

**AICPA**

**PEER REVIEWER'S ALERT 04-02**

# PEER REVIEWER'S ALERT 04-02

## TABLE OF CONTENTS

	<i>Page</i>
Professional Ethics Executive Committee Defers Effective Date of New Documentation Requirement under Interpretation 101-3 – <i>Nonattest Services</i>	1
GAO Amends Paragraph 46 of the <i>Interpretation of Continuing Education and Training Requirements</i>	1
Extensions under GAO Auditing Standards	3
Comparison of AICPA and GAO Rules of Independence for Nonattest Services	4
Issues Related to Audits of Non-Issuers	4
Guidance on Writing an Effective Letter of Response	5
Annual AICPA Peer Review Conference	6
Employee Benefit Plan Audit Quality Center	6
Updated Peer Review Manual and Team Captain Packages	7

## **Professional Ethics Executive Committee Defers Effective Date of New Documentation Requirement under Interpretation 101-3 – *Nonattest Services***

In order to provide members with additional time to update their firm policies and procedures and further educate firm personnel, the Professional Ethics Executive Committee (PEEC) has deferred until December 31, 2004 the effective date of the new requirement to *document in writing* the understanding established with the client in accordance with General Requirement No. 3 under Interpretation 101-3 – *Nonattest Services*. General Requirement No. 3 also contains a requirement to *establish an understanding* with the client regarding all nonattest services, which is not new and remains in effect. The documentation requirement will apply to all nonattest services (e.g., bookkeeping, tax, consulting, internal audit services, etc.) performed for an attest client after December 31, 2004, (i.e., nonattest engagements in process at or commencing after December 31, 2004). All other requirements of Interpretation 101-3 remain effective December 31, 2003 subject to the transition provisions as provided for in the Interpretation. Interpretation 101-3 can be found at: <http://www.aicpa.org/members/div/ethics/ruling.htm>.

## **GAO Amends Paragraph 46 of the *Interpretation of Continuing Education and Training Requirements***

The U.S. General Accounting Office (GAO) has rescinded portions of par. 46 of the [Interpretation of Continuing Education and Training Requirements \(April 1991\)](#) and issued revised guidance to replace this paragraph. Effective immediately, GAO has deleted inclusion of taxation in the listing of subjects and topics that would always satisfy the 80 hour requirement. GAO is also **rescinding** the following section of par. 46:

"...instruction in subjects and topics that meet the CPE requirements of licensing bodies (such as state boards of accountancy) or professional organizations (such as the American Institute of Certified Public Accountants (AICPA) or the Institute of Internal Auditors) would also satisfy the 80-hour CPE requirement."

Par. 3.45 of the 2003 revision of *Government Auditing Standards* (GAGAS), states that auditors planning, directing, performing field work, or reporting on an audit or attestation engagement under GAGAS, needs to maintain their professional competence through continuing professional education (CPE). As further discussed in Par. 3.45, each auditor performing work under GAGAS should complete, every 2 years, at least 80 hours of CPE that **directly enhance the auditor's professional proficiency to perform audits and/or attestation engagements**.

In some cases, auditors must apply professional judgment in determining whether training qualifies under GAGAS. For example, tax services, in general, are not related to the subject matter of audits performed under GAGAS, and, accordingly CPE related to tax would not normally qualify as CPE for purposes of satisfying GAGAS requirements. However, if taxation

relates to an objective of an audit conducted under GAGAS, certain training in taxation could possibly qualify as CPE under Yellow Book. For example, auditors employed by the federal Internal Revenue Service or state and local government employees who audit tax revenues may be able to claim GAGAS CPE credits for courses in taxation. Likewise, auditors auditing the financial statements of not-for-profit organizations under GAGAS might also be able to claim GAGAS CPE if knowledge of the relevant tax requirements is an important financial reporting objective that influences reporting for purposes of the financial statements. In such cases, the audit organization should clearly document the rationale for including such training as part of the GAGAS CPE requirement.

In addition to GAGAS CPE requirements, many state licensing bodies and/or professional organizations have also established CPE requirements for auditors. Although many of the training courses auditors take may be used to satisfy various requirements, in some cases certain training may qualify as CPE under one set of requirements but may not qualify as CPE under another. For example, training in public administration or legislative matters may qualify as GAGAS CPE but might not necessarily qualify under requirements established by a licensing body or certain professional organizations. In addition, certain tax training that would qualify as CPE training for state licensing would not qualify as CPE under the 2003 Yellow Book if it does not directly enhance the auditor's professional proficiency to perform audits and /or attestation engagements under GAGAS.

The requirements of the 2003 Yellow Book became effective for financial audits and attestation engagements of periods ending on or after January 1, 2004, and for performance audits beginning on or after January 1, 2004. As such, auditors need to consider this change in the CPE requirements when considering compliance with the GAGAS CPE requirements beginning in 2004.

For example, if an audit organization's 2-year period for CPE compliance was for calendar year 2003-2004, CPE taken in taxation during 2003 would generally count for GAGAS CPE requirements because the 1994 requirements were in effect during 2003. In 2004, if the audit organization is in the second year of the 2-year CPE cycle, auditors would use the new requirements for 2004 and apply the new requirements to the remaining number of CPE hours needed in 2004 to comply with the 80 hour requirement. Generally under these rules, course work in taxation will not count towards during 2004.

GAO is in the process of revising the *Interpretation of Continuing Education and Training Requirements* (April 1991) to reflect the current CPE requirements of the 2003 Yellow Book.

Beginning in 2004, reviewers still need to inquire if the courses taken satisfy the requirement that at least 24 of the 80 hours of CPE are in subjects directly related to government auditing, the government environment, or the unique or specific environment in which the audited entity operates, and the reviewer needs to determine if the overall 80 hours of CPE meet the above amended GAO requirements. The reviewer should inquire about the firm's cycle for GAO CPE to determine if the amended requirements affect the firm. For example, if a firm's two year cycle ends on December 31, 2003, the amended requirements would have not affect. Depending on the timing of the peer review, if the firm's two year cycle ends on December 31, 2004, the

reviewer should ensure the firm is aware of the new requirement and have taken steps to make certain they will meet the new requirements by the end of the cycle.

For individuals that do not meet the new GAO CPE requirements, 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.

If a reviewer concludes that required personnel lack or do not have appropriate governmental CPE, the reviewer should ensure that the CPE deficiencies noted on the MFCs provide enough detail so that committees can determine whether the findings are appropriate. For example, a training course in public administration may not meet state board of accountancy requirements; however, it does meet the GAO CPE requirement. The reviewer can assist the committee in verifying the reviewer's conclusion by providing detailed information on the MFC about the specific courses not meeting the requirements.

When a firm conducted a governmental audit and 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.

When the firm performed governmental engagements and the required personnel did not complete the CPE required by Government Auditing Standards, the engagements should be classified as not conforming to professional standards for purposes of the AICPA Peer Review Program.

### **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.

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

Peer reviewers and technical reviewers need to be aware of the differences in the independence rules for performing nonattest services between the AICPA and the GAO. The AICPA has posted on its website a comparison chart which compares the AICPA rules of independence as they compare 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.

### **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.

The AICPA will be issuing additional guidance in the near future. 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>.

## **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.

## **Annual AICPA Peer Review Conference**

The annual AICPA Peer Review Conference for 2004 will take place on August 2<sup>nd</sup> and 3<sup>rd</sup>. It will be held in San Diego, California at the Wyndham Emerald Plaza. The conference will include highlights of the revised AICPA Peer Review Program Standards and Interpretations, an update on the Center for Public Company Audit Firms Peer Review Program, and how the new documentation requirement of Interpretation 101-3 – Nonattest Services affects peer review. It will also include mock case sessions that include up-to-date topics such as implementation of the revised standards and interpretations, and peer review considerations regarding independence, licensure, and GAO requirements.

The Peer Review conference meets the requirements for mandatory continuing professional education in peer review training required every three years.

For more information on the conference or to register, visit [2004 Peer Review conference](#).

## **Employee Benefit Plan Audit Quality Center**

In its commitment to helping its members achieve the highest standards in performing quality employee benefit plan audits, the AICPA has launched the Employee Benefit Plan Audit Quality Center. The purpose of the Employee Benefit Plan Audit Quality Center is to promote the quality of employee benefit plan audits. This is a voluntary membership for firms that audit employee benefit plans.

One of the eligibility requirements is to make publicly available information about its most recently accepted peer review. Member firms are required to make publicly available the following information, if applicable, relative to the firm's peer review:

- Peer review report
- Letter of comment, if applicable
- Letter of response, if applicable
- Letter signed by the reviewed firm indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions, if applicable
- Letter notifying the firm that certain required actions have been completed, if applicable, and,
- Letter notifying the firm that the peer review has been accepted.

To join or obtain additional information about the Employee Benefit Plan Audit Quality Center, visit the AICPA website at: [Employee Benefit Plan Audit Quality Center](#).

## Updated Peer Review Manual and Team Captain Packages

In early May 2004, update Number 19 to the *AICPA Peer Review Program Manual (Manual)* was mailed to all subscribers. The updated engagement checklists and other forms which comprise the team captain/reviewer packages contained in the *Manual* are also posted on the AICPA Peer Review Program website. With regard to the packages posted on the website, certain checklists require some formatting modifications. The Peer Review Board not wish to delay the posting and will make the necessary changes in the coming weeks.

To access the team captain/reviewer packages, go to:

<http://www.aicpa.org/members/div/practmon/2004peermaterials.asp>

Due to significant revisions to the Governmental Audit Engagement Checklist, (Section 20,500) and Supplemental Checklist for Review of A-133 Single Audit Act Engagements (Section 22,020), these checklists will be issued shortly in a separate Update to the *Manual* and also posted on the website. If you have scheduled a review and will be performing the review within the next few weeks, before the revised checklists are posted to the website, you can continue to use last year's checklists until release of notification of posting of the revised checklists to the website. Once posted, use of last year's checklists should be discontinued.

As of May 10, 2004, use of any other checklist(s) versions prior to Update Number 19 should be discontinued.

In performing peer reviews, review teams and reviewers must complete all relevant programs and checklists issued by the AICPA Peer Review Board in a professional manner (which includes using checklists updated to encompass the most recent professional standards). Failure to do so may create a presumption that the review has not been performed in conformity with the Standards governing the program.

The team captain/reviewer packages posted on the website are in "*WORD*" template format and can be downloaded for completion on your computer.

If you have any questions, please send an e-mail to us at [peerev@aicpa.org](mailto:peerev@aicpa.org) or call us at (201) 938-3030.