# PRP Section 3200

## Peer Review Alerts

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NOTICE TO READERS

Peer Review Alerts (Alerts) are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA Peer Review Program. Alerts need not be exposed for comment and are not the subject of public hearings. This guidance is applicable to firms (and individuals) enrolled in the program; individuals and firms who perform and report on peer reviews; entities approved to administer the peer reviews; associations of CPA firms whose members are also AICPA members, authorized by the board to assist its members in forming review teams; and the AICPA program staff. The guidance is effective upon issuance unless otherwise indicated.

Alerts communicate timely information regarding the AICPA Standards for Performing and Reporting on Peer Reviews (Standards) and related guidance, as well as updates on the peer review environment.

The Alerts supersede and replace the previous Peer Reviewer’s Alerts which have mostly been incorporated into the Standards and related guidance. In addition, the process to maintain them will be different.

As new articles are issued quarterly by the Board, they are added to a “New Alerts” Section of the Alert. Annually, the Board will evaluate which articles are to be excerpted and incorporated into the Standards and related guidance. Articles that are of a transitional nature, are not appropriate to be incorporated into the Standards and guidance, or both, will remain in the Alert. Each previous version of the Alert will be archived on the peer review Web site, and the more relevant version will be issued.

(Issued Through November 1, 2009)

NEW ALERTS

Process to Incorporate Peer Review Alerts to Standards/Guidance Where Applicable

As described in the Notice to Readers in the Peer Review Alerts (Alerts), alerts communicate timely information regarding the AICPA Standards for Performing and Reporting on Peer Reviews (Standards) and related guidance, as well as updates on the peer review environment. Alerts are issued approximately quarterly and distributed to peer reviewers and posted to the Program’s website.

Periodically, the Board will evaluate which articles are to be incorporated into the Standards and related guidance. Articles that are of a transitional nature, are not appropriate to be incorporated into the Standards and guidance, or both, are added to Section 3200 Peer Review Alerts, which is a consolidation of previously issued alerts. Each previous version of the Alert will be archived on the peer review Web site, and the more relevant version will be issued. Peer Review Alert guidance is effective upon issuance as an Alert, unless otherwise indicated.

Peer Review Alert articles issued through January 1, 2009, and April, June and October Peer Review Alerts, have been reevaluated. As a result, the following changes have been made and incorporated into the Peer Review Program Manual:

PRP Section 1000 AICPA Standards for Performing and Reporting on Peer Reviews

- Conforming changes to Engagement Review reports at Appendixes M-Q (to address Alert article “Correction to Engagement Review Wording”)
- Conforming changes to System Review reports at Appendixes C-E, G, I and K (to address Alert article “Peer Review Reports of Firms Required to be Registered and Inspected by the PCAOB”)

PRP Section 2000 Peer Review Standards’ Interpretations

- Changes to existing Interpretations 34-1 to 3, 63-1, and 181-1b-1 & 2
PRP Section 3100 Supplemental Guidance
- Addition of articles entitled:
  - Non-SEC Issuer Entities Subject to SEC and PCAOB Independence Rules
  - QCM Peer Reviews
  - Selection of an A-133 Engagement for Review of Compliance Testing

PRP Section 3200 Peer Review Alerts
- Articles which were regulatory, administrative, oversight or transitional have been incorporated into those sections of this document.

PRP Section 3300 Report Acceptance Body Handbook
- Changes to Chapters 1 and 8 related to “Other Peer Reviewer or Reviewing Firm Qualification Considerations”
- Changes to Chapters 4 and 5 related to the reporting process, and to implementation plans

PRP Section 3600 Guidance for Writing Letters on Corrective Actions by Outside Parties
- New section

As a result of the Alert articles, several conforming changes have also been made to the Team Captain and Review Captain Checklists and the Instructions for Use of Matter for Further Consideration (MFC) Forms for Engagement Reviews and Instructions for Use of Findings for Further Consideration (FFC) Forms for Engagement Reviews.

REGULATORY ALERTS

Attestation Engagements Performed in Accordance With Generally Accepted Government Auditing Standards (GAGAS/Yellow Book)

Yellow Book states that each organization performing attestation engagements in accordance with GAGAS must establish a system of quality control that is designed to provide reasonable assurance that it and all its personnel comply with professional standards and applicable legal and regulatory requirements, and have an external peer review at least once every three years.

The organization should obtain an external peer review sufficient in scope to provide a reasonable basis for determining whether, for the period under review, the reviewed organization’s system of quality control was suitably designed and whether the organization is complying with its quality control system in order to provide the organization with reasonable assurance of conforming with applicable professional standards.

Therefore, if a firm enrolled in the AICPA Peer Review Program (PRP) only performs attestation engagements (in accordance with GAGAS), as its highest level of service, the firm is required to have a system review. Although some of the language in Yellow Book has recently changed, this is not a new requirement, and the Standards for Performing and Reporting on Peer Reviews were previously revised to reflect that firms performing “engagements” (not just “audits”) in accordance with GAGAS are required to have a system review.

Governmental Audit Quality Continues to Be a Concern

As noted in last year’s Peer Review Alert, a federal study on the quality of audits performed under OMB Circular A-133 was issued June 22, 2007. The report, titled Report on National Single Audit Sampling Project (the PCIE report), was issued by the President’s Council on Integrity and Efficiency (PCIE) and addressed to the OMB. The PCIE report clearly shows that improvements are needed in many areas. Both peer reviews and AICPA Professional Ethics Division (PED) investigations of audit organizations have previously indicated that there are problems in audits performed under Government Auditing Standards (GAS) and Circular A-133.

The PCIE Report
Overall, the federal study had two goals: (1) to determine the quality of single audits and establish a statistically based measure of audit quality; and (2) to recommend changes in single audit requirements, standards and procedures to
improve the quality of single audits. The scope did not include a review of the content of, or the audit work performed, related to the general-purpose financial statements, the auditor’s opinion on those statements, or the auditors’ review of internal control over financial reporting. To accomplish its goals, the PCIE conducted quality control reviews (QCRs) of a statistical sample of 208 audits randomly selected from approximately 38,000 audits submitted and accepted by the Federal Audit Clearinghouse between April 1, 2003 and March 31, 2004. The sample was split into two strata. Stratum I included audits of entities that expended $50 million or more of total federal expenditures. Stratum II included audits of entities that expended at least $500,000 but less than $50 million of total federal expenditures.

The results are presented in the report in varying ways and using different breakdowns and tables. Overall though, 35% of the audits reviewed were found to be unacceptable and another 16% were of limited reliability. In addition to providing the results by the number of audits looked at, the PCIE also analyzed the results in relation to the dollar amounts of federal awards reported in the audits reviewed. One piece of good news in the report was that approximately 93% of the federal dollars reported in the audits reviewed were covered by acceptable audits. This difference exists because the PCIE report shows a marked positive difference in the quality of the work performed in the larger audits in Stratum I.

What’s Next?

The issuance of the PCIE report is not the end of the story. There was a Senate hearing on the PCIE report last October and the AICPA and various federal agencies have efforts underway in response to the report. The AICPA and its Governmental Audit Quality Center (GAQC) have formed 7 task forces to study in detail the PCIE report findings and recommendations and to work with the OMB, the Inspectors General (IGs) and other interested parties in order to provide additional guidance to help members achieve the highest standards in performing quality governmental audits. Each task force is in the process of carefully studying the issues raised in the PCIE report. The task forces are:

1. Sampling/Materiality Issues in a Single Audit Environment
2. Internal Control and Compliance Responsibilities in a Single Audit Environment
3. Schedule of Expenditures Federal Awards Reporting Issues
4. Reporting Audit Findings in a Single Audit
5. Single Audit Training Needs and Continuing Professional Education Evaluation
6. Practice Monitoring in a Single Audit Environment
7. Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance

Most of the AICPA task forces are expected to complete their activities during 2009, the result of which will likely include a revised compliance auditing standard, new or clarified guidance in the AICPA Audit Guide, Government Auditing Standards and Circular A-133 Audits, and new illustrative practice aids. You should note that task force #6 previously mentioned falls under the jurisdiction of the AICPA Peer Review Board (PRB). It was established to develop ways in which the peer review process can aid in enhancing the quality and performance of Circular A-133 audits by member firms. The Task Force is in the first phase of its work, having recently met with the various federal agencies that perform QCRs to help the AICPA better understand the QCR processes across federal agencies and to assist the IGs in better understanding the peer review process. The Task Force will be reporting its progress at the November 2008 meeting of the PRB and anticipates presenting specific recommendations for actions at the Board’s January 2009 meeting so that its recommendations can be implemented in the performance of 2009 peer reviews.

The OMB has also established 8 of its own task forces to look at various issues associated with the PCIE report. The work of these task forces may result in proposed revisions to Circular A-133 sometime later in 2008 or in 2009 (e.g., the OMB may propose required additional single audit training and a related curriculum). The Government Accountability Office (GAO) has also received a Senate request to further study the single audit process in light of the PCIE report results. That study is underway and may continue into 2009.

Finally, the IGs at various federal agencies have stepped up the number of QCRs that they are performing. From the standpoint of these federal users, single audits conducted are a key accountability mechanism for the expenditure of taxpayer dollars. Consequently, the PCIE report has caused an increase in concern about the quality of the audits that the agencies rely upon.
The GAQC is a good information source for both Center members and non-members to keep abreast of developments in this area. Watch the GAQC Web site (www.aicpa.org/GAQC) for further updates.

What Can Peer Reviewers Do?

Peer reviewers that review single audits should first and foremost review the PCIE report in detail to gain a strong understanding of the numerous problem areas that were identified. Further, they should review Appendix A to this article which includes a summary of common deficiencies that were noted. Finally, the GAQC is a great resource for firms that perform governmental audits (including single audits) and their peer reviewers. Appendix B to this article provides more information on the GAQC and how to join or get more information.

Appendix A

Common Deficiencies Identified in the PCIE Report

Materiality. In single audits, the auditor must consider his or her findings in relation to each major program, which is a significantly lower materiality level than all programs combined. In some of the audits reviewed, the auditor did not document whether he or she considered materiality at the individual major program level.

Internal Control. The report found that in many single audits, auditors are not documenting their understanding of internal control over compliance as required by A-133 §.500(c)(1) in a manner that addresses the five elements of internal control. Further, the report stated that auditors did not document testing internal control of at least some compliance requirements as required by A-133 §.500(c)(2).

Compliance. The report stated that in some audits, auditors are not documenting compliance testing of at least some compliance requirements. For most audits considered unacceptable, the lack of documentary evidence for compliance testing was substantial. They found that the audit documentation did not always include evidence that the auditor tested major program compliance requirements or explain why certain generally applicable requirements identified in the OMB Compliance Supplement were not applicable to the audit.

Also, in some cases the auditor documented that types of compliance requirements identified as generally applicable to the major program in Part 2 of the OMB Compliance Supplement were not applicable (e.g., by only marking “N/A” next to the item in an audit program) but did not explain why.

Material Reporting Errors. Auditors misreported coverage of major programs. This occurred when the Summary of Auditor Results section of the Schedule of Findings and Questioned Costs identified that one or more major programs were audited as a major program when the audit documentation did not include support for all of the programs listed. Though inadvertent, this is a very consequential error because report users may erroneously rely on opinions that major programs have been audited as major.

Sampling. The PCIE report notes inconsistent numbers of transactions selected for testing of internal control and compliance testing for the allowable costs/cost principles compliance requirement across the audits that they reviewed. Also, many single audits did not document the number of transactions and the associated dollars of the universe from which the transactions were drawn.

Risk Assessments of Federal Programs. The report cited the following kinds of deficiencies in risk assessments of federal programs:

- Required risk analyses were not documented at all;
- The basis for the assessments of risk was not documented;
- The documentation indicated that the risk assessment was not performed or not properly performed for reasons including: not considering all programs, improperly clustering programs, not clustering programs, or mistakenly categorizing a program as Type A or as Type B; and
- The risk assessment decision was not consistent with information in the audit documentation.

Apparent Audit Findings Not Reported. In this scenario, the audit documentation or management letter content included matters that appeared to be audit findings. However, they were not reported as audit findings and there was no audit documentation explaining why.

Audit Finding Elements. A significant percentage of the audits reviewed in both strata, did not include all of the required reporting elements in the audit findings.
Schedule of Expenditures of Federal Awards (SEFA) Problems. For many audits reviewed, one or more of the following required SEFA content items were omitted. The report acknowledges that SEFA preparation is a client responsibility but that the auditor reports on the SEFA in relation to the financial statements and that the information in the SEFA is key to major program determination.

- Subgrant awards numbers assigned by pass-through entities not included
- Names of pass-through entities missing
- Grantor Federal agency names missing
- Grantor Federal agency subdivision names missing
- Multiple lines for Catalog of Federal Domestic Assistance (CFDA) numbers shown—total expenditures for CFDA not shown
- Programs that are parts of a cluster not shown as such
- Notes to SEFA missing
- Correct CFDA number; and
- Research and Development (R&D) programs not identified as such

Management Representations. For several audits, some or all of the management representations (identified in the AICPA Audit Guide, Government Auditing Standards and Circular A-133 Audits), were not obtained. In a few other cases, the management representations were obtained several days prior to the dates of the auditor’s reports.

Other Findings. Numerous other findings were noted, primarily attributed by the reviewers as being caused by a lack of due professional care. They include the following:

- Low-risk auditee determination not documented or incorrect
- Minimum Percentage of Coverage requirement not met
- Audit programs missing or inadequate for part of the single audit
- Part of a major program or a major program cluster not tested
- The Summary of Auditor’s Results section of the Schedule of Findings and Questioned Costs was missing some information or some information was erroneous
- Error in threshold distinguishing Type A and Type B programs
- Indications that current compliance requirements were not considered

Appendix B

AICPA Governmental Audit Quality Center

The AICPA Governmental Audit Quality Center (GAQC) is a firm-based, voluntary membership Center with the goal of enhancing and promoting quality governmental audits. Governmental audits include all audits performed under Government Auditing Standards such as single audits and financial statement audits of governments and not-for-profit organizations; audits performed under federal audit guides such as the Housing and Urban Development Consolidated Audit Guide and various Department of Education Audit Guides; and other grant and assistance program audits.

The Center has almost 1,100 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. Center members audit over 82% of the federal expenditures audited in single audits performed by CPA firms. The GAQC helps firms meet the challenges of performing quality audits by keeping members informed about the latest developments, as well as providing tools and information to help better manage a firm’s governmental audit practice.

Center Resources and Benefits. Center resources include timely e-mail news alerts on current governmental audit, accounting and regulatory developments; a dedicated Center Web site at www.aicpa.org/GAQC; CPE member-only teleconferences on a variety of technical, regulatory and practice management subjects; and an online discussion forum for networking and sharing best practices. Other resources and benefits include helpful practice aids, tools, articles, and savings on professional liability insurance.
Center Requirements. Among the GAQC membership requirements, Center members must designate a partner responsible for governmental audit quality that must also attend an annual 2-hour Center-sponsored Webcast; establish policies and procedures specific to the governmental audit practice; conduct annual internal inspections of their governmental audits; maintain their peer review report in a public file; and have their governmental audits selected in peer review reviewed by individuals employed by a Center member firm. Center members also must pay annual dues, which start at $150 per year for a firm with fewer than 10 CPAs.

GAQC Members Find Great Value in Their Membership. Overwhelmingly, Center members report high satisfaction with their Center membership. One of the most liked aspects of the Center is the timely information on matters of importance to governmental audits that assist member firms in enhancing the quality of their governmental audit practices. To join, or for more information about the GAQC, visit the Center Web site at: www.aicpa.org/GAQC; or call 202-434-9207.

Recent 403(b) Regulatory Changes and the Effect on Future Peer Reviews

Under U.S. Department of Labor (DOL) regulations issued on November 16, 2007, retirement plans sponsored by charitable organizations and schools under Internal Revenue Code section 403(b) and covered under the Employee Retirement Income Security Act of 1974 (ERISA) will be subject to the same reporting and audit requirements that currently exist for section 401(k) plans.

ERISA-covered 403(b) plans with 100 or more participants generally will be required to file audited financial statements beginning with their 2009 Form 5500 filing. 403(b) plans with fewer than 100 participants may be eligible to use abbreviated reporting forms without audited financial statements. The DOL estimates that approximately 7,000 “large” 403(b) plans will be subject to the new audit requirements and another 9,000 “small” 403(b) plans may be eligible to use the abbreviated reporting forms.

Reviewers should be aware of the effect of this change on the practices of the firms they peer review, especially on the risk assessment and engagement selection processes.

DOL’s ERISA Audit Quality Enforcement Initiative

The Department of Labor’s (DOL) Employee Benefits Security Administration (EBSA) has an ongoing enforcement initiative to monitor the quality of ERISA audits. The audit quality program is administered by the EBSA's Office of the Chief Accountant. The DOL will reject the Form 5500 filing where it has been determined that an audit failure has occurred, and may refer substandard work to the AICPA’s Professional Ethics Division or the appropriate State Board(s) of Accountancy. The DOL’s audit quality monitoring program has a three-tiered approach as described subsequently.

- “Augmented workpaper reviews” of firms that perform less than 100 ERISA audits. The DOL randomly select audits to review and sends letters to the plan administrator requesting copies of the audit working papers. The DOL has completed over 1,500 of these “augmented workpaper reviews” since the 2003 plan year. The DOL performs an in-house review of the Form 5500, the independent auditor's report, and selected working papers for each of those engagements. Those reviews can be expanded to include additional working paper reviews, discussions with firm representatives, and any additional procedures deemed necessary based on the findings of the initial reviews.

- “Mini-inspections” of firms that perform between 100 and 200 audits. The DOL will perform a “mini-inspection,” whereby the DOL will send letters to the audit firm’s managing partner requesting them to complete a Firm Inspection Program Questionnaire and submit a list of their ERISA audit engagements. The DOL will review the completed questionnaire and select several ERISA audits to perform an in-house review of the Form 5500, the independent auditor’s report, and selected working papers for each engagement. The “mini-inspections” could be expanded to include additional working paper reviews, discussions with firm representatives, and any additional procedures deemed necessary based on the findings of the initial reviews. For all reviews, the DOL will conduct a closing conference either by phone or in person to discuss the results of the inspection.

- “Inspections” of firms that perform over 200 ERISA audits. The DOL will send a letter to the audit firm’s managing partner to schedule an onsite inspection of that firm’s ERISA audit practice. This inspection will include completing the Firm Inspection Program Questionnaire and reviewing selected audit working papers. The engagements selected will be representative of the offices that perform ERISA engagements, as well as the types of ERISA audits performed by the firm. The firm inspection will conclude with a closing conference between the DOL representative and the appropriate firm personnel.
What Can Peer Reviewers Do?
Peer reviewers that review ERISA benefit plans could review the summary of common ERISA audit deficiencies, which follow. Also, the Employee Benefit Plan Audit Quality Center (EBPAQC) is a great resource for firms that perform governmental audits (including single audits) and their peer reviewers. In subsequent sections, we also provide more information on the EBPAQC and how to join or get more information.

Common ERISA Audit Deficiencies
The following are the more common audit deficiencies noted in DOL reviews and AICPA peer reviews.

- **Planning**
  - Inadequate audit planning.
  - Failure to assess the risk of material misstatement due to fraud.

- **Internal Controls**
  - Failure to document an understanding of internal controls, most often when a substantive audit is going to be performed.

- **Contributions**
  - No audit work performed.
  - Particularly multiemployer plans, failure to obtain adequate audit evidence for contributions back to contributing employers (multiemployer plans). Reliance on contribution reports is not enough.

- **Insufficient payroll audit procedures**
  - Failure to test elective deferrals.

- **Investments**
  - No work performed.
  - Failure to test end of year values.
  - Failure to properly test year end values, particularly hard-to-value assets.
  - Improper use of limited scope certifications.

- **Benefit payments**
  - No audit work performed.
  - Inadequate auditing regarding eligibility of claims to be covered by the plan.

- **Participant data**
  - Insufficient testing of payroll data.
  - Failure to test eligibility, forfeitures, and allocations.
  - In defined contribution plans with limited scope audits, failure of auditors to test the allocation earnings and gains/losses to participant accounts.
  - Sample sizes too low.
  - Some firms have reduced their sample sizes selected for compliance and substantive testing to unacceptably low levels.

- **Working paper documentation**
  - Adequacy of audit documentation continues to be an issue.
  - Only evidence of audit work having been performed is a sign off on an audit step without any supporting documentation.
AICPA Employee Benefit Plan Audit Quality Center

The AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) is a firm-based, voluntary membership center with the goal of enhancing and promoting quality employee benefit plan audits. The center has over 1,600 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. The EBPAQC helps firms meet the challenges of performing quality audits by keeping members informed about the latest developments, as well as providing tools and information to help better manage a firm’s ERISA benefit plan audit practice.

Center resources and benefits. Center resources include timely e-mail news alerts on current EBP audit, accounting, and regulatory developments; a dedicated center Web site at www.aicpa.org/EBPAQC; CPE teleconference “Live Forums” on a variety of technical, regulatory, and practice management subjects; and an online discussion forum for networking and sharing best practices. Other resources and benefits include online Resource Centers in the areas of 403(b) plan audits, new audit standards, stable value investments, and the Pension Protection Act of 2006; tools and aids to assist members in planning and performing their audits and improving their EBP practice, including a SAS No. 70 review checklist, an internal inspection tool, an audit preparedness checklist, tools to help auditors respond to a request for proposal; plan advisories on monitoring TPAs, the importance of internal controls, and valuing and reporting plan investments; and savings on professional liability insurance.

Center requirements. Center members must designate a partner responsible for audit quality; establish a program to ensure personnel possess current knowledge of applicable professional standards, rules, and regulations; establish policies and procedures specific to ERISA audits; maintain a minimum amount of CPE training in EBP audits, conduct annual internal inspections of their ERISA audits; maintain their peer review report in a public file; and have audits selected in peer review reviewed by individuals employed by a center member firm. Center members also must pay annual dues, which start at $150 per year for a firm with fewer than 10 CPAs.

The EBPAQC is making a difference in audit quality. Reviews performed by the DOL’s EBSA continue to show a difference in the quality of ERISA audits performed by center member firms compared with those performed by nonmember firms. Not only do center member firms have fewer ERISA audit failures, but those failures also tend to be much less severe than those by nonmember firms.

For more information about the EBPAQC, visit the center Web site at www.aicpa.org/EBPAQC or call 202-434-9207.

Auditors of Non-Public Broker Dealers Are Now Required to Register with the PCAOB

As the result of the expiration of an SEC Order, absent further action by the SEC, financial statements of non-public broker-dealers for fiscal years ending after December 31, 2008 must be certified by a public accounting firm that is registered with the PCAOB.

The SEC Order requiring registration had been originally issued in 2003 under Section 17(e) of the Securities Exchange Act of 1934, but was delayed several times via extensions up to January 1, 2009. In a Statement issued January 9, 2009 available at http://www.pcaobus.org/News_and_Events/News/2009/01-07.aspx, the PCAOB provided information on how affected firms should now apply for PCAOB registration (also see FAQs on the process at http://www.sec.gov/divisions/marketreg/faq-pcaobregbdauditors.htm and http://pcaob.org/Registration/Staff_QAs_on_the_Registration_of_Broker-Dealers.pdf).

The Statement also noted that “audits of non-public broker-dealers, like other private company audits, are not, under current law, subject to Board inspection and cannot be the basis for Board disciplinary action.”

Peer Review Standards’ Interpretations require firms to have their peer review administered by the National Peer Review Committee (NPRC) if they are required to be registered and inspected by the PCAOB. Firms not otherwise required to be administered by the NPRC may continue to have their peer reviews administered by state CPA societies, since the Statement only requires registration with the PCAOB but not inspection. Furthermore, audits of non-public broker-dealers remain in the scope of peer reviews.

The SEC and PCAOB’s actions on non-public broker-dealers are subject to change. In fact, on February 26, 2009, Congressman Paul E. Kanjorski (D-PA), Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, introduced H.R. 1212, a bill which proposes that the PCAOB have the full authority to inspect, examine, and discipline the auditors of all broker-dealers, not just public broker-dealers (see http://kanjorski.house.gov/index.php?option=com_content&task=view&id=1437&Itemid=1). We encourage you to monitor the SEC and PCAOB’s press releases and orders.
PCAOB Issues Summary of Inspections

On December 5, 2008, the PCAOB issued a report on its 2004–2007 inspections of domestic annually inspected firms. The report discusses observations identified during these inspections as well as certain efforts firms have represented they made to remediate possible defects in their quality control systems. The report can be found at: http://www.pcaobus.org/Inspections/Other/2008/12-05_Release_2008-008.pdf. Reviewers should be familiar with the findings and use this report as a tool for assisting firms in understanding the importance of performing and documenting certain audit procedures.

ADMINISTRATIVE ALERTS

Reviewers—Update Your Resume Annually and Advise AICPA Peer Review of Your Correct E-Mail Address

The AICPA peer review team will inform reviewers via e-mail each year that their resumes are to be updated. Reviewers can enter their resume online at www.aicpa.org/members/div/practmon/index.htm. If a reviewer’s resume is not updated or acknowledged within two years, the reviewer will be prohibited from performing peer reviews until the resume is updated.

The AICPA peer review team will send all future correspondence regarding the AICPA peer review program via e-mail. Therefore, it is imperative that all reviewers maintain a current e-mail address on file with the AICPA peer review program. Failure to inform the AICPA peer review team of e-mail address changes may result in not having all the necessary information to perform and report on a peer review in conformity with the Standards. If your e-mail address changes, please contact the AICPA peer review team at (919) 402-4502 immediately or send an e-mail to PeerReviewUpdates@aicpa.org.

OVERSIGHT ALERTS

Comments From Working Paper Oversights

The following is a summary of the most prevalent and recurring comments that have been generated as a result of the most recent working paper oversights performed by AICPA Peer Review Program staff.

Risk Assessment

The risk assessment does not discuss the firm’s system of quality control.

Factors to consider in assessing risk can include the following:

- The relationship of the firm’s audit hours to total accounting and auditing hours
- The size of the firm’s major engagement(s) relative to the firm’s practice as a whole
- Initial engagements and their effect on the firm’s practice
- The industries in which the firm’s clients operate and their risk level
- The results of the prior peer review
- Owners’ continuing professional education (CPE) policies
- The firm’s monitoring policies
- Adequacy of the firm's professional library
- Changes in the firm’s structure or personnel since the prior peer review
- Office locations.

Interpretation 52-1 of the Standards discusses the peer reviewer’s responsibility to document the risk assessment.
Supplemental Checklists on Engagement Reviews

In addition to using the Financial Reporting and Disclosure Checklist, the peer reviewer may also refer to the applicable supplemental checklists contained in PRP 22,000, “Engagement Checklist Supplements—System Reviews.” The supplemental checklists cover disclosure and financial presentation items that are unique to specific industries. Supplemental checklists are available for Banks and Savings Institutions, Construction Contractors, Common Interest Realty Associations, Health Care Organizations, HUD, Personal Financial Statements, Single Audit Act/A-133, and Yellow Book engagements.

Client Engagement Listings

The client engagement listing did not (1) indicate the 12-month period ended to which the listing applied, (2) had an incorrect peer review year, (3) contained engagements outside the scope of the peer review year, or (4) did not include all engagements covered by professional standards.

The peer reviewer should verify the accuracy of information submitted by firms prior to beginning the peer review through discussions with key personnel and comparison to the background information provided by the firm to the administering entity.

TRANSITION ALERTS

White Paper Issued for Navigating Through Revised Peer Review Standards

The AICPA’s Peer Review Board has issued a white paper, Navigating Through the Revised AICPA Standards for Performing and Reporting on Peer Reviews and Related Interpretations. The paper serves as a bridge between the current and revised Standards and Interpretations and explains how the changes may affect enrolled firms (including those responsible for the firm’s quality control function), peer reviewers, entities administering peer reviews, and peer review users, including regulators.

The white paper

- explains the top level changes in the reporting processes, considered to be the most significant of the changes;
- provides background and explanations to other significant changes (including the more principles-based approach and changes to engagement and report reviews);
- discusses how the comment letters received in response to the exposure draft were considered in the process of finalizing the revised Standards; and
- describes how readers can learn more about the revised Standards.

Some of the revised Standards and Interpretations changes affect enrolled firms’ 2009 peer review scheduling, for which planning could occur in fall 2008. In addition, there is a change in regard to independence requirements, which could affect how enrolled firms conduct their 2008 monitoring procedures.

To ensure AICPA Peer Review Program integrity and usefulness, the revisions were designed to meet stakeholders’ needs. The revisions recognize the public interest in the quality of the accounting, auditing, and attestation services provided by members’ firms. They also recognize the importance that peer review plays in the state board of accountancy licensure process and for other regulators such as the GAO. The revisions are expected to result in a more efficient and effective peer review process. The white paper will assist those parties interested in peer review to gain a better understanding of the revised guidance and serve as a helpful resource to navigating through the revised Standards and Interpretations.

The revised Standards and Interpretations are effective for peer reviews commencing on or after January 1, 2009 and are applicable to all AICPA members’ firms subject to peer review. Members’ firms currently enrolled in the Center for Public Company Audit Firms Peer Review Program are covered under this measure.

Independence Impairment for Those Performing Monitoring (Including Internal Inspections), Consulting Reviewers, and Preissuance Reviewers Intending to Perform Peer Reviews

Under Interpretations 21-2 and 21-3 of the revised Standards for Performing and Reporting on Peer Reviews, independence would be considered impaired for purposes of being able to perform a firm’s peer review (whether as a team captain or team member) for anyone also performing monitoring (which includes internal inspection),
preissuance review, or consulting review for the firm for the year immediately preceding or during the peer review year. It is very important for peer reviewers to focus on this matter immediately because although the interpretation becomes effective for reviews commencing on or after January 1, 2009, the effect is immediate if peer reviewers have already performed or were planning to perform a firm’s monitoring (including internal inspection), a preissuance review, or a consulting review in 2008, and they want to remain eligible to perform the firm’s peer review in 2009 (or later).

In conjunction with the guidance, reviewed firms and peer reviewers should consider the nature of any peer review services, including the performance of corrective or monitoring actions, to determine if there is an independence conflict.

Three-Year AICPA PRP Peer Review Training Requirement Versus Five-Year CPCAF PRP Peer Review Training Requirement

Interpretation 14 (33-1) to the revised Standards for Performing and Reporting on Peer Reviews discusses that in order to “maintain” the qualifications of a team captain or a review captain (assuming other qualifications are met), that individuals should participate in eight hours of peer review CPE within three years prior to the commencement of the review. Although the number of hours and three-year window has not changed for AICPA PRP reviewers, peer reviewers that only performed Center for Public Company Audit Firms (CPCAF) PRP reviews in the past would now be subject to the AICPA PRP requirements as of January 1, 2009, and would also only have a three-year window to take the peer review training rather than the existing five years under the CPCAF PRP. The effect of this interpretation is immediate for peer reviewers of CPCAF PRP reviews who have not participated in eight hours of CPE within three years prior to a review taking place on or after January 1, 2009 and want to remain eligible to perform the firm’s peer review.

Establishing and Maintaining a System of Quality Control for a CPA Firm’s Accounting and Auditing Practice (SQCS No. 7) Practice Aid Available

This AICPA Audit and Accounting Practice Aid updated the 2004 edition of Establishing and Maintaining a System of Quality Control for a CPA Firm’s Accounting and Auditing Practice. This Practice Aid is intended to help practitioners better understand and apply Statement on Quality Control Standards (SQCS) No. 7, A Firm’s System of Quality Control (AICPA, Professional Standards, vol. 2, QC section 10). That standard is included in appendix A of this Practice Aid. This version of the Practice Aid, prepared by the Quality Control Standards Task Force, has been revised to incorporate new policies and procedures that a firm should consider including in its system of quality control to be responsive to the issuance of SQCS No. 7. It is available for download at www.aicpa.org/download/members/div/auditstd/System_of_Quality_Control_Practice_Aid.pdf or can be purchased online at www.cpa2biz.com.

Documentation of a System of Quality Control Under the SQCS

Statements on Quality Control Standards (SQCS) require a firm to document its system of quality control policies and procedures. The AICPA has developed quality control questionnaires used in the peer review process which may also be sufficient documentation of the system of quality of control for some firms. In order for the questionnaire to properly satisfy the SQCS’s documentation requirement, it should be completed and in effect prior to the beginning of the peer review year. When determining the extent of documentation required for the questionnaire, the reviewed firm should consider that “Yes” and “No” answers may assist in identifying the control objective, but it would not typically satisfy the required documentation of how the control was met. Documenting how controls are met is an integral component of documenting the quality control policies and procedures and is expected to be included if the questionnaire is meant to satisfy the requirements of SQCS No. 7 and be used as the firm’s quality control document. The reviewed firm should document the control objective and the details of the policies and procedures. Firms that have a complex system will require more detailed and tailored documentation. The document would suffice for 3 years, but should be monitored and continually evaluated.

Statement on Auditing Standards (SAS) No. 115, Communicating Internal Control Related Matters Identified in an Audit

The Auditing Standards Board (ASB) has issued Statement on Auditing Standards (SAS) No. 115, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325). SAS
No. 115 supersedes SAS No. 112 and was issued to eliminate differences within the AICPA’s Audit and Attest Standards resulting from the issuance of Statement on Standards for Attestation Engagements (SSAE) No. 15, *An Examination of an Entity’s Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*. SSAE No. 15 establishes standards and provides guidance to practitioners performing an examination of a nonissuer’s internal control over financial reporting in the context of an integrated audit. SSAE No. 15 aligns the definitions of the various kinds of deficiencies in internal control and the related guidance for evaluating such deficiencies with the definitions and guidance in Public Company Accounting Oversight Board (PCAOB) Auditing Standards No. 5, *An Audit of Internal Control That is Integrated with an Audit of Financial Statements* (AICPA, PCAOB Standards and Related Rules, Rules of the Board, “Standards”). SAS No. 115, in turn, aligns the definitions and related guidance for evaluating deficiencies in internal control with the definitions and guidance in SSAE No. 15.

The SAS contains revised definitions of the terms *material weakness* and *significant deficiency* and revises the list of deficiencies in internal control that are indicators of material weaknesses. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2009. Earlier implementation is permitted.

**Updated and New Practice Aids for Peer Reviews Commencing on or after January 1, 2009**

The updated and new practice aids, issued in conjunction with the Revised Peer Review Standards and Interpretations, are now available and must be used for all reviews commencing on or after January 1, 2009. Important changes include:

*Summary Review Memorandum (SRM) on System Reviews*

A new form, the Disposition of Matters for Further Consideration (DMFC) Form, along with instructions for its use, is included in the 2009 SRM. Some terminology has been revised to be consistent with that of Statement on Quality Control Standards (SQCS) No. 7 (such as the phrase *professional staff* being replaced with *personnel*). Also, when a question in the SRM relates to an Interpretation of the Standards, it now refers to that particular Interpretation.

Question H1, relating to risk assessment, has been expanded to include how inherent and control risk impact detection risk and the scope of review procedures. In response to reviewer feedback, more space has been provided for reviewers to document their risk assessment. If more space is needed, please attach additional documents. Another new question was added regarding factors considered if the review was performed at a location other than the reviewed firm’s office. There is also a place to document when approval to perform the peer review at the other location was granted by the Administering Entity.

The ERISA industry categories in Part III “Scope of Work Performed” and Attachment I have been revised to no longer differentiate between limited and full scope audits, and a separate category has been created for ESOP plans (see separate article “2008 vs. 2009 ERISA Codes”).

Additional questions have also been added for the reviewer’s recommendation of an implementation plan(s) (in response to any Finding for Further Consideration Forms) or corrective or monitoring action(s) (in response to deficiencies or significant deficiencies noted in the report). There are also new questions relating to the team captain’s physical attendance (at the reviewed firm’s office) at the exit conference and asking if the majority of the review was done at the reviewed firm’s office.

Throughout the revised Standards, Interpretations, and all related documents, the concept of “substandard” engagements is no longer used, since the revised Standards emphasize a more systemic approach to issues noted. However, the SRM still requires that team captains identify which engagements are not performed and/or reported on in conformity with applicable professional standards in all material respects.

*Team Captain/Review Captain Checklists*

Changes to the team captain checklist reflect changes to the peer review reporting model and the conduct of the peer review, including the use of FFC forms and implementation plans. A new form, the Disposition of Matters for Further Consideration (DMFC) Form, along with instructions for its use, is included in the Review Captain Checklist.

*MFC/FFC Forms*

The Matter for Further Consideration (MFC) Form has been enhanced to ask for the underlying cause of the matter on System Reviews, where possible, and whether a similar matter was noted in the prior review. A new form called the Findings for Further Consideration (FFC) Form has been introduced to document findings, as required under the new reporting model.
Quality Control Questionnaires

The personnel thresholds on the quality control questionnaires have changed to “sole practitioner with no personnel” and “firms with two or more personnel”. The revised questionnaires reflect SQCS 7 requirements effective January 1, 2009, and should be used for all peer reviews commencing on or after January 1, 2009 whether the peer review year end is before or after January 1, 2009.

SQCS 7 relates to the firm’s quality control on a system-wide basis. Therefore, whether a reviewed engagement has a year end, or is performed, before or after January 1, 2009 is not relevant. What is relevant is whether the firm implemented SQCS 7 by January 1, 2009, and whether it was implemented appropriately.

For peer review year ends in 2009 or after (whether or not the year began in 2008), any items coming to the team captain’s attention relating to the firm’s noncompliance with SQCS 7 should be evaluated to determine if they rise to the level of a matter, finding, deficiency or significant deficiency. However, for peer review year ends prior to January 1, 2009, since SQCS 7 was not yet in effect, any items coming to the team captain’s attention relating to the firm’s noncompliance with SQCS 7 (which were not requirements under the former SQCS guidance) should only be communicated to the firm during the exit conference. Those items would not warrant further elevation to a matter, finding, deficiency or significant deficiency. This approach will help focus the reviewed firm’s attention on those items they still need to address to come into compliance with SQCS 7. This technique is similar to when a team captain discusses new professional standards with the reviewed firm as an educational service.

2008 vs. 2009 ERISA Codes

The ERISA industry codes have been revised for 2009, as reflected in the background form, reviewer’s resume and Summary Review Memorandum for System Reviews. The codes no longer differentiate between limited and full scope audits, and a separate code has been created for ESOP plans, as follows:

<table>
<thead>
<tr>
<th>2008 ERISA Codes</th>
<th>2009 ERISA Codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined Contribution Plans- Full Scope</td>
<td>Defined Contribution Plans- Full and Limited Scope (Including 403(b) Plans)</td>
</tr>
<tr>
<td>Defined Contribution Plans- Limited Scope</td>
<td>N/A</td>
</tr>
<tr>
<td>Defined Benefit Plans- Full Scope</td>
<td>Defined Benefit Plans- Full and Limited Scope</td>
</tr>
<tr>
<td>Defined Benefit Plans- Limited Scope</td>
<td>N/A</td>
</tr>
<tr>
<td>ERISA Health and Welfare Plans</td>
<td>ERISA Health and Welfare Plans</td>
</tr>
<tr>
<td>Other ERISA Plans</td>
<td>N/A</td>
</tr>
<tr>
<td>Employee Stock Ownership Plans (ESOP)</td>
<td></td>
</tr>
<tr>
<td>Other Employee Benefit Plans</td>
<td>Other Employee Benefit Plans</td>
</tr>
</tbody>
</table>

Update on the AICPA Peer Review Manual and Postings to the Website

The AICPA Peer Review Manual is posted to the website. Team captain and review captain packages are available at: http://www.aicpa.org/members/div/practmon/peermaterials09.asp.


The Report Acceptance Body Handbook is now included in the manual and is also available on the website. This handbook is a valuable tool to reviewers and peer review committees. Chapters 4 and 5 provide guidance related to the type of report to be issued in a system and engagement review, respectively.

Subscribers to the manual will also receive a CD version of the manual. The CD will include search capabilities.

Document Retention Procedures for all Peer Reviews

Interpretation 25-1 of the Standards requires that peer review documentation prepared during System and Engagement Reviews, with the stated exceptions, should be retained by the reviewing firm, the administering entity, and the association in an association formed review team (if applicable) until 120 days after the peer review is completed.

PRP §3200

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Effective January 1, 2009, this Interpretation is *effective for all reviews*, whether they commenced before or after January 1, 2009. This will eliminate the burden of determining which standards a review was performed under before determining which document retention procedure to follow.

**Industry Code added for SAS 70 Audits of Service Organizations**

At its May 2009 meeting, the AICPA Peer Review Board (PRB) approved the addition of an industry code that is for service organizations (SAS 70 audits). The industry code is now included on the reviewed firm’s background form and the reviewer’s resume. The level of experience peer reviewers must have is similar to other industries.

Peer reviewers with SAS 70 audit experience should update their resume on-line at http://www.aicpa.org/members/div/practmon/index.htm to reflect this experience.

**Audit Planning in a Recessionary Environment**

The U.S. economy is experiencing a great amount of instability. During 2008 and into 2009 deteriorating economic conditions and increased government intervention continues. The economic crisis undoubtedly is affecting both financial statement preparers and the auditors engaged to audit their financial statements. Few, if any, industries are immune to the effects of the crisis.

The AICPA has published an Audit Risk Alert focused on the current economic crisis, legislative and regulatory actions taken to curtail the crisis, and accounting and auditing issues arising as a result of these events. These tough economic times have made accounting for transactions and auditing entities more challenging than ever and this alert is an important tool in helping you identify the significant risks that may result in the material misstatement of financial statements.

The Alert covers issues arising from the economic crisis including:

- Fair value accounting considerations including measurements of fair value in illiquid markets and auditing those fair value measurements
- Other than temporary impairment issues
- Auditing accounting estimates
- Liquidity considerations
- Going concern considerations
- Fraud considerations

Whether you purchase this alert or not, you are encouraged to consider the above issues when planning your upcoming audit engagements and are further encouraged to make your peer review clients aware both of these issues as well as the availability of the Alert.

The Alert is an *other auditing publication* as defined in AU section 150. Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards. The auditing guidance in the Alert has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. The Alert has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

Click [here](#) for more information on the Alert.

**Required Identification of Review Type on Top of Reports**

In an effort to create a new reporting model which improves transparency and understandability, the *Standards* require that the type of peer review report (System Review Report or Engagement Review report) be identified at the top of the report (Paragraphs 96a, 122a and related Appendixes). Reports that do not state the review type at the top of the report cannot be accepted by administering entities.

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[The next page is 3301.]