AICPA

Private Companies
Practice Section

August 27, 2021

Ms. Sherry Hazel
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: ASB Proposed Statements on Quality Management Standards

Dear Ms. Hazel:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC appreciates the effort of the Auditing Standards Board (ASB or the Board) in converging with international quality management standards and strongly supports the Board's diligence in enhancing quality across all types of engagements through the proposed quality management standards. While TIC supports the overall direction of the proposed quality management standards, we believe that some aspects of the standards will place a significant burden on smaller firms. TIC's detailed comments are provided as follows with regard to selected questions that were included within the proposed statements.

Part 1: Proposed Statement on Quality Management Standards (SQMS), A Firm's System of Quality Management (SQMS No. 1).

1a: Which of the following best describes your view of the proposed SQMS No. 1? Please choose only one.

As noted in the introduction, TIC strongly supports the initiative to enhance quality; however, since there are concerns with some aspects of SQMS No. 1, TIC only somewhat supports the proposed SQMS No. 1.

1b: The fundamental aspects of proposed SQMS No. 1 are summarized in pages 8-14 of the Explanatory Memorandum. Please provide your views on (any or all of) the fundamental aspects.

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TIC appreciates the Board applying a risk-based approach to identify and respond to quality risks, because that approach corresponds with how engagements are performed, which results in harmony between the approaches. However, TIC suggests the Board consider the following revisions to several aspects of the proposed SQMS.

Prohibition on Self-Inspection

While TIC understands the position of the Board as outlined in the SQMS with regard to self-inspection and the importance of convergence with international standards when possible, TIC respectfully disagrees with the Board's conclusion "that this requirement is necessary to enhance audit quality" as indicated on page 28 of the proposed SQMS. The specific prohibition on self-inspection is an area where TIC believes that a divergence from international standards would be acceptable in certain circumstances with safeguards or other requirements as discussed elsewhere in this letter.

TIC is concerned that this prohibition may create undue operational and cost burdens on smaller firms or firms with specialized niches, as in many cases they simply do not have the resources to comply with this requirement. Our concerns regarding both the impact on quality and firm operations in this area as well as potential solutions to those concerns are documented in Section 2 below on Scalability.

1c. Are the requirements in SQMS No. 1 clear and understandable?

TIC believes the requirements in SQMS 1 are clear and understandable. Although clear and understandable, TIC also believes the requirements will take a significant amount of time to implement and our concern is that not all practitioners may have the resources available to carefully review the proposed SQMS at the level needed to fully understand and implement the guidance. While we acknowledge that all practitioners should prioritize quality on all types of engagements and their understanding and implementation of new standards, we also recognize that smaller firms have less resources available for new standards implementation.

Recognizing the resource limitation of smaller firms, TIC encourages the development of additional resources for practitioners to better understand and implement the new standards. One suggestion in this area is the development of resources in a tabular format which clearly outlines and maps the existing SQCS 8 requirements and what has changed under the proposed SQMS. This format should easily allow practitioners to identify gaps in their existing quality management system and the new requirements and help them determine what they need to do to ensure they are following the new requirements.

PART 2: Scalability of SQMS No. 1

2a. Is the new quality management approach in SQMS 1 scalable?

As detailed below in question 2c, TIC does not believe that the quality management approach in SQMS No. 1 is fully scalable.

2b. Would additional application material regarding scalability be helpful?
TIC encourages the Board to supply practitioners with as much application material as possible to assist with the understanding and implementation of SQMS No. 1. While the material included in proposed SQMS is helpful, typically, additional guidance is appreciated by practitioners.

2c. Please provide additional details regarding your responses to 2a and 2b.
As the collective voice of small and medium sized firms, TIC believes that the SQMS presents significant scalability concerns to many firms of this size. TIC acknowledges the difficulty in the standard setting process that the Board faces in serving firms that include tens of thousands of employees to sole practitioners. TIC appreciates the opportunity to identify areas of greatest concern related to scalability and provide suggestions that potentially would mitigate those concerns. Our thoughts in this area related to the content of the standard, as well as the breadth of guidance included, are outlined below.

Lack of Available Personnel with Sufficient SKE

An example of TIC's concern with the scalability of the proposed SQMS can be illustrated by the possibility of self-review at a small firm which operates with only one tax and one assurance partner. To comply with the proposed SQMS in this situation, the tax partner would need to perform the internal inspection or engagement quality review since the assurance partner would not be eligible to do so. The tax partner may not have suitable expertise to serve in that role which likely would not result in an improvement in quality. In this case, TIC believes that the assurance partner self-inspecting their work would be more likely to achieve the goal of evaluating whether a quality engagement was performed.

In situations like the above example, TIC notes that the firm could engage an external party to perform an inspection which would address self-review concerns; however, doing so results in the firm incurring additional costs. TIC is concerned that, as a result of the additional costs incurred to engage an external party, some practitioners facing this decision may choose to no longer provide those services.

See 'Suggestions to Alleviate Self-Inspection Risk' below for TIC's commentary on potential ideas to address the self-inspection risk.

Hinderance of Ability of Firms to Specialize

Many firms achieve success through carving niches for themselves in their local market in specific industries. In many cases, this specialization is the result of having one partner who has deep knowledge of a particular industry, which may have unique accounting and/or auditing considerations, such as employee benefit plans, not-for-profits, single audits, healthcare, and many others. In situations where a firm has a single partner with deep knowledge of an industry, requiring that a review of the engagement be performed by a different partner only to comply with proposed guidance prohibiting self-inspection may not result in the desired enhancement of quality. When considering specialized industries, even having another partner who performs similar engagements in other industries perform the review may not identify concerns with quality due to the specialized nature of the engagement. For example, a partner who serves mainly retail clients and restaurants may not have the expertise required to perform a meaningful inspection on the audit of an employee benefit plan.

The inclusion of this requirement could be detrimental to these sorts of niche practices, as firms potentially would incur significant additional costs to locate someone with sufficient industry expertise to perform the reviews. Further, external resources, if available, may not possess the same level of specialized knowledge as the firm performing the engagement which would not result in an enhancement to quality.

See 'Suggestions to Alleviate Self-Inspection Risk' below for TIC's commentary on potential ideas to address the self-inspection risk.

Suggestions to Alleviate Self-Inspection Risk

TIC recognizes that, when allowing even the most well-meaning and qualified individuals to self-inspect their work, they are susceptible to self-serving biases. As such, TIC recommends there be a general expectation of avoiding self-inspection. However, rather than a bright-line rule prohibiting self-inspection, we believe firms should be permitted to overcome the general expectation when certain safeguards are implemented. Example safeguards (there may be others), which may reduce the self-inspection risk to a sufficiently low level, include the following:

- Link to Peer Review. Linking the ability to self-inspect engagements to the results of the most recent peer review. TIC believes that the peer review process continues to be a vital part of ensuring that practitioners perform quality engagements. If the engagement partner has demonstrated their existing quality management processes produced successful peer reviews, then they should be allowed to continue using the processes which resulted in that success. Because of the complexity and nuance involved in the peer review process, TIC suggests that the ASB work with the Peer Review Board to determine what would be considered a successful peer review for this purpose.

  Conversely, TIC would support engagement partners being prohibited from self-inspection as a remedial action based on the result of their most recent peer review. That prohibition could extend until their next peer review is complete and they have demonstrated that they have proper quality management processes in place. At that time, the firm would be free to re-evaluate if they believe that self-inspection can be effective.

- Require Training. By including a requirement to attend an annual training course which covers risks associated with self-inspection and inherent biases, practitioners would be consistently made aware of the risks related to self-inspection, which would reduce the risk of the practitioner succumbing to their bias in reviewing the work. TIC believes that this suggestion would be similar to the requirement in many states related to required ethics CPE in order to maintain CPA licenses.

- Require Center Membership. The AICPA has many resources available which are designed to assist members in performing quality engagements including the Employee Benefit Plan Audit Quality Center and Government Audit Quality Center as well as other memberships such as the Not-For-Profit Section and Center for Plain English Accounting. Membership based on the types of clients being served by the practitioner, would demonstrate a commitment to quality which may help alleviate risk in this area.

- Use of Peer Review Checklists. As noted previously, the peer review process is critical in ensuring that quality engagements are performed. Requiring firms that self-inspect engagements to use the same checklists which are used by peer review would provide structure to internal inspections that comes from a qualified source outside of the entity. As these checklists are developed by parties outside the firm for the purpose of performing a quality review via the peer review process, they help the practitioner approach the engagement internal inspection from a different perspective than the review done during engagement performance. TIC believes that this approach to engagement inspection responds to the primary concerns related to self-inspection. TIC is aware that some firms already use these checklists for this purpose and those firms have indicated that they have identified issues to be corrected through their use.

Breadth of Proposed SQMS Makes Beginning Implementation a Daunting Undertaking

TIC is concerned that the volume of criteria and guidance included in the proposed SQMS will be daunting for many firms to determine how they should start implementing the guidance. We believe that this will be especially true for areas of the proposed SQMS which are not already included in extant guidance, such as the risk assessment process described in paragraphs 24-28. While the guidance that is included in the application and other explanatory material is helpful in understanding the requirements, TIC believes that it would be challenging for firms that do not have significant resources available to dedicate solely to implementing the standard. To address this concern, TIC suggests the development of a practice aid that would assist firms with clear steps on how to implement this portion of the guidance. Ideally, that practice aid would start with a less complex accounting firm that, for example, only performs compilations and reviews. Starting with a practice aid for a firm without high-risk engagements would provide the most useful resource to build upon. The AICPA could then add additional modules to the base practice aid for more complex situations. This would have the dual benefit of being accessible without being overwhelming for less complex firms and customizable based on the nature of engagements performed.

While the risk assessment guidance is where TIC believes many smaller firms will have the largest obstacles in implementation, the other areas of the quality management system, which have been modified from extant guidance and require a change to existing quality control processes, also will be challenging for many firms to identify given the volume of changes made in the proposed SQMS. As firms already have a quality control process in place based on extant guidance, TIC suggests that the Board and/or the AICPA create a guide which clearly links concepts in extant guidance with where they appear in the new guidance. This sort of document would provide the clearest pathway for understanding both how existing processes fit into the new requirements as well as help identify where there are gaps in the system which must be addressed in order to be in compliance.

From experience with past standards, TIC is aware that, in many cases, smaller firms ultimately rely upon practice aids and implementation guidance provided by third parties or which have trickled down to them from larger firms. While both of these resources can be helpful and have many benefits, they are not a substitute for similar resources which are provided directly by the Board and/or AICPA.

PART 3:
Proposed SQMS, Engagement Quality Reviews (SQMS No. 2)

3a: Which of the following best describes your view of the proposed SQMS No. 2? Please choose only one.

Consistent with our responses throughout this letter, TIC somewhat supports SQMS No. 2. TIC is concerned that the SQMS places too much emphasis on establishing rules for which individuals are eligible to serve as engagement quality reviewers (EQRs) with respect to the cooling-off period. By limiting which individuals may serve as an EQR, TIC believes that some firms may change their criteria for which engagements require an EQR. This scenario could result in less engagements being subject to EQR procedures. Alternatively, some firms may assign a reviewer who is not qualified to perform the EQR. Neither of these scenarios would enhance quality.

3b. Are the requirements in SQMS No. 2 clear and understandable?

The requirements in SQMS No. 2 are clear and understandable; however, TIC believes that they may be difficult for some firms to implement.

PART 4:
Proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (QM SAS)

***4a: Which of the following best describes your view of the proposed QM SAS?* Please choose only one.**

As noted throughout this letter, TIC strongly supports the enhancement of quality throughout all types of engagements; however, we have concerns with some aspects of the QM SAS, but somewhat support the proposed SAS.

4b. Are the requirements in QM SAS clear and understandable?

The requirements in the QM SAS are clear and understandable; however, TIC believes that they may be difficult for some firms to implement.

PART 5. Effective dates and implementation period

5. Are the effective dates clear?
Yes, the effective dates are clear as written in the proposed standards.

6. Is an 18-month implementation period appropriate?
While TIC acknowledges the need to implement the practices included in the exposure draft as soon as practicable, to enhance quality and serve the public interest, TIC does not believe that an 18-month implementation period is sufficient to implement such an extensive standard.

As previously discussed in this letter, many smaller firms operate with limited resources available to implement new standards. While we recognize that page count of a new standard does not always equate with complexity of implementation of a standard, as of the date of this letter, there are issued SASs which are not yet effective that comprise over 1,100 pages of standards for practitioners to understand and implement. That total excludes the proposed quality management standards which are an additional 200 pages. As our comment letters have indicated over the past several years, while TIC supports the efforts of the ASB to improve standards, the volume of new guidance which has been issued and is not yet applicable verges on becoming overwhelming for firms which do not have the ability to dedicate extensive resources exclusively to implementation of these standards.

For many smaller firms, a primary source of information both to inform and educate regarding upcoming changes to standards, as well as provide resources for implementation, are third-party resource providers. Given the volume of additional guidance which already is slated for implementation prior to the proposed quality management standards, TIC is concerned that the resource providers also will experience a resource crunch, delaying their issuance of implementation resources used by many smaller firms to assist them in adoption of the proposed standards.

An extension of the implementation period beyond 18 months also would serve to increase the opportunity for the peer review function to be included in the education process in a more comprehensive manner. TIC has heard feedback that many smaller practitioners gain significant knowledge and insights regarding upcoming standards directly from their peer reviewers. By extending the implementation period, more firms would have the opportunity to discuss implementation of the new standards with their peer reviewers which would aid both in the ease of adoption as well as increase quality through learning of best practices being considered by other firms.

While TIC understands that the Board has been working with peer review to ensure that they are operating in lock-step with regards to how quality management implementation issues will be evaluated as part of peer review, TIC remains concerned that a rushed implementation period could have additional unintended consequences in the form of peer review deficiencies. TIC would like to see an acknowledgement that quality management is a continual process of evaluation and enhancement and that firms will not be penalized for being in earlier stages of that process than others. Additional time being allotted for implementation of the standard would alleviate those concerns.

TIC believes that the key to successful implementation of the quality management standards will depend on the availability of quality educational, implementation, illustration, and best practice resources. Delay of the proposed effective date would provide additional time for these resources to be developed, whether by the Board, the AICPA, 3rd party providers, or peer review, which would result in a more effective and efficient implementation of the standards.

Lastly, delay of the proposed effective date would allow time for firms that are not implementing IASB ISQMs to learn from those that are.

PART 6. Other issues for consideration.

7. Please indicate your level of agreement that inspection of completed engagements by those involved in the engagements should be precluded in order to enhance audit quality.

While TIC acknowledges that there is a self-review threat when an inspection is completed by an individual who was involved in those engagements, TIC disagrees with inclusion of such a restriction, as we believe that adequate safeguards can be put in place to address the self-review risk in this area. Our concerns in this area as well as our suggestions can be found in Section 2 above.

8a. Should a cooling-off period be required before a former engagement partner can serve as an engagement quality reviewer on that engagement?

TIC does not support inclusion of a mandatory cooling-off period for former engagement partners to serve as an EQR on that engagement. TIC believes a risk-based approach is more appropriate.

8c. If you answered NO to 8a, please provide additional details regarding your response and provide examples of safeguards that could lower the objectivity threat to an acceptable level.

TIC believes that a cooling-off period should only be required as a response to an identified risk for a specific engagement. This view is based on TIC's collective experience where there were changes in which individual was serving as the engagement partner for reasons other than risk. TIC identified several situations in which a cooling-off period for a previous partner should not be required:

- Some firms identify engagements which are lower-risk and have the engagement partner transition the engagement to a senior-manager level to provide them with experience serving in an engagement executive role, which better prepares them to become a partner.
- Firms may choose to transition engagements to a newly promoted partner in order to provide that partner with a base client book of business, allowing the previous partner more time to pursue new clients.

- Partners who are nearing retirement may begin to transition clients to other partners to ease the succession of client responsibilities.
- Similar to the previous bullet point, when new partners are admitted to the firm, they may have clients transferred to them. In this situation, firms also may have policies that require an EQR for the first year after the partner joins the firm.

In the scenarios presented above, there is not a risk (i.e., familiarity) for which a cooling-off period would seem necessary. By requiring a cooling-off period in those scenarios, the previous partner would not be eligible to serve as an EQR on the engagement; however, that individual presumably has the most knowledge regarding the engagement. While TIC recognizes that there is no guidance which prevents the previous partner from remaining involved in the engagement, many smaller firms do not have the resources available to effectively have three different partners participate on engagements.

By removing the previous partner from the pool of potential EQRs, smaller firms may either choose an individual who is a less appropriate choice due to having less relevant SKE, or as we addressed above in our response to question 3a, making firm policy changes to modify which engagements require EQRs. Neither scenario likely would improve quality. The logistical challenges resulting from requiring a cooling-off period in these scenarios also may have the unintended consequence of firms choosing not to transition engagements to new partners. TIC views this outcome as potentially more harmful to quality over the long-term as it would deny new partners/senior managers opportunities to serve as engagement executives while being reviewed by the previous partners.

While the situations above would not warrant a cooling-off period, TIC does believe that when there is an identified quality risk for an engagement, firms should have a policy in place to require a cooling-off period as a response to that risk. The time of the cooling-off period would be determined based on firm policies in consideration of the objectivity/familiarity risks identified in the engagement. TIC believes that this risk-based approach is most consistent with guidance throughout auditing standards. This approach could be implemented in two manners:

a) Modify the proposed standard to remove the requirement of a cooling-off period, replacing it with a risk-based evaluation, or
b) Maintain that a cooling-off period should be the default assumption for all engagements but allow firms the ability to deviate if they can demonstrate the change is for reasons other than an identified risk.

While TIC believes that both approaches would be an improvement over the guidance in the proposed standard, our preference is for option a) above, as we believe that approach would be implemented most effectively.

9a. Should the engagement quality review be required to be completed before the report is dated, rather than before the report is released?

Yes, TIC agrees that completion of the EQR should be required before the report is dated. The necessity of an EQR is a response to an identified risk for an engagement; therefore, completion of the review by the EQR is considered an essential part of completing the engagement.

ADDITIONAL COMMENTS

Performing high quality engagements should be the objective of every practitioner and firm. TIC appreciates the efforts of the Board in drafting the proposed standards to work towards that objective. While the proposed standards include many useful concepts, TIC does not believe that the inclusion of some of the rules-based prohibitions identified throughout this letter are the best way to achieve the quality objective.

TIC believes that the best way to enhance quality is through *preventive measures* such as ensuring that the entire engagement team has appropriate SKE to perform the engagement, an engagement partner who focuses on quality throughout the engagement, and fostering an environment where quality is a critical component of completing an engagement. TIC believes processes or controls such as self-inspection prohibitions and EQR cooling-off requirements are *detective measures* and are less effective in enhancing quality compared to other preventive measures. In TIC's experience, you cannot review quality into a job - it must be built in from the start.

As noted previously, TIC is supportive of the Board including a risk assessment process within the proposed standards. While we do not have any significant concerns with the risk assessment approach, TIC is concerned there may be diversity in practice when applying this guidance. For example, some firms may identify quality risks at a very high level and others may take a very granular approach. This, in turn, would have an affect on the risk response and ongoing monitoring requirements. To address this concern, TIC encourages the development of a practice aid which includes examples that provide:

- A brief overview of the type of firm and their operating environment
- The quality objective being illustrated, with references to the specific paragraphs of the standard
- Examples of quality risks which may be identified by the firm related to that objective
- Example of responses to the identified risks

TIC appreciates the opportunity to present these comments on behalf of PCPS Member firms. If the AICPA chooses to undertake projects as suggested above to create implementation guides and other resources, TIC would welcome the opportunity to participate. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Bryan Bodnar

Chair, On Behalf of the PCPS Technical Issues Committee