
PRP Section 3200

Peer Review Alerts

Notice to Readers

Alerts communicate timely information regarding the AICPA Standards for Performing and Reporting on Peer Reviews (*Standards*) and related guidance, as well as updates on the peer review environment.

New Alerts are those issued by the Peer Review Board since the last edition of this Manual. The guidance in those alerts have already been incorporated into the *Standards* and related guidance, unless the guidance is effective at a future date, or was approved by the Peer Review Board after publication deadlines.

Alerts that are current or relevant updates on the peer review environment remain in the General and Regulatory Alert sections and are updated as necessary.

Previous “New Alerts” and superseded General, Regulatory, Administrative, and Oversight Alerts are archived on the peer review website.

New Alerts

Preparation Services Exposure Draft

On November 18, 2014, the Peer Review Board (board) issued an exposure draft, which proposed that firms that only perform preparation engagements under [AR-C Section 70, Preparation of Financial Statements](#) (AICPA, *Professional Standards*), issued as part of [Statement on Standards for Accounting and Review Services \(SSARS\) No. 21, Statement on Standards for Accounting and Review Services: Clarification and Recodification](#) (AICPA, *Professional Standards*), would not be required to enroll in the AICPA peer review program (program). However, it also proposed that a firm’s preparation engagements would be included in the scope of a peer review when the firm either elects to enroll in the program (for example, to comply with licensing or other requirements) or is already enrolled due to other engagements it performs. This proposal was issued in order to address the effect of these engagements on the scope of the program.

The board considered comments raised by the peer review community about the proposal and elected to adopt the proposed guidance changes. The changes are effective for peer reviews commencing on or after February 1, 2015.

Revision to Peer Review Guidance for Peer Reviewer Performance, Disagreements, and Qualifications

On November 18, 2014, the board issued the "Peer Reviewer Performance, Disagreements, and Qualifications" exposure draft, proposing revisions to standards and related interpretations designed to expedite remediation and removal of poor performing reviewers, improve consistency in the handling of reviewer

performance matters, and enhance reviewer qualifications and training requirements for reviewers of must-select engagements.

The board considered the feedback received during the comment period ended January 2, 2015, and adopted the proposed guidance presented at the January 27, 2015, board meeting. The change is effective for peer reviews commencing on or after May 1, 2016.

Enhancing Audit Quality Initiative—Emerging Industries and Risk Areas

The Emerging Industries and Risk Areas task force has made significant strides toward raising the audit quality bar through focusing firms and peer reviewers on new industries, industries with new or rising risks, audit areas of increased risk, or areas that have shown to have increased inspection matters in the past. This is an integral part of an AICPA-wide approach of enhanced materials, targeted training and robust peer reviews to enhance audit quality.

In May 2014, the board approved a partial implementation of the Emerging Industries and Risk Areas Initiative until responses to the "Enhancing Quality Initiative" concept paper (concept paper) were analyzed. The proposed emerging industries and risk areas to be incorporated into the finalization of the formal program are as follows:

- Single audit
- Crowdfunding

This initiative will encompass the following outreach plan:

- *Communication.* This peer review alert is designed to communicate the areas of emphasis to members, firms, and reviewers followed by an AICPA-wide focus on the training of firms and peer reviewers (see subsequent training section). Peer review courses will be tailored to include the upcoming focus areas so that reviewers are knowledgeable about the areas expected to be inspected. Further collaboration with internal AICPA teams, such as audit quality centers and others, will be conducted to ensure that a uniform message about the focus on the identified emerging industries and risk areas is being delivered during presentations.
- *Training.* Collaboration with the internal teams that direct the development and production of member learning and competency materials (publications, courses, and events) to ensure sufficient resources and opportunities in the emerging industries and risk areas for members, firms, and reviewers are available.
- *Emphasis.* Peer review materials and checklists will be developed and tailored to address the emerging industries and risk areas, fostering a more robust review in these areas.
- *Examples.* Peer review conference cases will be developed to highlight the focus areas.

Further details related to the emerging industries and risk areas proposed for the 2016 peer review season will be announced via upcoming peer review alerts.

General Alerts

Clarified Auditing Standards

It is critical that peer reviewers and reviewed firms understand the clarified auditing standards. In addition to clarifying and converging U.S. standards with international standards, there are numerous changes to audit reports and other communications and certain additional performance requirements. These standards are effective for audits of financial statements for periods ending on or after December 15, 2012.

Peer reviewers should consider the risk of implementing these new standards when planning peer reviews. Some firms have not yet had a peer review wherein the clarified standards have been in effect. The peer review checklists incorporate the requirements of the clarified auditing standards.

This alert highlights the most important aspects of the new standards and the related effects on peer review. Peer reviewers should consider reaching out to the firms that they review as soon as possible to emphasize the importance of consistent, timely implementation of the new standards and, when appropriate, direct them to resources to help them understand and implement the standards.

Overview of Key Clarified Auditing Standards Changes

The clarified auditing standards more clearly state the objectives of the auditor and the requirements with which the auditor has to comply to meet those objectives when conducting an audit in accordance with generally accepted auditing standards (GAAS). The codified clarified auditing standards (AU-C sections) are organized differently than the codified extant auditing standards (AU sections). Each AU-C section is organized into five sections:

- Introduction
- Objective
- Definitions
- Requirements
- Application and Other Explanatory Material

Because the Auditing Standards Board (ASB) used a principles-based approach when drafting the clarified auditing standards, certain requirements in the extant auditing standards that were duplicative of broader requirements have been moved to Application and Other Explanatory Material within the clarified auditing standards. Accordingly, all AU sections were modified. Some individual AU sections were revised specifically into individual AU-C sections, and other AU sections were grouped together and revised as one or more AU-C sections. As a result, topics in certain AU sections may have been retitled and assigned to different AU-C sections. The document *Extant AU Sections Mapped to Clarity Standards* provides a mapping of the extant AU sections to the AU-C sections. This document is located online. An archive of the webinar on the effect of the clarified auditing standards on the peer review process is also available online.

Although the primary purpose of redrafting the auditing standards was for clarity and convergence with the International Standards on Auditing, issued by the International Auditing and Assurance Standards Board, and not to create additional requirements, there are some new requirements and numerous chang-

es in audit reports and other communications. These new requirements and changes to auditor's reports and other communications are discussed further in this alert. They may be less prevalent if a firm has aligned its audit methodology with, or applied, International Standards on Auditing.

Anticipated Effects on Practice

Substantive changes to auditor requirements include the following:

1. Updated wording used in the auditor's report as provided in [AU-C section 700](#), *Forming an Opinion and Reporting on Financial Statements*; [AU-C section 705](#), *Modifications to the Opinion in the Independent Auditor's Report*; and [AU-C section 706](#), *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*):^{fn 1}
 - a. More detailed description in the auditor's report of management's responsibility for the preparation and fair presentation of the financial statements than what was required by the extant standards
 - b. Use of headings throughout the auditor's report to clearly distinguish each section of the report (for example, management's responsibility for the financial statements, auditor's responsibility, opinion, and, if applicable, other-matter, emphasis-of-matter, or report on other legal and regulatory requirement)
 - c. Replacement of the term *explanatory paragraph* with the terms *emphasis-of-matter paragraph* and *other-matter paragraphs* and the placement of such paragraphs within the auditor's report
2. Updated engagement letter wording (or other suitable form of contract) pursuant to the requirements of [AU-C section 210](#), *Terms of the Engagement* (AICPA, *Professional Standards*):
 - a. Documenting the reminder to management of its responsibilities on recurring audits
 - b. Documenting agreement of management that it acknowledges and understands its responsibility for selecting the appropriate financial reporting framework, establishing and maintaining internal control, and providing access and information to the auditor
3. Inspecting correspondence with relevant licensing and regulatory authorities to identify instances of noncompliance with laws and regulations that may have a material effect on the financial statements pursuant to [AU-C section 250](#), *Consideration of Laws and Regulations in an Audit of Financial Statements* (AICPA, *Professional Standards*)

^{fn 1} All AU-C sections can be found in AICPA [Professional Standards](#).

4. Communicating the potential effects of material weaknesses and significant deficiencies identified during the audit pursuant to [AU-C section 265](#), *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*)
5. Complying with the requirements of [AU-C section 550](#), *Related Parties* (AICPA, *Professional Standards*), when reporting on financial statements prepared in accordance with special purpose frameworks (for example, financial statements prepared using the cash or tax basis of accounting, among others) or International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board:
 - a. Auditing related party transactions under extant AU section 334, *Related Parties* (AICPA, *Professional Standards*), focused on the amounts and disclosures pursuant to accounting principles generally accepted in the United States of America. [AU-C section 550](#) is framework neutral, so additional considerations may be necessary when auditing financial statements prepared using IFRS or special purpose frameworks.
6. Complying with the broader scope and expanded requirements provided in [AU-C section 600](#), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*)

The document *Summary of Differences Between Clarified SASs and Existing SASs* provides a comprehensive analysis and discussion of the differences between the clarified auditing standards and the extant auditing standards, including those changes previously identified that are expected to result in adjustments to practice. This document is located online.

Effects on the Peer Review Risk Assessment

Peer reviewers should discuss the clarified auditing standards with the firm to obtain an understanding of the firm's general knowledge of the clarified auditing standards and implementation approach. This is an integral part of obtaining an understanding of the reviewed firm's system of quality control and evaluating whether it was sufficiently designed to identify and mitigate the risk of material noncompliance with applicable professional standards. This understanding and evaluation provides a basis for the review team to determine whether the reviewed firm has appropriately adopted comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

[Interpretation No. 52-1](#) to the peer review standards indicates that in assessing inherent risk factors, the peer reviewer should consider new professional standards and to how many engagements the new professional standards apply. The clarified auditing standards constitute an inherent risk factor not only because they are new, but because they have a pervasive effect on the reviewed firm and apply to all audit engagements of financial statements for periods ending on or after December 15, 2012.

Accordingly, as part of the risk assessment procedures performed on peer review engagements covering audits of financial statements for periods ending on or after December 15, 2012, the peer reviewer should discuss the clarified auditing standards with the partners of the firm, who set the tone at the top, and other members of management responsible for designing and implementing the firm's audit methodology and system of quality control to obtain an understanding of the firm's general knowledge of the

clarified auditing standards and whether the firm has complied with them, in all material respects, on audit engagements selected for peer review during the period.

The peer reviewer should focus on the firm's quality control policies and procedures. Are the quality control policies and procedures designed to require the professional personnel to have an understanding of the applicable professional standards necessary to perform engagements assigned to them? If so, did the firm comply with its quality control policies and procedures by providing opportunities for firm personnel to obtain the knowledge and expertise required to perform engagements assigned to them, specifically in regard to the clarified auditing standards and their anticipated effect on practice?

The peer reviewer should also determine if the firm's professional personnel possess a basic understanding and knowledge of the clarified auditing standards and their anticipated effect on practice. Based on discussion with the firm's partners and other professional personnel, the peer reviewer should factor the understanding of firm personnel into the assessment of inherent and control risk. This should be documented in the SRM.

It is particularly important that the peer reviewer evaluate the six key aspects of the clarified auditing standards, described previously, when assessing inherent risks and evaluating the firm's system of quality control and document such consideration in the SRM.

What If a Reviewed Firm Implemented the Clarified Auditing Standards (or Certain Aspects of Them) Early?

The ASB has determined that early adoption of the clarified auditing standards is not appropriate and that auditors should continue to comply with the extant auditing standards until the effective date of the clarified auditing standards. However, nothing precludes an auditor from implementing aspects of the clarified auditing standards before their effective date, as long as the auditor continues to comply with the extant auditing standards. This prohibition of early adoption is not located in *Professional Standards*, but rather, in the document *Clarity Project: Questions and Answers*, which is located online.

Accordingly, the AICPA Peer Review Board has concluded that early implementation of all or part of the performance requirements of the clarified auditing standards generally would not result in a material departure from professional standards (that is, if the firm was in compliance with the performance requirements of the clarified auditing standards, then, generally, it would also be in compliance with the performance requirements of the extant auditing standards). However, if the firm implements the reporting requirements contained in the clarified auditing standards early, then this would result in the firm's auditor's reports departing from the extant auditing standards, but not materially. Because the clarified reporting requirements improve various aspects of the auditor's report compared to the auditor's report under the extant standards, early implementation of clarified reporting requirements, even if the condition was pervasive to some or all of the reviewed firm's audit engagements not subject to the requirements of the clarified auditing standards, generally would not be elevated to a deficiency or significant deficiency leading to *pass with deficiencies* or *fail* reports, respectively.

[Paragraphs .69–.90](#) of PRP section 1000, *Standards for Performing and Reporting on Peer Reviews*, establish requirements and provide guidance for peer reviewers when identifying, aggregating, and evaluating matters, findings, deficiencies, and significant deficiencies, including a flowchart describing the aggregation of matters, findings, deficiencies, and significant deficiencies, where they are documented in the practice aids, and how they might affect the type of report issued. Additional guidance on findings and conclusions is also found in [paragraphs .33–.41](#) of PRP section 4200, *Instructions to Reviewers Performing System Reviews*. Also, [Interpretations No. 83-1](#), [83-2](#), and [84-1](#) in PRP section 2000, *Peer Re-*

view Standards Interpretations, establish requirements and provide guidance on determining the cause for a finding in a system review.

Conforming the Auditor's Report for Audits of Financial Statements for Periods Ending on or After December 15, 2012, to the Requirements of the Clarified Auditing Standards

Ordinarily, a firm's failure to update the wording in the auditor's report pursuant to the wording requirements promulgated in the clarified auditing standards should be considered a material departure from professional standards, in all material respects. The auditor's report is the public evidence of the auditor's work. The changes to the wording in the auditor's report aids users and are considered an important part of complying with the clarified auditing standards. [Paragraphs .20–.22](#) of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*), require auditors to comply with all relevant standards. Furthermore, the AICPA Code of Professional Conduct requires members to maintain professional competence through continuing professional education. Therefore, if a firm fails to update the wording in the auditor's report pursuant to the requirements of the clarified auditing standards, it is an indication that the professional personnel in the firm are not meeting their professional responsibilities.

In addition to fundamental changes to the paragraph arrangement and wording of the auditor's report, auditor's report wording, and paragraph arrangement may also be significantly affected by the requirements of [AU-C section 600](#) and [AU-C section 706](#), *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Reports* (AICPA, *Professional Standards*), respectively.

Expanded Requirements and Broader Definition of Group Audits

[AU-C section 600](#) contains new specific requirements with respect to

- group audit acceptance and continuance considerations.
- the group engagement team's process to assess risk.
- the determination of materiality to be used to audit the group financial statements.
- the determination of materiality to be used to audit components.
- the selection of components and account balances for audit testing.
- communications between the group engagement team and component auditors.
- assessing the adequacy and appropriateness of audit evidence by the group engagement team in forming an opinion on the financial statements.

Peer reviewers should be alert to the possibility that reviewed firms may misunderstand and incompletely apply these new concepts and specific requirements.

Due to the broader definition of group audits, peer reviewers need to be alert for situations in which a reviewed firm concludes that [AU-C section 600](#) does not apply when, in fact, it does. Certain new re-

quirements apply even when the group audit is conducted by a single auditing firm. Group financial statements include financial information of more than one component. A component may include subsidiaries, geographical locations, divisions, investments, products or services, functions, processes, or component units of state or local governments.

[AU-C section 600](#) significantly expanded the scope of the requirements and guidance of the extant guidance regarding using the work of component auditors to encompass audits of group financial statements. It better articulates the degree of involvement required when reference is made to the audit of the component auditor (formerly referred to as the other auditor) in the report of the auditor of the group financial statements (formerly referred to the principal auditor). Specifically, the following two conditions should be met in order for the auditor of the group financial statements to make reference to the audit of a component auditor in the auditor's report on the group financial statements:

- The group engagement partner has determined that the component auditor performed an audit of the financial statements for the component in accordance with the relevant requirements of GAAS.
- The component auditor did not issue an auditor's report that was restricted as to use.

If the component's financial statements were prepared using a different financial reporting framework from that used for the group financial statements, then reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group; and
- the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for and, thus, be involved in, the work of the component auditor.

Another important consideration for peer reviewers is the concept that auditors who do not meet the definition of a member of the group engagement team are considered component auditors. Therefore, a component auditor may work for a network or association firm of the group engagement partner's firm or may even work for a different office of the same firm.^{fn 2}

Because of these changes, there is an increased risk that peer reviewers will encounter situations in which the report of the auditor of the group financial statements references a component auditor when,

^{fn 2} A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. When this is the case, such a member of the group engagement team also is a component auditor. Also, in situations in which one firm performed the entire audit and there were components, [AU-C section 600](#), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*), would apply.

in fact, it should not. Furthermore, because [AU-C section 600](#) significantly expanded the scope of the requirements and guidance of extant AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*), regarding using the work of component auditors to encompass audits of group financial statements, it is also likely that peer reviewers may encounter situations in which audit firms may have misapplied the requirements and guidance of extant AU section 543 and, therefore, assumed that [AU-C section 600](#) did not apply to any of its audits engagements. However, depending on facts and circumstances specific to a given audit engagement, in some situations, an audit engagement may have been performed in accordance with applicable professional standards, in all material respects, despite the fact that the reviewed firm failed to realize that [AU-C section 600](#) applied to the audit engagement. Therefore, it is particularly important that peer reviewers are aware of, and understand, the implications of [AU-C section 600](#) on audit engagements and the resultant auditor's report. The document *Understanding the Responsibilities of Auditors for Audits of Group Financial Statements—What Are Group Audits* provides additional discussion regarding the requirements and guidance contained in [AU-C section 600](#). This document is located online.

Emphasis-of-Matter and Other-Matter Paragraphs Replace Explanatory Paragraphs

[AU-C section 706](#) introduces emphasis-of-matter and other-matter paragraphs that may be included in the auditor's report. An *emphasis-of-matter* (EOM) *paragraph* refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements. An *other-matter* (OM) paragraph refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report. EOM and OM paragraphs may be required by GAAS or may be included in the auditor's report at the discretion of the auditor. EOM and OM paragraphs replace explanatory paragraphs that were required under extant AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*).

Extant AU section 508 permitted explanatory paragraphs to precede or follow the opinion paragraph. [AU-C section 706](#) requires EOM and OM paragraphs to follow the opinion paragraph and be included in separate sections of the auditor's report under the section headings "Emphasis-of-Matter" and "Other Matter," respectively, or other appropriate headings. When both EOM and OM paragraphs are included in the auditor's report, the OM paragraph should follow the EOM paragraph. However, an OM paragraph may be placed elsewhere in the auditor's report if the content of the OM paragraph is relevant to [paragraphs .37–.38](#), the "Other Reporting Responsibilities" section of AU-C section 700 (for example, when the auditor of group financial statements refers to a component auditor in the auditor's report). As peer reviewers encounter audit engagements performed in accordance with the clarified auditing standards and that include EOM or OM paragraphs, or both, they will need to evaluate the placement of those paragraphs in the auditor's report in relation to the opinion paragraph and, in some cases, each other.

Noncompliant Auditor's Reports and Possible Effects on the Outcome of the Peer Review

If a reviewed firm does not conform the wording in its auditor's reports to the new reporting language required by the clarified auditing standards, and after considering the systemic cause, the peer reviewer concluded that the condition was pervasive across the firm's audit engagements performed under the clarified auditing standards, then this typically would be elevated to a deficiency or significant deficiency and a *pass with deficiencies* report or *fail* report, respectively. Even if a reviewed firm complied with

all requirements promulgated in the clarified auditing standards, except for those relating to auditor reporting, then, if pervasive, the typical result would be a deficiency or significant deficiency and a peer review report of *pass with deficiencies* or *fail*, respectively.

Isolated occurrences of a firm not conforming the wording used in its auditor's reports to the wording requirements of the clarified auditing standards will require the peer reviewer to exercise professional judgment to determine

- the relative significance of the matter to other audit engagements included in the firm's peer review year; and
- whether the firm's system of quality control provided reasonable assurance that the reviewed firm complied with the clarified auditing standards in all material respects.

If a peer reviewer concludes that nonconforming auditor report wording is relegated to a single audit engagement or identifies a particular pattern of noncompliance that supports a conclusion that the condition was not pervasive to a material portion of the firm's audit engagements performed under the clarified auditing standards (for example, noncompliance is relegated to one particular partner in the firm), then the typical result would be a *pass* report or *pass* with a FFC report.

[Paragraph .86](#) of the peer review standards establishes requirements and provides guidance regarding the peer reviewer's consideration of the pattern and pervasiveness of matters. Specifically, [paragraph .86](#) indicates that the peer reviewer must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. If the peer reviewer determines that noncompliance related to the firm not conforming the wording used in its auditor's reports to the wording requirements of the clarified auditing standards, then not only were auditing standards specific to auditor reporting not complied with, but neither was [AU-C section 200](#), which requires auditors to comply with all relevant standards.

The document *Summary of Clarified Auditing Reporting Standards* provides a summary of the clarified auditor reporting requirements, including requirements that are expected to result in adjustments to practice. This document is located online.

Other Instances of Noncompliance With Auditor Requirements of the Clarified Auditing Standards That Peer Reviewers May Encounter

In addition to the risk of firms failing to conform the wording of its auditors' reports to the requirements of the clarified auditing standards, there are several other practice areas where there is a higher risk of noncompliance related to the following requirements:

- Updating engagement letter wording to satisfy the requirements of [AU-C section 210](#)
- Inspecting correspondence with relevant licensing and regulatory authorities to identify instances of noncompliance with laws and regulations that may have a material effect on the financial statements as required by [AU-C section 250](#)
- Communicating the potential effects of material weaknesses and significant deficiencies identified during the audit as required by [AU-C section 265](#)

- Complying with the requirements of [AU-C section 550](#) when reporting on financial statements prepared in accordance with special purpose frameworks (for example, financial statements prepared using the cash or tax basis of accounting, among others)
- Satisfying the expanded auditor requirements contained in [AU-C section 600](#) relating to audits of group financial statements, including the work of component auditors

If the peer reviewer identifies and, after considering the systemic cause, concludes that noncompliance related to any of the five preceding audit areas was pervasive with respect to the firm's audit engagements performed under the clarified auditing standards, then the peer reviewer will likely conclude that a deficiency or significant deficiency exists and issue a peer review report of *pass with deficiencies* or *fail*, respectively. Isolated occurrences of a firm not complying with the five preceding audit areas will require the peer reviewer to exercise professional judgment to determine the significance of the matter to other audit engagements included in the firm's peer review year and whether the firm's system of quality control provided reasonable assurance that the reviewed firm complied with the clarified auditing standards in all material respects. If the peer reviewer concludes that noncompliance related to the five preceding audit areas is relegated to a single audit engagement or identifies a particular pattern of noncompliance that supports a conclusion that the condition was not pervasive to a material portion of the firm's audit engagements performed under the clarified auditing standards (for example, noncompliance is relegated to one particular partner in the firm), then the typical result would be a *pass* report or *pass with FFC* (or *FFCs*) report.

Again, [paragraph .86](#) of the peer review standards indicates that the peer reviewer must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. During this evaluation, it is important for the peer reviewer to note that [paragraphs .20–.22](#) of AU-C section 200 requires auditors to comply with all relevant standards. Accordingly, if the peer reviewer determines that noncompliance related to one or more, or all, of the five preceding audit areas was pervasive, then not only were auditing standards specific to the identified audit areas not complied with, but neither was [AU-C section 200](#).

Nonconforming Single Audit Engagements

In response to the National Single Audit Sampling Project report issued by the President's Council on Integrity and Efficiency (PCIE), the AICPA formed seven task forces, one of which is the Practice Monitoring Task Force—A-133 Subgroup.

The task force is studying the results of the PCIE report to determine ways in which the peer review process can aid in enhancing the quality of performance of OMB Circular A-133 (A-133) audits by member firms. The board has already implemented several task force recommendations including a revised, must select interpretation for A-133 engagements, a bifurcated A-133 peer review checklist to focus on the areas identified in the PCIE report, and an enhanced report acceptance process for peer reviews including these engagements.

The task force recognizes the need for guidance to peer reviewers and RABs on the need for recall and reissue of single audit compliance reports when a peer review finds that such engagements are not performed and reported on in accordance with professional standards in all material respects. Such re-

suances may result because the peer reviewer determines that the firm missed auditing a major program due to improper risk-based major program determination, failure to properly identify the low risk auditee status of the auditee resulting in a missed major program, failure to test internal controls over compliance or compliance, and other examples included in subsequent paragraphs.

If an error is found that results in the addition of a major program, performance of the appropriate testing on the new major program should be conducted. When the auditor determines that additional procedures are necessary, the auditor should refer to [AU-C section 585](#) or AU section 390, *Consideration of Omitted Procedures After the Report Date* (AICPA, *Professional Standards*), for additional guidance.

If, subsequent to issuing the single audit report, the auditor becomes aware that facts may have existed at the time of the single audit that might have affected the reporting had they been known at the time, the auditor should refer to [AU-C section 560](#) or AU section 561, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*), for additional guidance.

If the auditor decides to reissue the compliance report, the auditor should refer to [AU-C section 935](#) or AU section 801, *Compliance Audits*, paragraph .43, “Reissuance of the Compliance Report” (AICPA, *Professional Standards*).

When the auditor becomes aware of such concerns or other concerns after issuing the single audit reporting, an understanding of the scenario and effect should be gained in order to determine

- whether the auditor should perform additional audit procedures;
- whether the Schedule of Expenditures of Federal Awards (SEFA) must be revised by the auditee and the impact on the in-relation-to reporting on the SEFA;
- the impact on the single audit report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 and whether such report should be reissued;
- the impact on the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with GAS and whether such report should be reissued;
- whether the data collection form should be revised and resubmitted; and
- whether the Schedule of Findings and Questioned Costs should be modified by the auditor.

Additional guidance on the steps that a firm should take when they are required to re-audit and reissue can be found at the Governmental Audit Quality website. (*Note: The GAQC is currently revising their guidance on recall or reissue and expects to issue that guidance in late 2012.*)

Examples of the issues that arise that cause the team captain to consider whether a firm should perform additional audit procedures and reissue the prior year single audit reporting include the following:

- Missed major program due to improper risk assessment (two-year look-back rule, including American Recovery and Reinvestment Act of 2009 funding)
- Improper clustering of programs resulting in a missed major program

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- Failure to include and audit all programs with same CFDA number when determining major programs
- Failure to meet the percentage of coverage required (50 percent or 25 percent, depending on low risk auditee status)
- Failure to properly compute the program type A/B threshold determination resulting in a missed major program or incorrect program selection
- Improperly classifying an entity as a low-risk auditee resulting in missed major programs due to percentage of coverage audited as major
- Inadequate testing of internal over compliance (for example, not testing to support a low-assessed level of control risk, not testing controls relating to some direct and material compliance requirements, or inappropriate sample sizes or related documentation) or compliance (for example, failure to test compliance for all direct and material compliance requirements or inappropriate sample sizes or related documentation) to support the major program opinion

The following instances may also result in a consideration to re-audit and reissue the compliance report depending on the severity of the issue.

- Incorrect or inconsistent summary of auditor results (incorrect reporting of report qualifications, major programs selected, type A threshold amounts, low risk auditee status). Usually these could be considered editorial errors, but if substantive, they could elevate to major significance.
- Missing CFDA numbers on SEFA (or pass-through entity numbers omitted).
- SEFA not totaled properly.
- Incorrect auditor reports (for example, language used inconsistent with SAS No. 115, AU section 325, or [AU-C section 265](#); language used inconsistent with SAS No. 117, AU section 801, or [AU-C section 935](#); missing reporting elements; and so on).
- SEFA missing required footnotes.

In these circumstances when it is concluded that a single audit engagement is not performed in accordance with professional standards in all material respects, ordinarily the firm should recall and reissue the applicable reports. Otherwise the firm should document its considerations not to recall and reissue. Reviewers should thoroughly evaluate a firm's decision not to recall and re-issue the applicable reports and indicate if the reviewer agrees or disagrees with the firm's decision. Further, if the reviewer disagrees with the firm's actions in consideration of the applicable standards or its decision not to recall and reissue, the reviewer should evaluate whether this is indicative of a potential leadership or tone at the top deficiency.

SOC Engagements

Due to the complexity of SOC engagements, the board has considered implications for the formation of review teams, engagement selection, the review of the SSAE and SOC engagements, and RAB acceptance of the peer review report.

Formation of Review Teams

Consistent with other must select engagements, if a firm performs SOC 1 or SOC 2 engagements, someone on the review team should have experience with these types of engagements. In an effort to aid review teams and firms in finding a reviewer with SOC 1 or SOC 2 experience, please update your peer reviewer resume to include these types of engagements.

Although staff of CPAs may perform SOC 1 engagements, generally SOC 2 engagements would be performed by a CPA with an information technology (IT) background or by a CPA using the work of an IT specialist. Therefore, reviews for firms that perform SOC 1 engagements will require a team member with SOC 1 experience. Reviews for firms that perform SOC 2 engagements will require a team member with SOC 2 experience. Due to the specialized nature of SOC engagements, the lack of qualified peer reviewers, and the interest expressed by non-CPA SOC directors and partners to be involved in the peer review process, the board has determined that a specialist may be able to assist the team captain in lieu of a team member with SOC experience as described in proposed [interpretations 35-1](#) and [35-2](#) under “Qualifying for Service as a Specialist.”

A specialist meeting criteria established by the AICPA may be approved to assist the team in reviewing SOC 1 or SOC 2 engagements. When a specialist is used, the team captain, as always, is responsible for supervising and conducting the review, communicating the review team’s findings to the reviewed firm and AE, preparing the report on the review, and ensuring that peer review documentation is complete and submitted to the AE on a timely basis. The team captain should supervise and review the work performed by the specialist. The team captain will furnish instructions to the specialist regarding the manner in which materials and other notes relating to the review are to be accumulated to facilitate summarization of the review team’s findings and conclusions. The specialist may be required to be available or participate in the exit conference.

The firm and review team are required to obtain approval from the firm’s AE, as part of the scheduling process, if it will be using a specialist instead of a team member with SOC 1 or SOC 2 experience. The RAB Handbook will be revised in 2013 to incorporate the specialist criteria and approval process. A list of specialists preapproved by the board’s Oversight Task Force will be maintained by the AICPA. The qualifications of SOC 1 or SOC 2 specialists are as follows.

An individual serving as a SOC 1 or SOC 2 specialist on a system review must be recommended as a specialist by a CPA that is a member of the AICPA in good standing and is associated with a firm that has received a report with a peer review rating of *pass* for its most recent system review that was accepted timely, ordinarily within the last three years and six months. An individual serving as a SOC 1 or SOC 2 specialist on a system review should, at a minimum

- a. be currently active in public practice at a supervisory level for managing SOC 1 or SOC 2 examinations. To be considered currently active, a specialist should be presently involved in the SOC practice of a firm supervising one or more of the firm’s SOC engagements.

- b. be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass*^{fn 3} for its most recent system review that was accepted timely, ordinarily within the last three years and six months.^{fn 4}
- c. not be associated with an engagement that was deemed no performed or reported on in accordance with professional standards in all material respects on the specialist's firm's most recently accepted peer review.
- d. possess current knowledge of professional standards applicable to SOC 1 or SOC 2 examinations, including Type 1 and Type 2 reports, qualified and unqualified reports, carve in or carve out engagements, and engagements with and without relevant user entity controls.
- e. have at least 5 years of recent experience in the practice of public accounting with a minimum of 500 hours of SAS 70, SOC 1. or SysTrust/SOC 2 examinations.
- f. have provided the AE with information that accurately reflects the qualifications of the specialist, which is updated on a timely basis.

To become an approved specialist, the specialist candidate should provide the Peer Review Program SOC Specialist Form to the AICPA or an AE. The form is required to be signed by a CPA for recommendation as a specialist. If you are aware of someone interested in being a SOC 1 or SOC 2 specialist, please provide them with the Peer Review Program SOC Specialist Form and contact the Peer Review Program technical hotline at 919.402.4502 or at prtechnical@aicpa.org with questions.

Engagement Selection

SOC 1 and SOC 2 engagements can be included in the same pool of engagements for purposes of engagement selection (for example, if a firm performs three SOC 1 engagements and three SOC 2 engagements, the reviewer is not required to select both a SOC 1 and a SOC 2; selecting a SOC 1 engagement can satisfy the requirement). However, reviewers would be expected to fully document their consideration of all SOC engagements and the basis for their selection in the risk assessment. If a firm performs both SOC 1 and SOC 2 engagements and a proper risk assessment determined that only one SOC engagement should be selected, ordinarily a SOC 1 engagement should be selected over a SOC 2 engagement due to the reliance upon the report by other auditors. Because SOC 2 engagements are a new type of service, peer reviewers may deem it necessary to select both SOC 1 and SOC 2 engagements. However, there may also be situations in which it would be appropriate to pick one SOC 2 and not select

^{fn 3} A peer review report with a rating of pass was previously referred to as an unmodified report (with or without a letter of comments). If a firm's most recent peer review rating was a pass with deficiencies or fail, the firm's members are not eligible to perform peer reviews.

^{fn 4} If a firm's most recent review was a report review, then the firm's members are not eligible to perform peer reviews.

a SOC 1. Examples may include that the SOC 2 engagements have not previously been selected and the SOC 1 engagements have or the SOC 2 practice is growing and the SOC 1 practice is stable.

Review of SSAE and SOC Engagements

To provide reviewers with the appropriate tools to review SOC engagements, revised and new engagement checklists will be available in March 2013:

SSAEs

- Examinations under SSAEs will be removed from [checklist 23,500](#) (*Engagement Reviews—Other Attestation Engagements*) as they are no longer applicable in engagement reviews.
- [Checklist 21,000](#) (*System Reviews—Other Attestation Engagements*) will be divided into two—Examinations (revised 21,000) and Reviews (new [21,050](#)).

SOCs

- [Checklist 21,100](#) will continue to be used for SOC 1 engagements.
- [Checklist 21,150](#) was created for use when reviewing SOC 2 engagements.
- For SOC 3 engagements, reviewers will use the applicable attestation engagement checklists based on the nature of the engagement (examination, review, or agreed upon procedure).

RAB Acceptance of the Peer Review Report

[Interpretation No. 132-1](#) under “Qualifying for Service as a Peer Review Committee Member, Report Acceptance Body Member, or Technical Reviewer,” and RAB Handbook [chapter 1](#) note that at least one member of the RAB considering a peer review that includes a must select engagement must have current experience in such engagements. If the RAB does not have a member with the appropriate experience, they may call upon a consultant. A national list of consultants is maintained by the AICPA with an available pool of consultants with GAS, Employee Retirement Income Security Act of 1974 (ERISA), Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), broker-dealer, SOC 1, and SOC 2 experience to be called upon as necessary. The national RAB consultant does not need to physically participate in the RAB meeting and may participate via teleconference. The consultant only needs to participate in the RAB discussion of the respective review(s) and will not be eligible to vote on the acceptance of a review.

If you or anyone in your firm is interested in being a national RAB consultant for any of the must select engagements, please contact the Peer Review Program technical hotline at 919.402.4502 or at prptechnical@aicpa.org.

The qualifications of a national RAB consultant are as follows:

- Currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program, as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. To be considered currently active, a consultant should be presently involved in the supervision of one or more of his or her firm’s accounting or auditing engagements or carrying out a quality control function on the firm’s accounting or auditing engage-

ments. To be considered a consultant on GAS, ERISA, FDICIA, broker-dealer, SOC 1, or SOC 2 engagements, the current activity must include the respective industry asked to consult upon.

- Associated with a firm (or all firms, if associated with more than one firm) that has received a report with a peer review rating of *pass* (previously referred to as an unmodified report) on its most recently accepted system review that was accepted timely, ordinarily within the last three years and six months.
- Not associated with an engagement that was deemed not performed in accordance with professional standards on the consultant's firm's most recently accepted system review.

Determining and Documenting Matters and Findings in a System Review

The objective of a system review is to evaluate the design of, and compliance with, a firm's system of quality control. As such, the peer review standards emphasize properly identifying and classifying matters and findings, and evaluating the systemic cause of those findings.

Reviewers often have questions about which items should be included on a Matter for Further Consideration (MFC) form. [Paragraph .70a](#) of the standards states, "Matters are typically one or more 'No' answers to questions in peer review questionnaire(s) that a reviewer concludes warrants further consideration in the evaluation of a firm's system of quality control." Not all "no" answers should be included on a MFC form. The peer reviewer should carefully evaluate whether the "no" answer warrants further consideration. The peer reviewer should take into consideration all information available and use his or her professional judgment to evaluate whether a "no" answer warrants further consideration. If a peer reviewer does not elevate the "no" answer to a matter, the peer reviewer should thoroughly document his or her consideration of the "no" answer in the explanation of "no" answers section of the peer review checklists.

Reviewers have also questioned whether isolated "no" answers should be included on MFC forms. [Interpretation No. 84-1](#) of paragraph .84 in PRP section 1000, *Standards for Performing and Reporting on Peer Reviews* (PRP sec. 2000) states, "The reviewer should consider that a single disclosure matter and a single documentation matter may be isolated when taken individually but they may have resulted from the same underlying systemic cause. They should further consider that an isolated matter may be materially significant in amount or nature or both. Reviewers should document their consideration of an isolated matter and the conclusions reached in the MFC form. The documentation should include the details of the matter noted, how the reviewer expanded scope, if applicable, and why the reviewer concluded the matter was isolated." The fact that a matter is deemed isolated does not mean it does not need to be included on a MFC form. If a peer reviewer determines that a "no" answer warrants further consideration, and should be elevated to a matter, it should be included on a MFC form, regardless of whether the matter is isolated. As noted previously, the reviewer should document how the matter was determined to be isolated on the MFC form. If the reviewer determines that the "no" answer does not need to be included on a MFC form, the reviewer should thoroughly document his or her consideration of the "no" answer in the explanation of "no" answers section of the peer review checklists and include why the "no" answer was deemed isolated. Furthermore, the peer reviewer should revisit all items deemed isolated at the conclusion of peer review procedures, including items that were not elevated to matters. The peer reviewer should reevaluate whether the isolated matters were actually isolated and whether they

have a common systemic cause. These matters collectively could lead the reviewer to conclude that a finding or deficiency exists in the reviewed firm's system of quality control.

On system reviews, reviewers should identify the systemic cause of findings. [Paragraph .70b](#) of the standards states, "A finding is one or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform or report in conformity with applicable professional standards." As such, the Findings for Further Consideration (FFC) form asks for the reviewer to identify the systemic cause of a finding. There is an expectation that the reviewer follow the appropriate guidance to make a good faith effort to identify the underlying cause. Guidance on identifying the cause for a finding can be found at [Interpretation No. 83-1](#) of paragraph .83 in PRP section 1000, *Standards for Performing and Reporting on Peer Reviews* ([PRP sec. 2000](#)). Guidance is also included in [chapter 4](#), section II and III of the Report Acceptance Body Handbook, which is an integral part of the Peer Review Program Manual.

Reviewers in a system review must think of matters on MFC forms as symptoms of weaknesses in a firm's system of quality control, and try to understand the underlying cause for those matters that rise to the level of a finding. With a finding, the reviewer is considering more than just the "matter," he or she is considering the condition (that is, systemic cause) that resulted in the matter(s) occurring. Otherwise said, the reviewer must determine why the matters occurred.

Ordinarily it is not sufficient to only repeat the matters (documented on the MFC form[s]) as findings (on the FFC form). The reviewer is expected to evaluate whether the condition or systemic cause (which resulted in the matters) meets the definition of a finding, that is, that more than a remote possibility exists that the reviewed firm would not perform or report in conformity with applicable professional standards. A finding that does not meet the definition of a deficiency or significant deficiency remains a finding. Once the systemic cause is identified, the reviewer is also expected to combine FFC's with the same systemic cause.

As an example, "no" responses on engagement checklists may lead a reviewer to conclude there is a matter related to the firm's noncompliance with a new professional standard. The reviewer may then conclude that the cause of that matter is lack of sufficient continuing professional education (CPE) on new professional guidance. The reviewer may then conclude that based on the nature, causes, pattern and pervasiveness, and relative importance to the firm's system of quality control taken as a whole, the matter does not rise to the level of a deficiency or significant deficiency, but it is a finding. The matters (noncompliance with a new professional standard) and their condition or cause (lack of sufficient CPE on new professional guidance) are documented on the FFC form.

This exercise requires judgment and may be challenging, but it will assist the reviewer in making meaningful recommendations to the reviewed firm that are appropriate to reduce the likelihood of the finding recurring or developing into a deficiency (or significant deficiency) in the future. If a reviewer makes a good faith effort to identify the underlying cause of a finding, and documents the effort and results on the FFC form, it is not expected to result in reviewer feedback.

Combining Matters for Further Consideration and Findings for Further Consideration for Engagement Reviews

Based on reviewer comments, some consider the information furnished on MFC forms ([section 6500](#), *Instructions for Use of Matter for Further Consideration [MFC] Form for Engagement Reviews*) and FFC forms ([section 6600](#), *Instructions for Use of Finding for Further Consideration [FFC] Forms*) to

be repetitive for engagement reviews. MFC forms document engagement and other matters noted in an engagement review. A *matter* is noted as a result of evaluating whether an engagement submitted for review was performed or reported on, or both in conformity with applicable professional standards. Depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may or may not develop into a finding. The FFC form is prepared in connection with an engagement review if there are one or more matters that the peer reviewer believes results in the financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, not being performed or reported on in conformity with the requirements of applicable professional standards, but the results were not of such relative importance to include in a report with a peer review rating of *pass with deficiencies* or *fail*.

The Standards Task Force considered if the two forms could be combined for an engagement review. The task force concluded that it would not be practical to combine the forms because (1) not all MFCs rise to the level of FFCs and (2) multiple MFCs may be combined into one FFC.

Scope of Peer Review Oversight

[Paragraph .12](#) of the standards notes that peer reviews, including the reviewed firm and peer reviewers, are subject to oversight by the administering entity, the board, and other bodies agreed upon by the administering entity or the board. The main objectives of peer review oversight are ensuring compliance with the standards and other peer review guidance, and consistency in implementation of the standards and other peer review guidance. In order to meet these objectives, by default all peer review documentation is subject to oversight. A critical part of the peer review oversight process is corroborating the overall results of reviews. In order to do so, it is often necessary for those performing oversight to directly review the working papers of engagements that were peer reviewed (that is, during on-site oversight or desk review oversight). Further, those individuals performing on-site oversight may also deem it necessary to participate in meetings between the reviewed firm and the peer reviewer(s). This level of involvement by AICPA staff, board members, individuals designated by the administering entity, and other individuals designated to perform peer review oversight is considered within the normal scope of oversight. Reviewed firms and peer reviewers that fail to cooperate with oversight are deemed as not cooperating with the AICPA Peer Review Program.

As with other aspects of peer review, individuals that perform peer review oversight are governed by the confidentiality requirements in [paragraph .20](#) of the standards, and they are not permitted to disclose or share any information concerning the reviewed firm, its clients, and its personnel obtained during an oversight.

Reviewer Resume Experience Codes

The reviewer resume codes have been revised so that resume codes A, B and C may only be used for services performed in a peer reviewer's *own firm*. A new resume code ("other") has been added. The "other" code is used for supervising one or more accounting or auditing engagement or carrying out the quality control functions (services) *for a firm where the peer reviewer is neither a partner nor a professional employee (another firm)*. These services are otherwise known as independent contractor services. If the peer reviewer wants to use the "other" resume code, the reviewer must provide a description of the services performed in the text box provided on the reviewer resume. The services performed for another firm must be current, they must have been *performed* within one year of the date the reviewer is ap-

proved to perform the review. Once the peer reviewer is no longer engaged to perform the services for another firm, the peer reviewer is required to remove the industry code from his or her resume within one year of when the services were performed. If the nature or extent of the services performed changes, the peer reviewer must update the information on their resume. *All industry codes that relate to work performed for another firm that do not meet the following criteria must be removed by August 30, 2011.*

The revised reviewer resume codes on the reviewer resume will now read:

A—Currently (presently involved) in supervising or performing engagements, in your own firm; or carrying out all the quality control functions on engagements in your own firm (including review of related engagements as part of the firm’s monitoring or inspection process) and currently meeting relevant, industry-specific educational requirements, as applicable.

B—Recently (within five years) supervising or performing engagements in your own firm and currently meeting relevant, industry-specific educational requirements, as applicable.

C—Supervising or performing certain components (but not all) of quality control functions on engagements in your own firm and currently meeting relevant, industry-specific educational requirements, as applicable.

Other—Supervising one or more accounting or auditing engagements or carrying out the quality control functions for a firm when the peer reviewer is neither a partner nor a professional employee of the firm.

The peer reviewer should provide a list of all pertinent information (see following paragraph) to allow the administering entity (AE) to ensure that the reviewer is qualified to perform peer reviews of the requested industry. Based on the information provided by the peer reviewer, the AE will determine whether the peer reviewer is qualified to review engagements in that industry. The administrator may need to consult with a technical reviewer, report acceptance body (RAB) members, or committee members to determine if the reviewer qualifies to add the industry code to his or her resume. The AE individual(s) who is consulted should feel confident in approving the reviewer to perform peer reviews in that industry. Once the AE determines that the reviewer is qualified to perform the review, the reviewer will be approved to perform the review. In cases when local resources are unable to determine if a reviewer is qualified for a particular industry, the AE may also consult with AICPA staff.

Written information provided by the reviewer for services performed for another firm should include, but is not limited to, engagement year-end, the name of firm the work was performed for and the actual work performed (that is, financial statement review, working paper review, engagement quality control review, and so on). In order to add these services to the reviewer’s resume, the firm that the reviewer performs the services for must be enrolled in a peer review program and its previous peer review must have a *pass* rating.

At a minimum, the services performed for another firm should include a review of the financial statements and involvement in or review of the significant judgments and conclusions of the engagement team.

Only peer reviewers who are eligible to perform peer reviews may apply to have work performed for another firm added to their resume. Per [Paragraph .31b](#) of the standards, an individual must “be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program (see interpretations), as a partner of the firm, or as a manager or person with equivalent

supervisory responsibilities.” Therefore, an individual is not qualified to perform peer reviews if he or she only performs work for another firm.

After the effective date of this guidance, August 31, 2011, all reviewers will be required to update their resume within one year of the date they previously updated their resume. If reviewers do not update their resume, they will not be able to schedule reviews.

Regulatory Alerts

AICPA Governmental Audit Quality Center

The AICPA Governmental Audit Quality Center (GAQC) is a firm-based, voluntary membership Center with the goal of enhancing and promoting quality governmental audits. Governmental audits include all audits performed under GAS such as single audits and financial statement audits of governments and not-for-profit organizations; audits performed under federal audit guides such as the *Housing and Urban Development Consolidated Audit Guide* and various Department of Education Audit Guides; and other grant and assistance program audits.

The Center has almost 1,800 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. Center members audit over 82 percent of the federal expenditures audited in single audits performed by CPA firms. The GAQC helps firms meet the challenges of performing quality audits by keeping members informed about the latest developments, as well as providing tools and information to help better manage a firm’s governmental audit practice.

Center Resources and Benefits. Center resources include timely e-mail news alerts on current governmental audit, accounting and regulatory developments; a dedicated Center website at www.aicpa.org/GAQC; CPE member-only teleconferences on a variety of technical, regulatory and practice management subjects; and an online discussion forum for networking and sharing best practices. Other resources and benefits include helpful practice aids, tools, articles, and savings on professional liability insurance.

Center Requirements. Among the GAQC membership requirements, Center members must designate a partner responsible for governmental audit quality that must also attend an annual 2-hour Center-sponsored Webcast; establish policies and procedures specific to the governmental audit practice; conduct annual internal inspections of their governmental audits; maintain their peer review report in a public file; and have their governmental audits selected in peer review reviewed by individuals employed by a Center member firm. Center members also must pay annual dues, which start at \$190 per year for a firm with fewer than 10 CPAs.

GAQC Members Find Great Value in Their Membership. Overwhelmingly, Center members report high satisfaction with their Center membership. One of the most liked aspects of the Center is the timely information on matters of importance to governmental audits that assist member firms in enhancing the quality of their governmental audit practices. To join, or for more information about the GAQC, visit the Center website at www.aicpa.org/GAQC; or call 202.434.9207.

Enhanced Peer Review Guidance for the Review of Employee Benefit Plan Audit Engagements

Regulatory and legislative developments have underscored the significant public interest in, and a higher risk associated with, audits conducted pursuant to ERISA. Peer reviewers should consider whether the engagement selection process has adequately addressed these risks.

For example, unique risks associated with different types of ERISA plans are as follows:

- **Defined contribution plans.** Participant account and allocation testing and timely remittance of participant contributions.
- **Defined benefit plans.** Actuarial present value of accumulated plan benefits and changes in the actuarial present value of accumulated plan benefits.
- **Health and welfare plans.** Benefit obligations and changes in benefit obligations (for example, claims payable, claims incurred but not reported, postemployment benefits, postretirement health care benefits, and so on).
- **Employee stock ownership plans (ESOPs).** Annual appraisal of securities and leveraged ESOPs.
- **Other areas.** Plans with a master trust arrangement, multiemployer plans, initial audits of plans, terminating plans, plan mergers, and so on.

In accordance with [Interpretations 63-1](#), if a firm has more than one of the preceding types of plans, the reviewer must consider the unique risks associated with that type of plan and document how these risks were addressed in the summary review memorandum.

The Department of Labor’s ERISA Audit Quality Enforcement Initiative

The Department of Labor’s (DOL) Employee Benefits Security Administration (EBSA) has an ongoing enforcement initiative to monitor the quality of ERISA audits. The audit quality program is administered by the EBSA’s Office of the Chief Accountant. The DOL will reject the Form 5500 filing where it has been determined that an audit failure has occurred, and may refer substandard work to the AICPA’s Professional Ethics Division or the appropriate State Board(s) of Accountancy. The DOL’s audit quality monitoring program has a three-tiered approach as described subsequently.

- *“Augmented working paper reviews” of firms that perform less than 100 ERISA audits.* The DOL randomly select audits to review and sends letters to the plan administrator requesting copies of the audit working papers. The DOL has completed over 1,500 of these “augmented working paper reviews” since the 2003 plan year. The DOL performs an in-house review of the Form 5500, the independent auditor’s report, and selected working papers for each of those engagements. Those reviews can be expanded to include additional working paper reviews, discussions with firm representatives, and any additional procedures deemed necessary based on the findings of the initial reviews.
- *“Mini-inspections” of firms that perform between 100 and 200 audits.* The DOL will perform a “mini-inspection,” whereby the DOL will send letters to the audit firm’s managing partner requesting them to complete a Firm Inspection Program Questionnaire and submit a list of their ERISA audit engagements. The DOL will review the completed questionnaire and select several ERISA audits to perform an in-house review of the Form 5500, the independent auditor’s report, and selected working papers for each engagement. The “mini-inspections” could be expanded to

include additional working paper reviews, discussions with firm representatives, and any additional procedures deemed necessary based on the findings of the initial reviews. For all reviews, the DOL will conduct a closing conference either by phone or in person to discuss the results of the inspection.

- *“Inspections” of firms that perform over 200 ERISA audits.* The DOL will send a letter to the audit firm’s managing partner to schedule an onsite inspection of that firm’s ERISA audit practice. This inspection will include completing the Firm Inspection Program Questionnaire and reviewing selected audit working papers. The engagements selected will be representative of the offices that perform ERISA engagements, as well as the types of ERISA audits performed by the firm. The firm inspection will conclude with a closing conference between the DOL representative and the appropriate firm personnel.

What Can Peer Reviewers Do?

Peer reviewers that review ERISA benefit plans could review the summary of common ERISA audit deficiencies, which follow. Also, the EBPAQC is a great resource for firms that perform employee benefit plan audits and their peer reviewers. In subsequent sections, we also provide more information on the EBPAQC and how to join or get more information.

Common ERISA Audit Deficiencies

The following are the more common audit deficiencies noted in DOL reviews and AICPA peer reviews:

- Planning
 - Inadequate audit planning.
 - Failure to assess the risk of material misstatement due to fraud.
- Internal controls
 - Failure to document an understanding of internal controls, most often when a substantive audit is going to be performed.
 - Inadequate use of SOC 1 reports; lack of testing when SOC 1 report is obtained.
- Contributions
 - No audit work performed.
 - Particularly multiemployer plans, failure to obtain adequate audit evidence for contributions back to contributing employers (multiemployer plans). Reliance on contribution reports is not enough.
- Insufficient payroll audit procedures
 - Failure to test elective deferrals.

- Investments
 - No work performed.
 - Failure to test end of year values.
 - Failure to properly test year end values, particularly hard-to-value assets.
 - Improper use of limited scope certifications.
- Benefit payments
 - No audit work performed.
 - Inadequate auditing regarding eligibility of claims to be covered by the plan.
- Participant data
 - Insufficient testing of payroll data.
 - Failure to test eligibility, forfeitures, and allocations.
 - In defined contribution plans with limited scope audits, failure of auditors to test the allocation earnings and gains or losses to participant accounts.
 - Sample sizes too low.
 - Some firms have reduced their sample sizes selected for compliance and substantive testing to unacceptably low levels.
- Working paper documentation
 - Adequacy of audit documentation continues to be an issue.
 - Only evidence of audit work having been performed is a sign off on an audit step without any supporting documentation.

AICPA Employee Benefit Plan Audit Quality Center

The AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) is a firm-based, voluntary membership center with the goal of enhancing and promoting quality employee benefit plan audits. The center has over 1,900 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. The EBPAQC helps firms meet the challenges of performing quality audits by keeping members informed about the latest developments, as well as providing tools and information to help better manage a firm's ERISA benefit plan audit practice.

Center resources and benefits. Center resources include timely e-mail news alerts on current EBP audit, accounting, and regulatory developments; a dedicated center website at www.aicpa.org/EBPAQC; CPE teleconference "Live Forums" on a variety of technical, regulatory, and practice management subjects; and an online discussion forum for networking and sharing best practices. Other resources and benefits include online Resource Centers in the areas of 403(b) plan audits, new audit standards, stable value in-

vestments, and the Pension Protection Act of 2006; tools and aids to assist members in planning and performing their audits and improving their EBP practice, including a SOC 1 report review checklist, an internal inspection tool, an audit preparedness checklist, tools to help auditors respond to a request for proposal; plan advisories on monitoring TPAs, the importance of internal controls, and valuing and reporting plan investments; and savings on professional liability insurance.

Center requirements. Center members must designate a partner responsible for audit quality; establish a program to ensure personnel possess current knowledge of applicable professional standards, rules, and regulations; establish policies and procedures specific to ERISA audits; maintain a minimum amount of CPE training in EBP audits, conduct annual internal inspections of their ERISA audits; maintain their peer review report in a public file; and have audits selected in peer review reviewed by individuals employed by a center member firm. Center members also must pay annual dues, which start at \$190 per year for a firm with fewer than 10 CPAs.

The EBPAQC is making a difference in audit quality. Reviews performed by the DOL's EBSA continue to show a difference in the quality of ERISA audits performed by center member firms compared with those performed by nonmember firms. Not only do center member firms have fewer ERISA audit failures, but those failures also tend to be much less severe than those by nonmember firms.

For more information about the EBPAQC, visit the center website at www.aicpa.org/EBPAQC or call 202.434.9207.

Coordination of Peer Review and PCAOB Inspection

The board considered recent regulatory changes and the potential for future changes and clarified the following:

- Engagements subject to permanent inspection by the PCAOB are *excluded* from the scope of the Peer Review Standards.
- Engagements not subject to permanent inspection by the PCAOB that are performed under SAS, SSARS, SSAEs, GAS, or PCAOB Standards are *included* in the scope of the Peer Review Standards.
- Firms that perform engagements under PCAOB Standards or engagements subject to permanent inspection by the PCAOB are required to have their peer reviews administered by the National Peer Review Committee (NPRC).

This clarification applies to the SEC's recent rulings regarding broker-dealer and conflict mineral engagements. Both of these rulings and the peer review considerations are discussed in subsequent sections.

Broker-Dealers

On July 31, 2013, the SEC finalized its Broker-Dealer (BD) Rules. The final rule requires audits of all broker-dealers to be performed under PCAOB Standards. It also requires a new Compliance Report (examination) for BDs and an Exemption Report (review) for non-carrying BDs, both to be performed us-

ing PCAOB Standards. These requirements are effective for fiscal years ending on or after June 1, 2014. On October 10, 2013, the PCAOB adopted attestation standards for the purposes of performing the examination of the Compliance Report and the review of the Exemption Report (PCAOB Release No. 2013-007: Final Rule). They also adopted an auditing standard applicable when auditors are engaged to perform audit procedures and report on supplemental information that broker-dealers and others file with the SEC and related amendments to other PCAOB standards (PCAOB Release No. 2013-008: Final Rule).

Audits of all non-SEC issuer broker-dealers are currently subject to inspection by the PCAOB under an interim inspection program. The PCAOB anticipates presenting a rule proposal for a permanent inspection program in 2014 or later. Until such time, audits of non-SEC issuer broker-dealers are included in the scope of peer review. Firms performing these engagements under PCAOB Standards beginning with fiscal years ending on or after June 1, 2014, will be required to have their peer review administered by the NPRC.

Conflict Mineral Reports

On November 13, 2012, the SEC issued a final ruling on Conflict Mineral Reports requiring issuers to disclose conflict minerals that are necessary to the functionality or production of a product manufactured. The term “conflict minerals” is used to describe certain minerals—tantalum, tungsten, tin, and gold—that are mined in the Democratic Republic of the Congo (DRC) or the surrounding areas. Federal law does not prohibit companies from sourcing conflict minerals, nor impose a penalty for doing so. However, the intent is to rely on public pressure to dissuade U.S. companies from indirectly sourcing conflict minerals, and hence fund the armed groups in the DRC.

The final rule requires an Independent Private Sector Audit (IPSA) of Conflict Mineral Reports (CMR) to be performed under the auditing standards established by the Government Accountability Office (GAO). These IPSA engagements will be performed under *Government Auditing Standards* (GAS) using performance audit or attestation engagement standards. CMRs and the related filings related to special disclosures are to be filed with the SEC and made publicly available by the issuer. Issuers must comply with the final rules effective for fiscal years beginning January 1, 2013. The first reports are due by May 31, 2014, and May 31 annually thereafter. The AICPA has provided additional resources pertaining to this subject matter.

These IPSA engagements are not subject to PCAOB permanent inspection, therefore, they are subject to peer review requirements. Because these engagements are required to be performed using GAS, rather than PCAOB standards, they will not trigger administration by the NPRC. Reviewers should consider these engagements as part of the must select population of engagements subject to GAS. This will require a team member with GAS experience to be on the review team and to review the engagement if selected.

The following chart summarizes the impact of broker-dealer engagements and IPSA of CMRs on the scope and administration of a firm’s peer review.

| | PCAOB Permanent Inspection Scope | Peer Review Scope | Triggers NPRC Administration of Firm’s Peer Review |
|------------------------|-----------------------------------------|--------------------------|-----------------------------------------------------------|
| Broker-dealers engage- | No | Yes | No |

| | PCAOB Permanent In- spection Scope | Peer Review Scope | Triggers NPRC Admin- istration of Firm's Peer Review |
|------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|--------------------------|---------------------------------------------------------------------|
| ments under AICPA standards | | | |
| Broker-dealer engagements under PCAOB standards, before effective date of PCAOB permanent inspection program | No | Yes | Yes |
| Broker-dealer engagements under PCAOB standards, upon effective date of PCAOB permanent inspection program | Yes | No | Yes |
| Engagements of non-issuers under PCAOB standards, not covered by PCAOB permanent inspection | No | Yes | Yes |
| Engagements for SEC issuers under <i>Government Auditing Standards</i> (for example, IPSA of CMR), not covered by PCAOB permanent inspection program | No | Yes | No |
| Engagements under SASs, SSARS, SSAEs, <i>Government Auditing Standards</i> , not covered by PCAOB permanent inspection program | No | Yes | No |

For additional information, refer to the materials for Agenda Item 1.5 of the board's January 2014 open session materials. These changes are effective for reviews commencing on or after April 1, 2014 and will be incorporated in the April 2014 release of the Peer Review Program Manual.