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ASB Proposes Major Changes to Quality Control Standards

The Auditing Standards Board issued an exposure draft in February 2021 of three interrelated quality control standards that are intended to make important changes to how firms manage engagement quality in their practices.

- Proposed Statements on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*.
- Proposed Statements on Quality Management Standards (SQMS) 2, *Engagement Quality Reviews*.
- Proposed Statement on Auditing Standards, *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards* (QM SAS).

If issued as final, proposed SQMS 1 will supersede SQCS 8 and the proposed QM SAS will supersede AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. Various other AU-C sections would also be amended by the proposed guidance, as would AT-C 105.

These proposed changes are the first major changes to the quality control standards since 2008 when SQCS 8 was issued. The ASB issued the exposure draft to improve engagement audit quality and to converge with quality control standards issued by the International Auditing and Assurance Standards Board in December 2020.

Following are highlights of the proposed standards.

SQMS 1

SQMS 1 would supersede SQCS 8 and proposes a new risk-based approach for how firms address their responsibility to design, implement, and operate a system of quality management for their accounting and auditing practices. The new approach is designed to focus attention on risks that impact engagement quality and to improve scalability by tailoring the quality management system to a firm's size, engagements, and services performed.

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As proposed, a firm's system of quality management would have these eight integrated components, compared with six elements under SQCS 8:

1. Risk assessment.
2. Governance and leadership.
3. Relevant ethical requirements.
4. Acceptance and continuance of client relationships and specific engagements.
5. Engagement performance.
6. Resources.
7. Information and communication
8. Monitoring and remediation.

A significant proposed change related to monitoring affecting small firms is that neither engagement team members nor the engagement quality reviewer are allowed to perform inspections of engagements they are involved with.

There are also proposed changes to how firms establish policies or procedures for engagements subject to engagement quality reviews, along with several new definitions.

If issued as proposed, firms would have to design and implement systems of quality management that comply with proposed SQMS 1 by December 15, 2023, and perform the required evaluation of the system of quality management within one year following that date.

SQMS 2

SQMS 2 would apply to all engagements requiring performance of an engagement quality review. It's a separate standard addressing engagement quality review and reviewers, and it includes proposed requirements for appointment and eligibility of the engagement quality reviewer and performance and documentation of the review. The reviewer requirements are more robust than those in SQCS 8, including the requirement that there be a two-year "cooling-off period" before a former engagement partner can act as the engagement quality reviewer on their former engagement.

If issued as proposed, SQMS 2 would be effective for audits or reviews of financial statements for periods beginning on or after December 15, 2023, and other accounting and auditing engagements beginning on or after December 15, 2023.

Proposed QM SAS

The proposed QM SAS emphasizes the engagement partner's overall responsibility and accountability for managing and achieving quality and how the partner manages quality at the engagement level while leveraging the firm's system of quality management. If issued as proposed, the proposed QM SAS will supersede AU-C 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards,* and it will amend various AU-C sections and AT-C 105. The QM SAS would be effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2023.

Practical Consideration:

The ASB's comment period on these proposals ends June 11, 2021. The proposed guidance is available on the AICPA's website at **www.aicpa.org**.

New Attestation Standard on Direct Examinations

In September 2020, the AICPA issued SSAE 21, *Direct Examination Engagements*. SSAE 21 adds a new section to the attestation standards, AT-C 206, that creates a new form of examination which enables practitioners to perform an examination engagement and express an opinion by measuring or evaluating the *underlying subject matter* against criteria. The responsible party/client doesn't need to first measure or evaluate the underlying subject matter against the criteria themselves or provide an assertion about whether the underlying subject matter is in accordance with the criteria, as is required in a traditional examination engagement. However, the responsible party is still responsible for the underlying subject matter and the suitability and appropriateness of the criteria.

This new service will permit practitioners to report to users on new nonfinancial subjects for entities that may not have the expertise in-house to measure or evaluate those subjects themselves. Examples include compliance with contract terms, licensing agreements, or regulatory requirements. It will also allow smaller and start-up companies to obtain examination reports. The standard doesn't apply to examinations of prospective financial information or pro forma financial information covered by other attestation standards.

SSAE 21 amends AT-C 105, *Concepts Common to All Attestation Engagements*, and supersedes AT-C 205, changing it to *Assertion-Based Examination Engagements* to differentiate it from AT-C 206. Both direct examinations and assertion-based examinations provide reasonable assurance and result in an examination report. This new guidance is part of the AICPA's broader effort to revise the 2017 Clarified Attestation Standards, and is effective for reports dated on or after June 15, 2022. Early implementation is permitted.

Practical Consideration:

SSAE 21 is available on the AICPA's website at **www.aicpa.org**. and on Checkpoint at **checkpoint.riag.com**.

FASB Approves Alternative Goodwill Impairment Assessment

At its February 2021 virtual meeting, the FASB voted to approve the proposed Accounting Standards Update, *Intangibles—Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events*. They directed the FASB Staff to draft a final ASU for vote, expected to be issued in March as ASU 2021-03.

The proposal gives private companies and nonprofit organizations the option to perform the goodwill impairment assessment at their annual reporting date, rather than having to do the assessment as events occur during the year. Under GAAP, goodwill must be tested for impairment when there is a triggering event that indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying value (including goodwill). Triggering events can occur in interim periods, which would require an evaluation to be performed and impairment to be measured by private companies and nonprofit organizations throughout the year even if they don't prepare financial statements other than on an annual basis.

This project was added to the FASB's technical agenda in November 2020 to consider less costly and complex alternatives for assessing goodwill impairment triggering events. An exposure draft of the proposed ASU was issued in December, with comments due in January.

This proposal was one way the FASB attempted to provide private companies more flexibility in financial reporting during the COVID-19 pandemic. The uncertainties about the pandemic and related economic downturn created negative effects on earnings and cash flows for many entities and made projections and valuations related to goodwill impairments much more challenging.

The Board affirmed the following:

- The scope of the proposed ASU is limited to private companies and nonprofit organizations accounting for goodwill impairment under FASB ASC 350-20.
- Entities can adopt the amendments on an ongoing basis and aren't limited to a specific time period for adoption.
- The amendments can be adopted through a one-time transition election and applied prospectively, with no requirement to demonstrate that the accounting change is preferable.
- There are no additional disclosures required because of the amendments. The existing disclosures under FASB ASC 350-20 must be provided.

In addition, the FASB expanded the scope of the accounting alternative to give private companies and nonprofit organizations the option to perform the goodwill impairment triggering event assessment at the reporting date anytime they report financial information, including interim period reporting. The proposal had been limited to private companies and nonprofit organizations that report goodwill only on an annual basis.

Practical Consideration:

The project update for the proposed ASU is available on the FASB's website at **www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176175678353**.

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There is another separate, broader project underway at the FASB on the subsequent accounting for goodwill and certain identifiable intangible assets, including potential straight-line amortization of goodwill over ten years, that applies to all entities. FASB staff is continuing research and outreach related to this project.

Practical Consideration:

Information on this project is available on the FASB's website at **http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176171566054**.