August 25, 2025

To our peer review clients:

Annually, we make an effort to highlight recent changes in professional standards for our peer review clients. We hope what follows is helpful in your accounting and auditing practice.

Quality Management Standards – Effective Now

As of December 15, 2025, the AICPA's new Quality Management (QM) Standards are fully effective. If your peer review year spans this implementation date, you can't wait until your peer review year end to implement the new QM standards. Your system of quality management (SOQM) must comply with the new standards no later than December 15, 2025.

The QM Standards require significant revisions to the quality control systems of any CPA firm performing audits, reviews, compilations, or other attest engagements. Although the preparation service is a non-attest service, the new QM standards also apply to firms that have restricted their accounting practice to the preparation service.

This is important: *Under the QM Standards, your firm's quality management document will be designed by you specifically for your firm in response to your risk assessment. You will need to document the risk assessment supporting the policies and procedures in your quality management document. This documentation was not required under the old quality control standards.*

There are a family of standards issued in connection with the new QM Standards including three separate statements on the quality management standards themselves; SAS No. 146 on the auditor's responsibilities for quality management; and SSARS No. 26 amending the standards for review, compilation and preparation engagements. The first two statements on the QM standards require the most attention:

- *AICPA Statement on Quality Management Standards* (SQMS) No. 1 requires that a firm with an accounting or auditing practice design, implement, and operate a system of quality management. This new quality management standard replaces the existing standard: *AICPA Statement on Quality Control Standards* (SQCS No. 8). SQMS No. 1 requires your system of quality management (SOQM) have eight components. Most of these components carry over from the old quality control standards, but the first one is new and requires special attention. This is the risk assessment process. The QM standards require the firm to apply a risk-based approach in designing, implementing, and operating the components of its SOQM.

- *AICPA Statement on Quality Management Standards* (SQMS) No. 2 addresses the appointment and eligibility of the engagement quality reviewer and performance of engagement quality reviews (EQR) by a qualified party not part of the engagement team. SQMS No. 2 changes some terminology but builds on the existing requirements for independent pre-issuance reviews, formerly known as Engagement Quality Control Reviews (EQCR), contained in SQCS No. 8.

Implementing SQMS No. 1 will be a relatively heavy lift for most CPA firms, particularly for smaller firms that may be primarily a tax practice.

SQMS No. 1 requires you to consider how you manage risk in your accounting and auditing practice and based on those considerations you will need to prepare properly tailored policies and procedures. Moreover, you will need to document the risk assessment supporting those policies and procedures, documentation that was not required under the old quality control standards.

Under the old quality control standards, many firms would utilize a standard template, perhaps provided to them by a practice aid or by a CPE instructor, for use as their quality control document. Under the new quality management standards, the quality management document will be designed by you specifically for your firm in response to your risk assessment.

This does not mean you have to throw out your old quality control document, which might serve as a starting point. Many of the policies and procedures in your old quality control document will carry over.

The AICPA issued a practice aid to help you design your SOQM. There are two versions of the practice aid, one for sole proprietors, and another for small to medium sized partnerships, that you will find at:

https://www.aicpa-cima.com/resources/download/practice-aid-quality-management

Within the practice aid, whether for sole proprietor or for partnership, the most important tool is the "Example Risk Assessment Template." You can use this Excel template to document your risk assessment process. Also useful is the guide "Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice," particularly Chapter 3, entitled "Library of Quality Objectives, Potential Risks, and Potential Responses," which provides numerous example responses to identified risks.

However, if you are looking for a ready-made quality management document, the AICPA has not provided one. This makes sense because of the eight components required for your SOQM under the QM standards, the first one is risk assessment. If you simply adopt a ready-made QM document, you have not performed the risk assessment required under the standard.

The AICPA Excel template, when completed, cannot be deemed your Quality Management Document (or "Quality Control Document" using the old terminology). The AICPA Excel template on its own provides only partial documentation of your SOQM. The Excel template addresses six of the eight elements required under the new QM Standards. The two missing components are 1) the policies and procedures for risk assessment and 2) those for monitoring and remediation. You need to create a quality management document that formalizes and fleshes out the responses to quality risk summarized on the Excel template and be sure to address the additional two components.

SQMS No.1 explicitly requires that firm leadership take ultimate responsibility for the firm's system of quality management. That means the managing partner has final accountability for the firm's QM system, even if the managing partner is a tax partner. In that case, the managing partner would delegate operational responsibility for the QM system to a qualified individual or individuals, while retaining oversight. This oversight by the managing partner needs to be documented.

This is important: *The standards implementing Quality Management at the engagement level, such as SAS No. 146 on the auditor's responsibilities for quality management, and SSARS No. 26 amending the standards for review, compilation and preparation engagements, do not go into effect until the year following the December 15, 2025 effective date for the QM standards. In other words, SAS No. 146 and SSARS No. 26 are effective for engagements with periods beginning on or after December 15, 2025. Therefore, you may complete calendar year 2025 engagements under the old quality control standards.*

New Peer Review Standards

The AICPA quality management standards and the peer review standards are two different things. The AICPA recently issued *Peer Review Standards Update (PRSU) No. 2*, which aligns the peer review standards with the new QM standards.

If you have an audit practice and are undergoing a system peer review, expect your peer reviewer to ask to see documentation of your risk assessment supporting the policies and procedures in your new quality management document.

If you do not have an audit practice, and therefore undergo an engagement peer review, the engagement peer review will continue to be focused on the engagements, rather than on your QM system. As in the past, the peer reviewer on an engagement peer review will not ask to see your written policies and procedures for quality management.

You might ask then whether you need a quality management document if you do not conduct audits and therefore are not subject to a system peer review. The short answer is that you will need to comply with the new quality management standards even though your peer reviewer will not be testing compliance.

New GAO Yellow Book

The 2024 revision to the Yellow Book, which is effective for engagements beginning on or after December 15, 2025, incorporates the new AICPA quality management standards.

Other Governmental Matters

GASB No. 102, Certain Risk Disclosures, is effective for years ended June 30, 2025, and may require a footnote on concentrations or constraints for local governments. For example, if the local government relies on a small number of property owners for a significant portion of its property tax revenue, that would be a concentration. If the local government has issued significant debt, such that the total approaches the statutory legal debt limit, that would be a constraint. The disclosure is not required unless events associated with the concentration or constraint have occurred or are more than likely to occur within 12 months of the date the financial statements are issued.

If you're performing Oregon municipal agreed upon procedures engagements (AUPs), the OSCPA AUP toolkit remains a helpful resource at orcpa.org/gov-resources. On these engagements, you need two management representation letters, the fiscal affairs representation required by the Oregon Administrative Rules as well as the management representation letter required by the AICPA's standards for AUP engagements.

External Confirmations

The AICPA issued an exposure draft in February 2025 that would mandate confirmation of cash and cash equivalents in an audit engagement. If you do not confirm, you would have to document the basis for that decision. The comment period closed on June 30, 2025. As proposed, the effective date would be for audits of financial statements with periods ending on or after December 15, 2027.

Lease Accounting (ASC 842)

Firms continue to struggle with ASC 842, particularly with disclosures. Here are two sample disclosures for common scenarios that may help:

<u>Sample Disclosure – Lessor's Election of Practical Expedient:</u>

> The company leases a portion of its office building to two tenants with lease terms through May 2029. Tenants have access to common lighting, entry ways, and other aspects of the building as well as entitlement to certain parking. As a practical expedient, the company has selected to report the common use aspects of the leased facilities as part of rental income.

<u>Sample Disclosure – Lessee's Short-term Lease Election:</u>

> Operating leases with an initial term of 12 or fewer months and the lack of a purchase option that the company is reasonably certain to exercise are short-term leases. It is the company's policy to not recognize right of use assets and lease liabilities arising from short-term leases for any class of underlying asset. Amounts paid towards short-term leases are included in rent expense as payments are made.

If you are using a risk-free rate to compute the present value for new leases, or if you have a remeasurement event on an existing lease, you can find the rate based on the information provided at this site: Treasury yield curve: treasury.gov yield statistics

Uncertainty Regarding Tariffs

If your client is impacted by tariffs, you may wish to include the following footnote disclosure in the financial statements:

<u>Sample Disclosure – Tariffs:</u>

> The Company's operations may be affected by changes in U.S. trade policy, including tariffs on imported vehicles and parts. Such measures could increase inventory costs, reduce consumer demand, and disrupt supply chains. The outcome and timing of any trade actions remain uncertain. Management continues to monitor development and evaluate mitigation strategies, but cannot guarantee they will offset potential impacts.

Credit Loss Standard (ASC 326)

Now fully effective, ASC 326 continues to be a focus in peer review, but there is some good news to report. With respect to current accounts receivable and contract assets, ASC 326 required you to determine the impact of macroeconomic expectations on the allowance for credit losses. For example, if you expected economic conditions to deteriorate after the balance sheet date, you were supposed to quantify the impact on the allowance for credit losses. Now the good news: the AICPA issued ASU 2025-05 in July 2025 that provides relief, introducing an optional practical expedient that allows the reporting entity to assume that current economic conditions will remain unchanged going forward. The election of the practical expedient should be disclosed in the financial statements. Additionally, non-public entities that elect this practical expedient have the option to make an accounting policy election permitting them to give consideration to actual cash collection activity occurring after the balance sheet date but before financial statements are available for issuance when estimating expected credit losses. For example, the allowance for credit losses related to receivables collected before the entity's financial statements are available to be issued would be zero.

Sample Disclosure – Focus on Practical Expedient and Accounting Policy Elections in First Year:

> The Company elected the practical expedient in ASU 2025-05, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets*, which permits entities to assume that current economic conditions as of the balance sheet date will remain unchanged for the remaining life of current accounts receivable and contract assets arising under the revenue recognition standards. Accordingly, the Company's estimate of expected credit losses on such assets does not incorporate forecasts of future economic conditions. The Company also elected the related accounting policy, available to non-public entities, to consider cash collections on such assets that occur after the balance sheet date but before the financial statements are available to be issued when estimating expected credit losses. The date through which the Company considered subsequent collection activity was May 15, 20X6 [note that the date disclosure is required].

Sample Complete Disclosure – That Includes Practical Expedient and Accounting Policy Elections (Ongoing):

> Accounts receivable is stated at the amount management expects to collect, based on balances that the Company has an unconditional right to receive less management's estimate of amounts that may not be collectible. Adopting the allowed practical expedient and related accounting policy election, the Company develops its estimate of expected credit losses by determining which receivables have been collected between the balance sheet date and the date that the Company has selected to consider subsequent collection activity and by recognizing an allowance for the amounts that are uncollected based on its historical loss rates adjusted for current economic conditions. The allowance at December 31, 20X1 is $75,000. The Company does not require collateral and does not accrue finance charges on past due accounts. The date the Company selected to consider subsequent collection activity was May 15, 20X6 [note that the date disclosure is required].

Take care to use the new terminology (i.e., "credit losses" instead of "bad debts").

If you omit the credit loss disclosure because your clients have minimal write-offs, we recommend you document and disclose the materiality determination.

Revised Income Tax Disclosures (ASC 740)

FASB ASU 2023-09, issued in December 2023, is effective for annual periods beginning after December 15, 2025, with early adoption permitted. It expands income tax disclosure requirements on your C Corporation engagements:

- Requires the amount of income taxes paid be disaggregated by federal and state, and further disaggregated to disclose the amount paid to each individual taxing jurisdiction for which payments are equal to or greater than 5% of total income taxes paid.
- Adds qualitative (not quantitative) disclosure about specific categories of reconciling items, those categories including, among others, the effect of changes in tax laws, and changes in valuation allowances. Also, qualitative disclosure is required for individual taxing jurisdictions where there is a significant difference between the statutory tax rate and the effective tax rate.

Single Audit Threshold Increased

Effective for federal awards issued on or after October 1, 2024, the Single Audit threshold has increased from $750,000 to $1,000,000. This change applies under the revised Uniform Guidance released April 2024.

Additional updates include:

- De minimis indirect cost rate increased from 10% to 15%
- Raised threshold for Type A programs to $1,000,000 for smaller auditees
- Capitalization threshold for equipment raised from $5,000 to $10,000
- Updates to procurement standards and internal control expectations, including cybersecurity requirements

Ensure you are using the revised Uniform Guidance and that you have access to the new Federal Audit Clearinghouse (FAC) under GSA via login.gov.

We're here to help. If you have questions about implementing any of the new standards, or need sample policies, footnotes, or planning tools, please reach out. We appreciate your continued trust.

Very truly yours,

The RBH Group, LLC