

AICPA

PEER REVIEWER'S ALERT 06-01

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New Four Hour Peer Review Course

The AICPA released a new four hour course entitled, *AICPA Peer Review Program Standards: Practical Guidance for Selected Topics*, in December 2005. The course is designed to be an interactive workshop to reinforce and improve reviewer's understanding of selected topics such as risk assessment, surprise engagement selections, monitoring and type of report to issue. This course qualifies for four hours of CPE for reviewers under Interpretation No. 3 – Team Captain and Reviewer Training Courses. The prerequisite for this course is *How to conduct a Review under the AICPA Practice Monitoring Programs*.

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>.

Review 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

The Board recently 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 to perform a specific peer review.

As a reviewer, you will be asked to verify certain information listed on your resume. Verification procedures may include sending copies of:

- 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

Reviewers are encouraged to assist administering entities with the new requirement of the verification of resume information.

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.

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.

Documenting Risk Assessment

Just as the performance of an audit includes audit risk, the performance of a system review includes peer review risk. Peer review risk is the risk that the review team:

- Fails to identify significant weaknesses in the reviewed firm’s system of quality control for its accounting and auditing practice, its lack of compliance with that system, or a combination thereof.
- Issues an inappropriate opinion on the reviewed firm’s system of quality control for its accounting and auditing practice, its compliance with that system, or a combination thereof.
- Reaches an inappropriate decision about the matters to be included in, or excluded from, the report or letter of comments, or about whether to issue a letter of comments.

Peer review risk consists of three components:

- *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.
- 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.

- *Detection risk* – The risk that the reviewer (or review team) will fail to detect the design or compliance deficiencies in the reviewed firm's system of quality control that either result in the firm having less than reasonable assurance of conforming with professional standards in all material respects or 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.

Reviewers must properly 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 when documenting the risk assessment 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?
- Multi-state offices and multi-offices engagements

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.