SQCS 7

SQCS7, released in October 2007, becomes eligible for testing on the July, 2009 exam. The pages below should replace the section on Quality Control Standards in your text.

QUALITY CONTROL STANDARDS

I. APPLICABILITY

The AICPA Code of Professional Conduct requires firms providing auditing, attestation, and accounting and review services to adopt a system of quality control. A quality control system consists of policies and procedures designed, implemented, and maintained to ensure that the firm complies with professional standards and appropriate legal and regulatory requirements, and that any reports issued are appropriate in the circumstances. Statements on Quality Control Standards (SQCS) are issued by the Auditing Standards Board to provide guidance with respect to quality control.

II. ELEMENTS

The six interrelated elements of quality control are:

- Human resources
- Engagement/client acceptance and continuance
- Leadership responsibilities
- Performance of the engagement
- Monitoring
- Ethical requirements

PASS KEY

Help me maintain good quality in my accounting and auditing practice.

A. HUMAN RESOURCES

1. This element encompasses criteria for recruitment and hiring, determining capabilities and competencies, assigning personnel to engagements, professional development, and performance evaluation, compensation, and advancement.
2. Personnel management policies and procedures should be established to provide the firm with reasonable assurance that:
   a. Those hired possess the appropriate characteristics to enable them to perform competently.
   b. Engagement partners possess the competencies necessary to fulfill engagement responsibilities.
   c. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
   d. Personnel participate in continuing professional education and other professional development activities.
   e. Personnel selected for advancement have the qualifications necessary to fulfill the responsibilities to be assumed, and performance evaluation, compensation, and advancement procedures provide appropriate recognition and reward.

3. Examples include:
   a. Requiring timely identification of staffing requirements.
   b. Planning for the total personnel needs of all the firm's professional engagements.
   c. Requiring a background check on new personnel.
   d. Requiring supervisors to prepare performance evaluations.
   e. Requiring personnel to attend training.
   f. Consideration of continuity and periodic rotation of personnel.
   g. Consideration of opportunities for on-the-job training.

B. ENGAGEMENT/CLIENT ACCEPTANCE AND CONTINUANCE

1. Policies and procedures should be established for deciding whether to accept or continue a client relationship and whether to perform a specific engagement. These policies and procedures should provide the firm with reasonable assurance that the firm:
   a. Minimizes the likelihood of association with a client whose management lacks integrity.
      (1) The firm should consider the reputation of the client, the nature of the client's operations, and the client's overall attitude.
   b. Undertakes only those engagements that the firm can reasonably expect to complete with professional competence.
      (1) The firm must have sufficient personnel with appropriate knowledge and experience, or personnel who can attain appropriate competency levels. Specialists should be available if needed.
   c. Can comply with legal and ethical requirements.
      (1) Potential conflicts of interest should be identified and evaluated.

2. The firm should document how any issues with respect to the acceptance and continuance decision were resolved.

3. The firm should obtain an understanding with the client regarding the nature, scope, and limitations of the services to be provided.

4. Examples include:
   a. Reviewing the financial statements and credit rating of the proposed client.
b. Inquiring of third parties as to the reputation of the proposed client.
c. Evaluating the firm’s ability to service the client properly.
d. Periodically reevaluating clients for continuance.

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM

1. The firm's leadership bears ultimate responsibility for the firm's quality control system, and should create a culture that emphasizes quality. The "tone at the top" influences attitudes throughout the firm.
   a. Quality should be emphasized over commercial considerations.
   b. Performance evaluation, compensation, and advancement should demonstrate a commitment to quality.
   c. Sufficient resources should be devoted to developing, communicating, and supporting the quality control system.
   d. Those with operational responsibility for the quality control system should have appropriate experience, ability, and authority.

D. PERFORMANCE

Policies and procedures should be established to:

1. Achieve a consistently high level of performance. This may be accomplished by using written or electronic manuals, software tools, standardized documentation, and/or guidance materials for specific industries or specific types of subject matter.
2. Ensure that the engagement is appropriately supervised, and that work is appropriately reviewed.
3. Maintain confidentiality, safe custody, integrity, accessibility, retrievability, and retention of engagement documentation. Requirements imposed by specific laws or regulations should be addressed.
4. Allow consultation with experts inside or outside the firm with respect to complex, unfamiliar, unusual, difficult, or contentious issues.
5. Provide a means to resolve differences of opinion.
6. Establish and follow guidelines with respect to determining when an engagement quality control review should be performed.
   a. Care should be taken to appoint an appropriate (e.g., independent, technically competent) quality control reviewer.
   b. The engagement partner remains responsible for the engagement, despite the involvement of an engagement quality control reviewer.
   c. Engagement quality control review procedures should include an objective evaluation of judgments, conclusions, reports, and documentation.
   d. The engagement quality control review should be appropriately documented.
   e. The review should be completed before the engagement report is released.
7. Examples include:
   a. Designating individuals with expertise in matters related to the SEC.
   b. Referring questions to the appropriate group in the AICPA or state society.
   c. Developing and using standard audit forms, checklists, and questionnaires.
d. Establishing procedures for reviewing engagement documentation and reports.

e. Using passwords or other means of restricting access to engagement documentation.

E. MONITORING

1. Policies and procedures should be established to provide the firm with reasonable assurance that its quality control system is relevant, adequate, operating effectively, and complied with in practice.

   a. Monitoring involves an ongoing consideration and evaluation of the design and effectiveness of the quality control system.

   b. Monitoring helps the company determine whether:

      (1) The firm has complied with professional standards and legal/regulatory requirements.

      (2) The quality control system has been designed appropriately and implemented effectively.

      (3) The quality control system has operated effectively in ensuring that reports issued are appropriate.

   c. Monitoring should be performed by qualified individuals.

   d. A partner (or someone with appropriate experience and authority) should bear responsibility for the monitoring process.

2. Monitoring procedures include the performance of engagement quality control reviews, post-issuance reviews of engagement documentation, and inspections (internal or external) of a selection of completed engagements. Specific monitoring procedures include:

   a. Review of administrative records, working papers, reports, and financial statements.

   b. Discussions with firm personnel, including communication with management.

   c. Summarization of findings, and determination of corrective actions to take.

   d. Assessment of the firm's guidance materials, and compliance with firm guidelines.

   e. Peer review conducted under AICPA standards, which may substitute for some a firm's inspection procedures. (See item 5 below.)

   f. A "wrap-up" or second partner "preissuance" review of the audit documentation by a partner not otherwise involved in the audit. The Sarbanes-Oxley Act requires such review for every public company audit report. The purpose of this review is to focus on the fair presentation of the financial statements in conformity with generally accepted accounting principles.

3. The firm should take appropriate further action to address deficiencies, complaints, and allegations of noncompliance.

4. Monitoring procedures should be documented, including evaluation of deficiencies noted and corrective actions taken.
5. Peer Review

(1) Self-Regulation
Peer review occurs when one CPA firm reviews another CPA firm's compliance with its quality control system. A CPA firm that is a member of the AICPA must have a peer review every three years, in order to maintain membership in the AICPA. The firm being reviewed can select the review firm or may ask the AICPA or state society of CPAs to select a review team.

(2) Purpose
The purpose of peer review is to determine and report whether the CPA firm being reviewed has developed adequate policies and procedures for the elements of quality control and is following them in practice.

(3) Results
Upon completion of the peer review, a report is issued with conclusions and recommendations. A firm that fails to take corrective actions (where necessary to correct deficiencies) is subject to sanctions.

F. ETHICAL REQUIREMENTS

1. Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.
   a. Independence encompasses impartiality and freedom from any obligation to or interest in the client.
   b. Independence requirements should be communicated to firm personnel.
   c. Threats to independence should be identified and evaluated, and appropriate action should be taken.
   d. At least annually, all firm personnel subject to independence requirements should confirm their independence in writing (paper or electronic form).
   e. The firm's quality control system should address requirements for rotation of personnel.

2. Examples include:
   a. Maintaining records showing which personnel were previously employed by clients or have relatives holding key positions with clients.
   b. Notifying personnel as to the names of audit clients publicly held.
   c. Confirming with staff that prohibited relationships do not exist.
   d. Emphasizing independence of mental attitude in training and supervision.

3. The Sarbanes-Oxley Act (applying to audits of issuers) contains certain provisions that must be followed to maintain auditor independence.
   a. Audit firms may not perform the following nonaudit services contemporaneously with the audit: bookkeeping, financial information systems design/implementation, appraisal/valuation services, actuarial services, internal audit outsourcing services, management/human resource functions, investment services, legal services, and expert services unrelated to the audit.
(1) Other non-audit services (e.g., tax services) may be performed if they are pre-approved by the audit committee and disclosed to investors in periodic reports.

(2) Proposed tax services and related fees must be communicated to the audit committee in writing. The potential effects of the services on the firm's independence should also be discussed with the audit committee, and this discussion must be documented.

b. Audit firms may not audit public companies whose CEO, CFO, etc., is also a previous employee of the accounting firm who worked on the audit during the preceding year.

c. The lead partner and the reviewing partner must rotate off the audit every five years.

d. Audit firms may not enter into contingent fee arrangements (i.e., those in which the amount of the fee is dependent upon the results of the services performed) with audit clients.

e. Audit firms may not provide to audit clients any tax services related to certain confidential or aggressive tax transactions.

f. Audit firms may not provide any tax services to corporate officers of audit clients, or to family members of corporate officers.

PASS KEY
Routine tax return preparation, tax planning, and employee personal tax services are not prohibited by the Sarbanes-Oxley Act.

III. OTHER CONSIDERATIONS

A. NATURE AND EXTENT OF QUALITY CONTROL
The nature and extent of a firm's quality control policies and procedures depend on:
1. The firm's size;
2. Its organizational structure;
3. The nature and complexity of its practice;
4. The degree of operating autonomy allowed its personnel and its individual offices; and
5. Cost-benefit considerations.

B. COMMUNICATION
Quality control policies and procedures should be communicated to firm personnel.
1. Written communication is not required, but it can be helpful.
2. Communication should include procedures and objectives, and should emphasize personal responsibility and the importance of feedback.

C. DOCUMENTATION
The firm should document its quality control policies and procedures.
1. The extent of documentation may vary based on the size, structure, and nature of the firm.
2. Documentation should be retained for a sufficient period of time.
D. RELATIONSHIP BETWEEN AUDITING STANDARDS AND QUALITY CONTROL STANDARDS

1. GAAS vs. Quality Control Standards
   a. Generally accepted auditing standards and quality control standards are not synonymous. GAAS relate to the conduct of each individual audit engagement, whereas quality control standards relate to the conduct of all professional activities of the firm's practice as a whole.
   b. The quality control standards of a firm affect both the performance of each audit and the performance of the audit practice as a whole.

2. Quality Control Deficiencies
   a. While an effective system of quality control is conducive to complying with GAAS (or other professional standards), deficiencies in or noncompliance with a firm's quality control standards do not necessarily indicate a lack of compliance with GAAS (or other professional standards) for any one specific engagement.
   b. Deficiencies in quality control for an individual engagement does not necessarily imply that the firm's quality control system overall is insufficient.