Aug. 26, 2021

Tracy Harding, Chair
AICPA Auditing Standards Board
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Re: AICPA Auditing Standards Board Proposed Quality Management Standards

Ms. Harding:

The Accounting and Auditing Steering Committee and the Peer Review Committee (the committees) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciate the opportunity to comment on the following proposed standards.

- Proposed Statement on Quality Management Standards (SQMS), A Firm's System of Quality Management (referred to as proposed SQMS No. 1 for purposes of this memorandum)
- Proposed SQMS, Engagement Quality Reviews (referred to as proposed SQMS No. 2 for purposes of this memorandum)
- Proposed Statement on Auditing Standards Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards (QM SAS)

The PICPA is a professional association of more than 20000 working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The above mentioned PICPA committees are composed of practitioners from both regional and small public accounting firms.

The committees are supportive of AICPA's efforts to improve audit quality and recognize the value of converging with the International Auditing and Assurance Standards Board (IAASB) while minimizing differences with the PCAOB. However, the committees are not convinced that the proposed changes will result in the improvement of engagement performance. Instead, the committees are concerned that the significant implementation costs will adversely impact small and regional firms. The committees believe greater enhancements in audit quality could be achieved by investing in resources that help firms to apply emerging technologies (e.g., data analytics, artificial intelligence, etc.) in the audit process.

The committees' specific comments are enumerated below.

1. Risk Assessment Process

   The proposed SQMS No. 1 would require a firm to perform a tailored risk assessment of its quality risks, taking into consideration the nature and circumstance of the firm, the engagements performed, and the degree to which these firm-specific factors could adversely affect the achievement of the firm's quality objectives. For each quality risk identified, the firm is required to design and implement a response.

   Paragraph A48 provides examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and related examples of quality risks that may arise. One such example includes the following:

   - The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.
   - In the context of governance and leadership, this may give rise to a number of quality risks such as the following:
     - Leadership's responsibilities and accountability for quality are not clearly defined and assigned.
     - The actions and behaviors of leadership that do not promote quality are not questioned.

   The committees do not find this process to be intuitive and believe that many firms will struggle with the process, resulting in many quality management failures. More importantly, the committees do not believe that this will result in improved audit quality.

   Paragraph A49 provides an additional example of how complex this process could be. Specifically, it explains that responses to quality risks could *cause* additional quality risks.

   > Given the evolving nature of the system of quality management, the responses designed and implemented by the firm may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks. For example, the firm may implement a resource (for example, a technological resource) to address a quality risk, and quality risks may arise from the use of such resource.

   The committees view these additional risks as evidence that this process could be overly complicated.

Furthermore, as the risk assessment process is to be iterative, the firm needs to continuously be aware of any potential changes to quality risks. This is particularly onerous for small firms with limited accounting and auditing practices. Larger firms may have teams of quality management professionals that are dedicated to the implementation of this new approach, but smaller firms cannot afford the additional cost of continually reconsidering whether they have identified all appropriate quality risks.

- Consider a firm that performs only Statement on Standards for Accounting and Review (SSARS) engagements or a firm that performs a handful of attest engagements. How much time and training would it take to implement this new approach? Outside expertise may be needed as firms only performing SSARS may not be familiar with the risk assessment process, and peer reviewers would not be able to assist with quality management system design due to independence constraints.
- Consider a small firm of two partners, with five professionals total, where all attest engagements are performed by one partner. The new standard requires the managing partner to have ultimate responsibility and accountability for the system of quality management. Under the current standards, the managing partner can rely on the annual monitoring report and peer review to determine the adequacy of the firm's quality control system. How will this firm be able to maintain a fluid quality management system? How much time and effort will the managing partner need to spend to ensure that the system is updated every time risks are changed? How much training will this entail? This effort is difficult to conceptualize.

We have noted in connection with peer review results that many practitioners struggle with risk assessment and linking assessed risks to appropriately tailored responses, leading to overreliance on and improper use of practice aids. We believe that this proposed risked-based approach to tailoring a firm's quality management system will be difficult and costly for many firms to implement.

If the risk-based approach is retained, we recommend extensive practice aids for varying sizes of firms and templates that firms can tailor with dropdown menus providing examples of quality risks and sample responses.

2. Principles-Based Standards

The proposed SQCS No. 1 highlights its scalability, but it is not clear how this is accomplished in practice. For example, it makes little sense for a sole practitioner or a firm of –up to five practitioners, where only one partner is performing attest work, to spend time focusing on governance and information and communication. But how much

of these components can these firms eliminate without having a failed quality management system? The committees note that principles-based standards ultimately require more work than requirements that are clearly specified. The concepts are not easily implemented in practice, and interpretations will inevitably result in additional documentation and checklists. The audit risk assessment standards would be one example. They, too, were intended to be scalable, but as those standards have been interpreted by the AICPA, Government Accountability Office, and Department of Labor, the outcome has been to push for increased documentation. The standards themselves include sections for "smaller, less complex audits," but that is widely ignored in favor of detailed, properly completed, voluminous checklists. Under the mantle of "audit quality," the completion of a checklist (e.g., PPC's 7.1 checklist) may be overemphasized, without any consideration for whether the numbers on the financial statements are correct and supportable through proper audit procedures. The result has been an increased focus on "audit compliance" (i.e., work done to satisfy someone's interpretation of the standards) with little or no impact on the actual quality of the audit. We expect similar problems with the implementation of the proposed quality management standards.

3. Documentation
   The documentation requirements included in proposed SQMS No. 1 will be an additional burden on firms with smaller practices; especially if the risks change throughout the course of the year, resulting in the need to review the related documentation multiple times a year. Supporting practice aids and examples of such documentation will be needed to ensure practitioners understand the expectations.

   Additionally, the use of the term "consistent" is not entirely clear in Paragraph 58 of SQMS No. 1:
   a. "Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements."
   b. "Support the consistent implementation and operation of the responses."

4. Self-Inspection Prohibition
   Proposed SQMS No. 1 would prohibit the use of an engagement team member or the engagement quality reviewer of an engagement from performing any inspections on that engagement. We believe that this prohibition will create a struggle for qualified resources as firms will have to identify and engage multiple qualified quality review experts to

meet this compliance requirement. This could be challenging given the significant shortage of peer reviewers and other qualified professionals. This would impact smaller firms considerably as well as those firms that operate in niche practice areas. Consider the sole practitioner who will need an EQR professional or another qualified practitioner to perform inspections and a third expert to perform their peer review. This is excessive.

The Auditing Standards Board requested input regarding potential safeguards to reduce the self-review threat. The committees suggest a more flexible approach to developing self-inspection policies that take into consideration the risks associated with the firm's engagements, whether the firm's engagements are high risk, standards changes, or changes in the auditee's operating environment (e.g., COVID-19 impact); whether the firm is undergoing peer review in the current year; and whether the firm has had an engagement quality review for a selection of its attest work.

5. Cooling-Off Period
   The committees believe that the proposed cooling-off period in SQMS No. 1 that prohibits partners rotating off an engagement from serving as the engagement quality reviewer for a period of time would unduly penalize firms that require such engagement quality reviews (EQRs). Given the lack of qualified resources, a required cooling off period could present a significant compliance hurdle for firms with rigorous EQR policies. As the proposed standard continues to allow firms considerable latitude for determining which engagements will undergo an EQR, firms could respond to this new cooling-off period by revising their EQR policies to be less restrictive, which would work contrary to the objective of enhancing audit quality. In theory, involving another engagement quality control (EQC) reviewer may provide another perspective to the engagement, and therefore minimize the self-review threat, typically those firms engaging an EQC reviewer are performing high-quality engagements. The committees believe that any standard that discourages the use of an EQC reviewer would be contrary to high audit quality objectives. The committees do not support this change without definitive research that a cooling-off period for the EQC reviewer improves audit quality.

6. Monitoring and Remediation
   Proposed SQMS No. 1 would require a firm to tailor its monitoring procedures based on the reasons for the assessments given to the quality risks, the design of the responses, the design of the firm's risk assessment process and monitoring and remediation process, and any changes in the quality management system, the results of previous monitoring activities, and other relevant information. As the success of the firm's monitoring and remediation process is dependent on the effectiveness of the firm's risk assessment

process, the committees are concerned with the ability of firms to properly tailor monitoring to meet the quality control objectives.

7. Root Cause Identification
   For almost 20 years, peer review committee members have noted that practitioners and peer reviewers struggle with identifying the system cause of matters, findings, and deficiencies. Adding this requirement to SQMS No. 1 may add another area where smaller firms will not succeed. We anticipate many peer review findings that highlight that the firm did not identify an appropriate root cause, and as a result failed to implement an appropriate remedial response.

8. Peer Review

   - Use of peer review terms – The proposed SQMS No. 1 includes the use of the terms "findings" and "deficiencies," which are defined terms in the peer review standards. The explanatory material makes it clear that the Auditing Standards Board expects to provide implementation guidance that will assist firms and peer reviewers achieve a mutual and consistent understanding of the evaluation of deficiencies. The committees note that these concepts take a significant amount of time and effort to apply and that firms that are peer reviewers will need comprehensive retraining.

   - Review of a firm's quality management documentation and system – The committees are concerned with the complexity of evaluating the adequacy of each firm's tailored quality management document and the firm's risk assessment process. As it stands, if a firm uses a standard practice aid to serve as its quality management document, the peer reviewer only looks at the appropriateness of the tailored responses. The standard practice aide is typically covered by another quality control process (e.g., periodic attestation by an independent CPA). If the new quality management documents require significant tailoring, peer reviewers may be challenged to review each quality management document in a cost-effective manner. This additional cost may not be justifiable for firms that perform only a handful of attest engagements.

   - Impact on Peer Review Results – The committees are also concerned with the peer review impact among firms that do not identify specific quality management risks that a peer reviewer identifies as significant. As having a quality management document is foundational to having a functioning quality control system, the lack of comprehensiveness of the document could be seen as not having a properly tailored quality control system, which could lead to many new

peer review reports with the rating of "fail". As this quality management document tailoring process could be a challenge for many firms, the committees recommend that the AICPA Auditing Standards Board work with the AICPA Peer Review Board to identify the critical components that must be included to avoid having a deficient quality management document. The committees also recommend robust practice aids that will help firms maintain a robust quality management document.

- Peer Review Program (Standards, PRIMA coding, and training) – The proposed changes would result in the need for significant revisions to the AICPA peer review standards, as well as the AICPA practice aides used to complete peer reviews. Furthermore, changes will need to be made to PRIMA (e.g., changes to the number of quality control elements). The Peer Review Committee recommends a PRIMA task force be convened to begin to identify the changes that need to be made and the length of time needed to make any related changes. Significant training will be needed to make sure peer reviewers understand the new standards and how they should be implemented in practice.

9. Litigation Risks
   The committees expect firms will have considerable difficulty implementing these new standards and are concerned regarding the potential litigation risks in the event that a firm's quality management system is found to be deficient.

10. Stand-Back Requirement
    This new requirement seems overly theoretical, and it is not clear how it differs from concluding on the engagement and adding a check mark on a checklist. If this requirement is retained, the committees request that the requirement be clarified.

11. Transition Period and Peer Review and Monitoring Period Ramifications
    The proposed standards would require quality management systems to be designed and implemented as of a specific date and evaluated one year later. Is the intent to create a uniform peer review and monitoring period for all firms? The committees do not support requiring firms to change their monitoring procedures. There are many variables that go into determining an optimal year-end for monitoring, including the composition of the firm's engagements and year-ends and the availability of qualified quality management staff. For example, a niche firm that primarily performs employee benefit plan audits would not want to choose a Dec. 31 year-end as many of the engagements are not completed until Oct. 15. Thus, the monitoring of those engagements would be delayed.

If a new monitoring period is being established by this proposed standard, how does the Auditing Standards Board expect firms to address partial-year monitoring and peer review periods?

The committees support a transition process that is effective for a firm's monitoring period that begins after a specified date.

12. Effective Date
    - Given the enormity of a transition to this new approach, the committees recommend an effective date of at least 30 months after the standards are final.
    - Early adoption is unrealistic, as there are no supporting peer review systems (e.g., checklists, PRIMA changes, reports, etc.).
    - The AICPA Peer Review Board suggests staggered implementation dates based on firm size, with the larger firms going first. The committees support this suggestion. It would alleviate some of the pressure on the quality control resources and allow more time for the smaller firms to prepare for the transition.
13. PCAOB
    The committees note that the PCAOB has yet to finalize its project evaluating the IAASB's revised standard for implementation. The committees do not believe that the AICPA should move forward in advance of the PCAOB. Instead, the finalized AICPA standards should follow the implementation of PCAOB changes so that firms can learn from the transition best practices provided by larger firms.
14. Yellow Book Requirements
    How would a firm maintain compliance with both the Yellow Book quality control and peer review standards and the revised quality management standards? Any effective date should be deferred pending revisions to the Yellow Book standards. Maintaining peer review compliance with multiple sets of standards would be untenable.
15. Changes to Support Licensing Requirements
    The committees question whether any changes would be needed to state statutes.
16. Cost Benefit Analysis
    Given the pervasiveness of the proposed changes, the committees recommend that the Auditing Standards Board perform a cost-benefit analysis to determine whether the effort required to properly implement these proposed changes will result in sufficient tangible improvements to practice quality to justify the implementation costs. If fees cannot be increased due to market constraints, additional time that practitioners spend on this new

approach will decrease the time spent on performing the engagement. These cost-constraints are real; especially for smaller entities (e.g., not-for-profit organizations) that are required to have an audit due to state regulations but don't have funds to pay for increased audit fees. Here is an example: many local fire departments hold fund-raising events to meet their budgetary constraints. In Pennsylvania, these departments are required to be audited, and due to the high costs of these audits they are lobbying for legislation that would encourage practitioners to perform these audits for free (offering them 40 hours of CPE in exchange). We believe that there would be legislative push back on increased fees. Further, it is hard to justify increased costs to end users who will not see an immediate benefit from the increased fees. Given the enormity of the challenges of these proposed standards, the committees suggest considering practical expedients for small to midsize firms.

We appreciate your consideration of our input. We are available to discuss any of these comments with you at your convenience.

Sincerely,

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