

August 30, 2021

We have prepared the following comments in response to the Exposure Draft for Proposed Statements on Quality Management Standards.

### **Proposed SQMS No. 1**

1. *Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents' views on whether the requirements in proposed SQMS No. 1 are clear and understandable and whether the application material is helpful in supporting the application of those requirements.*

Overall, we agree with the general evolution of the current Statements on Quality Control Standards (SQCS) into the proposed Statements on Quality Management Standards (SQMS). The addition of the risk assessment process and information and communication components to the current six elements of quality control under SQCS along with the expansion of the human resources element to the broader "resources" component are positive changes. However, the requirements of SQMS No. 1 regarding the new component of risk assessment appear to be conceptual and not fully inclusive of clear guidance for successful implementation by firms.

Additional guidance will be needed for firms to properly assess the risks to the achievement of the identified specific quality objectives and additional quality objectives that will comprehensively address the requirements of the proposed standard.

Has the ASB considered the following questions when developing guidance?

1. How much latitude will firms have when determining quality risks?
2. Are there specific examples that always or in most cases pose a quality risk?
3. Are there examples or recommendations for the conditions, events, circumstances, actions, or inactions that create a quality risk?
4. Since the proposed language states "The assessment of quality risks does not require formal ratings or scores", is it appropriate to use low, moderate, and high or a score of 1 to 10 as appropriate ranges for risk? Without an end-result in mind for scoring and/or ranking risks, how will a firm determine, understand, and respond appropriately to the severity of the risks?
5. Will the firm be subject to the redetermination of the risk levels by the firm's peer reviewer? How does the firm's risk levels impact the peer reviewer's risk assessment process?
6. What if the peer reviewer determines the risks to be more severe than the peer reviewed firm?
7. When assessing the degree to which the factors may adversely affect the achievement of the quality objectives, are there examples that will assist firms in determining if a risk is low, moderate, or high?
8. Risk assessment is a complex process where mitigating procedures to eliminate risks could create other risks. Guidance needs to be established regarding when a firm

should stop identifying risks. For example, if the firm uses an outside reviewer to mitigate the self-review threat, there is now a risk that the outside reviewer doesn't identify all key findings during his/her review because the outside reviewer may or may not have been qualified. How should firms prevent being caught in a circular risk assessment process?

One possible avenue for successful application of the new standards would be the development of educational courses by the AICPA. Many areas of the newly proposed SQMS 1 and 2 will require practitioners, partners, and experienced staff members to think differently about their respective firm's structure and procedures that the firms utilize to document compliance with SQMS 1 and 2. The training would require an experienced professional as an instructor with real life examples of how firms of multiple sizes can achieve compliance with the new standards.

Other components of the Quality Management Standards will not feel as foreign to firms as 6 of the remaining 7 components are already rooted in QC Section 10.

2. *Respondents are asked to provide their views on the scalability of the new quality management approach. In addition, the ASB is seeking respondents' views on specific requirements in proposed SQMS No. 1 that may inhibit scalability and requirements for which additional application material regarding scalability would be helpful.*

The proposed standard's use of "scalability" appears to be abstract or conceptual at best. Firms of all sizes could be subject to regulatory reinterpretation (i.e., peer review) of its respective determination and response to the "scalability" rooted in individual or collective interpretations.

Uniform application of the scalability concept will require further specific guidance. Small, medium, and large size firms will need to be defined by a quantifier (i.e., number of personnel, number of A&A personnel, number of partners, number of engagements, etc.)

In addition, procedures that are appropriately and proportionally scaled to the firm's size as defined will need to be clearly detailed and provided to the firms. Implementation guidance will need to be expanded for firms to have an opportunity to succeed in implementation of the new standard.

Absence of the defined firm sizes and proportionally scaled procedures will leave firms subject to opposing individual judgements of the firm's peer reviewer and/or other regulatory bodies. This may lead to inconsistencies in practice and is likely to cause more confusion for firms of all sizes.

In addition, this may be a case where converging with international standards may not be achievable or desirable. Of the 2,400 firms administered by the Peer Review Alliance, only 10 firms have a practice area in International Standards on Auditing, Assurance Engagements, and related Services (ISAs), or any other standards issued by the International Auditing and Assurance Standard Board (IAASB). One must wonder then whether small firms in other countries perform audits to the same extent that local firms do in the United States. International markets may differ widely from the business environment in the United States.

## **Proposed SQMS No. 2**

- 3. Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents' views on whether the requirements in proposed SQMS No. 2 are clear and understandable, and whether the application material is helpful in supporting the application of those requirements.*

The requirements in proposed SQMS No. 2 are clear and understandable; however, the requirements may not be affordably or accessibly achievable by small firms. The proposed requirements will force small to mid-size full-service CPA firms to consider whether it is even feasible to continue to provide audit services. Small firms need accessible, high quality, and cost-effective options to obtain internal inspections. Paths to success for small firms need to be established and available in conjunction with the implementation dates of the standards.

Small firms who currently perform their own internal inspections will no longer be able to do so since they normally use personnel who were on the engagement team or performed the engagement quality review. Those firms will now need to pay for and rely upon qualified professionals outside the firm to perform internal inspections. Firms currently search the peer reviewer pool to find individuals who are deemed qualified to perform internal inspections. Because the peer reviewer pool is shrinking, it will be even more challenging for a firm to locate a qualified individual to perform an internal inspection.

Also, the services of an outside inspector could be cost prohibitive for small firms. Small firms often serve small audit clients that bigger firms will not accept. These small clients are less able to absorb the increases in fees due to limited resources. For example, the state of Illinois requires a municipality with a utility system to submit an audit, regardless of its size. One of our village clients has less than \$160,000 in total revenues but is required to have an audit. In the state of Illinois, approximately 1,600 audit reports are submitted to the Illinois Comptroller's office by counties, municipalities, and special districts, many of which have less than \$1,000,000 in revenue. In addition, there are approximately 850 school districts, all of which require audits under Government Auditing Standards. These governmental entities make up the majority of many small firms' audit practices in Illinois. This underscores the need to be able to affordably implement these new standards.

Please see the suggestions offered under Number 7 below for availability of internal inspectors and cost-effective implementation.

## **Proposed QM SAS**

- 4. Respondents are asked to provide their views on the preceding changes. In addition, the ASB is seeking respondents' views on whether the requirements in the proposed QM SAS are clear and understandable, and whether the application material is helpful in supporting the application of those requirements.*

We acknowledge agreement and support of the QM SAS.

## **Effective Date**

- 5. Respondents are asked to provide their views on whether the effective dates are clear.*

While the effective dates are clear, they do not take into consideration the strain the A&A community is currently experiencing due to implementing FASB 606 for certain clients due to COVID-19 delays, preparing to adopt the significant FASB standards that are effective for the 2022 year, and implementing SAS 134-137 over the next year. All of this is in addition to dealing with the significant effects of COVID-19 on internal processes and procedures, and all the new legislation as a result of COVID-19.

Standard-setting bodies should consider the real-world impact of the pandemic on delays in providing A&A services and accordingly determine any effective dates from the perspective of A&A professionals that are providing services to the public.

6. *Respondents are asked to provide their views on whether an 18-month implementation period is appropriate. If that period is not appropriate, please explain why and what implementation period would be appropriate.*

An 18-month implementation will be too short. This standard will force small to mid-size full-service CPA firms to consider whether they can afford to continue to provide audit services under these new standards. It is impossible for the small to mid-size firms to address all the other pending standards and implement the significant changes to the quality management standard within the current time frames. The AICPA should acknowledge the fatigue of the profession and take proactive steps to help reduce the burden on its members. Otherwise, audit quality will continue to suffer.

It was also mentioned during one of the Quality Management Roundtables that the ASB is concerned if the effective date is extended too far, firms might not take any action now and scramble to implement the new requirements later. However, extending the effective date an additional 18 to 24 months will allow the following to occur:

1. AICPA to develop implementation guidance and continuing education courses
2. Third-party providers to develop practice aids and other materials
3. Peer review team captains to discuss the new Quality Management Standards with firms undergoing peer reviews in the next couple years as part of their normal exit conference discussions on newer professional standards.

All three of these items should help to ensure a more successful implementation of the new requirements.

## **Issues for Consideration**

### *Issue 1 – Self-Inspection*

7. *Respondents are asked whether they agree that inspection of completed engagements by those involved in the engagements should be precluded in order to enhance audit quality. If not, please explain why and provide examples of safeguards that could lower the self-review threat to an acceptable level.*

We **do not** agree that inspection of completed engagements by those involved in the engagements should be precluded in order to enhance audit quality. Using a party that has no knowledge of the client and/or client activities, can in fact be detrimental and decrease audit quality.

An automatic preclusion of an involved party in a completed inspection discounts the value of the detailed knowledge that an experienced partner, sole practitioner, or staff member has obtained on an engagement. In most cases, the engagement partner or sole practitioner has the most knowledge about the client's financial activities. The presumption that a sole practitioner, engagement partner, or experienced staff member automatically lacks objectivity due to the knowledge gained about a client is flawed.

Also, there appears to be a presumption made that a sole practitioner or small firm would inevitably and/or automatically find itself facing a familiarity threat with a long-term client relationship. This is not necessarily true. In certain industries, such as governmental and nonprofit entities, mid- and upper-level management positions change frequently with elections and/or natural turnover for higher-level political positions. There are many client relationships that produce increased levels of professional skepticism rather than decreased levels of professional skepticism as time progresses due to the rapid turnover and/or complete turnover of a slate of office holders depending upon the political wave in any given election year. Auditors in these circumstances are not developing long-term relationships with mid- to upper-level management that present familiarity threats. Instead, auditors find themselves working with new management in the lead financial and executive office holder positions frequently and needing to respond to the risks that new management brings accordingly. Keeping procedures fresh in response to key management position turnover is not a new concept for sole practitioners or small firms under these circumstances. Accordingly, with the introduction of appropriate targeted training materials introducing procedures for self-inspections, sole practitioners and small firms can also achieve the same self-sufficient and resilient results.

One or more of the following suggested safeguards could be implemented:

1. Carve-out for compilations and preparation engagements – There should be a carve-out in the self-inspection prohibition for compilations and preparation engagements since CPAs offer no assurance or conclusions on these types of engagements.
2. A firm with a peer review report rating of pass – This safeguard could allow the firm to perform self-inspections for the two years after the year with a peer review report rating of pass.
3. The firm's personnel include a qualified, experienced peer reviewer – Qualified, experienced peer reviewers work directly from standards and have enhanced training that would enhance a firm's system of quality management and serve as a potential mitigating factor for the self-review threat.
4. For smaller firms performing their own inspections, there could be a cooling off period of 6 months before the internal inspection is performed.
5. Targeted training – Sole practitioners, engagement partners, and experienced staff members could attend engagement quality designed continuing education classes that are specifically designed to assist firms with reviewing engagements on either a pre-issuance or post-issuance basis from a professional standards approach. More specific examples of continuing education classes are detailed in a – c below.
  - a. *Industry specific classes* – A sole practitioner, engagement partner or experienced staff member could participate in live round table continuing education classes that are

- specifically designed to assist the firm in a review of the report, financial statements, and workpapers. Enhanced classes for Uniform Guidance audits, Employee Benefit Plan audits, audits performed under *Government Auditing Standards*, and other specialty categories could be designed. The classes could be designed in a roundtable format so that all class participants could address questions or problem areas. The classes could be offered in-person or via an online platform. The live format will enhance participation and improve the practitioner's ability to obtain and retain professional guidance to apply in practice.
- b. *Pre-issuance or post-issuance classes* – Continuing education classes could be developed for each pre-determined size of firm for the pre-issuance and/or post-issuance review of engagements. The classes could emphasize specific examples of review procedures that firms can do to enhance the quality of an engagement prior to issuance. The classes could be designed in a live round table format so that all class participants could address questions or problem areas. Each class participant would be required to submit one A&A engagement to review during the class prior to the class date. The class instructor would receive the A&A engagements in advance and could provide the firms with specific guidance to enhance audit quality. This class could be offered on a pre- or post-issuance basis. Developing classes designed just for sole practitioners or small firm owners will give these firms' owners an opportunity to attend classes with peers from firms of the same size that are experiencing the same professional challenges. **Note:** Monitoring classes are available in some areas on an annual basis. These classes include a lecture component where the instructor discusses the monitoring element of quality control and a workshop component where participants perform a self-review on one or more of their own firm's A&A engagements using checklists from the AICPA Peer Review Program Manual and assistance from the instructor and one or more facilitators.
  - c. *Inclusion of peer reviewer on live round tables* – Continuing education classes could be developed as stated above and include a qualified peer reviewer as the class instructor or class contributor as an enhancement to the classes. With peer reviewers serving as the instructor or contributor, firms can gain added knowledge of the standards from the reviewer's perspective prior to implementing any new procedures.
6. The AICPA could enhance and market the current search feature that exists on the AICPA website to assist the firms in finding a qualified inspector.

The challenge of locating a qualified party to complete the inspection outside the firm may not be overcome without significant expense to the firm. Also, the availability of an outside qualified inspector is limited. The incorporation of bullet points 4 and 5 may possibly assist sole practitioners and small firms in obtaining uniform inspections by qualified trained individuals at minimal expense for firms; but come at the possible expense of further reducing the pool of qualified individuals willing and able to perform external peer reviews.

In addition, if sole practitioners and small firms are required to outsource inspections, the same requirements should be extended to firms of all sizes. Also, while two firms could work together to perform each other's inspections and technically meet the new proposed standard, such cross reviews may not result in the desired improvements in audit quality. Finally, the external peer review program is designed to identify deficiencies in a firm's monitoring activities. If no deficiencies have been identified, then self-inspection appears to have been

successful and should be allowed to continue. Additional safeguards should only be required for those firms with deficiencies.

### *Issue 2 – Cooling-Off Period for Engagement Quality Reviews*

8. *Respondents are asked for their views on whether a cooling-off period should be required before a former engagement partner can serve as an engagement quality reviewer on that engagement, and (a) if so, the appropriate length of the required cooling-off period, or (b) if not, please explain why and provide examples of safeguards that could lower the objectivity threat to an acceptable level.*

We agree with the observation of the ASB that no research exists to support the supposition that a cooling-off period of a former engagement partner improves audit quality. Accordingly, adoption of 100% of the provisions of International Standards may not be the best design for all industries of the accounting profession. Also, a complete lack of knowledge about a client and its historical financial activities could in fact result in lower audit quality.

The conclusion that a former engagement partner automatically presents an objectivity threat appears presumptive at best. A former engagement partner, in most cases, will have historical knowledge of a client's financial activities that impact the entity's financial statements. Examples of historical knowledge that a former engagement partner may have that could enhance audit quality include prior debt offerings and refinances, major capital asset additions and dispositions, known occurrences of fraud or abuse, related parties and related party transactions, information obtained from past analytical procedures, and other information that is deemed relevant to the financial statements and report opinion(s).

Furthermore, when implementing new standards, the prior experience of a client is more critical than ever. For example, knowledge of a former partner would be very helpful when implementing FASB ASC 660 or the lease standards. This knowledge would result in higher audit quality rather than having a partner with no or little prior experience of the client.

### *Issue 3 – Completion of Engagement Quality Review and Dating of the Auditor's Report*

9. *Respondents are asked for their views on whether the engagement quality review should be required to be completed before the report is dated, rather than before the report is released.*

Requiring that the EQR be completed before the report is dated presents the best opportunity to improve engagement quality.

Thank you,



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