

Benefits of QC Monitoring

Under AICPA Statement on Quality Control Standards (SQCS) No. 7

<<http://www.aicpa.org/download/members/div/auditstd/QC-00010.PDF>>, an effective system of quality control (QC) provides reasonable assurance that a firm's accounting and auditing practice and its personnel comply with professional standards, applicable laws and regulations, and issue appropriate attest reports. The primary elements of that system are:

1. Leadership responsibilities for quality within the firm (i.e., "tone at the top")
2. Relevant ethical requirements
3. Acceptance and continuance of client relationships and specific engagements
4. Human resources
5. Engagement performance
6. Monitoring



The sixth element, monitoring, tests the firm's QC policies and procedures to ensure they are designed and working properly and are still appropriate. To be considered effective and comprehensive, monitoring controls should evaluate four key questions:

- (1) Are the QCs (policies and procedures) addressing each element in the system suitably designed?
- (2) Do professionals understand the firm's policies and procedures?
- (3) Are the policies and procedures being applied properly?
- (4) Are the policies and procedures still appropriate given changes affecting the firm?

The results of monitoring assessments drive management's decisions on whether or not the system needs improvement, allowing the firm to correct deficiencies and continually enhance its QC system. Because CPA firms usually view QC monitoring as a compliance exercise, its significant benefits can be overlooked. As a firm and the people within it change, policies and procedures also need to change; controls that monitor QC provide the impetus for these needed changes, whether they are small tweaks or significant changes to the QC system.

Using a brief case study, this article illustrates the benefits of QC monitoring. The case study will focus on certain procedures that monitor a

Continued on page 2

ABOUT THE AUTHOR & PUBLISHER

Cathy Allen, founder of **Audit Conduct, LLC**, develops courses and customized training on professional ethics and auditor independence for CPA firms, professional organizations, and other stakeholders of the accounting profession. She also helps CPA firms enhance their quality controls over ethics and independence compliance.

Continued from page 1

fictional firm's compliance with the second element of a QC system, *relevant ethical requirements.*

CASE STUDY

Warner & Townsend, CPAs (W&T) is a regional, mid-sized accounting firm with ten offices. W&T's main office is in Tampa, Florida where co-founders Charles Warner and Sheila Townsend serve as co-managing partners. The remaining offices are located in Georgia, Tennessee, and the Carolinas. W&T has sixteen partners and 180 full-time professional staff. W&T provides assurance, tax, and advisory services to a wide array of clients, mostly closely-held companies, employee benefit plans, charitable organizations, and governmental bodies. Financial statement audits make up approximately 40% of the firm's assurance practice. Sheila has primary responsibility for the firm's QC system.

Exhibit 1 describes some of the policies and procedures that W&T has implemented to help ensure compliance with relevant ethical requirements, i.e., independence. Exhibit 2 describes some of the monitoring procedures W&T has implemented to evaluate its policies and procedures in this area. (The exhibits describe only a sampling of the policies and procedures a firm could implement under SQCS No. 7.)

EXHIBIT 1: Independence Policies and Procedures

1. Nonaudit service (NAS) providers should supply information to the audit partner, which allows the partner to evaluate the potential impact of the NAS on the firm's independence and approve or reject the NAS proposal. This action should take place before a new NAS engagement is accepted.
2. The engagement team should ensure that the scope and nature of NAS provided to the client comply with Firm Policy, i.e., AICPA *Code of Professional Conduct*, and, if applicable, the rules of other regulators, e.g., the Government Accountability Office (GAO).
3. Before providing NAS to the client, the engagement team should reach an understanding with the attest client about the purpose, scope, and nature of the services and the team's and the client's respective responsibilities. That information should be documented in the firm's NAS engagement letter and retained in the NAS workpapers.
4. Engagement teams should consult with the appropriate parties on independence matters as needed and/or required by W&T policy. Consultations should be documented thoroughly and included in the attest engagement workpapers. Documentation should show that all matters under consideration were satisfactorily reviewed and approved.

EXHIBIT 2: Monitoring Procedures

Annual Inspections

- Sheila selected a cross-section of W&T's recently completed assurance engagements for inspection, using criteria that:
 - Favored selection of higher risk engagements (such as first year engagements or single audits performed under OMB Circular A-133), and
 - Ensured that engagements performed by all partners and managers in the assurance practice are reviewed at least once every three years.
- Sheila also selected experienced auditors (primarily, partners and managers) from each office of the firm to inspect engagements conducted by personnel in other W&T offices. Inspection team members had no previous involvement in the engagements they were scheduled to inspect.
- Each inspection team's primary goal was twofold: to assess whether (i) each engagement was performed in accordance with the firm's policies and procedures and (ii) the appropriate reports were issued.
- To assess independence compliance, the inspection team:
 - Interviewed engagement staff to gauge their understanding of the firm's policies and procedures.
 - Inquired how the engagement team determined that the firm was

Continued on page 3

Continued from page 2

EXHIBIT 2: Monitoring Procedures (continued)

independent of their client and evaluated whether the team reached the appropriate conclusion.

- Examined time and billing records to see what NAS services were provided to the client, and if relevant, affiliates of the client.
- Reviewed evidence of compliance with independence policies and procedures, e.g., when NAS services were provided, examined documentation of the understanding reached between client management and the NAS team.

Training Program Evaluation

To attain an understanding of the firm's independence training, Sheila:

- Reviewed participant evaluations of in-firm training sessions on independence.
- Interviewed participants about their experiences in internal and external training events involving independence.
- Evaluated independence training materials to determine whether they were current, comprehensive, and relevant.

Based on the results of inspections, Sheila evaluated whether independence training appeared to be adequate (e.g., were engagement teams aware of the independence policies and how to apply them; if certain policies or procedures were poorly understood, did the firm include these subjects in training?).

Monitoring Report

- Sheila prepared a monitoring report which summarized the monitoring procedures performed and the conclusions drawn as a result of those procedures.
- This year, several inspections cited a failure to comply with Policy #4 (Exhibit 1), i.e., *Consultations should be documented thoroughly and included in the attest workpapers. Documentation should show that all matters under consideration were satisfactorily reviewed and approved.* Since this finding was frequently cited, Sheila identified it as a deficiency in the firm's QC system. The monitoring report also outlined a high-level plan for addressing this deficiency, noting who would be responsible for determining and implementing an appropriate solution.

Communication of the Monitoring Results

- Sheila shared the monitoring report with the firm's partners and provided inspection results to other appropriate staff (e.g., managers involved in the engagements that lacked sufficient documentation for independence consultations).
- Omitting engagement details from the report, Sheila shared a high-level summary of the monitoring report with all of the firm's personnel.

BENEFITS OF QC MONITORING

This case study illustrates the benefits that W&T derives from the feedback loop embedded in QC monitoring. Briefly, these benefits are:

Preparedness. W&T used the results of its monitoring procedures to identify weaknesses in compliance with independence policies. Among other things, this helps the firm enhance its culture so that it identifies and resolves independence issues more readily and will be better prepared for upcoming regulatory inspections, peer reviews, and similar events.

Informed Decision-Making. Through QC monitoring, W&T can make informed decisions about training needs and other necessary enhancements to its QC system. For example, inspection teams noted that several teams failed to prepare adequate documentation of consultations on the resolution of independence matters. W&T's Training Director and management will address this deficiency by evaluating the scope of the issue, amending training sessions and communications, and implementing other appropriate activities to resolve the deficiency (e.g., clarify policies or procedures). Making better QC decisions not only improves

Continued on page 4



Continued from page 3

compliance with independence requirements but can also help enhance the firm's internal communications in other areas.

Enhanced Adaptability. Focusing on continuous improvement of the QC system makes the firm's operations more fluid, helping it to adapt more easily when changes (such as mergers, acquisitions, new standards, or regulatory requirements) occur. In the event of a regulatory review or investigation, W&T could address issues in an effective manner because a structure (i.e., people and processes) focused on QC monitoring already exists and is functioning efficiently.

Increased Profitability. Spending firm resources on non-effective (failing) policies and procedures wastes time and money and frustrates employees (i.e., when expected results do not materialize). Redirecting costs towards more effective policies and procedures results in better compliance and reduces inefficiencies and dissatisfaction with the QC system. These tangible and intangible benefits lead to better profitability.

Improved Recruiting, Retention, and Morale. Firms that maintain their reputation for quality benefit from improved staff and partner recruiting, retention, and morale.

Partners and staff who perform high quality work and set high ethical standards for themselves will naturally be drawn to the firm, while those who do not, either will not seek opportunities with the firm, or will be more likely to leave.

Quality: the Bottom Line. By making the most of its QC monitoring program, W&T continuously improves the quality of its services, helping it maintain its excellent reputation among the public, including: clients, prospective clients, peers, investors, students, prospective employees, regulators, and other members of the business community. ■