



November 4, 2014

*Sent via email to: EAQ@aicpa.org*

AICPA  
Enhancing Audit Quality  
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Re: Enhancing Audit Quality – Plans and Perspectives for the U.S. CPA Profession  
*A discussion paper seeking input from all stakeholders in the audit process  
of private entities*

To Whom it May Concern at the AICPA:

The Accounting and Auditing Standards Interest Group of the New Jersey Society of Certified Public Accountants (NJSCPA) is pleased to offer its feedback and comments on the above referenced discussion paper. The NJSCPA represents over 15,000 certified public accountants and prospective CPAs. The comments herein represent those of some of the individuals of our Accounting and Auditing Standards Interest Group only and do not necessarily reflect the views of all members of the NJSCPA.

We appreciate the opportunity to comment on the AICPA's discussion paper Enhancing Audit Quality relating to improving and strengthening the audit process of private entities. We commend the AICPA for launching its Enhancing Audit Quality initiative and its goal to align the objectives of all audit-related AICPA efforts to improve audit performance.

Responses to the questions and additional considerations are below.

### **Competence and Due Care**

Continue serving the public interest by aligning the CPA Exam with real-world practice for newly licensed CPAs. Determine marketplace needs through periodic comprehensive research efforts to maintain the exam's relevance and adequately assess competence of CPA candidates. Ensure that all CPAs who perform financial statement audits adhere to the requirements in the AICPA Code of Professional Conduct, including but not limited to competence and due care.

**Question 1:** *How can the profession reinforce the importance of the Code and ensure that all CPAs performing private entity financial statement audits adhere to the due care and competence requirements?*



At present, ethics training requirements are established by each Board of Accountancy. In New Jersey, the state mandates a triennial professional ethics training which covers the importance of the Code. We believe consideration should be made for regular, possibly annual ethics training promulgated by the AICPA. The training could be a joint program developed between the AICPA and the State Boards of Accountancy and be regularly or annually required by those accountants involved in the practice of auditing, referred to as “audit specialists”. Also see our response to question 3 regarding requiring audit CPE for auditors.

**Question 2:** *What are CPAs’ challenges and obstacles in exercising due care?*

Most of the group agreed that technical complexity in applying standards, ‘the audit as a commodity’ mentality and fee pressures (created by increasingly competitive bidding, thereby generally having the impact of driving down fees), information overload, client retention concerns and clients’ lack of knowledge of what an audit is, are challenges and obstacles in exercising due care. Others noted that education, background and knowledge of auditing by accounting graduates is very limited and more could be done on a college level to offer more classes including a course related to internal controls and bookkeeping 101, case studies on auditing and access to auditing internships to expand their knowledge and appreciation of auditing.

**Question 3:** *Should the AICPA provide additional (specific) guidance on what it means to be competent? If so, in what areas? What suggestions do you have to define competence?*

We all agreed that adequate guidance is now available to allow an auditor to determine what competence means. However we have some suggestions as to how to promote competence. For those involved in certain specialized industries, competence is embedded in the continuing professional education (CPE) requirements attached to such industries. For example, auditors of employee benefit plans or organizations receiving funding from the government (yellow book) generally require specialized CPE. In order to better support ‘competence’, consideration should be given to expanding the CPE requirements to include other challenging industries and specialty areas for those auditors, for example, broker dealers, schools, gaming, service organizations (SOC) and insurance. We also discussed the idea of requiring auditors and audit firms to have a minimum number of (non-industry specific) general auditing CPE hours. We understand that many jurisdictions only specify a minimum number of A & A CPE hours. For example, here in New Jersey, a CPA is required to take 24 hours of accounting and auditing (A&A) CPE in a triennial period, which may result in an auditor taking all accounting and no auditing CPE. We believe that the requirement for a minimum number of A & A CPE should be further delineated into a minimum number of hours in auditing, perhaps 8, and the balance of those hours in accounting. Further, we also discussed the benefit of mandatory sharing or distribution of identified audit deficiencies (trends) for private entity audits, identified through peer reviews, with all auditors. Although this information is currently available



we believe it could be more prominently distributed. Further, some noted that auditors may not be properly trained or supervised appropriately during an audit engagement.

The definition of competence is properly applying the standards. When an auditor is uncertain on how to apply a standard they should seek the advice of internal and external technical support (such as the AICPA), peers, attend training, etc. Competence is “knowing what you need to do and doing it right”!

**Question 4:** *What methods, other than existing ones, should the profession consider to facilitate the right match of competency with an audit engagement?*

There were differing opinions on this question. Some stated that audit services are selected in the open market and to a large extent the matching process is determined by the perceptions of the client. Maybe the AICPA could better educate the users of the audited financial statements. Others in the group suggested that the AICPA could track firms with auditing experience in specialized industries. Also, some suggested that consideration should be given to an AICPA registration and oversight program for auditors of private entities, similar to the PCAOB, for auditors of non-public entities. Such a program could also include the ability to independently inspect registered Firms, similar to the PCAOB inspection program. Further, such a program would take the place of the external peer review for auditors. This should improve the quality of peer reviewers and improve consistency. With respect to the economics of such, we discussed how registration fees could substitute for the cost of peer review that CPA firms are presently paying.

### **Auditing and Quality Control Standards**

Monitor the use of the Auditing Standards Board’s new clarified auditing standards to ensure they are being consistently understood and implemented to achieve high-quality audits. Revise standards, issue supplemental guidance or provide additional education and tools as necessary. Identify and better understand where and how audit deficiencies occur and their root causes so revisions can be made to the appropriate standards and/or guidance. Consider whether more specificity is needed in the quality control standards to drive quality performance.

**Question 5:** *Do you believe revisions should be made to the ASB’s auditing or firm quality control standards to improve audit quality in the near term? If so, what specific revisions would you propose and why do you believe they would improve audit quality?*

We do not believe that substantive revisions to either the ASB’s auditing or quality control standards are required to improve audit quality. However please see our response to questions number 1 and 3 regarding CPE.



**Question 6:** *Are revisions needed to the auditing or quality control standards to address specific industries or regulated areas? If so, what revisions are needed and what industries or areas should be addressed?*

We do not believe that substantive revisions to the auditing or quality control standards are required to address specific industries or regulated areas. Please refer to question number 3 for comments relating to CPE for industry specialization.

**Question 7:** *What other guidance is needed to help practitioners apply the auditing and quality control standards to improve audit performance and quality?*

Training is the key to improve audit performance and quality. Training includes on the job as well as formal classroom training. The State Boards of Accountancy should consider requiring trainings in auditing, and specialized industries, in a live format and other specialized trainings can be offered in a webinar or on-demand format to allow technical experts to be heard by a large national audience. Please see our responses to questions number 1 and 3 regarding CPE.

### **Guidance, Tools, Learning and Resources**

Enhance curricula, content and methods of instruction to support the major topical areas the profession serves, including but not limited to challenging areas such as employee benefit plan audits, governmental audits and financial reporting. Release a rigorous, profession-wide competency framework that has been validated by experts and regulators from around the globe. Develop additional individual and suites of resources or educational courses based upon areas of concern uncovered in peer reviews.

**Question 8:** *Based on your use of audit engagement training tools and resources, what additional authoritative publications or non-authoritative guidance, tools or training could be developed for audits of financial statements that would enhance competencies and drive quality engagement performance? For which industries or specialized topics is it difficult to obtain educational and professional resources?*

The group reemphasized that training and education are the drivers of quality. The AICPA should consider establishing a training database to locate hard to find courses. Some noted difficulties in finding tools related to International Financial Reporting Standards and Department of Education Title IV compliance auditing and training in Generally Accepted Privacy Principled audits. Some in the group suggested that free online access to AICPA audit and accounting guides and audit risk alerts would be very beneficial, including improved notification and distribution of such. Others suggested that an expansion of AICPA Audit and Accounting Guides to challenging areas with recurring audit



deficiencies would be helpful. Additional suggestions are included in the response to question number 3.

### **Practice Monitoring (Peer Review)**

Perform more extensive peer review procedures on high-risk and complex areas and engagements. Address the risks posed by low-volume auditors of high-risk and complex engagements by requiring the firm, in all cases where material non-conformity with applicable professional standards is noted, to engage a third party to perform pre- or post-issuance reviews of those engagements in the future with periodic reporting to a peer review Report Acceptance Body (RAB). Evaluate firms' engagements in "new" industries promptly, rather than waiting for their next peer review. Enhance the quality of peer reviewers by introducing a streamlined process for barring reviewers who do not meet required performance criteria. Establish systems to facilitate the identification of the firm and engagement populations subject to peer review. Explore ways in which peer review reporting can better articulate information users find meaningful. Facilitate the prevention of audit quality issues before they start by developing a next generation of peer review that provides firms with near real-time feedback on their accounting and auditing practice, enabling them to quickly leverage and implement prescriptive measures, in some instances even before an engagement is completed.

### **Near-Term Enhancements to Peer Review**

#### ***Enhance Quality of Peer Reviewers***

**Question 9:** *What advantages and challenges do these changes present? How could potential challenges or unintended consequences be minimized or avoided?*

The numerous advantages outweigh any challenges. Practice monitoring which relies on a triennial peer review period is an outdated model. We believe that the concept of real-time feedback will tremendously improve accounting and auditing practices. One challenge will be that firms will not want to have any additional cost that cannot be passed along to their clients, which may result in firms looking for peer reviewers who charge the lowest fees. Also see our response to Question 4 for considerations regarding a suggested approach to peer review for auditors.

**Question 10:** *Will removal of poor performing peer reviewers and the suggested training programs increase reviewer quality? Why or why not?*

Yes, we agree. Poor performing peer reviewers should not be allowed to continue in their role. The program should recruit peer reviewers to replace those that are not allowed to continue. The administering entities and state societies who administer the Peer Review



program are in the best position to accomplish the tasks. Suggested or required peer review training programs will have an impact on reviewer quality. Also see our response to Question 4 for considerations regarding a suggested approach to peer review for auditors of private entities.

**Question 11:** *What effect do you expect these requirements will have on the peer review program's ability to maintain a sufficient number of qualified peer reviewers? If you expect them to have an adverse impact on the peer reviewer pool, what implementation steps could mitigate the impact?*

We expect that the new requirements may initially decrease the number of peer reviewers, arising from several factors. Most peer reviewers charge below their regular billing rates, and with the new program an additional time commitment maybe required. The additional training may result in an increase to non-chargeable hours. However, see also our response to Question 4 for considerations regarding a suggested approach to peer review that some in our group advocated for— under this approach a pool of highly qualified full-time peer reviewers would be funded through registration fees.

**Question 12:** *What effect do you expect these requirements will have on peer review stakeholders and on the peer review program as a whole? What should the PRB require of new peer reviewers to give reasonable assurance that they will develop and maintain the experience and expertise to perform high-quality peer reviews?*

All new and existing peer reviewers should conduct a minimum number of audits on a regular basis, by specialized industry (for example, ERISA) as necessary. Those professionals within a firm that perform or are responsible for quality control functions would be good candidates for performing peer reviews. Training, timely feedback, as well as continual monitoring will enhance audit quality.

#### ***Address Risks Posed by Low-Volume Auditors of High-Risk Engagements***

**Question 13:** *What are the advantages and disadvantages of these changes? Are there potential unintended consequences? How could they be avoided or minimized?*

There are no disadvantages to the changes in the peer review process discussed above as they will only enhance audit quality. Low-volume auditors of high-risk engagements would need to be a “must-select” for peer review purposes. We noted however that a low-volume auditor isn't always automatically a low-quality auditor.

**Question 14:** *Should these requirements extend to firms that audit five or fewer engagements in any one industry (not just must-select industries)?*



Yes, these requirements should extend to firms that are referred to as low-volume auditors. A small firm is no reason to accept diminished audit quality. We understand the increase in risk posed by “low volume auditors”. However, a vocal minority in our group took exception to the term “low volume auditors” because they incorrectly perceived it as a limitation on their ability to practice. Accordingly, we caution the AICPA in how to introduce this concept.

### ***Deepen Review of High-Risk Industries and Areas of Concern***

**Question 15:** *What are the advantages and disadvantages of this initiative? If there are potential disadvantages or unintended consequences, how can they be avoided or minimized?*

There are significant advantages to focusing firms and peer reviewers on high-risk and emerging industries and areas of concern. Specialized training programs will need to be developed for these industries. In addition, deficiencies identified during the course of all peer reviews should be centralized in a database, to provide transparency of common peer review findings. It was emphasized that the accounting profession is constantly changing and peer reviewers must be able to focus on developing risk areas and share this information with peer reviewers and firms. There were no disadvantages identified.

**Question 16:** *Peer reviewers currently review complete sets of engagement working papers in order to cover a reasonable cross section of the engagements performed by each firm. The PRB is considering a new approach where reviewers would still obtain a reasonable cross section but would only review those sections of engagements that represent particularly high risk. Which approach do you support and why?*

We support the new approach to focus on review of high risk areas. The result would be a more effective and efficient peer review. Review of complete sets of working papers should still be performed on a limited basis to keep the process unpredictable. Additionally, peer reviewers should retain the right to expand their working paper review as preliminary findings, facts and circumstances dictate.

**Question 17:** *Are the targeted risk areas that the AICPA has identified for initial focus appropriate? What other high risk areas should the PRB consider?*

Yes, the targeted areas are appropriate for initial focus. The areas should be updated on an on-going basis as new risk areas are identified. Additional high risk areas that should be considered include; the development of expectations and performance of preliminary analytical procedures and review of client acceptance procedures. We also recommend that the AICPA develop a definition of what is represents a high risk area so that the principle can be consistently applied.



### ***Improve Engagement and Firm Tracking***

**Question 18:** *Recent changes were made to peer review practice aids to bring more attention to the completeness of the peer review population. These changes include revisions to the firm representation letter and additional questions in the Team Captain Checklist (System Reviews) and Review Captain Summary (Engagement Reviews). What other measures could ensure that peer reviewers receive complete information on the engagement population and that firms understand their responsibility to accurately report data?*

A detailed letter should be issued by the administrative entity to each firm subject to peer review which includes explicit instructions on how to complete the listing of engagements to ensure that it is complete and accurate. Some suggested that a warning should be included in the letter if a firm does not properly comply with the instructions. The administrative entity could provide a standardized template that firms would be required to use that would capture required engagement information on an annual basis. All states that currently require professional ethics training should consider enhancing the program to include a session on “a firm’s requirements for a peer review”.

**Question 19:** *How could the information provided be verified? What databases could be leveraged?*

The group was in agreement that it is not the responsibility of the peer reviewers to verify the information provided by a firm subject to peer review. However, if the peer reviewer identifies that the engagement listing is incomplete or inaccurate it must immediately bring this to the attention of the administrative body. Additionally, we note that this is a matter of professional conduct.

### ***Create a National Group of Technical Experts Reporting Directly to the PRB***

**Question 20:** *What are the advantages and challenges presented by these changes? How could related potential challenges or unintended consequences be minimized or avoided?*

The advantage is an enhanced peer review process with technical experts who have specialized knowledge. The group would also be able to train and perform peer reviews on a more consistent basis. The disadvantages are the costs associated with a national program, the potential for discouraging peer reviewers to perform reviews, and the questions of who would bear the costs of such a program.

**Question 21:** *What effect do you expect these requirements will have on the peer review program’s ability to maintain the current pool of peer reviewers and attract new ones? If you expect them to have an adverse impact, what implementation steps could mitigate the impact?*



Initially the new requirements will decrease the current pool of peer reviewers and may also create difficulty in attracting new peer reviewers. The increased scrutiny by technical experts will result in more time needed to perform a peer review and reduce the realization rates to conduct a peer review.

**Question 22:** *What effect do you expect these requirements will have on other peer review stakeholders and on the peer review program as a whole?*

The new requirements would enhance peer review quality but there is an additional cost associated with these new requirements that needs to be quantified and considered. The new requirements would also improve engagement performance quality because of the increased frequency review of must-select engagements and perhaps even discourage less qualified firms from performing must-select audits.

#### ***Make Peer Review Results More Informative***

**Question 23:** *Are the current report rating grades (pass, pass with deficiencies, fail) clear and meaningful? Do you find these categories useful? If not, how would you change the report rating grades? (The peer review reporting model is discussed briefly starting on page 21 of the Peer Review Q&A and in more detail starting in paragraph .94 of the Peer Review Standards; links to these materials appear below.)*

Yes, the current report rating grades are clear and meaningful and the categories are useful. They do not need to be modified.

**Question 24:** *What actions, if any, does your organization take when a firm receives a pass, pass with deficiencies or fail report? What actions do you think should be taken by others?*

An exit conference with firm managers and partners in attendance should be required. When a firm receives a fail and/or pass with deficiency and corrective actions need to be taken, the following year follow up should be required to ensure that the corrective actions were properly implemented. We all agreed that a peer reviewer with performance issues should not be allowed to continue conducting peer reviews.

**Question 25:** *What information about a firm would be useful in better understanding, evaluating and using its peer review report? How should it be made available?*

The current practice is appropriate. Additional information requested by a user of the peer review report may be provided at the discretion of the firm.

**Question 26:** *Which model do you find more helpful: the peer review reporting model (opinion on the overall system of quality control) or the reporting model used by many*



*regulatory bodies (a list of engagements and topics of deficiencies)? Could a hybrid model better meet your needs? If so, what would that model look like?*

There were differing opinions on this question. Some stated that the current peer review reporting model is appropriate. Others stated that a hybrid model would be a better approach. All agreed that comments related to the system of quality control should be kept private.

**Question 27:** *Please share any other suggestions for enhancing the transparency and usability of peer review reporting. Explain how your suggestions would be helpful to you and what you will be able to do with the improved reporting.*

We suggest that non AICPA member firms' deficiencies be accumulated into a central data base. Also, currently it is up to the peer reviewer to determine when a deficiency should be reported. What one peer reviewer may write up another may not and therefore we believe that there are inconsistencies. This should be addressed. We also suggest that the findings are summarized in the elements of a quality control system and provide suggestions to improve the weakness/correct the finding. Lastly, the nature of exit conference items should also be accumulated and shared.

**Question 28:** *How would your suggestions for improvement enhance audit quality? How will they be more beneficial for the users of the report?*

The suggestions discussed above would enhance audit quality. Please refer to our individual responses.

**Question 29:** *Beyond what is mentioned throughout the "Practice Monitoring" section of this paper, what other requirements should the AICPA Peer Review Program consider that would meaningfully impact audit quality?*

Some suggested that firms should be required to track engagements subject to peer review at the administrative entity level to ensure completeness and accuracy of the information.

### ***Additional Considerations***

Overall, some in the group believe the reason audit quality has diminished over the years is because certain clients view an audit as a commodity, rather than a service. Those clients are likely to engage the cheapest audit firm because they don't view a high quality audit as a value added service. Some CPA firms that provide audit services may also share this view, and accordingly, drive down their pricing and perform lower quality audits in order to save time. The AICPA should do more to educate the public about the value of a high quality audit, how to recognize a high quality audit, the peer review process and peer review reports, and the importance of hiring a qualified firm for their audit.



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Some in the group are peer reviewers and have issued failed peer review reports. In such cases, when the reviewed firm inquires what the consequences of this failure means to their malpractice insurance premiums, and ability to serve current clients, the peer reviewer is unable to respond. We are concerned that for some firms in these circumstances it doesn't mean anything.

Many clients and prospects don't know to ask for the most recent peer review report. Over the years, emphasis has been placed on what auditors don't perform in their audits through case-by-case litigation. Some suggested that perhaps we, and the AICPA, need to proactively emphasize the high quality audit services that should be performed, what auditors should be doing, and the consequences of them not being performed on our profession, and the clients and the public interest that we serve.

Thank you for the opportunity to comment. We are available to discuss our comments at your convenience.

Respectfully submitted,

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