

**AICPA**

**PEER REVIEWER'S ALERT 06-02**

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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”.

## 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 one engagement conducted pursuant to the Act should be selected for review.

## 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.

## 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.

### 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.

### 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.

## 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.**

## New Peer Review Interview Procedures

The Peer Review Board approved an additional checklist to be completed when performing system reviews. The checklist entitled “Managing Partner / Chief Executive Officer Interview” is located in the AICPA Peer Review Manual Section 4750. The objective of this interview is to assist the peer review team in gaining an understanding of the firm leadership’s involvement with its system of quality control. The questions are designed to help the review team gain an understanding of management’s philosophy towards and support of the quality control initiatives in the firm and should be considered in assessing inherent and control peer review risk.

The interview should occur during the planning stage or early in the peer review. The questionnaire should be completed by the firm executive who sets the tone for the firm in connection with its audit and accounting practice. The form may be provided to and completed by the appropriate person in advance of the interview to facilitate the interview process. The team captain should review the responses with the appropriate person during the peer review.

## Additional Revisions to the AICPA Standards for Performing and Reporting on Peer Reviews and Interpretation 14

At its May 2006 meeting, the AICPA Peer Review Board (PRB) made some revisions to the *Standards for Performing and Reporting on Peer Reviews (Standards)* and Interpretation 14 which are summarized below.

The PRB considered questions and feedback received from technical reviewers, peer reviewers, firms, etc. As a result, the Board has been (and will continue) to issue guidance addressing such matters. In addition, there are some matters that the PRB determined would be best addressed by making limited revisions to the *Standards* where; 1) there are substantive errors and/or omissions, 2) the Board’s intent on an issue can be very easily clarified, and 3) isolated typographical errors can be easily corrected. The PRB was not attempting to and did not make revisions to the entire *Standards*.

The PRB appreciates the joint cooperation of peer reviewers and the administering entities incorporating these revisions into the peer review process as soon as possible. Administering

entities may request peer reviewers to revise peer review reports and/or letters of comments for these matters but the administering entity may use their professional judgment when issues are identified for the first time. If the documents are not revised when this is identified for the first time (which may include a batch of reviews sent in by the reviewer), feedback of an educational nature should be issued to the peer reviewer. Reviewers would then be expected to issue reports and letters of comments in accordance with the revised language. Administering entities should use professional judgment if there are issues with letters of response (LOR).

A summary of the revisions include:

- The first sentence in the letter of comments for system reviews has been revised to appropriately reflect that the system of quality control was reviewed for the period in effect. Similar revisions were made to the exhibit letters of response.
- The sample signature areas for reports and letters of comments have been revised to remove examples that would be associated with CART system reviews (which no longer exist). Other revisions providing clarity to the signature area were made as well.
- Letter of response exhibits were revised to more accurately reflect what documents are being responded to such as not indicating a response to an LOC when an adverse report is issued (there are no LOCs when adverse reports are issued). Other similar revisions were made as well.
- Elimination of Interpretation 14 and incorporating it in the actual *Standards*. This relates to an engagement review and documentation required by “professional standards”, rather than only the “*Statements on Standards for Accounting and Review Services and the Statements on Standards for Attestation Engagements*”.
- On an adverse system review report, the opinion paragraph was revised by replacing “and” with “or” as highlighted here regarding the “...auditing practice not being designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA **OR** was not complied with during the year then ended...”
- Some exhibits of deficiencies in modified and adverse reports were revised to identify the industry and level of service for engagements deemed substandard.

## Revisions to the AICPA Peer Review Program Manual

In conjunction with the revisions approved to the *Standards* at its May 2006 meeting, the AICPA Peer Review Board (PRB) also approved revisions to the *AICPA Peer Review Program Manual (Manual)*. Some of the revisions to the *Manual* incorporated the revisions made to the *Standards* but also included other guidance issued by the PRB. The revisions were made to better clarify and tighten up the guidance (and correct some errors) to make the process more effective and efficient from what we have learned after the first year the most recent *Standards* have been effective. The following sections of the *Manual* are being revised:

3300	4100	7100
3400	4200	7200
3500	6100	7400
3600	6200	
3900	6400	

## New Statements on Auditing Standards

The AICPA's Auditing Standards Board (ASB) has issued the following nine Statements on Auditing Standards (SAS):

- SAS No. 103, Audit Documentation, supersedes SAS 96
- 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.

These Statements will be effective for audits of financial statements for periods beginning on or after December 15, 2006. However, early adoption is permitted. For more information on these Standards see:

SAS 103:

[http://www.aicpa.org/download/members/div/auditstd/riasai/Aud\\_Doc\\_SummaryLG.pdf](http://www.aicpa.org/download/members/div/auditstd/riasai/Aud_Doc_SummaryLG.pdf)

SAS 104-111

[http://www.aicpa.org/download/members/div/auditstd/riasai/RAS\\_Summary\\_for\\_Website.pdf](http://www.aicpa.org/download/members/div/auditstd/riasai/RAS_Summary_for_Website.pdf)

## 2006 Engagement Checklists

The 2006 Engagement Checklists have been posted to the AICPA Peer Review Program Website located in the 2006 Team Captain Packages. A checklist for Personal Financial Statement engagements is now included. The following links can be used to directly access the System Review and Engagement/Report Review checklists:

[System Review Team Captain Materials](#)

### ENGAGEMENT/REPORT REVIEW REVIEWER PACKAGE

In addition to updating the checklists, there were changes made to the following:

Staff Interview Questionnaire	4700
Managing Partner/Chief Executive Officer Interview (new section)	4750
Summary Review Memorandum – AICPA and CPCAF Peer Review Programs	4800
Team Captain Checklist	4900
Instructions for Use of Matter for Further Consideration Forms – System Reviews	4950

The update to the AICPA Peer Review Program Manual will be delivered early June.

## Two – Hour Conference Call

There will be a two-hour conference call on July 11 from 1:00 -3:00 PM EDT. The call will address the following:

- Important issues in Oversight
- Top concerns of technical reviewers
- Current issues being addressed by the AICPA Peer Review Board
- An interactive question and answer session

Committee chairs, technical reviewers, peer reviewers and administrators are encouraged to participate in the call. Further details will follow via email. Peer reviewers should update their email address to ensure receipt of the details. If you would like to pre-register for the conference call, please use the following link:

<http://wcc.webeventservices.com/view/wl/r.htm?e=24649&s=1&k=C0D70E7FCE71804C46343E540517B0BF&cb=genesys>

### *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.

### **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.