



Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice

**For Small- and
Medium-Sized Firms**



Quality control standards task force (2016)

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Prepared by the Quality Control Standards Task Force of the American Institute of Certified Public Accountants

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Notice to readers

This AICPA Audit and Accounting Practice Aid updates *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which was issued in 2011. Although this practice aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

This practice aid does not address the quality control requirements of the Sarbanes-Oxley Act of 2002 (SOX), nor does it address the quality control requirements of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary. Auditors of non-issuers who are engaged to report on audit engagements in accordance with PCAOB auditing standards also must report on those engagements in accordance with generally accepted auditing standards (GAAS). AU-C section 700, *Forming an Opinion and Reporting on Financial Statements (AICPA, Professional Standards)*, as amended, provides reporting guidance for audits of non-issuers when the auditor is asked to report in accordance with GAAS and PCAOB auditing standards.

Additional information about the PCAOB and SOX can be obtained at the PCAOB website at pcaobus.org

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Overview: Read this first!

This AICPA Audit and Accounting Practice Aid *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* is intended to help practitioners better develop the policies and procedures that comprise a firm's system of quality control, as required by QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*).

A firm's system of quality control consists of *policies* designed to achieve the objectives of the system, and the *procedures* necessary to implement and monitor compliance with those policies. As with other internal controls (for example, an entity's controls over financial reporting), they should be designed to provide reasonable assurance that the objectives will be achieved.

This practice aid includes illustrative policies and procedures for a small or medium-size firm, along with guidance on designing and maintaining a system of quality control. In addition, this practice aid includes an overview of QC section 10 as well as QC section 10.

This version of the practice aid prepared by the Quality Control Standards Task Force has been revised to

- ▶ make the illustrative policies and procedures more easily customizable for practitioners using this practice aid and
- ▶ include tips, warnings and reminders to help practitioners better implement the policies and procedures.

How this practice aid will help you

Peer Review will assess the design of your firm's system of quality control and compliance with that system. If your firm's system of QC has deficiencies, your firm may not be meeting professional standards. Agree with the standards or not, the practitioners in your firm have an obligation to comply with them or your firm will have to take remedial actions and be monitored by Peer Review. If your firm's system of quality control is bad enough, you risk losing your license. Firms that struggle with engagement quality and have been referred to the AICPA Professional Ethics Division or disciplined by regulators have been shown to have substandard systems of quality control. This document is intended to help your firm design a system of quality control that meets the requirements of the quality control standards and is tailored to the facts and circumstances of your practice. It also contains helpful guidance on implementing the policies and procedures that compose your firm's system.

How to use this practice aid

The AICPA encourages you to use this practice in developing and documenting your system of quality control and, as such, we grant permission to copy and incorporate portions of the work as necessary. This permission is for internal use only, except for educational purposes. The materials or any portion thereof may not be incorporated into a for-sale work or otherwise distributed without separate written permission from the AICPA.

Make this document your firm's own by tailoring the illustrative policies and procedures as necessary for the facts and circumstances of your practice. Not all of these policies and procedures may be applicable to your firm. Likewise, you may wish to add policies and procedures that your firm has implemented as part of its QC system. Note that the notation "paragraph .XX of QC section 10" refers to the requirement paragraph relevant to that policy. Some of the policies and procedures presented in this practice aid are not specified in QC section 10; however, they represent the views of the task force regarding best practice for meeting the requirements for a quality control system.

In addition to the illustrative policies and procedures, this practice aid includes tips, warnings, and notes to help your firm implement and monitor the policies and procedures. These include references to resources offered by the AICPA at no charge to assist practitioners in enhancing engagement quality and improving efficiency. The task force developed these tips, warnings, and notes based on years of experience as peer reviewers and partners responsible for their firms' system of quality control. They provide insightful and practical advice.

Chapter 1: overview of statements on quality control standards

The objectives of a system of quality control are to provide a CPA firm with reasonable assurance¹ that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control* (Redrafted), (AICPA, *Professional Standards*, QC sec. 10), was issued by the Auditing Standards Board of the AICPA in November 2010 and has been effective for a firm's accounting and auditing practice since January 1, 2012. This standard supersedes SQCS No. 7, *A Firm's System of Quality Control*.

A system of quality control consists of policies designed to achieve the objectives of the system, and the procedures necessary to implement and monitor compliance with those policies. The nature, extent, and formality of a firm's quality control policies and procedures will depend on various factors, such as the firm's size, the number and operating characteristics of its offices, the degree of authority allowed its personnel, the knowledge and experience of its personnel, and the nature and complexity of the firm's practice.

Communication of quality control policies and procedures

The firm should communicate its quality control policies and procedures to its personnel. Most firms will find it appropriate to communicate their policies and procedures in writing and distribute them—or make them available electronically—to all professional personnel. Effective communication includes the following:

- ▶ A description of quality control policies and procedures and the objectives they are designed to achieve
- ▶ The message that each individual has a personal responsibility for quality
- ▶ A requirement for each individual to be familiar with and to comply with these policies and procedures

Effective communication also includes procedures for personnel to communicate their views or concerns on quality control matters to the firm's management.

¹ The term *reasonable assurance*, which is defined as a high, but not absolute, level of assurance, is used because absolute assurance cannot be attained. QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), states, "Any system of quality control has inherent limitations that can reduce its effectiveness."

Elements of a system of quality control

A firm must establish and maintain a system of quality control. The firm's system of quality control should include policies and procedures that address each of the following elements of quality control identified in QC section 10:

- ▶ Leadership responsibilities for quality within the firm (the "tone at the top")
- ▶ Relevant ethical requirements
- ▶ Acceptance and continuance of client relationships and specific engagements
- ▶ Human resources
- ▶ Engagement performance
- ▶ Monitoring

The elements of quality control are interrelated. For example, a firm continually assesses client relationships to comply with relevant ethical requirements—including independence, integrity, and objectivity—and policies and procedures related to the acceptance and continuance of client relationships and specific engagements. Similarly, the human resources element of quality control encompasses criteria related to professional development, hiring, advancement, and assignment of firm personnel to engagements, all of which affect policies and procedures related to engagement performance. In addition, policies and procedures related to the monitoring element of quality control enable a firm to evaluate whether its policies and procedures for each of the other five elements of quality control are suitably designed and effectively applied.

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control, as a whole, may still be effective in providing the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances.

If a firm merges, acquires, sells, or otherwise changes a portion of its practice, the surviving firm evaluates and, as necessary, revises, implements, and maintains firm-wide quality control policies and procedures that are appropriate for the changed circumstances.

Leadership responsibilities for quality within the firm (the “tone at the top”)

The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. The firm should establish and maintain the following policies and procedures to achieve this purpose:

- ▶ Require the firm’s leadership (managing partner or board of managing partners, chief executive officer, or equivalent) to assume ultimate responsibility for the firm’s system of quality control.
- ▶ Provide the firm with reasonable assurance that personnel assigned operational responsibility for the firm’s quality control system have sufficient and appropriate experience and ability to identify and understand quality control issues and develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.

Establishing and maintaining the following policies and procedures assists firms in recognizing that the firm’s business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs:

- ▶ Assign management responsibilities so that commercial considerations do not override the quality of the work performed.
- ▶ Design policies and procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel, to demonstrate the firm’s overarching commitment to the objectives of the system of quality control.
- ▶ Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

Relevant ethical requirements

The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- ▶ Require that personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office (GAO), and any other applicable regulators.

- ▶ Establish procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.
- ▶ Establish procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.
- ▶ Require that the firm withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.
- ▶ Require written confirmation, at least annually, of compliance with the firm's policies and procedures on independence from all firm personnel required to be independent by relevant requirements.
- ▶ Establish procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of the engagement. This would apply to national firm personnel, foreign firm personnel, and foreign-associated firms.²
- ▶ Require the rotation of personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period.

Acceptance and continuance of client relationships and specific engagements

The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- ▶ is competent to perform the engagement and has the capabilities, including the time and resources, to do so;
- ▶ can comply with legal and relevant ethical requirements;
- ▶ has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity; and
- ▶ has reached an understanding with the client regarding the services to be performed.

² A foreign-associated firm is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.

This assurance should be obtained before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- ▶ Evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances.³
- ▶ Evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.
- ▶ Obtain an understanding, preferably in writing, with the client regarding the services to be performed.
- ▶ Establish procedures on continuing an engagement and the client relationship, including procedures for dealing with information that would have caused the firm to decline an engagement if the information had been available earlier.
- ▶ Require documentation of how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.

Human resources

The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm to issue reports that are appropriate in the circumstances. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- ▶ Recruit and hire personnel of integrity who possess the characteristics that enable them to perform competently.
- ▶ Determine capabilities and competencies required for an engagement, especially for the engagement partner, based on the characteristics of the particular client, industry, and kind of service being performed. Specific competencies necessary for an engagement partner are discussed in paragraph .A27 of QC section 10.
- ▶ Determine the capabilities and competencies possessed by personnel.

³ Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.

- ▶ Assign the responsibility for each engagement to an engagement partner.
- ▶ Assign personnel based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.
- ▶ Have personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable continuing professional education requirements of the AICPA, state boards of accountancy, and other regulators.
- ▶ Select for advancement only those individuals who have the qualifications necessary to fulfill the responsibilities they will be called on to assume.

Engagement performance

The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed.

Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the engagement performance element of quality control:

- ▶ Plan all engagements to meet professional, regulatory, and the firm's requirements.
- ▶ Perform work and issue reports and other communications that meet professional, regulatory, and the firm's requirements.
- ▶ Require that work performed by other team members is reviewed by qualified engagement team members, which may include the engagement partner, on a timely basis.
- ▶ Require the engagement team to complete the assembly of final engagement files on a timely basis.
- ▶ Establish procedures to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.
- ▶ Require the retention of engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.

- ▶ Require that
 - consultation take place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
 - sufficient and appropriate resources are available to enable appropriate consultation to take place;
 - all the relevant facts known to the engagement team are provided to those consulted;
 - the nature, scope and conclusions of such consultations are documented; and
 - the conclusions resulting from such consultations are implemented.
- ▶ Require that
 - differences of opinion be dealt with and resolved;
 - conclusions reached are documented and implemented; and
 - the report not be released until the matter is resolved.
- ▶ Require that
 - all engagements be evaluated against the criteria for determining whether an engagement quality control review should be performed;
 - an engagement quality control review be performed for all engagements that meet the criteria; and
 - the review be completed before the report is released.
- ▶ Establish procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.
- ▶ Establish criteria for the eligibility of engagement quality control reviewers.

Monitoring

The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- ▶ Adherence to professional standards and regulatory and legal requirements.
- ▶ Whether the quality control system has been appropriately designed and effectively implemented.
- ▶ Whether the firm's quality control policies and procedures have been operating effectively, so that reports issued by the firm are appropriate in the circumstances.

Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the monitoring element of quality control:

- ▶ Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.
- ▶ Assign performance of the monitoring process to competent individuals.
- ▶ Require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures. Monitoring procedures consist of the following:
 - Review of selected administrative and personnel records pertaining to the quality control elements
 - Review of engagement working papers, reports, and clients' financial statements
 - Discussions with the firm's personnel
 - Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate that improvements are needed
 - Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures
 - Communication of the identified findings to appropriate firm management personnel
 - Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis

- Assessment of
 - the appropriateness of the firm’s guidance materials and any practice aids;
 - new developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm’s policies and procedures where appropriate;
 - compliance with policies and procedures on independence;
 - the effectiveness of continuing professional development, including training;
 - decisions related to acceptance and continuance of client relationships and specific engagements; and
 - firm personnel’s understanding of the firm’s quality control policies and procedures, and implementation thereof.
- ▶ Communicate, at least annually, to relevant engagement partners and other appropriate personnel, any deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.
- ▶ Communicate the results of the monitoring of its quality control system process to relevant firm personnel at least annually.
- ▶ Establish procedures designed to provide the firm with reasonable assurance that it deals appropriately with complaints and allegations, as listed here. This includes establishing clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisal and documenting complaints and allegations and the responses to them:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm’s system of quality control
 - Deficiencies in the design or operation of the firm’s quality control policies and procedures, or noncompliance with the firm’s system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations
- ▶ Require appropriate documentation to provide evidence of the operation of each element of its system of quality control. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following, for example:
 - The size of the firm and the number of offices
 - The nature and complexity of the firm’s practice and organization

- ▶ Require retention of documentation providing evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

Some of the monitoring procedures discussed in the previous list may be accomplished through the performance of the following:

- ▶ Engagement quality control review
- ▶ Post-issuance review of engagement working papers, reports, and clients' financial statements for selected engagements
- ▶ Inspection⁴ procedures

Documentation of quality control policies and procedures

The firm should document each element of its system of quality control. The extent of the documentation will depend on the size, structure, and nature of the firm's practice. Documentation may be as simple as a checklist of the firm's policies and procedures or as extensive as practice manuals.

Applying the quality control standards

The policies and procedures described in chapter 2 are those that a firm with two or more personnel may consider establishing and maintaining. The policies and procedures actually used need not necessarily include nor be limited to all those illustrated.

⁴ Inspection is a retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Although monitoring procedures are meant to be ongoing, they may include inspection procedures performed at a fixed point in time. Monitoring is a broad concept; inspection is one specific type of monitoring procedure.

Chapter 2: quality control policies and procedures

Leadership Responsibilities for Quality Within the Firm (the “Tone at the Top”)

The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing an engagement.

Warning! The firm’s commitment to quality is the cornerstone of a system of quality control. The actions and messages of the firm’s leadership set a tone; if that tone does not reflect a commitment to quality, it is not likely that the firm’s system of quality control will be effective.

Tip! An action plan for tone at the top can be found at aicpa.org/pcps/quality

Policy 1: The firm documents its QC policies and procedures and communicates them to the firm’s personnel. (See paragraph .18 of QC section 10.)

The QC partner is responsible for documenting the firm’s QC policies and procedures and keeping that documentation up-to-date (reviewing at least annually).

New hires are required to acknowledge receipt of the firm’s QC document in writing, and that they have been informed that failure to adhere to the firm’s policies and procedures or failure to demonstrate commitment to ethical principles may result in disciplinary action.

At least annually, firm personnel receive training on the firm’s QC policies and procedures, and acknowledge receipt of the QC document. This training is provided through [*select as appropriate*: an informal discussion; an in-house training session; in-house training sessions with a web-based or video-based discussion of QC] to ensure all personnel hear the message the same way.

Tip! You can find a template for training professionals [here](#).

Training on the firm’s QC policies and procedures includes the following:

- ▶ A review of changes during the year
- ▶ A “refresh” of the understanding of experienced employees and partners
- ▶ A discussion of the “why” behind policies and procedures. Those responsible for QC matters are always prepared to demonstrate, explain, or make the case for why a requirement is in place (that is, what benefit it serves).
- ▶ “Tests” on the QC document to determine which part of the policy is misunderstood or not well-known

Note! Consider your firm’s risk in determining which of these procedures to adopt.

Policy 2: The firm’s policy is to promote an internal culture that recognizes that quality is essential in performing engagements. (See paragraph .19 of QC section 10.)

Leadership Responsibilities for Quality Within the Firm (the “Tone at the Top”)

The firm promotes an internal culture that recognizes quality is essential through *[describe the firm’s specific action. For example, a mission statement that includes the firm’s core values and the importance of quality; frequent messages to personnel about the importance of quality and that it is not sacrificed to the need to achieve profitability; the status of the QC partner within the firm (that is, the QC function is not relegated to an administrative role); the QC partner reports directly to the owners; and quality is considered in performance appraisals and compensation.]*

Tip! Culture is evidenced anecdotally. The most meaningful document that conveys a firm’s culture is not its mission statement, but rather its budget. Budgeting enough time is critical to achieving quality in performing engagements.

Tip! Messages can be as informal as emails, or “reminders” at staff meetings.

Policy 3: The firm’s leadership assumes ultimate responsibility for the firm’s system of quality control. (See paragraph .19 of QC section 10.)

The managing partner, *[Name]*, accepts ultimate responsibility for the firm’s system of quality control and for setting a tone that emphasizes the importance of quality and of following the firm’s system of quality control.

Note! The managing partner has the ultimate responsibility and that responsibility remains, even if a different person is the QC partner. The person in charge of the accounting and auditing practice, if different, is also responsible for setting the proper tone at the top.

The managing partner acknowledges this responsibility, and the importance of quality, through *[a written]* communication to firm personnel at least once a year.

Policy 4: The firm does not allow commercial considerations to override the quality of the work performed, and assigns management responsibilities accordingly.

The managing partner and each engagement partner evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control.

Note! Tight deadlines, scope creep and incentive-based compensation are examples of matters that may result in overrides to the objectives of the system of quality control.

The firm emphasizes to all personnel that fee considerations and scope of services should not infringe upon quality work.

Note! What happens in your firm if the engagement team goes significantly over budget for the engagement? Is there explicit or implicit pressure on personnel to skip planned procedures due to time constraints?

Leadership Responsibilities for Quality Within the Firm (the “Tone at the Top”)

The firm considers the costs associated with a strong system of quality control, such as the costs of maintaining necessary competency, practice aids, and professional subscriptions, hiring consultants and engagement quality control reviewers, as an investment and factors them in when determining rates and fees so that commercial considerations will not override the quality of work performed.

Policy 5: Personnel with sufficient and appropriate experience, authority and ability are assigned responsibility for developing, implementing and operating the firm’s quality control system. (See paragraph .20 of QC section 10.)

[Name of partner or director] is designated as the QC partner and has overall responsibility for developing and implementing appropriate policies and procedures for the firm’s quality control system.

Note! As your firm grows or develops specializations, the firm may need to designate additional partners with QC responsibility.

The firm’s QC partner has the following characteristics:

- ▶ Sufficient and appropriate experience and competency to serve in that capacity
- ▶ Up-to-date industry-specific CPE credits in any high-risk areas he or she reviews

Note! “Up-to-date” means within the past 24 months — or more recent if there have been new professional standards or changes in regulations.

Policy 6: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

The firm provides the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm’s quality control policies and procedures.

Note! Is this time budgeted?

The firm obtains feedback from personnel, such as the method for personnel to propose new or revised policies and procedures.

Tip! This can be as informal as sending a request to all firm personnel when updating the firm’s policies and procedure asking for input; or as formal as utilizing an independent third-party provider to facilitate the communication by personnel (anonymously, if desired).

Policy 7: Performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel demonstrate the firm’s overarching commitment to the objectives of the system of quality control.

Performance evaluation and advancement systems are designed and implemented that reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards.

Warning! You may talk the talk, but if compensation is based primarily on concepts like realization, “eat what you kill,” and coming in under budget, you aren’t walking the walk.

Leadership Responsibilities for Quality Within the Firm (the “Tone at the Top”)

The firm’s compensation system provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:

- ▶ Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed
- ▶ Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with firm experts

Note! Quality is both expected and rewarded.

Relevant ethical requirements

The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity.

Policy 1: The firm and its personnel comply with relevant ethical requirements. (See paragraph .21 of QC section 10.)

Tip! Relevant ethical requirements are those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the GAO (U.S. Government Accountability Office), and any other applicable regulators.

A partner [name] is responsible for staying informed on relevant ethical requirements; providing guidance; answering questions; monitoring compliance; and resolving matters with respect to independence, integrity, and objectivity.

Tip! You can reach the AICPA's Ethics Hotline at 888.777.7077 or ethics@aicpa.org. You can find the AICPA Ethics Tools and Aids, including the Plain English Guide to Independence, at aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/Pages/default.aspx

All personnel have access to current guidance materials regarding the applicable independence, integrity, and objectivity requirements through [identify how, for example through subscription service or via the AICPA's website].

Documentation of the resolution of ethical matters is required when consultation, including of professional literature, has occurred.

When providing nonattest services (such as bookkeeping, financial statement preparation, and tax services) to clients for whom the firm also performs an audit, review, compilation, or attestation engagement, the firm, its personnel, and when applicable, others subject to independence requirements, meet all the requirements of the "Nonattest Services" subtopic of the AICPA Code of Professional Conduct, (AICPA, *Professional Standards, ET sec. 1.295*) [aicpa.org/codeofconduct] and the requirements of other regulators as applicable.

Warning! Peer reviewers will ask for documentation of compliance, including documentation that the client has suitable skills, knowledge, and experience to accept responsibility.

The firm has established and follows a process for identifying all services performed for each client and evaluating, at the attest engagement level, whether non-attest services are provided that might impair independence. [Describe the process.]

Warning! As firms get larger, it may be more difficult to track what services are being performed for every client in order to determine that independence is not being impaired.

Relevant ethical requirements

The firm maintains a current list of

- ▶ all entities with which firm personnel are prohibited from having a financial or business relationship and
- ▶ all activities that the firm is prohibited from performing, as defined in the firm's independence policies.

Note! Examples of prohibited activities include providing certain valuation and information technology services to an audit client. See the rules of specific standard-setters to determine the extent and relevance of any prohibition.

The firm has clear and concise written independence guidance covering relationships and activities that impair independence, including but not limited to investments, loans, brokerage accounts, business relationships, employment relationships, and fee arrangements.

Policy 2: The firm communicates its independence requirements to firm personnel and, when applicable, others subject to them. (See paragraph .22a of QC section 10.)

The firm provides its personnel with a list of all entities with which firm personnel are prohibited from having a business relationship and informs them on a timely basis as to any changes in the firm's clients to which independence policies apply.

Warning! Your firm's system may need to take the existence of related entities into account.

The firm reminds personnel of independence considerations for regulated industries.

Warning! Regulators often have more restrictive independence requirements. For example, many regulators prohibit the CPA's involvement in the preparation of financial statements and define "preparation" very broadly. Know your industry.

The firm provides reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity, as necessary and at least annually.

The firm informs its personnel of the types of financial or other relationships that may impair independence and that may be prohibited.

The firm requires professional personnel to take independence and ethics training [*specify period, such as annually*]. Such training covers the firm's independence and ethics policies and the independence and ethics requirements of all applicable regulators.

Warning! The state-specific ethics course required by many states for licensure may not be sufficient for the needs of your practice and your firm may have to supplement that.

Relevant ethical requirements

Policy 3: The firm evaluates threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time. The firm takes appropriate action to eliminate them or reduce them to an acceptable level by applying safeguards. (See paragraph .22b of QC section 10.)

Approval of the assignment of engagement personnel by another partner or manager is required for each audit or attestation examination.

New personnel assigned to the engagement are encouraged to bring a fresh perspective.

Warning! The procedure is effective only when the engagement partner has the appropriate attitude.

A partner who is not otherwise associated with the engagement reviews the engagement.

The firm (the managing partner, QC partner, and others as appropriate) considers the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.

When a relationship or circumstance that may create threats to compliance with the rules is identified, the firm performs procedures to evaluate threats and apply safeguards [using the Conceptual Framework Toolkit for Members in Public Practice].

Tip! You can find the Conceptual Framework Toolkit for Members in Public Practice free of charge at competency.aicpa.org/media-resources/208443-conceptual-framework-toolkit-for-members-in-public

The engagement partner [considers or provides the firm with] relevant information about client engagements, including the scope of services and any changes, such as new engagements or changes in the level of service, to enable [the engagement partner or the firm] to evaluate the overall impact, if any, on independence requirements. (See paragraph .23a of QC section 10.)

The firm requires personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken. (See paragraph .23b of QC section 10.)

Relevant ethical requirements

The firm compiles and communicates relevant information to appropriate personnel so that (a) the firm and its personnel can readily determine whether the firm and its personnel satisfy independence requirements; (b) the firm can maintain and update information relating to independence, and (c) the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level. (See paragraph .23c of QC section 10.)

The firm requires personnel to consult with individuals outside the firm on independence, integrity, or objectivity concerns that research has not clearly resolved.

Warning! Make sure personnel are not afraid to ask; if they ask only when they are sure there is a problem, problems may be getting overlooked. Not wanting to know the answer to an independence question is a good indication that consultation is needed. The AICPA's Ethics Hotline can be reached at 888.777.7077 or ethics@aicpa.org; GAO's Yellow Book Technical Assistance can be reached at 202.512.9535 or yellowbook@gao.gov.

Policy 4: Personnel notify the firm of breaches of independence requirements and the firm takes appropriate actions to resolve such situations. (See paragraph .24 of QC section 10.)

All professional personnel are required to notify [specify who in the firm—for example, the managing partner of the office] of any potential activities involving themselves, their spouses, or their dependents that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship. (See paragraph .24a of QC section 10.)

The firm has a process that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy.

Note! This process can be as informal as a suggestion box or as formal as a whistleblower program.

The firm's policy and procedures manual sets forth the consequences for professional personnel who violate the firm's independence policies and procedures, including engaging in activities with entities with which firm personnel are prohibited from having a business relationship.

Relevant ethical requirements

The firm determines the need for safeguards for engagements when the familiarity threat exists on an audit, review or attestation engagement.

Tip! A familiarity threat may exist when, for example, you have performed the engagement for the entity for an extended period of time, such as five years or more. The safeguard may be having an engagement quality control review (EQCR) or inspection performed periodically by someone not otherwise involved with the engagement.

The firm promptly communicates identified breaches of these policies and procedures, and the required corrective actions, to (a) the engagement partner who, with the firm, needs to address the breach and (b) other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action. (See paragraph .24b of QC section 10.)

The engagement partner and other relevant personnel confirm to the firm that the required corrective actions have been taken (See paragraph .24c of QC section 10.)

Appropriate personnel [*identify*] are responsible for periodically [*identify time period*] reviewing unpaid fees from clients to ascertain whether any outstanding amounts may impair the firm's independence, and following up with the engagement partner.

Policy 5: The firm does not accept or withdraws from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

Warning! Threats to independence may arise during the engagement; for example, when the firm is asked to perform nonattest services during the course of an attest engagement or the assessment of the client's knowledge, skills and experience changes. Evaluate threats and apply safeguards before performing the procedures; you can't reverse impaired independence.

The firm consults internally, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

Note! The client's needs may be met with a different service that doesn't require independence.

Relevant ethical requirements

The firm withdraws from the engagement when withdrawal is possible under applicable law or regulation, or does not accept the engagement, when effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

Policy 6: The firm obtains written confirmation, upon hire and at least annually thereafter, of compliance with its policies and procedures regarding independence from all personnel required to be independent by relevant requirements. (See paragraph .25 of QC section 10.)

Warning! QC section 10 requires written confirmation of independence, at least annually, by all personnel—that means partners and staff, including paraprofessionals. Failure to obtain written confirmations at least annually is a failure to comply with professional standards.

Personnel provide written representations, upon hire and on an annual basis thereafter, that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation. Personnel are required to review the most current list of all entities with which firm personnel are prohibited from having a business relationship prior to providing the written representation.

[Specify name or position, for example: The firm's quality control partner] is responsible for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions.

On each engagement, the engagement partner signs a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.

Note! This procedure necessitates that each engagement include a program step requiring sign-off for compliance with independence regulations, whether in the acceptance and continuance form or other phase of the engagement.

Policy 7: When another firm, or firm personnel in associated member firms, performs part of the engagement, the firm confirms the independence of the other firm and adherence to other relevant ethical requirements.

Written confirmations are obtained regarding the other firm's independence with respect to audit engagements and either written or oral confirmations are obtained for review or attestation engagements. Oral confirmations are documented.

The firm's policies and procedures manual or practice aids describe the form and content of independence representations, and frequency with which they are to be obtained.

Relevant ethical requirements

As a member of a network, the firm

- ▶ meets all the relevant ethical requirements and
- ▶ monitors its independence with respect to financial statement audits, reviews, and other attest engagements performed by other members of the network.

Policy 8: The firm rotates personnel for audit or attest engagements for which regulatory or other authorities require such rotation after a specified period. (See paragraph .26 of QC section 10.)

The quality control partner monitors regulatory requirements for financial institutions and other regulated entities and notifies partners of the need for rotation.

Tip! You may decide that for certain industries, rotation of partners, though not required by regulators, is appropriate for your system of QC.

Acceptance and continuance

The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client.

Warning! A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Consider both the client's integrity and reputation and your firm's expertise and ability to meet the client's needs. Both these factors can affect the firm's reputation and involvement in litigation.

Policy 1: The firm considers the risk associated with providing professional services in particular circumstances, including evaluating factors that have a bearing on management's integrity. The firm only accepts or continues engagements and client relationships when it concludes that the risk is at an acceptable level. (See paragraphs .27-.28 of QC section 10.)

Note! The risk is that (a) the firm and its personnel will fail to comply with professional standards and applicable legal and regulatory requirements, or (b) reports issued by the firm will not be appropriate in the circumstances.

The firm informs personnel of the firm's policies and procedures for accepting and continuing clients, through discussion or distribution of the firm's policies and procedures manual, and informing professional personnel that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients, including who in the firm is authorized to accept engagements on behalf of the firm. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.

The firm communicates with the predecessor auditor as required, and considers communicating with the predecessor accountant when recommended, by professional standards. This communication includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion-shopping.

Note! Communicating with the predecessor auditor is required by generally accepted auditing standards. Other professional standards may require or recommend communicating with the predecessor accountant. Best practice is to communicate, even if not required.

Acceptance and continuance

The firm obtains and evaluates relevant information before accepting or continuing any client, such as the following:

- ▶ The nature and purpose of the services to be provided and management's understanding thereof
- ▶ The identity of the client's principal owners, key management, related parties, and those charged with its governance
- ▶ The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports
- ▶ Information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge.
- ▶ Information, from discussion with the client and inquiries of others, concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards, compliance with laws and regulations, and internal control over financial reporting.

Note! This information directly relates to the risk that the firm will fail to perform and report in conformity with applicable professional standards. For smaller clients, this assessment may be quite simple. The results of this assessment are used in determining whether to accept the engagement and, if so, how the engagement is conducted.

The firm conducts a background check of the business, its officers, and the person(s) in question by using resources available on the Internet and evaluates the information obtained regarding management's integrity. An investigative firm is used when the firm is unable to obtain sufficient information about the prospective client after completing the previously listed steps, or when the firm becomes aware that there is an indication that management or someone affiliated with the prospective client may be less than reputable.

The firm evaluates the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. The firm takes appropriate safeguards, if necessary, or if safeguards cannot reduce the threat to objectivity and independence to an acceptably low level, the firm does not accept the engagement.

Acceptance and continuance

If a potential conflict of interest is identified in accepting an engagement from a new or existing client, the firm determines whether it is appropriate to accept the engagement. If issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, the firm considers whether ethical requirements included in the "Conflicts of Interest for Members in Public Practice" interpretation (AICPA, Professional Standards, ET sec. 1.110.010), apply, such as disclosure of the relationship to the client and other appropriate parties, and documents how the issues were resolved.

The firm considers the timing of the acceptance of the engagement and how that affects the firm's ability to perform all procedures necessary for the engagement (for example, inventory observation, both beginning and ending.)

Policy 2: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued. (See paragraph .27 of QC section 10.)

Warning! This policy and its related procedures are key to managing the risk that the firm will fail to perform and report in conformity with applicable professional standards.

If the engagement is for a level of service that the firm is not currently providing (for example, reviews or audits), the firm considers the implications for obtaining the necessary competency and the implications for Peer Review.

The firm defines high-risk engagements based on the characteristics of the firm. The firm considers the following criteria in determining whether the engagement is high-risk *[list criteria, such as the following]*:

Note! High-risk engagements, by their nature, require more resources.

Acceptance and continuance

- ▶ *Whether the client is in a specialized industry—that is, an industry for which there is an AICPA Audit and Accounting Guide, or the engagement is subject to governmental auditing standards—and the extent of the firm’s experience in this area.*

Warning! “You don’t know what you don’t know” when performing an engagement in a specialized industry for the first time (or maybe even the fifth). Specialized industries require an ongoing investment in training to obtain and maintain the necessary competence.

AICPA Audit and Accounting Guides for specific industries:

- ▶ Airline
- ▶ Brokers and Dealers in Securities
- ▶ Construction Contractor
- ▶ Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies
- ▶ Employee Benefit Plans
- ▶ Entities With Oil and Gas Producing Activities
- ▶ Gaming (formerly Casinos)
- ▶ Government Auditing Standards and Single Audits
- ▶ Health Care Entities
- ▶ Investment Companies
- ▶ Life and Health Insurance Entities
- ▶ Not-for-Profit Entities
- ▶ Property and Liability Insurance Entities
- ▶ State and Local Governments

Acceptance and continuance

- ▶ *New industry for the firm*
- ▶ *New or specialized accounting pronouncements apply to the client*
- ▶ *New professional standards apply to the firm relating to the engagements*
- ▶ *Engagements that require an inordinate amount of time to complete relative to the available resources of the firm*
- ▶ *Conditions such as these exist at the entity:*
 - *Aggressive earnings management*
 - *Unreliable processes for developing accounting estimates, or questionable estimates by management*
 - *Questions regarding the entity's ability to continue as a going concern*
- ▶ *The entity is in the development stage*

Warning! Accepting an engagement in a new industry requires the firm to learn that industry. Hiring experienced staff, more consultation, performing an EQCR—these may all be necessary and come at a cost

Note! Engagements like this can affect the firm's other engagements.

The firm accepts engagements that meet the firm's criteria as high-risk only when the firm has, or is willing to make, the investment to acquire the necessary competency. The firm acknowledges that accepting a high-risk engagement entails assigning more experienced staff, may necessitate the use of external resources, and requires that an EQCR be performed.

The firm evaluates whether the firm (or practice office) has, or can reasonably expect to obtain, the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.

Warning! The firm is required to have obtained the necessary knowledge and expertise before the report is issued, so as to have reasonable assurance that the firm met professional standards and that the report is appropriate. Best practice is to have that knowledge and expertise when planning the engagement, so you don't have to go back at the end and identify what you didn't know at the beginning.

The firm determines that the following are in place before accepting an engagement:

- ▶ Sufficient personnel with the necessary capabilities and competence. This includes determining that personnel have sufficient knowledge and experience for specialized industries and the firm has sufficient technical resources available to engagement personnel, including Audit and Accounting Guides, and when necessary has arranged for personnel to receive appropriate CPE and training.

Acceptance and continuance

- ▶ Whether specialists will be needed and, if so, will be available (through, for example, the resources of another practice office or alternative source).
- ▶ Individuals meeting the criteria and eligibility requirements to perform an EQCR are available, when needed — for example, for engagements that meet the firm's definition of high-risk.
- ▶ The firm is able to complete the engagement within the reporting deadline.

Tip! Identifying the person who will perform the EQCR prior to acceptance of the engagement and agreeing on engagement terms has several advantages:

- ▶ Eliminates the concern that an EQC reviewer will not be available at the end of the engagement
- ▶ Reduces the time pressure to identify a EQC reviewer at the end of the engagement (when the cost may be higher)
- ▶ Allows that person to perform the EQCR at various stages of the engagement

The firm obtains relevant information to determine whether the relationship should be continued and the firm evaluates the client continuance decision at least annually *[insert timing — for example, a preliminary decision at the end of the current year engagement for (every client or high-risk clients) as part of finalizing the current year engagement and a final evaluation before the engagement letter is sent for the next engagement]*.

Tip! The benefit to considering whether to continue the engagement and client relationship at the end of the current engagement is that the memory is fresh in terms of client integrity and issues encountered, and there may be less financial pressure at this time.

Acceptance and continuance

The following are conditions that the firm considers in evaluating whether to continue an engagement or client relationship *[describe conditions, such as the following]*:

- ▶ *Conditions such as these exist at the entity:*
 - *Aggressive earnings management*
 - *Unreliable processes for developing accounting estimates, or questionable estimates by management*
 - *Questions regarding the entity's ability to continue as a going concern*
- ▶ *The entity is in the development stage.*
- ▶ *The client is delinquent in paying fees. (This may also affect the firm's independence.)*
- ▶ *The firm is unable to meet the client's deadlines.*
- ▶ *The services required have grown beyond the firm's ability to deliver (scope creep).*
- ▶ *The firm is no longer willing to make the investment required to maintain competency.*
- ▶ *The firm is unable to obtain the necessary resources to carry out the engagement, such as a person to perform an EQCR or replace the loss of key personnel.*
- ▶ *Internal or external inspections have indicated deficiencies in the execution of the engagement (or similar engagements) and the firm is unable to mitigate the deficiencies.*
- ▶ *Partner rotation is required by law or regulation for the engagement under consideration.*
- ▶ *The client has ignored prior recommendations, such as those that address deficiencies in internal control.*

Warning! Do not put your clients on "auto-renew." Continuance of clients is an active decision and not the default mode.

When triggering events occur, the firm reevaluates the decision to accept or continue an engagement or client relationship.

The following are examples of such triggering events:

- ▶ *Significant changes in the client, such as a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or its financial stability*
- ▶ *Changes in the nature or scope of the engagement, such as*
 - *requests for additional services;*
 - *a request to step down from an audit to a review engagement, or*
 - *an initial public offering.*
- ▶ *The decision to discontinue services to clients in a particular industry.*

Note! The procedure is not to decline the engagement when such a request is made, but to evaluate the client's reasons for the request and then to determine whether to accept or decline.

Acceptance and continuance

When making the decision, the firm evaluates the information obtained regarding acceptance or continuance of the client or engagement by doing the following:

- ▶ The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm *[using the AICPA PCPS Client Acceptance Evaluation Tool or Client Continuance Evaluation Tool]*.
- ▶ The engagement partner makes a recommendation about whether to accept or continue the engagement, or the client relationship, and submits the recommendation with supporting documentation to the managing partner (of the practice office or of the firm) for approval.

Note! Acceptance and continuance decisions are iterative and are made before each engagement is accepted and as necessary when circumstances change.

Note! You can find the AICPA PCPS Client Acceptance Evaluation Tool and Client Continuance Evaluation Tool at aicpa.org/InterestAreas/

The recommendation made by the engagement partner is reviewed and approved by *[specify, for example, the partner responsible for the quality control function or the managing partner, or in certain defined circumstances, such as high-risk engagements, both.]* If the recommendation to accept a client or continue a client relationship is not approved, the managing partner and the other partners discuss why not.

When the firm becomes aware of information that would have caused the firm to decline the engagement if the information had been available earlier, the firm considers the professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities, and the firm considers whether to withdraw from the engagement or from the client relationship.

Note! See procedures for withdrawal later in this document.

The engagement partner documents evidence of consideration and approval of engagement acceptance (or continuance) in the planning section of the engagement documentation.

Policy 3: The firm obtains an understanding with the client regarding the services to be performed. (See paragraph .29 of QC section 10.)

The firm prepares a written engagement letter for each engagement, documenting the understanding with the client regarding the nature, scope, and limitations of the services to be performed. The firm obtains the client's signature on that letter before significant resources are committed to the engagement.

Tip! Having an "evergreen" engagement letter, or an engagement letter that covers more than one year, exposes the firm to a variety of risks. If circumstances necessitate the use of a multiyear engagement letter, even when not required by the standards, best practice is to send a written updating letter annually.

If the nature or scope of the engagement changes, the firm documents the change in an addendum to the engagement letter that is sent to the client.

Acceptance and continuance

Policy 4: The firm has established procedures on withdrawal from an engagement or from both the engagement and the client relationship, as follows: (See paragraph .30 of QC section 10.)

The firm considers whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal.

The firm discusses with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship if the firm determines that it is appropriate to withdraw.

The firm considers the implications for previous engagements with this client, including the need to withdraw previously issued reports.

Policy 5: The firm documents how issues relating to acceptance or continuance of client relationships were resolved.

The firm documents, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

Human resources

The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements, and (b) to enable the firm to issue reports that are appropriate in the circumstances.

Policy 1: The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .31 of QC section 10.)

Note! This requirement is for the firm to have sufficient personnel so that engagement teams as a whole have the necessary competence and capabilities. However, the commitment to ethical principles applies to each individual.

Policy 2: The firm hires only personnel that have the characteristics to enable them to perform competently.

An individual in the firm [*name or title*] is responsible for the firm's hiring and human resources management, including evaluation of personnel needs; establishment of hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement; and providing final approval.

Note! Depending on the size and structure of the firm, some of these procedures may be delegated—for example, to the practice office level.

The firm has a process to identify personnel needs at all levels for use in hiring.

The firm has hiring criteria which address the following:

- ▶ The attributes, achievements, and experiences desired in entry-level and experienced personnel to enable them to perform competently within the firm.
- ▶ How the firm evaluates personal characteristics such as integrity, competence, and motivation of new hires.
- ▶ Any additional information the firm requires for experienced hires, such as background checks and inquiries about any outstanding regulatory actions.

The firm identifies sources of employment candidates, such as universities and executive recruiters.

The firm has criteria for determining which individuals will be involved in the interviewing and hiring process.

Individuals who will be interviewing candidates or otherwise participating in the hiring process are trained in interviewing techniques.

Note! This training may be very informal, but is necessary, if only to be sure they don't ask anything illegal.

Human resources

The firm evaluates the results of the hiring process for each candidate, including approval by the managing partner or a person designated by the managing partner of all hiring decisions, in accordance with applicable legal and regulatory requirements.

Policy 3: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner. (See paragraph .33 of QC section 10.)

The firm specifies the knowledge, skills, and abilities (competencies) that the engagement partner for each of the firm's accounting, auditing, or attestation engagements (the partner or other person who is responsible for supervising those types of engagements and signing or authorizing someone to sign the accountant's report on such engagements) should possess to fulfill his or her engagement responsibilities.

Such competencies for the practitioner-in-charge include the following:

- ▶ An understanding of the role of the firm's system of quality control and the AICPA Code of Professional Conduct
- ▶ An understanding of the performance, supervision, and reporting aspects of the engagement
- ▶ An understanding of the applicable accounting, auditing, or attestation professional standards, including those standards directly related to the industry in which a client operates
- ▶ An understanding of the industry in which a client operates, including the industry's organization and operating characteristics, so as to identify the areas of high or unusual risk associated with an engagement, and to evaluate the reasonableness of industry-specific estimates
- ▶ Skills that indicate sound professional judgment, including the ability to exercise professional skepticism
- ▶ An understanding of how organizations are dependent on or enabled by information technologies, and the manner in which information systems are used to record and maintain financial information

Policy 4: The firm determines the capabilities and competencies possessed by personnel. (See paragraph .34 of QC section 10.)

The firm evaluates personal characteristics such as integrity, competence, and motivation of personnel on an ongoing basis.

Note! The criteria used in evaluating these personal characteristics for new hires can be adapted for this procedure.

The firm periodically evaluates all personnel, including owners, who sign reports on behalf of the firm to assess whether they possess the knowledge, skills, and abilities (competencies) necessary to enable them to be qualified to perform the firm's accounting, auditing, or attestation engagements (for example, by means of coaching, peer evaluation or self-appraisal).

Human resources

Policy 5: The firm assigns responsibility for each engagement to an engagement partner. The identity and role of the engagement partner are communicated to management and those charged with governance; the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that individual. (See paragraph .33 of QC section 10.)

Responsibility for each engagement is assigned to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role.

Tip! The criteria used in evaluating these personal characteristics for new hires can be adapted for this procedure.

The identity and role of the engagement partner are communicated to management and those charged with governance at the beginning of the engagement.

The responsibilities of an engagement partner are clearly defined by the firm and are communicated to the engagement partner.

The partner responsible for partner assignments monitors the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities.

When an engagement is found to be materially non-conforming after report issuance (for example, through firm monitoring, peer review or regulatory inspection), the firm

- a. requires the engagement partner to take appropriate training and monitors that person's performance (for example, through EQCR) until the firm is satisfied that remediation has occurred;
- b. limits or prohibits the engagement partner's assignments on future engagements in that industry or area; or
- c. dismisses the engagement partner from the firm.

Policy 6: The firm assigns appropriate personnel with the necessary competence and capabilities to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances. (See paragraph .34 of QC section 10.)

Human resources

The firm assigns personnel (including partners) to engagements based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.

- a. The firm designates a responsible party(ies) for the assignment of personnel to engagements, including partner and manager assignments.
- b. The firm considers each of the following factors to determine how personnel are assigned to engagements:
 - Engagement size and complexity
 - Specialized experience or expertise required
 - Personnel availability and involvement of supervisory personnel
 - Timing of the work to be performed
 - Continuity and rotation of personnel
 - Opportunities for on-the-job training
 - Previous knowledge
 - Skills and abilities [competencies] gained through other experience
 - Situations in which independence or objectivity concerns exist.
- c. The engagement partner approves the composition of the engagement team before work to obtain engagement evidence begins.

Warning! Do not confuse availability with appropriateness. Availability is necessary but it is not, in and of itself, sufficient.

Approval of partner and manager assignments from the managing partner or other partner is required in the case of high-risk or significant client engagements.

The firm assures that individuals are maintaining the appropriate licenses to perform their assigned engagements, including for states other than where the individual primarily practices public accounting.

Tip! www.CPAMobility.org may be helpful in determining the necessary individual licenses.

When the firm accepts an audit in an industry in which the firm's personnel do not have recent experience, the firm consults appropriate resources (for example: literature, the AICPA Technical Hotline, or a suitably qualified external person) to determine the extent of changes relevant to the engagement. When determined to be necessary, the firm engages a suitably qualified external person to assist with the performance of an audit as a member of the engagement team.

Tip! How recent depends upon changes in the industry and related accounting; not more than five years is a useful guideline but it could be less, especially in regulated industries.

The firm maintains the appropriate firm license(s) or permit(s), including for states other than where its main office is domiciled.

Tip! www.CPAMobility.org may be helpful in determining the necessary firm licenses or permits.

Human resources

In all states where the firm practices, the firm:

- a. is licensed under the same name(s) under which it practices,
- b. must obtain license(s) or permit(s) which are effective before any reports are issued in the state,
- c. considers variations in licensing bodies' rules and regulations and how they affect the firm's need to be licensed in that state, and
- d. addresses any restrictions on practice imposed by the licensing bodies.

Policy 7: Personnel, including partners, participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other regulators.

The firm has an individual or individuals responsible for the firm's CPE and professional development activities, including maintaining CPE records and course materials for personnel.

The firm encourages personnel to pass the Uniform CPA Examination and covers the cost, including paid time off to take the exam.

The firm has an orientation and training policy for new hires.

The firm informs personnel of their responsibilities and professional opportunities.

The firm provides CPE to personnel in subjects that are relevant to their responsibilities, either through in-house programs or externally developed courses.

[If the firm practices in a specialized industry] a partner is designated with firm-wide responsibility for the quality of the firm's practice in *[name the specialized industry]*. That partner is required to take annual CPE in the specialized industry.

All personnel must comply with the professional education requirements of the board(s) of accountancy in state(s) where they are licensed and, as applicable, the AICPA, the state CPA society, and *Government Auditing Standards*—the Yellow Book.

The firm establishes CPE requirements for professional personnel. Under these requirements

- a. all professional personnel must participate in CPE and professional development activities that support their performance in their assigned engagements and are appropriate when considering their role in the firm.

Warning! The requirements for CPE are intended to address competency, not just maintaining a CPA license. Accordingly, all professional personnel, not just those with a CPA license, must take CPE. Taking more CPE than required by state law or regulation may be needed to obtain the necessary competency.

Human resources

- b. If an individual signs opinions on, performs engagement quality control review for or manages engagements in a specialized industry or area, the individual must have a minimum of eight hours of CPE specific to the industry or area every three years (or within the firm's or individual's CPE period covering a three-year period).
- c. All personnel must take ethics CPE periodically *[specify the period—for example, the minimum required by state law or regulation]*.

Note! This applies to non-licensed professional personnel, as well.

The firm reimburses personnel who are CPAs for membership in a state society and the AICPA, including AICPA section memberships, as relevant.

Tip! This best practice provides personnel with a wealth of resources, such as access to the AICPA Technical Hotline, professional journals, the Ethics Hotline, audit tools, and more.

The firm informs personnel of changes in accounting and auditing standards, independence, integrity, and objectivity requirements and the firm's technical policies and procedures with respect to them (for example, by distributing technical pronouncements and holding training courses on recent changes and areas noted by the firm as needing improvement).

The firm encourages personnel to participate in professional development activities, such as taking graduate-level courses, becoming members of professional organizations, serving on professional committees, speaking to professional groups, and writing for professional publications.

Policy 8: Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume. (See paragraph .32 of QC section 10.)

Note! In the smallest firms, procedures to address this policy may be developed on an "as-needed" basis.

Human resources

The firm has a director of human resources to identify and communicate (for example, through the firm's policies and procedures manual) the qualifications necessary to accomplish responsibilities at each professional level in the firm. This includes the following:

- ▶ Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.
- ▶ Informing firm personnel about the criteria for advancement to the next higher level of responsibility.
- ▶ Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.

Note! In smaller firms, a partner or other person may function in this role without the title.

The *[director of human resources (specify designated person(s))]*, is *[or are if applicable]* responsible for making advancement and termination decisions, including identifying responsibilities and criteria for evaluation at each level and deciding who will prepare evaluations.

The firm designates who is responsible for periodically evaluating the performance of personnel at each level and advising them of their progress in the firm.

Periodically *[specify the period—for example, at least annually or at the conclusion of engagements that last at least three weeks]*, the firm reviews with personnel the evaluation of their performance, including an assessment of their knowledge, skills and abilities (competencies), and progress with the firm. The discussion addresses performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.

Tip! Timely feedback and effective performance reviews give due recognition and reward to the development and maintenance of competence.

The firm establishes compensation and advancement criteria for partners and other high-level staff that address

- ▶ feedback based on monitoring results, peer reviews and regulatory inspections,
- ▶ appropriate identification of significant and emerging accounting and auditing issues; and
- ▶ appropriate consultation with firm experts when challenging issues arise.

Tip! Technical knowledge, adherence to firm policies and procedures, staff development, client management and practice development are all important considerations in determining partner and senior-level compensation.

Engagement performance

The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality-control review should be performed.

Policy 1: The firm uses quality control materials (QCM) (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to assist with engagement performance. (See paragraph .35 of QC section 10.)

The firm QC partner establishes procedures to ensure that, whether the firm develops its own QCM or obtains it from a third-party provider,

- ▶ the material is reliable and suitable for the practice;
 - ▶ the QCM is up to date;
 - ▶ modifications to the package and to individual forms are appropriate; and
 - ▶ the forms being used are appropriate for the engagement.
-

Policy 2: Planning for engagements meets professional, regulatory and the firm's requirements.

The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations.

The firm trains personnel on the use of the firm's practice aids (audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like).

Planning considerations may vary depending on the size and complexity of the engagement. The firm follows the following procedures for planning engagements:

- ▶ When the firm accepts an audit, review or attestation examination in an industry in which the firm's personnel do not have recent experience, the firm requires all senior members of the engagement team to take industry-specific CPE before planning procedures are performed.

Warning! The planning phase starts before work to obtain engagement evidence begins!

Tip! How recent depends upon changes in the industry and related accounting; not more than five years is a useful guideline but it could be less, especially in regulated industries. Also, make sure that the engagement team is using the most recent AICPA Audit and Accounting Guide for that industry, when applicable.

Engagement performance

- ▶ The engagement partner accepts responsibility for planning the engagement.
- ▶ Appropriate personnel are assigned responsibilities during the planning phase.
- ▶ The engagement partner, or personnel designated by the engagement partner, develops or updates background information on the client and the engagement.
- ▶ Planning includes determination of whether the engagement meets the firm's criteria for performing an EQCR. If so, the person performing the EQCR reviews the planning in a timely manner.
- ▶ If a specialist or consultant is utilized to provide the engagement team with the necessary competence, that person reviews the planning in a timely manner.

Warning! The higher the risk that the firm will fail to perform and report in conformity with applicable professional standards in an engagement, the more important that the engagement partner be more deeply involved in planning.

Tip! Best practice is to have the planning reviewed before fieldwork begins.

The engagement team prepares planning documentation that includes the following:

- ▶ Proposed work programs tailored to the specific engagement
- ▶ Staffing requirements
- ▶ Whether there is a need for specialized knowledge and how that will be obtained (for example, from other practice offices or through consultation)
- ▶ Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
- ▶ Consideration of risks, including fraud considerations, affecting the client and the engagement and how they may affect the procedures to be performed
- ▶ A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures
- ▶ Approval of planning and of the proposed work program by the engagement partner before work to obtain engagement evidence begins

Note! Though planning is an iterative process, having the engagement partner approve planning before fieldwork begins results in a more effective and efficient engagement.

Policy 3: The engagement is performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.

Each engagement is assigned an engagement partner who accepts ultimate responsibility for the engagement.

A written work program is used in each engagement.

Engagement performance

Each engagement is required to be supervised by suitably experienced engagement team members. Engagement supervision includes the following:

- ▶ Briefing the engagement team on the objectives of their work
- ▶ Tracking the progress of the engagement
- ▶ Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement
- ▶ Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
- ▶ Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

Engagement personnel prepare working papers that adhere to the firm's guidelines, applicable regulatory requirements and professional standards for the form and content of documentation of the work performed and conclusions reached.

Note! If you haven't documented what you have done, it's as if you didn't do it. Remember, the standard requires documentation for "an experienced reviewer with no connection to the audit"—someone with no access to anything except what is in the working papers. Therefore, the working papers need sufficient detail for the reviewer to understand exactly what was done.

Engagement documentation makes clear when and by whom engagement documentation was prepared and reviewed.

Policy 4: Qualified engagement team members review work performed by other team members on a timely basis. (See paragraph .36 of QC section 10.)

The firm's methodology prescribes who on the engagement team reviews the work of other members of the engagement team.

Note! This can include the extent of the engagement partner's review.

For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.

Engagement performance

The firm prescribes the extent of review of the nature, timing and extent of procedures performed to have reasonable assurance that they are consistent with the approach described in the planning documentation. Exceptions are investigated and resolved.

Warning! The financial statements can be materially correct, the report can be appropriate in the circumstances, and yet, the engagement may not be in compliance with professional standards because, for example, the engagement team did not obtain sufficient appropriate audit evidence or the documentation does not reflect all of the procedures performed and evidence obtained.

Engagement documentation is reviewed to determine whether the following have occurred:

- a. The work has been performed in accordance with professional standards and applicable legal and regulatory requirements.
- b. Significant findings and issues have been raised for further consideration.
- c. Appropriate consultations have taken place and the resulting conclusions have been documented and implemented.
- d. The nature, timing, and extent of the work performed is appropriate and without need for revision.
- e. The work performed supports the conclusions reached and is appropriately documented.
- f. The evidence obtained is sufficient and appropriate to support the report.
- g. The objectives of the engagement procedures have been achieved.

Warning! The review of engagement documentation to determine whether the work has been performed in accordance with professional standards is not the same as the review that determines whether the report issued by the firm is appropriate in the circumstances. Reviewing engagement documentation entails reviewing the working papers for documentation of sufficient appropriate engagement evidence.

Policy 5: Engagements as specified in the firm's methodology are reviewed by a person who is not a member of the engagement team before the reports or other communications are issued.

Note! An EQC review is one type of pre-issuance review. Other pre-issuance review by a person who is not a member of the engagement team may be less extensive than an EQCR.

Engagement performance

The firm's methodology specifies which engagements require pre-issuance review by a person who is not a member of the engagement team and prescribes the extent of the pre-issuance review of the report and other communication, financial statements, and selected documentation of the work performed and conclusions reached. This includes

- ▶ assigning a reviewer with the appropriate qualifications and
- ▶ prescribing the documentation that the reviewer must review for each level of service and permitting the reviewer to select additional documentation to review.

Tip! A pre-issuance review by a person who is not a member of the engagement team, though only required by the standard for engagements meeting the firm's criteria for an EQC review, provides a fresh look and is very helpful. The firm can prescribe procedures for different levels of services that are less extensive than those required for EQC review.

Policy 6: The firm establishes, documents and follows procedures when the firm uses external personnel, such as from other firms, for audit or accounting engagements.

Those procedures address the following:

- ▶ The form in which instructions are given to external personnel
- ▶ The extent to which their work is reviewed

Tip! For example: when external personnel are used to observe inventory; when using independent contractors as part of the engagement team; or when assuming responsibility for the work of component auditors.

Policy 7: The firm has criteria for determining whether an EQCR should be performed, evaluates all engagements against the criteria, performs an EQCR for all engagements that meet the criteria, and completes the review before the report is released. (See paragraphs .38–.40 of QC section 10.)

Tip! If your acceptance and continuance policies and procedures limit engagement risk, the need for an EQCR may be diminished.

Warning! Criteria that are not responsive to the structure and nature of the firm's practice are not appropriate.

Engagement performance

The firm's criteria for requiring that an EQCR be performed are based on the firm's assessment, given the structure and nature of the firm's practice, of which engagements would most benefit from an independent review.

Warning! It is critical that the firm carefully consider, in setting criteria for an EQCR, which engagements have the highest risk of not being performed in accordance with the standards or that the report will not be appropriate in the circumstances. Consider the engagements that the firm actually performs in setting the criteria, and not only engagements that are clearly outside the firm's expertise. Recognize that the risk factors to the firm change over time and the firm's criteria for an EQCR may need to change accordingly.

The firm's criteria include *[specify criteria, which could include, but are not limited to, the following]*:

- ▶ The identification of unusual circumstances or risks in an engagement, or class of engagements, as pre-determined by the firm. For example,
 - audits in which a going concern issue was identified but the report was not modified;
 - a compilation with disclosures when the firm has only been doing compilations without disclosures; or
 - a review (or other engagement) for an entity with issues that the firm rarely encounters (for example, joint ventures).
- ▶ An engagement quality control review is required by law or regulation.
- ▶ An engagement for which the undue influence threat may exist (such as an engagement that represents more than 10 percent of the firm's audit and accounting practice).

Warning! Appropriate criteria for most firms will consist of a mix of the following and not rely on just one criterion.

Warning! The engagement partner or QC partner can always request an EQCR, but having your firm's only criterion for performing an EQCR be "the engagement partner or the quality control partner have identified unusual circumstances or risks in an engagement" is not appropriate. This criterion is too subjective to be responsive to the structure and the nature of the firm's practice. Likewise, the client's revenue volume or total assets as the sole criterion is not appropriate because these are not, in and of themselves, indicators of the risk of the engagement.

Engagement performance

- ▶ A high-risk engagement, as defined by the firm, using the same criteria used for acceptance and continuance.
- ▶ An engagement in an industry in which the firm's practice is limited and the firm's personnel have little or no experience.
- ▶ An engagement for which the familiarity threat may exist.
- ▶ An engagement for an entity operating in a highly specialized or regulated industry, including financial institutions and employee benefit plans, and audits in accordance with government auditing standards.

The firm evaluates all engagements against the criteria and performs an EQCR for all engagements that meet the criteria.

Warning! Performing only one or two audits in a particular industry increases your risk. Don't think, "Oh, I only do one, how risky can it be?"

Note! If the firm has a concentration in a specialized industry, more appropriate criteria may be based on risk factors within that specialization. For example, a firm that specializes in EBP audits may require an EQCR for all audits of a specific type of EBP.

Policy 8: Engagement quality control reviewers meet the firm's criteria for eligibility. (See paragraphs .42-.44 of QC section 10.)

Tip! The AICPA's list of peer reviewers and your state society are resources for finding an EQCR reviewer.

Selection of the engagement quality control reviewer is not made by the engagement partner.

The engagement quality control reviewer meets the following criteria:

- ▶ Has sufficient technical expertise and experience.
- ▶ Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement quality control reviewer. If the reviewer's objectivity becomes impaired, the reviewer must be replaced.
- ▶ Does not make decisions for the engagement team or participate in the performance of the engagement except to serve as a consultant to the engagement partner at any stage during the engagement, with the understanding that the engagement quality control reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.
- ▶ Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities.
- ▶ Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team.

Engagement performance

When the firm does not have suitably qualified personnel to perform the EQCR, the firm contracts with a suitably qualified external person to perform the engagement quality control review.

Policy 9: The firm establishes procedures addressing the nature, timing, extent, and documentation of the EQCR. (See paragraph .40 of QC section 10.)

Regarding the EQCR, the engagement partner understands and performs the following:

- ▶ The engagement partner remains responsible for the engagement and its performance, and the engagement quality control reviewer does not make decisions for the engagement team.
- ▶ The engagement partner may consult the engagement quality control reviewer at any stage during the engagement, with the understanding that the engagement quality control reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.

For engagements that meet the firm's criteria for having an EQCR performed, the engagement partner

- a. determines that an engagement quality control reviewer has been appointed;
- b. discusses with the engagement quality control reviewer the significant findings or issues that arose during the engagement, if any; and
- c. does not release the report until the completion of the EQCR.

Tip! The EQCR is completed when the EQC reviewer decides it is completed.

Timing of the EQCR

Performing an EQCR is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the EQCR does not need to be completed before the date of the auditor's report. When the EQCR results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained.

Warning! Although permitted by the standard, completing the EQCR after dating the report is far from optimal, and the time between dating the report and then completing the EQCR is expected to be minimal.

The firm's procedures require that for audit and examination engagements, the engagement quality control reviewer do the following:
(See paragraph .41 of QC section 10.)

Engagement performance

- ▶ Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.
- ▶ Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.
- ▶ Confirm with the engagement partner that there are no significant unresolved issues.
- ▶ Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
- ▶ Review documentation of the resolution of significant accounting, auditing or financial reporting issues, including documentation of consultation with firm personnel or external sources.
- ▶ Review the summary of uncorrected misstatements related to known and likely misstatements.
- ▶ Review additional engagement documentation to the extent considered necessary.
- ▶ Read the financial statements and the report and consider whether the report is appropriate.
- ▶ Complete the review before the release of the report.
- ▶ Conduct the review at appropriate stages during the engagement to the extent possible.
- ▶ Determine whether the issues raised in the review require additional procedures that necessitate changing the auditor's report date.

Note! Conducting the EQCR at appropriate stages during the engagement reduces the time pressure for resolving issues that the EQC reviewer identifies.

Before reports are released, matters that would cause the reviewer to question the engagement team's judgments and conclusions are resolved and the resolution is documented.

The EQCR is documented. Documentation includes the following:

- ▶ That the procedures required by the firm's policies on EQCR have been performed
 - ▶ That the EQCR has been completed before the report is released
 - ▶ An assertion that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate **(See paragraph .45 of QC section 10.)**
-

Engagement performance

Policy 10: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented. (See paragraph .37 of QC section 10.)

The firm informs personnel of its consultation policies and procedures.

The firm identifies circumstances, including specialized situations, in which firm personnel are expected to consult. Those circumstances include the following [*specify the criteria*]:

- ▶ *Application of newly issued technical pronouncements*
 - ▶ *Industries with special accounting, auditing, or reporting requirements*
 - ▶ *Emerging practice problems*
 - ▶ *Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made*
 - ▶ *Reissuance of a report, consideration of omitted procedures after a report has been issued or subsequent discovery of facts that existed at the time a report was issued*
 - ▶ *Filing requirements of regulatory agencies*
-

The firm has established criteria which require consultation with outside parties, such as other firms, the AICPA Technical Hotline (877.242.7212), AICPA Audit Quality Centers, AICPA Center for Plain English Accounting, other professional and regulatory bodies, and commercial organizations that provide relevant quality control services. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.

The firm requires sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.

The firm designates individuals within and outside the firm as consultants in certain areas. Such individuals have appropriate knowledge, authority and experience. A list is maintained of the individuals within and outside the firm that the firm has designated as consultants, along with the areas of their expertise.

Engagement performance

The firm requires the engagement partner to determine the need to consult. That determination is based on the following:

- ▶ The materiality of the matter
- ▶ The experience of senior engagement personnel in a particular industry or functional area
- ▶ Whether the financial reporting framework or professional standards applicable to the engagement are as follows:
 - a. Based on authoritative pronouncements that are subject to varying interpretations
 - b. Based on varied interpretations of prevailing practice
 - c. Under active consideration by an authoritative body

Warning! Encourage partners to ask; those who ask only when they are unable to draw their own conclusion may not know whether they have come to the correct conclusion.

The firm maintains and provides its personnel access to adequate and current reference materials, including materials relevant to its clients. Those materials include the most current versions of the following:

- ▶ AICPA Professional Standards
- ▶ AICPA Audit and Accounting guides relevant to all industries in which the firm practices
- ▶ FASB pronouncements
- ▶ Any other pronouncements relevant to the firm's practice (such as SEC pronouncements, GASB pronouncements, Government Auditing Standards [the Yellow Book], and other government audit guides relevant to the firm's practice)

Tip! GAO's Yellow Book Technical Assistance can be reached at 202.512.9535 or yellowbook@gao.gov.

Those consulted are provided with all relevant facts that will enable them to provide informed advice.

The firm resolves differences of opinion between engagement personnel and specialists before report issuance.

The firm requires documentation of consultations. That required documentation includes the following:

- a. All relevant facts and circumstances
 - b. References to professional literature used in the determination
 - c. Conclusions reached, and how they were implemented
 - d. Signatures of engagement partner and consultant
 - e. Reference to the engagement working papers
-

Engagement performance

Policy 11: The firm addresses and resolves differences of opinion within the engagement team, with those consulted, and, when applicable, between the engagement partner and the engagement quality control reviewer. (See paragraphs .46-.48 of QC section 10.)

The firm follows procedures for consultation in resolving differences within an engagement team. If further action is necessary, the engagement and the quality control partners, and the firm's leadership if necessary, resolve the differences.

Note! Resolution does not require consensus. Although consensus is optimal, ultimately the managing partner is responsible for determining the resolution.

The conclusion reached to resolve the matter of disagreement and how that conclusion was implemented are documented.

The firm will not release the report until any differences of opinion are resolved.

Any party to the consultation or difference of opinion who disagrees with the final conclusion may document his or her disagreement with, and disassociate themselves from, the resolution of the matter.

Policy 12: Engagement teams complete the assembly of final engagement files on a timely basis. (See paragraph .49 of QC section 10.)

Tip! Assembling the final files sooner rather than later is best practice.

Final engagement files are assembled by the earlier of time limits required by professional standards and applicable regulatory requirements, if any, or 60 days from the report release date.

Tip! Since deadlines have power, it is helpful for the firm to specify a time limit for all engagements in the absence of time limits required by professional standards or regulatory requirements.

Policy 13: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (See paragraph .50 of QC section QC sec. 10.)

Engagement performance

The firm implements adequate and appropriate controls over the confidentiality, custody, integrity, accessibility, and retrievability of the firm's engagement documentation.

Adequate and appropriate controls over confidentiality, custody, integrity, accessibility, and retrievability of engagement documentation include the following:

- ▶ Requiring that engagement documentation clearly indicates when and by whom it was prepared and reviewed.
- ▶ Procedures to protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
- ▶ Procedures to prevent unauthorized changes to the engagement documentation. For electronic engagement documentation this includes
 - Using passwords or data encryption, or both, to restrict access to authorized users
 - Using appropriate back-up routines at appropriate stages during the engagement
- ▶ Procedures for tracking the distribution of engagement documentation materials to personnel at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.
- ▶ Procedures to allow access to paper engagement documentation for the engagement team and other authorized users, and restrict access by others.
- ▶ Maintaining engagement documentation in one location to enhance retrievability (this applies to both hardcopy and electronic documentation, although back-up files would be maintained elsewhere).
- ▶ Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
 - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.

Policy 14: The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations. (See paragraph .51 of QC section 10.)

The quality control partner maintains a list specifying the period of time sufficient to meet the needs of the firm, the requirements of the state board(s) of accountancy and applicable professional standards, for each level of engagement service.

Tip! Your firm's professional liability insurance carrier can be a resource in determining appropriate time limits.

Engagement documentation is retained for the specified period of time.

Monitoring

The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- ▶ Adherence to professional standards and regulatory and legal requirements
- ▶ Whether the quality control system has been appropriately designed and effectively implemented
- ▶ Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

Tip! PRP Section 10,000, *Monitoring Guidance*, is available free of charge at www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/2015/DownloadableDocuments/May2015-10000-Mon-Guide.pdf

This section of the Peer Review Manual contains guidance on performing and documenting monitoring, as well as checklists and sample summary reports.

Note

The purpose of monitoring is to provide feedback on how the system of QC is working and whether changes are needed. Monitoring activities include inspections of engagement documentation, reports and financial statements, and inspections of other elements covered by the firm's QC system.

Reviews of engagement documentation, reports and financial statements can occur

- ▶ before the report is issued (EQCR or other pre-issuance review) or
- ▶ after the report is issued (post-issuance review).

EQCR and other pre-issuance reviews are not, in and of themselves, inspection procedures. However, to the extent that information obtained from a pre-issuance review is evaluated in terms of what happens on other engagements and addressed systemically—that is monitoring.

Post-issuance reviews can occur on an engagement-by-engagement basis or at set times during the year.

The difference between engagement performance QC procedures and monitoring QC procedures is that monitoring procedures are designed to determine the root cause of the problem and to then fix the problem systemically. Engagement QC fixes the problem at the engagement level but does not look for the root cause, nor are engagement procedures designed to fix the problem systemically.

Tip! Monitoring is a continuous process. If you are in the frame of mind to always be looking for errors and systemic causes, that's monitoring. Send an email to the firm when you see something—that's monitoring, communicating and documenting. Save the email in a "monitoring" folder and you've documented as you go along so you can "get credit" for what you already do.

Note! Inspection of engagement documentation, reports and financial statements is only one element of monitoring. Don't forget other aspects, such as human resources, CPE, licenses, and the requirements of Audit Quality Centers of which your firm is a member.

Monitoring

Policy 1: The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. (See paragraph .52 of QC section 10.)

Policy 2: The firm assigns responsibility for the firm's monitoring process, including performance, to [insert name or title of a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume this responsibility—hereinafter referred to as the QC partner]. (See paragraph .52b of QC section 10.)

The firm determines that the QC partner and all others responsible for conducting monitoring procedures

- ▶ have sufficient training, experience and competence to execute their responsibilities;
 - ▶ have no history of limitations or restrictions on their ability to practice public accounting; and
 - ▶ have not acted as engagement partner on one or more materially non-conforming engagements that were uncovered through peer review, monitoring, or regulatory inspection.
-

The QC partner is responsible for determining that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors that may be considered include the following:

- ▶ *External factors*
 - Changes in professional standards or other regulatory requirements applicable to the firm's practice
 - Changes in applicable AICPA membership requirements
 - Mergers and divestitures of portions of the practice
 - ▶ *Internal indicators*
 - Results of inspections and peer reviews
 - Review of litigation and regulatory enforcement actions against the firm and its personnel
-

Note! Examples of changes in professional standards that may result in a need to revise quality control policies and procedures are the issuance of Statements on Standards for Accounting and Review Services (SSARS) No. 21 and the changes to preparation services, and changes to the Code of Professional Conduct.

Monitoring

At least annually, the QC partner performs, or selects an individual or team to perform, inspection procedures on the firm's quality control system, for each practice office.

Note! Even if the firm performs continuous monitoring (such as inspections performed while planning for next year's engagement), annually "pulling it all together" and determining that all monitoring procedures have been documented helps provide reasonable assurance of meeting the requirements of the standards.

Tip! Many firms perform their annual inspection at the same time of the year as their peer review is performed.

The QC partner uses criteria established by the firm to determine that individuals responsible for the inspection and other monitoring procedures have sufficient experience and authority to assume that responsibility.

Policy 3: The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and all elements of the firm's quality control policies and procedures.

In accordance with the membership requirements of the AICPA Governmental Audit Quality Center and the AICPA Employee Benefit Plan Audit Quality Center, the engagement letter covering the firm's peer review will require that the governmental audits and ERISA employee benefit plan audits selected for review during the firm's peer review be reviewed by someone who is employed by a member firm of the respective center. Also, information relative to the firm's most recently accepted peer review is available to the public in accordance with the membership requirements of the respective centers.

Monitoring

The QC partner (and the team or designated individual) plans the annual inspection procedures to be performed. Inspection procedures include review of engagements that represent a reasonable cross-section of the firm's accounting and auditing practice using criteria, which could include but are not limited to, the following:

- ▶ Engagements required to be selected during peer review (under Government Auditing Standards, ERISA, FDIC Improvement Act financial institutions, carrying broker-dealers and examinations of service organizations [SOC 1® and SOC 2® engagements])
- ▶ Specialized industries with emphasis given to high risk engagements
- ▶ Initial engagements
- ▶ Level of service performed
- ▶ An appropriate cross-section of the firm's auditing and accounting partners, taking into account partners who have had negative results in the prior reviews and partners who have specialties other than accounting and auditing, but still service accounting and auditing clients
- ▶ Engagements from a merged-in practice
- ▶ SEC registrants and other engagements performed in accordance with the standards of the PCAOB
- ▶ Engagements with areas that have been identified as findings in other reviews (that is, PCAOB, peer review, or prior internal inspection)

Note! The most effective monitoring focuses on areas of high-risk (the risk that the firm isn't meeting professional standards or its own QC policies and procedures).

Warning! Identifying a cross-section of the firm's practice requires properly identifying all the types of engagements the firm performs. Accordingly, the firm needs sufficient detail to track its engagement population—for example, a time and billing system that separately identifies an EBP audit performed in conjunction with the employer audit. This also has implications for document retention and peer review.

Warning! Remember—you don't know what you don't know. If you are new to an industry, or if very few people in the firm have experience in an industry or technical area, hiring an external inspector to perform all or some inspection procedures may be beneficial.

The firm has procedures that establish the approach for performing postissuance reviews, addressing, for example

- ▶ the comprehensiveness of the review (similar to that performed in an inspection or peer review);
- ▶ the frequency for summarizing findings;
- ▶ the extent of documentation required; and
- ▶ the retention period for detailed inspection documentation (as opposed to summaries).

The selected engagements are reviewed for compliance with the firm's policies and procedures.

When deficiencies are identified in engagements, the QC partner considers the need to expand the selection of engagements to assist in determining whether the deficiencies noted are systemic or repetitive.

Monitoring

In addition to engagement inspection and reviews, the firm's monitoring procedures include performing appropriate tests of compliance with the firm's policies and procedures on a sample basis.

The procedures include the following:

- ▶ Assessing the appropriateness, reliability and suitability of the firm's guidance materials and practice aids, such as audit programs, forms and checklists, and determining whether they reflect recent professional pronouncements. This assessment includes soliciting comments from professional personnel as to the effectiveness of practice aids and tools.
- ▶ Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.
- ▶ Interviewing personnel at all professional management and staff levels to obtain information about operating procedures and assess their understanding of the firm's quality control policies and procedures and implementation thereof.
- ▶ Reviewing correspondence regarding the resolution of independence and client acceptance matters within the practice office.
- ▶ Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.
- ▶ Reviewing summaries of CPE records for a sample of personnel to track compliance with the requirements of the AICPA and other regulatory bodies (such as GAO and the Office of Management and Budget [OMB]), as well as the firm's CPE requirements.
- ▶ Reviewing other administrative and personnel records pertaining to the quality control elements, such as
 - personnel evaluations, including documentation of hiring and advancement decisions; and
 - participants' evaluations of practice office training programs.
- ▶ Reviewing—or designating a management-level individual to be responsible for reviewing—professional development activities to determine whether they are appropriate, effective, and meet the needs of the firm.
- ▶ Soliciting information from the firm's personnel, either during staff meetings or through interviews of selected professional personnel, regarding the effectiveness of training programs, including in-house training programs.
- ▶ Periodically reviewing the process for personnel evaluation and counseling to ascertain the following:
 - Whether procedures for evaluation and documentation are being followed on a timely basis
 - That personnel decisions are consistent with evaluations
 - Whether personnel who have been promoted have achieved the applicable requirements for advancement
 - That recognition is given to outstanding performance

Tip! For small firms, this can be done by providing information at staff meetings.

Note! This procedure encompasses reviewing both individual personnel's compliance and the firm's tracking of that compliance.

Note! Professional development activities include the plan for both the firm and each individual to gain the skills, competencies and knowledge necessary for the firm's practice.

Note! As the firm's personnel increase in number, the need for more formal procedures also increases.

Monitoring

- ▶ Considering whether the firm's professional development programs should be revised, based on the results of the firm's inspection or peer review and recommending revisions.

Policy 4: The firm communicates (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel, and (b) the results of the monitoring of its quality control system process to relevant firm personnel at least annually. (See paragraph .55 of QC section 10.)

Note! When discussing the severity of issues with controls, the AICPA auditing, attestation, and accounting and review services standards use the terms deficiency, significant deficiency and material weakness, whereas the Peer Review standards use the terms finding, deficiency, and significant deficiency. The use of the terms deficiency and significant deficiency in QC section 10 and this Practice Aid is consistent with the use in the AICPA auditing, attestation, and accounting and review services standards, adapted as necessary in the circumstances.

For each engagement reviewed, the monitoring team (or individual) is responsible for (a) identifying and summarizing the deficiencies noted, and (b) discussing the results of the inspection or review with the engagement partners and other appropriate personnel responsible for each of the engagements selected for review and determining whether any corrective action needs to be taken or improvements made with respect to those specific engagements. **(See paragraph .55 of QC section 10.)**

At the conclusion of the inspection or review, the QC partner, along with the monitoring team (or individual) is responsible for evaluating the effect of deficiencies noted as a result of the monitoring process and determining whether they are systemic, repetitive or other significant deficiencies that require prompt corrective action. **(See paragraph .54 of QC section 10.)**

Recommendations for appropriate corrective actions include one or more of the following:

- Taking appropriate corrective action in relation to an individual engagement or member of personnel
- The communication of the findings to those responsible for training and professional development
- Changes to the quality control policies and procedures
- Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.
(See paragraph .56 of QC section 10.)

Note! Deficiencies may indicate a lack of due care or a lack of competency in various areas, and the corrective actions should be responsive.

Monitoring

When the results of the monitoring procedures (through firm monitoring, peer review or regulatory inspection) indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm

- a. determines what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements;
- b. considers whether to obtain legal advice; and
- c. takes and documents the appropriate action.

The firm documents the actions taken. **(See paragraph .57 of QC section 10.)**

Note! In such circumstances for audit engagements, AU-C 560, *Subsequent Events and Subsequently Discovered Facts* and AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date* (AICPA, *Professional Standards*), are applicable.

The firm prepares a monitoring report that summarizes (a) the monitoring procedures performed, (b) the conclusions reached from such procedures, (c) any systemic, repetitive or other significant deficiencies noted, and (d) recommended remedial actions. **(See paragraph .58 of QC section 10.)**

The summary monitoring report is provided at least annually to relevant engagement partners and other appropriate individuals with the firm, including the firm's leadership.

The partners review the recommended corrective actions and reach final conclusions regarding the actions to be taken.

[In firms with multiple practice groups:]

The practice group responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.

The QC partner is responsible for monitoring and documenting the implementation of specific corrective actions or steps based upon the results of the monitoring process.

If the firm is a member of a network and places reliance on the network's monitoring policies and procedures, the firm requires that

- a. at least annually, the network communicates the overall scope, extent, and results of the monitoring process to appropriate individuals within the firm and
- b. the network communicates promptly any identified deficiencies in the quality control system to the firm and the firm takes appropriate actions. **(See paragraph .59 of QC section 10.)**

The QC partner may identify the need to do the following:

- ▶ Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed
- ▶ Improve compliance with firm policies and procedures related to the other elements of quality control

The firm summarizes and communicates at least annually to relevant engagement partners and other appropriate individuals with the firm, including the firm's leadership, the monitoring process results, and any changes to the firm's policies and procedures.

Monitoring

The firm communicates in training programs, meetings, and firm policy correspondence the need for changes and improved compliance with the system of quality control.

**Policy 5: The firm deals appropriately with complaints and allegations.
(See paragraphs .61-.62 of QC section 10.)**

The managing partner periodically reminds personnel during staff meetings that they may raise any concerns regarding complaints or allegations about noncompliance with professional standards, regulatory and legal requirements, or the firm's system of quality control with any partner without fear of reprisals.

The firm has established channels for communication of complaints and allegations through the firm's website to the attention of the firm's ethics committee in a confidential manner.

Note! This procedure may not be practicable for all firms.

When complaints and allegations arise, the firm assigns a partner who is not otherwise involved in the engagement, or a suitably qualified external person or another firm, to investigate complaints and allegations. The firm documents the complaints and allegations and the responses to them.

The firm consults with legal counsel or its professional liability insurance carrier as necessary.

The firm documents the complaints and allegations and the responses to them.

If, during the investigation into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm takes appropriate actions **(See paragraph .61 of QC section 10.)**

**Policy 6: The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.
(See paragraph .62 of QC section 10.)**

The firm documents the performance of each element of its QC system on an ongoing basis.

Note! Documentation may include an assertion as to whether the firm's system of quality control provides reasonable assurance for an annual period.

Monitoring

The firm documents its monitoring of the QC system. Documentation is provided through the firm's summary monitoring report, electronic databases, manual notes, checklists, and forms.

Tip! PRP Section 10,000, *Monitoring Guidance*, is available free of charge at www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/2015/DownloadableDocuments/May2015-10000-Mon-Guide.pdf

This section of the Peer Review Manual contains guidance on performing and documenting monitoring, as well as checklists and sample summary reports.

Documentation addresses:

- a. a description of the monitoring procedures performed to review and test compliance with firm quality control policies and procedures relating to all of the elements of quality control, such as
 - i. review of the firm's professional library and practice aids to determine that they were appropriate and up-to-date; and
 - ii. interviews of a sample of personnel regarding the effectiveness of the firm's professional development programs.
- b. the deficiencies identified through the monitoring procedures and an assessment of the significance of those deficiencies, and
- c. recommended corrective actions that are designed to prevent the recurrence of the deficiency.

Policy 7: The firm retains documentation providing evidence of the operation of the system of quality control for an appropriate period of time. (See paragraph .63 of QC section 10.)

The firm retains monitoring documentation for a time sufficient to allow those monitoring the QC system, including peer reviewers, to evaluate the firm's compliance with its system. The firm generally retains such documentation until the next peer review report has been completed.

Appendix: QC section 10: A firm's system of quality control

(Supersedes SQCS No. 7.)

Source: SQCS No. 8; SAS No. 122; SAS No. 128.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Introduction

Scope of This Section

- .01 This section addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.
- .02 This section, although applicable to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards*, does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, which are similar to those of this section.
- .03 Other professional standards set out additional requirements and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for example, addresses quality control procedures for engagements conducted in accordance with generally accepted auditing standards. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]
- .04 A system of quality-control consists of policies designed to achieve the objective set out in paragraph .12 and the procedures necessary to implement and monitor compliance with those policies.

Authority of the SQCSs

- .05 This section applies to all CPA firms with respect to engagements in their accounting and auditing practice. The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network.
- .06 Statements on Quality Control Standards (SQCSs) contain the objective of the firm in following the SQCSs and requirements designed to enable the firm to meet that stated objective. In addition, SQCSs contain related guidance in the form of application and other explanatory material, as discussed further in paragraph .09, and introductory material that provides context relevant to a proper understanding of the SQCSs and definitions.
- .07 The objective provides the context in which the requirements of SQCSs are set and is intended to assist the firm in the following:
 - Understanding what needs to be accomplished
 - Deciding whether more needs to be done to achieve the objective
- .08 SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:
 - *Unconditional requirements*. The firm is required to comply with an unconditional requirement in all cases in which such a requirement is relevant. SQCSs use the word *must* to indicate an unconditional requirement.
 - *Presumptively mandatory requirements*. The firm is also required to comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement, provided that the firm documents the justification for the departure and how the alternative policies established, or procedures performed, in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

- .09** When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may
- explain more precisely what a requirement means or is intended to cover,
 - include examples of policies and procedures that may be appropriate in the circumstances.

The words *may*, *might* and *could*, among others, are used to describe these actions and procedures. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in SQCSs. When appropriate, additional considerations specific to governmental entities or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in SQCSs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in SQCSs.

- .10** QCSs include, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the SQCSs. These are provided to assist in the consistent application and interpretation of SQCSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. The AU-C glossary contains a complete listing of terms defined in this section. It also includes descriptions of other terms found in this section to assist in common and consistent interpretation. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Effective Date

- .11** The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Objective

- .12** The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that
- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
 - b. reports issued by the firm are appropriate in the circumstances.

Definitions

- .13** For purposes of SQCSs, the following terms have the meanings attributed as follows:

Accounting and auditing practice. A practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

Engagement documentation. The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*).

Engagement partner. The partner or other person in the firm who is responsible for the engagement and its

performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is only for those engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external specialists engaged by the firm or a network firm.^{fn1}

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, Using the *Work of Internal Auditors*.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

Inspection. A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Inspection includes a review of completed engagements.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET section 0.400, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the ASB or ARSC under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Reasonable assurance. In the context of this section, a high, but not absolute, level of assurance.

Relevant ethical requirements. Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended,

^{fn1} Paragraph .06 of AU-C section 620, Using the Work of an Auditor's Specialist, defines the term auditor's specialist. [FootNote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Applying and Complying With Relevant Requirements

- .14 Personnel within the firm responsible for establishing and maintaining the firm's system of quality control should have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objective and apply its requirements properly.
- .15 The firm should comply with each requirement of this section unless, in the circumstances of the firm, the requirement is not relevant to the services provided by a firm's accounting and auditing practice. (Ref: par. .A1)
- .16 The requirements are designed to enable the firm to achieve the objective stated in this section. The proper application of the requirements is, therefore, expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm should consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this section to meet the stated objective.

Elements of a System of Quality Control

- .17 The firm must establish and maintain a system of quality control. The system of quality control should include policies and procedures addressing each of the following elements:
 - a. Leadership responsibilities for quality within the firm (the tone at the top)
 - b. Relevant ethical requirements
 - c. Acceptance and continuance of client relationships and specific engagements
 - d. Human resources
 - e. Engagement performance
 - f. Monitoring

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control as a whole may still be effective in achieving the objective described in paragraph .12.

- .18 The firm should document its policies and procedures and communicate them to the firm's personnel. (Ref: par. .A2–.A3)

Leadership Responsibilities for Quality Within the Firm

- .19 The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: par. .A4–.A5)
- .20 The firm should establish policies and procedures designed to provide it with reasonable assurance that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's leadership has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: par. .A6)

Relevant Ethical Requirements

- .21** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: par. .A7–.A9)

Independence

- .22** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm; its personnel, and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Such policies and procedures should enable the firm to
- a. communicate its independence requirements to its personnel and, when applicable, others subject to them and
 - b. identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.
- .23** Such policies and procedures should require
- a. engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall effect, if any, on independence requirements;
 - b. personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
 - c. the accumulation and communication of relevant information to appropriate personnel so that
 - i. the firm and its personnel can readily determine whether they satisfy independence requirements;
 - ii. the firm can maintain and update information relating to independence, and
 - iii. the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.
- .24** The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for
- a. personnel to promptly notify the firm of independence breaches of which they become aware,
 - b. the firm to promptly communicate identified breaches of these policies and procedures to
 - i. the engagement partner who, with the firm, needs to address the breach and
 - ii. other relevant personnel in the firm and, when appropriate, the network and those subject to the independence requirements who need to take appropriate action, and
 - c. prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter so that the firm can determine whether it should take further action.
- .25** At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in the "Independence Rule" (ET sec. 1.200.001) and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. (Ref: par. .A10) [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]
- .26** The firm should establish policies and procedures for all audit or attestation engagements for which regulatory or other authorities require the rotation of personnel after a specified period, in compliance with such requirements.

Acceptance and Continuance of Client Relationships and Specific Engagements

- .27** The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only when the firm
- a. is competent to perform the engagement and has the capabilities, including time and resources, to do so, (Ref: par. .A11)
 - b. can comply with legal and relevant ethical requirements; and
 - c. has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity. (Ref: par. .A12–.A13)
- .28** Such policies and procedures should
- a. require the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: par. .A14)
 - b. require the firm to determine whether it is appropriate to accept the engagement if a potential conflict of interest is identified in accepting an engagement from a new or an existing client.
 - c. if issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, require the firm to
 - i. consider whether ethical requirements that exist under the "Conflicts of Interest" interpretation (ET sec. 1.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001) apply, and
 - ii. document how the issues were resolved.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

- .29** To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that provide for obtaining an understanding with the client regarding those services. (Ref: par. .A15)
- .30** The firm should establish policies and procedures on continuing an engagement and the client relationship that address the circumstances when the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures should include consideration of the following:
- a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities
 - b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship (Ref: par. .A16)

Human Resources

- .31** The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to
- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
 - b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A17–.A24)
- .32** The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities that they will be called on to assume.

Assignment of Engagement Teams

- .33** The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that
- a.** the identity and role of the engagement partner are communicated to management and those charged with governance;
 - b.** the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and (Ref: par. .A25–.A30)
 - c.** the responsibilities of the engagement partner are clearly defined and communicated to that individual.
- .34** The firm should establish policies and procedures to assign appropriate personnel with the necessary competence and capabilities to
- a.** Perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
 - b.** Enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A31)

Engagement Performance

- .35** The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should include the following:
- a.** Matters relevant to promoting consistency in the quality of engagement performance (Ref: par. .A32–.A33)
 - b.** Supervision responsibilities (Ref: par. .A34)
 - c.** Review responsibilities (Ref: par. .A35)
- .36** The firm's review responsibility policies and procedures should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.

Consultation

- .37** The firm should establish policies and procedures designed to provide it with reasonable assurance that
- a.** appropriate consultation takes place on difficult or contentious issues;
 - b.** sufficient resources are available to enable appropriate consultation to take place;
 - c.** the nature and scope of such consultations are documented and are agreed upon by both the individual seeking consultation and the individual consulted; and
 - d.** the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented. (Ref: par. .A36–.A40)

Engagement Quality Control Review

- .38** The firm should establish criteria against which all engagements covered by this section should be evaluated to determine whether an engagement quality control review should be performed. (Ref: par. .A41)
- .39** The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review should be performed for that engagement.
- .40** The firm should establish policies and procedures setting out the nature, timing, and extent of an engagement quality control review. Such policies and procedures should require that the engagement quality control review be completed before the report is released. (Ref: par. .A42–.A44)

- .41** The firm should establish policies and procedures to require the engagement quality control review to include
- a. discussion of significant findings and issues with the engagement partner;
 - b. reading the financial statements or other subject matter information and the proposed report;
 - c. review of selected engagement documentation relating to significant judgments that the engagement team made and the related conclusions it reached; and
 - d. evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate. (Ref: par. .A45–.A47)

Criteria for the Eligibility of Engagement Quality Control Reviewers

- .42** The firm should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through
- a. the technical qualifications required to perform the role, including the necessary experience and authority; and (Ref: par. .A48)
 - b. the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: par. .A49)
- .43** The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Accordingly, such policies and procedures should provide that the engagement quality control reviewer
- a. when practicable, is not selected by the engagement partner.
 - b. does not otherwise participate in the performance of the engagement during the period of review.
 - c. does not make decisions for the engagement team.
 - d. is not subject to other considerations that would threaten the reviewer's objectivity.
- .44** The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. (Ref: par. .A50)

Documentation of the Engagement Quality Control Review

- .45** The firm should establish policies and procedures on documentation of the engagement quality control review, which require documentation that
- a. the procedures required by the firm's policies on engagement quality control review have been performed;
 - b. the engagement quality control review has been completed before the report is released; and
 - c. the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

Differences of Opinion

- .46** The firm should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted, and, when applicable, between the engagement partner and the engagement quality control reviewer. (Ref: par. .A51–.A52)
- .47** Such policies and procedures should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation.
- .48** Such policies and procedures should require the following:
- a. Conclusions reached be documented and implemented
 - b. The report not be released until the matter is resolved

Engagement Documentation

Completion of the Assembly of Final Engagement Files

- .49** The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. (Ref: par. .A53–.A54)

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation

- .50** The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (Ref: par. .A55–.A58)

Retention of Engagement Documentation

- .51** The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations. (Ref: par. .A59–.A62)

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures

- .52** The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process should:
- include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements;
 - require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility, and
 - assign the performance of monitoring the firm's system of quality control to qualified individuals. (Ref: par. .A63–.A73)

Evaluating, Communicating, and Remediating Identified Deficiencies

- .53** Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.
- .54** The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either
- instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements and that the reports issued by the firm are appropriate in the circumstances or
 - systemic, repetitive, or other significant deficiencies that require prompt corrective action,
- .55** The firm should communicate to relevant engagement partners, and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action (Ref: par. .A74)
- .56** Recommendations for appropriate remedial actions for deficiencies noted should include one or more of the following:
- Taking appropriate remedial action in relation to an individual engagement or member of personnel
 - The communication of the findings to those responsible for training and professional development
 - Changes to the quality control policies and procedures
 - Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly

- .57** The firm should establish policies and procedures to address cases when the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures should require the firm to
- a. determine what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements and
 - b. consider whether to obtain legal advice.
- .58** The firm should communicate, at least annually, the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's leadership. This communication should be sufficient to enable the firm and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities to provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:
- a. A description of the monitoring procedures performed
 - b. The conclusions drawn from the monitoring procedures
 - c. When relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies
- .59** Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. When firms within a network operate under common monitoring policies and procedures designed to comply with this section, and these firms place reliance on such a monitoring system, the firm's policies and procedures should require that
- a. at least annually, the network communicate the overall scope, extent, and results of the monitoring process to appropriate individuals within the network firms and
 - b. the network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

Complaints and Allegations

- .60** The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with
- a. complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and
 - b. allegations of noncompliance with the firm's system of quality control.

As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: par. .A75)

- .61** If, during the investigations into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm should take appropriate actions, as set out in paragraph .56. (Ref: par. .A76–.A77)

Documentation of the System of Quality Control

- .62** The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: par. .A78–.A80)
- .63** The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the firm to evaluate the firm's compliance with its system of quality control or for a longer period if required by law or regulation.^{fn 2}
- .64** The firm should establish policies and procedures requiring documentation of complaints and allegations described in paragraph .60 and the responses to them.

Application and Other Explanatory Material

Applying and Complying With Relevant Requirements

Considerations Specific to Smaller Firms (Ref: par. .15)

- .A1** This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff). Requirements in this section, such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph .34), for review responsibilities (see paragraph .36), and for the annual communication of the results of monitoring to engagement partners within the firm (see paragraph .58) are not relevant in the absence of staff.

Elements of a System of Quality Control (Ref: par. .18)

- .A2** In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve and the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. By encouraging firm personnel to communicate their views or concerns on quality control matters, the firm recognizes the importance of obtaining feedback on the firm's system of quality control. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing.

Considerations Specific to Smaller Firms

- .A3** Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

Leadership Responsibilities for Quality Within the Firm

Promoting an Internal Culture of Quality (Ref: par. .19)

- .A4** The firm's leadership, and the examples it sets, significantly influences the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures and the requirement to
- perform work that complies with professional standards and applicable legal and regulatory requirements.
 - issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in partner and staff appraisal procedures and the firm's internal documentation and training materials, such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

- .A5** Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Promoting such an internal culture includes the following:
- Establishment of policies and procedures that address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel in order to demonstrate the firm's overarching commitment to quality
 - Assignment of management responsibilities so that commercial considerations do not override the quality of the work performed
 - Provision of sufficient and appropriate resources for the development, documentation, and support of its quality control policies and procedures

^{fn2} PR section 100, Standards for Performing and Reporting on Peer Reviews, is applicable to firms enrolled in the AICPA Peer Review Program.

Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: par. .20)

- .A6** Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Relevant Ethical Requirements

Compliance With Relevant Ethical Requirements (Ref: par. .21)

- .A7** The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:
- Responsibilities
 - The public interest
 - Integrity
 - Objectivity and independence
 - Due care
 - Scope and nature of services
- .A8** Independence requirements are set forth in the "Independence Rule" and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]
- .A9** The fundamental principles are reinforced, in particular, by the following:
- The leadership of the firm
 - Education and training
 - Monitoring
 - A process for dealing with noncompliance

Written Confirmation (Ref: par. .25)

- .A10** Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating noncompliance, the firm demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

Acceptance and Continuance of Client Relationships and Specific Engagements

Competence, Capabilities, and Resources (Ref: par. .27a)

- .A11** Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, including whether
- firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
 - firm personnel have experience with relevant regulatory or reporting requirements or the ability to effectively gain the necessary competencies;
 - the firm has sufficient personnel with the necessary competence and capabilities;
 - specialists are available, if needed;

- individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when applicable; and
- the firm is able to complete the engagement within the reporting deadline.

Integrity of a Client (Ref: par. .27c)

.A12 Matters to consider regarding the integrity of a client include, for example, the following:

- The identity and business reputation of the client's principal owners, key management, and those charged with governance
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management and those charged with governance toward such matters as internal control or aggressive interpretation of accounting standards
- Indications of an inappropriate limitation in the scope of the work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and nonreappointment of the previous firm

The extent of knowledge that a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

.A13 Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements, and discussions with other third parties
- Inquiry of other firm personnel or third parties, such as bankers, legal counsel, and industry peers
- Background searches of relevant databases

Continuance of a Client Relationship (Ref: par. .28a)

A14 Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess, and cannot obtain, the necessary expertise.

Obtaining an Understanding With the Client (Ref: par. .29)

.A15 Professional standards applicable to the engagement may contain requirements for obtaining a written understanding with the client.

Withdrawal (Ref: par. .30)

.A16 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship may address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with governance the appropriate action that the firm might take based on the relevant facts and circumstances
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to remain in place or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities
- Documenting significant matters, consultations, conclusions, and the basis for the conclusions

Human Resources (Ref: par. .31)

.A17 Personnel issues relevant to the firm's policies and procedures related to human resources include, for example, the following:

- Recruitment and hiring, if applicable
- Performance evaluation, compensation, and advancement
- Determining competencies and capabilities, including time to perform assignments
- Professional development
- The estimation of personnel needs

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

.A18 *Competencies and capabilities* are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

.A19 Competence can be developed through a variety of methods; these methods include, for example, the following:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff, such as other members of the engagement team
- Independence education for personnel who are required to be independent

.A20 The continuing competence of the firm's personnel depends, to a significant extent, on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education (CPE) and other professional development activities that enable them to fulfill responsibilities assigned and to satisfy applicable CPE requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

.A21 The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

.A22 Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps that a firm may take in developing and maintaining competence and commitment to ethical principles include the following:

- Making personnel aware of the firm's expectations regarding performance and ethical principles
- Providing personnel with an evaluation of, and counseling on, performance, progress, and career development
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles and that failure to comply with the firm's policies and procedures may result in disciplinary action.

Considerations Specific to Smaller Firms

- .A23** The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control

- .A24** CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern public practice. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute, including related administrative rules, designed by the AICPA and the National Association of State Boards of Accountancy to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "[a]ny individual licensee ... who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm, shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs accounting and auditing services on the firm's behalf to meet the competency requirement referred to in the UAA. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Assignment of Engagement Teams

Engagement Partners (Ref: par. .33)

- .A25** In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than public practice, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by CPE and consultation. The following are examples:
- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
 - An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
 - A person in academia might obtain the necessary competencies to perform engagements covered by this section by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program or by engaging a consultant to assist on such engagements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

- .A26** The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner. For example
- the competencies expected of an engagement partner to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
 - supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.

- the engagement partner for an attestation engagement to examine the effectiveness of an entity's internal control over financial reporting that is integrated with an audit of financial statements would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, whereas an engagement partner of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

.A27 In practice, the competencies necessary for the engagement partner are broad and varied in both their nature and number. Competencies include the following, as well as other competencies as necessary in the circumstances:

- Understanding of the role of a system of quality control and the Code of Professional Conduct. An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.
- Understanding of the service to be performed. An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- Technical proficiency. An understanding of the applicable professional standards, including those standards directly related to the industry in which a client operates, and the kinds of transactions in which a client engages.
- Familiarity with the industry. An understanding of the industry in which a client operates to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- Professional judgment. Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration, including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- Understanding the organization's IT systems. A sufficient understanding of how the organization is dependent on, or enabled by, information technologies and the manner in which the information systems are used to record and maintain financial information to determine when involvement of an IT professional is necessary for an audit engagement.

Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control

- .A28** The competencies previously listed are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.
- .A29** In establishing policies and procedures related to the nature of competencies needed by the engagement partner of an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.
- .A30** Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

Engagement Teams (Ref: par. .34)

- .A31** The firm's assignment of engagement teams and the determination of the level of supervision required include, for example, consideration of the engagement team's
- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
 - understanding of professional standards and legal and regulatory requirements;
 - technical knowledge and expertise, including knowledge of relevant IT;
 - knowledge of relevant industries in which the clients operate;
 - ability to apply professional judgment; and
 - understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

Engagement Performance

Consistency in the Quality of Engagement Performance (Ref: par. .35a)

- .A32** The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:
- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work
 - Processes for complying with applicable engagement standards
 - Processes of engagement supervision, staff training, and mentoring
 - Methods of reviewing the work performed, the significant judgments made, and the type of report being issued
 - Appropriate documentation of the work performed and of the timing and extent of the review
 - Processes to keep all policies and procedures current
- A33** Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

Supervision (Ref: par. .35b)

- .A34** Engagement supervision includes the following:
- Tracking the progress of the engagement
 - Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement
 - Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
 - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

Review (Ref: par. .35c)

.A35 A review consists of consideration of whether

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings and issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the report; and
- the objectives of the engagement procedures have been achieved.

Consultation (Ref: par. .37)

.A36 Consultation includes discussion at the appropriate professional level with individuals within or outside the firm who have relevant specialized expertise.

.A37 Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the firm. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

.A38 Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience

and when conclusions resulting from consultations are appropriately documented and implemented.

.A39 Documentation that is sufficiently complete and detailed of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

Considerations Specific to Smaller Firms

.A40 A firm needing to consult externally may take advantage of advisory services provided by the following:

- Other firms
- Professional and regulatory bodies
- Commercial organizations that provide relevant quality control services

Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm determine whether the external provider is suitably qualified for that purpose.

Engagement Quality Control Review

Criteria for an Engagement Quality Control Review (Ref: par. .38)

- .A41** The structure and nature of the firm's practice are important considerations in establishing criteria for determining which engagements are to be subject to an engagement quality control review. Such criteria may include, for example, the following:
- The nature of the engagement, including the extent to which it involves a matter of public interest
 - The identification of unusual circumstances or risks in an engagement or class of engagements
 - Whether laws or regulations require an engagement quality-control review

Nature, Timing, and Extent of the Engagement Quality Control Review (Ref: par. .40–.41)

- .A42** An engagement quality control review may include consideration of the following:
- The engagement team's evaluation of the firm's independence in relation to the specific engagement
 - Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
 - Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached
- .A43** If the engagement quality control review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement.
- .A44** Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant issues to be promptly resolved to the engagement quality control reviewer's satisfaction before the report is released.
- .A45** The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner.
- .A46** Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review for audits, as well as reviews of financial statements and other assurance and related services engagements, include the following:
- Significant risks identified during the engagement and the responses to those risks
 - Judgments made, particularly with respect to materiality and significant risks
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement
 - The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies
- .A47** When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply.

Criteria for the Eligibility of Engagement Quality Control Reviewers

Sufficient and Appropriate Technical Expertise, Experience, and Authority (Ref: par. .42a)

- .A48** What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

Consultation With the Engagement Quality Control Reviewer (Ref: par. .42b)

- .A49** The engagement partner may consult the engagement quality control reviewer at any stage during the engagement (for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer). Such consultation avoids identification of differences of opinion at a late stage of the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform the role. When the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

Objectivity of the Engagement Quality Control Reviewer (Ref: par. .43–.44)

Considerations Specific to Smaller Firms

- .A50** Suitably qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews and no person in the firm meets the eligibility requirements for an engagement quality control reviewer. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts suitably qualified external persons or other firms, the requirements in paragraphs .43–.44 and the guidance in paragraph .A49 apply.

Differences of Opinion (Ref: par. .46)

- .A51** Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.
- .A52** Procedures to resolve such differences may include consulting with another practitioner or firm or a professional or regulatory body.

Engagement Documentation

Completion of the Assembly of Final Engagement Files (Ref: par. .49)

- .A53** Professional standards, law, or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. When no such time limits are prescribed, paragraph .49 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.
- .A54** When two or more different reports are issued regarding the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on financial information prepared in accordance with generally accepted accounting principles and, at a subsequent date, an auditor's report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation (Ref: par. .50)

- .A55** Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or a legal or professional duty exists to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly when data of a personal nature are concerned.

- .A56** Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, or retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that
- enable the determination of when and by whom engagement documentation was prepared or reviewed;
 - protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
 - prevent unauthorized changes to the engagement documentation; and
 - allow access to the engagement documentation by the engagement team and other authorized parties, as necessary, to properly discharge their responsibilities.
- .A57** Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include the following:
- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
 - Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
 - Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement
 - Procedures for restricting access to, and enabling proper distribution and confidential storage of, hard copy engagement documentation
- A58** For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation may include requiring the engagement teams to
- generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary.
 - enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons for a firm to retain original paper documentation.

Retention of Engagement Documentation (Ref: par. .51)

- A59** The needs of the firm for retention of engagement documentation and the period of such retention will vary with the nature of the engagement and the firm's circumstances (for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements). The retention period may also depend on other factors, such as whether professional standards, law, or regulation prescribe specific retention periods for certain types of engagements or whether generally accepted retention periods exist in the absence of specific legal or regulatory requirements.
- .A60** In the specific case of audit engagements, the retention period would be no shorter than five years from the report release date.
- A61** Procedures that the firm may adopt for retention of engagement documentation include those that enable the requirements of paragraph .51 to be met during the retention period, such as, for example, procedures to
- enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.

- provide, when necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

A62 Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided that such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the firm or its personnel.

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures (Ref: par. .52)

A63 The purpose of monitoring compliance with quality control policies and procedures is to assess, for the system of quality control as a whole, whether the firm is achieving the objective described in paragraph .12 through an evaluation of the following:

- Adherence to professional standards and applicable legal and regulatory requirements
- Whether the system of quality-control has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

The evaluation may identify circumstances that necessitate changes to, or improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

A64 Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Review of selected administrative and personnel records pertaining to the quality control elements
- Review of engagement documentation, reports, and clients' financial statements
- Discussions with the firm's personnel
- Determination of corrective actions to be taken and improvements to be made in the system, including providing feedback into the firm's policies and procedures relating to education and training
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures

A65 Monitoring procedures also may include an assessment of the following:

- The appropriateness of the firm's guidance materials and any practice aids
- New developments in professional standards and legal and regulatory requirements and how they are reflected in the firm's policies and procedures, when appropriate
- Written confirmation of compliance with policies and procedures on independence
- The effectiveness of continuing professional development, including training
- Decisions related to acceptance and continuance of client relationships and specific engagements
- Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof

.A66 Some of the monitoring procedures discussed previously may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection procedures

Reviews of the work or report when performed by engagement team members prior to the date of the report are not monitoring procedures.

.A67 The need for, and extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

.A68 The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm
- The number and geographical location of offices
- The results of previous monitoring procedures
- The degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them)
- The nature and complexity of the firm's practice and organization
- The risks associated with the firm's clients and specific engagements

.A69 Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

.A70 The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections.

The Relationship of Peer Review to Monitoring

.A71 A peer review does not substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

Considerations Specific to Smaller Firms

.A72 In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

- .A73** Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

Communicating Deficiencies (Ref: par. .55)

- .A74** The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

Complaints and Allegations

Source of Complaints and Allegations (Ref: par. .60)

- .A75** Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

Investigation Policies and Procedures (Ref: par. .61)

- .A76** Policies and procedures established for the investigation of complaints and allegations may include, for example, that the partner supervising the investigation
- has sufficient and appropriate experience,
 - has authority within the firm, and
 - is otherwise not involved in the engagement.

The partner supervising the investigation may involve legal counsel as necessary.

Considerations Specific to Smaller Firms

- .A77** In the case of firms with few partners, it may not be practicable for the partner supervising the investigation not to be involved in the engagement. These small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

Documentation of the System of Quality Control (Ref: par. .62)

- .A78** The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:
- The size of the firm and the number of offices
 - The nature and complexity of the firm's practice and organization

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring inspections.

- .A79** Appropriate documentation relating to monitoring includes, for example, the following:
- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
 - A record of the evaluation of the following:
 - Adherence to professional standards and applicable legal and regulatory requirements
 - Whether the system of quality control has been appropriately designed and effectively implemented
 - Whether the firm's quality control policies and procedures have been appropriately applied so that the reports that are issued by the firm are appropriate in the circumstances

- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary

Considerations Specific to Smaller Firms

A80 Smaller firms may use more informal methods in the documentation of their systems of quality control, such as manual Notes, checklists, and forms.

Exhibit – Comparison of Section 10, A Firm's System of Quality Control, and International Standard on Quality Control 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

.A81

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board (ASB).

Differences in Language

The ASB has made various changes to the language throughout section 10, as compared with ISQC 1. Such changes have been made to use terms applicable in the United States and to make section 10 easier to read and apply. The ASB believes that such changes will not create differences between the application of ISQC 1 and the application of section 10.

Requirements in Section 10 Not in ISQC 1

Section 10 requires firms to establish policies and procedures providing

- in paragraph .30, for obtaining an understanding with the client regarding the nature, scope and limitations of the services to be performed.
- in paragraph .33, that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
- in paragraph .44, that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.
- in paragraph .48, that when differences of opinion exist, a member of the engagement team be able to document that member's disagreement with the conclusions reached, after appropriate consultation.

ISQC 1 does not have equivalent requirements.

Requirements in ISQC 1 Not in Section 10

Paragraph 25 of ISQC 1 requires the firm to establish policies and procedures setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time. The ASB believes that the familiarity threat should not be singled out among other threats to independence.

Paragraph 48(a) of ISQC 1 requires including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner as a monitoring procedure. The ASB believes that this requirement is overly prescriptive and that a risk-based approach to inspections is more appropriate.

Requirements in ISQC 1 Revised in Section 10

Paragraph .41 of section 10 requires that when an engagement quality-control review is performed, the engagement quality-control review be completed before the report is released. Paragraph 36 of ISQC 1 requires that the quality-control review be completed before the report is dated. The ASB believes that an engagement quality-control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 10, when the engagement quality-control review results in additional procedures having to be performed, the date of the report would be changed.

Paragraph 48(c) of ISQC 1 requires that those performing the engagement or the engagement quality-control review are not involved in inspecting the engagements. Paragraph .53c of section 10, consistent with the requirement in paragraph 100 of Statement on Quality Control Standards No. 7, A Firm's System of Quality Control, requires that performance of monitoring of the firm's system of quality control be assigned to qualified individuals. Paragraph .A72 of section 10 Notes that in small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality-control policies and procedures. The ASB concluded that it was not necessary to change existing practice because in the United States, the peer review process provides a safeguard and provides evidence that the monitoring procedures are effective.

Paragraph A49 of ISQC 1 references the requirement in paragraph 40 of ISQC 1 to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer and states, "Accordingly, such policies and procedures provide ...". The ASB believes that notwithstanding its placement as application material, the language is indicative of a requirement and, accordingly, has included a requirement for the provision of these specific policies and procedures in paragraph .44 of section 10. The ASB believes this will not create a difference in the application of ISQC 1 and the application of section 10.

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