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South Carolina Association of CPAs | West Virginia Society of CPAs | Wisconsin Institute of CPAs

August 30, 2021

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AICPA Auditing Standards Board
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RE:

- Proposed Statements on Quality Management Standards (SQMS):
 - *Quality Management: A Firm's System of Quality Management (SQMS No. 1)*
 - *Quality Management: Engagement Quality Reviews (SQMS No. 2)*
- Proposed Statement on Auditing Standards: *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standard (QM SAS)*

Dear Board Members:

The Peer Review Alliance (PRA) is an approved peer review administrator of the AICPA Peer Review Program and one of the largest administrators in the United States. With approximately 2,400 CPA firms under its administration, PRA assists firms ranging in size from sole practitioner to over 300 professionals in meeting their peer review needs, including 650 sole practitioners with no additional staff and 1,080 firms with 2-5 professionals.

The PRA Report Acceptance Committee (the "Committee" or "we") is pleased to comment on the proposed standards listed above. The organizational and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the positions of the Committee rather than any individual members of the Committee, the organizations with which such members are associated, or the partner state CPA societies.

The Committee acknowledges that the following response may include divergent views. The intent in presenting these views is to ensure that the response adequately illustrates the Committee's support for and concerns with the proposed standard and provides suggested alternative approaches where disagreement may be present.

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.

The proposed standard requires the firm to establish *specific* quality objectives for each component except monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the system of quality management; however, based on the nature and circumstances of the firm and its engagements, the firm may not find it necessary to establish additional quality objectives.

Requiring “specific” quality objectives while stating the firms can apply professional judgement appears contradictory in nature and not a design for successful implementation. Additional guidance will be needed for firms to properly identify the specific quality objectives and additional quality objectives that will comprehensively address the requirements of the proposed standard.

The same can be said for the risks to the achievement of the specific quality objectives and quality risks. 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?
9. In practice, firms receiving a peer review report rating of pass with deficiencies or fail tend to have a difficult time identifying the root cause of the deficiency and developing appropriate corrective or monitoring actions to help prevent recurrence. Significant assistance will be necessary for firms to develop an appropriate risk assessment and establish mitigating steps.

One possible avenue for successful application of the new standards would be the development of Critical Thinking Classes 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. How to achieve correct and effective implementation may seem elusive. Over the years, firms have familiarized themselves with common and effective A&A procedures and have become reliant upon third-party vendor software and practice aids to achieve and document compliance with professional standards. The ability to step back,

rethink, and invent strategies and procedures to accomplish compliance with new standards may be challenging for firms. Also, implementation dates that may be during or shortly after a pandemic, may add stressors that inhibit firms' natural creativity. Developing Critical Thinking Classes that are designed to assist firms with solving problems differently and/or the process of creating new ideas could be beneficial to firm's successes. The AICPA could assist firms by developing Critical Thinking Classes that assemble smaller groups of practitioners, partners, and experienced staff members from similarly sized firms in live or on-line platforms who can approach compliance with the new standards with a networking approach. The class 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. Initially, these critical thinking classes would help firms evolve their quality control systems to adjust to SQMS.

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 24,000 firms enrolled in the AICPA Peer Review Program, only 192 firms reported having a practice area in international standards on audit, assurance, or related services in their peer review scheduling information. 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 sole practitioners and small firms. Sole practitioners and small firms need

accessible, high quality, and cost-effective options to obtain EQRs. Paths to success for sole practitioners and small firms need to be established and available in conjunction with the implementation dates of the standards.

Typically, firms rely upon qualified professionals to perform EQCRs outside the firm. Firms currently search the peer reviewer pool to find individuals who are deemed qualified to perform EQCRs. Because the peer reviewer pool is shrinking, it is challenging for a firm to locate a qualified individual to perform an EQCR. Also, the services of an outside reviewer could be cost prohibitive for sole practitioners and small firms. Please see the suggestions offered under Number 7 below for suggestions on cost-effectiveness and availability of EQCRs.

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 appropriately consider the delays in completing A&A engagements that have occurred in response to COVID-19. Firms that are providing A&A services directly to the public have not been able to complete A&A engagements due to illness of the firm's or client's staff, limitations on being allowed on-site, and/or state or local lock down requirements that have limited mobility to clients. Some firms may be 18 months behind in providing A&A services, which corresponds to the current length of the pandemic. A resurgence of the virus is clear as of the date of this response. Firms will need to first complete the outstanding A&A engagements and then address any pending peer reviews that have also been delayed in response to the pandemic prior to addressing, understanding, and implementing a new system of Quality Management.

Furthermore, the A&A community is currently 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 will be implementing SAS 134-137 over the next year.

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.

With the backlog of work that exists in providing A&A services and the extended peer reviews, an 18-month implementation could be too short for some firms. The standard-setting committee will need to obtain information from firms on the amount of A&A backlog and extended peer reviews prior to determining an implementation date. Firms should have a 12-to-18-month extension available.

Once the number of peer reviews on extension falls to pre-pandemic levels, it could be an indicator that the backlog of A&A engagements has been completed.

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. In most cases, the sole practitioner, engagement partner, or experienced staff member is lacking an overarching professional standards-based approach to inspection of engagements. Assisting firms in designing a new approach to self-inspection services that is designed to be focused on the language from professional standards rather than repeating audit procedures from audit programs will be beneficial in enhancing the firm's ability to perform self-inspections.

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.

Possible safeguards could include one or any combination of the following:

1. 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* (i.e., no deficiencies or significant deficiencies).
2. 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.
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 sole practitioners performing their own inspections, there could be a waiting period of 6 months before the internal inspection is performed.
5. Targeted training – Sole practitioners, engagement partners, and experienced staff member 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. **Note:** Governmental report review classes are available in some areas on an annual basis. These classes are generally limited to the report and accompanying financial statements only and are not offered in a frequency that would allow a firm to obtain a quality EQR prior to issuance.
 - 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. Firms currently have corrective action assigned that require either a pre- or post-issuance review of an engagement in response to matters noted during a peer review. While this can be helpful for firms, an enhancement for firms’ education could be direct participation in a pre- or post-issuance review of the firms’ 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. We often hear that peer review has become punitive rather than educational. 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. Considering the lack of a well-known network of qualified inspectors, the AICPA could leverage the current peer reviewer search system to assist firms in identifying qualified inspectors. This may include further promoting this system and allowing entry of resumes for inspectors that do not also perform peer reviews. In addition, implementation guidance should include consideration of how to select 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 outside qualified inspectors may be limited. The incorporation of bullet points 4 and 5 can assist sole practitioners and small firms in obtaining uniform inspections by qualified individuals at minimal expense for firms; but it may result in reducing the pool of 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. The premise that having another partner within the same firm or sister office reviewing engagements and always resulting in a quality inspection is flawed. A familiarity threat still exists within the firm. 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.

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 606 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.

The Committee appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Randall L. Miller, CPA
Chair, Peer Review Alliance Report Acceptance Committee

Kim Meyer, CPA
Vice Chair, Peer Review Alliance Report Acceptance Committee

APPENDIX A

PEER REVIEW ALLIANCE REPORT ACCEPTANCE COMMITTEE ORGANIZATION AND OPERATING PROCEDURES

2021 – 2022

The Peer Review Alliance Report Acceptance Committee (Committee) is composed of the following technically qualified, experienced members. These members have peer review experience and Committee service ranging from newly appointed to over 30 years. The Committee is an appointed senior technical committee of the Illinois CPA Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of peer review and quality control standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of peer review or quality control standards. The Subcommittee develops a proposed response that is considered, discussed, and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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James Gibson, CPA
Jennifer Goettler, CPA
James Javorcic, CPA
Steven Kessler, CPA

Marcum LLP
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ECS Financial Services, Inc.
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