

**AICPA**

**PEER REVIEWER'S ALERT 05-01**

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# **AICPA Peer Review Program Standards and Interpretations**

## **Revisions to Interpretations No. 3 and 12**

Effective January 10, 2005, the Peer Review Board approved changes to *Interpretation No. 3 – Team Captain and Reviewer Training Courses* and *Interpretation No. 12 – Other Enrollment Requirements*.

The change to *Interpretation No. 3 – Team Captain and Reviewer Training Courses* was the deletion to the reference of the “AICPA Peer Review Board-RAB Training Course (which may only be taken once per calendar year).”

*Interpretation No. 12 – Other Enrollment Requirements* was modified to include the following statement:

Firms that perform audits of non-SEC issuers pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB) are eligible to enroll in the AICPA Peer Review Program. However, engagements performed pursuant to the standards of the PCAOB will be excluded from the firm’s peer review and the peer review report would include a scope limitation without exception. Firms have the option of enrolling in the Center for Public Company Audit Firms Peer Review Program where the engagements would be included in the scope for possible selection in the peer review.

Firms should consider their respective State Board of Accountancy rules and regulations when making a choice of which Peer Review Program to enroll in.

## **System Reviews**

### **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.

# Engagement Reviews

## 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

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.

## Reviewers' Information

### 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 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.

### 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 inquires 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.

### Team Captain and Reviewer CPE Requirements for Peer Review Training

In order to maintain qualifications of a reviewer, when the function of the reviewer goes beyond reviewing engagements, individuals should participate in eight (8) hours in continuing professional education in peer review training within three years prior to the commencement of a review. A reviewer goes beyond reviewing engagements when he/she prepares any other peer review documentation beyond preparing and completing the engagement checklist and MFC forms.

The Board has approved a four (4) hour training course on the “Revised AICPA Peer Review Standards and Interpretations.” Individuals taking this class to satisfy the continuing professional education requirement must ensure that eight hours of training are completed within three years prior to commencement of a review. Reviewers should also update their resume to reflect the courses taken.

For additional clarification, examples are provided below:

#### Example 1

On July 15, 2002, a reviewer completes the eight (8) hour “Advanced Training Course for Reviewers: Current Issues in Practice Monitoring” On May 4, 2005, the reviewer completes the four (4) hour course “Revised AICPA Revised Standards and Interpretations.” Since the reviewer must have completed eight hours of peer review training within three years prior to commencement of a review, the reviewer would not qualify to commence a peer review until another four (4) hour course is approved by the Board or completion of the eight (8) hour course prior to July 15, 2005.

#### Example 2

On July 15, 2003, a reviewer completes the eight (8) hour “Advanced Training Course for Reviewers: Current Issues in Practice Monitoring” On May 4, 2005, the reviewer completes the four (4) hour course “Revised AICPA Standards and Interpretations.”

Since the reviewer must have completed eight hours of peer review training within three years prior to commencement of a review, the reviewer must complete at least another four (4) hour course prior to July 15, 2006.

## 2005 AICPA Peer Review Program Conference

The 2005 AICPA Peer Review Program Conference will be held on July 31, August 1-2, 2005 in Chicago, Illinois. This conference will include the latest developments, insights and training regarding the peer review process that peer reviewers, technical reviewers, administrators, committee members, and Chiefs of Staff will be encountering regarding the AICPA Peer Review Program. Attendees will get updated information that affects their role in the peer review process, participate in challenging mock cases and share recent peer review information, ideas and experiences. Conference highlights will include:

- Implementation issues regarding AICPA Peer Review Program Standards and Interpretations
- Update on Current Issues and Emerging Topics in Peer Review
- Special sessions for reviewers include subjects such as employee benefit plans and GAO audit requirements.
- Interactive environment via stimulating idea exchanges, case studies, lectures and discussions.

Additional conference and registration information will be available in the near future.

## Update on the AICPA Peer Review Program Manual

There have been several enhancements and revisions to the AICPA Peer Review Program Manual (Manual). Major revisions and enhancements have been made to:

- Section 3300 – *Guidance for Writing Peer Review Reports* which now includes Checklists for Reviewing Drafts of Reports on System, Engagement and Report Reviews.
- Section 3400 – *Guidance for Writing Letters of Comments on System Reviews*, which includes illustrative examples of a comment or deficiency and recommendation for an isolated deficiency.
- Section 3500 – *Guidance for Writing Letters of Comments on Engagement Reviews* provides reviewers with a checklist that may be used to make certain that the letter of comments includes all required information.
- Section 3900 – *Additional Guidance for Performing and Reporting on Peer Reviews* includes all additional and transitional guidance issued by the Peer Review Board subsequent to the issuance of the revisions to AICPA Peer Review Program Standards.
- Section 4100 – *Instructions to Firms Having System Reviews* includes “Checklist for Implementation of Your Peer Review” in Appendix A. This checklist has been added to assist the firm in preparing for the review team’s visit.
- Section 4200 – *Instructions to Reviewers Performing System Reviews* (New Section in the Manual) provides detailed guidance to review teams assigned to perform peer reviews. This section includes, among other items, detailed guidance on scope of reviews and factors to consider when assessing inherent risk.

In order to assist administering entities and peer reviewers' with peer reviews that commenced before January 1, 2005, the AICPA has created a paperback version that will include Sections 1000 – 10,000. The paperback version will be issued automatically for those individuals who subscribe to the service.

### Consolidated Reviewers' Alert

A Consolidated Reviewers' Alert which contains all current, relevant information from the 1997 Annual Reviewers' Letter through AICPA Peer Reviewers' Alert 04-02 can be found at: [http://www.aicpa.org/download/practmon/Consolidation\\_Reviewers\\_Alert\\_04-02.pdf](http://www.aicpa.org/download/practmon/Consolidation_Reviewers_Alert_04-02.pdf).

Reviewers should use this document for guidance and reference material. The originally issued Alerts can be located in an Archive on the website at: [http://www.aicpa.org/members/div/practmon/Archived\\_Reviewers\\_Alerts.htm](http://www.aicpa.org/members/div/practmon/Archived_Reviewers_Alerts.htm).

The Peer Review Board will continue to issue new Alerts each time the Board needs to communicate information regarding the peer review Standards, guidance and other peer review information. The new Alerts will be sequentially numbered with the year of issue being the first two digits and the second two digits indicating the Alert number for that year.

## **Accounting and Auditing Issues**

### 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.