November 7, 2014

Ms. Tommye E. Barie, CPA, Chair of the Board of Directors
Mr. Barry C. Melancon, CPA, CGMA, President and CEO
AICPA
220 Leigh Farm Road
Durham, NC 27707-8110

By email: EAQ@aicpa.org

Re: AICPA Enhancing Audit Quality: Plans and Perspectives for the US CPA Profession—August 7, 2014

The North Carolina Association of Certified Public Accountants, representing thousands of CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the discussion paper referenced above. The NCACPA Peer Review Committee deliberated the discussion paper and submits the following response.

Generally speaking, the NCACPA Peer Review Committee supports much of the content in this discussion paper. Most of the focus intends to, and substantially achieves, the goal of voicing concerns felt by many in the accounting community that any negative public perception regarding audit quality is detrimental to our profession and must be addressed.

While our committee is interested in and affirms the provisions contained in the entire document, we have directed our response to those matters we believe directly impact practice monitoring and enforcement.

Competence and Due Care

We support the concept that competence and due care are foundational in any system of quality control a firm might implement. The problems we encounter in performing peer reviews often have their genesis in the wide plethora of cultures of firms that are developed from many different sources of education, training, practice methodologies, and experiences. The quality of these firms is usually determined by the marriage of each of these attributes, and it varies widely. Other such factors that impact firm quality include firm size, practice depth, industry specialization, and frankly, integrity. Unfortunately, accounting and auditing standards, complexity, oversight, and expectations of users have all changed at an unprecedented pace in recent years. That trend is unlikely to abate in the foreseeable future.

These factors put small, and even medium size firms (which represent a significant number of firms in AICPA membership), at a severe disadvantage related to maintaining competence and obtaining basic knowledge necessary to serve existing high-risk clients. While this is a challenge for those firms and engagement partners to perform high-risk work, competence must be maintained or obtained.

We believe the following points are foundational and important in these discussions about competence and due care:

- It is should not be the role of the AICPA or the Peer Review program to be responsible for the firm's ultimate obligation to perform audit work in accordance with standards. The responsibilities for quality currently, and will always, lie with the individual firm.
- The profession must better define what quality is and the measures of quality. Those definitions must be defined inclusively with third-party users and regulators to establish those metrics used

to judge firms. An example is the pass/fail nature of peer review and the lack of any differentiation to a third-party user between a firm with MFCs or FFCs and one without.

- We agree a desire for excellence is important to achieving quality. However, perfection is unachievable in a dynamic and changing environment filled with estimates, interpretations, and judgments. The profession as a whole has grown weary of standards which infer acceptance of "reasonable assurance," while users and regulators demand "perfection" without defining what perfection is, nor the measures used to evaluate compliance. We practice in a world that gives no credit for getting multitudes of things right, but reacts adversely when one thing is performed incorrectly. This conversation has to be less about how to identify and then correcting performance, and more about how we prevent firms from getting it wrong in the first place.
- The AICPA's role must ultimately be one of communicating and measuring the competence of its firm members and peer reviewers, not the assurance of specific audit quality. The liability for quality must belong to the firm and not necessarily be shared by the membership. Allowing audit users, regulators, or third parties to paint the profession based on inadequacies of a small percentage of firms is inappropriate, and should be defended vigorously.
- Competitive bid processes and fixed fee contracts for attest services can conceivably impair independence because auditor financial compensation based on the lowest responsible bidder encourages a firm to focus on limiting work performed and establishing higher-risk thresholds in order to obtain or retain work. Audit quality suffers because firm realization may be impacted if issues are discovered during an audit requiring additional time in a fixed fee engagement. Until decisions about auditor selection are made based on qualifications, experience, reputation, and training rather than fee, quality will continue to suffer.

Auditing and Quality Control Standards and Guidance, Tools, Learning, and Resources

As previously stated, accounting and auditing standards, complexity, oversight, and user expectations have changed at an unprecedented pace. Users are in general agreement that "one size fits all" standards are no longer desirable or necessary. Users are willing to accept standards departures to avoid issues that are complex or difficult to quantify.

We applaud the Clarification Project and recent revisions to quality control standards as positive first steps. However, until we can find appropriate means to accelerate competency in new standards, quality will continue to be at risk.

We believe the following points are foundational and important in these discussions about auditing and quality control standards:

- We believe a requirement for mandatory continuing education in accounting and auditing subjects for firms practicing in financial reporting engagements is long overdue. If a firm chooses to perform such engagements, then it should not fall to peer reviewers to educate firms.
- Education in A&A areas should include meaningful assessment of competence in subjects covered by courses taken, particularly in high-risk audit areas. Credit for hours attended and credit for competence should be separately measured and tracked. Competence evaluation in high-risk industries should be required in addition to continuing education. Failure to achieve competence should result in retesting or use of external Engagement Quality Control Reviews (EQCR) until retesting is achieved.
- We applaud the Future of Learning initiatives as positive first steps. However, until we can find appropriate means to accelerate competency in new standards, quality will continue to be at risk.
- We believe in mandatory membership in the AICPA Audit Quality Centers and required participation in key events offered which should be prerequisites in order for firms to practice in the Governmental and Employee Benefit Plan areas.

Practice Monitoring

No other area being considered has more potential impact on quality than Peer Review. Of all the information included in the discussion paper, no other area is more controversial.

Most peer reviewers take great pride in the impact we have on firms as part of the existing Peer Review Program, including the original tenants which require the program to be remedial and educational. We believe there are many good points raised for discussion in the paper. We also believe AICPA should focus on substantive short and long term adjustments to the current program, rather than focusing on the long term technological metamorphosis under consideration

With regard to peer review in its current form, before we totally abandon the current program in favor of something technologically different and more regulatory, we believe there are a number of changes which should be considered to enhance the current program and support a more intentional focus on quality.

We believe the following points are foundational and important in these discussions about practice monitoring:

- Firms should be required to annually submit timely monitoring results and internal findings to the AICPA Peer Review Program in non-peer review years and such results should be evaluated and tracked to evaluate whether external monitoring might be considered. Monitoring should consider regulatory actions or inquiry and how the firm responds to such matters. We feel there is a direct correlation between firms that do adequate monitoring and quality work. Penalties for not performing proper monitoring have become unacceptably low and should rise to the level of a deficiency. Reports on monitoring should be required within the same cycles currently used for peer review reporting. Firms failing to submit monitoring reports should be required to have accelerated reviews or to have high-risk engagements subjected to EQCR or pre-issuance review using a referral through each state's Administering Entities (AE), if concerns exist about a firm's work.
- Entry into new areas of practice, particularly high-risk audit engagements, should require pre-issuance review by a qualified peer reviewer with reporting to the program prior to report issuance by that firm. Results should be allowed to count toward a firm's monitoring and should be a part of the same annual reporting requirement mentioned previously. The profession has to make provision for firms to be able to perform audits of high-risk entities or it becomes a restriction of trade. Having said that, we believe the nature of high-risk work demands a requirement that learning involve competent consultation and verification of quality on initial engagements in a new practice area.
- The AICPA should use its technology to track firms performing DOL and GAO Clearinghouse engagements and make information available to peer reviewers through AEs as peer reviews are scheduled. Efforts should be developed with other higher-risk users and industries to track firms performing such work and such information should be shared with the AE's to insure the accuracy of scheduling information.
- Mandatory CPE requirements should be developed by the AICPA and monitored as a part of peer review to ensure that firms performing audit and even SSARS level work are maintaining competence in the areas in which they practice. Failing to obtain such ongoing and regular CPE should rise to the level of a deficiency. As peer reviewers, we have seen a direct correlation between firms that challenge themselves in CPE and those that take updates while practicing in complex industries. The AICPA should work to provide programs and competency evaluation tools covering all industries for which an industry audit guide is offered. Firms practicing in those areas should have CPE and competency evaluations at least once in a peer review cycle of three years.
- We believe peer review, if properly performed, is effective. We further believe more consistent follow-up, when problems are identified, will have a much more profound impact on quality.

RABs are too quick to recommend CPE when pre-issuance review or mandatory EQCR would be more effective at having an immediate impact on quality.

Regarding the AICPA's emphasis on the evaluation and possible removal of existing peer reviewers, evaluations of those reviewers must be done by peers. If grounds for barring reviewers are determined to exist, the results of that evaluation should be independently verified by a second peer. Our concern is that in our state, we have a significant shortage of peer reviewers. The perception peer review will soon become more confrontational, and perhaps regulatory, is likely to negatively impact AE's abilities to obtain new reviewers and volunteers for committees.

Consideration might also be given to the establishment of an "approved pool" of reviewers to perform reviews of all high-risk engagements that require qualification, training, and approval through the AICPA. Assignment of team members to peer reviews for such engagements would allow for oversight, reviewer evaluation, and control to remain with the AICPA rather than the AEs. This option would be less likely to prevent firms from participating in the peer review process or becoming reviewers and gives clearer guidance on what is expected from reviewers of these types of engagements.

Finally, the profession as a whole understands and embraces the need for quality. However, the definition of quality and what is substandard is a debate not so easily resolved. Even when quality issues are identified, the secondary judgment of whether the quality issues are pervasive is even more challenging. Third-party users would have us fail a firm for any evidence of poor quality.

We believe every firm has engagements in which quality may be less than desirable. We still believe the overall goal should continue to be the education and remediation of CPA firms as stated in the original standards. Anything else is regulatory and must likely include a firm's right to due process and perhaps legal representation.

If you would like additional discussion with respect to the attached comments, please contact J. Scott Hughes, CPA, Chair of the NCACPA Peer Review Committee, at (828) 225-3627.

Sincerely,

J. Scott Hughes, CPA
Chair
NCACPA Peer Review Committee

cc: NCACPA Board of Directors
NCACPA Management