

August 31, 2021

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Ms Harding:

The Minnesota Society of Certified Public Accountants (MNCPA) appreciates the opportunity to comment on the exposure draft of the “Proposed Statements on Quality Management Standards – Quality Management: *A Firm’s System of Quality Management Engagement Quality Reviews*” and “Proposed Statement on Auditing Standards – *Quality Management of an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.”

The MNCPA is a not-for-profit professional organization. Since 1904, we have offered services and professional development for CPAs and other accounting professionals. We currently have more than 8,000 members working in public accounting, industry, government and education.

Our purpose is to help our members succeed professionally while being mindful of serving the public. We support efforts improve audit quality and understand efforts to converge with International Auditing Standards. We support the theory behind each firm assessing the risks to quality they face, and designing appropriate responses to those risks.

But we have concerns about the impact on sole proprietors and small firms, especially ones that have done and continue to do quality work. If a firm is demonstrating that they are achieving high quality under the current quality standards, it is not in the best interests of CPAs, their clients (many of whom have resource constraints in purchasing professional services), or the profession as a whole to add costly administrative burdens that do not significantly enhance quality.

#### SQMS 1

##### *Prohibition against self-inspection*

The proposed SQMS 1 prohibits the use of an engagement team member or the engagement quality reviewer of an engagement from performing any inspections on the engagement (i.e. prohibition against self-inspection).

On p. 27 the exposure draft, under **Issue 1 – Self-Inspection**, the ASB notes that current QC section 10 did not include this prohibition, and thus did not converge with ISQC 1, because “the ASB has previously concluded that it was not necessary to change existing practice to converge with ISQC 1 because in the United States, the peer review process provides a safeguard and provides evidence that monitoring procedures involving self-inspection can be effective.”

On p. 29 of the exposure draft: “Other than the peer review process, the ASB was unable to identify anything unique in the United States with regard to self-inspection, nor did the ASB believe that safeguards exist that could lower the self-review threat to an acceptable level. The ASB recognizes that the extant standard permits those involved in the engagement to inspect their own work, and some practitioners may be capable of doing so effectively. However, while concerned about the impact on smaller firms, the ASB believes that this requirement is necessary to enhance audit quality. Accordingly, proposed SQMS No. 1 converges with the IAASB standards with respect to self-inspection.”

Response to this argument:

1. In the United States, no firm with an accounting and auditing (A&A) practice relies solely on self-inspection, because peer review includes a review of selected A&A engagements by an independent party on a periodic basis of no less often than every three years. In the application guidance for SQMS 1, a three-year inspection cycle for partners who perform audits is given as an example of a reasonable cycle (every five years for partners not involved in audit engagements). Can a similar cycle apply to firms who have limited personnel either in the firm as a whole or in a specific narrow practice area?
2. The ASB had “previously concluded that the peer review process provided evidence that monitoring procedures involving self-inspection can be effective.” The implication is that the ASB has now arrived at the opposite conclusion. But peer review results provide ample evidence that there continue to be many firms who have an effective monitoring process that involves self-inspection, with external inspection done only in the peer review year by the peer reviewer. Why must the firms who are successfully self-monitoring be required to add the cost of a “mini peer review” every year, when there is no evidence that to do so would enhance quality beyond what they are already achieving?
3. Review by a party other than the preparer is no guarantee of enhanced quality. Peer reviewers are specially trained individuals who must meet certain qualifications and are subject to much oversight. If the ASB is concluding that the existing peer review process is not doing enough to catch poor quality, why does it believe that involving another reviewer – who may have less training and qualification than the firm’s peer reviewer – would be likely to enhance quality on a significant basis?
4. The ASB believes that this prohibition is necessary to enhance audit quality. Many CPA firms do not perform audits but only compilations and/or reviews. These types of engagements provide a higher level of financial attestation than preparation engagements, and thus is of value to the marketplace. It is also important to note that preparation engagements are not subject to any oversight when they are the highest level of service a firm provides. With the elimination of self-inspection, and if there were no allowance for a three-year inspection cycle as noted in the next comment, a potential outcome is that more firms drop compilation and review engagements and move to preparations, which could lead to a decrease in quality and we would argue reduces public protection.

**We recommend that the standard allow for self-review as a legitimate monitoring activity, even if it does not meet the level of formal “inspection.”**

*How often is “inspection” required?*

In the monitoring and remediation section of SQMS 1, we find the following:

**36.** The firm should establish a monitoring and remediation process to (Ref: par. A148)

- a.* provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
- b.* take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

**37.** The firm should design and perform monitoring activities to provide a basis for the identification of deficiencies.

**39.** The firm should include the inspection of completed engagements in its monitoring activities and should determine which engagements and engagement partners to select. In doing so, the firm should (Ref: par. A150 and A162–A166)

- a.* take into account the matters in paragraph 38;
- b.* consider the nature, timing, and extent of other monitoring activities undertaken by the firm and the engagements and engagement partners subject to such monitoring activities; (Ref: par. A167) and
- c.* select at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.

In the application guidance, we find:

**A165.** Examples of policies and procedures that a firm may establish to apply a cyclical basis for the inspection of completed engagements for each engagement partner include the following policies or procedures that

- set forth the standard period of the inspection cycle, such as the inspection of a completed engagement for each engagement partner performing audits of financial statements once every three years, and for all other engagement partners, once every five years.
- set out the criteria for selecting completed engagements, including that for an engagement partner performing audits of financial statements, the engagements selected include an audit engagement.
- address the selection of engagement partners in a manner that is unpredictable.
- address when it is necessary or appropriate to select engagement partners more, or less, frequently than the standard period set out in the policy.

Based on the language in the proposed standard and application guidance, it would seem that a firm without the personnel internally to overcome the self-inspection prohibition could set a standard period of the inspection cycle as every three years, coinciding with the firm’s peer review, so that the peer review would provide a non-preparer inspection. If in the firm’s ongoing assessment of risk, they see an increase (e.g. through merger with another firm, acceptance of clients in a new industry, significant loss of firm personnel, etc.), they would need to develop a response to address the risk. Perhaps this would include hiring an external party to do a pre- or post-issuance review, but there may be a variety of ways to address an increase in risk.

Monitoring of the firm’s system (as opposed to the specific activity of inspection of completed engagements) must happen more frequently than every three years, because an annual evaluation of the

system is required by the standard. But a firm could design other appropriate monitoring activities for the non-peer review years, including a self-review of completed engagements.

If the firm's every-third-year inspection cycle (i.e. peer review) uncovered findings and deficiencies, then the firm would likely need to revise its inspection cycle and involve non-preparers more often. Peer review would likely even mandate this by requiring a pre- or post-issuance review of engagements by a third party or requiring a firm to hire a third party to perform its annual inspection. But if a firm's peer review does not result in findings and deficiencies, then why is involvement of a third party required more often than every third year?

**We would like the ASB to clarify whether a firm could satisfy the prohibition against self-review by setting an inspection cycle of every three years, with the firm's peer review providing the required non-preparer inspection.** We would expect that such a clarification would have provision that if/when a firm experiences significant new risks, a three-year inspection cycle may not be appropriate.

**If an inspection cycle of every three years is not allowed under the new standard, then we recommend that firms which do not perform audits be exempt from the self-review prohibition.**

#### SQMS 2

Proposed SQMS 2 requires a cooling-off period that prohibits partners rotating off an engagement from serving as the engagement quality reviewer for a minimum of two years. We question the effectiveness of this prohibition in enhancing audit quality.

1. In many cases, an engagement team member from the previous one or two years may be the very best person to enhance audit quality due to their depth of knowledge of the client. Having the EQR performed by someone without experience may enhance audit quality or may detract from it. It seems best to leave that up to the judgment of the firm.
2. If a cooling-off period remains in the standard, our concern is that firms may feel the need to make EQR policies less restrictive. In other words, design their policies to make fewer engagements subject to EQR. This could result in a decline in quality, not an improvement.

**We recommend that a mandatory cooling-off period be removed from the standard, allowing firms to retain flexibility for determining which individual within the firm is most likely to enhance audit quality as the engagement quality reviewer.**

#### Proposed effective dates

Learning about the new quality standards and then designing and customizing a system of quality management will be a considerable project for firms and will ideally involve deep and thoughtful consideration. But firms are already in the midst of implementing multiple major accounting and auditing standards that were delayed due to the pandemic. The implementation dates in the proposed Statements do not seem reasonable based on the current environment.

**We suggest either a delay in the proposed effective dates of one or two years, or a staggered implementation based on firm size.**

#### Guidance for firms

While we support the theory of firms assessing the risks to quality specific to their practice and customizing their responses based on their own circumstances, the implementation of this process has the potential to place an enormous burden on firms, especially those of smaller size, and increase costs

to their clients with no discernible benefit. Provision of guidance to firms in navigating the process is imperative.

**We think implementation guidance is essential and encourage development of a variety of resources.**

The MNCPA thanks you for considering our comments and concerns and the ASB's commitment to quality and supporting CPAs.

Respectfully,



Katie Gabriel, CPA

Chair

Minnesota Society of CPAs