

# Audit Update

November 18, 2024

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## General Disclaimer

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Official positions of standard setters are determined through certain specific committee procedures, due process, and extensive deliberation.

Application of accounting and auditing principles is the responsibility of an organization's management and their independent public accountant.

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## Learning Objectives

1. Identify the core elements of the quality management standards
2. Describe changes to audit standards



## Agenda

Quality Management Standards

SAS 147

SAS 149

# Quality Management Standards



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## Suite of Standards

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SQMS1

SQMS2

SSARS 26

SAS 146

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## The Why

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- The environment in which firms operate has evolved
- The power and use of technological resources have increased exponentially, both by businesses and by firms
- The expectations of regulators, given high-profile business failures, are higher
- This model provides a more scalable approach to quality for firms of all sizes

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SQMS No. 1



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## Background

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### **Statement on Quality Management Standards (SQMS) 1, A Firm's System of Quality Management**

- Issued: June 2022
- Effective Date:
  - Designed and Implemented: December 15, 2025
  - Evaluation: One year following December 15, 2025
- Background:
  - Alignment with IAASB

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## New Approach

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- Shifts from a policies-based approach to a risk-based approach
- Emphasizes leadership responsibility in proactively managing quality that requires a firm to design, implement, and operate a system of quality management customized to the circumstances of the firm's A&A practice

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## Evaluation

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- At least annually, the individuals assigned ultimate responsibility and accountability for the system of QM, on behalf of the firm, evaluate the system of QM and conclude whether the system of QM provides the firm with reasonable assurance that the objectives of the system are being achieved

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## Components of QM

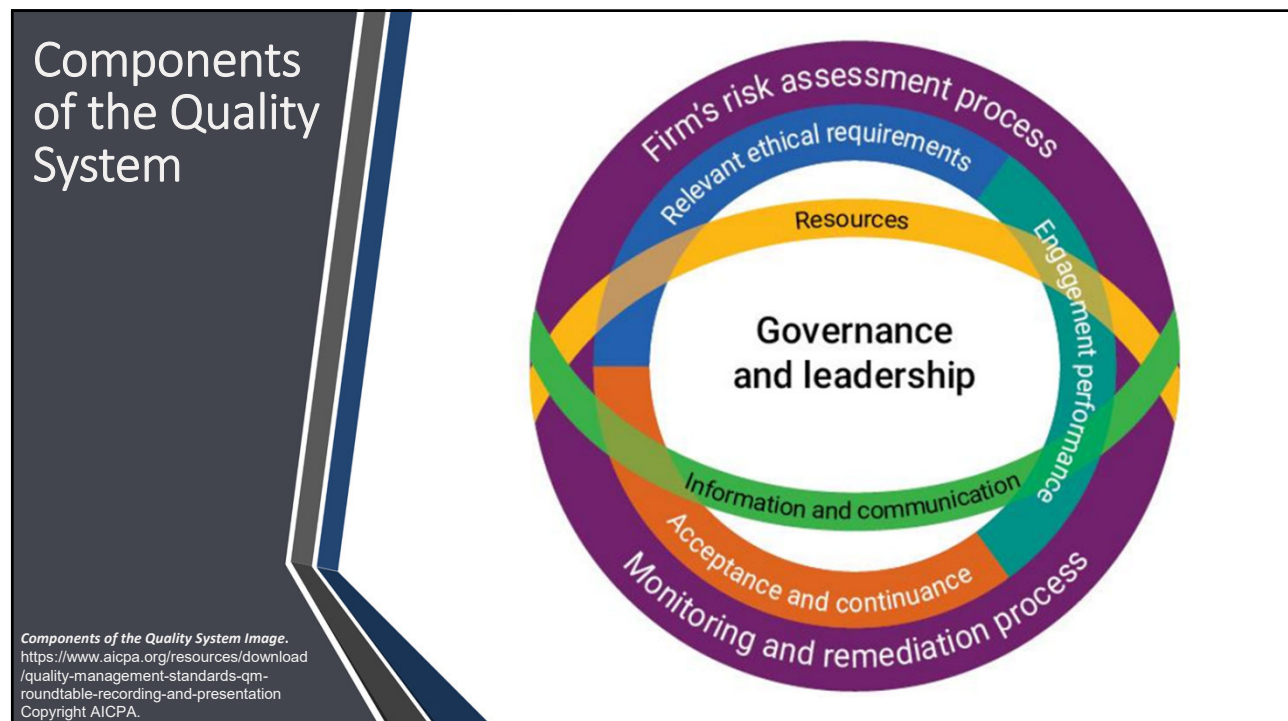


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## Components of the System of QM

- The firm's risk assessment process (new)
- Governance and leadership (renamed/updated)
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Engagement performance
- Resources (renamed/expanded)
- Information and communication (new)
- Monitoring and remediation process (renamed/updated)

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## Objective of the Firm

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- The objective of the firm in the context of the standard is to design, implement, and operate a system of quality management that provides the firm with reasonable assurance that the objectives of the system of quality management are achieved

## Objective of System of QM

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- The system of quality management is designed to achieve the following objectives:
  1. The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements
  2. Engagement reports issued by the firm are appropriate in the circumstances



# Risk Assessment

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## Risk Assessment Process

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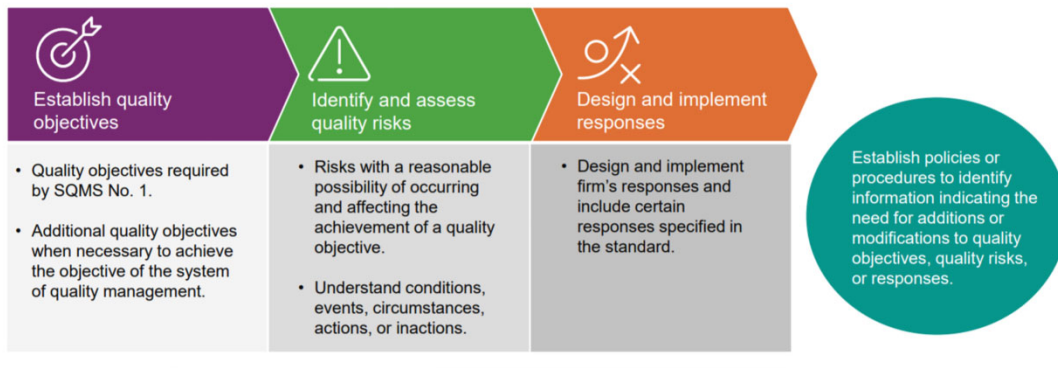
- The firm's risk assessment process is a new component that comprises the process the firm is required to follow in implementing the risk-based approach to quality management

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## Risk Assessment Process Cont'd

### The risk assessment process (NEW!)

Risk Assessment Image.  
Copyright AICPA.



<https://www.aicpa.org/resources/download/quality-management-standards-qm-roundtable-recording-and-presentation>

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## Quality Risks

- The firm should identify and assess quality risks to provide a basis for the design and implementation of responses

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Examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives	Examples of quality risks that may arise
The strategic and operational decisions and actions, business processes, and business model of the firm: The firm's overall financial goals are overly dependent on the extent of services provided by the firm not within the scope of this SQMS.	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> <li>• Resources are allocated or assigned in a manner that prioritizes the services not within the scope of this SQMS and may negatively affect the quality of engagements within the scope of this SQMS.</li> <li>• Decisions about financial and operational priorities do not fully or adequately consider the importance of quality in performing engagements within the scope of this SQMS.</li> </ul>
The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> <li>• Leadership's responsibilities and accountability for quality are not clearly defined and assigned.</li> <li>• The actions and behaviors of leadership that do not promote quality are not questioned.</li> </ul>

Risk Assessment Image.  
 Accessed February 2023  
 Copyright AICPA  
<https://www.aicpa.org/resources/download/aicpa-statement-on-quality-management-standards-no-1>


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## Response

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- The firm should design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks


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## Policies & Procedures

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- The firm should establish policies or procedures that are designed to identify information that indicates additional quality objectives, or additional or modified quality risks or responses, are needed due to changes in the nature and circumstances of the firm or its engagements

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## Governance & Leadership

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## Governance & Leadership

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- Addresses the importance of quality in the firm's strategic decisions and actions, including financial and operational priorities, as well as firm leadership's ability to influence decisions about the firm's resources
- Other matters such as the firm's culture, how it demonstrates a commitment to quality, and how responsibilities with respect to the system of QM are assigned may also be addressed

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## Relevant Ethical Requirements

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## Relevant Ethical Requirements

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- The firm and its personnel should establish quality objective that fulfill relevant ethical requirements, including those related to independence which include:
  - Understanding the relevant ethical requirements to which the firm and the firm's engagements are subject, and
  - Fulfilling their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject

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## Acceptance & Continuance

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## Acceptance & Continuance

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- Judgments by the firm about whether to accept or continue a client relationship or specific engagement are appropriate based on the following:
  - Information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client
  - The firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements

## Acceptance & Continuance Cont'd

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- The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement


# Engagement Performance

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## Engagement Performance

Engagement teams understand and fulfill their responsibilities	Direction and supervision of engagement teams	Professional judgment
Consultations	Differences of opinion	Engagement documentation

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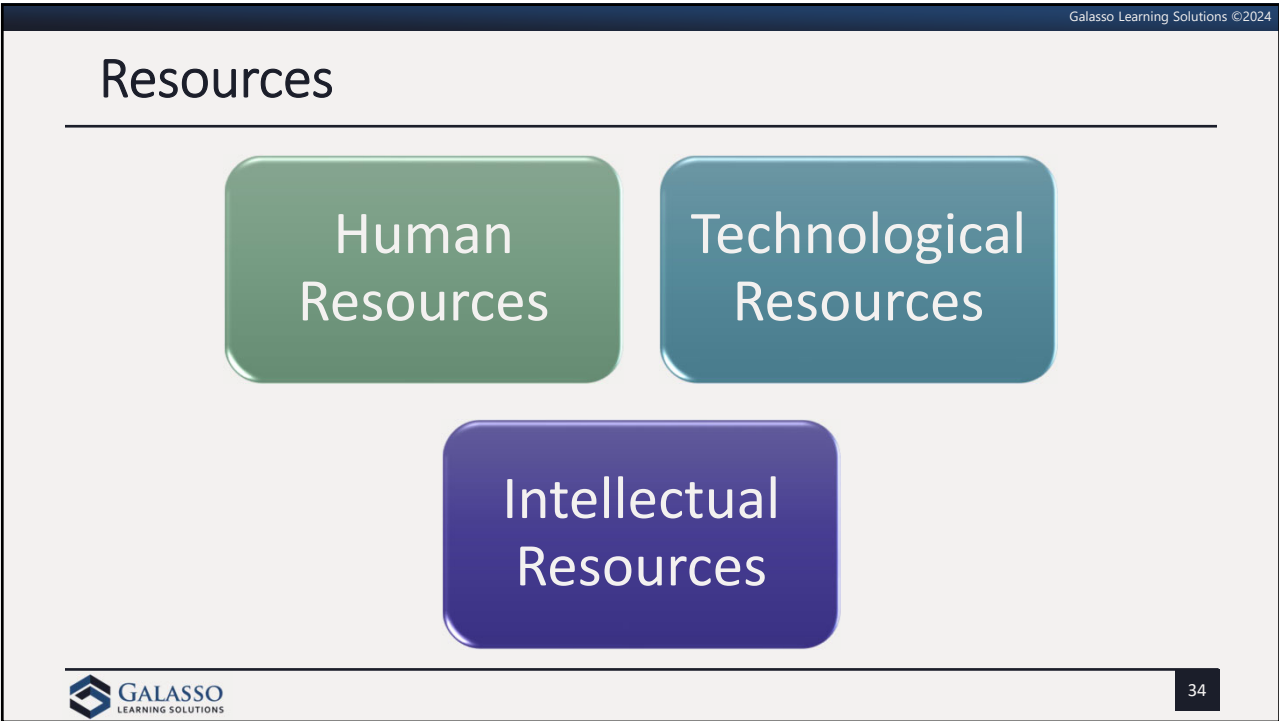
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# Information & Communication

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## Information and Communication

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- The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources
- The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another

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# Monitoring & Remediation

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## Monitoring and Remediation

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- The firm should establish a monitoring and remediation process to:
  - Provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management
  - Take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis

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## Addressing Deficiencies

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- The firm should evaluate findings to determine whether deficiencies exist, including in the monitoring and remediation process
- The firm should evaluate the severity and pervasiveness of identified deficiencies by
  - Investigating the root causes of the identified deficiencies
  - Evaluating the effect of the identified deficiencies, individually and in aggregate, on the system of quality management

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## Addressing Deficiencies Cont'd

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- The firm should design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis

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## Addressing Deficiencies Cont'd

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- The firm should respond to circumstances in which findings indicate that there is an engagement for which required procedures were omitted during the performance of the engagement, or that the report issued may be inappropriate
- The firm's response should include the following:
  - Taking appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements
  - When the report is considered to be inappropriate, considering the implications and taking appropriate action, including considering whether to obtain legal advice

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## Evaluating the System



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## Evaluating the System

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- Based on the evaluation, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management should conclude, on behalf of the firm, one of the following:
  - The system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved
  - Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved
  - The system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved

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Effective Date



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## Effective Date

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- Systems of quality management in compliance with the SQMS No. 1 are required to be designed and implemented by December 15, 2025
- The evaluation of the system of quality management required by the SQMS No. 1 is required to be performed within one year following December 15, 2025

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# SQMS No. 2



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## Background

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### Statement on Quality Management Standards (SQMS), Engagement Quality Reviews

- Issued: June 2022
- Background:
  - Alignment with IAASB

## Purpose

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- SQMS No. 2 addresses the appointment and eligibility of the engagement quality reviewer and performance of engagement quality reviews
- Applies to all engagements for which an engagement quality review is required to be performed in accordance with SQMS No. 1
  - When the firm decides that an engagement quality review is an appropriate response to a quality risk



## Why a Separate QMS?

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- SQMS No. 1 requires a firm to determine when an engagement quality review is an appropriate response to quality risks
- SQMS No. 2 addresses the appointment and eligibility of the EQ reviewer and the performance of EQ reviews

## Public Interest

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- The public interest is served by the consistent performance of quality engagements
- Objective - An engagement quality review is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon
  - Not an evaluation of whether the entire engagement complies with standards / regulatory requirements

## Appointment and Eligibility

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- The firm should establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual or individuals with the competence, capabilities, and appropriate authority within the firm to fulfill the responsibility

## Appointment and Eligibility Cont'd

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- The firm should establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer
- Those policies or procedures should require that such individuals
  - Not be members of the engagement team;
  - Have the competence and capabilities, including sufficient time, to perform the duties assigned to them; and
  - Comply with relevant ethical requirements, including addressing threats to their objectivity and independence and, if applicable, the provisions of law and regulation

## Appointment and Eligibility Cont'd

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- The firm's policies or procedures should also address threats to objectivity created by an individual being appointed as the engagement quality reviewer after previously serving as the engagement partner

## Appointment and Eligibility Cont'd

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- The firm should establish policies or procedures that
  - Require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review; and
  - Address the engagement quality reviewer's responsibility for determining the nature, timing, and extent of the direction and supervision of individuals assisting in the engagement quality review and the review of their work

## Impairment

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- The firm should establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances

## Completion of EQR

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- The engagement quality reviewer should determine whether the requirements in SQMS 2 with respect to the performance of the engagement quality review have been fulfilled and whether the engagement quality review is complete
  - If so, the engagement quality reviewer should notify the engagement partner that the engagement quality review is complete

## Documentation

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- The firm should establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review
- The firm should establish policies or procedures that require documentation of the engagement quality review and require that such documentation be included with the engagement documentation

## Effective Date

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- For audits or reviews of financial statements for periods beginning on or after December 15, 2025
- For other engagements in the firm's accounting and auditing practice beginning on or after December 15, 2025

# SAS 147



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## SAS 147

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### **Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations**

- Issued: June 2022
- Background:
  - Ethics interpretation changes
    - Responding to Noncompliance With Laws and Regulations (ET sec. 1.180.010 and ET sec. 2.180.010 )

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## Inquiry of Predecessor Auditor

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- If management authorizes the predecessor auditor to respond to the auditor's inquiries, the auditor should inquire of the predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement, including
  - Identified or suspected fraud involving
    - Management,
    - Employees who have significant roles in internal control, or
    - Others, when the fraud resulted in a material misstatement in the FS
  - Matters involving noncompliance or suspected noncompliance with laws and regulations that came to the predecessor auditor's attention during the audit, other than when matters are clearly inconsequential

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## Interplay with Ethics

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- The predecessor auditor has a responsibility to respond to the auditor's inquiries on a timely basis and on the basis of known facts, absent unusual circumstances and unless prohibited by applicable law
- However, if the predecessor auditor decides, due to impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to fully respond to the auditor's inquiries, the predecessor auditor should clearly state that the response is limited
  - Such unusual circumstances are expected to be rare

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## Documentation

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- When the engagement is accepted, the auditor should document
  - The inquiries of the predecessor auditor and
  - The results of those inquiries

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## Effective Date

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- For audits of financial statements for periods beginning on or after June 30, 2023

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# SAS 149



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## SAS 149

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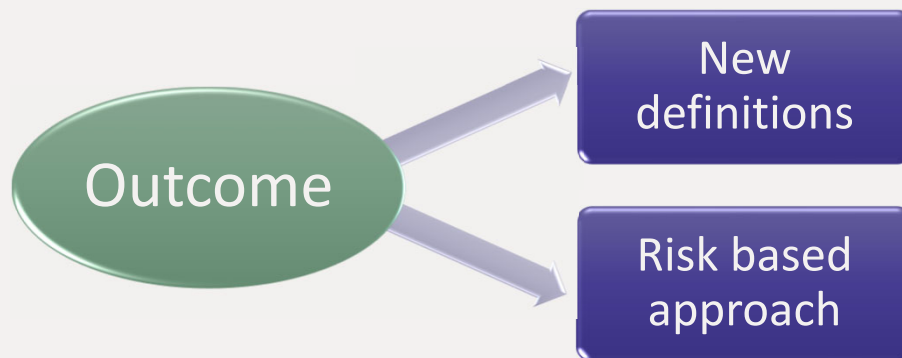
### **Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**

- Issued: March 2023
- Background:
  - Convergence with IAASB

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## Background

- Common Audit Deficiency in Peer Review



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## Definition

### Component

- An entity, business unit, function, or business activity determined by the group auditor for purposes of planning and performing audit procedures in a group audit
- The group auditor uses professional judgment in determining components at which audit work will be performed

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## Groups & Components

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- Group financial statements include the financial information of more than one entity or business unit through a consolidation process

A group may be organized in various ways

- Parent / Sub
- JVs
- Equity method investments
- Branches/Divisions
- Functions/Business Activities

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## Audit Approach

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- The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed RMM of the group financial statements
  - Use professional judgment in determining the components at which the audit work will be performed
  - Based on the group auditor's understanding of the group and its environment, and other factors
    - i.e., the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and control

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## New Definition

### Referred-To Auditor

- An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements
- A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit

## Revised Definition

### Component Auditor

- An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.

## Scalability

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- Applies to all group audits, regardless of size or complexity
  - Intended to be applied in the context of the nature and circumstances of each group audit

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## Update

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- Introduces a risk-based approach to planning and performing a group audit
  - Requires use of professional judgment in determining the components for which procedures would be performed

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## Overall Group Audit Strategy

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- The group auditor should establish, and update as necessary, an overall group audit strategy and group audit plan
- The group auditor should determine:
  - The components at which audit work will be performed
  - The resources needed to perform the group audit engagement, including the nature, timing and extent to which component auditors are to be involved
  - The components for which, if any, the auditor's report on the group financial statements will reference the audit of a referred-to auditor
  - For components that are accounted for by the equity method, whether to use audited FS as audit evidence regarding the noncontrolled entity's financial results

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## Single Audits

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- Adds 2 paragraphs to AU-C 935 around use of other auditors
  - Makes AU-C 600 not applicable in its entirety to Single Audits

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## Effective Date

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- For audits of group financial statements for periods ending on or after December 15, 2026

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## Also Issued

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- SQMS No. 3, Amendments to QM Sections 10, A Firm's System of Quality Management, and 20, Engagement Quality Reviews
  - Conforming amendments

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## 3, 2, 1 Method of Applying New Knowledge

**3** things I learned

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**2** actions to apply what I learned

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**1** way I will share my learning

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## Let's Keep in Touch



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# What Questions Do You Have?



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