February 2014 Peer Review Update

The February Peer Review Update contains two sections:

14-01 Peer Review Alert, and
February 2014 Reviewer Focus.

PEER REVIEW ALERT 14-01 (February 2014)

The Peer Review Alert contains two articles:

1. Coordination of Peer Review and PCAOB Inspection
2. Noncooperation Revisions – Completeness of Peer Review Scope

Coordination of Peer Review and PCAOB Inspection

The Peer Review Board considered recent regulatory changes and the potential for future changes and clarified the following:

- Engagements subject to permanent inspection by the PCAOB are ***excluded*** from the scope of the Peer Review Standards
- Engagements not subject to permanent inspection by the PCAOB that are performed under SAS, SSARS, SSAEs, GAS, or PCAOB Standards are ***included*** in the scope of the Peer Review Standards
- Firms that perform engagements under PCAOB Standards or engagements subject to permanent inspection by the PCAOB are required to have their peer reviews administered by the National Peer Review Committee (NPRC).

This clarification applies to the SEC's recent rulings regarding broker dealer and conflict mineral engagements. Both of these rulings and the peer review considerations are discussed below.

Broker-Dealers
On July 31, 2013, the SEC finalized its Broker-Dealer Rules. The final rule requires audits of all broker-dealers to be performed under PCAOB Standards. It also requires a new Compliance Report (examination) for carrying BDs and an Exemption Report (review) for non-carrying BDs, both to be performed using PCAOB Standards. These requirements are effective for fiscal years ending on or after June 1, 2014. On October 10, 2013, the PCAOB adopted attestation standards for the purposes of performing the examination of the Compliance Report and the review of the Exemption Report (PCAOB Release No. 2013-007: Final Rule). They also adopted an auditing standard applicable when auditors are engaged to perform audit procedures and report on supplemental information that broker-dealers and others file with the SEC and related amendments to other PCAOB standards (PCAOB Release No. 2013-008: Final Rule).
Audits of all non-SEC issuer broker-dealers are currently subject to inspection by the PCAOB under an interim inspection program. The PCAOB anticipates presenting a rule proposal for a permanent inspection program in 2014 or later. Until such time, audits of non-SEC issuer broker-dealers are included in the scope of peer review. Firms performing these engagements under PCAOB Standards beginning with fiscal years ending on or after June 1, 2014, will be required to have their peer review administered by the NPRC.

Conflict Mineral Reports

On November 13, 2012, the SEC issued a final ruling on Conflict Mineral Reports requiring issuers to disclose conflict minerals that are necessary to the functionality or production of a product manufactured. The term “conflict minerals” is used to describe certain minerals—tantalum, tungsten, tin, and gold—that are mined in the Democratic Republic of the Congo (DRC) or the surrounding areas. Federal law does not prohibit companies from sourcing conflict minerals, nor impose a penalty for doing so. However, the intent is to rely on public pressure to dissuade U.S. companies from indirectly sourcing conflict minerals, and hence fund the armed groups in the DRC.

The final rule requires an Independent Private Sector Audit (IPSA) of Conflict Mineral Reports (CMR) to be performed under the auditing standards established by the Government Accountability Office (GAO). These IPSA engagements will be performed under *Government Auditing Standards* (GAS) using performance audit or attestation engagement standards. CMRs and the related filings related to special disclosures are to be filed with the SEC and made publicly available by the issuer. Issuers must comply with the final rules effective for fiscal years beginning January 1, 2013. The first reports are due by May 31, 2014, and May 31 annually thereafter. The AICPA has provided additional resources pertaining to this subject matter.

These IPSA engagements are not subject to PCAOB permanent inspection, therefore, they are subject to peer review requirements. Because these engagements are required to be performed using GAS, rather than PCAOB standards, they will not trigger administration by the NPRC. Reviewers should consider these engagements as part of the must select population of engagements subject to GAS. This will require a team member with GAS experience to be on the review team and to review the engagement if selected.

The chart below summarizes the impact of broker dealer engagements and IPSA of CMRs on the scope and administration of a firm’s peer review.

	PCAOB permanent inspection scope	Peer Review scope	Triggers NPRC administration of firm’s peer review
Broker dealers engagements under AICPA standards	No	Yes	No
Broker dealer engagements under PCAOB standards, before effective date of PCAOB permanent inspection program	No	Yes	Yes
Broker dealer engagements under PCAOB standards, upon effective date of PCAOB permanent inspection program	Yes	No	Yes
Engagements of non-issuers under PCAOB standards,	No	Yes	Yes

not covered by PCAOB permanent inspection			
Engagements for SEC issuers under Government Auditing Standards (e.g. IPSA of CMR), not covered by PCAOB permanent inspection program	No	Yes	No
Engagements under SASs, SSARS. SSAEs, Government Auditing Standards, not covered by PCAOB permanent inspection program	No	Yes	No

For additional information, refer to the materials for Agenda Item 1.5 of the Peer Review Board's January 2014 open session materials. These changes are effective for reviews commencing on or after April 1, 2014 and will be incorporated in the April 2014 release of the Peer Review Program Manual.

Noncooperation Revisions – Completeness of Peer Review Scope

Firms are required to accurately represent their accounting and auditing practice, as defined by the *AICPA Standards for Performing and Reporting on Peer Reviews*, for the purposes of including them in peer review scope. Recently, staff has received public evidence that indicates some firms are not including all engagements in the scope of peer review. The objectives of the program are achieved through the performance of peer reviews involving procedures tailored to the nature of a firm's practice. Peer review scope is critical to the effectiveness of peer review. Accordingly, the Peer Review Board has approved revisions to guidance when a firm omits, withholds, or misrepresents information about its accounting and auditing practice. The revised guidance:

- Adds failure to accurately represent its accounting and auditing practice, as defined by the *AICPA Standards for Performing and Reporting on Peer Reviews,* and/or notify its administering entity of changes in that practice to the list of reasons for which a firm's enrollment in the AICPA Peer Review Program may be dropped, which may occur without a hearing, by the AICPA Peer Review Board to Interpretation 5h-1.
- Clarifies Interpretation 5h-1 to state that a firm's failure to cooperate once a review has commenced includes omission or misrepresentation of information relating to its accounting and auditing practice as defined by the *AICPA Standards for Performing and Reporting on Peer Reviews*, including, but not limited to, engagements performed under Government Auditing Standards; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and 2 engagements] and will result in the termination of the firm's enrollment in the AICPA Peer Review Program, subject to a hearing.

- Adds to the letter communicating that a firm does not have an accounting and auditing practice (No A&A letter) a representation that of understanding that a failure to properly represent the firm's practice or immediately notify their administering entity of any changes in it may result in the firm's enrollment being dropped automatically.
- Adds to the minimum the minimum representations that are made to the team captain or review captain completeness of the engagement listing provided to the reviewer, including, but not limited to, inclusion of all engagements performed under Government Auditing Standards; audits of employee benefit plans, audits performed under FDICIA, audits of carrying broker-dealers, and examinations of service organizations Service Organizations Control (SOC) 1 and 2 engagements, as applicable.
- Adds the written representations from management of the reviewed firm to the documents to be maintained by the administering entity until the subsequent peer review's acceptance and completion.

These changes can be found as the January 30, 2014 Board Open Session Agenda Item 1.6 and will be included in the 2014 Peer Review Program Manual. The guidance is effective for peer reviews commencing on or after April 1, 2014.

Firms that find themselves in these or similar positions may correct the situation by immediately contacting their administering entity to determine the appropriate course of action in order to avoid their peer review enrollment being dropped, their membership being terminated, and referral to the AICPA Professional Ethics Division for investigation of a possible violation of the AICPA *Code of Professional Conduct.*

Reviewer Focus

Welcome to the February 2014 edition of ***Reviewer Focus***. We designed this communication to focus your attention on current issues to assist you in more effectively performing your peer reviews and enhancing the quality of the work performed by your peer review clients. The information contained herein has ***not*** been approved by the AICPA Peer Review Board and thus does not constitute —other guidance as defined in the *AICPA Standards for Performing and Reporting on Peer Reviews*

This edition of Reviewer Focus contains three articles:

Common Matters Identified During Peer Review

Since December 2012, peer review has been collecting data on matters identified during a firm's peer review. The purpose is to capture this information, use it to learn about the trouble spots, and develop resources within the AICPA that will allow firms to have a more focused remedy for their findings. Our ultimate goal is to assist firms with the hurdles they've faced in the past, provide them with tools to drive up their quality and overall "up the game on quality" in the profession.

Each AICPA team has been trained on how to access the MFC data and has begun to analyze the information. Some examples of how other teams in the Institute have indicated they'll utilize the information gathered are:

- Accounting & Auditing - will incorporate information into audit guides and alerts
- Center for Plain English Accounting (CPEA) – has already used the information in their December Report, incorporating peer review findings related to clarified standards implementation issues. The team plans to use the information regularly to write reports and articles on common findings.
- Ethics – will use the information to identify areas that should be looked at during investigations
- Financial Reporting Executive Committee - will utilize information to develop Technical Practice Aids for accounting issues
- GAQC – used the data for a December 2013 YB webcast and is using it to gather common deficiencies for its 2014 conference presentations
- Peer Review – monitors the data on an ongoing basis and reports common trends to reviewers on at least a quarterly basis. The top trends identified are reported along with more specifics on hot topics (e.g., detailed clarified standard implementation issues).
- Private Companies Practice Section (PCPS) - will use the information for alerts including the common matters by firm size with tips on how to avoid them
- Professional Development (CPE) - will incorporate practice points into existing courses, develop timely webinars on new standard implementation issues, and provide information to CPA2Biz to market courses

With this project and the related collaborative efforts we believe we'll make a significant positive impact on audit quality in the profession. See below for some of the trends identified.

Program Questionnaire Matters [System of Quality Control (QC) Related]

- Most of the QC related MFCs were from firms with 2-5 personnel.
- 56% of the QC related MFCs were associated to monitoring. The matters included instances where firms:
  - Did not have a policy related to monitoring and inspections
  - Had a policy but were either not following it or the policy was inadequate as it did not identify matters or cover all risky areas
- 17% of the QC related MFCs were associated to engagement performance, most notably not establishing appropriate engagement quality control review criteria.
- 14% of the QC related MFCs were associated to human resources (HR).
  - Of the HR related MFCs, the majority did not establish appropriate procedures to ensure staff had adequate CPE. Examples include:
    - Lack of checkpoints to ensure staff met the governmental CPE requirements
    - Review of ERISA CPE for staff where the majority of a firm's clients were ERISA
    - Staff was taking CPE after audits were performed instead of before

Engagement Questionnaire (Related to Specific Engagements)

- Most of the QC related MFCs were from firms with 2-5 personnel.
- Overall, the biggest trends identified were related to FASB, SSARS, and the clarified auditing standards (consistent across industries and levels of service).
  - FASB
    - No disclosure of tax years that remain subject to examination by major tax jurisdictions
    - No disclosure of the date through which subsequent events were evaluated
    - Incorrect classifications on the cash flow statement
  - SSARS
    - Failure to implement SSARS 19 (e.g. engagement letters and report changes)
    - Engagement letters or reports contain references to financial statements being prepared in accordance with GAAP for a Special Purpose Framework (SPF) engagement
    - Failure to include a title on the accountant's report
    - The financial statement titles do not match those identified in the accountant's report
  - Clarified Audit Standards
    - Failure to update the audit report to conform to the audit standards.
    - Failure to appropriately document planning procedures, including risk assessment, planning analytics, and internal control testing
    - Representation letters that were dated incorrectly, did not cover the appropriate periods or were missing required representations
- The largest trends for the must select categories are as follows:
  - GAS
    - No disclosure of tax years that remain subject to examination by major tax jurisdictions

        - Representation letters that were dated incorrectly, did not cover the appropriate periods or were missing required representations
        - Insufficient Planning documentation – mainly risk assessment
        - On A-133 engagements, insufficient documentation in relation to sampling procedures for tests of controls and tests of compliance
        - On A-133 engagements, incorrect completion of the Schedule of Findings and Questioned Costs
    - ERISA
        - No disclosure of tax years that remain subject to examination by major tax jurisdictions
        - Insufficient procedures and documentation for reliance upon SOC 1 reports in lieu of testing income allocations and investment options at the participant level
        - Missing or insufficient fair value disclosures related to fair value hierarchy of investments, description of the levels, descriptions of the methods used and tabular presentation of amounts. Also included insufficient procedures and documentation regarding the procedures to obtain assurance of the fair value measurements.
        - Failure to disclose investments that represent five percent or more of net assets
        - Auditors' report did not conform to the new clarified standards.
    - FDICIA
        - Failure to include all elements required by professional standards in the accountant's report on internal controls
        - Failure to understand and comply with the independence rules applicable to these engagements, i.e. SEC independence rules do not allow the auditor to also prepare the client's financial statements
        - No disclosure of tax years that remain subject to examination by major tax jurisdictions
    - Broker-Dealers (Carrying and Non-Carrying)
        - Failure to comply with SEC Independence Rules, including not preparing financial statements for clients
        - No disclosure of tax years that remain subject to examination by major tax jurisdictions
        - Audit reports on financial statements were not updated to conform with clarified audit standards and inappropriately referenced use of the PCAOB standards to perform the audits (when SAS were followed)
        - Audit reports on internal controls were not appropriate, including using the non-carrying format for a carrying firm, outdated definitions of internal control and restrictions of the report to management and regulations
        - Failure to use a broker-dealer specific financial statement checklist thus missing required disclosures
    - SOC
        - SOC 1
            - The service auditor lacked the experience and training required under SSAE 16 to properly complete a Service Organization Control Report.
            - The client acceptance, the description of controls and the audit documentation omitted reference to the need for complimentary user controls if any exist, the risks that threaten the achievement of the control objectives and the linkage between the controls

included in the control description, and the proper identification of subservice organizations and related services and ultimate use of the carve out method.

- The information included in the report did not have sufficient support in the workpapers, such as
  - No documentation to assess the nature, timing, and extent of the procedures (specifically sampling methodology)
  - Control testing did not address the elements of the control, all IT general controls and change management controls
  - No documentation of procedures to support the Other Information included in the report
- Incorrect references included or incorrect language used in the report including user controls, carve outs, and other information.

- SOC 2 (only one MFC has been reported)
  - The report issued included non-standard wording regarding complementary user entity controls

Online MFC Updates

Updates are provided regularly. New Items Are in Red

New Changes to Online MFCs

- The MFC Forms screen now includes filter options to help navigate the review listing. In each filter, reviewers have the option to search for reviews.
- The instructions on the MFC Forms screen include details of each filter option.
- The filters are:
  - Open MFCs – Reviews in Process
  - Open MFCs – Submitted to AE
  - Accepted Reviews with MFCs – Within 120 Days (of acceptance)
  - MFCs Not Yet Started
  - All Reviews – Within 120 Days (of acceptance)

Tips & Tricks

- Quick Access Instructions for PRISM - For CPA Firms now available.
- Step-by-Step Instructions – Use as a guide when completing MFC forms.
- Quick one page instructions – For both reviewers and firms are now available.
- Advance email - Send firms an email to prepare them for completing the forms online. Refer to the sample email on the online MFC page.
- PRISM link – Save as a favorite for easy access. It is the same link for reviewers, firms, and technical reviewers.
- No MFCs Required – If no MFCs are required, simply click the button that says “No MFCs Required.” No further actions are necessary by the reviewer unless MFCs are requested by the technical reviewer or RAB.
- Add Engagement – For each engagement questionnaire MFC (i.e. resulting from an engagement checklist), this button MUST be clicked for the final MFC to include engagement questionnaire data, regardless of whether the MFC will include one or multiple engagements on one MFC. *If you do not click “Add Engagement” you will lose the information entered if you leave the screen* (for example by clicking Save & Return).

- Deleting an MFC – MFCs can be deleted from your MFC Dashboard by clicking the red "X" on the right side of the dashboard. You are not able to delete MFCs from within an open MFC; you must delete it from the dashboard.
    - NOTE – you can practice creating MFCs and allow your firm to practice responding to them using an active review. You can simply delete the MFC when you are finished. Keep in mind that your ability to edit MFCs will lock after you submit them to the administering entity (AE). Therefore, we don't recommend that you submit the MFCs to the AE while practicing as that will require the AE to request revisions in order for you to delete them.
- Printing – The print buttons for MFCs, DMFC, and the MFC Dashboard open up another window where you can select a printer. If the window doesn't open, the problem is typically due to a pop up blocker which should be disabled while using PRISM.
- Screen Size – Some reviewers have indicated that the entire dashboard does not show on their screen causing them to have to scroll to get to buttons. You can easily change the font size of your screen by pressing Ctrl and + or –.
- MFC Status – This is the easiest way to troubleshoot problems. The MFC dashboard includes a status for each MFC that has been created. The status will provide an indication as to what step is required next. We have found there are times when a reviewer believes they have sent MFCs to the firm but the status indicates that they still need to do so. Refer to troubleshooting tips using the MFC Status.
- Technical Reviewer Revisions – Use the Request Revision button to request any changes that are necessary, including changes to the DMFC or to delete an MFC. For example, if you are requesting MFC 3 to be deleted, check the box for MFC 3 and then click Request Revision and indicate the MFC should be deleted as the reason. If you need the disposition of MFC 2 to be changed, request a revision for MFC 2 and indicate the DMFC should be revised as the reason for the request. NOTE – PRISM only shows the most current version of the MFC. Therefore, if you want a prior MFC to compare to the most recent version, you will have to print it before you request a revision.

Enhancements that are Coming

- Printing – We've received requests to improve the print features within PRISM. Some of the items we are addressing include printing multiple MFCs to one file, printing MFCs in numerical order, putting the MFC number on each page that prints, and increasing the font size on the print outs.
- Areas that can't be completed – These areas are grayed out and may be difficult for some to read. We are investigating how to make those areas darker but still clear that you are unable to complete those sections.
- We are still evaluating additional comments received at the Peer Review Conference and will make appropriate enhancements.

Situations That May Be Encountered

- License Issues – Supplemental guidance in Section 3100 of the PRPM indicates that an FFC or deficiency may be necessary in relation to licensing issues identified during the peer review. The identification of these issues typically arises during completion of the Team Captain Checklist (TCC) or the Review Captain Summary (RCS). Therefore, the TCC and RCS were added to PRISM under the list of Engagement Checklist. An MFC related to licenses should be created using one of these checklists and selecting "Other" as the professional standards reference.

- Access Issues – Invalid usernames and passwords, the firm representative wasn't listed on the scheduling form as the managing partner or peer review contact, there are duplicate member records, etc. Have the firm confirm they are able to log into aicpa.org and access PRISM as part of your planning procedures. Requests for access issues can take 24-48 hours to be resolved.
- Finding Reviews –The online MFCs are only required for peer reviews of AICPA member firms that commence after July 1, 2013. If a review commenced after July 1, 2013 and does not appear in the list, please contact the AICPA. If you are not sure how to identify AICPA firms, refer to the July Peer Review Update.

SRM Statistics When Audits are Incomplete

Members of the peer review community have expressed confusion over how to reflect incomplete audit engagements in their SRM statistics.

Standards paragraph .58 states, "If the current year's engagement has not been completed and issued…the prior year's engagement may be reviewed". This means the population of engagements a reviewer is selecting from includes the following:

- When a firm has completed an audit with a year-end within the peer review year, the current year audit
- When a firm is engaged to perform an audit with a year-end within the peer review year but that audit is not complete, the prior year audit

SRM statistics should reflect this population. Reviewers with questions about how to present their SRM statistics should contact AICPA Staff at (919) 402-4502 or prsupport@aicpa.org.

Save the Date – 2014 Peer Review Conference

The AICPA Peer Review Team will host our annual conference from August 4-5, 2014, with optional sessions on August 3, in Denver, Colorado. Please join us in Denver for the annual conference and to celebrate Peer Review's 25th Anniversary! Check out our conference web page for more details.