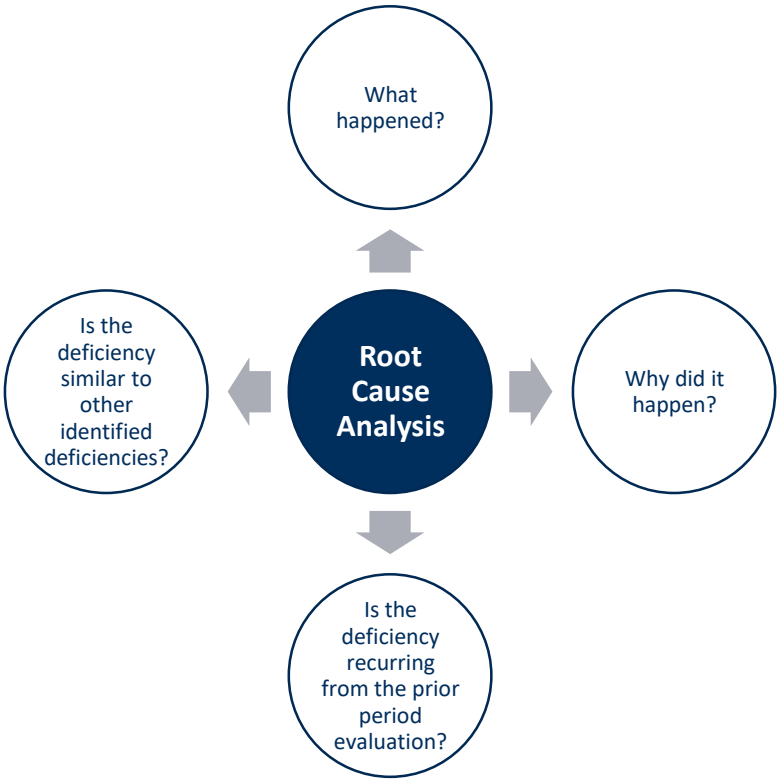
Nature, severity, and pervasiveness of the matter/likelihood of affecting other QC system components or engagements, and the severity of any such affect:

- Similar engagement deficiencies across multiple engagements
- Multiple QC components and multiple quality objectives affected within each of the QC components (e.g., Resources – quality objectives related to competence, firm methodology, training; Engagement Performance – quality objectives related to supervision, due professional care; Information & Communication – quality objectives related to communication of information to firm personnel and other participants); or
- Single QC component and multiple quality objectives affected within the QC component (e.g., Engagement Performance – quality objectives related to due professional care, supervision, consultations, etc.)

2. Responding to QC deficiencies

a. Root cause analysis

QC 1000 requires the firm to perform a root cause analysis of all QC deficiencies, which involves identifying and evaluating the causal factors that led to each QC deficiency. The firm may perform root cause analysis on QC deficiencies individually or may group similar QC deficiencies together.



Root cause analysis looks for different types of causes through investigating the patterns of negative effects, finding hidden flaws in the QC system, and discovering specific actions that contributed to the problem.

A firm might find it helpful when performing root cause analysis to leverage information obtained from its evaluation of whether a QC deficiency exists. That is, information about the nature, severity, or pervasiveness of the matter that gave rise to the QC observation and the likelihood that the matter that gave rise to the QC observation could affect other components of the QC system or other engagements may provide evidence of what caused the problem to occur.

Proper determination of the causal factors that led to QC deficiencies is essential to developing effective remedial actions.

Identifying and understanding the underlying causes of a problem supports developing solutions that address those causes, rather than just the symptoms.

The firm's approach to root cause analysis can vary and procedures could take different forms depending on the circumstances, which allows for scalability. For example, a firm's approach to root cause analysis may include one or more of the following:

- Interviews with engagement teams and firm leadership;

- Use of proprietary tools to analyze large amounts of data;
- Root cause analysis training and the use of templates to facilitate consistency; and
- Consideration of available metrics, such as engagement hours, training records, audit milestone dates, and partner experience.

Some key elements that may lead to more robust and comprehensive root cause analysis include:

- Monitoring audit deficiencies identified and performing root cause analysis on a continual basis. This allows firms to obtain information that allows them to react more timely and implement remedial actions to reduce recurring deficiencies in other audits.
- Process mapping at the engagement level and the firm level of the underlying work flows of how a firm conducts its practice. A well-defined process makes it easier to analyze negative events to determine what went wrong.
- Consideration of both positive and negative quality events (i.e., actions, behaviors, or conditions that resulted in positive or negative outcomes) to identify whether such actions, behaviors, or conditions were present on engagements where QC deficiencies were identified.
- Measuring, in real time, the effectiveness of remedial actions and audit quality improvement plans or initiatives to identify whether remedial efforts are effective.

Nature, timing, and extent of the root cause analysis. The nature, timing, and extent of the root cause analysis needs to be commensurate with the nature, severity, and pervasiveness of the QC deficiency. A QC deficiency that could affect multiple engagements may require more urgent root cause analysis, depending on the circumstances. To illustrate, a QC deficiency related to a firm's approach to testing business combinations would be more urgent if a firm's clients regularly enter into such transactions.

Taking into account the nature, severity, and pervasiveness of the QC deficiency, root cause analysis may be performed at different points in time or, depending on the size and nature of the firm, operate as more of a continual process.

In some instances, the causal factors may be relatively apparent and therefore require less analysis than in a situation where the cause of the deficiency is complex and requires significant investigation and analysis. Generally, the more thorough the analysis, the more likely

the causal factors will be identified and the greater the likelihood that the firm could design and implement remediation efforts that will be effective in preventing similar QC deficiencies from occurring again.

Example
For a smaller firm, the firm's procedures to understand the root cause of a QC deficiency may be simple, since the information to inform the understanding may be readily available and concentrated in a single location, and the root cause may be more apparent. In the case of a larger firm with multiple locations, the procedures to understand the root cause of an identified QC deficiency may include using individuals specifically trained on investigating the root cause of QC deficiencies, and developing policies and procedures which are more formalized for identifying the root cause.

When the root cause of a QC deficiency relates to a third-party or a network provider. A firm may determine the root cause of a QC deficiency is related to the use of a resource or service provided by a third-party provider. If such situation occurs, the firm is responsible for addressing the effect of the deficiency on its QC system. This could include, among other things, working with the third-party provider to design and implement remedial actions or deciding to end the relationship with the third-party provider and, as part of the firm's remedial actions, revising its policies and procedures in the area affected.

Irrespective of the approach taken and the extent of participation by third parties, the firm remains responsible for its QC system.

If a firm belongs to a network and uses network resources or services to enable the operation of the firm's QC system or the performance of its engagements, a root cause of a QC deficiency could be related to the network resource or service. Similar to a firm's use of resources or services provided by a third-party provider, a firm is responsible for addressing the effect of the deficiency on its QC system regardless of whether the remedial actions taken by the firm are coordinated with the network or designed and implemented exclusively by the firm. Further, the firm remains responsible for determining whether the actions taken by the network sufficiently remediate the QC deficiency.

b. Remedial actions

QC 1000 requires firms to design and implement timely remedial actions to respond to QC deficiencies, taking into account the results of the firm's root cause analysis and the nature, severity, and pervasiveness of the QC deficiency.

Considerations for timeliness of remedial actions. The timing of a firm's efforts to design and implement remedial actions depends on the results of the firm's root cause analysis and the nature, severity, and pervasiveness of the QC deficiency. For example, where there is a high risk of severity or pervasiveness, remedial actions may have to be immediate to be considered

timely. The firm is expected to respond in a manner that would mitigate the occurrence of additional QC deficiencies related to similar underlying causes.

In some circumstances, due to the extent of remedial actions necessary to address the QC deficiency, a firm might design and implement temporary remedial actions until permanent actions can be designed and implemented.

Example
A firm could design and implement supplemental audit practice aids to address QC deficiencies until the firm is able to revise its comprehensive audit methodology.

In other situations, a complex QC deficiency may result in the firm developing a multi-step plan with milestones necessary to be achieved as the firm designs and implements its remedial actions.

In other situations, the extent of remedial actions the firm needs to take to address a particular QC deficiency may be reduced by other compensating responses that the firm has in place. If the remedial actions, including any relevant compensating responses, have been tested and found effective in addressing the issue, the firm might determine, based on the facts and circumstances, that no further remedial action is necessary.

c. Monitoring remedial actions

QC 1000 also requires firms to monitor the implementation and operating effectiveness of remedial actions to determine whether they were implemented as designed and operate effectively to remediate the QC deficiency.

If not, the firm takes timely actions until the monitoring activities indicate the QC deficiency was remediated. Timely actions could include, among other things, one or more of the following:

- Adjusting the implemented remedial actions;
- Designing and implementing additional remedial actions; or
- Performing additional root cause analysis to determine if other causes exist and, if so, designing and implementing remedial actions to address such causes.

Once additional actions are taken, the firm continues monitoring activities until it determines that the QC deficiency has been remediated.

XII. EVALUATION OF AND REPORTING ON THE QC SYSTEM

A. Annual Evaluation of the Firm's QC System QC 1000.77

A firm's evaluation of the results of its monitoring and remediation process helps the firm identify the areas within the QC system that are designed, implemented, and operating effectively, as well as areas that require attention. This perspective will assist firm leadership in allocating resources to address QC deficiencies and provide them with a basis for communicating to others—within or outside the firm—the status of the firm's QC system.

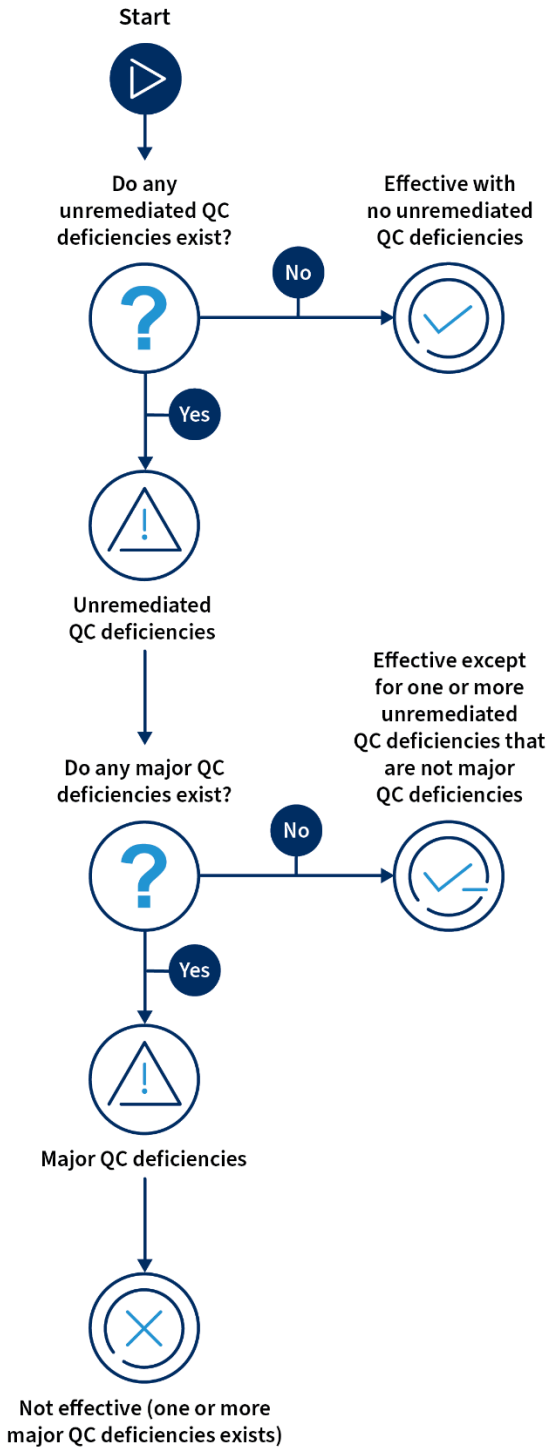
QC 1000 requires a firm to evaluate the effectiveness of its QC system based on the results of its monitoring and remediation activities, and conclude, as of September 30 of each year (the "evaluation date"), that its QC system is:

- Effective with no unremediated QC deficiencies;
- Effective except for one or more unremediated QC deficiencies that are not major QC deficiencies; or
- Not effective (one or more major QC deficiencies exists).

Firms that were not required to implement and operate a QC system at any time within the previous 12 months are not subject to the requirement to evaluate and report on their QC system.

The chart that follows depicts the process of evaluating and concluding on the effectiveness of the firm's QC system.

Annual Evaluation of the Firm's QC System



B. Determine Whether Major QC Deficiencies Exist QC 1000.78

QC 1000 requires firms to evaluate unremediated QC deficiencies, as of the evaluation date, to determine whether major QC deficiencies exist. While the identification of QC deficiencies will be an ongoing process throughout the year, the determination of whether any of those QC deficiencies, alone or in combination, constitute one or more major QC deficiencies will be required only as part of a firm's annual evaluation of its QC system.

1. Determining whether a QC deficiency has been remediated

An unremediated QC deficiency is one for which remedial actions that completely address the QC deficiency have not been fully implemented, tested, and found effective. Substantial progress towards remediation is not sufficient.

2. Identifying presumed major QC deficiencies

A major QC deficiency is presumed to exist if the unremediated QC deficiency or combination of unremediated QC deficiencies either:

- Relates to the firm's governance and leadership that affect the overall environment supporting the operation of the QC system; or
- Results in or is likely to result in one or more significant engagement deficiencies in engagements that, taken together, are significant in relation to the firm's total portfolio of engagements.

A QC deficiency is unremediated until remedial actions that completely address it have been fully implemented, tested, and found effective. Substantial progress towards remediation is not sufficient.

Relates to the firm's governance and leadership. A firm's governance and leadership establish the environment that determines how firm personnel carry out responsibilities for the operation of a firm's QC system and the performance of its engagements. Because of the pervasive impact of leadership and "tone at the top," one or more unremediated QC deficiencies related to firm governance and leadership that affect the overall environment supporting the operation of the QC system would almost always severely reduce the likelihood of the firm achieving the reasonable assurance objective or one or more quality objectives.

Results in or is likely to result in significant engagement deficiencies. It is presumed that a major QC deficiency exists if an unremediated QC deficiency or combination of unremediated QC deficiencies exists that results in or is likely to result in one or more significant engagement deficiencies in engagements that, taken together, are significant in relation to the firm's total portfolio of engagements.

Significant engagement deficiency. Significant engagement deficiencies are a subset of engagement deficiencies as defined by QC 1000. A significant engagement deficiency exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB or failed to perform interim review or attestation procedures necessary in the circumstances; (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement; (3) the engagement report is not appropriate in the circumstances; or (4) the firm is not independent of its client. The description is consistent with the use of the term in AS 1220.12, .17, and .18B.

Significant in relation to the firm's total portfolio of engagements. The significance of the engagements in relation to the firm's total portfolio may be determined based on quantitative or qualitative criteria or a combination of both. For example:

- The number of engagements or firm personnel affected or likely to be affected;
- The associated revenue or profit;
- The associated risks; or
- The relevant industry.

3. Evaluating other QC deficiencies to determine if major QC deficiencies exist

The circumstances where a major QC deficiency is presumed to exist are not an exhaustive list of possible major QC deficiencies. For example, a deficiency that requires significant effort and resources to remediate may be a major QC deficiency.

To help firms make the determination of whether a major QC deficiency exists, QC 1000 provides factors on which to base the determination, which assist firms in applying the definition.

Severity and pervasiveness of the unremediated QC deficiency or combination of unremediated QC deficiencies. In assessing the severity and pervasiveness of the unremediated QC deficiency, firms consider the below factors. In performing the assessment, the firm needs to consider both quantitative and qualitative implications.

- The number of components or quality objectives directly or indirectly affected;
- The extent to which the unremediated QC deficiency or combination of unremediated QC deficiencies relate to a component, quality objective, or quality response that affects the design or operation of other aspects of the QC system;
- The number and pervasiveness of root causes;
- The persistence of the unremediated QC deficiency or combination of unremediated QC deficiencies over time;

- The number of engagements that are affected or are likely to be affected in the future if not remediated;

- The number of engagements that may have unsupported opinions unless additional procedures are performed; and

- The number of engagements for which the firm revised and reissued its engagement report(s) because, after additional procedures were performed, the financial statements or management's report on ICFR was restated or revised.

The firm considers both quantitative and qualitative implications when evaluating the severity and pervasiveness of unremediated QC deficiencies.

For example, an unremediated QC deficiency that affects engagements only in a single industry, where a firm has few clients and no intention to acquire more and the engagements represent an insignificant portion of the firm's total portfolio of engagements under PCAOB standards, is less likely to be severe or pervasive.

QC 1000 does not require the firm to determine that an unremediated QC deficiency is both severe and pervasive in order for it to constitute a major QC deficiency, nor is the list of examples exhaustive.

The extent to which remedial actions have been implemented, tested, and found to be effective. In addition to assessing the severity and pervasiveness of a QC deficiency, firms consider the extent to which remedial actions have been implemented, tested, and found to be effective when determining whether a major QC deficiency exists. Before the annual evaluation date, a firm may implement remedial actions that reduce the severity or pervasiveness of an unremediated QC deficiency. To illustrate, if a firm identifies an issue with its audit software, it could develop a temporary "work around" to mitigate the unremediated QC deficiency until a permanent solution is employed. For this factor to be relevant for a firm when determining whether a major QC deficiency exists as of the annual evaluation date, the remedial actions have to be tested and the results have to show that such remedial actions are operating effectively.

The illustration that follows provides an example of when a QC deficiency may be less likely to be a major QC deficiency, compared to an example of a QC deficiency that is more likely to be a major QC deficiency.

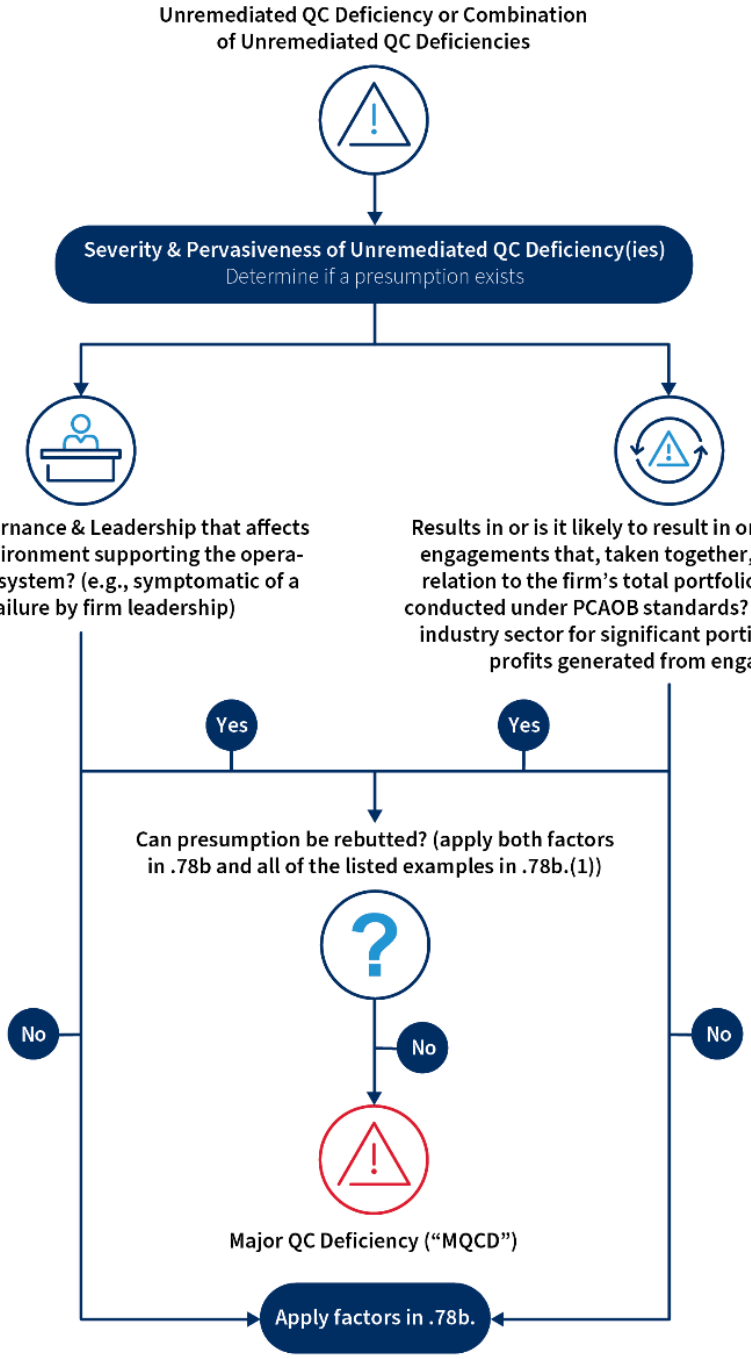
4. Rebutting the presumption that a major QC deficiency exists

A firm may rebut the presumption that a major QC deficiency exists. In order to do so, the firm would evaluate all of the factors discussed above and included in QC 1000.78b and demonstrate that the unremediated QC deficiency does not constitute a major QC deficiency.

When a firm rebuts the presumption that a major QC deficiency exists, the firm is required to disclose the basis for its determination in its report to the PCAOB on Form QC, as discussed further in section XII.C below.

The chart that follows illustrates the process of determining whether major QC deficiencies exist, and how to consider them when concluding on the effectiveness of the firm's QC system.

Determine Whether a Major QC Deficiency(ies) Exists



*SED – Significant engagement deficiency. A significant engagement deficiency exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB or failed to perform interim review or attestation procedures necessary in the circumstances, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client.

C. Report to the PCAOB on Form QC QC 1000.79-.80

This section addresses the requirements related to the firm's annual reporting of the results of its QC system evaluation to the PCAOB on Form QC.

1. When a Form QC is required to be filed

If a registered public accounting firm is required to perform an evaluation of its QC system as of September 30 of any year under QC 1000.77, the firm must file with the Board a report on such evaluation on Form QC not later than November 30 of that year.

Even if a firm did not perform engagements in accordance with PCAOB standards during the reporting period, the firm may still have responsibilities with respect to past engagements. In such circumstances, the firm is required to perform an evaluation of its QC system under QC 1000.77 and file Form QC. The introduction section of this guidance document includes examples of possible scenarios and reporting dates for firms transitioning to and from being subject to the requirements to implement and operate a QC system and thus to evaluate and report on its effectiveness (see section II.A.3).

2. Timing of the firm's report and the reporting period covered

Firms have until November 30 to report on Form QC to the PCAOB. This provides firms with 61 days after the evaluation date of September 30 to file Form QC.

The reporting period, which the Firm should enter in Item 2.1 of Form QC, is the period beginning on October 1 of the prior year in which Form QC is required to be filed and ending September 30 of the year Form QC is required to be filed. That period is what Form QC refers to as the "reporting period." In the first year that the firm is required to file this Form, the reporting period is the period beginning on the date that the firm becomes subject to APLR with respect to an engagement and ending the following September 30 of the year the Form QC is required to be filed.

For firms that are subject to APLR with respect to an engagement on the date that QC 1000 becomes effective, the reporting period for the first Form QC filing will be December 15, 2026 to September 30, 2027.[10]

3. How and where to file Form QC

Unless directed otherwise by the Board, the registered public accounting firm must file Form QC and the related exhibits electronically with the Board through the Board's Web-based system. Firms will file Form QC in a manner consistent with the way that they file other PCAOB forms. Instructions on how to file Form QC will be available before September 30, 2027.

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10 *See Form 19b-4,* PCAOB File No. 2025-01 (Aug. 28, 2025).

4. Contents of Form QC

The contents of Form QC address the matters listed in QC 1000.79-.80. In addition, Form QC elicits certain information about the firm and the individuals responsible for the QC system, aggregated information about the items required to be reported in QC 1000.80, the areas of QC to which any unremediated QC deficiencies relate, and a certification of the evaluation of the QC system by certain designated individuals. Additional guidance on select topics and parts of Form QC are provided below.

General instructions and detail of narrative disclosures. Form QC calls for basic information about the firm (e.g., the firm's name, the evaluation date, the overall conclusion of the firm's evaluation, the number of unremediated QC deficiencies, and for each unremediated QC deficiency, whether it is or is not a major QC deficiency and the areas of the QC system to which it relates).

Narrative disclosures on Form QC can be provided at an appropriately summarized level.

Form QC requires firms to provide narrative information, including a description of each unremediated QC deficiency, the basis for the firm's QC deficiency determination, a summary of remedial actions, and the firm's major QC deficiency presumption analysis (if applicable).

Evaluation of the firm's system of quality control. In this part of Form QC, the firm must report the overall conclusion on the effectiveness of the QC system, details on unremediated QC deficiencies, and the firm's major QC deficiency presumption analysis (if applicable).

Individual(s) responsible for the system of quality control. QC 1000 requires the individual that is ultimately responsible and accountable for the QC system as a whole, and the individual with operational responsibility and accountability for the QC system as a whole, to certify the firm's annual evaluation of its QC system on Form QC. These certifications are required to be furnished as exhibits. If the same individual is assigned both of these roles, they may sign a single certificate indicating both capacities. If a firm has co-principal executive officers, the references to "the individual assigned ultimate responsibility and accountability for the QC system as a whole" apply to each of the co-principal executive officers and each of them is required to certify the firm's annual evaluation of its QC system in a report to the PCAOB.

The exhibits may be provided in a form (e.g., pdf) that shows a manual signature, or may be signed and retained in the same manner as provided in Rule 2204.

Certification of the firm. Form QC must be signed on behalf of the Firm by an authorized partner or officer of the Firm including, in accordance with Rule 2204, both a signature that appears in typed form within the electronic submission and a corresponding manual signature retained by the Firm. The signature must be accompanied by the signer's title, the capacity in which the signer signed the Form, the date of signature, and the signer's business mailing address, business telephone number, and business email address.

Exhibits. Where an exhibit consists of more than one document, each document must be numbered consecutively (e.g., Exhibit 3.2.a.1, Exhibit 3.2.a.2, etc.), and the firm must provide a list of the title or description of each document comprising the exhibit.

5. Filing and Amending Form QC

Form QC captures, and conveys to the Board, the conclusions reached by the firm as a result of its completed annual evaluation, and that evaluation cannot disregard information that comes to light before Form QC has been filed.

Form QC should be complete and accurate as of the date of filing.

Form QC should be complete and accurate, and individual(s) in the firm must, on behalf of the firm, certify that the form does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which the statements were made, not misleading. Inaccuracies or omissions could form the basis for disciplinary sanctions for failing to comply with the reporting requirements, and it is therefore in the firm's interest to correct such errors as soon as possible. The firm may do so by filing an amendment pursuant to PCAOB Rule 2203A and the Form QC instructions specific to amendments.

Information that relates to the firm's QC system as of the evaluation date (September 30), and that comes to the firm's attention after the evaluation date but before the firm has filed Form QC, should be factored into the firm's evaluation and reflected, if and as appropriate, in Form QC. In contrast, any information that relates to the firm's QC system as of the evaluation date, but that comes to the firm's attention after the firm has filed its Form QC, would not need to be reflected on Form QC or on an amendment to Form QC (although it may constitute a QC observation to be considered in the next annual evaluation of the QC system).

The amendment obligation is not subject to any materiality or other thresholds.

When to amend a Form QC filing. Amendments are appropriate only to correct information that was incorrect at the time of the filing, or to supply omitted information that should have been supplied at the time of the filing.

The amendment process should not be used to update information reported on a Form QC that was correct at the time of the filing. In the event of changes to a firm's legal name or the contact information of the firm's primary contact with the Board, the firm should comply with the requirements to file a special report on Form 3. In the event of other changes to information reported on Form QC, the firm should provide up-to-date information on its next report on Form QC.

XIII. DOCUMENTATION

QC 1000 establishes comprehensive requirements regarding QC system documentation.

A. Overarching Documentation Requirement — QC 1000.81

QC 1000 requires firms to prepare and retain documentation of the design, implementation, and operation of the QC system and of the annual evaluation of the QC system.

The documentation of the design and implementation of the QC system captures decisions made regarding "the who, what, when, where, why, and how" of the QC system.

The documentation of the design and implementation of the QC system will help firm personnel and others understand what is expected of them in fulfilling their responsibilities and support consistent implementation and operation of the firm's QC system. For example, documentation of the design of policies and procedures regarding general and specific independence matters would enable a consistent understanding by firm personnel and others about who is responsible for what, when the responsibilities are triggered, and why certain actions are necessary. Such documentation will allow for consistent actions by firm personnel and others in implementing the design of those policies, helping to ensure that the QC system operates as designed.

The documentation of the operation of the firm's QC system enables the firm to determine if the policies and procedures were operated in the manner that the firm intended. It also provides evidence of compliance with the specified quality responses and other requirements of QC 1000. For example, it provides evidence of how the firm complied with specific communication requirements related to the operation of the firm's QC system and the performance of its engagements and whether the quality responses implemented by the firm operated as designed.

B. Nature and Extent of Documentation — QC 1000.82-.83

1. Specific matters that must be included in the firm's QC documentation

QC 1000.82 includes a list of specific matters that firms must include in the QC documentation. These include information regarding:

- ***Lines of responsibility and supervision within the firm's QC system.*** Documentation of the lines of responsibilities and supervision within the QC system should reduce operational ambiguity and provide clarity about who within the firm is accountable for various firm supervisory responsibilities within the firm's QC system.

- ***Certain aspects regarding the firm's risk assessment process.*** This is intended to ensure that the firm will have adequate evidence to support its annual risk

assessment. This documentation is valuable in subsequent risk assessments and could help to support decisions about, for example, whether to establish additional quality objectives, identify new or modified quality risks, or design and implement new quality responses. Specifically, the documentation must include descriptions of:

- Quality objectives;
- Quality risks related to the established quality objectives and the basis for the assessment of quality risks; and
- Quality responses and how the firm's quality responses are designed to address the quality risks.

- ***Certain aspects of the monitoring and remediation process.*** This documentation assists the firm in monitoring its monitoring and remediation process and in making its annual evaluation of the effectiveness of the QC system pursuant to QC 1000.77. Specifically, the documentation must include descriptions of:
  - The engagement and QC system-level monitoring activities performed, including, if applicable, monitoring activities performed by a network;
  - If a firm determines an engagement deficiency exists but that there is sufficient appropriate audit evidence to support the auditor's opinion, the basis to support the firm's determination;
  - Actions taken to address engagement deficiencies pursuant to QC 1000.68-.69;
  - The evaluation of QC observations to determine whether QC deficiencies exist and the basis for each determination; and
  - Root cause analysis and remedial actions to address identified QC deficiencies and the monitoring activities performed to evaluate the implementation and operating effectiveness of such remedial actions.

- ***The basis for the firm's conclusion on the effectiveness of the QC system.*** This documentation provides evidence of the decisions made in reaching the conclusion about the effectiveness of the firm's QC system, which may be valuable in future evaluations and in establishing compliance with the firm's reporting obligations to the PCAOB.

- ***Information related to the firm's use of resources or services from a network or third-party service provider.*** Documentation of such matters will serve as evidence of decisions made regarding resources or services used by the firm. Some networks or third-party providers may provide documentation about their services or resources to the firm. For example, the firm may obtain an understanding of how the resources were developed and maintained by the network through

documentation provided by the network. This documentation may need to be supplemented by the firm depending on various factors, including the extent of the documentation provided and whether the firm supplements or adapts the resource or service. Specifically, the documentation must include descriptions of:

- The firm's understanding of how the resources or services used by the firm are developed and maintained;
- If the firm supplemented or adapted such resources or services, how and why they were supplemented or adapted; and
- How the firm implemented and operated such resources or services.

An experienced auditor must have sufficient documentation to be able to evaluate whether the quality responses operated effectively.

2. Sufficiency of the QC documentation

QC 1000 requires the QC documentation to be in sufficient detail to:

- Support a consistent understanding of the QC system by firm personnel, including an understanding of their roles and responsibilities with respect to the firm's QC system; and
- Enable an experienced auditor that understands QC systems, but has no experience with the design, implementation, and operation of the firm's QC system, to understand the design, implementation, and operation of the QC system, including the quality objectives, quality risks, quality responses, monitoring activities, remedial actions, and basis for the conclusions reached in the evaluation of the QC system.

Similar to AS 1215, *Audit Documentation*, QC 1000 applies the experienced auditor threshold when determining the sufficiency of the documentation to be prepared and retained by the firm. Requiring documentation to be in sufficient detail to support a consistent understanding of the QC system by firm personnel, including an understanding of their roles and responsibilities with respect to the firm's QC system, will help to clarify the firm's expectations of its personnel and promote consistent compliance with the firm's QC policies and procedures. Firms would initially determine the appropriate level of detail of documentation based on the experience they already have in implementing and operating a QC system under current standards and whether their personnel understand their roles and responsibilities, and modify documentation as needed over time based on their monitoring and remediation activities and the results of their QC system evaluations.

Sufficient documentation of the QC system provides clarity around the firm's policies and procedures, enables proper monitoring, and supports the evaluation and continuous

improvement of a firm's QC system. The documentation facilitates the retention of organizational knowledge, providing a history of the basis for decisions made by the firm about its QC system. Further, it assists others conducting reviews of the firm's QC system by providing evidence of the system's design, implementation, and operation.

A note to QC 1000.83b explains that with respect to the operation of the QC system, the documentation must include documentation that enables an experienced auditor to evaluate the operation of the quality responses. This note clarifies that the firm need not prepare and retain excessively voluminous documentation of the day-to-day operation of every action of its QC system, provided the information is not required to satisfy the requirements of QC 1000.82-.83.

Specifically, documentation of every aspect of the operation of the firm's QC system may not be required to evidence that each quality response operated effectively.

Example
There may be certain documentation, such as emails or meeting invitations that are sent as part of the day-to-day operation of the QC system, that may not be necessary to enable an experienced auditor to evaluate the effective operation of the quality responses. In these circumstances, the firm may determine it is not required to prepare and retain this information within the documentation of its QC system. However, there may be circumstances in which an email or meeting invitation needs to be retained because it evidences how a quality response operated to address a quality risk and is necessary to enable an experienced auditor to evaluate the operation of the quality response.

3. Documentation of sensitive or highly confidential information

To the extent that the operation of the firm's QC system includes sensitive or highly confidential data such as employee related data, the firm has flexibility to not include the sensitive data fields in the documentation that is prepared and retained to the extent that they are not necessary to evidence that the quality response operated effectively.

Example
A firm may obtain personal financial information from its employees in connection with monitoring an individual's compliance with applicable independence requirements, for example, banking or brokerage account details. The firm might determine that certain information such as account numbers and terms are not required to evidence the operation of the quality response. If so, the firm could instead include summarized information that is relevant for determining compliance with the independence requirements such as the name of the institution that the account is with, and the type and contents of the account.

SCALABILITY CONSIDERATIONS

The extent of documentation sufficient to evidence whether the quality responses operated effectively would scale with the size of the firm's PCAOB practice and the risks and complexities of their engagements and, in turn, the assessed quality risks and the quality responses established to address them.

When determining the form, content, and extent of documentation, the firm will consider, among other things, the nature and circumstances of the firm and the nature and complexity of the matter being documented. For example, for a large multi-office firm that performs many audits under PCAOB standards, the extent of documentation would be greater than for a small, single-office firm with a few firm personnel that audits one issuer or broker-dealer.

The firm's documentation may take the form of formal written manuals and checklists or may be informally documented (e.g., in e-mail communications), subject to the requirement of QC 1000.83 that the documentation be in sufficient detail to support a consistent understanding of the QC system by firm personnel and for an experienced auditor to understand the design, implementation, and operation of the QC system. The firm may determine that a detailed memo is a more appropriate form of documentation for more complex matters, whereas, for less complex matters, briefer communications, such as e-mail, may suffice.

In determining the sufficiency of the detail and extent of the QC documentation, the firm may identify quality responses for which the extent of evidence required to be able to demonstrate that the quality response operated effectively could be scaled down from the entire body of documentation produced in the day-to-day operation of the QC system.

Example
In the event that a large volume of automated emails sent by the firm to its employees are evidence supporting that a quality response operated, the firm could evaluate whether alternative evidence (such as email delivery reports or other aggregated data) would provide sufficient support regarding the operation of the quality response—without having to prepare and retain all of the individual emails within the QC documentation.

The nature and circumstances of the firm and the nature and complexity of the matter being documented are not the only factors that could drive the form, content, and extent of documentation. There may be other factors, such as the nature of the firm's engagements or the frequency and extent of changes in the firm's QC systems.

C. Documentation Assembly and Retention

QC 1000.84 & .86

Under QC 1000, a complete and final set of documentation as required by QC 1000.81-.83 with respect to the 12-month period ended the prior September 30 and any evaluation required as of that date should be assembled

The firm must retain QC documentation for seven years.

for retention not later than December 14 of the same year ("QC documentation completion date").

QC 1000.86 requires the firm to retain the QC documentation required under QC 1000.81-.83 and .85 for seven years from the QC documentation completion date, unless a longer period is required by law.

D. Subsequent Additions to the QC Documentation **QC 1000.85**

Circumstances may require additions to documentation after the QC documentation completion date. Documentation must not be deleted or discarded after the QC documentation completion date; however, information may be added. Any documentation added is required to indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.

Documentation must not be deleted or discarded after the QC documentation completion date.