

AICPA

Consolidation of  
Peer Reviewers' Alerts  
January 2008

## **Consolidation of Peer Reviewers' Alerts**

The following is a consolidation of current, relevant information from the following previously issued Reviewers' Alerts:

- AICPA Peer Reviewers' Alert 07-01, 07-02, 07-03, 07-04
- AICPA Peer Reviewers' Alert 06-01, 06-02
- AICPA Peer Reviewers' Alert 05-01, 05-02, 05-03, 05-04
- AICPA Peer Reviewers' Alert 04-01, 04-02, 04-03, 04-04
- AICPA Peer Reviewers' Alert 03-01
- June 2003 Reviewers' Alert
- March 2003 Reviewers' Alert
- November 2002 Reviewers' Alert
- December 2001 Reviewers' Alert
- April 2001 Reviewers' Alert
- 2000 Annual Reviewers' Alert
- 1999 Annual Reviewers' Alert
- 1998 Annual Reviewers' Alert
- 1997 Annual Reviewers' Alert

|  |    |
|--|----|
| <b>Consolidation of Peer Reviewers' Alerts</b>   | i  |
| <b>System Reviews</b>  | 1  |
| ▪ Systemic Approach to Peer Review   | 1  |
| ▪ Commencement of Field Work on a System Review  | 1  |
| ▪ Documentation/Performance Deficiencies   | 2  |
| ▪ Isolated Deficiencies  | 3  |
| ▪ Isolated Deficiencies-Additional Guidance  | 4  |
| ▪ Monitoring Deficiencies  | 5  |
| ▪ Identifying Substandard Engagements in the System Review Report  | 6  |
| ▪ Engagement Selection on System Reviews-Determining<br>A Reasonable Cross Section of an Accounting and<br>Auditing Practice   | 6  |
| ▪ Must Cover vs. Must Select   | 7  |
| ▪ Engagement Selection Guidance for AICPA PRP and CPCAF PRP<br>Peer Reviews  | 8  |
| ▪ Selecting the "Surprise" Engagement  | 8  |
| ▪ Selecting the "Surprise" Engagement-Additional Guidance  | 9  |
| ▪ Surprise Engagement Selection under Interpretation No.1 is Not<br>Applicable   | 10 |
| ▪ When to Issue a Modified or an Adverse System Review Report  | 11 |
| ▪ Scope Limitations when a Firm's only Audit Subject to Government<br>Auditing Standards Cannot Be Selected on the Peer Review | 12 |
| ▪ Issues Related to Audits of Non-Issuers  | 13 |
| ▪ Exit Conference  | 13 |
| ▪ Exit Conference-Additional Guidance  | 14 |
| ▪ Documenting Risk Assessment  | 14 |
| ▪ Components of Risk Assessment and Definition of Peer Review Risk   | 14 |
| ▪ Inherent Risk Factors  | 16 |
| ▪ Control Risk Factors   | 16 |
| ▪ Detection Risk   | 17 |
| <b>Letters of Comment</b>  | 19 |
| ▪ Repeat Findings  | 19 |
| ▪ Indicating "Must Select" Engagements in the Letter of Comment  | 20 |
| <b>Letters of Response</b>   | 20 |
| ▪ Guidance on Writing an Effective Letter of Response  | 20 |
| ▪ Letter of Response Can be Mailed or Faxed  | 21 |
| ▪ Threshold for Preparing an MFC   | 22 |
| ▪ Q&A about Completing the MFC   | 22 |
| <b>Matters for Further Consideration</b>   | 24 |
| ▪ Matters for Further Consideration (MFC) Forms and<br>References to Professional Standards                                    | 24 |

|   |    |
|---|----|
| <b>Firm Representation Letter</b>   | 24 |
| ▪ Dating of the Firm Representation Letter  | 24 |
| ▪ Firm Representation Letter to the Peer Reviewer   | 24 |
| ▪ Reviewed Firm Representation Letters to the Team Captain/Reviewer   | 25 |
| ▪ Firm Representation Letters on “Report Days”  | 25 |
| <b>Engagement Reviews</b>   | 26 |
| ▪ Applicability of Interpretation 101-3 and its Documentation requirements<br>on an Engagement Review                               | 26 |
| ▪ Unmodified Report on an Engagement Review of a Firm<br>That Only Performs Compilations That Omit<br>Substantially All Disclosures | 27 |
| ▪ Performing Engagement Reviews and Using Supplemental<br>Engagement Checklists   | 28 |
| ▪ Circumstances Calling for a Modified or Adverse Report  | 28 |
| <b>Licensure</b>  | 29 |
| ▪ Licensure   | 29 |
| ▪ Guidance for Failure to Have or to Maintain a Firm or Individual<br>License to Practice Public Accounting                         | 30 |
| Firm License  | 30 |
| Individual License  | 30 |
| ▪ Licensure Verification  | 31 |
| ▪ Out of State Reviewers May Need to Obtain Out of State<br>License   | 32 |
| ▪ Sole Practitioner’s Failure to Have an Individual License   | 32 |
| <b>General</b>  | 33 |
| ▪ Completion of Engagement Checklist  | 33 |
| ▪ Requests for Change in Peer Review Year Ends  | 33 |
| ▪ Reviewer Resume Verification Process  | 34 |
| Background Forms and Reviewer Resumes   | 34 |
| Enhanced Oversight Procedures-Verification of Reviewer<br>Resume Information  | 35 |
| ▪ Illegal Acts  | 36 |
| ▪ Personal Financial Statements   | 36 |
| ▪ Medicare Cost Reports   | 37 |
| ▪ Review Requirements for Joint Ventures  | 37 |
| ▪ Special Rules for Resignations  | 37 |
| ▪ Reinstatement for Firms Dropped or Terminated from the Peer<br>Review Program   | 38 |
| ▪ Incomplete Engagement   | 38 |
| ▪ Reviewer Checklists – Ensure Consistency  | 39 |
| ▪ AICPA Peer Review Program Implications of Interpretation<br>101-3 – Performance of Nonattest Services                             | 40 |
| System Review   | 41 |
| Engagement Review   | 42 |

|   |    |
|---|----|
| Report Review   | 43 |
| <b>Quality Control Standards</b>  | 44 |
| ▪ Monitoring  | 44 |
| Documenting Monitoring for Sole Practitioners   | 44 |
| ▪ Personnel Management  | 45 |
| Staff Interviews  | 45 |
| <b>Government Accountability Office (GAO)</b>   | 46 |
| ▪ Government Auditing Standards – United States Government<br>Accountability Office (Yellow Book) and Governmental<br>Accounting and Financial Reporting Standards (GASB) | 46 |
| ▪ Extensions under GAO Auditing Standards   | 47 |
| ▪ Government Auditing Standards CPE Requirements and Peer Review  | 47 |
| ▪ Comparison of AICPA and GAO Rules of Independence<br>For Nonattest Services   | 48 |
| ▪ Governmental Audit Quality Continues to Be a Concern  | 48 |
| Common Deficiencies   | 49 |
| Going Forward – Challenge to Continue   | 49 |
| ▪ Peer Reviews Performed by Other Professional Organizations  | 50 |
| <b>Department of Labor (DOL)</b>  | 50 |
| ▪ DOL’s ERISA Audit Quality Enforcement Initiative  | 50 |
| ▪ Common ERISA Audit Deficiencies   | 51 |
| <b>Reviewers’ Information</b>   | 52 |
| ▪ Non-Equity Partners as Team Captains on System Reviews  | 52 |
| ▪ Enhanced Oversight on Engagements   | 52 |
| ▪ Oversight of Reviews – Confidentiality Issues   | 53 |
| ▪ Reviewers’ Firms Can be Selected for Oversight  | 53 |
| ▪ Suspension of Reviewers and Reviewer Performance Issues   | 54 |
| ▪ Disagreements between Reviewers and Reviewed Firms  | 55 |
| ▪ Reviewer Resume Form  | 56 |
| ▪ Acceptance of Review Teams  | 56 |
| ▪ Reviewers – Update Your Resume Annually and Advise AICPA<br>Peer Review of your Correct E-Mail Address  | 56 |
| ▪ Change in Experience Code on Reviewer Resume  | 57 |
| ▪ Candidates Interested in Serving on the AICPA<br>Peer Review Board  | 58 |
| ▪ Acceptance of System, Engagement and Report Reviews   | 59 |
| ▪ Revisions to CPE requirements for committee members and technical<br>Reviewers  | 60 |
| ▪ How to Locate a Comprehensive Listing of Peer Reviewer CPE<br>Courses   | 60 |
| ▪ Considerations Related to Accepting an Audit Engagement   | 60 |
| ▪ FDICIA Engagements \$500 Million or Greater   | 61 |
| ▪ Transition Guidance on CPE for New Peer Review Standards  |    |

|   |    |
|---|----|
| Effective January 1, 2009   | 61 |
| <b>Ethics Information for Peer Reviewers</b>  | 63 |
| ▪ AICPA Professional Standards ET Section 302 – Contingent Fees   | 63 |
| ▪ Resources Available on Interpretation 101-3 Performance of<br>Nonattest Services  | 63 |
| <b>Accounting and Auditing Issues</b>   | 65 |
| ▪ Keeping Current on Professional and Industry Developments   | 65 |
| ▪ Important web-site Links  | 65 |
| ▪ Documentation on a Review Engagement of Financial Statements<br>for periods ending on or after December 15, 2004                      | 66 |
| ▪ Management Representation Letters   | 68 |
| ▪ Extension of Order Regarding Broker-Dealer Financial<br>Statement Requirements under Section 17 of the<br>Exchange Act                | 68 |
| ▪ Recently Issued Statements on Auditing Standards and<br>Statements on Standards for Attestation Engagements                           | 68 |
| ▪ Peer Review Guidance for SAS No. 112, <b>Communicating Internal<br/>        Control Related Matters Identified in an Audit</b>        | 70 |
| ▪ <b>SAS No. 112 FAQ</b>  | 70 |
| <b>Center for Public Company Audit Firms Peer Review Program</b>  | 77 |
| ▪ Interpretation – Team Captain Training Courses  | 77 |
| ▪ Center for Public Company Audit Firms Peer Review Program<br>April 2004 Bridging Document   | 77 |
| <b>Other</b>  | 78 |
| ▪ Reporting Firm Structure Changes to Administering Entities<br>and Their Effect on a Firm’s Enrollment and Peer<br>Review Requirements | 78 |

# **System Reviews**

## **Systemic Approach to Peer Review**

The AICPA has identified situations in which reviewers continue to focus on selected engagements and fail to appropriately evaluate the firm's system of quality control—the primary objective of a system peer review and the basis for the peer review report. For example, after discovering a substandard engagement, some reviewers consider the need to issue a modified peer review report before identifying the underlying cause of the engagement deficiency.

Reviewers must think of engagement deficiencies as symptoms of weaknesses in the firm's system of quality control. A reliable method for identifying the systemic cause of engagement deficiencies is to require complete answers on the Matters for Further Consideration (MFC) forms instead of merely a check mark for the “yes we agree” response and a survey of firm personnel about causes of identified engagement deficiencies.

We believe that the failure to understand root causes of engagement deficiencies has led some reviewers to regularly and inappropriately recommend the use of standard forms and checklists for improving a firm's system of quality control. Although forms and checklists are helpful in many circumstances, their use will not cure all deficiencies. For example, checklists will not help firms that lack overall knowledge of accounting and auditing matters or knowledge in the specific area in which the deficiency arose. Nor will standard checklists help firms in which policies and procedures for the review of engagements are routinely overridden. In addition, separate engagement deficiencies that are exactly the same may result from completely different quality control weaknesses in the firm. Without understanding the underlying cause, a reviewer cannot make recommendations that are appropriate to reducing the likelihood of the deficiencies recurring. Guidance for determining the underlying cause of engagement deficiencies can be found in the case studies guidelines for writing letters of comments in section 3400 of the *AICPA Peer Review Program Manual*. In addition, the peer review courses and related supporting documentation materials stress the importance of evaluating the reviewed firm's system of quality control.

## **Commencement of Field Work on a System Review**

A peer review commences when the review team begins field work on a system review (or begins the review of engagements on engagement and report reviews). For purposes of approval of peer reviewers, providing the firm the list of engagements selected for the peer review, firm resignations, firm drops or terminations, field work ordinarily begins the date the reviewer/review team arrives at the reviewed firm's office. Peer reviewers are expected to perform system reviews at the reviewed firm's office unless it is performed under Interpretation No. 1. Understandably reviewers/review teams will likely perform some preliminary work/planning prior to arrival at the reviewed firm's office. In

those circumstances, judgment must be used in determining whether the fieldwork has started at some time prior to arrival, particularly when any preliminary work allows a reviewer to determine that there is a strong likelihood that there are significant deficiencies with the firm's system of quality control or engagements selected for the peer review.

If the system review is performed under Interpretation No.1, field work begins when the review team starts to review the documents submitted by the reviewed firm identified in paragraph 2 of the Interpretation.

### **Documentation/Performance Deficiencies**

Statement on Auditing Standards No. 96 (SAS 96) indicates that the auditor should prepare and maintain audit documentation, the form and content of which should be designed to meet the circumstances of a particular audit engagement. The quantity, type, and content of the audit documentation are matters of the auditor's professional judgment. Audit documentation serves to provide principal support for the auditor's report and aids in the conduct and supervision of the audit. SAS 96 also states that it does not imply that the auditor would be precluded from supporting his or her report by other means in addition to the audit documentation. Reviewers should be familiar with these and the other matters discussed in SAS 96.

If it is determined that documentation that should have been present is lacking, (assumes appropriate alternative procedures were not performed and documented), this would be an engagement deficiency for peer review purposes. In the past we have usually addressed documentation and performance deficiencies separately, but if a firm's documentation does not meet the requirements of SAS 96 (or other SASs with specific documentation requirements), a documentation deficiency really is a performance deficiency.

The Board recognizes that various examples of letters of comments in the guidance materials need to be updated for this matter, particularly in closing the loop on a comment in a letter of comments or a deficiency in a modified report.

If a firm has a documentation/performance deficiency, the team captain should use professional judgment including consideration of the nature, significance and pervasiveness of the matter in determining whether a single (or other) engagement(s) should be deemed substandard (and ultimately whether a modified or adverse report should be issued).

The following is an example of documentation deficiencies resulting in a modified report

Reasons for Modified Opinion and Recommendation (recommendation not included in this example)

The firm's policies and procedures require that firm personnel have the experience, expertise and training necessary to provide them with the proficiencies required to perform their assigned accounting and auditing engagements with the competencies specified by professional standards. During our review we noted, that although the firm's CPE hours were in compliance with regulatory requirements, insufficient CPE was obtained in certain auditing areas that included recent and current auditing developments. Consequently, our review disclosed several instances where engagement personnel were insufficiently familiar with the current audit documentation standards and, as a result, we noted engagement deficiencies regarding documentation of the nature timing, extent and results of auditing procedures. Specifically, audits of employee benefit plans subject to ERISA lacked sufficient documentation of inquiries of a predecessor auditor, analytical procedures, understanding clients internal control, planning decisions regarding sampling and whether the testing had been performed to verify benefit plan contributions had been properly credited to the investments selected by the participants. Although the firm represented to us that sufficient work was completed in all of the above areas, we were unable to determine what had been performed in these areas due to the lack of documentation (without extensive oral inquiries with the firm). Therefore, we deemed these two ERISA audits as substandard engagements. The firm has indicated that it plans to add the appropriate documentation to its existing audit work papers.

If the nature and pervasiveness of the deficiencies don't rise to the level of a modified report (inconsequential procedures, partial documentation exists, only one minor area on few different engagements, etc), and once again the reviewer must use some professional judgment consistent with other guidance issued by the Board, the loop of a letter of comment might be closed as follows (assuming a different set of circumstances):

### **Isolated Deficiencies**

An isolated deficiency occurs when there is an incident of noncompliance with the *professional standards* or the quality control policies and procedures on one engagement and the identical *professional standards* or quality control policies and procedures were complied with on the remaining engagements. The reviewer must consider the pattern and pervasiveness of engagement deficiencies and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature and significance in the specific circumstance in which they were observed. Reviewers must try to determine why the deficiency occurred and should analyze the nature, significance, and cause of the isolated deficiency and its implication, if any, on the system of quality control. If the reviewer determines that the isolated incident increases the possibility that the firm might not conform with professional standards in a significant respect, the reviewer must consider carefully the need for a modified or an adverse report. Sometimes engagement deficiencies may be individually different, not individually significant, and not directly traceable to the design or compliance with a particular quality control policy or procedure. In such situations, the reviewer might conclude that the deficiencies were isolated because of cases of human error that would not result in a modified or adverse report.

Reviewers may need to expand their review procedures on a system review to other similar engagements and/or perform additional procedures in an effort to determine if the deficiency is truly isolated. For example, a single disclosure deficiency and a single documentation deficiency may be isolated when taken individually but they may have resulted from the same underlying systemic cause. Further, an isolated deficiency may be materially significant in amount or nature or both. In each of the above situations, the isolated deficiencies should be included in the letter of comments if they created a condition in which there was more than a remote possibility that the firm will not comply with professional standards.

### **Isolated Deficiencies – Additional Guidance**

For a deficiency (which in this capacity includes the types of matters that could be included in a LOC) to be deemed isolated, the team captain should expand scope to other engagements and determine that such deficiency did not occur elsewhere, thus evidencing that the noncompliance with the firm’s system of quality control was truly isolated. In this situation, team captains should focus on the underlying cause of the deficiency when analyzing if the deficiency is isolated and may consider a “key area” approach when expanding scope to other engagements to determine if the deficiency is isolated. The team captain’s ability to conclude a deficiency is isolated is dependent on his/her ability to expand scope to engagements that are classified by common characteristics such as, but not limited to, the industry, level of service, the practitioners in charge, or engagements that must be selected in a peer review.

The team captain may also focus on the systemic cause for the deficiency in order to arrive at a conclusion that the deficiency is isolated. For example, the team captain expands scope to an adequate number of other similar engagements performed and finds the proper treatment of complex accounting or auditing issues through appropriate consultation of professional standards or other procedures performed by the firm. **The team captain should not conclude a deficiency is isolated if he or she cannot adequately expand scope.**

Team captains should document their consideration of an isolated deficiency and the conclusions reached in the Summary Review Memorandum and Matters for Further Consideration form. The documentation should include the details of the deficiency noted, how the team captain expanded scope and why the team captain concluded the deficiency was isolated. The documentation should provide enough information for the peer review committee to determine if the team captain’s conclusion is appropriate.

Paragraph 95 of the Standards indicates that, ordinarily, an isolated deficiency or isolated instance of noncompliance with the firm’s quality control policies and procedures would not be included in the report of letter of comments. However, a team captain should analyze the nature, importance, action the firm will take causes (if determinable), of the isolated deficiency as well as the implications for the firm’s system of quality control as a

whole together with the review team’s other findings before making a final determination of whether to include a comment in the letter of comments related to the isolated deficiency or isolated instance of noncompliance. If an isolated matter is included in the LOC, it should be identified as such.

Peer review committees must analyze the team captain’s conclusions to determine that the team captain adequately expanded the scope of the review to determine that the deficiency was in fact isolated. In addition, peer review committees should not automatically request a team captain to remove a comment from the letter of comments solely because a team captain has determined the deficiency is isolated and believes that inclusion in the letter of comments is warranted. Likewise, the peer review committee should not require a team captain to include a comment regarding an isolated deficiency in the letter of comments.

### **Monitoring Deficiencies**

The AICPA Peer Review Board has provided guidance when a firm’s system of quality control does not conform with the requirements of the *Statements on Quality Control Standards* (SQCS). The Board has determined that the impact on the peer review when a firm does not document or perform monitoring as required by the SQCS is as follows:

#### **GUIDANCE FOR MONITORING DEFICIENCIES**

| <b><u>FINDING</u></b>  | <b><u>CONCLUSION</u></b>   |
|--|--|
| There is a marginal documentation, <b>or marginal</b> performance of monitoring, <b>and</b> there are <b>no comments in the LOC</b> , then                   | Unmodified report with no LOC; monitoring issue is an exit conference item                   |
| Did not document, <b>or</b> did not perform monitoring as required by the SQCS, <b>and</b> there are <b>no</b> other comments in the LOC, then               | Unmodified report with LOC for the lack of documentation or performance of monitoring        |
| Did not document, <b>or</b> did not perform monitoring as required by the SQCS, <b>and</b> has other comments in the LOC that result in an unmodified report | Unmodified report with LOC for lack of documentation or performance of monitoring            |
| Did not document, <b>or</b> did not perform monitoring as required by the SQCS, <b>and also has</b> deficiencies resulting in modified or adverse report.    | Deficiency noted in the modified/adverse report for the lack of documentation or performance |

## **Identifying Substandard Engagements in the System Review Report**

Reviewers should be aware that the AICPA *Standards for Performing and Reporting on Peer Reviews* PRP 3100.90m require that if a system review report is modified or adverse, substandard engagements should be identified by its industry and level of service. This is applicable for substandard engagements that resulted in the report being modified or adverse. Consistent with 3100.139 Appendix G and 3100.145 Appendix M, the industry and level of service should be identified in the deficiencies that are included in the body of the report.

## **Engagement Selection on System Reviews– Determining a Reasonable Cross Section of an Accounting and Auditing Practice**

Selection of engagements should be performed using the risk-based approach, and the engagement selection should also provide a reasonable cross-section of the firm's accounting, auditing, and attestation engagements. When selecting engagements for review, what should be considered as a reasonable cross section of a reviewed firm's accounting and auditing practice? The term "reasonable cross section", is referred to in paragraph 60 of the *Standards for Performing and Reporting on Peer Reviews (Standards)*, which states:

"Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size, industry area, level of service, personnel (including turnover, use of merged-in personnel, or personnel not routinely assigned to accounting and auditing engagements), litigation in industry area, and initial engagement."

A reasonable cross section of a firm's accounting and auditing practice, not only includes consideration of the specific industries that are required to be selected, but other industries that have a significant public interest. The reviewer also needs to carefully consider the industries that the firm has identified in the category of "other audits" when determining whether to select such an engagement(s). In addition, a reasonable cross-section takes into account the levels of accounting and auditing services, the number of partners, the number of practice offices, and materiality thresholds of accounting and auditing hours. A reasonable cross section does not always require that at least one engagement from every level of service provided by the firm be selected for review; however, it often may be appropriate in the circumstances. Therefore, there is a relationship between a risk-based approach and a reasonable cross section when selecting engagements, and in that regard each peer review needs to be considered on a case-by-case basis.

The reviewer should explain and document in the *Summary Review Memorandum* key decisions that he or she made when they chose not to select any one or more of the

following: a level of service, an engagement that is a significant public interest significant, industries where the firm performs a significant number of engagements, etc. This does not give authority to the reviewer to avoid selecting an engagement(s) by simply documenting the reason(s) why he or she did not select certain engagement(s). Decisions for not selecting certain engagements must make sense, and must not conflict with the *Standards*. The reviewer should anticipate questions regarding engagement selection from the administering entity.

### **Must Cover vs. Must Select**

“Must Cover” is a term used to indicate that the review team must have experience in a certain industry in order to be approved as the reviewer. This requirement is to ensure a proper risk assessment is made by the review team. It is important to note that engagements in these industries are not required to be selected for testing; the requirement is only that a member of the review team have such experience. On a system review, the following are considered “Must Cover”:

- Reviewed firm identifies industries in which over ten percent of the firm’s auditing practice hours are concentrated
- When the reviewed firm does not have any industry concentrations of 10%, the firm’s three largest industry concentrations
- If the reviewed firm has any “Must Select” engagements, these industries are also “Must Cover.”

It is important to note that “Must Selects”, unlike other “Must Covers” are required to be selected in accordance with Interpretation No. 2 – Engagement Selection in System Reviews. Interpretation No. 2 indicates that at least one of each of the following types of engagements is required to be selected for review on a system review:

- Governmental – If a firm performs an engagement (which may not be an audit) of an entity subject to Government Auditing Standards (GAS), at least one engagement conducted pursuant to those standards should be selected for review.
- Employee Benefit Plans - If a firm performs an audit of an entity subject to Employee Retirement Income Security Act of 1974 (ERISA), at least one engagement conducted pursuant to those standards should be selected for review.
- Depository Institutions – If a firm performs an audit of a federally insured depository institution subject to the Federal Deposit Insurance Corporation Improvement Act (FDICIA, the “Act”) at least on engagement conducted pursuant to the Act should be selected for review.

## **Engagement Selection Guidance for AICPA PRP and CCAF PRP Peer Reviews**

The Standards for Performing and Reporting on Peer Reviews (*Standards*) require that, after selecting engagements to be reviewed based on risk assessment, the review team should ensure that the scope of the review includes, at a minimum, one engagement from each of the following higher risk industries when the firm performs them: benefit plans under ERISA, engagements performed under GAGAS (Yellow Book) and audits subject to FDICIA. However, peer reviewers are reminded that the scope of the engagements selected should include a reasonable cross-section of the firm's accounting and auditing engagements, appropriately weighted considering risk. Thus, **the peer reviewer will often need to select greater than the minimum of one engagement from these industries in order to attain this risk weighted cross-section.**

For benefit plans under ERISA, the peer reviewer should also consider whether the engagement selection process has adequately addressed the risks involved in limited vs. full scope audits and in different types of benefit plans such as defined benefit, defined contribution and voluntary health and welfare plans. Similar considerations should be made on GAGAS and FDICIA engagements. The team captain's consideration of this coverage should be discussed in his or her risk assessment in the summary review memorandum. This discussion should include any factors considered when the reviewed firm has a significant number of engagements in one of these high risk areas and it is not otherwise evident why only one engagement from the industry has been included in the scope of the review.

### **Selecting the "Surprise" Engagement**

The AICPA Peer Review Program Standards require that the initial selection of engagements to be reviewed should be provided to the reviewed firm no earlier than two weeks before the start of fieldwork (also known as the commencement of the peer review). This should provide ample time to enable the firm (or office) to assemble the required client information and engagement documentation before the review team starts the fieldwork. However, at least one engagement from the initial selection to be reviewed should be provided to the firm once the review team arrives at the reviewed firm's offices and not provided to the firm in advance of the start of fieldwork. This engagement should be the firm's highest level of service and should not increase the scope of the review.

The following steps should be followed when making the selection of the surprise engagement:

1. Complete the risk assessment. The review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the inherent and control risk associated with those areas.

2. Select engagements for review which provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding the reviewed firm's system of quality control.
3. Based on those engagements selected for review, determine which engagement should be provided to the firm once the review team arrives at the reviewed firm's office and not provided to the firm in advance of the start of fieldwork ("surprise engagement"). **If the risk assessment warrants, more than one surprise engagement may be selected.**

If, after completing the engagement selection in Step 2, the team captain determines that there is only one audit required to be selected or that the only audit is a "must select" engagement, the team captain should select an engagement from a different level of service. The selection should be based on the risk assessment performed in Step 1 and the engagement should be from the list of engagements determined in Step 2.

In scenarios such as this, the team captain should not select a second audit engagement if it was not part of the initial engagement selection. By selecting a second audit, the team captain is increasing the scope of the review.

### **Selecting the "Surprise" Engagement-Additional Guidance**

The team captain should review the firm's system of quality control and perform other procedures described in the Standards to assess the various risk elements on the peer review. Based on the risk assessment, the team captain would determine which engagements should be selected for the peer review, independent of any surprise selection. Then, the team captain should select the surprise engagement from the engagements that were selected for the peer review.

Although the Standards indicate that the engagement should be the firm's highest level of service, (which ordinarily means an audit) the guidance (Section 3900.18) provides that in situations where the audit cannot be the "surprise" selection, the next highest level of service should be selected. The team captain should not be increasing the original scope of the review selection whether another audit or another level of service is selected as the surprise engagement.

For example, sole practitioner #1 only has one "must select" audit engagement (i.e. ERISA) and one very small manufacturing audit, and 15 review engagements, the team captain's risk assessment may determine that selecting the ERISA covers the audit level of service, and there would be no need to select the manufacturing audit, and the peer reviewer would select one or more reviews. Sole practitioner #2 has two ERISA audits

and several audits of manufactures and 15 review engagements. As far as the surprise engagements selections the following should be considered:

1. In the case of sole practitioner #1, the ERISA audit cannot be a surprise as it is a must select, and assuming that the risk assessment concluded that the other audit would not be selected, a review engagement would be the surprise. The team captain's conclusion should be adequately documented in the SRM, that the appropriate "audit level" coverage results with the "must select" audit, and it was appropriate to select the surprise engagement from the next highest level of service.
2. In the case of sole practitioner #2, it is likely that the risk assessment would identify that only one ERISA and at least one manufacturing audit and one or more reviews would be selected. So if two audits were going to be selected by the reviewer and there is a population large enough for it to be a surprise, that is the level of service the surprise engagement should come from. The reviewer could select one of the two ERISA audits or one of the manufacturing audits to be the surprise. Of course whether the surprise engagement or not, an ERISA audit must be selected. Once again the team captain's conclusion should be adequately documented in the SRM.
3. Another situation that is more difficult to apply is when on sole practitioner #1's peer review, the peer reviewer's risk assessment determines that in addition to the ERISA audit, it would be appropriate to look at several key audit areas of the firm's manufacturing audit (maybe it wasn't a very small audit). It would be acceptable for the manufacturing audit, even though only the key audit areas are being reviewed, to satisfy the surprise engagement requirement.

The Board also recognizes that it is not always possible for the reviewer to know whether a reviewed firm expects a certain engagement to be selected. In Example 3 above, the reviewed firm may or may not have expected the manufacturing audit to be selected. Reviewers are asked to use their professional judgment in these situations.

### **Surprise Engagement Selection under Interpretation No. 1 is Not Applicable**

For system reviews, paragraph 61 of the Standards require that at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance ("surprise engagement").

Interpretation No. 1, "*System Reviews Performed at a Location Other Than the Practitioner's Office*," provides the review to be conducted at the reviewer's office or another agreed upon location providing certain criteria is met. Based on the risk assessment, the reviewer selects the engagements to be reviewed which are submitted by the firm. Due to the limited number of engagements covered by the SASs, Government

Auditing Standards or examinations of prospective financial statements under the SSAEs, the requirement to select a “surprise” engagement on a system review under Interpretation No. 1 is **not** applicable.

### **When to Issue a Modified or an Adverse System Review Report**

The objective of a system of quality control is to provide the firm with reasonable assurance of conforming to professional standards in the conduct of its accounting and auditing practice. When this objective is not met, because of design or compliance deficiencies, the firm will ordinarily receive a modified or an adverse report. Paragraph 135 of the Standards should be considered when considering the type of report to issue in a system review and judgment on the part of the review team also plays a role.

Circumstances that ordinarily would support the issuance of an unmodified report include circumstances in which there are:

1. Design deficiencies in the firm’s system of quality control but the firm has reasonable assurance of conforming with professional standards.
2. Isolated, unintentional instances of non-compliance with the firm’s system of quality control.

Circumstances that ordinarily would result in the consideration of the issuance of a modified report are:

1. Collectively and individually significant instances of noncompliance with firm policies and/or professional standards such that the firm does not have reasonable assurance of conforming with professional standards in certain areas. This includes AU Section 561 (non-GAAP), AU Section 390 (non-GAAS). *Government Auditing Standards* or non-SSARS problems.
2. Scope limitations.
3. Failure to perform adequate monitoring procedures since the prior peer review when there are other significant deficiencies on the current peer review.
4. Design deficiencies indicated by deficiencies the engagements reviewed that lead to the conclusion that the firm did not have reasonable assurance of conforming with professional standards during the year under review.
5. Significant documentation deficiencies that do not adequately demonstrate compliance with SAS 96.

Circumstances that ordinarily would result in the issuance of an adverse report are as follows:

1. A high degree of noncompliance with policies and/or professional standards such that the firm does not have reasonable assurance of conformity with professional standards in certain areas. This includes AU Section 561 (non-GAAP), AU Section 390 (non-GAAS), *Governmental Auditing Standards* or non-SSARS problems.
2. The lack of an effective system of quality control to the extent that the firm does not have reasonable assurance of conforming with professional standards.

### **Scope Limitations when a Firm's only Audit Subject to Government Auditing Standards Cannot Be Selected on the Peer Review**

Not only do the AICPA *Standards for Performing and Reporting on Peer Reviews (Standards)* require that at least one Government Audit be selected on the peer review but Yellow Book also has this requirement (Chapter 3.54b).

Therefore, when the reviewer cannot select at least one of the reviewed firm's governmental audits, the firm has failed to comply with *Standards* and Yellow Book. As a result, not only should the peer review report reflect the scope limitation, the report should also be modified for the failure to comply with Government Auditing Standards.

The example of how the language may be worded in the fourth and fifth paragraphs of the report in *Standards* Paragraph 142 does not specifically address the firm's failure to comply with Yellow Book, including a separate deficiency for the matter.

Therefore, when a reviewer is unable to review the firm's only Government Audit, the fourth and fifth paragraphs of the report as well as the deficiency that resulted in a modified report should more appropriately be worded similar to what follows:

In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards*. As a result we were unable to include within the scope of this review all of the engagements required to be selected by the Standards established by the Peer Review Board of the AICPA.

In our opinion, except for the effects of the deficiency described below and any deficiencies or comments that might have come to our attention had we not been limited in scope as noted above, the system of quality control for the accounting and auditing practice of [*Name of Firm*] in effect for the year ended March 31, 2005, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA and was complied with during the year then

ended to provide the firm with reasonable assurance of conforming with professional standards.

#### Reasons for Modified Opinion and Recommendation

Deficiency – In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, the firm was not in compliance with the Yellow Book peer review engagement selection requirements

Recommendation – We recommend that the firm emphasize to its client, that its name does not have to be revealed to the peer reviewer, the importance of the firm adhering to *Government Auditing Standards*, including the possible consequences of noncompliance.

Although the firm’s representation about the governmental audit is included in the peer review report, it would not be inappropriate for the reviewer to require the reviewed firm to also identify this matter in its representation letter to the reviewer.

#### **Issues Related to Audits of Non-Issuers**

The AICPA has issued a letter providing some guidance regarding the applicability and appropriateness of applying standards established by the PCAOB to an audit of a non-issuer, such as a privately held business, a not-for-profit organization or a governmental entity. During the planning stage of a peer review, reviewers must be cognizant of any audits for a non-issuer performed by a firm under PCAOB standards. Any engagements selected for peer review that were performed under PCAOB standards must be in compliance with all applicable PCAOB standards.

For additional information related to this topic, refer to the memo to Managing Partners of Audit Firms issued by Susan Coffey, Vice President, Audit Quality and Professional Ethics at: <http://www.aicpa.org/download/ethics/audreportltr.pdf>.

#### **Exit Conference**

The exit conference is the culmination of the peer review. Normally, senior management, the individual responsible for maintaining the system of quality control, and the review team attend the exit conference. At the exit conference, the review team’s primary focus is to discuss the peer review report and letter of comments, if applicable. Since the review team captain is responsible for the results of the peer review, the team captain should be physically present at the exit conference. The only exception to this rule is when a peer review is performed under Interpretation No. 1 of the *Standards for Performing and Reporting on Peer Reviews*, which allows a peer review to be performed at a location other than the reviewed firm’s office. As a reminder, the exit conference is

not the place to surprise the firm with the intention of issuing a modified or adverse report or to discuss any unresolved accounting and auditing issues.

### **Exit Conference – Additional Guidance**

When, in the unusual circumstances, the team captain does not have the experience to review engagements performed under GAGAS, audits of employee benefit plans under ERISA or audits of an insured depository institution subject to the FDIC Improvement Act of 1991, and a team member is reviewing such engagements, the team member must participate in the exit conference (in person or via teleconference) if Matters for Further Consideration (MFC) related to the engagement are issued. If there are no MFC related to the engagement reviewed by the team member, his/her presence is not mandatory, but they should be available for consultation, if necessary.

### **Documenting Risk Assessment**

*Note: This article is from the Peer Review Course: AICPA Peer Review Program Standards: Practical Guidance for Selected Topics*

#### **Components of Risk Assessment and Definition of Peer Review Risk**

Reviewers must assess peer review risk and use a risk-based approach in the selection of engagements and offices for review (*Standards*, par. 55-56).

.55 In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the peer review risk associated with those areas. The higher the assessed levels of peer review risk, the greater the number of offices or engagements that need to be reviewed. The assessed level of peer review risk may be affected by circumstances arising within the firm (for example, individual partners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

.56 When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 2. This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

Generally accepted auditing standards require audit risk assessment during audit planning, and peer review risk is likewise assessed in planning a system review. Some reviewers have developed the habit of formalizing the risk assessment after arriving on-

site in the reviewed firm's office or after selecting one or more engagements for review. Ineffectiveness and, at the very least, inefficiency should be expected when using this approach. Based on the assessed peer review risk, a risk-based approach is used in the selection of engagements for review (and, for firms with multiple offices, in the selection of offices to visit during the review).

Peer review risk consists of three *components*:

1. *Inherent risk* – The likelihood that a firm's accounting or auditing engagements will fail to comply with professional standards, assuming the firm does not have a system of quality control.

2. *Control risk* – The risk that a firm's system of quality control will not prevent the performance of an engagement that does not comply with professional standards. Control risk is further broken down into two parts:

a. *The firm's control environment* – The collective effects of various factors that establish, enhance, or mitigate the effectiveness of specific quality control policies and procedures. A firm's control environment reflects the overall attitude, awareness, and actions of firm management and the message management sends to employees concerning the importance of quality work and its emphasis in the firm.

b. *The firm's quality control policies and procedures* – Every firm has quality control policies and procedures, even where they are informally documented or not documented at all and/or are not well understood throughout the firm. Sometimes, however, the quality control policies and procedures are so immature or incomplete that the firm effectively has none beyond the owners asserting the firm complies with relevant professional standards – the understanding of which may be shallow or very outdated.

3. *Detection risk* – The risk that the reviewer (or review team) will fail to detect design or compliance deficiencies in the reviewed firm's system of quality control that either

a. Result in the firm having less than reasonable assurance of conforming with professional standards in all material respects or

b. Constitute conditions whereby there is more than a remote possibility that the firm will not conform with professional standards on accounting and auditing engagements in all material respects.

The above outlines the *components* of peer review risk. A more practical *definition* of peer review risk is, however, needed in order to fully understand its significance in achieving the objectives of peer review. Peer review risk is the risk that the reviewer will

- Fail to identify significant weaknesses in the reviewed firm's system of quality control or the degree of compliance therewith, and as a result

- Issue an inappropriate report on the reviewed firm's system of quality control for its accounting and auditing practice or the firm's compliance with that system or both, or
- Reach an inappropriate conclusion about whether or not to issue a letter of comments and/or about the comments to be included in or excluded from the letter of comments.

The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. This is explained in the text that follows.

### **Inherent Risk Factors**

In assessing inherent risk factors, the reviewer should consider

- Circumstances arising within the firm (for example, the firm or individual partners have engagements in several specialized industries);
- Circumstances outside the firm that impact the firm's clients (for example, new professional standards or those being applied initially for one or more clients, changes in regulatory requirements, adverse economic developments in an industry in which one or more of the firm's clients operate, or significant developments in the client's organization).
- Variances that may occur from year to year, engagement to engagement or, perhaps, from partner to partner, within the firm. For example, inherent risk will always be higher for an audit of a company or organization operating in a high-risk industry than for a compilation of financial statements without disclosure for a company operating in a non-complex industry; and there are many situations between these two extremes.

### **Control Risk Factors**

Assessing control risk requires reviewers to evaluate the effectiveness of the reviewed firm's quality control policies and procedures in preventing the performance of engagements that do not comply with professional standards. When assessing control risk, the review team should evaluate the reviewed firm's quality control policies and procedures and discuss with the firm if it considered the guidance in the AICPA's *Establishing and Maintaining A System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. The reviewer should evaluate whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control in the context of the firm's overall control environment and the inherent risk embodied in its accounting and auditing practice.

The assessed levels of risk are the key considerations in deciding the number and types of engagements to review and, where necessary, offices to visit. Through the assessment of risk, the reviewer determines the coverage of the firm's accounting and auditing practice that will result in an acceptably low peer review risk. Engagements selected should

provide a reasonable cross-section of the firm's accounting and auditing practice, with a greater emphasis on those engagements in the practice with higher assessed levels of peer review risk.

Reviewers must document, as part of the Summary Review Memorandum (SRM), the risk assessment of the firm's accounting and auditing practice and its system of quality control, the number of offices and engagements selected for review, and the basis for that selection in relation to the risk assessment. To effectively assess risk of the firm's accounting and auditing practice and its quality control policies, risk assessment documentation should not only address the engagements selected and the reasoning behind that selection, but also the environment of the firm and its system of quality controls. Some factors that should be considered in assessing risk include the following:

- The relationship of the firm's audit hours to total accounting and auditing hours
- Size of the firm's major engagement(s), relative to the firm's practice as a whole
- Initial engagements and their impact on the firm's practice
- The industries in which the firm's clients operate, especially the firm's industry concentrations
- The results of the prior peer review
- Owners' continuing professional education (CPE) policies and the firm's philosophy toward continuing education – Accumulate the necessary hours or maintain the needed skills and improve delivery of professional services?
- The firm's monitoring policies
- Adequacy of the firm's professional library
- Risk level of the engagements performed – Does the firm perform audits of employee benefit plans, entities subject to A-133 and others under *Government Auditing Standards*, HUD-regulated entities, and other with high-risk features or complex accounting or auditing applications?
- Have there been any major changes in the firm's structure or personnel since the prior peer review?

### **Detection Risk**

Inherent risk and control risk directly relate to the firm's accounting and auditing practice and its system of quality control, respectively, and should be assessed in planning the review. Based on the combined assessment, the reviewer selects engagements for review and determines the scope of other procedures to reduce the peer review risk to an acceptable level. The lower the combined inherent and control risk, the higher the detection risk that can be tolerated. Conversely, a high combined inherent and control

risk assessment results in a low detection risk and the resulting increase in the scope of review procedures.

Below is an example of an appropriately documented risk assessment in the SRM:

**4A. Describe your assessment of the inherent and control risk related to the reviewed firm’s accounting and auditing practice and its system of quality control. The assessment of these risks is qualitative and not quantitative. (Attach a memorandum if more space is needed.)**

*Inherent and Control Risk Factors* – Firm’s practice has a few high- or moderate-risk clients, nine audits subject to YB (cities or local school districts, most subject to A-133), two other audits (a major construction company + a text book distributor), a few reviews (retail trade or medical practices), and the usual compilations for a rural-area firm.

One firm owner has significant experience in YB audits and is a respected “expert” on GASB 34. The other firm owner also has YB experience and recently served as a CPE discussion leader on 101-3 implementation in “small” firms. Each owner each serves as partner-in-charge on audits and a cross-review system is in place. The five other professionals are each CPAs and the practice has been very stable for 20+ years. Firm owners make all decisions relative to the QC functional elements. Most of the firm’s CPE is group discussion, including an annual in-house (joint venture with a regional firm) A&A update with an outside speaker. The firm’s second office is a satellite office only used in tax season.

Based on review of completed QC questionnaire, system in place is common to that found in firms with similar characteristics that have experienced successful peer reviews. The firm owners appear very conscious of QC matters. The firm uses an outside party to assist in its monitoring in year two of the three-year cycle, and internal monitoring procedures are strong and acceptably documented for each year (including the year covered by the review). The firm’s review history is very favorable and there are no known factors that suggest the level of QC has dropped.

Conclusion: Inherent risk = moderate, due to YB/A-133 and construction audits; Control risk = low, due to QC system features; Detection risk = low due to cross-section selected

**4B. Based on the above assessment describe how you arrived at the office(s) and engagement(s) selected for review.**

Because of the concentration, selected two governmental audits (one A-133 and one new client, representing both owners); one construction audit (high-risk industry is not firm’s strength); the retail trade review, and 3 compilations representing 3 industries (one w/ & two w/o disclosures). This covers each owner, all types of engagements, the “must select” requirement, and results in an acceptably low level of detection risk.

## Letters of Comment

### Repeat Findings

On *system reviews*, a repeat finding is a deficiency noted during the current review that was caused by the same system of quality control weakness noted in the prior review's letter of comments. The review team should read the prior letter of comments and letter of response and evaluate whether corrective actions discussed have been implemented to determine whether the systemic cause is the same. If the corrective actions have been implemented and the same engagement deficiency is occurring, the review team should determine the weakness in the firm's system of quality control that is causing the deficiency to occur. In this case, if the corrective actions appear to be effective, the deficiency may be caused by some other weakness in the firm's system of quality control. If the underlying cause of the deficiency is different, this would not be a repeat finding.

Assume that in the prior peer review the underlying cause of disclosure deficiencies was that although the partner performed pre-issuance reviews on all engagements before releasing them the reviews were not performed comprehensively enough in scope to avoid significant disclosure deficiencies. Although not required by professional standards, the partner did not use an engagement reporting and disclosure checklist, nor did the firm's system of quality control require its use nor did the firm's system employ any other method which would ensure that the partner review would be performed comprehensively on all engagements. The use of this checklist could have contributed to a comprehensive review assuming all of the relative procedures to each engagement were performed. This was clearly a design deficiency. In the current peer review there are still significant disclosure deficiencies but upon investigation the review team finds that currently the firm's system of quality control requires the use of the reporting and disclosure checklist. A different partner is responsible for performing the pre-issuance reviews and the review team finds out that the partner is not performing it on all engagements. This is a compliance deficiency and as such would not be deemed a repeat finding even though it led to significant disclosure deficiencies as in the prior peer review.

On *engagement reviews*, a repeat finding is one in which the identified engagement deficiency is the same as noted in the prior review's letter of comments. For example, if a reviewer notes an engagement that had a disclosure and/or a financial statement presentation deficiency in a prior review's letter of comments, any disclosure or financial statement presentation deficiency noted in the current review would qualify as a repeat finding, although it may be a different type of disclosure deficiency. In addition, if the current and prior-year letter of comments have reporting deficiencies, they should be highlighted as repeat findings, even if they are not the same types of reporting deficiencies.

On *report reviews*, a repeat finding is one in which the identified engagement deficiency is the same as noted in the firm's prior peer review; similar to the manner in which engagement review repeat findings are handled.

On reviews in which there are repeat findings that have occurred on two or more prior reviews the reviewer should state in the current finding that, “this finding was noted on previous reviews.”

A firm that repeatedly receives peer reviews with consistent significant deficiencies that are not corrected may be deemed as a firm refusing to cooperate. For such firms that fail to cooperate, the AICPA Peer Review Board may decide, pursuant to due process procedures that it has established, to appoint a hearing panel to consider whether the firm’s enrollment in the AICPA peer review program should be terminated or some other action taken. Therefore, it is critical that peer reviewers appropriately identify the underlying causes of deficiencies on system reviews and that findings on all peer reviews are appropriate.

### **Indicating “Must Select” Engagements in the Letter of Comment**

Reviewers should be aware that the AICPA *Standards for Performing and Reporting on Peer Reviews* PRP 3100.94f require that any comments included in the letter of comments (“LOC”)) that pertain to engagements subject to Government Auditing Standards (GAS), Employment Retirement Income Security Act (ERISA) or the Federal Deposit Insurance Corporation Improvement Act (FDICIA) must indicate such in the letter of comment. This requirement to specifically identify the engagements by industry applies to whether the engagement is substandard or not.

## **Letters of Response**

### **Guidance on Writing an Effective Letter of Response**

The purpose of the letter of response is for a firm to stipulate, in writing, the specific action(s) that will be put into effect to enhance the current system of quality control and to correct deficiencies noted by the reviewer. The description of the action(s) the firm has taken or will take should ensure prevention of recurrence of the matter discussed in the letter of comments. The action(s) should be feasible, genuine and comprehensive.

Too often the letter of response is vague and repetitive of the letter of comments. When a response is vague, it is difficult to determine if the planned action will be appropriately implemented to ensure prevention; or if the action is inappropriate for correcting the matter discussed in the letter of comments. The letter of response should not be used as a place to indicate justification for the firm’s actions that related to the deficiency.

Example:

The letter of comment indicates that certain disclosures are missing.

Response 1:

The firm will enhance its policy to identify when a financial disclosure checklist should be used and who will be assigned the responsibility to prepare the disclosure checklist. The financial disclosure checklist will be included as part of the pre-issuance review process.

Response 2:

The firm will consider the use of a disclosure checklist in the future.

Response 1 provides specific guidance as to when and who is responsible for the completion of the disclosure checklist. It indicates the changes to the current policy and procedures to ensure no disclosure deficiencies occur in the future. Response 2 addresses the comment but is vague as to when a disclosure checklist should be used and who would be responsible for completing it. Implementation in this format would be difficult to monitor. Response 1 is feasible, genuine and comprehensive as it relates to implementing the disclosure checklist into the firm's system of quality controls.

*Letters of Response*—the reviewed firm should submit the letter of response for review and comment to the peer reviewer prior to submitting its response to the administering entity. However, if the firm does not submit its letter of response to the peer reviewer, the technical review and committee acceptance process should not be delayed and the required working papers, including the report and letter of comment should be submitted to the administering entity.

If the reviewed firm submits its letter of response to the peer reviewer and the peer reviewer communicates to the administering entity that it chose not to review the letter of response, the peer reviewer will receive feedback at a minimum the first time this happens. Subsequently, the report acceptance body will determine that the peer review was not performed in accordance with *Standards* in all material respects.

### **Letter of Response Can be Mailed or Faxed**

The AICPA Peer Review Board has determined that during the course of a peer review, the response to a letter of comment can be transmitted by fax, e-mail, or other electronic means as long as the firm's signature appears on the letter of response.

## **Threshold for Preparing an MFC**

A Matter for Further Consideration form (MFC) should be prepared as a way to document all significant matters that require additional information or explanation of the facts from the reviewed firm. For example, when the review team encounters situations in which it questions whether a necessary A&A procedure was performed, a required footnote disclosure, or a transaction was accounted for correctly, the reviewer should document the issue on a Matter for Further Consideration Form (MFC).

## **Q&A about Completing the MFC**

The following questions and answers about completing MFC forms are based on observations from MFC forms submitted as part of the technical review process.

*Question:* Should the professional standards reference section always be completed?

*Answer:* Yes. This section should also be completed before the MFC is given to the firm for their comments. Including a specific reference allows the firm to consult with that section of professional standards in order to prepare an informed response.

*Question:* Should reviewed firms always comment beyond a simple “yes” or “no” to indicate their agreement with a matter?

*Answer:* If the reviewed firm disagrees with the matter, they should detail the basis for their disagreement, including the references to professional standards that support that basis. If the reviewed firm agrees with the comment, they should be encouraged to provide information that can help the reviewer identify any systemic cause underlying the matter.

*Question:* When should a reviewer complete the “additional comments” section of an MFC?

*Answer:* This section should be used to clarify the matter, if needed, after receipt of the reviewed firm’s response. It should also be used to reconcile any discrepancies between the reviewer’s description of the matter and the firm’s response. Comments should be added to document the resolution of a matter based on an expansion of scope. For example, the firm might agree that a matter represents a deficiency, but the reviewer’s review of additional engagements shows that the matter was isolated. This conclusion can be documented on the MFC form. Alternatively, the reviewer might describe a design deficiency. Although the firm might agree with the matter, it might disagree that the matter represents a deficiency because of compensating controls that the firm has in place. In this case, the reviewer should add additional comments to indicate the reviewer’s conclusion as to the adequacy of the compensating controls in meeting the related quality control objective. In addition, this section could be used

to clarify if the deficiency was significant enough to cause the engagement to be considered sub-standard.

*Question:* The bottom of the MFC includes a section labeled “Program Questionnaire” and another labeled “Engagement.” Should both sections be used?

*Answer:* Generally not. If the matter being considered was noted as a result of a procedure other than reviewing a specific engagement (such as reviewing the reviewed firm’s responses to the Quality Control Policies and Procedures Questionnaire), complete the lower left section of the MFC form by referencing the section, elements and program step of the checklist or form that identifies the matter. If the matter was generated as part of the review of specific engagements, use the bottom right section.

*Question:* How does a reviewer differentiate among the types of matters (i.e., design, performance, compliance, and documentation)?

*Answer:* “Design” refers to the reviewed firm’s “blue print” for its system of quality control policies and procedures. That blue print should be adequate to allow the firm to achieve reasonable assurance of conforming with professional standards. “Performance” matters, in the broadest sense, refer to any departure from professional standards. While performance matters can represent symptoms of a design deficiency, they can also include isolated occurrences of deficiencies due to human error. When a performance matter is first noted, the reviewer may not have reached a conclusion as to whether the matter is also symptomatic of a design deficiency. “Compliance” matters represent instances where a firm has not followed one of its quality control policies or procedures, but no engagement deficiencies resulted from the noncompliance. For example, the firm might not have prepared a disclosure checklist on several of its engagements, but the reviewer noted no instances of missing or incorrect disclosures on those engagements. “Documentation” matters represent instances where the reviewer is satisfied that all appropriate underlying procedures were performed, but that the existing documentation does not support that conclusion. Due to the integration of documentation within the requirements of professional standards, it can be difficult to distinguish engagement documentation matters as to “performance” or “documentation.” If a firm’s documentation does not meet the requirements of professional standards, a documentation deficiency is really a performance deficiency.

## **Matters for Further Consideration**

### **Matters for Further Consideration (MFC) Forms and References to Professional Standards**

Matters for Further Consideration (MFC) forms on system, engagement, or report reviews require that the reference be made to the applicable professional standard(s) to which the deficiency relates. If there are multiple references that may be necessary, the reviewer can include an attachment to the MFC form as well. Failure to complete this part of the MFC form will only delay the completion of the peer review so all reviewers should ensure that the MFC forms are filled out correctly and completely.

## **Firm Representation Letter**

### **Dating of the Firm Representation Letter**

For system reviews the representations should be dated the same date as the peer review report. In contrast, for engagement and report reviews, the representations should be the date the firm submits the list of engagements to the reviewer. It is important to be aware of this distinction and ensure that the Firm Representation Letters are dated properly for all types of peer reviews.

### **Firm Representation Letter to the Peer Reviewer**

Appendix B (Paragraph 134) of the Standards contains guidance and an example of the firm representation letter submitted to the peer reviewer. A question has come up as to whether the reviewer can require the reviewed firm to include other matters (not specifically identified in Appendix B). This becomes a very important issue since a firm's failure to sign the representation letter may be considered a scope limitation. The Board did not intend for the representation letter to be onerous for the reviewed firm but also understands the value to the reviewer of obtaining certain representations in writing. Allowing reviewers to add whatever they want to the representation letter would make it very difficult to maintain consistency in the program. Some of the inquiries received relate to adding the following to the representation letter: information about specific states, alternative practice structures, situations where independence violations would be created for attest clients, identifying all compilations where the firm was not independent., etc.

The Board believes that the representation letter should comply with the spirit of the guidance/example in Appendix B of the Standards. However, if during the review, something comes to the reviewer's attention whereby the reviewer believes the reviewed

firm is providing contradicting or questionable information, the reviewer should investigate the matter further and may consider having the firm include the matter in the representation letter.

### **Reviewed Firm Representation Letters to the Team Captain/Reviewer**

Reviewed firm representation letters should not be required to be submitted to the administering entity as a part of the administering entity's policies. The team captain/reviewer should retain the representation letter with the peer review documents and other materials prepared during system, engagement or report reviews. These documents and other materials should be retained in accordance with the Interpretation related to peer review material retention policies. The committee or report acceptance body should not be requesting team captains/reviewers to submit the firm representation letter with the report, letter of comments and letter of response (if applicable). However, if the review is selected for oversight, the representation letter should be submitted with the other required documents.

### **Firm Representation Letters on "Report Days"**

For engagement and report reviews, some administering entities have a "report day" where several peer reviewers come into the administering entity's offices to perform a volume of these peer reviews. The reviewed firm has given authority to the administering entity to choose the reviewer from a list of reviewers that the reviewed firm has seen. The reviewed firm sends in all of the necessary information needed for the review to take place, including its representation letter to the reviewer. Since the reviewed firm will likely not know who the reviewer will be, the reviewed firm should address the firm representation letter to "The Reviewer."

For engagement and report reviews, the firm representation letter should be dated the same date the firm submits the list of engagements to the reviewer. For reviews being performed on report days, the representation letter should be dated the same date the firm submits the list of engagements to the administering entity.

# Engagement Reviews

## **Applicability of Interpretation 101-3 and its Documentation requirements on an Engagement Review**

Reviewers (and the firms they review) should be aware that Ethics Interpretation 101-3, including its documentation requirements, is applicable to engagements performed under the SSAEs as well as SSARS, including compilations (although the requirement is contained in the AICPA Code of Professional Conduct).

Engagement reviews include the testing of the firm's compliance with 101-3, including reviewing the firm's documentation required by 101-3.

A common question is how the last sentence of third paragraph of the engagement review report should be tailored for documentation requirements. There are very few situations where a firm undergoing an engagement review would NOT be subject to either documentation requirements required by the SSAES, SSARS or 101-3.

1. The firm does not perform any non-attest services for its attest clients (including compilation clients). In this case 101-3 is not applicable.
2. The firm only performs compilations and the reports have appropriately disclosed the lack of independence. In this case 101-3 is not applicable.
3. If the firm performs engagements under the SSAES or reviews under SSARS, the firm is subject to the documentation requirements contained in those respective standards.

Therefore, when considering how to tailor the last sentence of the third paragraph of the engagement review report for documentation, the firm would have to meet the situations described in 1. and 2. above for the reviewer to state "and there was no documentation required for the engagements submitted for review". If a firm falls under 3) above or performs non-attest services for its attest clients,(including compilation clients), there is documentation required by professional standards (which the report should indicate) and the documentation should be submitted to the reviewer for review.

The 101-3 documentation requirement also does not apply to nonattest services performed *prior to* the client becoming an attest client. However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. (f/n 6 in Int. 101-3).

If a firm fails to meet the documentation requirements of 101-3 (general requirement no. 3) that alone does not cause an impairment of independence and therefore does not

automatically result in the engagement being deemed substandard for peer review purposes. Failure to meet the documentation requirements of 101-3 would be included in the letter of comments, and would not by itself cause the report to be modified or adverse (or the engagement to be deemed substandard).

Another situation to consider is the illustrative engagement review report found in PRP Section 3300.55, as this report would only be used in circumstances where the firm only performed compilations that omit substantially all disclosures (where they would have been eligible for a report review). Reference to the documentation reviewed would be applicable unless the firm's compilation reports indicate a lack of independence (keeping in mind that these are omit disclosure compilations) or the firm does not perform non-attest services for the compilation client.

Reviewers should also be aware of other documentation that may be required by professional standards such as the AICPA Professional Ethics Executive Committee's Exposure Draft on Proposed Revision to Interpretation 101-1 and Conceptual Framework for AICPA Independence Standards. Although only an exposure draft at the time of the issuance of this Alert, the revision would require members to use the risk-based approach described in the *Conceptual Framework for AICPA Independence Standards* when considering whether a member-client relationship not specifically addressed by the Code "would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence." ***If the threat to independence is not at an acceptable level, members would be required to document the threat and the safeguards applied.*** The Board will issue further guidance on this matter if the exposure draft is approved (and would also affect system reviews).

### **Unmodified Report on an Engagement Review of a Firm that Only Performs Compilations That Omit Substantially All Disclosures**

The *AICPA Peer Review Program Manual* pages 3312-3313 paragraph .55 provides an example of when a reviewer should tailor the standard unmodified report on an engagement review. The AICPA Peer Review Board (Board) approved a modification to this title which adds, "Only Available for Firms that would have been Eligible to have a Report Review."

The scope paragraphs for engagement reviews (and report reviews) are currently written so that it is clear that the firm did not perform engagements requiring a system review (or an engagement review if the firm was undergoing a report review).

In order to qualify as a peer reviewer, the Board requires that the reviewed firm have no less than an engagement review, regardless if the firm only issued compilations that omitted substantially all disclosures. For those firms, the Board has provided tailoring on an unmodified report on an engagement review, for a firm that only performs compilation engagements that omit substantially all disclosures. The standard report should not be tailored to reflect other types of engagements that the firm does not perform because the

main purpose of the standard language in the report is to make it clear that the firm did not perform any engagements that would have required the firm to have undergone a system review.

## **Performing Engagement Reviews and Using Supplemental Engagement Checklists**

PRP Section 23,000 of the *AICPA Peer Review Program Manual* (the Manual) provides peer reviewers with peer review engagement checklists when performing engagement reviews, which include the following:

- PRP Section 23,200, “Engagement Reviews—General” (to be used for reviews and full disclosure compilations)
- PRP Section 23,300, “Engagement Reviews—Compilations That Omit Substantially All Disclosures Checklist”
- PRP Section 23,400, “Engagement Reviews—Agreed-Upon Procedures Engagement Checklist”
- PRP Section 23,500, “Engagement Reviews—Other Attestation Engagement Checklist”

However, these checklists do not cover disclosure and financial presentation items that are unique to any specific industries. When performing an engagement review, the reviewer may select a review engagement or a compilation engagement in a specific industry, such as a construction contractor. In addition to using the appropriate peer review engagement checklist contained in PRP Section 23,000, (as noted above) when reviewing an engagement in a specific industry, the reviewer may also refer to the applicable supplemental checklist contained in PRP Section 22,000, “Engagement Checklist Supplements – System Reviews.” Those checklists provide reviewers with questions on financial statements and notes that are relevant to specific industries, such as construction contractors and common industry realty associations.

## **Circumstances Calling for a Modified or Adverse Report**

The objectives of an engagement review are to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements or information and the related accountant’s report on accounting, review and attestation engagements submitted for review, conform in all material respects with the requirements of professional standards and whether the reviewed firm’s documentation conforms with the requirements of SSARS and the SSAEs applicable to those engagements in all material respects. Accordingly, if the review discloses significant departures from professional standards in the engagements reviewed, those departures should be clearly described in the peer review report as exceptions to the limited assurance expressed in the report. An engagement is ordinarily considered substandard when deficiencies, individually or in aggregate exist, that are material to understanding the report or financial statements or

represents a critical attestation, or accounting procedure required by professional standards. Therefore, the identification of one or more substandard engagements causes an exception to the limited assurance in an engagement report.

The AICPA Peer Review Board has determined the following guidelines when one or more engagements are deemed substandard on an engagement review. The identification of one substandard engagement automatically results in a modified report, unless only one engagement was reviewed, then the report is adverse. When more than one engagement is substandard, but not all, a modified report should be issued. An adverse report would be issued when all of the engagements submitted for review are all deemed substandard. In addition, the Board has determined that reviewers should not expand scope beyond the original selection in an effort to issue a different report.

Appendix O of the Standards provides additional guidance on when to issue a modified or adverse report on an engagement review and provides several examples of departures.

## **Licensure**

### **Licensure**

Firms are required to comply with the rules and regulations of state boards of accountancy and other regulatory bodies in the states where they practice. As a part of the peer review, firms should submit written representations (See Appendix B of the Peer Review Program Standards) from the firm's management indicating compliance with such required rules and regulations. If the reviewed firm is aware of any situation whereby they are not in compliance with the rules and regulations of the state boards of accountancy or other regulatory bodies, they should tailor the representation letter to provide information on the areas of non-compliance.

Reviewers should continue to make inquiries of the firm to determine if it is appropriately licensed as required by the state boards of accountancy in the state or states in which it practices.

The reviewer must analyze the information obtained through inquiry and in the written representation letter to determine the impact on the report and letter of comments.

## **Guidance for Failure to Have or to Maintain a Firm or Individual License to Practice Public Accounting**

### **Firm License**

For system reviews, when a reviewer identifies that a firm does not possess the required applicable license(s) to issue accounting and auditing engagements, for any period of time covered by the peer review year, the letter of comment must (not optional) include a finding indicating this fact.

For engagement and report reviews, when a reviewer identifies that a firm does not possess the required applicable license(s) to issue accounting or attestation engagements for the period when the peer reviewed engagements were issued, the letter of comments/report on report reviews must (not optional) include a finding/comment indicating this fact.

On all peer reviews, the administering entity's peer review committee (committee) must require a follow-up action that the firm submits a valid license(s) to the committee in order for the peer review to be completed. If the reviewed firm obtains a valid license(s) prior to the committee follow-up requirement, they should immediately submit the license to the committee. In this situation, the committee will be able to accept the review without the need for a follow-up action because the reviewed firm will have already obtained a valid license(s). In either case, on report reviews, this comment would require the peer review to be submitted for committee consideration.

For states that have retroactive license provisions, the above rules apply even though the firm has the opportunity to obtain a valid license.

Another significant revision to the guidance is that the engagements performed and/or issued during the period when the firm did not possess a license are no longer deemed substandard for peer review purposes solely for this issue. Therefore, this matter no longer impacts whether an adverse, modified or unmodified peer review report is issued, unless the firm has a repeat finding/comment for the failure to possess a firm license(s).

### **Individual License**

The Board has the following guidance with respect to individual licensure. For system, engagement and report reviews, engagements should be classified as not conforming with professional standards for purposes of the AICPA Peer Review Program (also known as: substandard engagements) if the partners or other employees with reporting responsibilities do not have a current individual license to practice public accounting as required by the State Board(s) of Accountancy.

The presence of an engagement not conforming to professional standards identified in a system review does not automatically result in a modified report. For system reviews, reviewers must consider the pattern and pervasiveness of all deficiencies, including the

lack of an individual license, in determining the systemic failure in the firm's system of quality control as a whole.

For engagement reviews, if a reviewer reviews an engagement that was issued when the individual did not possess the required license to practice, a modified report should be issued as required by guidance stating that when an engagement significantly departs from professional standards, a modified report is automatically issued. If a reviewer determines that all of the engagements reviewed were issued when the individual(s) did not possess the required license, an adverse report is automatically issued. Therefore, if the firm only has one engagement and it is substandard, an adverse report is automatically issued. If more than one, but not all, of the engagements reviewed are substandard, the reviewer should consider the nature of the deficiencies found when determining whether the report should be modified or adverse.

For report reviews, the reviewer should include the departure from professional standards in the report as a comment with the recommendation to obtain proper licensure.

### **Licensure Verification**

The AICPA Peer Review Board ("PRB") has concluded that it would not prohibit, as a part of a system, engagement or report review, the verification of the *practice unit* license (firm license) in the state which the practice unit is domiciled (main office is located). The PRB also concluded that it would not prohibit the verification of an out-of-state *practice unit* license on an individual engagement basis when that engagement is selected for review and was performed by the reviewed firm in another state requiring a firm license. Testing *individual* licenses should be limited to inquiry and should not extend to verification unless there is evidence obtained as a part of the peer review that the firm is not accurately representing its compliance with individual licensure requirements.

Licensure deficiencies should be included in the peer review report and/or letter of comments in accordance with current guidance issued by the PRB. For system reviews, when a reviewer identifies that a firm does not possess the required applicable license(s) to issue accounting and auditing engagements, for any period of time covered by the peer review year, the peer review report and/or letter of comment must (not optional) include a finding indicating this fact. For engagement and report reviews, when a reviewer identifies that a firm does not possess the required applicable license(s) to issue accounting or attestation engagements for the period when the peer reviewed engagements were issued, the peer review report and/or letter of comments or report on report reviews must (not optional) include a finding/comment indicating this fact.

In addition, firm representation letters should be tailored to reflect the firm's compliance/noncompliance with the rules and regulations of state boards of accountancy and other regulatory bodies in the states where they practice.

On all peer reviews with licensure deficiencies, the administering entity's peer review committee (committee) must require a follow-up action that the firm submits a valid license(s) to the committee in order for the peer review to be completed. If the reviewed firm obtains a valid license(s) prior to the committee follow-up requirement, they should immediately submit the license to the committee. In this situation, the committee will be able to accept the review without the need for a follow-up action because the reviewed firm will have already obtained a valid license(s). In either case, on report reviews, this comment would require the peer review to be submitted for committee consideration.

The firm's license number should not be identified on such peer review documents and the information obtained should not be reported directly to the state board since it was obtained as a part of the peer review.

In addition, the state board of accountancy may be sent a list of firms with *accepted* peer reviews ("accepted" as defined in the Interpretations to the *Standards*) in a given period which would allow the state board of accountancy to verify that firms undergoing peer review are licensed in that state.

State CPA Societies administering the AICPA Peer Review Program are not prohibited from gathering information from firms and report to the state boards on licensure compliance matters. This type of arrangement should be made outside of the peer review process and should not involve peer reviewers or peer review staff.

### **Out of State Reviewers May Need to Obtain Out of State License**

Peer reviewers should be aware that if you are planning on performing a peer review outside of your state, you may need to obtain a temporary license from that state's board of accountancy in order to conduct that review. Please confirm with the applicable state board of accountancy if such a temporary license is required.

### **Sole Practitioner's Failure to Have an Individual License**

The Consolidated Reviewers' Alert addresses firm and individual licensure issues. The guidance implies that all engagements performed by a sole practitioner without an appropriate individual license for the period under review would be deemed as substandard. This raises the question of whether an adverse report should automatically be issued on a system review for this one matter, independent of whether there were any deficiencies on the engagements reviewed.

Since a substandard engagement on a system review does not automatically result in a modified or adverse peer review report, reviewers must consider the pattern and pervasiveness of all deficiencies in determining the systemic failure in the firm's system of quality control as a whole. For example, if the reviewer determined that the sole practitioner did not have an individual license for only part of the year under review

which resulted in an isolated substandard engagement; the reviewer could determine that the issuance of an unmodified report is warranted.

If the failure to have an individual license results in the issuance of substandard engagements (not deemed isolated), a modified report would be warranted. When determining whether an adverse report should be issued on a system review, the reviewer must use judgment and should consider the significance of the deficiencies on the engagements reviewed. If there are no other significant deficiencies or significant matters to include in the report or letter of comments, an adverse peer review report would not be warranted.

For engagement reviews, if the reviewer reviews an engagement that was issued when the practitioner did not possess the required individual license to practice, a modified report should be issued as required by guidance which states that when an engagement significantly departs from professional standards, a modified report is automatically issued. If the reviewer determines that all of the engagements reviewed were issued when the practitioner did not possess the required license, an adverse report is automatically issued.

For report reviews, the reviewer should include the departure from professional standards in the report as a significant comment with the recommendation to obtain the proper individual license.

## General

### **Completion of Engagement Checklists**

Engagement checklist questions are often designed with “considerations” presented in a bullet point format. Reviewers should answer such questions based on their *overall assessment* of the firm’s compliance with applicable professional standards giving attention to the multiple related considerations which are bulleted below the question. **Reviewers should use professional judgment in evaluating whether to answer the questions “Yes” or “No”. If based on professional judgment, the overall answer to the question is “No”, the matter should be included in an MFC if it is significant. However, if the matter is not significant enough to be included in an MFC, it should be included in the “Explanation of “NO” Answers and Other Comments” section of the checklist.**

### **Requests for Change in Peer Review Year Ends**

Administering entities should consider many factors when considering allowing a firm to change its peer review year end. Firms should select peer review year ends that make

sense considering the nature of their practice (when are audits are being performed and issued so they will be available for the peer review, tax season, etc). If a firm realizes that it does not have an efficient peer review year end, it may request a one-time permanent change to its year end from the administering entity. The firm must keep in mind that it may also need approval from governmental bodies requiring peer review such as the Government Accountability Office or State Boards of Accountancy (ies).

However, a change in year end should usually not be approved when there is a public interest concern to consider such as when the firm is attempting to have an engagement or report review rather than a system review (even when the firm's prior review was a system review). Another matter is when a change in year end would cause the firm's only ERISA, GAO or FDICIA audit to fall out of the peer review selection process.

For example, a firm is scheduled to have its 12/31/06 year end peer review due 6/30/07. The firm only has one audit and it's a 3/31/06 fiscal year end (and also has one review engagement) and the firm believes this may be the last year performing the audit. The firm wants to keep its due date of 6/30/07 but wants to change the year end by *just* three months to 3/31/07 (i.e. 3/31/06audit theoretically falls out as the year under review would be 4/1/06-3/31/07).

So in this case, if firm is allowed to change its year end by three months, it could undergo an engagement review (and have its only audit excluded from its peer review). If the firm's only audit was a governmental audit that would fall outside the scope, and if the firm had no other accounting or auditing engagements, the firm wouldn't even be subject to peer review. These situations would not be in the public interest and ordinarily requests for change in year ends for these and similar situations should not be approved.

## **Reviewer Resume Verification Process**

### **Background Forms and Reviewer Resumes**

It is critical to the success of peer review that team captains, peer reviewers and the entire peer review team have the appropriate knowledge and experience necessary to effectively and appropriately perform a firm's peer review. There is a relationship between the peer reviewer/review team's knowledge and experience as it relates to the reviewed firm's areas of practice, specific industries and levels of service and the quality of the work performed by the peer reviewer/review team. The firm background form and the reviewer resume contain very important information that assists reviewers and administering entities in determining whether the reviewer/review team has the appropriate knowledge and experience to perform a review.

The AICPA Peer Review Board (Board) approved revisions to the background and resume forms to create a mechanism to better identify industries and levels of service in which firms practice, and to facilitate the matching of reviewer qualifications on system, engagement and report reviews.

## Key Revisions:

- Firms no longer identify industries in which they practice accounting, (firms now provide only audit industries).
- Firms indicate any industries in which they practice, regardless of the percentage of the practice.
- Firms identify any industries in which over ten percent of the firm's auditing (only) practice hours are concentrated and these result in a must cover for the review team
- Industries were narrowed down to include only the must cover industries on system reviews
- Resume instructions were changed to request reviewers to identify practice areas in which they were currently active in auditing.
- Resume and background forms were revised to contain more similar information.

The background and resume forms now have ERISA industries broken out by seven codes:

1. Defined Contribution Plan Full Scope (380),
2. Defined Contribution Plan Limited Scope (385),
3. Defined Benefit Plan Full Scope (390),
4. Defined Benefit Plan Limited Scope (395),
5. ERISA Health & Welfare Plan (400),
6. Other ERISA Plans (405), and
7. Other Employee Benefit Plans (410)

In addition, Government Audit Standards industries are broken out by four codes:

1. HUD Programs (222),
2. School Districts (320),
3. State and Local Governments (325), and
4. Industries Covered Under Single Audit Act A-133 (420).

Standards require that reviewers update their resumes bi-annually within two years prior to commencement of the review to remain qualified to perform reviews. As a result of these changes, reviewers should consider updating their resume more often.

## **Enhanced Oversight Procedures-Verification of Reviewer Resume Information**

In 2005, the Board implemented a variety of enhanced oversight procedures and one of the key enhancements relates to the administering entity verifying peer reviewers' experience, including the accuracy of the information on reviewers' resumes. Ensuring that reviewers' resumes are updated annually and are accurate, not only facilitates the timeliness of the scheduling process, but is one critical element in determining if the

reviewer/review team has the appropriate knowledge and experience (including current engagement responsibilities) to perform a specific peer review.

As a reviewer, you either have been asked or will be asked to verify certain information listed on your resume. Verification procedures may include sending copies of the following to the administering entity::

- License to practice as a certified public accountant
- CPE certificate from qualified reviewer training course
- CPE certificates to meet requirements under Interpretation No. 4
  - 48 CPE credits related to accounting and auditing to be obtained every three years with at least 8 hours in one year
  - Reporting period to be the same as the reviewer maintains for the AICPA.
- CPE records that qualify to perform Yellow Book audits, if applicable

Suggested information that may be verified and documented by the administering entity:

- Reviewer is either a partner or manager in a firm enrolled in a practice monitoring program
- Reviewer's firm has received an unmodified report on its most recently accepted peer review
- A&A experience on resume matches to firms background information; any differences should be explained in writing
- Level of participation by reviewer in the experience listed

It is important to comply with the administering entity's request for information in a timely manner.

### **Illegal Acts**

Under current guidance, reviewers have no responsibility to detect illegal acts that have either a direct or indirect effect on the firm's ability to practice public accounting.

If the reviewer comes across an illegal act during a review, the AICPA Peer Review staff should be contacted immediately for advice on how to proceed.

### **Personal Financial Statement**

Statement on Accounting and Review Services No. 6 (SSARS 6) provides an exemption from the requirements of SSARS 1 for personal financial statements included in written personal financial plans prepared by an accountant.

Personal financial statements included in written personal financial plans that are not issued in compliance with SSARS 1 should not be selected for review nor included within the scope of a peer review. Personal financial statements included in written personal financial plans prepared in compliance with SSARS 1 are within the scope of a peer review.

### **Medicare Cost Reports**

Firms that only prepare Medicare Cost Reports are required to have a peer review if the firm issues a compilation report on the engagement indicating that the financial statements were compiled in accordance with SSARS.

A firm that audits Medicare Cost Reports is required to have a system review.

A firm is required to have a peer review if it performs other levels of service on Medicare Cost Reports that are included in the definition of an audit and accounting practice in accordance with *Standards*.

A firm that is not required to and does not issue an accountant's report on a Medicare Cost Report it prepared is not required to have a review because of the lack of specific guidance on Medicare Cost Reports and lack of consistency within the profession.

### **Review Requirements for Joint Ventures**

Joint ventures formed specifically to perform certain engagements are not required to have a peer review provided that:

- Each of the firms that sign the joint venture report is required to have system reviews and agree to list the joint venture(s) on their client rosters during their peer reviews, and
- The joint venture is not operating and structured as a separate firm. (Joint ventures do not include part time work arrangements, when only one firm issues the report.) If the letterhead used for the joint venture does not identify the separate firms that joined together to perform the engagement, then the joint venture is operating as a separate firm.

### **Special Rules for Resignations**

A firm not in the course of a peer review may resign from the AICPA Peer Review Program by submitting a letter of resignation. However, once a peer review commences, a firm will not be able to resign from the Peer Review Program except as stated in B below. The submission by a firm of its resignation from the peer review program during

the course of its peer review is considered a failure to cooperate with the administering entity, and may lead to the termination of the firm's enrollment in the program by a hearing panel of the AICPA Peer Review Board.

A firm will be allowed to resign during the course of a peer review when the firm submits a letter waiving its right to a hearing and agrees to allow the AICPA to report the fact that the firm has resigned from the peer review program in such form and manner as the AICPA Council may prescribe. However, if (1) the firm has been notified of the reviewer's or administering entity's intent to issue or require a modified or adverse report or (2) the reviewer or the administering entity has knowledge of the discovery of an engagement that was not conducted in accordance with professional standards on which the firm must take, or would likely be required to take, action in accordance with professional standards, then the firm will only be allowed to resign when the firm waives its right to a hearing and agrees to allow the AICPA to report in such form and manner as the AICPA Council may prescribe the fact that the firm has resigned from the peer review program and that the situation in (1) or (2) above existed.

A peer review commences when the review team begins the fieldwork on a system review or begins the review of engagements on an engagement or report review. A review is deemed completed when the firm has taken any actions deemed necessary by the peer review committee and has been notified of the completion of the review by the administering entity.

### **Reinstatement for Firms Dropped or Terminated from the Peer Review Program**

The AICPA Peer Review Board adopted a policy that states that a firm that has been terminated or dropped from the program may re-enroll in the program once it completes the delinquent action that caused the firm to be terminated or dropped. The entity administering the peer review and the AICPA Practice-Monitoring staff will make the determination of whether the completed action is acceptable. If the firm is past its next peer review due date, the firm will be required to have a review within 90 days of re-enrolling in the program in lieu of completing the delinquent action related to its prior peer review.

### **Incomplete Engagements**

In certain instances, a firm may not have all engagements that fall in its peer review year completed and issued at the time of its peer review. If there is a comparable engagement, thereby providing an adequate cross section of engagements despite the incomplete engagements, the peer review should proceed as planned, substituting the comparable engagement. However in accordance with paragraph 3100.46 of Standards for Performing and Reporting on Peer Reviews, if the current year's engagement has not

been completed and issued, and a comparable engagement within the peer review year is not available, the prior year's engagement should be reviewed.

However, if there is an incomplete engagement (which is an initial engagement) and there is no comparable engagement, the firm should request an extension from the administering entity. Although the administering entity will likely grant the extension, the firm needs to consider if it will be meeting the requirements of its state board or other regulatory bodies. If an extension is not possible, the peer review should be performed and the report should be modified due to a scope limitation. For example, a firm is performing an initial Yellow Book audit that falls in its peer review year. The Yellow Book audit is not complete and there is no comparable audit. The firm can request an extension from the administering entity. However, if the GAO will not grant an extension, the firm will have to proceed with its peer review and receive a modified report due to a scope limitation. A waiver of a scope limitation is not generally appropriate in this situation.

If the situation arose due to a permanent change in the nature of the firm's business, the firm should consider requesting a change in its peer review year-end date. If there is any uncertainty as to how the situation should be handled, the administering entity should be contacted.

### **Reviewer Checklists – Ensure Consistency**

Reviewers should be diligent in completing Question No.2 on the Reviewers / Team Captain Checklists.

Question No. 2 is the following:

*Obtain the firm's background and scheduling information from the firm, and review and compare such information with that furnished by the firm. If the information provided to the administering entity differs significantly from the information provided by the firm to you, please reconcile and notify the administering entity.*

In order to fully address this question, the reviewer should obtain the firm's background and scheduling information from the firm and review and compare such information to the engagement statistics that the firm provides to the reviewer.

Reviewers should also ensure that the engagements provided on the List of Accounting and Auditing Engagements or on the Engagement Summary Form are engagements with periods ending during the year under review. The date of the report and the date the financial statements were issued should not be considered when completing these forms. However, the date of the report would be appropriate for attestation engagements, including financial forecasts and projections. In addition, engagements selected for review should be made from those listed on the List of Accounting and Auditing Engagements or on the Engagement Summary Form and therefore have period end dates that fall in the firm's peer review year (with the exception of attestation engagements).

## **AICPA Peer Review Program Implications of Interpretation 101-3 – Performance of Nonattest Services**

At its January 2005 meeting the AICPA Professional Ethics Executive Committee (PEEC), adopted revisions to Interpretation 101-3 – *Performance of Nonattest Services* (“101-3”) to provide clarification on the applicability and intent of the rule and ensure its continued effectiveness in promoting independence when a member renders nonattest services to an attest client. The revisions do not relax the rule or change its meaning. PEEC believed these changes were necessary and appropriate after it became evident, based on feedback from a significant number of members, that a number of 101-3’s requirements warranted further clarification regarding client competency, documentation of understanding, and routine activities.

One of the revisions PEEC has adopted relates to general requirement no. 3, which requires that a member document his or her understanding with the client regarding key aspects of the nonattest services engagement. 101-3 has been revised to reflect that a failure to document the understanding with the client would **not** be considered to impair a member’s independence provided such understanding had been established; but rather, would be considered a failure to comply with an Ethics standard under Rule 202.

According to 101-3, before a member or his or her firm (“member”) performs nonattest services for an attest client, the member should determine that the requirements described in 101-3 have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member’s independence would be impaired. However, PEEC acknowledged that a failure to **document** the understanding, when in fact the understanding with the client had been established, should **not** result in an impairment of independence.

The AICPA Peer Review Board (Board) guidance has and continues to be that when a firm performs an engagement when it lacks independence, the engagement would be deemed substandard (except on compilation engagements where the accountants report has appropriately noted the lack of independence). Therefore, if a firm fails to meet the documentation requirements of 101-3 (general requirement no. 3) that alone does not cause an impairment of independence and therefore does not automatically result in the engagement being deemed substandard. When a firm fails to meet any of the other requirements of 101-3 (general requirement no. 2), independence has been impaired and therefore would result in the engagement being deemed substandard.

Guidance on AICPA Interpretation 101-3, Performance of Nonattest Services can be found on the AICPA web site as well as guidance related to the revisions adopted by PEEC related to Understanding General Requirement No. 2: <http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools>.

The Board has also considered the impact of 101-3 on each type of peer review. The guidance details three specific areas for reviewers to consider:

- What procedures should peer reviewers perform to determine if firms are performing non-attest services and if the firm is in compliance with the requirements of 101-3 where applicable?
- What documentation should peer reviewers be discussing with the firm and/or physically be reviewing?
- How should peer reviewers treat the firm's failure to comply with Interpretation 101-3?

### **System Reviews**

Review teams should first evaluate the firm's policies and procedures and compliance therewith for identifying all services performed for all clients. The peer review quality control policies and procedures questionnaires completed by the reviewed firm requests the firm to identify whether the firm performs nonattest services (The firm's own quality control documents may contain this information as well). In addition, the peer review engagement checklist profile information completed by the reviewed firm on all engagements selected for review asks the firm if it performs nonattest services for the client. The questionnaires and profile information also serve as representations made by the reviewed firm for the review team to follow when completing the team captain and engagement checklists.

Review teams should then determine whether the firm has complied with the requirements of 101-3, including the firm's documentation of the understanding with the client. Review teams should consider the pattern and pervasiveness of any 101-3 deficiencies as well as their systemic cause. These deficiencies along with the other deficiencies noted during the peer review must be considered when determining their affects on the peer review report and/or letter of comments.

#### Summary of Key Points:

- Failure to meet the documentation requirements of 101-3 alone does not cause an impairment of independence and therefore does not automatically result in the engagement being deemed substandard.
- Failure to meet any of the other requirements of 101-3 (general requirement no. 2), creates an impairment of independence and therefore would result in the engagement being deemed substandard.
- Procedures and Consideration on System Reviews
  - Evaluate the firm's policies and procedures and review the firm's compliance with 101-3 when they are performing nonattest services for attest clients
  - Review the firm's related documentation to determine compliance with 101-3
  - Consider the pattern and pervasiveness of 101-3 and other deficiencies to determine the affects on the peer review report and/or letter of comments.

- If the firm fails to comply with the documentation requirements of 101-3 **AND** has numerous other deficiencies on an engagement (not related to 101-3), consideration should be given as to whether the engagement is substandard (similar to consideration on any engagement that has numerous deficiencies).

### **Engagement Reviews**

Review teams should first evaluate the engagement checklist profile information completed by the reviewed firm on all engagements submitted for review. This document asks the firm if it performs non-attest services for the client along with specific questions regarding documentation required by 101-3. The profile information also serves as representations made by the reviewed firm for the reviewer to follow when completing the reviewer's checklist and the engagement checklists. The profile information also provides common examples of non-attest services to assist the reviewed firm.

Engagement reviews include the review of documentation required by the Statements on Standards for Accounting and Review Services and the Statements on Standards for Attestation Engagements, which encompass the AICPA Code of Conduct, therefore, reviewers should review the firm's documentation of the understanding with the client to determine if the firm is in compliance with 101-3.

The firm's failure to comply with documentation requirements of 101-3 alone would not result in an engagement being deemed a substandard engagement or result in the issuance of a modified report, but would be included as a finding in the letter of comments. When a reviewer determines that the engagement is substandard for the failure to comply with any of the other requirements of 101-3, the reviewer should follow the guidance outlined in Appendix O of the Standards for Performing and Reporting on Peer Reviews (*Standards*) in determining whether to issue a modified or adverse report. Appendix O states that the identification of at least one substandard engagement automatically results in the issuance of a modified peer review report unless only one engagement was reviewed (an adverse report would be issued). The reviewer would issue an adverse report when all of the engagements submitted for review were deemed substandard.

#### Summary of Key Points:

- Failure to meet the documentation requirements of 101-3 alone does not cause an impairment of independence and therefore does not automatically result in the engagement being deemed substandard.
- Failure to meet any of the other requirements of 101-3 (general requirement no. 2), creates an impairment of independence and therefore would result in the engagement being deemed substandard.
- Procedures and Consideration on Engagement Reviews
  - Review the firm's representations regarding the performance of nonattest services and its compliance with 101-3 when they are performing nonattest services for attest clients.

- Review the firm's related documentation to determine compliance with 101-3.
- Failure to meet the documentation requirements of 101-3 would be included in the letter of comments, and would not by itself cause the report to be modified or adverse (or the engagement to be deemed substandard).
- Paragraph 147-1e (Appendix O of the *Standards*) indicates that departures from professional standards, noted in a significant number of areas *on one engagement*, that individually may not be considered a significant departure from professional standards, may be considered substandard when the departures are considered in aggregate.
- Failure to meet any of the other requirements of 101-3 creates an impairment of independence and therefore would result in the engagement being deemed substandard and the issuance of a modified report (or an adverse report if all engagements reviewed are deemed substandard).

### **Report Reviews**

Review teams should first evaluate the engagement checklist profile information completed by the reviewed firm on all engagements submitted for review. This document asks the firm if it performs nonattest services for the client along with specific questions regarding documentation required by 101-3. The firm is also asked to describe the documentation of the understanding with the client required by 101-3. This profile information also serves as representations made by the reviewed firm for the reviewer to follow when completing the reviewer's checklist and the engagement checklists. The profile also provides common examples of nonattest services to assist the reviewed firm.

Report reviews do not specifically include the review of engagement documentation required by professional standards, therefore, reviewers should not review any 101-3 engagement documentation to determine if the firm is in compliance with 101-3. Reviewers will determine 101-3 related documentation deficiencies based on the representations of the firm on the engagement profile and should not include them in the peer review report. However, such deficiencies should be communicated to the reviewed firm in a manner deemed appropriate by the reviewer. The peer reviewer's focus is first, where applicable, that the reviewed firm has the understanding with the client on all matters required by 101-3 (general requirement no. 2), and that the reviewed firm understands the documentation requirements (general requirement no. 3).

The reviewer should include a significant comment in the report when the engagement is substandard for failure to comply with any of the other requirements of 101-3 resulting in the impairment of independence.

#### Summary of Key Points:

- Procedures and Consideration on Report Reviews

- Review the firm’s representations regarding the performance of nonattest services and its compliance with 101-3, including representations regarding documentation, when they are performing nonattest services for attest clients
- DO NOT review the firm’s 101-3 engagement documentation
- Failure to meet the documentation requirements of 101-3 should NOT be included in the report since report reviews do not specifically cover the firm’s engagement documentation. However, any documentation deficiencies should be communicated to the reviewed firm in a manner deemed appropriate by the reviewer.
- Failure to meet any of the other requirements of 101-3 (general requirement no. 2), creates an impairment of independence and therefore would result in the engagement being deemed substandard and the issuance of a report with significant comments

## **Quality Control Standards**

### **Monitoring**

#### **Documenting Monitoring for Sole Practitioners**

Paragraph 25 of SQCS No. 2 requires a firm to prepare appropriate documentation to demonstrate compliance with the firm’s policies and procedures for its system of quality control. “The form and content of such documentation is a matter of judgment and depends on a number of factors such as the size of the firm, the number of offices, the degree of authority allowed its personnel and its offices, the nature and complexity of the firm’s practice, its organization, and appropriate cost-benefit considerations”.

In the case of sole practitioners where monitoring is being performed by the same person who is also responsible for compliance with his or her own firm’s quality control policies and procedures, a critical review of his or her own performance and an assessment of his or her own strength and weaknesses, and the maintenance of an attitude of continual improvement is crucial. However, changes in the conditions and environment within the firm, such as when the firm gets a new client in an industry not previously serviced or a significant change in the size of the firm has occurred, may indicate the need for the sole practitioner’s quality control policies and procedures to be monitored by another qualified person. As part of its monitoring process, the sole proprietor should evaluate the relevance and adequacy of the firm’s quality control policies and procedures, the appropriateness of the firm’s guidance materials and practice aids, the effectiveness of the firm’s professional development activities, and the firm’s compliance with its quality control policies and procedures. All deficiencies noted during monitoring procedures should be periodically summarized in a manner that would enable the firm to determine what actions, if any, are necessary to prevent the recurrence of the deficiencies in the

future. After summarization of the deficiencies noted during the monitoring procedures, a written summary report should be prepared regarding the deficiencies noted. At a minimum, whether the monitoring is done by the sole proprietor or another qualified individual, a written report should be prepared on the scope of the monitoring procedures, the results of the monitoring procedures, and the corrective actions the firm plans to take to correct any findings. It is recommended that detailed monitoring working papers be discarded after a summary report has been prepared.

When performing peer reviews of sole proprietors, reviewers should ensure that the sole proprietor documents compliance with his or her firm's policies and procedures for its system of quality control, furthermore, if the monitoring was performed by the sole proprietor, reviewers should ensure that the monitoring was done objectively. If the monitoring was done by another individual, the reviewer should ensure that that person is suitably qualified. Finally, the reviewer should make the sole proprietor aware that if the firm plans on using its inspection procedures to reduce the scope of its peer review, in the year of its peer review, detailed inspection working papers should not be discarded until the peer reviewer has had an opportunity to test the inspection procedures.

## **Personnel Management**

### **Staff Interviews**

In the course of conducting oversights, the AICPA staff has noted that some reviewers are ignoring the interview of the reviewed firms' professional personnel and the completion of the required Staff Interview Questionnaire when conducting peer reviews. The review of a CPA firm's quality control policies and procedures requires that professional personnel be interviewed. The objective of these interviews is to provide corroborative evidence that certain policies and procedures, as stated by management, have been properly communicated. Reviewers performing peer reviews should document the work performed using the programs and checklists issued by the Peer Review Board for that purpose. Failure to complete all relevant checklists and programs in a professional manner may create the presumption that the review has not been performed in conformity with these standards. Therefore, when the reviewed firm has professional staff, the staff interview is a required procedure to be completed on every system review or there may be a presumption the peer review was not performed in accordance with the Peer Review Program Standards. The Staff Interview Questionnaires in sections 4700 and 5300 (if applicable) of the Peer Review Manual should be used when conducting the staff interviews.

## Government Accountability Office (GAO)

### Government Auditing Standards—United States Government Accountability Office (Yellow Book) and Governmental Accounting and Financial Reporting Standards (GASB)

This article is intended to offer clarification on an engagement that is performed under *Government Auditing Standards* (“Yellow Book”) in contrast to one performed that is only subject to the accounting and financial reporting provisions of GASB.

An audit performed under the accounting and financial reporting provisions of GASB (GASB 34/35) may or may not be required to be performed under the requirements of *Government Auditing Standards* (“Yellow Book”) as well as the requirements of A-133 Single Audits.

The determining factor for an A-133 Single Audit requirement would be that the entity has expended \$500,000 or more in Federal Funds (this engagement would also automatically be subject to the requirements under Yellow Book). The determining factor for being subject to the requirements of Yellow Book without the requirements of an A-133 Single Audit would ordinarily be based upon applicable laws or agreements. One such example would be an entity providing funding to the audited organization requires that an audit under Yellow Book be performed (even though the Federal Funds expended amounted to less than \$500,000). Also some state laws or regulations require certain types of governmental entities to have audits performed under the requirements of the Yellow Book whether or not any federal aid was received and expended.

These requirements would also apply to Non-profit Organizations.

Page 20103 of the Peer Review Manual presents a Governmental Engagement Checklist Matrix which provides guidance for peer reviews of state and local government engagements. It indicates which checklists are to be used as determined by whether the engagement is subject to Yellow Book and/or A-133 Single Audit requirements. Note that there are separate checklists for the review of the A-133 (Single Audit Act) aspect of the engagement and for the review of the Yellow Book aspect of the engagement. If an audit has been performed in accordance with A-133 (Single Audit Act), both of these checklists must be completed.

Section IIIA of the Summary Review Memorandum presents statistics for the Scope of Work Performed for the reviewed firm’s Accounting and Auditing practice. For engagements performed under the Statements on Auditing Standards (SAS), line 1 includes only audits subject to *Government Auditing Standards*. This section is further broken down by “Single Audit Act Engagements (A-133)” and “All Other”. Audits performed under the Single Audit Act (A-133) would be listed on the first line of this sub-section; Audits performed under the Yellow Book requirements only, would be listed on the second line of this sub-section. Accordingly, audits of entities subject to the

requirements of GASB and not subject to the requirements of the Single Audit Act(A-133) or Yellow Book, would be listed on the last line of this section, “All Other”.

### **Extensions under GAO Auditing Standards**

The U.S. General Accounting Office (GAO) requires audit organizations performing audits and attestation engagements in accordance with generally accepted government auditing standards (GAGAS) to have an external peer review of their auditing and attestation engagement practice at least once every 3 years. Per the GAO, the external peer review should be conducted within 3 years from the date they start field work on the first engagement under GAGAS. Subsequent external peer reviews should be conducted every 3 years. Extensions beyond 3 months can only be granted by GAO and should only be requested for extraordinary circumstances.

If a reviewer is performing a peer review on a firm that performs GAGAS engagements and the peer review is beyond the three month extension period, reviewers should inquire whether an extension of time beyond the three months was granted by the GAO. If the firm did not, the firm is not in compliance with GAO regulations. If a firm is performing governmental engagements and the firm does not have a quality or peer review done on the firm every three years, the engagements should be classified as not conforming to professional standards for purposes of the AICPA Peer Review Program.

### **Government Auditing Standards CPE Requirements and Peer Review**

Some firms with engagements subject to *Government Auditing Standards* tend to spend a limited number of hours on the engagements, have limited partner involvement, and often have limited continuing professional education (CPE) in the governmental area

Reviewers should not only consider the degree of noncompliance with the CPE requirements and the pervasiveness of engagement deficiencies, but also the materiality of the firm’s government audits to its whole practice. Reviewers should also ensure that the CPE deficiencies noted on the MFCs provide enough detail so that committees can determine whether the findings are appropriate. Some reviewers may have been improperly concluding that personnel lack or do not have appropriate governmental CPE when in fact they had accounting and auditing CPE, which in certain circumstances counts as governmental CPE.

If a firm conducts a governmental audit when the required personnel were not in compliance with the CPE requirements set forth in those standards:

1. Consideration should be given to reporting the failure in the letter of comments even if there are no other problems with the engagement.

2. Consideration should be also be given to issuing a report modified for personnel management if serious deficiencies are noted on the engagement.
3. Firms should be advised to obtain the required CPE before performing another government engagement.

Keep in mind, if a firm is performing governmental engagements and the firm does not have a quality or peer review done on the firm every three years, or the required personnel did not complete the CPE required by Government Auditing Standards, the engagements should be classified as not conforming with professional standards for purposes of the AICPA Peer Review Program.

### **Comparison of AICPA and GAO Rules of Independence For Nonattest Services**

Peer reviewers and technical reviewers need to be aware of the differences between the AICPA and the GAO in the independence rules for performing nonattest services. The AICPA has updated a comparison chart for revisions to AICPA Interpretation 101-3 as adopted by the Professional Ethics Executive Committee in January 2005. The chart compares the AICPA rules of independence to the GAO rules of independence. The chart is divided among various categories of nonattest services: overarching principle, bookkeeping services, payroll services, appraisal and valuation services, information technology services and human resources services.

This chart can be located at: [http://www.aicpa.org/download/ethics/2004\\_02AICPA-GAO\\_rules\\_comparison.pdf](http://www.aicpa.org/download/ethics/2004_02AICPA-GAO_rules_comparison.pdf). Reviewers should be aware of these differences when reviewing GAO engagements. Any GAO engagement where independence has been impaired, under either rules of independence, should be deemed substandard for AICPA Peer Review Program purposes.

### **Governmental Audit Quality Continues to Be a Concern**

Federal Offices of Inspectors General (OIGs) continue to be very active in reviewing the quality of auditors' work and this is not expected to change. From the standpoint of the federal user, audits conducted under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (also referred to as single audits), are a key accountability mechanism for the expenditure of taxpayer dollars. Consequently, audit quality continues to be an area of utmost importance. Both peer reviews and AICPA Professional Ethics Division (PED) investigations of audit organizations continue to indicate that there are problems in audits performed under *Government Auditing Standards* (GAS) and Circular A-133. Federal OIGs have also found similar problems based on their ongoing quality control reviews (QCRs) of single audits. As a result, the OIGs are nearing the completion of a coordinated and comprehensive review of single

audit quality. Their effort included a review of more than 200 single audits and was designed to identify how extensive the audit quality problems may be. The OIGs plan to publicly report on their findings in March 2007 and to continue performing normal QCRs on an ongoing basis.

AICPA Ethics Interpretation No. 501-3 “Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audit,” of Rule 501, *Acts Discreditable*, of the AICPA Professional Code of Conduct states that when an auditor undertakes an audit of government grants, government units, or other recipients of government monies and agrees to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, the auditor is obligated to follow those standards or guidelines in addition to generally accepted auditing standards. An auditor’s violation to do so is an act discreditable to the profession and a violation of Rule 501. OIGs take these violations very seriously and are likely to refer any firm performing substandard work to the AICPA PED and/or the appropriate state board of accountancy.

### **Common Deficiencies**

The following are some of the more common deficiencies noted in QCRs and AICPA peer reviews of audits performed under GAS and Circular A-133.

- Audit documentation lacking (this one area is the root of many other quality problems).
- Failure to audit as major programs Type A programs not qualifying as low-risk.
- Failure to audit Type A programs as major because of errors made in determining the Type A/Type B program dollar threshold.
- Failure to audit all programs included in a cluster of programs.
- Failure to meet the percentage-of-coverage requirement in Circular A-133, section 520(f).
- Using inadequate or outdated reference material.
- Problems with compliance and internal control work, particularly a lack of attention to internal control.
- Problems with the schedule of expenditures of federal awards that goes unnoticed by the auditor.
- Extremely small samples, inadequate sampling techniques, and a general lack of documentation about samples and their selection.
- Inadequate GAS, Circular A-133, and Data Collection Form reporting.
- Auditor finding write-ups that do not include all of the required elements.
- Noncompliance with GAS Continuing Professional Education and audit documentation requirements.

### **Going Forward—Challenges to Continue**

There are a number of developments on the horizon that will continue to provide challenges for auditors that perform these audits. First, there are a number of new AICPA auditing standards (for example, SAS Nos. 103 – 113) that will need to be

implemented this year as well as over the next few years. Second, there are currently ongoing AICPA technical projects to determine the effect of new AICPA auditing standards on single audits and other compliance audits that will likely result in new guidance. (For example, looking at how SAS No. 112, *Communicating Internal Control Related Matters in an Audit*, will be implemented in a single audit or compliance auditing environment). Third, the U.S. Government Accountability Office is issuing a comprehensive revision to *Government Auditing Standards* in early 2007 that auditors will need to understand. Finally, the results of the federal single audit quality study may ultimately result in other changes in standards, guidance, and possibly law and/or regulation. Even if your firm is not a member of the GAQC, you should consider bookmarking the [GAQC Web site](#) to stay on top of the latest developments in these areas.

### **Peer Reviews Performed by Other Professional Organizations**

Peer reviewers should be aware that there are professional organizations with peer review programs to assist government audit organizations in meeting their Government Auditing Standards peer review requirements. For example, the President's Council on Integrity and Efficiency (PCIE) peer review program arranges reviews for Federal Inspector Generals, the National Association of State Auditors, Comptrollers and Treasurers (NASACT) program arranges reviews for state auditors, and the Association of Local Government Auditors (ALGA) program arranges reviews for local government auditors. Each of these programs have established their own set of standards for conducting peer reviews and should be contacted for additional information when a peer reviewer is considering performing a peer review for one of their members.

## **Department of Labor (DOL)**

### **DOL's ERISA Audit Quality Enforcement Initiative**

The DOL's 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 (OCA). The EBSA will reject the Form 5500 filing where it has been determined that an audit failure has occurred. In addition, the EBSA will refer the substandard work to the AICPA's Professional Ethics Division or the appropriate State Board(s) of Accountancy. For firms that perform a limited number of employee benefit plan audits, the OCA will send letters to the plan administrator requesting copies of the audit workpapers. The OCA will perform an in-house review of the Form 5500, the independent auditor's report, and selected workpapers for each of those engagements. Those reviews will be expanded to include additional workpaper reviews, discussions with firm representatives, and any additional procedures deemed necessary based on the findings of the initial reviews.

## **Common ERISA Audit Deficiencies**

*Note: Based upon DOL reviews and AICPA peer review findings, the Employee Benefit Quality Center compiled this listing of deficiencies.*

- 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 SAS 70 reports; lack of testing when SAS 70 report is obtained
- Contributions
  - No audit work performed
  - Particularly multi-employer plans, failure to obtain adequate audit evidence for contributions back to contributing employers (multi-employer 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 value hard-to-value- assets
  - Improper use of limited scope certifications
- Benefit payments
  - No audit work performed
  - Inadequate auditing regarding eligibility of claims to be covered by the plan
- Participant data
  - Insufficient testing of payroll data
  - Failure to test eligibility, forfeitures and allocations
  - In defined contribution plans with limited scope audits, failure of auditors to test the allocation earnings and gains/losses to participant accounts.
  - Sample sizes too low
  - Some firms have reduced their sample sizes selected for compliance and substantive testing to unacceptably low levels.
- Workpaper 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

## **Reviewers' Information**

### **Non-Equity Partners as Team Captains on System Reviews**

For purposes of meeting the requirement that a team captain on a system review must be a partner, a non-equity partner should be treated like any other partner. Depending on how a CPA firm is legally organized, its partner(s) could have other names such as shareholder, member or proprietor, etc.

### **Enhanced Oversight on Engagements**

The Board recognized that the success of the Program is largely dependent upon reviewer performance. Accordingly, the revisions to the Standards and guidance incorporate a number of changes the Board believes will improve reviewer performance, including more intensive oversight of reviewers.

*Interpretation 10 - Peer Review Material Retention Policies* states that all peer review materials are subject to oversight or review by the administering entity, the Peer Review Board (Board), or other bodies the Board may designate, including their staff. In addition, the Peer Review Program Standards paragraphs 44, 77, and 85 states that a system, engagement and report review, respectively, are subject to oversight by the AICPA and the administering entity.

The Board has established additional policies and procedures related to the oversight process which are effective immediately. Although the primary focus of the enhancements to oversight is on peer reviewers, it also focuses on the administering entities' administrative staffs, technical reviewers, peer review committees, and report acceptance body (RAB) members

Peer reviewers may see an increase in oversight as a result of the following oversight policies and procedures:

- At least two engagement oversights must be performed by the administering entity's peer review committee on an annual basis. An engagement oversight is the review of the "must select" engagements and includes all peer reviewer materials and the reviewed firm's financial statement and workpapers on the engagement. The team captain would not be notified of the oversight until after submission of his/her materials to the administering entity.
- At a minimum, the administering entity should conduct oversight on 2% of all reviews performed in a twelve month period of time, and within the 2% selected there must be at least 2 of each type of peer review evaluated (i.e., system,

engagement and report reviews). This oversight could be random or could be a combination of a targeted and random selection.

The Board also provided additional oversight procedures be performed by Administering Entities (AE). Effectively immediately, AE should verify the information on the reviewer resume (applies to reviewer's home state). All reviewer resumes should be verified over a three year period. The verification procedures must include, but are not limited to, calling/writing peer reviewers and requesting them to provide specific information such as the number of engagements they are specifically involved with and in what capacity and then determining whether the peer reviewer's firm actually performed those engagements during its last peer review.

In addition, AE must question reviewers who may not appear to have the requisite experience to review engagements performed under GAGAS, audits of employee benefit plans under ERISA and audits of an insured depository institutions subject to the FDIC Improvement Act of 1991. For example a peer reviewer who himself or herself audits the financial statements of a defined contribution plan may not be qualified to peer review an audit of the financial statements of a health and welfare plan. Similarly, a peer reviewer who himself or herself audits the financial statements of a local government may not be qualified to peer review an audit of the financial statements of an entity subject to the reporting requirements of HUD.

Last, any reviewer feedback forms and other performance correspondence relating to reviewers performing reviews outside his/her home state will be sent to the administering entity where the reviewer has his/her main office. This will allow the administering entity, where the reviewer's main office is located, to monitor the overall performance of the reviewer.

### **Oversight of Reviews – Confidentiality Issues**

Administering entities may encounter confidentiality issues when requesting working papers for oversight. An example might be confidential information included in the working papers on an ERISA engagement. The administering entity can request the firm mask the confidential information prior to submission of the working papers for oversight or arrange for a peer review committee member to go on-site to review the working papers.

### **Reviewers' Firms Can be Selected for Oversight**

Some of the objectives of the oversight program are to provide reasonable assurance that:

1. Reviews are being conducted and reported upon in accordance with the *Standards for Performing and Reporting on Peer Reviews (Standards)*; and
2. Results of reviews are being evaluated on a consistent basis in all jurisdictions.

Chapter 2 of the Oversight Handbook describes the requirements for oversight by the Peer Review Board and gives guidance to administering entities regarding oversight. In administering the AICPA Peer Review Program, administering entities have the responsibility of determining which reviewers or reviewed firms are selected for oversight. The selection is judgmental and may be based on a number of criteria including, but not limited to firms that:

- Received consecutive modified and/or adverse peer review reports prior to the current review;
- Previously received an adverse report;
- Previously had a modified or adverse engagement review or a report review that contain significant deficiencies and is having its first system review;
- Conducted several engagements in high-risk industries and is having its first system review;
- Performed a significant number of peer reviews where the managing owner and/or several owners are peer reviewers.

In conclusion, reviewers and reviewed firms are subject to oversight by an administering entity at anytime.

### **Suspension of Reviewers and Reviewer Performance Issues**

Reviewers have a responsibility to perform reviews in a timely and professional manner required by the *Standards*. This applies not only to the initial submission of the report, letter of comments (LOC), if any, and working papers, but also to the timely completion of any additional actions necessary to complete the review, such as completing omitted documentation of the work performed on the review or resolving questions raised by the accepting committee. Once the review begins, reviewers must complete any omitted procedures noted during the technical review process and resolve any questions raised by the report accepting body. This failure to “wrap up” the review in a timely manner will delay the review, can cause the reviewer to receive an unfavorable status with the administering entity’s peer review committee, and can cause the reviewed firm to be untimely in the submission of its report to relative regulatory bodies.

Reviewers must not accept review engagements unless they are quite confident that they can complete the engagements, prepare the report and LOC, and review the letter of response (LOR) prior to the reviewed firm’s due date, while keeping in mind that the reviewed firm will need time to prepare its LOR. Reviewers should keep the administering entity informed of any potential issues raised by the reviewed firm that may possibly delay the timely submission of the review documentation. If the reviewer anticipates during initial discussions with the reviewed firm that the report, LOC, and LOR will not be submitted to the administering entity timely, the reviewer should contact or have the reviewed firm contact the administering entity to see if an extension is possible (keeping in mind that some regulators may not accept an extension). If an

extension is not possible, the reviewer should suggest to the reviewed firm that the firm needs to find another reviewer because he or she will not be able to complete the peer review timely. Some reviewers take on too many reviews concurrently and habitually submit them untimely. Reviewers have been suspended or removed from the reviewer's data bank upon the recommendation of the administering entities for this untimeliness. Reviewers must be cautioned to respect the reviewed firm's due date and the *Standards* and submit the documents timely.

## **Disagreements between Reviewers and Reviewed Firms**

Reviewers and reviewed firms on occasion disagree on accounting, auditing, or peer review standards. Guidance issued by the AICPA Peer Review Board indicates that, reviewers should consult with the appropriate authoritative body to attempt to resolve the disagreement. For example, if a reviewed firm disagrees on the implementation of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 133, the reviewer should contact the technical hotline at FASB for resolution. If the reviewer and reviewed firm disagree on a peer review issue, the reviewer should contact the entity administering the peer review. Remember, consultation with the administering entity is required when the reviewer and the reviewed firm have a disagreement on a significant matter including (1) the type of report to be issued, (2) letter of comments to be issued, and (3) matter that may require the application of the guidance in the AICPA *Professional Standards*, AU sections 390 and 561.

Whenever there is a disagreement between a reviewer and a reviewed firm, that disagreement should be communicated in writing with the administering entity. The disagreeing party should give reasons for his/her disagreement as well as provide evidence supporting his/her position. If after consultation with the administering entity or the appropriate authoritative body the reviewer and reviewed firm still disagree, the matter should be referred to the administering entity's peer review committee for resolution.

Once the administering peer review committee has received the information, it should review it and, if necessary, get assistance from representatives of technical or ethical committees, appropriate AICPA staff or representatives of the authoritative body issuing the guidance. According to the nature of the situation, the peer review committee may consider performing oversight on the peer review or engagement that is the source of the disagreement. Resolution of a disagreement can also be achieved by giving the disagreeing parties the opportunity to appear before the committee to make presentations or respond to questions. The administering entity's decision regarding an issue under contention should be communicated in writing to the parties of the disagreement, even if it is to convey the fact that the matter is being referred to the AICPA Peer Review Board.

If the administering entity's full peer review committee is unable to resolve the disagreement, the committee may refer the matter to the AICPA Peer Review Board

(Board) for final resolution. However, the administering entity's peer review committee is responsible for determining whether a disagreement still exists and only that committee may refer the matter to the Board for final resolution.

### **Reviewer Resume Form**

Peer review standards require reviewers to have recent experience in the practice of public accounting or auditing. The AICPA Peer Review Board (Board) has determined that, by itself, continuing professional education courses and "other" types of experience do not meet the requirements of recent experience for a reviewer.

### **Acceptance of Review Teams**

The administering entities and the AICPA peer review program staff continue to find that reviewers are performing and completing peer reviews without the approval of the administering entity. In addition, they continue to find that reviewers are changing the peer review year-ends without approval of the administering entity. Reviewers are reminded that they should not schedule a review, perform a review, or change a peer review year-end without consulting with and receiving approval from the administering entity.

The applicable state CPA society is authorized by the AICPA Peer Review Board to administer the peer review program and, as such, should be kept informed at all stages of the peer review process. The reviewed firm should not schedule and the reviewer should not begin a review until the approval has been received from the administering entity. This eliminates potential problems with the qualifications of the reviewer and ultimately, the acceptance of the review. Also, reviewers should not change the review year-end without soliciting the assistance and approval of the administering entity. Reviewers must not obligate themselves to so many reviews simultaneously that it causes them to submit their reviews to the administering entity untimely.

### **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 now enter their resume on-line at <http://www.aicpa.org/members/div/practmon/index.htm>. The request to update reviewer resumes will no longer be sent through the mail. If a reviewer's resume is not updated or acknowledges within 2 years, the reviewer will be prohibited from performing peer reviews until the resume is updated.

The AICPA peer review team will send all future correspondence regarding the AICPA peer review program via e-mail. Therefore it is imperative that all reviewers maintain a

current e-mail address on file with the AICPA peer review program. 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](mailto:PeerReviewUpdates@aicpa.org).

The Reviewers' Alert and the Reviewers' Resume are also available for download at the AICPA peer review web-site at <http://www.aicpa.org/members/div/practmon/index.htm>. All peer reviewers are expected to have current e-mail addresses and 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*.

### **Change in Experience Codes on the Reviewer Resume**

The AICPA Peer Review Board (Board) approved a change to the experience codes for peer reviewers. The Experience Codes on the Reviewer Resume have been revised to provide further clarification as to their meanings and reflect the guidance as contained in the *Standards*.

- Code A should be used for those currently (presently involved) in supervising or performing engagements; or carrying out all components of the quality control functions on engagements. All components of the quality control functions on engagements would include pre or post issuance reviews of the complete engagement, i.e. both financials and workpapers, as part of the firm's monitoring process.
- Code B should be used for those recently involved (meaning not presently involved, but within the past 5 years) in supervising or performing engagements; or carrying out all components of the quality control functions on engagements.
- Code C should be used for those supervising or performing certain aspects of the quality control functions on engagements such as pre issuance reviews of just the financial statements but not the engagement workpapers.

A reviewer must have at least five years of recent experience in the practice of public accounting. Reviewers are reminded in some cases it may be necessary to have "current" practice experience in high-risk industries or industries in which new standards have been implemented.

Effective Date:

The changes are effective October 1, 2007. Peer reviewers are requested to review their current resume and make changes as necessary to reflect the appropriate experience code based upon the revised definitions.

## **Candidates Interested in Serving on the AICPA Peer Review Board**

Part of the annual AICPA Peer Review Board appointment process includes soliciting recommendations from the requesting of the state CPA society executive directors (from the administering entities) and contacting AICPA members who have shown an interest in the past in serving on the AICPA Peer Review Board. We are looking for candidates for service on the AICPA Peer Review Board who—

- Have in-depth knowledge of the peer review process
- Understand the issues facing the profession
- Can communicate with individuals and groups
- Can use computer technology
- Can think and act in terms of the AICPA vision and mission
- Will carry out responsibilities delegated and follow through on assignments
- Will share their views so that issues are fully deliberated and seek clarification on issues and points not fully understood
- Serve or have served on the state CPA society's peer review committee

There are several openings each year on the AICPA Peer Review Board that need to be filled. The appointed candidates will be selected by the AICPA Nominations Committee and approved at the fall Council meeting. However, the recommendations of the AICPA Peer Review Board are heavily considered. As in other AICPA areas, we are particularly interested in increasing the number of women and minorities and members under 35 on our committee. Members selected will serve for one year with reappointment for up to three years. It is expected that most contributing members will be reappointed and will serve for the maximum period.

The AICPA Peer Review Board has two task forces, Education and Communication Task Force and Oversight Task Force that include members who are not on the AICPA Peer Review Board. The Education and Communication Task Force includes two State CPA Society Administrators. The Oversight Task Force includes seven CPA's who are involved in peer review. There will be openings on both of these task forces beginning with the 2008/2009 committee year. Below are some of the candidate responsibilities for each task force:

### Education and Communication Task Force:

- Assist in organizing, preparing, and participating in the annual AICPA Peer Review Conference
- Participate in task force meetings, either via phone or in person
- Provide input that will assist State CPA Society Administrators in their responsibilities

### Oversight Task Force:

- Perform at least 2 Administrative Oversight Visits of Administering Entities each year
- Attend one oversight task force meeting (in conjunction with attending the annual AICPA Peer Review Conference) in person and other meetings via phone, as necessary

If you know of a person who has an interest in serving on the AICPA Peer Review Board or one of the task forces, please have that person apply online via the Volunteer Central website at <http://volunteers.aicpa.org>.

Instructions for individuals applying:

After login, please do the following:

1. Select Apply located towards the top of the screen.
2. Select Applications
3. Select from categories on the left of screen Peer Review.
4. Click the check box next to Peer Review Board and then select Apply in the lower right of the screen

Also, we urge you to provide additional information, particularly your resume if available by selecting Resume located on the same screen as Applications (refer to # 2 above). Your Skills can also be indicated by selecting Skills from the same screen. Although the Resume and Skills are optional they will assist the Peer Review Board members in reaching a final decision in recommending applicants to the Nominations Committee. If you have any questions or need assistance with this process please contact David Ray of the AICPA Volunteer Services Team at 212-596-6030 or via email to [volunteerservices@aicpa.org](mailto:volunteerservices@aicpa.org).

### **Acceptance of System, Engagement and Report Reviews**

As of January 1, 2005, system, engagement, and report reviews that require committee consideration, are required to be presented to a report acceptance body in a timely manner, ordinarily within 120 days of receipt of the report, letter of comments and letter of response, if applicable, from the reviewed firm. For report reviews that do not require committee consideration, the review must be accepted by the technical reviewer within 45 days of receipt of the report from the reviewed firm.

This additional requirement places a responsibility on the team captain and reviewer to resolve questions raised by the committee or technical reviewer and to perform any additional actions necessary to complete the review in a timely manner. Team captains and reviewers need to be cognizant of the 120/45 day timeframe for reviews to be presented to the report acceptance body. Failure to respond to inquiries or requests made by the technical reviewer or committee may result in the review not being presented within 120 days as required by the Standards. If a reviewer continuously fails to respond to questions or complete necessary areas, the committee may need to take appropriate actions.

## **Revisions to CPE requirements for committee members and technical reviewers**

The revision to the Standards for Performing and Reporting on Peer Reviews (“Standards”) effective January 1, 2005 includes training requirements for peer review committee members and technical reviewers. Each member of a committee charged with the responsibility for acceptance of reviews should be trained in the Standards and guidance by completing a course that meets the team captain training requirements established by the Peer Review Board (Board) within three years prior to serving on the committee or during the first year of service on the committee.

Each technical reviewer charged with the responsibility for performing technical reviews should complete within the three-year period preceding the commencement of the technical review one or more training courses that are applicable to the type of peer review being evaluated and that meet the requirements of team captain/reviewer training requirements established by the Board.

*Interpretation No. 3 – Team Captain and Reviewer Training Courses* explains the specific type of course or courses that need to be completed in order to qualify as a system review team captain, engagement and report reviewer.

## **How to Locate a Comprehensive Listing of Peer Reviewer CPE Courses**

A complete listing of peer review CPE courses can be located at [www.aicpalearning.org](http://www.aicpalearning.org). Once you are at the site, click on State Society Public Seminars and search from there.

## **Considerations Related to Accepting an Audit Engagement**

Reviewers can discuss the following with reviewed firms, when applicable, as an opportunity to add value.

### Accepting an Audit Engagement

There are many considerations a practitioner should evaluate when accepting either an initial audit or an initial audit in a specialized area (e.g. Governmental) or an audit in another state. The practitioner should consider the following:

- Peer Review requirements (i.e. step-up system review)
- Board of Accountancy Licensure Requirement for both
  - Firm License
  - Individual License
- Board of Accountancy rules and regulations
- GAO rules and regulations

Only after evaluating the ramifications of these consideration as well as other possible considerations should a practitioner accept such an audit engagement.

### **FDICIA Engagements \$500 Million or Greater**

The FDIC raised the asset-size threshold test of its regulation [12 CFR Part 363.3\(b\)](#) in late 2005. This particular regulation *requires an attestation report on management's assertion concerning the institution's internal control structure and procedures for financial reporting when a \$1 billion asset-threshold test is met.* The threshold for management's assertion concerning internal control structure was formerly \$500 million. The threshold requiring annual audited financial statements, 12 CFR Part 363.3(a), remains unchanged at \$500 million.

12 CFR Part 363 Appendix A – Guidelines and Interpretations, specifically Interpretation 15 “Peer Reviews” requires the auditor of the institution to have a peer review that includes the review of at least one audit of an insured depository institution subject to the Act, and the interpretation is still based on the \$500 million threshold requiring annual audited financial statements. As such, the *Standard's* Interpretation No. 2 “Engagement Selection in System Reviews” also uses a threshold of \$500 million when it requires that if a firm performs an audit of a federally insured depository institution subject to the Act and the peer review is intended to meet the requirements of the Act, at least one engagement conducted pursuant to the Act should be selected for peer review. Interpretation 2 also requires that the peer review of the institution should include a review of the report on internal control, since those reports are required to be issued under the Act, as stated above. However, this only applies if the engagement selected is above the new \$1 billion threshold (as there would be no report on internal control required if the engagement is between the \$500 million and \$1 billion thresholds).

We strongly encourage peer reviewers and reviewed firms who meet these criteria to review the Appendix A referenced above closely, as there are detailed document retention policies for peer review working papers based upon when the report is filed with the FDIC. The Appendix also describes specific filing requirements for submitting the peer review documents to the FDIC.

### **Transition Guidance on CPE for New Peer Review Standards Effective January 1, 2009**

#### Peer Review CPE Due in Calendar 2007

If a reviewer is due to attend a peer review course in 2007, the reviewer must attend CPE as required by Standards. The reviewer is then encouraged (not required) to attend an AICPA 2-4 hour Webcast on the new Standards that will be developed and released in 2008 before doing reviews under the new Standards in 2009 or 2010. This will assist the reviewer in understanding the new Standards and implementing them more efficiently and effectively.

### Peer Review CPE Due in Calendar 2008

If a reviewer is due to attend a course in 2008, the reviewer could receive a waiver from 1/1/2008 until the date of the conference (expected to be early November 2008). The waiver will allow those impacted to be approved as a reviewer during most of 2008. It is anticipated that the courses on the new Standards will be available by October 1, 2008. Reviewers covered under the waiver would be required to attend a course on the new Standards by the date of the 2008 Conference or they would need to attend the conference in order to receive the appropriate CPE. After the conference, the waivers will expire and reviewers not meeting the CPE requirement would no longer be approved.

“AICPA's Advanced Workshop: Practical Guidance for Peer Reviewers” will continue to be available in 2008 for those reviewers who do not request the waiver. The Peer Review Board encourages reviewers with CPE due in 2008 to take this course and then attend the Webcast update on the new Standards. New reviewers in 2008 who have not previously attended the two-day How-to course should see the section, *Guidance for New Reviewers*, to determine their options for attaining appropriate training.

Reviewers who want to obtain the waiver should submit their requests to the AICPA at [PeerReviewUpdates@aicpa.org](mailto:PeerReviewUpdates@aicpa.org) with “**Waiver Request**” in the subject line. Requests should include the member name and member number in order for the AICPA to process the requests in a timely manner.

### Peer Review CPE Due in Calendar 2009

The reviewer should stay on their normal three year schedule as required in the current Standards.

### Transition Webcast on the New Standards

The AICPA will develop a 2-4 hour Webcast on the changes to the peer review Standards that will be available in late 2008. This course will be available for accounting CPE credit but will not go towards meeting the peer review CPE requirement. The course will primarily be for:

- Reviewers who took CPE in 2007 and 2008 under the current Standards who are strongly encouraged (not required) to attend a course on the new Standards before performing a peer review under the new Standards.
- Technical reviewers involved in the peer review process that will be involved in peer reviews under the new Standards.
- Peer Review Committee Members involved in the peer review process that will be involved in peer reviews under the new standards.
- New reviewers taking the How-to course under the current Standards in 2007 or 2008

### Guidance for New Reviewers

The two-day How-to course under the current Standards will still be offered during late 2007 and ongoing through 2008. New reviewers who are interested in peer review or have potential reviews for 2008 are encouraged to take the course under the current

Standards. The AICPA will offer several regional How-to courses over the next year. As an incentive for new reviewers taking the course and completing their reviewer resume, the AICPA will cover the costs of the 2-4 hour Webcast on the new Standards mentioned above. This course will provide the new reviewers with the information needed to perform reviews under the new Standards efficiently and effectively.

## **Ethics Information for Peer Reviewers**

### **AICPA Professional Standards ET Section 302 - Contingent Fees**

Although contingent fees are becoming an area of greater discussion and scrutiny, the issue is not a new one.

Testing firms' compliance with individual sections of the *AICPA Code of Conduct (Code)* is not a part of the current peer review process. However, this does raise the question as to what extent the requirements of the *Code* should be tested in peer review, and/or what should be done if a failure to comply with *ET Section 302* is noted by the peer reviewer.

Ethics Interpretation 101-3 from the *Code* has been included in the peer review process because it has a direct link to independence. Very specific guidance for dealing with performance and documentation issues has been issued on this topic.

While the Peer Review Board wants to stress that it believes adherence to the *Code*, including compliance with the contingent fee rules, is extremely important, testing a firm's compliance with every section in the *Code* is not practicable.

Therefore, reviewers are currently not required to specifically test contingent fees. However, if a peer reviewer becomes aware of a violation of *ET Section 302* related to a firm's accounting and auditing practice through the review of work papers or inquiry with the reviewed firm, consideration should be given to including this matter as an LOC item depending on the significance and pervasiveness of the deficiency.

### **Resources available on Interpretation 101-3-Performance of nonattest services**

The AICPA Professional Ethics Division has been receiving a significant number of questions regarding the application of the new nonattest services rules under AICPA Interpretation 101-3, *Performance of Nonattest Services*. Peer reviewers will be evaluating whether firms are compliant with the independence rules as part of this year's peer review program. To assist peer reviewers, the AICPA Professional Ethics Division has provided important resources to help in understanding the application and intent of the new rules.

### **Resources available on Interpretation 101-3**

**April 2003 CPA Letter article**, *Navigating the General Requirements of the Nonattest Services Rules of the AICPA Code of Professional Conduct, Interpretation 101-3—Performance of Nonattest Services*

[www.aicpa.org/download/cpaltr/2004\\_04/supps/F-SmlApr.pdf](http://www.aicpa.org/download/cpaltr/2004_04/supps/F-SmlApr.pdf)

**Frequently asked questions and answers** on the new nonattest services rules

[http://www.aicpa.org/download/ethics/nonattest\\_q\\_a.pdf](http://www.aicpa.org/download/ethics/nonattest_q_a.pdf)  
and [http://www.aicpa.org/download/ethics/QA\\_IT.pdf](http://www.aicpa.org/download/ethics/QA_IT.pdf)

In addition the Professional Ethics Executive Committee, at its July 29-30, 2004 meeting, adopted an additional revision to Interpretation 101-3, which provides that the general requirement to *document in writing* the understanding established with the client will not apply until the client becomes an attest client of the member or member's firm. The revision will permit a member to prepare the required documentation upon acceptance of an attest engagement, provided the member is able to demonstrate his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client.

[http://www.aicpa.org/download/ethics/20040205\\_deferral.pdf](http://www.aicpa.org/download/ethics/20040205_deferral.pdf)

If you need additional guidance on the independence rules, please call the AICPA Ethics Hotline at 888-777-7077 (menu option 5, followed by option 2) or contact the ethics division by e-mail at [ethics@aicpa.org](mailto:ethics@aicpa.org).

### **Guidance to Peer Reviewers related to Interpretation 101-3**

The AICPA Peer Review Board has issued the guidance, including a flowchart, to assist peer reviewers and others with respect to the implications of Interpretation 101-3, *Performance of Nonattest Services* on the AICPA Peer Review Program. This guidance is located at: [http://www.aicpa.org/members/div/practmon/Ethics\\_Rule\\_101-3.htm](http://www.aicpa.org/members/div/practmon/Ethics_Rule_101-3.htm).

The information includes revisions made by the AICPA Professional Ethics Executive Committee (PEEC) at the January 2005 meeting. The revisions were made to provide clarification on the applicability and intent of the rule and ensure its continued effectiveness in promoting independence when a member renders nonattest services to an attest client.

The AICPA Professional Ethics Division has established a hotline to answer technical questions related to Interpretation 101-3. The hotline number is 1-800-841-5380.

# Accounting and Auditing Issues

## **Keeping Current on Professional and Industry Developments**

Annually, the AICPA publishes a general *Audit Risk Alert* to help auditors plan their current year-end audits. The Alert advises auditors of current professional, economic, and industry developments.

The AICPA also publishes annually the industry Audit Risk Alert series, providing current developments in specified industries and practice areas. Audit Risk Alerts are available for the following industries:

Bank, Credit Union, and Other Depository and Lending Institutions  
Common Interest Realty Associations  
Compilation and Review  
Construction Contractors  
Employee Benefit Plans  
Government Auditing Standards and Circular A-133 Audits  
Health Care  
High-Technology  
Investment Companies  
Manufacturing  
Not-for-Profit Organizations  
Real Estate  
Securities  
State and Local Governments

## **Important Web-site Links**

In Our Opinion Newsletter (The Newsletter of the AICPA Audit and Attest Standards Group):

<http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion/>

Newly Released Ethics Rulings and Interpretations:

<http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Spotlights+and+Current+Developments/>

General Accounting Standards Board: [www.gasb.org](http://www.gasb.org)

Federal Accounting Standards Advisory Board: [www.fasab.gov](http://www.fasab.gov)

Government Auditing Standards (Yellow Book) [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm)

## **Documentation on a Review Engagement of Financial Statements for periods ending on or after December 15, 2004**

One of the objectives of an engagement review is for the reviewer to determine whether the firm's documentation conforms with the requirements of Statements on Standards for Accounting and Review Services (SSARS) and Statements on Standards for Attestation Engagements (SSAEs) applicable to those engagements in all material respects. For a review engagement under SSARS for reviews of financial statements for periods ending on or after December 15, 2004, the documentation should include any findings or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. The documentation of the inquiry and analytical procedures should include the following—

1. The management representation letter.
2. The matters covered in the accountant's inquiry procedures.
3. The analytical procedures performed.
4. The accountant's expectations (as discussed in AR 100.29) where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations.
5. Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts.
6. Any additional procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.
7. Unusual matters that the accountant considered during the performance of the review procedures, including their disposition.

AR 100.29 describes the process the accountant should undertake with respect to performing analytical procedures in a review engagement. In addition, Appendix H of SSARS No. 10 provides examples of analytical procedures an accountant may consider when conducting a review of financial statements.

AR 100.31 provides inquiries that the accountant should consider making and other review procedures the accountant should consider performing when conducting a review of financial statements. Appendix B of SSARS No. 1 (as amended), provides a more detailed listing of illustrative inquiries an accountant might consider when performing a review engagement.

The introductory paragraph of Appendix B states that the inquiries to be made in a review of financial statements should be based on the accountant's professional judgment. It goes on to state that in determining the appropriate inquiries, the accountant may consider: (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data. The inquiries should generally be made of members of management with financial reporting and accounting responsibilities. As to the various inquiries provided in Appendix B, they are not meant to apply to every engagement, to be all-inclusive, or to serve as a program or checklist in the conduct of a review.

Examples of appropriate documentation for a review engagement should include any one or more of the following:

- A program or checklist that covers the inquiries made by the accountant, such as those generally described in AR 100.31, and also those more specifically described in Appendix B to SSARS No. 1.
- Notations in the documentation and/or memos that describe the analytical procedures performed, such as: comparison of financial statements with comparable prior periods, comparison of financial statements with anticipated results (for example, budgets and forecasts), and ratio analysis. The accountant should also have documented the expectations where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations. Also, the results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts. The accountant should also document any additional procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.
- Memos in a narrative format that discuss any unusual matters the accountant considered during the review, as well as how the accountant disposed of those matters.
- The representation letter.

Since the form and content of documentation may vary from one engagement to another, and will be based upon the judgment of the accountant who performed the review of financial statements, the peer reviewer needs to use reasonable judgment in determining whether the documentation appears to be appropriate.

## **Management Representation Letters**

SSARS requires a written representation letter from management for all financial statements and periods covered by the accountant's review report. The representations should be made as of a date no earlier than the date of the accountant's review report.

For purposes of peer review, the Peer Review Board has determined that if a management representation letter is dated differently than the report date, the incorrect dating alone would not cause a substandard engagement. It may be considered a deficiency, depending on how materially different the dates are and the pervasiveness should be considered when determining whether a comment should be included in the letter of comments on a system review. On an engagement review, if the dating is not materially different, it would not be required to be included in the letter of comment, if it is materially different, it would be an LOC item. The reviewer should use his/her judgment in determining whether the dating is materially different.

If the management representation letter does not meet substantially all of the other requirements or the firm failed to obtain a management representation letter, the engagement should be deemed substandard.

## **Extension of Order Regarding Broker-Dealer Financial Statement Requirements under Section 17 of the Exchange Act**

The Securities and Exchange Commission is extending its Order, originally issued on August 4, 2003, and extended on July 14, 2004 under Section 17(e) of the Securities Exchange Act of 1934, regarding audits of financial statements of broker-dealers that are not issuers ("non-public broker-dealers"). According to the extension, non-public broker-dealers may file with the Commission a balance sheet and income statement and may send to their customers a balance sheet certified by an independent public accountant, instead of by a registered public accounting firm, for fiscal years ending before January 1, 2007. The SEC extension can be found at <http://www.sec.gov/rules/other/34-52909.pdf>.

## **Recently Issued Statements on Auditing Standards and Statements on Standards for Attestation Engagements**

The AICPA's Auditing Standards Board (ASB) has issued the following Statements on Auditing Standards (SAS) and Statements on Standards for Attestation Engagements:

SAS Nos. 104 – 111 are effective for audits of financial statements for periods beginning on or after December 15, 2006. However, early adoption is permitted.

- [SAS No. 104](#), Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures (“Due Professional Care in the Performance of Work”)
- [SAS No. 105](#), Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards
- [SAS No. 106](#), Audit Evidence
- [SAS No. 107](#), Audit Risk and Materiality in Conducting an Audit
- [SAS No. 108](#), Planning and Supervision
- [SAS No. 109](#), Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- [SAS No. 110](#), Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained
- [SAS No. 111](#), Amendment to Statement on Auditing Standards No. 39, Audit Sampling.

SAS No. 112 is effective for audits of financial statements for periods ending on or after December 15, 2006. However, early adoption is permitted.

- [SAS No. 112](#), *Communicating Internal Control Related Matters Identified in an Audit*

SAS No. 113 has two different effective dates. The amendments in paragraphs 1 through 5 of SAS No. 113 are effective for audits of financial statements for periods beginning on or after December 15, 2006. However, early adoption is permitted. The amendments in paragraphs 7 through 14 are effective for audits of financial statements for periods ending on or after December 15, 2006. Earlier adoption is also permitted.

- [SAS No. 113](#), *Omnibus 2006*

SSAE No. 14 is effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006.

- [SSAE No. 14](#), *SSAE Hierarchy*

Please click through the above links for summaries of each new SAS and SSAE.

## **Peer Review Guidance for SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit**

The objective of SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, is to provide new definitions and guidance to assist auditors in better communicating internal control deficiencies. In addition, SAS No. 112 heightens the auditor's awareness that his/her clients are ultimately responsible for their system of internal control and financial statements and, therefore, must weigh and manage the associated risks. SAS No. 112 is effective for all financial statement audits for periods on or after December 15, 2006. For audits that have period end dates prior to December 15, 2006, the peer reviewer should apply SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, requirements.

While auditors are not required to search out or have procedures in place to identify deficiencies in internal control, auditors are required to "...evaluate identified control deficiencies and determine whether these deficiencies, individually or in combination, are significant deficiencies or material weaknesses" according to the AICPA's "Communicating Internal Control." In other words, when an auditor "trips across" an internal control deficiency in the course of an audit, the auditor then must evaluate the control deficiency to determine whether it's a significant deficiency or material weakness.

SAS No. 112 has two unconditional requirements:

- The auditor must evaluate identified control deficiencies and then determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses. (There are new definitions of significant deficiencies and material weaknesses from those defined in SAS No. 60)
- The auditor must communicate, in writing, significant deficiencies and material weaknesses to management and those charged with governance. This communication includes significant deficiencies and material weaknesses identified and communicated to management and those charged with governance in prior audits but not yet remediated.

SAS No. 112 defines control deficiencies, significant deficiencies and material weaknesses in the following manner:

**Control Deficiency** - A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

**Significant Deficiency** - A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

**Material Weakness** - A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Note: The definition of significant deficiency above is different than the definition/criteria used in determining significant deficiencies in peer review.

Below is a chart to assist peer reviewers in evaluating the various situations that may be encountered during a peer review of audits that have period end dates subsequent to December 15, 2006 where SAS No. 112 would be applicable.

| <u>Situation</u>   | <u>SAS 112 Guidance</u>  | <u>Peer Review Guidance</u>  |
|--|--|--|
| Auditor did not have specific procedures in place to identify control deficiencies.  | <p>The auditor is not required to search out or have procedures in place to identify control deficiencies.</p> <p>Note: The auditor is required to obtain an understanding of internal control sufficient to plan the audit by performing procedures to understand the design of controls relevant to an audit of financial statements and determining whether they have been placed in operation.</p> | <p><b>No MFC</b> - having specific procedures in place to identify control deficiencies is not a requirement of SAS No. 112.</p> <p>However, if the auditor has failed to obtain an understanding of internal control sufficient to plan the audit, an MFC related to that matter would be warranted</p>   |
| Auditor identified control deficiencies and determined that those deficiencies, individually or in combination, represent a significant deficiency or material weakness. | The requirements of SAS No. 112 are met providing the auditor communicates the identified deficiency or weakness in writing to management and those charged with governance no later than 60 days following the report release date.   | <p><b>No MFC</b> if a written, timely communication<sup>1</sup> was made to management and those charged with governance.</p> <p><b>MFC</b> if the auditor fails to communicate the deficiency and/or weakness in writing to management and those charged with governance no later than 60 days following the report release date.</p> <p><b>REPORT/LOC:</b><br/>If the matter described in the MFC is pervasive, consideration should be given to including the</p> |

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|  |  | <p>matter in the LOC or report. The auditor should use judgment in evaluating the significance of the failure to communicate and, generally, the peer reviewer should respect the auditor's professional judgment. If, however, the failure to communicate included audits conducted under Generally Accepted Government Auditing Standards (the Yellow Book), or included clients with operating audit committees, the engagement could be deemed to be substandard. In circumstances where an engagement is not conducted under the Yellow Book and/or there is no operating audit committee, generally the engagement would not be deemed substandard if this was the only deficiency noted.</p> |
| <p>Auditor identified control deficiencies and did not evaluate whether they were a significant deficiency or a material weakness.</p>   | <p>SAS No. 112 requires the auditor to evaluate the identified control deficiencies to determine whether these deficiencies, individually or in combination, are significant deficiencies or a material weakness.</p>  | <p><b>MFC</b> since the auditor identified the control deficiencies but did not evaluate whether they were a significant deficiency or material weakness.</p> <p><b>NOTE:</b> See preceding guidance in evaluating if a substandard engagement exists and the related impact on the report or LOC.</p>  |
| <p>Auditor identified control deficiencies and upon evaluation, determined that they were not a significant deficiency or material weakness. The control deficiencies were not communicated to management or those</p> | <p>SAS No. 112 requires the auditor to evaluate the identified control deficiencies to determine whether these deficiencies, individually or in combination, are significant deficiencies or a material weakness. If control deficiencies are evaluated and determined not to be a</p> | <p><b>NO MFC</b> since SAS No. 112 requires the auditor to evaluate the identified control deficiencies to determine whether these deficiencies, individually or in combination, are significant deficiencies or a material weakness. Since the control deficiencies were evaluated and determined not to</p>   |

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| charged with governance.  | significant deficiency or material weakness, SAS No. 112 does not require the control deficiencies to be communicated with management or those charged with governance.  | be a significant deficiency or a material weakness, they are not required to be communicated to management or those charged with governance.   |
| Auditor identified control deficiencies and upon evaluation, determined that they were not a significant deficiency or material weakness. During the peer review, the team captain determines that the identified control deficiencies are a significant deficiency which should have been communicated in writing. | N/A  | This should be handled as a disagreement in the same manner as other disagreements between reviewer and firm. The team captain, and if possible the reviewed firm, should contact the AICPA technical hotline or AICPA Audit and Attest staff for additional guidance. The team captain may also need to consult with the technical reviewer and committee chair.  |
| During an audit procedure, the auditor determined a control deficiency was a significant deficiency or material weakness. The auditor orally communicated the identified deficiency as soon as it was identified to management and those charged with governance.   | SAS No. 112 allows the auditor the ability to orally communicate identified deficiencies or weakness provided that the auditor issues a written communication no later than 60 days following the report release date. | <b>No MFC</b> if a written, timely communication <sup>1</sup> was made to management and those charged with governance.<br><br><b>MFC</b> if the auditor failed to communicate the deficiency and/or weakness in writing to management and those charged with governance no later than 60 days following the report release date.<br><br><b>NOTE:</b> See preceding guidance in evaluating if a substandard engagement exists and the related impact on the report or LOC. |
| The client has effective internal controls in place over fixed assets. However, as a convenience for the client, the auditor  | Nothing in SAS No.112 precludes the auditor from performing this service.  | <b>No MFC</b> since the client has effective internal control procedures in place over fixed assets and the client's review of the auditor's proposed journal entry included the recomputation   |

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| <p>develops journal entries for fixed asset depreciation and recommends client's posting to its general ledger. Client recomputes selected auditor calculations to verify accuracy.</p>   |   | <p>of selected auditor calculations to satisfy the auditor's computations were properly made.</p>  |
| <p>Auditor prepares FASB 109 disclosure and provides necessary journal entries for posting by client. Client has a level of understanding such that the auditor meets AICPA Ethics independence requirements but the auditor determines the client does not have the ability to independently prepare the correct entries. Therefore the auditor has determined that a control deficiency exists.</p> | <p>Since the client does not have the ability to fully understand the disclosure and detect a misstatement, the auditor has appropriately detected a control deficiency. The control deficiency must be evaluated to determine if it was a significant deficiency or a material weakness.</p> | <p><b>No MFC</b> if the auditor evaluates the control deficiency and determines that a significant deficiency or material weakness exists and a written, timely communication<sup>1</sup> was made to management and those charged with governance no later than 60 days following the report release date.</p> <p><b>No MFC</b> if the auditor evaluates the control deficiency and determines that a significant deficiency or material weakness does not exist and thus no communication was made to management or those charged with governance.</p> <p><b>MFC</b> if the auditor (1) did not determine whether the deficiency was significant or constituted a material weakness; or (2) determined the deficiency was significant or constituted a material weakness and failed to provide written communication to management and to those charged with governance no later than 60 days following the report release date.</p> <p><b>NOTE:</b> See preceding guidance in evaluating if a substandard engagement exists and the</p> |

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|   |   | related impact on the report or LOC.   |
| During interim fieldwork and before the client's year end date, the auditor identifies a control deficiency and determines it is a material weakness. The auditor provides a written communication in a letter to management and those charged with governance. | SAS No. 112 does not distinguish how the written communication is to be done. It does specify that it must be provided no later than 60 days following the report release date.   | <b>No MFC</b> since the written communication <sup>1</sup> was provided no later than 60 days following the report release date.   |
| The auditor does not identify any control deficiencies during the audit. The auditor provides written communication to the client indicating that significant deficiencies were not identified during the audit.  | SAS No. 112 indicates that the auditor should not issue a written communication stating that no significant deficiencies were identified during the audit because of the potential for misinterpretation of the limited degree of assurance provided by such a communication.<br><br><b>NOTE:</b> A client may ask the auditor to issue a communication indicating that no material weaknesses were identified during the audit of the financial statements for the client to submit to governmental authorities. | <b>MFC</b> should be issued if the auditor provided written communications that no significant deficiencies were identified.<br><br><b>REPORT/LOC:</b><br>If the matter described in the MFC is pervasive, consideration should be given to including the matter in the LOC or report. The auditor should use judgment in evaluating the significance of the departure from professional standards.<br><br>. |
| Auditor drafts the financial statements, including footnote disclosures. However, the auditor determines the client does not have the ability, either internally or through the use of a qualified outside party, to independently prepare or review financial  | The control deficiency must be evaluated to determine if it is a significant deficiency or a material weakness. SAS No. 112 provides that ineffective oversight of the entity's financial reporting and internal control by those charged with governance should be regarded as at least a significant deficiency and a strong indicator of a material  | <b>No MFC</b> if a written, timely communication <sup>1</sup> was made to management and those charged with governance.<br><br><b>MFC</b> if the auditor failed to provide written communication to management and to those charged with governance no later than 60 days following the report release date.   |

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| <p>statements and related footnote disclosures. As such, there are no controls in place to prevent and detect misstatements in this area. Therefore, the auditor has determined that a control deficiency exists.</p> | <p>weakness in internal control. Therefore, the auditor should have communicated this deficiency to management and those charged with governance no later than 60 days following the report release date.</p> <p><b>Note:</b> Generally, no control deficiency would exist where the client possesses or acquires, from a source other than the audit firm, a level of understanding necessary to prepare the financial statements and related footnotes and reviews the financial statements and related footnotes in sufficient detail to assume responsibility and prevent and detect misstatements.</p> | <p><b>NOTE:</b> See preceding guidance in evaluating if a substandard engagement exists and the related impact on the report or LOC.</p> |
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<sup>1</sup> The written communication should:

- State that the purpose of the audit was to express an opinion on the financial statements, but not to express an opinion on the effectiveness of the entity's internal control over financial reporting.
- State that the auditor is not expressing an opinion on the effectiveness of internal control.
- Include the definition of the terms significant deficiency and, where relevant, material weakness.
- Identify the matters that are considered to be significant deficiencies and, if applicable, those that are considered to be material weaknesses.
- State that the communication is intended solely for the information and use of management, those charged with governance, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties. If an entity is required to furnish such auditor communications to a governmental authority, specific reference to such governmental authorities may be made.

### SAS No. 112 Frequently Asked Questions

The PCPS Firm Practice Center has developed a [SAS No. 112 Frequently Asked Questions](#). The FAQs document is intended to address the most common practitioner questions related to applying SAS No. 112. In addition, it provides links to additional resources that may be helpful in understanding and applying SAS No. 112

# **Center for Public Company Audit Firms Peer Review Program**

## **Interpretation — Team Captain Training Courses**

Effective February 9, 2006, the Center for Public Company Audit Firms (“CPCAF”) Peer Review Committee approved the following Interpretation regarding team captain training courses:

1. Question: Paragraph 31 of the Standards for Performing and Reporting on Peer Reviews (SEC Practice Section *Peer Review Reference Manual*, PRP section 2000.31) states that reviewers should “possess current knowledge of the peer review process. Accordingly, a review team captain must have obtained this current knowledge either by attending a reviewers’ training course that uses AICPA materials and that was conducted within five years or by serving as a Committee member within five years preceding commencement of the review.”

What specific type of course or courses, if any, should a CPCAF Peer Review Program (PRP) review team captain complete?

2. Interpretation: To initially qualify as a CPCAF PRP team captain, an individual should complete the AICPA two-day introductory reviewer training course, “How to Conduct a Review Under the AICPA Practice-Monitoring Program” (“How to”). In order to maintain the qualifications of a team captain, individuals should participate in eight (8) hours of continuing professional education in peer review training within five years prior to the commencement of a review. The reviewer should complete a combination of the courses which combined totals the eight (8) hour requirement. These courses are: the AICPA two-day introductory “How to” training course; the AICPA one-day advanced reviewer training course, “Advanced Training Course for Reviewers: Current Issues in Practice Monitoring”; the AICPA annual Peer Review Program Conference, the 4 hour courses “AICPA Peer Review Program Standards: Practical Guidance for Selected Topics” course or “Revised AICPA Peer Review Standards and Interpretations” or other courses approved by the Peer Review Committee.

## **Center for Public Company Audit Firms Peer Review Program** **April 2004 Bridging Document**

Effective January 1, 2004, the AICPA SEC Practice Section (“SECPS” or “Section”) was restructured into the Center for Public Company Audit Firms (“Center” or “CPCAF”). As a result of the establishment of the Public Company Accounting Oversight Board (“PCAOB”), which by law is required to inspect and discipline auditors of SEC issuers, the Section was restructured in order to (a) remove those activities that will now be performed by the PCAOB (e.g., monitoring member firms’ SEC practices through programs like peer review and quality control inquiry, establishing practice requirements

such as concurring review), and (b) continue to serve and represent firms that practice or are interested in practicing before the SEC and PCAOB.

The PCAOB inspects, disciplines, and establishes auditing, quality control and independence standards for auditors of public companies. As a result, the regulation of accounting firms has changed dramatically and has had a significant impact on the activities previously performed by the SECPS. Therefore, the SECPS peer review program was reevaluated to identify the revisions necessary to bridge the SECPS peer review program to the PCAOB's inspection process, thereby transitioning into the Center for Public Company Audit Firms (Center) peer review program (PRP). The changes from this reevaluation are documented in a bridging document which can be found at <http://www.aicpa.org/download/centerprp/2004bridging.pdf>.

## Other

### **Reporting Firm Structure Changes to Administering Entities and Their Effect on a Firm's Enrollment and Peer Review Requirements**

Details of firm structure changes, whether a merger, demerger, dissolution or other change, should be communicated to the administering entity via the Notification of Change in Firm Structure Form (Form) available at [http://www.aicpa.org/download/members/div/practmon/firm\\_structure.pdf](http://www.aicpa.org/download/members/div/practmon/firm_structure.pdf). The Form should be submitted on a timely basis after the structure change occurs, and regardless of the firm's next peer review due date. The Form will be used to process the adjustments to a firm's enrollment and personnel's membership records, including whether there is a firm to be withdrawn from one of the AICPA's peer review programs. It also helps to determine if a new firm has been created which may be required to enroll in the one of the programs.

Firms should consult with their administering entity or AICPA staff for assistance in completing and submitting the Form.

It is advisable to contact AICPA staff in advance to obtain guidance in determining the effect of a firm structure change on a firm's enrollment or peer review requirements. Firm structure changes are evaluated on a case by case basis since there are many variables to be considered, however, AICPA staff will consider the following:

- Applicable regulatory requirements for the firm to obtain a peer review, including the state board of accountancy requirements in the states the firm practices in and whether the firm is subject to Government Accountability Office (GAO) peer review requirements.

- The nature of the firm's current and planned accounting and auditing practice, including whether it has and/or will continue to issue engagement reports under its firm name on its firm letterhead.
- Timing of the firm structure change, and whether it occurred before, within or after the firm's peer review year.
- Intention of the firm's personnel to remain an AICPA member(s).
- If necessary and upon the firm's consultation with them, the opinions of the firm's legal counsel.