AICPA® Peer Review Program

Q&A: Quality Control Considerations for System Reviews

At the May 2016 Peer Review Board (PRB) meeting, the new Guidelines for Review and Testing of Quality Control Policies and Procedures checklists were approved effective for reviews commencing on or after January 1, 2017 with early implementation permitted. In response, the Peer Review team in collaboration with the AICPA's A&A team have developed the following tool to assist reviewers with their understanding of the Statement on Quality Control Standards number 8 (SQCS No. 8) and how those quality control (QC) standards should be considered during a system peer review that commences after January 1, 2017.

Question: In a peer review of a firm's system of quality control in a system review, a peer reviewer evaluates compliance with QC through various procedures including a review of selected engagements. If all the engagements examined are found to be in conformity with professional standards in all material respects, does that mean that the firm's system of quality control has been designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards, including SQCS No. 8, in all material respects?
Answer: Not necessarily. A peer reviewer is required to obtain peer review evidence that provides him or her with a reasonable basis for expressing an opinion on the firm's system of quality control. Even if a peer reviewer does not identify any significant issues during his or her review of a firm's engagements, the peer reviewer may identify significant issues during their testing of other elements of a firm's system of quality control. The peer reviewer would need to determine whether or not those issues would lead them to conclude that the firm's system of quality control has not been suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Additionally, QC 10.12 states:

> *The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that*
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> *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.*

Question: Is reasonable assurance, as used in SQCS No. 8, the same as reasonable assurance as used in the auditing standards?
Answer: Yes. Reasonable assurance, as used in SQCS No. 8 means a high, but not absolute, level of assurance.

Question: While SQCS No. 8 requires a firm's system of QC to provide reasonable assurance that the firm's system of quality control is properly designed and complied with, is the peer reviewer required to obtain reasonable assurance in a peer review?
Answer: Yes. While the peer review report does not explicitly refer to the peer reviewer obtaining reasonable assurance, obtaining reasonable assurance is implicit in obtaining the evidence necessary to form an opinion. Paragraph .36 of the Peer Review Program Manual in part states: "A System Review is intended to provide the reviewer with a

reasonable basis for expressing an opinion." Reasonable assurance is the only level of assurance that could possibly be expected in a peer review.

Question: Similar to the auditing standards, the Peer Review Standards require the peer reviewer to plan and perform the peer review so that peer review risk is reduced to an appropriately low level. What is meant by peer review risk?
Answer: Peer review risk is the risk that the peer review team will fail to identify significant weaknesses in or issue an inappropriate opinion on the firm's system of quality control for its accounting and auditing practice, its lack of compliance with that system, or a combination thereof, or reaches an inappropriate decision about the matters to be included, or excluded from, the report.

Question: Do the peer review standards require that a *pass with deficiency* or *fail* report be issued for a design deficiency, even if the engagements that were subject to review were found to be appropriate?
Answer: Yes. As described above, a peer review opinion is on the firm's system of quality control, not on the engagements reviewed. If a peer reviewer believes that there is a deficiency with the design of the QC system, a *pass with deficiency* or *fail* peer review report should be issued because the firm's QC system would not provide reasonable assurance of meeting the objective of the QC standard.

Question: If reasonable assurance is not obtained with respect to one element, is the peer reviewer required to issue a *pass with deficiency* or *fail* peer review report?
Answer: Not necessarily. The reviewer should consider whether that risk is mitigated by the firm's QC policies and procedures. QC 10.17 states in part:

> *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 (see preceding inquiry for Paragraph .12 in its entirety).*

Question: In some firms where there are no formal quality control procedures for the firm as a whole, one partner may perform engagement procedures in a manner differently from another partner. Additionally, one partner might not require staff to follow the same policies or procedures as the other partner. While the engagement reports were found to be appropriate, there really is no firm system of quality control. What type of peer review report should be issued in this circumstance?
Answer*: The QC standard requires the firm to establish policies and procedures to provide the firm with reasonable assurance that the QC objectives, as stated in paragraph .12, will be met. If each partner applies policies and procedures differently, then the system of quality control will be unable to provide the firm with reasonable assurance. Therefore, a *pass* peer review report would not be appropriate.
*Note: while this example illustrates engagement performance, the concept could be applied to any of the QC elements.

Question: Within the engagement performance element of the QC standard, a firm is required to establish criteria against which all engagements should be evaluated to determine whether an engagement quality control review (EQCR) should be performed. In some peer reviews, it is found that the firm has set the criteria in such a way that an EQCR would never apply. What should a peer reviewer do in the case?
Answer: The quality control standard does not preclude firms from setting criteria that do not result in any EQCRs being performed. Although, an EQCR may be an important control in order for the firm's engagement performance controls to provide the firm 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. A peer reviewer should apply professional judgment in evaluating the suitability of the firm's criteria. If a peer reviewer finds the EQCR criteria are not suitable for a particular firm, the peer reviewer should evaluate that design matter, consider the interrelationships among the other QC elements and weigh the matters noted against compensating policies and procedures to determine whether a finding or deficiency exists.

Question: Some firms do not have a monitoring process designed to provide the firm with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. Should this be considered at least a finding?
Answer: Yes, at a minimum. The quality control standard does not permit a firm to carve out or exclude any element. The monitoring process is very important to the maintenance of quality, especially in today's changing A&A environment. If a firm's monitoring controls are not designed appropriately or complied with to provide reasonable assurance, then the firm's system of quality control is not compliant with the QC Standard. The peer reviewer, using his or her professional judgment, may determine that such an issue is a deficiency or a significant deficiency. To further assist reviewers and firms, PRP Section 10,000, Monitoring Guidance, can be found at; http://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.

Question: The QC standard contains both requirements and application material. Is a firm required to follow the application material?
Answer: Application material is provided in the standard to provide further explanation of requirements and guidance for carrying them out. Since the application material does not set forth requirements, a firm is not obligated to follow the application material. However, the firm is required to meet the requirement that the individual application paragraph applies to and is obligated to document how the requirement is fulfilled. Additionally, the application material is an integral part of the QC standard and needs to be read and understood by the firm.

Question: One of the required elements of a QC system is relevant ethical requirements. What are some common sources of relevant ethical requirements (e.g. independence, integrity and objectivity) to consider when developing the related policies and procedures for this QC element?
Answer: Relevant ethical requirements that firms should consider when developing policies and procedures for this element 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.

Question: A firm states they have verbally confirmed that all personnel required to be independent are indeed independent. Would this satisfy QC requirements?
Answer: No. QC section 10.25 requires written confirmation of independence, at least annually, by all personnel, which includes partners and staff (including paraprofessionals). Failure to obtain written confirmations at least annually is a failure to comply with professional standards. Further, as regulators may have more restrictive independence requirements, it is important to be aware of industry specific requirements.

Question: In the preceding inquiry, what would be the peer review implications?
Answer: As stated in the preceding answer, a failure to document independence is a failure to perform the procedure. Reviewing the firms written independence representations, is a required procedure for testing compliance with a firm's QC policies and procedures. Therefore, the lack of written independence representations will result in a finding, at a minimum. The peer reviewer should consider PRP section 1000 paragraph .86 to determine if a deficiency or significant deficiency exists.

Question: How do the terms *deficiency* and *significant deficiency* as used in SQCS No. 8 adapt to Peer Review Standards?
Answer: 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 SQCS No. 8 is consistent with the use in the AICPA auditing, attestation, and accounting and review services standards, adapted as necessary in the circumstances.

Question: With respect to the peer review guidance changes effective for reviews commencing on or after January 1st, 2017, are firms able to continue to use PRP section 4300 *Quality Control Policies and Procedures Documentation Questionnaire for a Sole Practitioner with No Personnel* or 4400 *Quality Control Policies and Procedures Documentation Questionnaire for Firms with Two or More Personnel* to document their QC policies and procedures?
Answer: Effective January 1, 2017, PRP sections 4300 and 4400 will be eliminated from the Peer Review Program Manual. Theses sections were discontinued because the PRB concluded they were not an effective resource for a firm's QC document. It is **strongly recommended** that a firm discontinue use of these documents as they will not be maintained or updated by AICPA Staff as the applicable professional standards evolve. If a firm chooses to continue using PRP sections 4300 or 4400 as their QC

document, it will be the firm's responsibility to update their QC document to address current applicable professional standards. If a firm does not have a QC document in accordance with current applicable standards, the firm will not be in compliance with SQCS No. 8. The AICPA has numerous resources to assist firms with their transition away from PRP Sections 4300 and 4400, including the following:

PCPS Toolkit

- Free; no requirement to be an AICPA or PCPS member
- Includes the new checklists that peer reviewers will use in 2017 to take a closer look at quality control (AICPA members only)

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

- Free model QC documents for sole proprietors and small- to medium-sized firms
- New practice aid more easily customizable, replaces previous version from 2011
- Best practices, tips and suggestions for applying the quality control standard.

AICPA Self-Study Online Course on QC Matters

- Provides comprehensive review of a firm's system of quality control standards
- Prepares you to compare your firm's existing system of quality control to the requirements in QC section 10, *A Firm's System of Quality Control* (AICPA, Professional Standards), and determine and implement any necessary changes to your firm's system