

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 website, and the more relevant version will be issued.

(Issued Through February 1, 2014)

GENERAL ALERTS**Enhanced Guidance on Understanding the Adequacy of Quality Control Material Used by a Reviewed Firm**

The Peer Review Board (board) approved revisions to guidance related to understanding the adequacy of quality control materials (QCM) used by a reviewed firm. Such materials provide guidance to assist firms in performing and reporting in conformity with professional standards. They may include, but are not limited to, such items as accounting and auditing manuals, checklists, questionnaires, and work programs. The revisions are intended to assist peer reviewers in obtaining a sufficient understanding of a reviewed firm's system of quality control, specifically how the firm uses QCM to promote consistency in the quality of engagement performance. These revisions impact all peer reviewers.

The revised guidance affects PRP Section 2000 and Interpretations 42-2 and 42-3 under "Understanding the Firm's System of Quality Control." It also introduces new supplemental guidance regarding evaluating a firm's QCM in PRP Section 3100, *Supplemental Guidance*. Corresponding revisions have also been made to PRP Section 4800, *Summary Review Memorandum (SRM)*, and the Quality Control Questionnaires, specifically PRP Sections 4300–4600, *Quality Control Policies and Procedures Documentation Questionnaire for Firms with Two or More Personnel*, its related questionnaires, *Guidelines for Review...*, and those related to sole practitioners with no personnel.

These changes can be found as the September 27, 2013, Board Open Session Agenda Item 1.2A-9 and will be included in the 2014 Peer Review Program Manual (PRPM). The guidance is effective for peer reviews commencing on or after January 1, 2014. However, early implementation is allowed and encouraged.

A summary of the key revisions to the guidance is as follows:

- Significant revisions were made to Interpretation 42-2 (formerly 42-3) to indicate that a review team should understand a reviewed firm's policies and procedures for
 - developing and maintaining QCM (when QCM are internally developed) or for adopting, updating, and modifying QCM (when QCM are obtained from third parties).
 - determining the reliability of the QCM utilized by the reviewed firm.
 - determining the suitability of the QCM utilized by the reviewed firm.

The review team should also determine if these policies and procedures are appropriately designed and complied with. The revisions indicate that the results of these procedures should be considered when the team captain prepares his risk assessment, determines scope, performs functional testing, concludes on the peer review, and considers the systemic causes for matters, findings, deficiencies, and significant deficiencies.

A summary of the new and key revisions to the guidance is as follows:

- Revisions were made to Interpretation 42-3 (formerly 42-2) to provide further guidance on how a review team should evaluate the QCM review report for QCM used by the reviewed firm and obtained from third parties. The revisions focus on considering the scope of the QCM review.
- New supplemental guidance provides four practical examples for evaluating a firm's QCM using the guidance in Interpretations 42-2 and 42-3.
- Corresponding revisions were made to the summary review memorandum (SRM) and quality control questionnaires QCQs to incorporate the objectives of the guidance in the revised interpretations.

Clarifying Changes to Quality Control Policies and Procedures Documentation

The board approved clarifying changes to guidance for requesting a firm's quality control document or responses to quality control policies and procedures documentation questionnaires. The clarifications affect PRP Section 4300 and 4400 *Quality Control Policies and Procedures Documentation Questionnaires for a Sole Practitioner With No Personnel* and for *Firms With Two or More Personnel*, respectively, and PRP Section 4100, *Instructions to Firms Having a System Review*. The clarifications can be found as the September 27, 2013, Board Open Session Agenda Item 1.2B-2 and will be included in the 2014 PRPM. The guidance is effective upon issuance.

A summary of the clarifications are as follows:

- Firms have previously been expected to provide a copy of their quality control document to their team captain. The changes specify that the document supplied should reflect the policies and procedures effective for the peer review year.
- Team captains have previously been permitted to request that a firm complete the applicable quality control questionnaire even if the firm has a quality control document. The changes clarify that the firm should still provide a copy of their quality control document to their team captain. The changes also provide some examples as to why completion of the questionnaire would still be requested by the team captain when a quality control documentation has been provided.
- Firms without quality control documents have been able to complete the applicable Quality Control Policies and Procedures Questionnaire as the primary documentation of their system of quality control (to assist them in complying with the documentation requirements of Statement of Quality Control Standard [SQCS] No. 8, *A Firm's System of Quality Control (Redrafted)* [AICPA, *Professional Standards*, QC sec. 10]). If the questionnaire completed for the peer review was not in effect for the peer review year, the changes indicate the firm should also attach previously completed questionnaire(s) that were effective for the peer review year (which could be the questionnaire completed for the firm's last peer review).

The changes ensure that team captains focus first on whether a firm has a quality control document effective for the peer review year and whether the applicable quality control questionnaire needs to be completed to supplement that quality control document. The changes also ensure that if the firm does not have a quality control document, that it provides the applicable completed quality control questionnaire effective for the peer review year.

Team captains should refer to “Monitoring and Documentation of a Firm’s System of Quality Control” within 3100 Supplemental Guidance to determine the impact on a peer review when there is marginal or a lack of documentation of a firm’s system of quality control as required by the SQCS.

Enhanced Guidance on QCM Review Reports and Performing QCM Reviews

The board approved revisions to guidance related to performing and reporting on reviews of QCM. Such materials provide guidance to assist firms in performing and reporting in conformity with professional standards. They may include, but are not limited to, such items as accounting and auditing manuals, checklists, questionnaires, and work programs. Users of QCM review reports could be peer reviewers or CPA firms utilizing QCM. The revisions are intended to improve users’ understanding of QCM review reports. The revisions are also intended to provide clarity on how a reviewer should conduct a QCM review.

The revised guidance affects PRP section 1000, appendix R, “Illustration of a Report With A Review Rating of Pass in a Review of Quality Control Materials,” and corresponding appendixes S and T for report ratings of pass with deficiencies or fail, respectively. It also introduces two new Interpretations to PRP section 2000, No. 167-1, “Identifying Scope During QCM Review Planning,” and No. 199-1, “Non-Cooperation.” This revised guidance also makes conforming changes to PRP Section 1000, paragraph .175, “Performing Tests of the Materials,” and related Interpretation 176-1, “Independent QCM Reviews.”

These changes can be found as the September 27, 2013, Board Open Session Agenda Item 1.2A-9 and will be included in the 2014 PRPM. The guidance is effective for peer reviews commencing on or after January 1, 2014. However, early implementation is allowed and encouraged.

A summary of the key revisions to the guidance is as follows:

- Revisions were made to the QCM report to inform users to carefully consider the scope of the QCM review. The report also instructs users to understand the intended uses and limitations of the QCM as reflected in the QCM’s user instructions and related information, and the level of explanatory guidance provided by the QCM. The report now informs users that they are responsible for evaluating the suitability of the QCM. Lastly, the report also informs users that the reliability of the QCM is dependent on the effectiveness of the users’ processes and could vary from user to user.
- New Interpretation 167-1 indicates that when the QCM provider determines the scope of the QCM review, the scope should be documented during planning by the QCM provider and QCM reviewer, and will be incorporated into the QCM review report. As an example, scope can vary depending on which QCM elements of a QCM guide (such as practice aids, letter templates, sample completed aids or templates, and so on) are covered by the QCM review.
- New Interpretation 199-1 provides circumstances in which a QCM provider is deemed as failing to cooperate once the QCM review has commenced, and how the National Peer Review Committee (PRC) should proceed. It also addresses a QCM provider’s withdrawal from the QCM review process after the QCM review’s commencement, and QCM providers’ responses to findings and deficiencies noted in a QCM review.

Changes were incorporated to Standards paragraphs .156 and .158 effective January 1, 2012, that were also not reflected in Standards paragraph .175 and related Interpretation 176-1. The conforming changes affect references to phrases reading “user firms in conforming with all the components which are integral to the professional standards the materials purport to encompass.”

Firm Responsibilities and Reviewer and Report Acceptance Body Responses Related to Nonconforming Engagements

The board approved guidance related to responding to engagements that are deemed as not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming engagements). If nonconforming engagements are identified during the peer review, the reviewed firm has the responsibility to make appropriate considerations about how to remediate the engagement, such as whether to perform omitted procedures, reissue the accountant or auditors reports, or have previously issued financial statements revised in accordance with professional standards. The approved guidance emphasizes that the peer reviewer and the report acceptance body (RAB) should also evaluate whether the firm's response is appropriate, whether lack of appropriate response is indicative of other weaknesses in the firm's system of quality control, or whether monitoring procedures are necessary to verify if the engagement was remediated.

The guidance, which is included as revisions to Interpretation 67-1, a new article in PRP Section 3100 Supplemental Guidance, and revisions to PRP Section 3300, *Report Acceptance Body Handbook*, chapters 4 and 5, can be found as the August 14, 2013, Board Open Session Agenda Item 1.4 and will be included in the 2014 PRPM. The guidance is effective for peer reviews commencing on or after January 1, 2014. However, early implementation is allowed and encouraged.

When updates to Interpretation 67-1 and Sections 3100 and 3300 are available on www.AICPA.org, we will send a separate e-mail notification.

A summary of the key revisions to the guidance is as follows:

- Revision to Interpretation 67-1 includes the following:
 - Continue to prohibit the reviewer and administering entity (AE) from instructing or requiring a reviewed firm to perform omitted procedures, reissue accounting and auditing reports, or to have previously issued financial statements revised and reissued. However, Interpretation 67-1 was revised to allow a monitoring action if the reviewed firm indicates that such remediation is necessary and will be performed.
- PRP Section 3100 Supplemental Guidance addresses a reviewed firm's responsibility to consider applicable professional standards and to provide a response, deemed sufficient (genuine, comprehensive, and feasible) by the reviewer and the RAB, for each nonconforming engagement identified during the peer review:
 - The firm should document and provide a written response to the reviewer about the firm's considerations of whether or not to perform omitted procedures, reissue accounting or auditing reports, have revisions made to previously issued financial statements, or remediate a subsequent engagement.
 - The firm should thoroughly consider the continued reliance by third-party users on reports issued and work performed. The firm particularly should consider the expectations of regulatory bodies that the firm will perform procedures and/or correct reports in a timely manner.
 - The firm should include the summary of its considerations and conclusions in its response generally documented on a matter for further consideration (MFC) form.
 - The reviewer should thoroughly evaluate and document his or her assessment of the firm's considerations on documents submitted to the RAB (MFC form, additional team or review captain comments, and SRM or Team or Review Captain's Checklist).
 - The reviewer or AE should not require or instruct the firm to perform omitted procedures, reissue accounting or auditing reports, or to have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make. However, the AE can require the reviewed firms to make appropriate considerations regarding nonconforming engagements as a condition of acceptance of the peer review. The firm's actions may affect other monitoring actions the AE's peer review committee may impose, including actions to verify that the firm adheres to the intentions indicated in the firm's response. This may include requiring a firm to agree to have someone who is acceptable to the RAB review the engagement remediation.

- In a system review, a lack of a firm’s appropriate considerations and response should cause the reviewer to evaluate whether this is indicative of a potential failure to comply with the leadership or tone at the top element in the firm’s system of quality control.
- Revisions to the Report Acceptance Body Handbook chapters 4 and 5 include the following:
 - The RAB should not accept a peer review if the firm’s response is not deemed to be sufficient (genuine, comprehensive, and feasible), including documenting its considerations regarding nonconforming engagements.

The RAB should ordinarily consider whether to impose a monitoring action (corrective action or implementation plan, as applicable) to require review by someone acceptable to the RAB of the firm’s remediation of the nonconforming engagement. This would be applicable in cases in which a nonconforming engagement supports a peer review report deficiency, supports an initial finding for further consideration (FFC) in a must-select industry, or supports a repeat FFC in any industry. This type of corrective action or implementation plan should only be considered when the firm has already indicated in its response that it agrees with the reviewer’s determination that the engagement does not conform to applicable professional standards in all material respects and performance of omitted procedures or reissuance of the auditor’s or accountant’s report, or revisions to previously issued financial statements is appropriate under the circumstances.

Joining an Audit Quality Center as a Corrective Action

The board approved guidance related to responding to engagements that are deemed as not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming engagements).

The guidance, which is included as revisions to PRP Section 3300, *AICPA Peer Review Program Report Acceptance Body Handbook*, chapter 4, can be found as the August 14, 2013, Board Open Session Agenda Item 1.5 and will be included in the 2014 PRPM. The guidance is effective for peer reviews commencing on or after January 1, 2014.

A summary of the key revisions to chapter 4 of the *Report Acceptance Body Handbook* is as follows:

- If engagement performance deficiencies are related to a specific industry (governmental or employee benefit plans), the RAB may consider that joining an audit quality center and submitting evidence of joining such a center may be a viable corrective action in addition to other corrective actions. For this type of corrective action, the report deficiency must be supported by industry specific engagements that are not performed or reported on in conformity with applicable professional standards in all material respects.
- A RAB would be able to require that a firm join the Employee Benefit Plan Audit Quality Center (EBPAQC) or Governmental Audit Quality Center (GAQC) for firms enrolled in the AICPA Peer Review Program (PRP) when the RAB believes that membership and compliance with the directives of the Audit Quality Centers (AQC) would improve the quality of the firm’s system of quality control related to these types of engagements.
- The requirement to join the EBPAQC or GAQC may only be prescribed as a corrective action when the firm is eligible to enroll in the centers and in conjunction with other corrective actions.
- In all other instances joining an AQC may be a recommendation from the reviewer to the firm communicated on an MFC form, FFC form, or as an exit conference item (for example, when the firm is not eligible to join because there are no AICPA members within the firm, or when a nonconforming engagement does not support a peer review report deficiency but rather a matter or a finding).

Evaluating Compliance With the 2011 Yellow Book Independence Requirement Related to Non-Audit Services

The board approved important guidance for evaluating a reviewed firm’s compliance with the December 2011 Revision of *Government Auditing Standards* (GAS). This guidance is in the form of a Q&A for Peer Reviewers and includes an exhibit to assist the peer reviewer in the evaluation.

This new guidance included in PRP Section 3100, *Supplemental Guidance*, can be found as the May 7, 2013, Board Open Session Agenda Item 1.2B-1 and will be included in the 2014 PRPM. The guidance is effective upon issuance.

A summary of the guidance is as follows:

- The board has determined that when a firm performs an engagement in accordance with GAS when independence is impaired, the engagement would be deemed as not performed or reported on in conformity with applicable professional standards in all material respects. However, a firm failing to comply with the documentation requirements of the December 2011 Revision of GAS (2011 Yellow Book) does not impair independence (see paragraph 3.59 of the 2011 Yellow Book) and further inquiries by the reviewer are required to establish if independence impairments existed.
- The 2011 Yellow Book contains additional requirements beyond those required under AICPA Ethics Interpretation 101-3. Documentation of compliance with those requirements is explicitly required. Therefore, material noncompliance with either the independence evaluation or the documentation requirements of the 2011 Yellow Book would result in the engagement being deemed as not performed or reported on in conformity with applicable professional standards in all material respects.
- The 2011 Yellow Book emphasizes that documentation is required for the evaluation of each of the elements of independence, which consists of management's ability to oversee the non-audit services, including whether management has suitable skills, knowledge, and/or experience (SKE), significant threats that require the application of safeguards along with the safeguards applied, and the understanding established with the audited entity regarding the non-audit services to be performed. Therefore, failure to document one or more of these elements is considered a departure from professional standards.
- If there is a failure to document one or more of the elements of the independence evaluation required by the 2011 Yellow Book, ordinarily the engagement should be considered as not performed in conformity with applicable professional standards in all material respects. If there is marginal documentation of a particular element required by professional standards, the peer reviewer should use judgment to determine the degree of noncompliance on the conclusion of the engagement.
- If the firm failed to document all of the elements required by GAS to evaluate independence, the reviewer should presume that independence was impaired. However, the audit firm may be able to provide convincing evidence that the lack of documentation does not indicate independence impairments.
- If the peer reviewer concludes that there is a failure to comply with the documentation requirements of the 2011 Yellow Book, the peer reviewer should remind the firm of its responsibilities under AU-C section 585, *Consideration of Omitted Procedures After the Report Date* (previously AU section 390) (AICPA, *Professional Standards*). The peer reviewer should further ascertain if independence was impaired and expect a prompt response to support the auditor's assertion that independence was not impaired. If the reviewer subsequently concludes that the audit firm has sufficiently demonstrated compliance with applicable independence evaluation elements, the audit firm should also take appropriate action to revise documentation in accordance with AU-C section 230, *Audit Documentation* (previously SAS No. 103 and AU section 339) (AICPA, *Professional Standards*), in order to comply with the 2011 Yellow Book independence requirements. Due to the firm's failure to materially comply with the documentation requirements of the 2011 Yellow Book, the reviewed engagement would be considered not performed or reported on in conformity with applicable professional standards in all material respects.
- If the firm cannot provide sufficient evidence to demonstrate that the firm was independent, then the engagement is not performed or reported on in conformity with the 2011 Yellow Book in all material respects. Lack of independence on an audit engagement requires the auditor to take all appropriate steps under professional standards which may include preventing further reliance on the auditors' report, or revising and reissuing the auditors' report. The peer reviewer should remind the firm of its responsibilities under AU-C section 585, *Consideration of Omitted Procedures After the Report Date* (previously AU section 390) (AICPA, *Professional Standards*), and AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (previously AU section 561) (AICPA, *Professional Standards*), regarding potential retraction of the engagement.

- If the peer reviewer determines that the firm failed to materially comply with the documentation or independence evaluation requirements of the 2011 Yellow Book, the peer reviewer should ordinarily prepare a MFC form to which the reviewed firm must respond. (Refer to Interpretation 67-1 under “Concluding on the Review of an Engagement.”) The reviewed firm should include the actions taken or planned regarding the engagement on the MFC form. The reviewer should indicate whether the reviewer concurs with the firm’s response, actions, or planned actions within section IV of the Summary Review Memorandum.

Engagement Reviews—Areas of Common Noncompliance With Applicable Professional Standards

The board approved important changes related to guidance for engagement reviews. A listing of areas of common noncompliance with applicable professional standards appeared in PRP Section 3300, *AICPA Peer Review Program Report Acceptance Body Handbook*, and PRP Section 6200, *Instructions to Reviewers Performing Engagement Reviews*. In order to eliminate any potential inconsistencies, the listing in PRP 3300 and the listing in PRP 6200 have been deleted. The listing will only appear in appendix E of PRP Section 6200.

Several changes were made in order to clarify this guidance. The introductory paragraph was revised to include additional language from the standards to emphasize that a reviewer may conclude that one or more findings results in a deficiency or significant deficiency. The wording for some of the noncompliance matters was simplified and duplicates were deleted. Because there was confusion about the listing of specific financial statement areas of common noncompliance and how these matters should be treated, this list was deleted in its entirety.

The revisions to PRP Section 3300, *AICPA Peer Review Program Report Acceptance Body Handbook*, and PRP Section 6200, *Instructions to Reviewers Performing Engagement Reviews*, are reflected in the May 7, 2013, Board Open Session Agenda Item 1.2C-1. These revisions are effective upon issuance and will be included in the 2014 PRPM.

Reviewer Performance Revisions

The board approved revisions to guidance related to reviewer performance which are intended to provide more consistency in the program with regard to reviewer performance evaluation and communications. In addition, this will aid reviewers by providing further education about the performance of peer reviews. The reviewer feedback form was also revised to reflect the changes in the guidance and is currently available to administering entities.

The revised guidance included in PRP Section 3300, *AICPA Peer Review Program Report Acceptance Body Handbook*, chapter 8, section IV can be found as the May 7, 2013, Board Open Session Agenda Item 1.2A-2 and will be included in the 2014 PRPM. The guidance is effective for peer reviews commencing on or after January 1, 2014. However, early implementation is allowed and encouraged.

A summary of the key revisions to the guidance is as follows:

- Revisions were made to more explicitly state that a reviewer feedback form should not be issued to a reviewer to communicate trivial or preferential matters. Reviewer weaknesses communicated on a reviewer feedback form must be substantiated by peer review guidance with specific references, when possible, to enhance reviewer education.
- A reviewer feedback form should not be issued for matters that are communicated through other means in the peer review process. For instance, if peer review working papers are submitted late, there is a separate communications process as well as procedures that should be followed. Therefore, it is not necessary to communicate this through a reviewer feedback form.
- All reviewer performance weaknesses should be evaluated for severity and communicated through appropriate methods, such as other communications from the technical reviewer, a reviewer feedback form, performance monitoring letter, or performance deficiency letter.
- Reviewer performance weaknesses that are noted as a result of oversight must be communicated through appropriate methods, depending on the severity of the weaknesses noted, in addition to communication of the results of the oversight.

- The itemized listing of items (not all inclusive) that would ordinarily be considered justification for feedback was revised to group by category and provide specific references to peer review guidance.
- Technical reviewers may provide other communications to reviewers that are less critical in nature than the weaknesses generally considered on a reviewer feedback form; this is not considered feedback. Other communications from a technical reviewer should not be provided in lieu of issuing a reviewer feedback form, if the circumstances warrant such. Technical reviewers should consider communicating to the committee the aggregation of less critical departures from peer review guidance to collectively determine if the situation warrants the issuance of a reviewer feedback form. If a reviewer feedback form is warranted, the committee should issue it.

MFC Forms Guidance

Electronic MFC forms are required for peer reviews commencing on or after July 1, 2013. For engagement reviews, review captains may continue to complete the MFC forms on the reviewed firm's behalf until the electronic forms are implemented.

During 2012, the board approved several changes to the instructions for MFC forms that were effective January 1, 2013. The key changes were communicated in the December Reviewer Focus.

One of the approved changes related to firm signatures on MFC forms in an engagement review. As engagement reviews are typically performed offsite, review captains were previously permitted to complete the firm's response on its behalf after a teleconference to discuss the matter identified. The board determined that due to the ability of the firm to access the MFC form electronically, this option is no longer necessary. The reviewed firm representative would be expected to complete the firm's portions of the MFC form and to sign the form after discussing it with the appropriate individuals within the firm, including those charged with governance.

Due to the change in effective date for the electronic forms from May 1 to July 1, 2013, and the anticipated volume of engagement reviews during that period, the board determined requiring the firm to complete the firm's portion of the MFC and sign the form should also be delayed until July 1, 2013.

The reviewer has the option to

- implement the requirement early and have the firm sign the MFC, or
- follow the previously permitted guidance by completing the firm's response and signing the form on the firm's behalf after discussions regarding the matter.

Upon board approval in January, this change will be retroactive to January 1, 2013. This means that if an engagement review is submitted between January 1, 2013 and January 25, 2013 (board approval date), the technical reviewer should not require the review captain to obtain the firm's signature.

All other changes, as discussed in the referenced Reviewer Focus, are still effective for reviews commencing on or after January 1, 2013.

Considering the Results of Regulatory and/or Governmental Oversight

The board recently approved revisions to the Interpretations to clarify planning considerations for peer reviewers performing system reviews. The revisions are intended to aid peer reviewers in understanding how the results of regulatory and/or governmental oversight or inspections (for instance, Department of Labor inspections, oversight by a state entity, or Public Company Accounting Oversight Board [PCAOB] inspections) should be considered during the procedures to plan peer reviews.

The revisions have resulted in the following new interpretations:

- Interpretation 40-1, which addresses general considerations for regulatory and/or governmental oversight or inspections (replaces the extant Interpretation 40-1)

- Interpretation 40-2, which addresses additional considerations for PCAOB inspections
- Interpretation 83-3, which addresses considerations for the peer reviewer when the peer review has detected issues that are similar to issues raised in a regulatory or governmental oversight or inspection

These changes are effective upon issuance of this alert.

Other Planning Considerations

40-1 *Question*— Paragraph .40 of the standards notes that the peer reviewer should consider whether the areas to be addressed in the written representation require additional emphasis in the course of the review. To what extent should the team captain consider the results of regulatory and/or governmental oversights in the planning and performance of the peer review?

Interpretation—If the firm has undergone oversights or inspections by regulatory or governmental entities (for instance, the Department of Labor, the Department of Health and Human Services, or other local, state, or federal entities), the team captain should consider the results of those oversight reviews during planning and when determining the nature and extent of peer review procedures. The results from regulatory and/or governmental oversights are sources of information that should be considered within the context of peer review, as they can provide valuable information that may assist the review team in planning its procedures. However, the team captain should keep in mind that the goals of regulatory or governmental oversight may differ from the purpose of a system review, and it would be inappropriate to place reliance on regulatory or governmental oversight results. The team captain should consider and document the following factors regarding the procedures and results of regulatory and/or governmental oversights and communications from regulatory and/or governmental bodies:

- *The impact of regulatory and/or governmental oversight on the scope of the peer review.* When the types of engagements subject to regulatory and/or governmental oversight are also within the scope of engagements that can be selected for peer review, the review team should consider how the nature, cause, pattern, and/or pervasiveness of the oversight results impact the peer review in terms of inherent risk (for example, the firm's demonstrated expertise in performing those types of engagements) and control risk (for example, how the system of quality control is designed to prevent issues in those types of engagements, and the effectiveness of those controls based on the regulatory and/or governmental results), and document those considerations in the risk assessment.
 - If the oversight results indicate a lack of comments or only minor issues, the team captain should document the nature of the oversight results as a consideration in the risk assessment. Although a lack of comments is not necessarily indicative that the firm's system of quality control is operating effectively for the relevant industry practice, it is a factor in assessing inherent and control risk. When the oversight results include more substantive comments, the review team should evaluate the significance of the comments relative to the applicable industry and other industries and practice areas, and consider what impact, if any, they have on the peer review scope.
 - If the oversight results include deficiencies or indications of engagements that were not performed or reported on in conformity with applicable professional standards in all material respects in the view of the oversight body, the team captain should understand the underlying cause(s) identified by the firm and evaluate how the firm responded to the oversight results in order to properly consider the impact on the peer review risk assessment and engagement selection. If similar matters are identified as a result of the review team's review of engagements during the peer review, the team captain should consider whether the underlying causes identified by the firm (if any) are similar to the underlying causes identified by the review team.
- *The timing of the regulatory and/or governmental oversight results.* The team captain should consider the time period covered by the regulatory oversight results in determining their usefulness

for assessing peer review risk and determining the impact (if any) on the extent of peer review procedures. When possible, the team captain should obtain the oversight results from the most recently available oversight reviews. The team captain should inquire about any open or ongoing oversight reviews, the status of those oversight reviews, and the firm's preliminary remediation plans (if applicable).

- *The firm's responsiveness to regulatory and/or governmental oversight results.* The team captain should consider the degree of the firm's responsiveness to oversight findings and other communications, as evidenced by the remediation planned or taken. Remediation efforts by the firm may impact industries that are subject to peer review, and can be useful in assisting the team captain with considering the design of the firm's system of quality control or compliance with it. The team captain should document this consideration in the risk assessment during the planning of the review.
- *The size of the firm relative to its specialized industry practice(s).* The team captain should consider the relative significance of the specialized industry practice(s) subject to regulatory oversight to the firm's total practice in determining the relevance of the regulatory oversight results to the peer review. The team captain should document this consideration in the SRM (when applicable).

40-2 *Question*—What additional considerations related to the results of PCAOB inspections should the team captain address in the planning and performance of the peer review?

Interpretation—Although the PCAOB inspection reports only cover the portion of a firm's practice that is subject to permanent inspection, most firms typically have only one system of quality control. As a result, the PCAOB inspection report may contain information that could assist the reviewer in assessing risk, planning, and performing peer review procedures. The team captain should read the public portions of the most recently released PCAOB inspection reports and discuss both the public and nonpublic portions of the reports with appropriate firm personnel. If the report on the firm's most recent PCAOB inspection report has not been released, the team captain should discuss any findings that may have been communicated orally or in draft form with appropriate firm personnel. The firm is required to discuss relevant PCAOB matters with the team captain.

In considering the impact of the PCAOB report on the nature, planning, and extent of peer review procedures, the review team should consider the nature, cause, pattern, and/or pervasiveness of the findings contained in the PCAOB inspection report. The review team should also consider the relative importance of the finding(s) to the firm as a whole. When applicable, the review team should

- consider the information contained in public portions of the PCAOB inspection reports.
- consider the information in the nonpublic portions of the PCAOB inspection reports (based upon discussion with the firm).
- perform further inquiry of the firm in determining the offices, partners, and so on related to findings detailed in the PCAOB report.
- determine which PCAOB findings (if any) may be applicable to the portion of the firm's practice that was not subject to PCAOB inspection.
- understand the underlying cause(s) of the findings (as determined by the firm).
- understand how the firm remediated the findings for the most current inspection (or the firm's remediation plan).
- consider the firm's remediation history with respect to PCAOB inspection findings (if any).

The team captain should document in the risk assessment how this information impacts the planned peer review procedures. Discussion of PCAOB inspection findings should not be interpreted as permitting the peer reviewer to request the nonpublic portions of the PCAOB inspection report.

Determining the Cause for a Finding in a System Review

83-3 *Question*—Paragraph .83 of the standards notes the importance of determining the cause of the identified findings or failures to determine whether they are systemic in nature. How do the results of regulatory and/or governmental oversight factor into this determination?

Interpretation—If similar issues were raised in both the regulatory and/or governmental oversight(s) and in the peer review, the review team should further understand the causes identified by the reviewed firm and consider whether there may be a systemic issue related to the design of the system of quality control or compliance with it. It may also be helpful when considering appropriate recommendations to understand remediation taken by the firm. See Interpretations 40-1 and 40-2 for additional considerations.

Clarified Auditing Standards

It is critical that peer reviewers and reviewed firms understand the clarified auditing standards. In addition to clarifying and converging U.S. standards with international standards, there are numerous changes to audit reports and other communications and certain additional performance requirements. These standards are effective for audits of financial statements for periods ending on or after December 15, 2012.

Peer reviewers should consider the risk of implementing these new standards when planning their 2013 peer reviews. The 2013 peer review checklists have been updated to incorporate the requirements of the clarified auditing standards.

This alert highlights the most important aspects of the new standards and the related effects on peer review. Peer reviewers should consider reaching out to the firms that they review as soon as possible to emphasize the importance of consistent, timely implementation of the new standards and, when appropriate, direct them to resources to help them understand and implement the standards.

Overview of Key Clarified Auditing Standards Changes

The clarified auditing standards more clearly state the objectives of the auditor and the requirements with which the auditor has to comply to meet those objectives when conducting an audit in accordance with generally accepted auditing standards (GAAS). The codified clarified auditing standards (AU-C sections) are organized differently than the codified extant auditing standards (AU sections). Each AU-C section is organized into five sections:

- Introduction
- Objective
- Definitions
- Requirements
- Application and Other Explanatory Material

Because the Auditing Standards Board (ASB) used a principles-based approach when drafting the clarified auditing standards, certain requirements in the extant auditing standards that were duplicative of broader requirements have been moved to Application and Other Explanatory Material within the clarified auditing standards. Accordingly, all AU sections were modified. Some individual AU sections were revised specifically into individual AU-C sections, and other AU sections were grouped together and revised as one or more AU-C sections. As a result, topics in certain AU sections may have been retitled and assigned to different AU-C sections. The document *Extant AU Sections Mapped to Clarity Standards* provides a mapping of the extant AU sections to the AU-C sections. This document is located online. An archive of the webinar on the effect of the clarified auditing standards on the peer review process is also available online.

Although the primary purpose of redrafting the auditing standards was for clarity and convergence with the International Standards on Auditing, issued by the International Auditing and Assurance Standards Board, and not to create additional requirements, there are some new requirements and numerous changes in audit reports and other communications. These new requirements and changes to auditor's reports and other communications are discussed further in this alert. They may be less prevalent if a firm has aligned its audit methodology with, or applied, International Standards on Auditing.

Anticipated Effects on Practice

Substantive changes to auditor requirements include the following:

1. Updated wording used in the auditor's report as provided in AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*; AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*; and AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*)¹
 - a. More detailed description in the auditor's report of management's responsibility for the preparation and fair presentation of the financial statements than what was required by the extant standards
 - b. Use of headings throughout the auditor's report to clearly distinguish each section of the report (for example, management's responsibility for the financial statements, auditor's responsibility, opinion, and, if applicable, other-matter, emphasis-of-matter, or report on other legal and regulatory requirement)
 - c. Replacement of the term *explanatory paragraph* with the terms *emphasis-of-matter paragraph* and *other-matter paragraphs* and the placement of such paragraphs within the auditor's report
2. Updated engagement letter wording (or other suitable form of contract) pursuant to the requirements of AU-C section 210, *Terms of the Engagement* (AICPA, *Professional Standards*)
 - a. Documenting the reminder to management of its responsibilities on recurring audits
 - b. Documenting agreement of management that it acknowledges and understands its responsibility for selecting the appropriate financial reporting framework, establishing and maintaining internal control, and providing access and information to the auditor
3. Inspecting correspondence with relevant licensing and regulatory authorities to identify instances of non-compliance with laws and regulations that may have a material effect on the financial statements pursuant to AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* (AICPA, *Professional Standards*)
4. Communicating the potential effects of material weaknesses and significant deficiencies identified during the audit pursuant to AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*)
5. Complying with the requirements of AU-C section 550, *Related Parties* (AICPA, *Professional Standards*), when reporting on financial statements prepared in accordance with special purpose frameworks (for example, financial statements prepared using the cash or tax basis of accounting, among others) or International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board
 - a. Auditing related party transactions under extant AU section 334, *Related Parties* (AICPA, *Professional Standards*), focused on the amounts and disclosures pursuant to accounting principles generally accepted in the United States of America. AU-C section 550 is framework neutral, so additional considerations may be necessary when auditing financial statements prepared using IFRS or special purpose frameworks.
6. Complying with the broader scope and expanded requirements provided in AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*)

The document *Summary of Differences Between Clarified SASs and Existing SASs* provides a comprehensive analysis and discussion of the differences between the clarified auditing standards and the extant auditing standards, including those changes previously identified that are expected to result in adjustments to practice. This document is located online.

¹ All AU-C sections can be found in AICPA *Professional Standards*.

Effects on the Peer Review Risk Assessment

Peer reviewers should discuss the clarified auditing standards with the firm to obtain an understanding of the firm's general knowledge of the clarified auditing standards and implementation approach. This is an integral part of obtaining an understanding of the reviewed firm's system of quality control and evaluating whether it was sufficiently designed to identify and mitigate the risk of material noncompliance with applicable professional standards. This understanding and evaluation provides a basis for the review team to determine whether the reviewed firm has appropriately adopted comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

Interpretation No. 52-1 to the peer review standards indicates that in assessing inherent risk factors, the peer reviewer should consider new professional standards and to how many engagements the new professional standards apply. The clarified auditing standards constitute an inherent risk factor not only because they are new, but because they have a pervasive effect on the reviewed firm and apply to all audit engagements of financial statements for periods ending on or after December 15, 2012.

Accordingly, as part of the risk assessment procedures performed on peer review engagements covering audits of financial statements for periods ending on or after December 15, 2012, the peer reviewer should discuss the clarified auditing standards with the partners of the firm, who set the tone at the top, and other members of management responsible for designing and implementing the firm's audit methodology and system of quality control to obtain an understanding of the firm's general knowledge of the clarified auditing standards and whether the firm has complied with them, in all material respects, on audit engagements selected for peer review during the period.

The peer reviewer should focus on the firm's quality control policies and procedures. Are the quality control policies and procedures designed to require the professional personnel to have an understanding of the applicable professional standards necessary to perform engagements assigned to them? If so, did the firm comply with its quality control policies and procedures by providing opportunities for firm personnel to obtain the knowledge and expertise required to perform engagements assigned to them, specifically in regard to the clarified auditing standards and their anticipated effect on practice?

The peer reviewer should also determine if the firm's professional personnel possess a basic understanding and knowledge of the clarified auditing standards and their anticipated effect on practice. Based on discussion with the firm's partners and other professional personnel, the peer reviewer should factor the understanding of firm personnel into the assessment of inherent and control risk. This should be documented in the SRM.

It is particularly important that the peer reviewer evaluate the six key aspects of the clarified auditing standards, described previously, when assessing inherent risks and evaluating the firm's system of quality control and document such consideration in the SRM.

What If a Reviewed Firm Implemented the Clarified Auditing Standards (or Certain Aspects of Them) Early?

The ASB has determined that early adoption of the clarified auditing standards is not appropriate and that auditors should continue to comply with the extant auditing standards until the effective date of the clarified auditing standards. However, nothing precludes an auditor from implementing aspects of the clarified auditing standards before their effective date, as long as the auditor continues to comply with the extant auditing standards. This prohibition of early adoption is not located in *Professional Standards*, but rather, in the document *Clarity Project: Questions and Answers*, which is located online.

Accordingly, the AICPA Peer Review Board has concluded that early implementation of all or part of the performance requirements of the clarified auditing standards generally would not result in a material departure from professional standards (that is, if the firm was in compliance with the performance requirements of the clarified auditing standards, then, generally, it would also be in compliance with the performance requirements of the extant auditing standards). However, if the firm implements the reporting requirements contained in the clarified auditing standards early, then this would result in the firm's auditor's reports departing from the extant auditing standards, but not materially. Because the clarified reporting requirements improve various aspects of the auditor's report compared to the auditor's report under the extant standards, early implementation of clarified reporting requirements, even if the condition was pervasive to some or all of the reviewed firm's audit engagements not subject to the requirements of the clarified auditing standards, generally would not be elevated to a deficiency or significant deficiency leading to pass with deficiencies or fail reports, respectively.

Paragraphs .69–.90 of PRP section 1000, *Standards for Performing and Reporting on Peer Reviews*, establish requirements and provide guidance for peer reviewers when identifying, aggregating, and evaluating matters, findings, deficiencies, and significant deficiencies, including a flowchart describing the aggregation of matters, findings, deficiencies, and significant deficiencies, where they are documented in the practice aids, and how they might affect the type of report issued. Additional guidance on findings and conclusions is also found in paragraphs .33–.41 of PRP section 4200, *Instructions to Reviewers Performing System Reviews*. Also, Interpretation Nos. 83-1, 83-2, and 84-1 in PRP section 2000, *Peer Review Standards Interpretations*, establish requirements and provide guidance on determining the cause for a finding in a system review.

Conforming the Auditor's Report for Audits of Financial Statements for Periods Ending on or After December 15, 2012, to the Requirements of the Clarified Auditing Standards

Ordinarily, a firm's failure to update the wording in the auditor's report pursuant to the wording requirements promulgated in the clarified auditing standards should be considered a material departure from professional standards, in all material respects. The auditor's report is the public evidence of the auditor's work. The changes to the wording in the auditor's report aids users and are considered an important part of complying with the clarified auditing standards. Paragraphs .20–.22 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards)*, require auditors to comply with all relevant standards. Furthermore, the AICPA Code of Professional Conduct requires members to maintain professional competence through continuing professional education. Therefore, if a firm fails to update the wording in the auditor's report pursuant to the requirements of the clarified auditing standards, it is an indication that the professional personnel in the firm are not meeting their professional responsibilities.

In addition to fundamental changes to the paragraph arrangement and wording of the auditor's report, auditor's report wording, and paragraph arrangement may also be significantly affected by the requirements of AU-C section 600 and AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Reports (AICPA, Professional Standards)*, respectively.

Expanded Requirements and Broader Definition of Group Audits

AU-C section 600 contains new specific requirements with respect to

- group audit acceptance and continuance considerations.
- the group engagement team's process to assess risk.
- the determination of materiality to be used to audit the group financial statements.
- the determination of materiality to be used to audit components.
- the selection of components and account balances for audit testing.
- communications between the group engagement team and component auditors.
- assessing the adequacy and appropriateness of audit evidence by the group engagement team in forming an opinion on the financial statements.

Peer reviewers should be alert to the possibility that reviewed firms may misunderstand and incompletely apply these new concepts and specific requirements.

Due to the broader definition of group audits, peer reviewers need to be alert for situations in which a reviewed firm concludes that AU-C section 600 does not apply when, in fact, it does. Certain new requirements apply even when the group audit is conducted by a single auditing firm. Group financial statements include financial information of more than one component. A component may include subsidiaries, geographical locations, divisions, investments, products or services, functions, processes, or component units of state or local governments.

AU-C section 600 significantly expanded the scope of the requirements and guidance of the extant guidance regarding using the work of component auditors to encompass audits of group financial statements. It better articulates the degree of involvement required when reference is made to the audit of the component auditor (formerly referred to as the other auditor) in the report of the auditor of the group financial statements (formerly referred to the principal auditor). Specifically, the following two conditions should be met in order for the auditor of the group financial

statements to make reference to the audit of a component auditor in the auditor's report on the group financial statements:

- The group engagement partner has determined that the component auditor performed an audit of the financial statements for the component in accordance with the relevant requirements of GAAS.
- The component auditor did not issue an auditor's report that was restricted as to use.

If the component's financial statements were prepared using a different financial reporting framework from that used for the group financial statements, then reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and
- the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for and, thus, be involved in, the work of the component auditor.

Another important consideration for peer reviewers is the concept that auditors who do not meet the definition of a member of the group engagement team are considered component auditors. Therefore, a component auditor may work for a network or association firm of the group engagement partner's firm or may even work for a different office of the same firm.²

Because of these changes, there is an increased risk that peer reviewers will encounter situations in which the report of the auditor of the group financial statements references a component auditor when, in fact, it should not. Furthermore, because AU-C section 600 significantly expanded the scope of the requirements and guidance of extant AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*), regarding using the work of component auditors to encompass audits of group financial statements, it is also likely that peer reviewers may encounter situations in which audit firms may have misapplied the requirements and guidance of extant AU section 543 and, therefore, assumed that AU-C section 600 did not apply to any of its audits engagements. However, depending on facts and circumstances specific to a given audit engagement, in some situations, an audit engagement may have been performed in accordance with applicable professional standards, in all material respects, despite the fact that the reviewed firm failed to realize that AU-C section 600 applied to the audit engagement. Therefore, it is particularly important that peer reviewers are aware of, and understand, the implications of AU-C section 600 on audit engagements and the resultant auditor's report. The document *Understanding the Responsibilities of Auditors for Audits of Group Financial Statements—What Are Group Audits* provides additional discussion regarding the requirements and guidance contained in AU-C section 600. This document is located online.

Emphasis-of-Matter and Other-Matter Paragraphs Replace Explanatory Paragraphs

AU-C section 706 introduces emphasis-of-matter and other-matter paragraphs that may be included in the auditor's report. An *emphasis-of-matter* (EOM) *paragraph* refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements. An *other-matter* (OM) *paragraph* refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report. EOM and OM paragraphs may be required by GAAS or may be included in the auditor's report at the discretion of the auditor. EOM and OM paragraphs replace explanatory paragraphs that were required under extant AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*).

² A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. When this is the case, such a member of the group engagement team also is a component auditor. Also, in situations in which one firm performed the entire audit and there were components, AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*), would apply.

Extant AU section 508 permitted explanatory paragraphs to precede or follow the opinion paragraph. AU-C section 706 requires EOM and OM paragraphs to follow the opinion paragraph and be included in separate sections of the auditor's report under the section headings "Emphasis-of-Matter" and "Other Matter," respectively, or other appropriate headings. When both EOM and OM paragraphs are included in the auditor's report, the OM paragraph should follow the EOM paragraph. However, an OM paragraph may be placed elsewhere in the auditor's report if the content of the OM paragraph is relevant to paragraphs .37–.38, the "Other Reporting Responsibilities" section of AU-C section 700 (for example, when the auditor of group financial statements refers to a component auditor in the auditor's report). As peer reviewers encounter audit engagements performed in accordance with the clarified auditing standards and that include EOM or OM paragraphs, or both, they will need to evaluate the placement of those paragraphs in the auditor's report in relation to the opinion paragraph and, in some cases, each other.

Noncompliant Auditor's Reports and Possible Effects on the Outcome of the Peer Review

If a reviewed firm does not conform the wording in its auditor's reports to the new reporting language required by the clarified auditing standards, and after considering the systemic cause, the peer reviewer concluded that the condition was pervasive across the firm's audit engagements performed under the clarified auditing standards, then this typically would be elevated to a deficiency or significant deficiency and a pass with deficiencies report or fail report, respectively. Even if a reviewed firm complied with all requirements promulgated in the clarified auditing standards, except for those relating to auditor reporting, then, if pervasive, the typical result would be a deficiency or significant deficiency and a peer review report of pass with deficiencies or fail, respectively.

Isolated occurrences of a firm not conforming the wording used in its auditor's reports to the wording requirements of the clarified auditing standards will require the peer reviewer to exercise professional judgment to determine

- the relative significance of the matter to other audit engagements included in the firm's peer review year, and
- whether the firm's system of quality control provided reasonable assurance that the reviewed firm complied with the clarified auditing standards in all material respects.

If a peer reviewer concludes that nonconforming auditor report wording is relegated to a single audit engagement or identifies a particular pattern of noncompliance that supports a conclusion that the condition was not pervasive to a material portion of the firm's audit engagements performed under the clarified auditing standards (for example, noncompliance is relegated to one particular partner in the firm), then the typical result would be a pass report or pass with a FFC report.

Paragraph .86 of the peer review standards establishes requirements and provides guidance regarding the peer reviewer's consideration of the pattern and pervasiveness of matters. Specifically, paragraph .86 indicates that the peer reviewer must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. If the peer reviewer determines that noncompliance related to the firm not conforming the wording used in its auditor's reports to the wording requirements of the clarified auditing standards, then not only were auditing standards specific to auditor reporting not complied with, but neither was AU-C section 200, which requires auditors to comply with all relevant standards.

The document *Summary of Clarified Auditing Reporting Standards* provides a summary of the clarified auditor reporting requirements, including requirements that are expected to result in adjustments to practice. This document is located online.

Other Instances of Noncompliance With Auditor Requirements of the Clarified Auditing Standards That Peer Reviewers May Encounter

In addition to the risk of firms failing to conform the wording of its auditors' reports to the requirements of the clarified auditing standards, there are several other practice areas where there is a higher risk of noncompliance related to the following requirements:

- Updating engagement letter wording to satisfy the requirements of AU-C section 210
- Inspecting correspondence with relevant licensing and regulatory authorities to identify instances of noncompliance with laws and regulations that may have a material effect on the financial statements as required by AU-C section 250

- Communicating the potential effects of material weaknesses and significant deficiencies identified during the audit as required by AU-C section 265
- Complying with the requirements of AU-C section 550 when reporting on financial statements prepared in accordance with special purpose frameworks (for example, financial statements prepared using the cash or tax basis of accounting, among others)
- Satisfying the expanded auditor requirements contained in AU-C section 600 relating to audits of group financial statements, including the work of component auditors

If the peer reviewer identifies and, after considering the systemic cause, concludes that noncompliance related to any of the five preceding audit areas was pervasive with respect to the firm's audit engagements performed under the clarified auditing standards, then the peer reviewer will likely conclude that a deficiency or significant deficiency exists and issue a peer review report of pass with deficiencies or fail, respectively. Isolated occurrences of a firm not complying with the five preceding audit areas will require the peer reviewer to exercise professional judgment to determine the significance of the matter to other audit engagements included in the firm's peer review year and whether the firm's system of quality control provided reasonable assurance that the reviewed firm complied with the clarified auditing standards in all material respects. If the peer reviewer concludes that noncompliance related to the five preceding audit areas is relegated to a single audit engagement or identifies a particular pattern of noncompliance that supports a conclusion that the condition was not pervasive to a material portion of the firm's audit engagements performed under the clarified auditing standards (for example, noncompliance is relegated to one particular partner in the firm), then the typical result would be a pass report or pass with FFC (or FFCs) report.

Again, paragraph .86 of the peer review standards indicates that the peer reviewer must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. During this evaluation, it is important for the peer reviewer to note that paragraphs .20–.22 of AU-C section 200 requires auditors to comply with all relevant standards. Accordingly, if the peer reviewer determines that noncompliance related to one or more, or all, of the five preceding audit areas was pervasive, then not only were auditing standards specific to the identified audit areas not complied with, but neither was AU-C section 200.

Nonconforming A-133 Engagements

In response to the National Single Audit Sampling Project report issued by the President's Council on Integrity and Efficiency (PCIE), the AICPA formed seven task forces, one of which is the Practice Monitoring Task Force—A-133 Subgroup.

The task force is studying the results of the PCIE report to determine ways in which the peer review process can aid in enhancing the quality of performance of OMB Circular A-133 (A-133) audits by member firms. The board has already implemented several task force recommendations including a revised, must select interpretation for A-133 engagements, a bifurcated A-133 peer review checklist to focus on the areas identified in the PCIE report, and an enhanced report acceptance process for peer reviews including these engagements.

The task force recognizes the need for guidance to peer reviewers and RABs on the need for recall and reissue of single audit compliance reports when a peer review finds that such engagements are not performed and reported on in accordance with professional standards in all material respects. Such reissuances may result because the peer reviewer determines that the firm missed auditing a major program due to improper risk-based major program determination, failure to properly identify the low risk auditee status of the auditee resulting in a missed major program, failure to test internal controls over compliance or compliance, and other examples included in subsequent paragraphs.

If an error is found that results in the addition of a major program, performance of the appropriate testing on the new major program should be conducted. When the auditor determines that additional procedures are necessary, the auditor should refer to AU-C section 585 or AU section 390, *Consideration of Omitted Procedures After the Report Date* (AICPA, *Professional Standards*), for additional guidance.

If, subsequent to issuing the single audit report, the auditor becomes aware that facts may have existed at the time of the single audit that might have affected the reporting had they been known at the time, the auditor should refer to AU-C section 560 or AU section 561, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*), for additional guidance.

If the auditor decides to reissue the compliance report, the auditor should refer to AU-C section 935 or AU section 801, *Compliance Audits*, paragraph .43, “Reissuance of the Compliance Report” (AICPA, *Professional Standards*).

When the auditor becomes aware of such concerns or other concerns after issuing the single audit reporting, an understanding of the scenario and effect should be gained in order to determine:

- whether the auditor should perform additional audit procedures;
- whether the Schedule of Expenditures of Federal Awards (SEFA) must be revised by the auditee and the impact on the in-relation-to reporting on the SEFA;
- the impact on the single audit report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 and whether such report should be reissued;
- the impact on the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with GAS and whether such report should be reissued.
- whether the data collection form should be revised and resubmitted; and
- whether the Schedule of Findings and Questioned Costs should be modified by the auditor.

Additional guidance on the steps that a firm should take when they are required to re-audit and reissue can be found at the Governmental Audit Quality website. (*Note:* The GAQC is currently revising their guidance on recall or reissue and expects to issue that guidance in late 2012.)

Examples of the issues that arise that cause the team captain to consider whether a firm should perform additional audit procedures and reissue the prior year single audit reporting include the following:

1. Missed major program due to improper risk assessment (two-year look-back rule, including American Recovery and Reinvestment Act of 2009 funding)
2. Improper clustering of programs resulting in a missed major program
3. Failure to include and audit all programs with same CFDA number when determining major programs
4. Failure to meet the percentage of coverage required (50 percent or 25 percent, depending on low risk auditee status)
5. Failure to properly compute the program type A/B threshold determination resulting in a missed major program or incorrect program selection
6. Improperly classifying an entity as a low-risk auditee resulting in missed major programs due to percentage of coverage audited as major
7. Inadequate testing of internal over compliance (for example, not testing to support a low-assessed level of control risk, not testing controls relating to some direct and material compliance requirements, or inappropriate sample sizes and/or related documentation) or compliance (for example, failure to test compliance for all direct and material compliance requirements or inappropriate sample sizes and/or related documentation) to support the major program opinion

The following instances may also result in a consideration to re-audit and reissue the compliance report depending on the severity of the issue.

1. Incorrect or inconsistent summary of auditor results (incorrect reporting of report qualifications, major programs selected, type A threshold amounts, low risk auditee status). Usually these could be considered editorial errors, but if substantive, they could elevate to major significance.

2. Missing CFDA numbers on SEFA (and/or pass-through entity numbers omitted).
3. SEFA not totaled properly.
4. Incorrect auditor reports (for example, language used inconsistent with SAS 115, AU section 325, or AU-C section 265; language used inconsistent with SAS 117, AU section 801, or AU-C section 935; missing reporting elements; and so on).
5. SEFA missing required footnotes.

In these circumstances when it is concluded that a Circular A-133 engagement is not performed in accordance with professional standards in all material respects, ordinarily the firm should recall and reissue the applicable reports. Otherwise the firm should document its considerations not to recall and reissue. Reviewers should thoroughly evaluate a firm's decision not to recall and re-issue the applicable reports and indicate if the reviewer agrees or disagrees with the firm's decision. Further, if the reviewer disagrees with the firm's actions in consideration of the applicable standards or its decision not to recall and reissue, the reviewer should evaluate whether this is indicative of a potential leadership or tone at the top deficiency.

Approval of Revisions Proposed in Peer Review Exposure Draft

On October 9, 2012, the board approved the revisions proposed in the June 2012 Exposure Draft, "Proposed Changes to the AICPA Standards for Performing and Reporting on Peer Reviews: Scope of System Review and Must Select Engagements." As proposed in the exposure draft, the board has added all examinations performed under the Statements on Standards for Attestation Engagements (SSAEs) to the scope of a System Review and Service Organization Control (SOC) 1 and SOC 2 engagements to the types of engagements that must be selected in a system review.

The following revisions to the proposed changes were also approved:

- Standards paragraphs .58, .104, and .208 and Interpretation 7-2 under "Engagements Under Peer Review," were revised to clarify that financial forecasts or projections and agreed upon procedures should be included in the peer review year based on report date. All other engagements should be included based on period end.
- Interpretation 7-2 clarified that audits of non-SEC issuers performed under PCAOB Standards are included in a system review.
- Interpretation 59-1 under "Office and Engagement Selection in System Reviews," was revised to do the following:
 - Remove "the size of the audit firm" from the list of considerations when performing a risk assessment.
 - Change "reasonableness of fees charged for SOC engagements" to "reasonableness of hours spent on SOC engagements." A similar consideration for hours was added to the other must select considerations as well.
 - Provide considerations for when scope should be expanded to include SOC 3 engagements.

The following additional PRPM revisions were also approved:

- Interpretation 63-3 under "Office and Engagement Selection in System Reviews," was created to describe the difference between must select and must cover engagements, as described in Peer Review Alert 11-04.
- Conforming changes to the rest of the PRPM.

The changes proposed in the exposure draft and the additional revisions previously discussed are effective for reviews commencing on or after March 1, 2013, and will be included in a March 2013 release of the PRPM.

SOC Engagements

Due to the complexity of SOC engagements, the board has considered implications for the formation of review teams, engagement selection, the review of the SSAE and SOC engagements, and RAB acceptance of the peer review report.

Formation of Review Teams

Consistent with other must select engagements, if a firm performs SOC 1 or SOC 2 engagements, someone on the review team should have experience with these types of engagements. In an effort to aid review teams and firms in finding a reviewer with SOC 1 and/or 2 experience, please update your peer reviewer resume to include these types of engagements.

Although staff of CPAs may perform SOC 1 engagements, generally SOC 2 engagements would be performed by a CPA with an information technology (IT) background or by a CPA using the work of an IT specialist. Therefore, reviews for firms that perform SOC 1 engagements will require a team member with SOC 1 experience. Reviews for firms that perform SOC 2 engagements will require a team member with SOC 2 experience. Due to the specialized nature of SOC engagements, the lack of qualified peer reviewers, and the interest expressed by non-CPA SOC directors and partners to be involved in the peer review process, the board has determined that a specialist may be able to assist the team captain in lieu of a team member with SOC experience as described in proposed interpretations 35-1 and 35-2 under "Qualifying for Service as a Specialist."

A specialist meeting criteria established by the AICPA may be approved to assist the team in reviewing SOC 1 or SOC 2 engagements. When a specialist is used, the team captain, as always, is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm and AE, preparing the report on the review, and ensuring that peer review documentation is complete and submitted to the AE on a timely basis. The team captain should supervise and review the work performed by the specialist. The team captain will furnish instructions to the specialist regarding the manner in which materials and other notes relating to the review are to be accumulated to facilitate summarization of the review team's findings and conclusions. The specialist may be required to be available or participate in the exit conference.

The firm and review team are required to obtain approval from the firm's AE, as part of the scheduling process, if it will be using a specialist instead of a team member with SOC 1 or SOC 2 experience. The RAB Handbook will be revised in 2013 to incorporate the specialist criteria and approval process. A list of specialists preapproved by the board's Oversight Task Force will be maintained by the AICPA. The qualifications of SOC 1 or 2 specialists are as follows.

An individual serving as a SOC 1 or 2 specialist on a system review must be recommended as a specialist by a CPA that is a member of the AICPA in good standing and is associated with a firm that has received a report with a peer review rating of pass for its most recent system review that was accepted timely, ordinarily within the last three years and six months. An individual serving as a SOC 1 or 2 specialist on a system review should, at a minimum

- a. be currently active in public practice at a supervisory level for managing SOC 1 and/or SOC 2 examinations. To be considered currently active, a specialist should be presently involved in the SOC practice of a firm supervising one or more of the firm's SOC engagements.
- b. be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of pass¹ for its most recent system review that was accepted timely, ordinarily within the last three years and six months.²
- c. not be associated with an engagement that was deemed no performed or reported on in accordance with professional standards in all material respects on the specialist's firm's most recently accepted peer review.

¹A peer review report with a rating of pass was previously referred to as an unmodified report (with or without a letter of comments). If a firm's most recent peer review rating was a pass with deficiencies or fail, the firm's members are not eligible to perform peer reviews.

² If a firm's most recent review was a report review, then the firm's members are not eligible to perform peer reviews.

- d. possess current knowledge of professional standards applicable to SOC 1 and/or SOC 2 examinations, including Type 1 and Type 2 reports, qualified and unqualified reports, carve in or carve out engagements, and engagements with and without relevant user entity controls.
- e. have at least 5 years of recent experience in the practice of public accounting with a minimum of 500 hours of SAS 70, SOC 1, and/or SysTrust/SOC 2 examinations.
- f. have provided the AE with information that accurately reflects the qualifications of the specialist, which is updated on a timely basis.

To become an approved specialist, the specialist candidate should provide the Peer Review Program SOC Specialist Form to the AICPA or an AE. The form is required to be signed by a CPA for recommendation as a specialist. If you are aware of someone interested in being a SOC 1 or 2 specialist, please provide them with the Peer Review Program SOC Specialist Form and contact the Peer Review Program technical hotline at 919.402.4502 or at prtechnical@aicpa.org with questions.

Engagement Selection

SOC 1 and SOC 2 engagements can be included in the same pool of engagements for purposes of engagement selection (for example, if a firm performs three SOC 1 engagements and three SOC 2 engagements, the reviewer is not required to select both a SOC 1 and a SOC 2; selecting a SOC 1 engagement can satisfy the requirement). However, reviewers would be expected to fully document their consideration of all SOC engagements and the basis for their selection in the risk assessment. If a firm performs both SOC 1 and SOC 2 engagements and a proper risk assessment determined that only one SOC engagement should be selected, ordinarily a SOC 1 engagement should be selected over a SOC 2 engagement due to the reliance upon the report by other auditors. Because SOC 2 engagements are a new type of service, peer reviewers may deem it necessary to select both SOC 1 and SOC 2 engagements. However, there may also be situations in which it would be appropriate to pick one SOC 2 and not select a SOC 1. Examples may include that the SOC 2 engagements have not previously been selected and the SOC 1 engagements have or the SOC 2 practice is growing and the SOC 1 practice is stable.

Review of SSAE and SOC Engagements

To provide reviewers with the appropriate tools to review SOC engagements, revised and new engagement checklists will be available in March 2013:

SSAEs

- Examinations under SSAEs will be removed from checklist 23,500 (*Engagement Reviews—Other Attestation Engagements*) as they are no longer applicable in engagement reviews.
- Checklist 21,000 (*System Reviews—Other Attestation Engagements*) will be divided into two—Examinations (revised 21,000) and Reviews (new 21,050).

SOCs

- Checklist 21,100 will continue to be used for SOC 1 engagements.
- Checklist 21,150 was created for use when reviewing SOC 2 engagements.
- For SOC 3 engagements, reviewers will use the applicable attestation engagement checklists based on the nature of the engagement (examination, review, or agreed upon procedure).

RAB Acceptance of the Peer Review Report

Interpretation 132-1 under “Qualifying for Service as a Peer Review Committee Member, Report Acceptance Body Member, or Technical Reviewer,” and RAB Handbook chapter 1 note that at least one member of the RAB considering a peer review that includes a must select engagement must have current experience in such engagements. If the RAB does not have a member with the appropriate experience, they may call upon a consultant. A national list of consultants is maintained by the AICPA with an available pool of consultants with GAS, Employee Retirement Income Security Act of 1974 (ERISA), Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), carrying broker-dealer, SOC 1, and SOC 2 experience to be called upon as necessary. The national RAB consultant does not need to physically participate in the RAB meeting and may participate via teleconference. The consultant

only needs to participate in the RAB discussion of the respective review(s) and will not be eligible to vote on the acceptance of a review.

If you or anyone in your firm is interested in being a national RAB consultant for any of the must select engagements, please contact the Peer Review Program technical hotline at 919.402.4502 or at prptechnical@aicpa.org.

The qualifications of a national RAB consultant are as follows:

- Currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program, as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. To be considered currently active, a consultant should be presently involved in the supervision of one or more of his or her firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements. To be considered a consultant on GAS, ERISA, FDICIA, carrying broker-dealer, SOC 1, or SOC 2 engagements, the current activity must include the respective industry asked to consult upon.
- Associated with a firm (or all firms, if associated with more than one firm) that has received a report with a peer review rating of pass (previously referred to as an unmodified report) on its most recently accepted system review that was accepted timely, ordinarily within the last three years and six months.
- Not associated with an engagement that was deemed not performed in accordance with professional standards on the consultant's firm's most recently accepted system review.

Revisions to Natural Disaster and Other Catastrophic Events Guidance

The board approved revisions to Interpretation 18-2 under "Timing of Peer Reviews," which provides guidance for firms impacted by natural disasters or other catastrophic event. The revisions offer additional guidance and considerations for reviewed firms that should be discussed with their administering entities in order to assist the administering entities in making appropriate extension and/or year-end change decisions. The revisions also provide guidance for firms in the following situations:

- Firms whose reviews commenced and were ongoing at the time of the event
- Firms whose offices and/or personnel were not directly impacted by the event, but their scheduled peer reviewer was impacted and may be unable to perform the peer review

The revisions include a reminder for peer reviewers to alert the firms they are scheduled to review and the AE when the peer reviewer's firm was affected by the event. This will help reviewed firms and their administering entities determine if an extension is the best course of action, or whether it is necessary for the reviewed firm to schedule another peer reviewer.

These changes are effective upon issuance of this alert.

18-2 *Question*—Situations may arise when circumstances out of a firm's control, such as a natural disaster or other catastrophic event, affect a firm's ability to comply with some or all of the peer review requirements, including timing of the peer review. What should a firm do in those specific circumstances?

Interpretation—The AE should be consulted, when possible, about how the firm believes the situation has affected or will affect its peer review and/or its ability to perform scheduled peer reviews (if applicable).

If the situation affected both the firm's operations and its ability to comply with peer review requirements, the firm should discuss the following with the AE:

- The firm's current peer review year-end and due date
- The extent of damage to the firm's office(s) and the working papers subject to peer review (if applicable); this would include off-site storage or data retention facilities that house working papers subject to peer review

- The availability, or lack thereof, of personnel that performed engagements subject to peer review
- The firm's ability to continue operating and performing engagements subject to peer review
- If known, whether the firm's scheduled peer reviewer was also impacted
- The amount of time the firm deems necessary before it would be ready to undergo a peer review

The AE will assist in determining whether there could be a possible scope limitation due to the exclusion of any affected engagements or offices, the need for a change in year-end or an extension of due date, and the effect on the firm's continuing peer review cycle. These situations will be considered on a case-by-case basis.

If the firm's peer review already commenced and the continued performance of the peer review is impacted, the firm should notify its AE as soon as reasonably possible. The AE will assist in determining the best course of action.

If the situation did not directly affect the firm's operations but has impacted the firm's ability to comply with peer review requirements (that is, the firm's scheduled peer reviewer was directly affected and may no longer be able to perform the peer review), the firm should consult with its AE. The AE will assist the firm in determining whether it is appropriate to extend the peer review due date or if the firm should engage another firm to perform its peer review. In making this determination, the AE will consider the following:

- The firm's peer review year-end and the timing of when engagements falling within the peer review year are performed
- The length of time between the timing that the situation arose and the firm's due date
- The amount of time that the currently scheduled peer reviewer or review team would need before being able to perform the peer review
- Whether the firm has very specialized industries or types of engagements

If the firm performs peer reviews and is scheduled on a review that it will be unable to perform by the reviewed firm's due date (or at all), the reviewing firm should communicate this information to the reviewed firm and the AE as soon as reasonably possible. Contacting the reviewed firm and the AE is especially important when the peer review has commenced but the reviewing firm has doubts about its ability to complete the review.

Determining and Documenting Matters and Findings in a System Review

The objective of a system review is to evaluate the design of, and compliance with, a firm's system of quality control. As such, the peer review standards emphasize properly identifying and classifying matters and findings, and evaluating the systemic cause of those findings.

Reviewers often have questions about which items should be included on a Matter for Further Consideration (MFC) form. Paragraph .70a of the standards states, "Matters are typically one or more 'No' answers to questions in peer review questionnaire(s) that a reviewer concludes warrants further consideration in the evaluation of a firm's system of quality control." Not all "no" answers should be included on an MFC form. The peer reviewer should carefully evaluate whether the "no" answer warrants further consideration. The peer reviewer should take into consideration all information available and use his or her professional judgment to evaluate whether a "no" answer warrants further consideration. If a peer reviewer does not elevate the "no" answer to a matter, the peer reviewer should thoroughly document his or her consideration of the "no" answer in the explanation of "no" answers section of the peer review checklists.

Reviewers have also questioned whether isolated "no" answers should be included on MFC forms. Interpretation No. 84-1 of paragraph .84 in PRP section 1000, *Standards for Performing and Reporting on Peer Reviews* (PRP sec. 2000) states, "The reviewer should consider that a single disclosure matter and a single documentation matter may be isolated when taken individually but they may have resulted from the same underlying systemic cause. They should further consider that an isolated matter may be materially significant in amount or nature or both. Reviewers should document their consideration of an isolated matter and the conclusions reached in the MFC form. The documentation

should include the details of the matter noted, how the reviewer expanded scope, if applicable, and why the reviewer concluded the matter was isolated.” The fact that a matter is deemed isolated does not mean it does not need to be included on an MFC form. If a peer reviewer determines that a “no” answer warrants further consideration, and should be elevated to a matter, it should be included on an MFC form, regardless of whether the matter is isolated. As noted previously, the reviewer should document how the matter was determined to be isolated on the MFC form. If the reviewer determines that the “no” answer does not need to be included on an MFC form, the reviewer should thoroughly document his or her consideration of the “no” answer in the explanation of “no” answers section of the peer review checklists and include why the “no” answer was deemed isolated. Furthermore, the peer reviewer should revisit all items deemed isolated at the conclusion of peer review procedures, including items that were not elevated to matters. The peer reviewer should reevaluate whether the isolated matters were actually isolated and whether they have a common systemic cause. These matters collectively could lead the reviewer to conclude that a finding or deficiency exists in the reviewed firm’s system of quality control.

On system reviews, reviewers should identify the systemic cause of findings. Paragraph .70b of the standards states, “A finding is one or more related matters that result from a condition in the reviewed firm’s system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with applicable professional standards.” As such, the Findings for Further Consideration (FFC) form asks for the reviewer to identify the systemic cause of a finding. There is an expectation that the reviewer follow the appropriate guidance to make a good faith effort to identify the underlying cause. Guidance on identifying the cause for a finding can be found at Interpretation No. 83-1 of paragraph .83 in PRP section 1000, *Standards for Performing and Reporting on Peer Reviews* (PRP sec. 2000). Guidance is also included in chapter 4, section II and III of the Report Acceptance Body Handbook, which is an integral part of the Peer Review Program Manual.

Reviewers in a system review must think of matters on MFC forms as symptoms of weaknesses in a firm’s system of quality control, and try to understand the underlying cause for those matters that rise to the level of a finding. With a finding, the reviewer is considering more than just the “matter,” he or she is considering the condition (that is, systemic cause) that resulted in the matter(s) occurring. Otherwise said, the reviewer must determine why the matters occurred.

Ordinarily it is not sufficient to only repeat the matters (documented on the MFC form[s]) as findings (on the FFC form). The reviewer is expected to evaluate whether the condition or systemic cause (which resulted in the matters) meets the definition of a finding, that is, that more than a remote possibility exists that the reviewed firm would not perform or report in conformity with applicable professional standards. A finding that does not meet the definition of a deficiency or significant deficiency remains a finding. Once the systemic cause is identified, the reviewer is also expected to combine FFC’s with the same systemic cause.

As an example, “no” responses on engagement checklists may lead a reviewer to conclude there is a matter related to the firm’s noncompliance with a new professional standard. The reviewer may then conclude that the cause of that matter is lack of sufficient continuing professional education (CPE) on new professional guidance. The reviewer may then conclude that based on the nature, causes, pattern and pervasiveness, and relative importance to the firm’s system of quality control taken as a whole, the matter does not rise to the level of a deficiency or significant deficiency, but it is a finding. The matters (noncompliance with a new professional standard) and their condition or cause (lack of sufficient CPE on new professional guidance) are documented on the FFC form.

This exercise requires judgment and may be challenging, but it will assist the reviewer in making meaningful recommendations to the reviewed firm that are appropriate to reduce the likelihood of the finding recurring or developing into a deficiency (or significant deficiency) in the future. If a reviewer makes a good faith effort to identify the underlying cause of a finding, and documents the effort and results on the FFC form, it is not expected to result in reviewer feedback.

Combining Matters for Further Consideration and Findings for Further Consideration for Engagement Reviews

Based on reviewer comments, some consider the information furnished on MFC forms (section 6500, *Instructions for Use of Matter for Further Consideration [MFC] Form for Engagement Reviews*) and FFC forms (section 6600, *Instructions for Use of Finding for Further Consideration [FFC] Forms*) to be repetitive for engagement reviews. MFC forms document engagement and other matters noted in an engagement review. A *matter* is noted as a result of evaluating whether an engagement submitted for review was performed or reported on, or both in conformity with

applicable professional standards. Depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may or may not develop into a finding. The FFC form is prepared in connection with an engagement review if there are one or more matters that the peer reviewer believes results in the financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, not being performed or reported on in conformity with the requirements of applicable professional standards, but the results were not of such relative importance to include in a report with a peer review rating of *pass with deficiencies* or *fail*.

The Standards Task Force considered if the two forms could be combined for an engagement review. The task force concluded that it would not be practical to combine the forms because (1) not all MFCs rise to the level of FFCs and (2) multiple MFCs may be combined into one FFC.

Scope of Peer Review Oversights

Paragraph 12 of the standards notes that peer reviews, including the reviewed firm and peer reviewers, are subject to oversight by the administering entity, the AICPA Peer Review Board (PRB), and other bodies agreed upon by the administering entity or the board. The main objectives of peer review oversight are ensuring compliance with the standards and other peer review guidance, and consistency in implementation of the standards and other peer review guidance. In order to meet these objectives, by default all peer review documentation is subject to oversight. A critical part of the peer review oversight process is corroborating the overall results of reviews. In order to do so, it is often necessary for those performing oversight to directly review the working papers of engagements that were peer reviewed (that is, during on-site oversight or desk review oversight). Further, those individuals performing on-site oversight may also deem it necessary to participate in meetings between the reviewed firm and the peer reviewer(s). This level of involvement by AICPA staff, board members, individuals designated by the administering entity, and other individuals designated to perform peer review oversights is considered within the normal scope of oversight. Reviewed firms and peer reviewers that fail to cooperate with oversight are deemed as not cooperating with the AICPA Peer Review Program.

As with other aspects of peer review, individuals that perform peer review oversights are governed by the confidentiality requirements in paragraph 20 of the standards, and they are not permitted to disclose or share any information concerning the reviewed firm, its clients, and its personnel obtained during an oversight.

Reviewer Resume Experience Codes

The reviewer resume codes have been revised so that resume codes A, B and C may only be used for services performed in a peer reviewer's *own firm*. A new resume code ("other") has been added. The "other" code is used for supervising one or more accounting or auditing engagement or carrying out the quality control functions (services) *for a firm where the peer reviewer is neither a partner nor a professional employee (another firm)*. These services are otherwise known as independent contractor services. If the peer reviewer wants to use the "other" resume code, the reviewer must provide a description of the services performed in the text box provided on the reviewer resume. The services performed for another firm must be current, they must have been *performed* within one year of the date the reviewer is approved to perform the review. Once the peer reviewer is no longer engaged to perform the services for another firm, the peer reviewer is required to remove the industry code from his or her resume within one year of when the services were performed. If the nature or extent of the services performed changes, the peer reviewer must update the information on their resume. *All industry codes that relate to work performed for another firm that do not meet the following criteria must be removed by August 30, 2011.*

The revised reviewer resume codes on the reviewer resume will now read:

A—Currently (presently involved) in supervising or performing engagements, in your own firm; or carrying out all the quality control functions on engagements in your own firm (including review of related engagements as part of the firm's monitoring or inspection process) and currently meeting relevant, industry-specific educational requirements, as applicable.

B—Recently (within five years) supervising or performing engagements in your own firm and currently meeting relevant, industry-specific educational requirements, as applicable.

C—Supervising or performing certain components (but not all) of quality control functions on engagements in your own firm and currently meeting relevant, industry-specific educational requirements, as applicable.

Other—Supervising one or more accounting or auditing engagements or carrying out the quality control functions for a firm when the peer reviewer is neither a partner nor a professional employee of the firm.

The peer reviewer should provide a list of all pertinent information (see following paragraph) to allow the administering entity (AE) to ensure that the reviewer is qualified to perform peer reviews of the requested industry. Based on the information provided by the peer reviewer, the AE will determine whether the peer reviewer is qualified to review engagements in that industry. The administrator may need to consult with a technical reviewer, report acceptance body (RAB) members, or committee members to determine if the reviewer qualifies to add the industry code to his or her resume. The AE individual(s) who is consulted should feel confident in approving the reviewer to perform peer reviews in that industry. Once the AE determines that the reviewer is qualified to perform the review, the reviewer will be approved to perform the review. In cases when local resources are unable to determine if a reviewer is qualified for a particular industry, the AE may also consult with AICPA staff.

Written information provided by the reviewer for services performed for another firm should include, but is not limited to, engagement year-end, the name of firm the work was performed for and the actual work performed (that is, financial statement review, working paper review, engagement quality control review, and so on). In order to add these services to the reviewer's resume, the firm that the reviewer performs the services for must be enrolled in a peer review program and its previous peer review must have a pass rating.

At a minimum, the services performed for another firm should include a review of the financial statements and involvement in or review of the significant judgments and conclusions of the engagement team.

Only peer reviewers who are eligible to perform peer reviews may apply to have work performed for another firm added to their resume. Per Paragraph .31b of the standards, an individual must "be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program (see interpretations), as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities." Therefore, an individual is not qualified to perform peer reviews if he or she only performs work for another firm.

After the effective date of this guidance, August 31, 2011, all reviewers will be required to update their resume within one year of the date they previously updated their resume. If reviewers do not update their resume, they will not be able to schedule reviews.

Completeness of Peer Review Scope

Firms are required to accurately represent their accounting and auditing practice, as defined by Peer Review Program (PRP) section 1000, *Standards for Performing and Reporting on Peer Reviews* (Standards), 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 Standards, 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 Standards, including, but not limited to, engagements performed under Government Auditing Standards; audits of employee benefit plans, audits performed under the Federal Deposit Insurance Corporation Improvement Act (FDICIA), and audits of carrying broker-dealers; and examinations of service organizations (Service Organizations Control [SOC] 1 and 2 engagements). Such acts of omission or misrepresentation of information 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 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 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, whether issued or not, under Government Auditing Standards; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers; and examinations of service organizations 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.

REGULATORY ALERTS

Governmental Audit Quality Continues to Be a Concern

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, 35 percent of the audits reviewed were found to be unacceptable and another 16 percent 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 percent 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.

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 (for example, 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 or 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
- 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

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 GAS 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 percent 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 website 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 website at www.aicpa.org/GAQC; or call 202-434-9207.

Enhanced Peer Review Guidance for the Review of Employee Benefit Plan Audit Engagements

Regulatory and legislative developments have underscored the significant public interest in, and a higher risk associated with, audits conducted pursuant to ERISA. Peer reviewers should consider whether the engagement selection process has adequately addressed these risks.

For example, unique risks associated with different types of ERISA plans are as follows:

- Defined contribution plans. Participant account and allocation testing and timely remittance of participant contributions.
- Defined benefit plans. Actuarial present value of accumulated plan benefits and changes in the actuarial present value of accumulated plan benefits.
- Health and welfare plans. Benefit obligations and changes in benefit obligations (for example, claims payable, claims incurred but not reported, postemployment benefits, postretirement health care benefits, and so on).
- Employee stock ownership plans (ESOPs). Annual appraisal of securities and leveraged ESOPs.
- Other areas. Plans with a master trust arrangement, multiemployer plans, initial audits of plans, terminating plans, plan mergers, and so on.

In accordance with Interpretation 63-1, if a firm has more than one of the preceding types of plans, the reviewer must consider the unique risks associated with that type of plan and document how these risks were addressed in the summary review memorandum in question H2.

The Department of Labor'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 EBPAQC is a great resource for firms that perform employee benefit plan 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.
 - Inadequate use of SOC 1 reports; lack of testing when SOC 1 report is obtained.
- 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 or 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 website 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 SOC 1 report 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 website at www.aicpa.org/EBPAQC or call 202.434.9207.

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 in subsequent sections.

Broker-Dealers

On July 31, 2013, the SEC finalized its Broker-Dealer (BD) 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 following chart 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, not covered by PCAOB permanent inspection	No	Yes	Yes
Engagements for SEC issuers under Government Auditing Standards (for example, 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.

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 (PRP) via e-mail. Therefore, it is imperative that all reviewers maintain a current e-mail address on file with the AICPA PRP. 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.

Engagement Quality Control Review

The firm either failed to establish or established inappropriate, vague, or insufficient criteria for the purposes of establishing a threshold for engagement quality control review. Statement on Quality Control Standards (SQCS) No. 7 and, subsequently, SQCS No. 8, requires a firm to "...establish criteria against which all engagements covered by this statement are to be evaluated to determine whether an engagement quality control should be performed." The peer reviewer should address this aspect of the design of the firm's quality control policy in the peer review.

Monitoring

The firm failed to appropriately respond to questions pertaining to performance of post-issuance review, review of compliance with firm QCPP, and/or documentation of firm monitoring procedures. The peer reviewer should require the firm to correct these responses or address this aspect of the design of the firm's quality control policy within the peer review.

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