SCACPA
South Carolina Association of CPAs

SCACPA Task Force Comments on proposed changes to Audit Standards

1. **<u>Request for comment:</u> 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.**

   The added components of quality management and the emphasis on integration are positive changes. These changes will add more depth to the standard and result in a more comprehensive quality management system for many firms.

2. **<u>Request for comments:</u> 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.**

   Overall, the proposed standard is not scalable. The requirements of the standard for cooling off periods, and independence as it relates to internal inspections are not achievable in small firm practice settings. If the standard were to be equal in the efforts required to meet expectations, then small firms and large firms alike would be required to seek outside sources to meet the objectives of the standard. As currently stated, larger firms with more robust infrastructure would be able to meet the objectives of the proposed standard with little or no effect on its operating environment.

   Because the proposed standard is more comprehensive than previous guidance, we feel it would be beneficial to be provided parameters for the different size firms as well as a definition of "smaller firms." Clarity on defining "smaller firms" as 1-5 partners, 1 CPA or a different definition would be necessary. If possible, clear parameters, specific guides, practice aids considering the needs of smaller firms would be beneficial. Smaller firms could have difficulty in implementing the new requirements specifically in risk management.

   This may be a case where merging with international standards may not be achievable. Anecdotally, the limited occasions our members have been contacted to perform engagements in accordance with international standards, the contact has been made by international accounting firms. There has been no case where a local firm in another country has contacted our members to perform services under international standards. This begs the question, do small firms in other countries perform audits to the extent local firms do in the United States. This would lead to the conclusion that international markets differ widely from the business environment in the United States.

3. <u>Request for comments:</u> **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.**

   We believe it is beneficial to have the Engagement Quality Review guidance in a separate standard. We believe the requirements are consistent with the existing literature and will provide appropriate guidance to firms in implementing this process. One could make the argument to make a more standard uniform across all firms, that every firm would need to seek an outside quality control reviewer to keep the impacts of the new standard fair across all firm types and sizes

   We believe the proposed requirements may not be affordable or achievable by small firms. Typically, firms rely upon qualified professionals to perform EQCRs outside the firm. Firms currently utilize peer reviewers who are 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. Small firms who are required to utilize the services of an outside review may be prohibited to continue their work due to cost restraints.

4. <u>Request for comment:</u> **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 agree with the language in the proposed auditing standard that requires the engagement partner to take ultimate responsibility for ensuring the overall quality of the engagement.

5. <u>Request for comment:</u> **Respondents are asked to provide their views on whether the effective dates are clear.**

   The effective dates are clear.

6. <u>Request for comment:</u> **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.**

   Given the disruption caused by the recent pandemic including related demands on the time of firm management, we believe the proposed implementation date should be delayed a year or two to give firm management more time to focus on required changes.

7. **<u>Request for comments:</u> 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.**

While we acknowledge that inspection of completed engagements by personnel with no previous involvement on the engagement may or may not to lead to more effective inspection results, there is an incorrect presumption that knowledge of the client lacks objectivity. We believe client knowledge is beneficial in an effective review. In addition, we believe the requirement will place an unfair burden on firms with a limited number of personnel.

Sole practitioners and other small firms will often have to hire an outside firm to perform this inspection. These firms are less able to pass these additional costs on to clients and may also have trouble finding a comparable-sized firm with the appropriate industry expertise to perform the work. There are less peer reviewers and other outside firms may not have the expertise to provide the appropriate external inspection. If a small firm is already performing well, including getting pass ratings on its peer review and avoiding nonconforming issues, the requirement would seem to be an unnecessary cost burden. This could also cause some of these peer reviewers to make certain economic decisions such as performing services for a firm two out of three years. It may create a situation where it is more economically advantageous to avoid performing peer review and only perform firm on firm internal inspections.

There are further safeguards that can be implemented to lower self-review threat and enhance audit quality. First there could be a requirement of an internal inspection by manager level or higher. The reviewer should be required to have twenty-four hours of A&A CPE in the previous two years. In addition, practice aids should be developed on how to perform an effective review and should involve such items as a focus on new standards applicable to the client, key audit matters related to the engagement and the high-risk areas of the engagement. For sole proprietors performing their own review, there should be a cooling off period of 6 months before the internal inspection is performed for the engagement. Personnel performing inspections should have a minimum of eight hours CPE every three years that specifically relate to performing internal inspections or engagement quality reviews.

Larger firms with multiple technical experts on staff are likely to already have this policy in place and therefore, will not have to make operational changes or incur additional cost to implement this requirement. Again, one could make the argument to make a more standard uniform across all firms, that every firm would need to seek an outside quality control reviewer to keep the impacts of the new standard fair across all firm types and sizes.

Another possible impact would be more small firms leaving the auditing profession creating less competitive options for the general public when hiring an auditor creating more expense for an audit. Increased fees because of this requirement and possible reduction in available *auditors could discourage clients, including smaller nonprofits, from having an audit performed. This would not serve the public interest.*

8. **<u>Request for comments:</u> 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 do not believe the cooling-off requirement is necessary for an EQR. Our experience has been that this situation rarely comes up in practice, even at large firms. A partner who relinquishes a client usually does so because he/she is retiring and is therefore, unlikely to take on a technical role. In cases where a retiring-partner is passing the practice on to his/her children or younger partners at the firm, it may be beneficial to have that partner's experience during the transition period.

   The act of transferring a client to a new engagement partner alone should suffice in reaching an objective mind state. The former engagement partner's familiarity with a client would provide for a more robust review to enhance engagement quality.

   There may also be a benefit to having a Partner with prior experience with a client, not involved in the current engagement, perform an engagement quality review. As long as the partner does not contribute to the current year engagement, there should not be a threat to their objectivity as EQR.

   For sole proprietors and small firms, a cooling-off period of a week or two between the completion of the engagement and the issuance of the report would allow a sole proprietor or engagement partner a period of time to step away from the engagement prior to a required final review of the engagement and prior to issuance could serve as a safeguard. A cooling-off time period would allow the sole practitioners and engagement partner to have time to gather a fresh perspective prior to a review of the report and final statements prior to issuance.

9. **<u>Request for comments:</u> 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.**

   In cases where engagement quality review is required by the firm's quality management document, we believe the review is an essential part of the engagement completion process and the report should not be dated any earlier than the date this review is performed.