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Ms. Sherry Hazel
Audit and Attest Standards – Public Accounting
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1345 Avenue of the Americas, 27th Floor
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Response to the American Institute of Certified Public Accountants' *Proposed Statements on Quality Management Standards and Proposed Statement on Auditing Standards, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*

Dear Ms. Hazel:

This letter provides GAO's response to the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board's (ASB)

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

GAO provides standards for performing high-quality audits of government organizations, programs, activities, and functions and of government assistance to contractors, nonprofit organizations, and other nongovernment organizations with competence, integrity, objectivity, and independence.¹ These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed when required by law, regulation, agreement, contract, or policy. For financial audits, GAGAS incorporates by reference the AICPA's Statements on Auditing Standards (SAS). For attestation engagements, GAGAS incorporates by reference the AICPA's Statements on Standards for Attestation Engagements.

We support the ASB's efforts to strengthen standards for quality management at the audit organization and engagement levels and adapt the standards to allow for differences in the size or nature of audit organizations and the services they provide. There are opportunities to strengthen the proposed standards, which we discuss in our detailed responses to the request for specific comments.

In general, we believe that the following changes would strengthen the proposed standards:

- Clarifying certain requirements and application guidance to enhance the usability of the proposed standards.

¹GAO, *Government Auditing Standards: 2018 Revision Technical Update April 2021*, [GAO-21-368G](#) (Washington, D.C.: April 2021).

- Requiring that engagement quality reviews be completed before the report is released, as it is impractical to require that such reviews be completed before dating the report because of the extent of the engagement procedures required up to the report date.
- Removing application guidance that permits inspections of in-process engagements. Unless an audit organization's quality management system is permitted to function through the completion of the engagement, the audit organization cannot determine whether a potential finding or deficiency would have been identified and rectified through the quality management process.

We also provide additional comments in Enclosure I for consideration.

GAO Responses to the Request for Specific Comments

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.**

We believe that the requirements in the proposed Statement on Quality Management Standards (SQMS) No. 1 are generally clear and understandable and that the application material is helpful in supporting the implementation of the requirements. We provide a number of suggestions to clarify and enhance the usability of the requirements and application guidance in SQMS No. 1.

SQMS No. 1 Requirements

- a. We suggest that the ASB make the following changes (in **bold**) to paragraph 32b to enhance clarity:
 - b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements **and** the resources assigned or made available to the engagement teams. **In addition**, the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members **with an appropriate level of skill and proficiency**.

We suggest adding "with an appropriate level of skill and proficiency" to reflect our view that skill and proficiency as well as experience are essential for directing, supervising, and reviewing high-quality engagements.

- b. We suggest the following items to SQMS No. 1 Definitions in paragraph 17:
 - Include the full definition of "network" as defined in the AICPA Code of Professional Conduct.
 - Define the term "remediation."
 - Provide further clarity as to the meaning "external oversight authority" as used in the definition of external inspections.
 - Define "inspections." There are several references to inspections in the requirements and application guidance. However, it is our view that inspections should be defined

- in the definition section to enhance the clarity and ability of the auditor to implement the standard. We suggest the following definition, based on GAGAS paragraph 5.54:
- Inspection. Inspection is a retrospective evaluation of the adequacy of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

SQMS No. 1 Application Guidance

- c. We suggest that the ASB develop implementation guidance to assist audit organizations in developing a system of quality management. The implementation guidance should provide examples of risks (referred to in the proposed standard as quality risks) to the achievement of quality objectives. These examples should link the risks to the specified responses required in SQMS No. 1 paragraph 35. In addition, the guidance should provide examples explaining how the specified responses are based on and respond to the reasons for the assessments given to quality risks, as required by SQMS No. 1 paragraph 27.
- d. We suggest that the ASB modify paragraph A124 because the sentence that we underlined conveys a requirement.

Paragraph A124:

The specified responses may address multiple quality risks related to more than one quality objective across different components. For example, policies or procedures for complaints and allegations may address quality risks related to quality objectives in resources (for example, personnel's commitment to quality), relevant ethical requirements, and governance and leadership. The specified responses alone are not sufficient to achieve the objectives of the system of quality management.

We suggest that the ASB either add a requirement to paragraph 27, such as "The firm should design and implement responses to address the quality risks in addition to those listed in paragraph 35," or remove the requirement language in paragraph A124.

- e. We suggest that the ASB delete paragraph A150

Paragraph A150:

Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor whether an aspect of the system of quality management is designed, implemented, and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while they are in the process of being performed that appear similar in nature to an inspection of in-process engagements (for example, reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent a quality risk from occurring). The purpose of the activity drives its design and implementation and where it fits within the system of quality management (that is, whether it is an inspection of an in-process engagement that is a monitoring activity or a review of an engagement that is a response to address a quality risk).

We believe that it is inappropriate to have inspections of in-process engagements. We believe that in-process reviews should be considered part of the engagement quality management process, not a monitoring activity. Further, unless an audit organization's quality management system is permitted to function through the completion of the engagement, the audit organization cannot determine whether a potential finding or deficiency would have been identified and rectified through the quality management process. An in-process inspection may interrupt the quality management process, thereby affecting the audit organization's ability to rely on the system of quality management.

It is also our view that inspecting in-process engagements could blur the distinction between quality management within individual engagements and the quality objective related to the monitoring and remediation process. As a result, permitting inspections of in-process engagements may cause additional difficulties in applying the quality management standards.

- f. We believe that additional clarification is needed in paragraph A213. It is unclear what the ASB means by an independent assurance report on its system of quality management:

Paragraph A213:

This proposed SQMS does not require the firm to obtain an independent assurance report on its system of quality management or preclude the firm from doing so.

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.

- a. We believe that the proposed quality management approach is generally scalable. However, certain requirements may prove difficult for small governmental audit organizations that are required to follow SQMS No. 1. We suggest that the ASB develop additional implementation guidance that specifically addresses scalability scenarios to facilitate the development and adoption of the proposed quality management standards.
- b. The underlined portions of paragraphs A168 and A169 could affect the scalability of the SQMS No. 1.

Paragraph A168:

The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs

- an inspection of an engagement was
 - in the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period, or

— for all other engagements, an engagement team member or the engagement quality reviewer of that engagement.

- another type of monitoring activity participated in designing, executing, or operating the response being monitored.

Paragraph A169:

In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.

We believe that paragraphs A168 and A169 imply that small governmental audit organizations that are required to follow the SQMS would have to contract with service providers to perform *all* monitoring activities. We acknowledge that there is a self-review threat when individuals monitor a response that they helped to design, execute, or operate. GAGAS paragraph 5.48 states, “Monitoring is most effective when performed by persons who do not have responsibility for the specific activity being monitored.” However, we believe that there are measures that could be implemented to mitigate this threat to objectivity. For example, third-party inspections would mitigate at least some of the self-review threat discussed in paragraph A168. As such, it is possible that individuals within small governmental audit organizations could perform certain monitoring activities.

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.

We believe that the requirements in SQMS No. 2 are clear and understandable and that the application material is helpful. We provide suggestions to clarify the application guidance.

Application Guidance: SQMS No. 2

- a. Define close personal relationship as used in paragraph A13. The AICPA Code of Professional Conduct provides a definition of close relative in paragraph .08, Close relative: A parent, sibling, or nondependent child. [Prior reference: paragraph .04 of ET section 92.]
- b. Add language to the examples in paragraph A13 to explain why a threat to the engagement quality reviewer’s objectivity may be affected similar to those in the AICPA Code of Professional Conduct’s Topic 1.210 – Conceptual Framework Approach. We also suggest adding the language underlined below to paragraph A13.

Paragraph A13:

Threats to the engagement quality reviewer’s objectivity may be created by a broad range of facts and circumstances. Examples follow:

- A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, the engagement partner or other

engagement team member. There is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member or their previous involvement in the engagement.

- A familiarity or self-interest threat may arise when the engagement quality reviewer is an immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team. There is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member or their previous involvement in the engagement. Such a relationship may make the engagement quality reviewer sympathetic to the engagement partner or another member of the engagement team. With a self-interest threat, there is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to obtain a financial or nonfinancial benefit from the engagement partner or other members of the engagement team.
- An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner). With an intimidation threat, there is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member due to intimidation from members of the engagement team, engagement partner, or others.

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 support the ASB's efforts to clarify and strengthen the key elements of quality management and the related specific responsibilities of the engagement partner and auditor at the engagement level for an audit of financial statements. In general, we believe that the requirements in the proposed QM SAS are clear and understandable and that the application material is helpful.

We suggest the following items to QM SAS Definitions in paragraph 12:

- Include the full definition of "network" as defined in the AICPA Code of Professional Conduct.
- Define the term "remediation."

- Include and define “inspections.” There are several references to inspections in the application guidance. It is our view that inspections should be defined in the definition section to enhance the clarity and ability of the auditor to implement the standard.

We also suggest clarifying the difference between unconscious and conscious auditor biases in QM SAS paragraph A35.

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

We believe that the effective dates are clear.

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.

We do not offer a response regarding a specific implementation period necessary for audit organizations to develop, evaluate, and refine their systems of quality management, including monitoring and remediation processes.

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 believe that inspections of completed engagements should be conducted by individuals who were not involved in the engagement.

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.


In general, we believe that the engagement quality reviewer should be an individual who was not previously assigned to the engagement. If the engagement quality reviewer is a former engagement partner, we believe that a cooling-off period should be required. However, there are challenges with determining an appropriate period, as we believe that threats to objectivity are a function of both time and the extent of the former engagement partner’s familiarity with and role in developing key decisions and audit approaches.

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.

Engagement quality reviews should be required to be completed before the report is released. We believe that it is impractical to require the engagement quality review to be completed before the report release date because of the extent and timing of engagement procedures and documentation up until the report date.

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke at the end.

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

Enclosure I: Additional Comments

1. Paragraph 10 of Proposed Statement on Quality Management Standards (SQMS) No. 1, *Quality Management: A Firm's System of Quality Management*, reads as follows (underline added):

- i. This proposed SQMS requires that, at least annually, the individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and concludes whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 15a–b, are being achieved.

The equivalent paragraph 9 in International Standard on Quality Management (ISQM) No. 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, uses “individual(s).” We suggest that the Auditing Standards Board (ASB) add “individual or” in front of “individuals” in paragraph 10 to indicate that this role can be fulfilled by a single person or multiple people, depending on the complexity and size of the specific audit organization. In addition, “evaluate” and “concludes” are plural and singular verbs, respectively, whereas the ISQM No. 1 uses a singular verb in both cases.

2. In all three proposed standards, there are references to subparagraph numbers for the respective definition sections in the application material. (Examples include but are not limited to paras. A10 (Ref: para. 17b) and A14 (Ref: para. 17g) of SQMS No. 1, para. A11 (Ref: para. 13c) of SQMS No. 2, *Engagement Quality Reviews*, and para. A15 (Ref: para. 12d) of Proposed Statement on Auditing Standards, *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards* (QM SAS). These headings appear to be holdovers from the respective equivalents in ISQM No. 1, ISQM No. 2, *Engagement Quality Reviews*, and International Standard on Auditing 220, *Quality Management for an Audit of Financial Statements*, which use subparagraphs for each defined term. To improve the usability of the SQMS and QM SAS, we encourage the ASB to restore the subparagraphs in the definition paragraphs as indicated in the application guidance.
3. The heading between SQMS No. 1 paragraphs A140 and A141 should be in italics.
4. The ASB may wish to consider the implications of the quality management requirements on peer reviews that take place during the implementation period and consult with the American Institute of Certified Public Accountants' Peer Review Board about issuing guidance to assist audit organizations and peer reviewers through the transition. For example, matters to consider could include how an audit organization and peer reviewer should proceed if (1) the new system of quality management is implemented partway through the year covered by the peer review, (2) the peer review report covers the previous system of quality control that has now been replaced by the new quality management system, and (3) there are deficiencies identified in an audit organization's previous peer review report on the system of quality control that has been replaced by the new quality management system.
5. In proposed QM SAS paragraph A85, item 2, refer to paragraph A35 instead of paragraph A34.